# Thackray Newsletter

**— Know Your Buy & Sells a Month in Advance —**

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***Market Update***


A long, long time ago, investors focused on the fundamentals of companies and were concerned about future cash flow streams. Concepts such as the discounted cash flow models were used in order to value companies. Today, a lot of investors make their decisions based upon whether more stimulus is about to be announced by the government or the central bank. In the short-term, it does not matter if it is a good idea or not, it is what is driving the markets.

The upcoming US Presidential election has brought the concept of stimulus to the forefront. The Federal Reserve is begging the government to launch another stimulus package and investors are expecting it. Both the Republicans and Democrats want a stimulus package, but it is a question of how much, when and what for? Investors see this as a win-win situation.

The stock markets are having a knee jerk reaction to every stimulus comment that Trump and Pelosi release to the media. The markets have been rallying recently on the possibility of a Blue Wave, a sweep by the Democrats in the House and the Senate, which would result in more

S&P 500 Technical Status


There is a battle going on in the stock market between the technology and the cyclical sectors. The industrial sector (a cyclical sector) has been having spurts of outperformance since May.

Recently, investors have been warming to the possibility of the reflation trade. Inflation expectations have been increasing and sectors that benefit from higher inflation (and as a consequence higher interest rates) have been showing improving performance. The yellow hilite bars in the graph represent times when the industrial sector has outperformed the S&P 500. Notice how the tech sector underperformed the S&P 500 at the same time.

The technology sector has been leading the stock market for the last couple of years. This bull market has been led by the technology sector and will probably die with the technology sector. The industrial sector will probably start a more sustained outperformance compared to the S&P 500, when the technology sector decisively breaks its upward trend line compared to the S&P 500.

Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **September 30,** 2020

| Symbol | Holdings | % of NAV |
|---|---|---|
| | Canadian Dollar Exposed Assets | |
| | Bonds | |
| HBB | Horizons CDN Select Universe Bond ETF | 5.7% |
| HFR | Horizons Active Ultra-Short Term Investment Grade Bond ETF | 3.2% |
| | United States Dollar Exposed Assets | |
| | Bonds | |
| HTB | Horizons US 7-10 Year Treasury Bond ETF | 22.1% |
| | Equities | |
| XLP | Consumer Staples Select Sector SPDR Fund | 17.1% |
| | US Dollar Forwards (October 2020) - Currency Hedge ** | -0.5% |
| | Cash, Cash Equivalents, Margin & Other | 52.5% |
| | Total ( NAV $228,040,588) | 100.0% |

** Reflects gain / loss on currency hedge (Notional exposure equals 34.8% 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.

stimulus (and more debt). Even Trump has realized that investors are begging for stimulus to keep the stock market alive. Last week, Trump tweeted out that he wanted more stimulus than either the Republicans or Democrats are willing to offer. It is all about stimulus, but if a stimulus package is not forthcoming over the next week or two, investors may shift their focus to earnings—at least temporarily.

### *Earnings Recess*

Although earnings have taken a back seat to all the stimulus chatter, earnings will become important for at least a brief period of time this month. October starts Q3 earnings season and helps to give perspective on how the rest of the year is going to play out in the economy and the stock market.

Currently, Q3 earnings are expected to come in at a decrease of 20.7% on a year-over-year basis (Refinitiv October 9). For the first time since 2010, analysts have been raising their estimates for Q3. The typical process is for analysts to lower their estimates as the earnings season approaches, as analysts are generally too optimistic. Nevertheless, earnings on an absolute basis are still expected to be negative compared to this time last year.

As earnings growth is expected to taper, but still move higher on an absolute basis, corporate guidance is going to be increasingly important. Quite a few large firms have recently announced layoffs as government monetary support has been drying up. Many other companies have figured out that they cannot survive with their current operations, regardless of government support and need to cut back on costs. The result is that layoffs have been increasing.

On the other hand, a lot of other companies have been performing well over the last few months and hiring employees. Corporate guidance across different industry sectors should help investors to determine the net outcome of economic growth in the future.

