Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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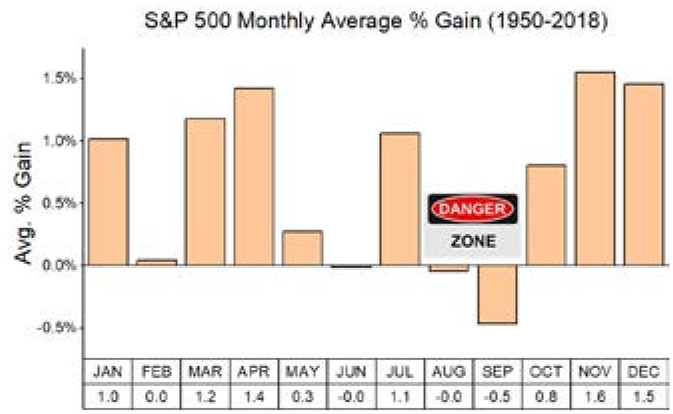
Market Update

Danger Zone

The two months of the year that would have been best to avoid over time in the stock market are August and September. From 1950 to 2018, over the two worst contiguous months of the year, August and September, the S&P 500 has lost on average, 0.5%.



S&P 500 - Technical Status

Last week, the S&P 500 was down five days in a row. On Friday, the index closed just above its 50 day moving average. Since March, the overall S&P 500 rising trend has been in divergence with a declining MACD trend. Typically, a rising stock market pushes the MACD higher, not lower. Divergences get resolved. Of course, the MACD could turn up, but many other momentum signals are pointing down, such as the RSI.

Although the 50 day moving average is just a number, many technical traders follow the indicator. In other words, crossing below the 50 day moving average can become a self fulfilling prophecy.

More investors trade off the 200 day moving average, currently at 2790. Throughout much of the current 10-year bull market, the S&P 500 has bounced off its 200 day moving average. Buying at the 200 day moving average (buying the dip), has proven to be profitable. This time around, if the S&P 500 breaks the 200 day moving average, it may not be an immediate buy signal. The stock market is in a very weak seasonal period, in which corrections can be sustained longer compared to other times of the year. It is probably not a good time to buy the dip, just because it is a dip. Caution is advised.

Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **July 31st,** 2019

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HCRE	Horizons Equal Weight Canada REIT Index ETF	7.9%
	Bond	
HFR	Horizons Active Floating Rate Bond ETF	11.3%
HBB	Horizons CDN Select Universe Bond ETF	3.9%
	Commodities	
HUG	Horizons Gold ETF	9.8%
	United States Dollar Exposed Assets	
	Short Term & Bond	
HTB	Horizons US 7-10 Year Treasury Bond ETF	48.2%
HUF	Horizons Active US Floating Rate Bond (USD) ETF	1.1%
	Equities	
XLP	Consumer Staples Select Sector SPDR Fund	14.6%
IWB	iShares Russell 1000 ETF	6.0%
IBB	iShares Nasdaq Biotechnology ETF	4.8%
GDX	VanEck Vectors Gold Miners ETF	2.9%
XLV	Healthcare Select Sector SPDR Fund	2.0%
HXS	Horizons S&P 500® Index ETF	1.9%
EWJ	iShares MSCI Japan ETF	-2.0%
XLI	Industrial Select Sector SPDR Fund	-2.0%
XLY	Consumer Discretionary Select Sector SPDR Fund	-5.0%
IWM	iShares Russell 2000 ETF	-6.1%
	US Dollar Forwards (July 2019) - Currency Hedge **	-0.2%
	Cash, Cash Equivalents, Margin & Other	0.8%
	Total (NAV $275,845,508)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 18.2% of current NAV)

The objective of HAC is long-term capital appreciation in all market cycles by tactically allocating its exposure amongst equities, fixed income, commodities and currencies during periods that have historically demonstrated seasonal trends. The Thackray Market Letter is for educational purposes and is meant to demonstrate the advantages of seasonal investing by describing many of the trades and strategies in HAC.

A loss of 0.5%, doesn't sound like a lot, but the danger is hidden in the average. The problem is that when "bad things" happen they often happen in August and September. August and September have had more than their fair share of market declines and have produced some of the worst two month losses over the long-term. It is typically a time to be cautious in the stock markets.

On August 2nd, I had the privilege of being a guest co-host with Paul Bagnell at BNN Bloomberg on "The Street." In the clip below, I discuss the Danger Zone –August and September.

https://www.bnnbloomberg.ca/video/u-s-stock-market-entering-the-danger-zone-horizons-etf-management~1744346

Seasonality does not cause a sharp market correction: It provides a backdrop for a fragile market to correct sharply!

In the current bull market, investors may not have seen sharp declines in August and September play out as in the past. The reason, most of the Federal Reserves dovish actions were carried out in the summer months, helping to juice the market at this time. The Federal Reserve meets annually in Jackson Hole, Wyoming, towards the end of August, and have in the past invited other key central bankers selectively from other parts of the western world. The meeting has often produced dovish statements, leaks of QE and announcements of QE. The result has been strength in the summer months for the stock market that otherwise would not have occurred. Sure it could happen again, but given the recent hawkish statement of Powell at the last meeting, I would not count on a surprise huge stimulus program.

Note: I wrote my commentary, below, on the yuan on Saturday August 3rd, before the Chinese let their currency devalue on Sunday. My comments still stand. In fact, it is possible that the Chinese will continue with their currency devaluation.

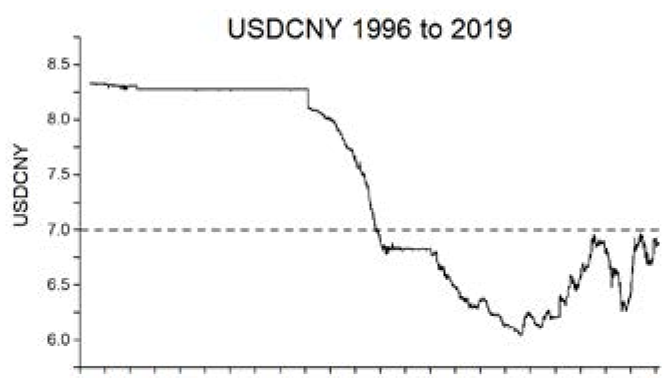
The most recent large correction in the summer months took place in late August 2015. Overnight, China announced that they were devaluing the yuan, by a much larger amount than anyone expected. Investors got spooked and the stock market corrected sharply. Ironically, as the US-China trade war deteriorates further, China may take similar action once again in order to counter the impact of the tariffs.

Tariff Trouble - More than meets the eye, or pocket book

It is no secret that Trump is pushing Powell to decrease rates faster (you just need a Twitter account to follow the overt statements of pressure). Powell, did not cut rates as much as Trump wanted. Maybe it was not a coincidence that Trump announced additional tariffs on China the day after the Federal Reserve announced only a 25bps rate cut. Increased tariffs hinder Chinese/US/World growth, making it more prudent for the Federal Reserve to reduce its federal funds rate. Right after the Trump announced increased tariffs on China, investors adjusted their probability that the Federal Reserve will raise its federal funds rate from 60% to 90% at its next meeting.

The US proposed 10% tariffs on $300 billion of Chinese goods has some obvious effects of making goods coming into the US more expensive. This round of tariffs will directly affect US consumers, as the tariffs apply to common retail goods such as apparel, toys and consumer electronics. But the implications of the tariffs go far beyond increasing prices of products from China. When China decides to retaliate, it could get "messy."

China does not buy as many goods from the US as the US buys from it. But that does not mean that they do not have any tools to retaliate. One of the ways that they could retaliate is to lower the value of their currency, which would help to boost their export sector.



The graph above shows the long-term relationship between USD and Yuan. The data is from the Federal Reserve and is of July 26th. The demarcation line for the currency wars to begin is generally thought to be 7.0 USDCNY. If the yuan breaks this level, then it is a clear sign that China is upping the ante in the trade war. Up until now, China has been saving this ammunition, and waiting for the right time.