### *The law of big numbers*

Recently, some of soft economic data has been showing signs that the economy is losing some of its strength. Of course the economy cannot improve at a record rate of growth for a sustained period of time. The rate of growth has to slow, otherwise the economy would quintuple in just a few years. It is just the law of mathematics and big numbers. The question remains, how much of a slowdown in the growth of the economy is acceptable?

### *The Blue Wave is Swamping the Markets*

Wow! How the narrative has changed recently. It was just a few weeks ago that the narrative was that if the Democrats swept the election, it would be bad for the stock market due to higher taxes, greater government debt and more regulations creating a drag on the economy. Now, the narrative has flipped: all of the bad things for economic growth would only impact the economy in the long-term (a year or two out). What is more appealing is the promise of greater stimulus and "free money," to help create a positive environment for a higher stock market in the short-term. As Biden's odds of winning the election have increased, the stock market has moved higher. The odds of the Republicans keeping the Senate seem to be dismissed by investors.

### *Emotional investment decisions around elections have not worked*

### *Bottom Line: It is typically best not to invest on how you want things to be, but rather on the way they are!*

I remember talking to an investor that was so emotional before the last US Presidential election in 2016, they stated that they were thinking of selling everything before the election. They were concerned that if "*X*" got into power that the economy was going to suffer and the stock market was going to crash. They were wrong. The problem was that the investor was making an emotional decision. They did not want "X" to be elected and as a result, they were planning on making an emotional investment decision.

The irony was that it did not matter who was elected, Clinton or Trump, the stock market would have probably have move higher.

Covid-19 has made a mess of the economy and government actions are setting up for problems down the road. Governments continue to implement stimulus programs that are poorly directed and extremely inefficient. This will not change if the Democrats are elected. Given the misallocation of capital that is taking place, it is easy to become negative on the future state of the economy and society, but that should not necessarily effect your current investment decisions.

If either Trump or Biden win the election, the government is probably going to spend a lot more money, which could drive the stock market higher. Of course there are different policy platforms between the Republicans and Democrats and the long-term economic consequences of either party could have a detrimental impact on the economy.

The problem is trying to determine when the long-term negative consequences of increased debt and misallocation of capital is going to impact the stock market. Investors could shift their perspective next month, next year or in a few years. Trying to guess is a difficult exercise.

### *Seasonal trends*

Federal Reserve and government stimulus actions have dominated the markets and overwhelmed financial, technical and seasonal trends. In its rapid accent from its March low, the stock market has not had a significant pullback. The stock market pulled back in September, but by most measures the pullback was not significant.

Stimulus and expectations of stimulus have distorted the natural rhythms of the market. Typically, the stock market tends to be weak in the "summer" months as investors pull back on risk, but with full on stimulus investor risk appetite has remained high. What does it mean for the future?

The fact that the stock market has rallied over the summer months, does not mean that it will correct over the next six months. On average, when the stock market has made a big gain in its weaker six month period, the stock market has tended to perform well over the next six months.

## *What the HAC?*

In September, HAC was conservatively positioned. HAC maintained a position in the consumer staples position. HAC also held a positions in US government bonds and Canadian bonds. HAC also exited its position in gold miners and increased its position in gold bullion.

## *Seasonal Opportunities*

### *Gold*

*Gold has a strong seasonal period from July 12 to October 9*

There are arguments for gold on a long-term macro basis as central banks are committed to "money printing" and governments spend more and more money. Eventually, the velocity of money will increase and cause inflation.

On a shorter-term basis, gold tends to be weak for most of October and into November. From a macro level, the case for gold long-term appears to be good. In my latest -This month - Last Month video, I discuss the seasonal performance of gold at this time of the year (alphamountain.com). Over the last ten years, gold has been negative eight out of ten times from October 10 to December 26. The next strong seasonal period for gold starts on December 27. This could be a good opportunity for gold as it has performed well starting in late December over the last few years.


My Call: Gold will probably be moderately negative in October until early December, before starting to form a base and move higher later in the month.

### *Gold Miners*

*Gold miners have a strong seasonal period from July 27 to September 25*

The seasonal period for gold miners has finished. The next seasonal period for the sector starts on December 23. If the price of gold bullion moves lower over the next few months, and the stock markets hit an air pocket, gold miners could correct sharply. A better opportunity could be develop later in the year.