Powell vs PMIs

The US economy is growing, but not by a lot. Most of the world is contracting according to Manufacturing PMIs, including Europe, China and Japan. Last week the ISM Manufacturing PMI came in at 51.2, worse than expected but still in growth territory. How long can the world contract and the US grow. To be fair, the PMIs are considered soft data as they are based on surveys. They are leading indicators. Most investment pundits prefer to wait for the damage or good news to show up in the GDP, which is considered hard data before passing judgement. It looks like Powell is trying to partially hedge himself, and wait for more evidence in the hard data before aggressively cutting rates. The bond market thinks that the Federal Reserve is wrong and the Fed should be paying more attention to the PMIs. We shall see.

Earnings Guidance – not good

Investment pundits are telling us that the earnings are good, the beats are good and everything is just fine. Be careful with the metric of companies beating their earnings estimates, because the bar is typically set low and analysts have been reducing their expectations recently.

What is not being mentioned is that more than half of the companies giving forward guidance, are guiding below analyst expectations. This has not happened since 2015. Yes, earnings maybe positive this quarter, but the future does not necessarily look good.

Yields plunging after Federal Reserve cuts

A Lower federal funds rate is good for the economy and should help drive the stock market higher – right? Not necessarily. The last two times that the Federal Reserve embarked on a cutting cycle, 2001 and 2007, the stock market stumbled. It could be different this time.....probably not.

Late September/October - Buying opportunity ahead?

No one knows if the stock market is going to correct further. What we do know is that on average over the long-term, August and September tend to be weaker months of the year and tend not to be the best time to over extend risk.

The silver lining is that any correction that takes place at this time could lead to a good buying opportunity. When a correction takes place at this time of the year, often a good time to increase equity holdings is either late in September or in October, depending on market dynamics. I will cover this topic more in future newsletters.

What the HAC is going on?

In July, HAC was predominately invested in fixed income. During the month, HAC increased its allocation to gold and entered into a position in gold equities. The fund also took on a number of small pair trades.

Seasonal Opportunities

Biotech – Maybe not this year

Biotech has a seasonal period from June 23rd to September 13th (Thackray's 2019 Investor's Guide).

From April to mid-July, the biotech sector was trading in a consolidation box relative to the S&P 500. In mid-July, the biotech sector broke below its consolidation box. The main reason for the erosion was political, as Trump was working to increase drug price transparency by trying to have drug prices advertised during drug commercials.

July is typically a strong month for the biotech sector. The seasonal statistics are very strong. This past July did not play out as expected. The biotech sector underperformed the S&P 500, broke quickly below its consolidation box relative to the S&P 500 and then rallied back into its consolidation box. At the current time, the trade needs to be monitored.

My Call: The biotech sector will probably moderately outperform the S&P 500 over the next few weeks, but further underperformance of the sector should lead to consideration to exit the seasonal trade early.

Consumer Staples – Steady as it goes

The consumer staples sector tends to perform well from mid-April to October 27th on a seasonal basis.

The consumer staples sector has been performing at market since the beginning of the year. In a more recent time frame, since April, the consumer sector has been outperforming the S&P 500. As the yield on the 10-year Treasury Note has been decreasing, it has helped the relative performance of the consumer staples sector.

My Call: The consumer staples sector will probably continue to outperform the S&P 500. The sector tends to be particularly strong relative to the S&P 500 in October. At this time, the sector in expected to outperform until late October, following its seasonal trend.

Canadian REITs – Still some room left?

Canadian REITs have a strong seasonal period from May 20th to September 20th

The Canadian REIT sector has been positive in its seasonal period so far. Technically, on an absolute basis, the sector has formed an ascending triangle which is a bullish formation. So far, lower interest rates have helped support the sector. If and when the economy starts to show significant signs of slowing down, the Canadian REIT sector would be expected to perform poorly. So far, the conditions have not developed in such a manner.