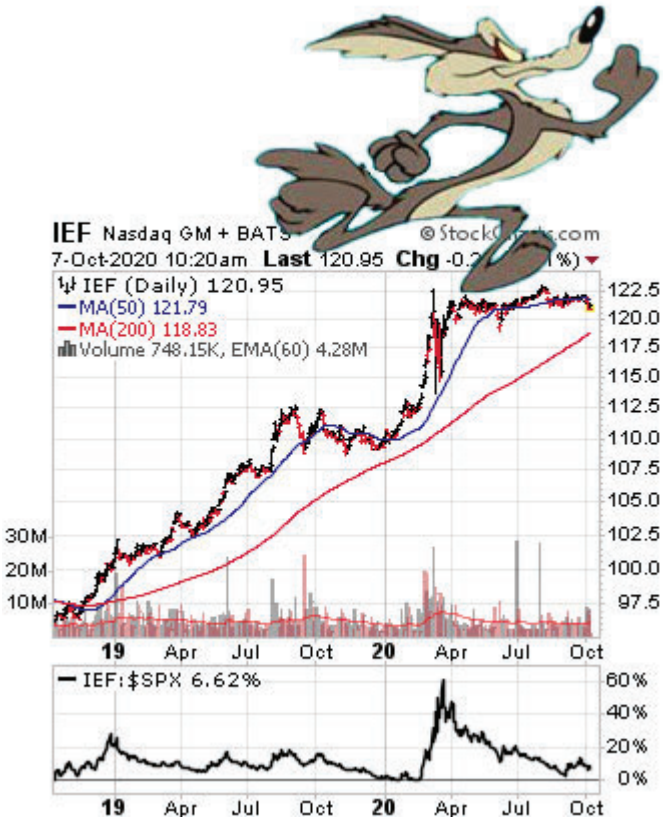

My Call: Gold miners will probably underperform the S&P 500 until mid-to-late December and then perform very well.

### *US Government Bonds*

*US government bonds have a strong seasonal period from May 5 to October 3*

The seasonal period for US government bonds has finished. The reason that I have included bonds in this report is to highlight that bonds tend to perform poorly at the end of their seasonal period in early October. To make matters worse, government bonds have already started to show weakness. With all of the "free money stimulus" being thrown around, there is a danger that this will push rates up at the long end of the curve. The Federal Reserve can put an effort into capping a potential rate increase, but it is possible that their actions could lag increasing rates.

The US government 7-10yr government bonds have been relatively flat from April. The price action of US government bonds has been unusually flat. Visually, it looks like a plateau. I have added to the graph a picture of Wile E. Coyote running on the "price" plateau of IEF and potentially falling off a cliff in the future. The picture is a throw back to the Road Runner and Wile E. Coyote cartoon that used to air on TV. A classic scene was Wile E. Coyote chasing the Road Runner and running off a cliff, hanging in the air with no support and then crashing to the ground. If yields do break higher, the US government bonds would be expected to fall.




My Call: US government bonds will probably head lower as interest rates slowly head higher until the end of the year.

### *Consumer Staples*

*The consumer staples sector has a strong seasonal period from April 23 to October 27*

Since June, the consumer staples sector has been performing at market. It should be noted that consumer staples tends to be one of the top performing sectors in the month of October. In this transition month, investors look to be invested, but also tend to be cautious and as a result favor consumer staples.

My Call: The consumer staples sector will probably outperform the S&P 500 in October.

### *Consumer Discretionary*

*The consumer discretionary sector has a strong seasonal period from October 28 to April 22*

The consumer discretionary sector has outperformed the S&P 500 since March. This has largely been because of large "stay at home" stocks such as Amazon have disproportionately pushed up the value of sector.


The risk to this sector is if the Democrats are able to obtain power and pursue breaking up the monopolies and dominant companies. Companies such as Amazon would probably suffer. In today's world, the time before Biden would take power and be able to implement changes is a long way away (at least a few months). As a result, investors have continued to push the price of monopolies or dominate companies higher, such as Amazon.