Caution: The REIT sector has a fairly strong track record of performing poorly after it finishes its seasonal period on September 20th.

Of course, it is possible for the REIT sector to continue to perform well after its seasonal period, but past seasonal trends do not support this price action.

My Call: The Canadian REIT sector will probably continue to outperfom the S&P/TSX Composite Index in the month of August.

US Government Bonds – In their seasonal sweet spot

US government bonds have a strong seasonal period from May 6th to October 3rd. The sweet spot for the seasonal trade is August and September. Canadian government bonds have a similar seasonal period (Thackray's 2019 Investor's Guide).

US government bonds have continued to rally, much to the surprise of a lot of investors. It was less than a year ago that the 10-year Treasury note was yielding over 3.2% and it is now below 2%. Despite a strong rally, US government bonds can continue to rally in August and September. In fact, these two months are the sweet spot for the US government bond trade.

Caution: US government bonds have a fairly strong track record of performing poorly for a few weeks after the sector's seasonal period ends on October 3rd.

Of course, it is possible that US government bonds could continue to perform well through October, but past seasonal trends do not support this price action.

My Call: US government bonds will probably perform well in August and into late September.

Gold – Still shining bright – More investors interested

Gold bullion has a seasonal period of strength from July 12th to October 9th, with the sweet spot of the trade being in August and September (Thackray's 2019 Investor's Guide).

Gold seems to be the forgotten precious metal over the last five years. Recently, gold has broken out above its 2014 high. As bond yields have fallen, the opportunity cost of holding gold has fallen and its price has risen. Once again, investors are interested in the precious metal.

The sweet spot for the gold bullion trade is August and September. Despite its strong performance, gold could move much higher. Investors, tend to have a recent relative value bias. If an investment has had a strong rally, then investors tend to wait for the security to pull back before trying to take a position. Although this can sometimes be successful with stocks, it is less so with commodities as the moves tend to be much larger. In other words, gold could still continue to rally despite performing well over the last few months.

My Call: Gold bullion will probably continue to perform well in August and most of September. Gold bullion often turns lower in early October and caution is advised at this time.

Gold Miners

The seasonal period for gold miners starts on July 27th and lasts until September 25th. The sweet spot for the trade is August and most of September (Thackray's 2019 Investor's Guide).

On an absolute basis, gold miners appear to be breaking out relative to their 2014 high. Gold miners were higher in 2016 for a short period of time, but the main consolidation took place in 2013 and 2014 around these levels.

In my last newsletter, I discussed gold miners relative performance compared to the stock market's performance. Currently, both gold and gold miners are performing well. If the stock market does turn sharply lower and gold bullion is negative, it would be expected that the gold miners would also be negative.

Currently, gold miners are in their seasonal period, which does not finish until towards the end of September. There is still lots of time for the sector to move higher.

> My Call: The gold miners sector will probably continue to perform well in August and into late September.

Energy – Possible trade – fading

The energy sector has a secondary seasonal period from July 24th to October 3rd. Although this trade is not as seasonally strong as the main energy trade that lasts from late February into early May, it is worth consideration, especially if the energy sector has corrected before the start of its seasonal period (Thackray's 2019 Investor's Guide).

For the energy sector's secondary seasonal period to be of interest, ideally the sector should have corrected into the beginning of the seasonal period and the sector should start to show strong positive momentum.

The price of oil did correct into the beginning of its seasonal period, but has so far failed to show positive momentum. The price of oil has been forming a consolidation wedge and could break out either higher or lower.

The energy sector also has a negative trend with lower highs and continued underperformance relative to the S&P 500. So far, the sector has not shown the positive momentum needed to be of interest in its secondary seasonal period.

Currently, the seasonal trade does not look attractive.

West Texas Intermediate

Energy Sector

Although the short-term supply/demand fundamentals are favorable for the price of oil, long-term demand erosion is a concern as the global economy continues to slow down.

Short Sells for Pair Trades

Consumer Discretionary – Short Sell

The consumer discretionary sector, on a seasonal basis tends to underperform the consumer staples sector from mid-April to late October.

The consumer discretionary sector has been underperforming the staples sector since last October with a few ups and downs along the way. Recently, in mid-July, the discretionary sector started to turn down relative to the staples sector.

If the market continues to stumble and the yields on the 10-year Treasury note continues to erode, it would be expected that the staples sector would outperform the discretionary sector.

My Call: The consumer discretionary sector will probably underperform the consumer staples sector until late October.

Industrials– Short Sell

The industrials sector tends to underperform the S&P 500 in August and into September. Recently, the sector has been underperforming the S&P 500. It is still in its downward trading channel relative to the S&P 500. On an absolute basis, the sector has turned down from its high set last October. Currently, the industrial sector continues to show negative momentum relative to the S&P 500.

My Call: The industrial sector will probably continue to underperform the S&P 500 into mid-September.

Japan– Short Sell

The Japanese stock market tends to underperform the US stock market in the summer months into October. Japan is embroiled in its own trade war with South Korea which has been having a negative impact on the stock market. The Chinese slowing economy has not helped the Japanese stock market. Below is the graph of a hedged ETF (HEWJ) performance relative to the S&P 500.

My Call: The Japanese stock market has been underperforming the US stock market for an extended period of time with this trend expected to continue into October.

Small Caps– Short Sell

Small caps tend to underperform large caps into mid-August, but can continue to underperform into October. Currently, the small cap sector continues to underperform the large cap sector. Recently, the small cap sector has been showing improving relative performance relative to the large cap sector, but has not broken out above its downward trend channel.

My Call: The small cap sector will probably continue to underperform the large cap sector into October.

Currency Corner

CADUSD

The Canadian dollar has a secondary seasonal period from August 20th to September 25th. This trades has historically not been as strong as the April seasonal period, but it is still worth consideration (Thackray's 2019 Investor's Guide).

On an absolute basis, the Canadian dollar is half-way in its trading range and is currently heading down relative to the US dollar. A weaker price for oil and increased geopolitical tensions have not helped the Canadian dollar. Given the current situation, the Canadian dollar does not appear to be well setup for its secondary seasonal period.

My Call: The Canadian dollar will probably perform equal to the US dollar or slightly worse, over the next month and a half. At that point, the Canadian dollar will probably head lower relative to the US dollar.

Brooke's Rant

U-turn Powell

"You can only do so many U-turns until you are considered lost"

Ok, in all fairness, it is not just Powell that has been confusing investors, other members of the Federal Reserve are sending mixed messages. In mid-July, New York Fed President John Williams suggested that the Federal Reserve needs to take quick action to support the US economy. Many investors took this to mean that the Federal Reserve was set to cut 50bps in its next meeting. The next day, the Federal Reserve had to walk back William's comments.

Powell pulled a U-turn in December 2018, moving from ultra hawkish to dove, on a dime. It was not the shift that surprised investors, but the speed of the shift. Although there might have been a good reason for the shift, it was hard to reconcile the sharp U-turn with a lack of deterioration in the US economic data.

At the end of July, after cutting the federal funds rate by 25bps, Powell said that this was a mid-cycle policy adjustment. How do they make this stuff up? What is that supposed to mean? Not sure, and Powell had a difficult time explaining the concept and was a lot more hawkish than he previously portrayed his position just weeks earlier. Although this policy action was not officially a U-turn, It was an abrupt change in expectations.

The problem with the Federal Reserve trying to control investor perception without a clear logical path on rate direction, is that investors start to believe that the Federal Reserve can be pushed around. If investors demand an easy monetary policy from the Federal Reserve and the stock market starts to correct sharply, investors believe that the Federal Reserve will be there for them if the stock market declines. When Powell was raising rates in the autumn of last year, nobody said there was a "Powell Put" on the stock market. Today, "Powell Put" has become a fairly common phrase. Powell is out of U-turns.

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