My Call: The consumer discretionary sector will probably perform moderately above market until the end of the year.

### *Technology*

*The technology sector has a strong seasonal period from October 9 to December 5 and a second seasonal period from December 15 to January 17*

Recently, investors have been intermittently rotating between the technology and cyclical sectors. There is a quite a bit of talk in the media about investors rotating from the technology sector to cyclical sectors such as the industrial or material sectors, based upon the economy improving and inflation increasing. This could happen, but this scenario probably needs a catalyst such as rising rates or the government cracking down on large technology companies, before the technology sector starts to underperform on a sustained basis.


My Call: The technology sector will probably moderately outperform the S&P 500 until early December.

### *Industrials*

*The industrial sector has a strong seasonal period from October 28 to December 31*

As the economy has been improving, the industrial sector has been outperforming since May. Technically, the industrial sector has been forming a bullish pattern of higher lows.

The industrial sector has been benefiting from the reflation narrative that investors are warming up to, which should help the industrial sector perform relatively well compared to the S&P 500.


My Call: The industrial sector will probably outperform the S&P 500 until the end of the year.

### *Materials*

*The materials sector has a strong seasonal period from October 28 to January 6*


The materials sector has been outperforming the S&P 500 since May. It has established an upward trading channel relative to the S&P 500. Currently, it is at the bottom of the channel and turning higher. If the economy continues to show signs of improvement and the stock market moves higher, the materials sector would be expected to outperform.

My Call: The materials sector will probably outperform the S&P 500 until the end of the year.

### *Transportation*

*The transportation sector has a strong seasonal period from October 10 to November 13*

The transportation sector has been outperforming the S&P 500 since May and is now well past the level it was in late February compared to the S&P 500. A lot of businesses have performed poorly in the pandemic, but a lot of other businesses have performed well as investors continued to spend money.The transportation sector has been performing well as some businesses that have performed well in the pandemic have been restocking in case there is a second wave. Businesses that performed well in the recovery were caught off guard and ran out of inventory and have recently been restocking in order to avoid the same fate of low inventory levels that they suffered in the first wave.

The transportation sector may be a vulnerable to the economy growing at a rate that is slower than expected. It hasn't happened yet, but there are some signs that this scenario could be developing. In the meantime, the sector is still in an uptrend and outperforming the S&P 500.


My Call: The transportation sector will probably start to underperform the S&P 500 in mid-November.

### *Retail*

*The retail sector has a strong seasonal period from October 28 to November 29*

The retail sector has been performing well as consumers continue to spend money.

Not all ETFs are the same. The RTH (ETF) is cap weighted with Amazon representing approximately 20% of the ETF.


But it is not just Amazon. The XRT (ETF) has been outperforming the S&P 500 and it is equally weighted. Amazon represents less than 1.5% of the fund. Although there is an overall bifurcation in the sector with some retail businesses performing well and others poorly, the sector as an aggregate has outperformed the S&P 500.


A lot of retail companies have gone bankrupt and many others continue to be shuttered waiting out the pandemic. It is hard to imagine that this sector of the stock market has outperformed the S&P 500 for an extended period of time. The winners in the sector have more that offset the losers.

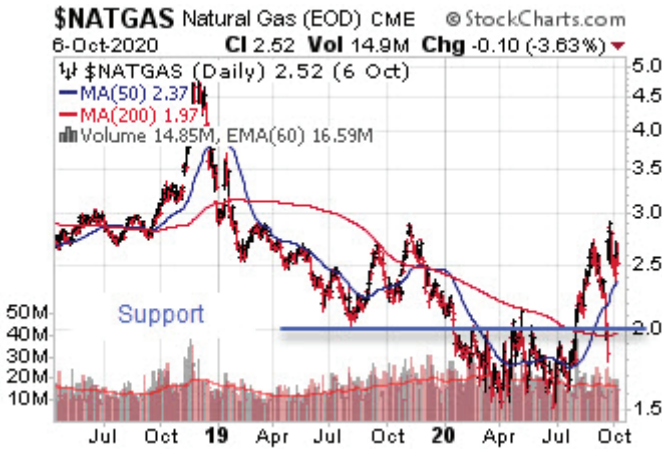
My Call: The retail sector will probably outperform the S&P 500 in the initial stages of its seasonal period starting in late October, but could start to underperform before its seasonal period ends late in November.

### *Natural Gas*

*Natural gas has a seasonal period from September 5 to December 21*

Natural gas has risen off a bottom in July, but recently has been extremely volatile. The seasonal sweet spot for natural gas is in November. This year has a large number of storms and hurricanes threatening the US and potentially shutting down natural gas supply.

More storms and hurricanes could lead to higher natural gas prices, but the main impetuous for strong natural gas prices is the need to heat homes and businesses in winter.




My Call: Natural gas will probably remain volatile and be higher at the end of November.

### *Agriculture*

*The agriculture sector has a strong seasonal period from September 26 to November 11*

The agriculture sector has been moderately outperforming the S&P 500 and is at the bottom of its trading range.

The seasonal period for the agriculture sector is fairly short. If the sector has strong momentum, the sector's outperformance can continue past the end seasonal period.


My Call: The agriculture sector will probably moderately outperform the S&P 500 over the next month.

### *Canadian Banks*

*The Canadian banking sector has a strong seasonal period from October 10 to December 31*

Canadian banks have been outperforming the TSX since June. Stronger than expected earnings released at the end of August have helped to support the Canadian banks.


Technically, Canadian banks have been developing a bullish pattern of higher lows. When Canadian banks have moved higher in the summer months because of strong earnings, they can often start to fade on their full-year earings that typically get reported towards the end of November.

The question that remains for the Canadian banks is the impact on earnings as mortgage forbearances roll-off in the near future. So far, with a strong housing market, this has not had an impact, but this could change fairly quickly.

My Call: Canadian banks will probably outperform the TSX up until the end of November when the banks start releasing their Q4 earnings.

### *Metals & Mining*

*The metals and mining sector has a strong seasonal period from November 19 to January 5 and then from January 23 to May 5*

The metals and mining sector have been moderately outperforming the S&P 500 since late March. The sector is still off its all-time highs and is still negative for the year. The sector has not kept up to other cyclical sectors such as the industrial or materials sectors. On a seasonal basis, this is a natural progression of trends as the metals and mining sector tends to lag the other cyclical sectors of the market at this time of the year.


My Call: The metals and mining sector will probably perform at market or slightly above market until late November before its performance increases relative to the S&P 500.

### *Emerging Markets*

*The emerging markets sector has a strong seasonal period from November 24 to April 18*

Emerging markets outperformed the S&P 500 from late May to July, underperformed until late August and then

outperformed in September. A weaker USD would help support emerging markets.

Emerging markets could be an interesting opportunity in late November.

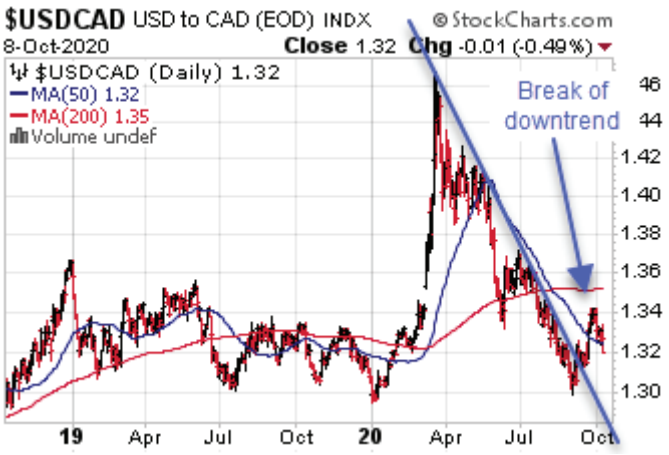

My Call: The emerging markets sector will probably perform at market until late November, at which time the sector will probably outperform until the end of the year as the USD heads lower on a seasonal basis.

## *Currencies*

### *USDCAD*

The US dollar has underperformed the Canadian dollar since April, but in September started to show strength as the stock market corrected. In the first few days of October, the USD has retreated as investors moved to a risk-on mode. In addition, investors have shifted to the stance that Biden is expected to win the presidency. The narrative that is currently circulating is that if the Democrats get into power, then this will be bad for the US dollar as massive government debts will have downward pressure on the US dollar.

Nevertheless, the US dollar has broken its downward trend line, which is positive, and in its strong seasonal period relative to the Canadian dollar which lasts until mid-December.



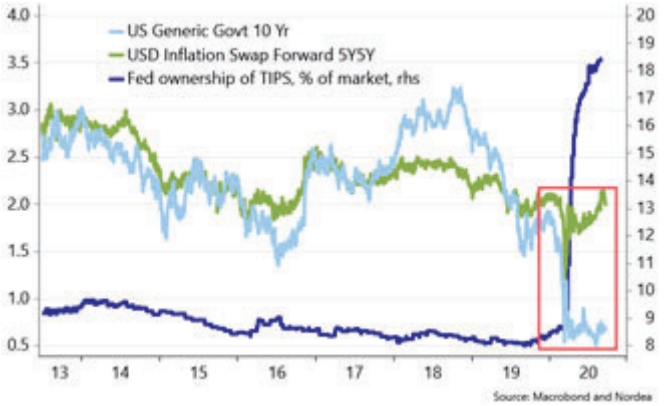

My Call: The US dollar will probably start to stabilize shortly. Nevertheless, consideration to exit a long US dollar position should be given if the US dollar continues to weaken.

## *Brooke's Rant(s)*

### *Powell - Getting the Tail to Wag the Inflation Dog*

Recently Powell announced that the Federal Reserve was moving to an average inflation target regime, which would allow inflation to run above 2% (previous target) for some time before taking any tightening action. Currently, inflation expectations are rising, but are not a problem. In the graph below, the TIP (ETF) (inflation protected bonds) is outperforming the US government 7-10 notes IEF (ETF). Although the duration of these products are not the same, the outperformance of the TIP's product still indicates rising inflation expectations.


What is largely going unnoticed is that the Federal Reserve is aggressively buying TIPs (Treasury Inflation Protected notes)? These notes are guaranteed by the US government and the payout on the notes increase if inflation increases. The Federal Reserve currently owns almost 20% of the TIPs market, dark blue line in graph below (source: Nordea.com).




Why is the Fed buying TIPs? Buying TIPs does not push down interest rates, which is the objective of quantitative easing. Buying TIPs does not help lower interest rates in the mortgage market, which is the objective of the Federal Reserve as it currently owns over a quarter of the Mortgage Backed Securities (MBS) market. So why is the Federal Reserve buying TIPs?

***My theory:*** The inflation rate is currently low. Inflation expectations have been rising, but are still well below target. The Federal Reserve is using this opportunity to actively buy TIPs to create a bank of assets to help manage inflation expectations in the future.

Down the road, when inflation does start to rise above 2%, the Federal Reserve can manipulate the market by selling their TIP holdings into the market, which would help to drive down the price of TIPs, which in turn would artificially signal to investors that inflation expectations are decreasing. I have been critical of the Federal Reserve fairly consistently in the past because of their constant market manipulation that causes a misallocation of prices, but buying TIPS to manipulate inflation expectations in the future is sneaky clever. A "hat tip," to Powell on this one.

***Of Course it is 2020 - We have the Greek alphabet wreaking havoc in the Atlantic basin***

The US is currently being hit by a series of storms whose names are based upon the Greek alphabet. Ironically, the letters are used to describe risk-return metrics in the options and investment markets. Alpha, beta and gamma recently came into the Atlantic basin. Following meteorological reports is akin to reading financial pages. It just seems weird to read about Gamma or alpha approaching for an assault on land.

The World Meteorological Organization (WMO) has run out of Tropical Storm Names, as more storms have developed in 2020 than the listed potential names for the year. The WMO has a list of 21 potential storm names for the year, listed alphabetically from A to W (there are no Q, U, X, Y or Z names because of availability). The only other time that the WMO ran out of storm names was in 2005, when they had to use six letters of the Greek alphabet.

**In 2020, I will get really concerned if the WMO has to name a storm "Omega!"**