Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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Market Update

Reflationary trade powers higher for now

Investors have become focused on the "reflationary trade." The media has obliged and has increased their discussions on the theme. The focus on the reflation trade has helped the cyclical sectors of the stock market to outperform.

Many investors argue that the cyclical sectors of the stock market have underperformed for so long that they have only just started a long-term bull market of outperformance. Wow. How the narrative has changed from a few years ago when investors believed that growth would dominate forever into the future.

The term reflation has two different meanings in the investment community. The first definition focuses on economic expansion largely due to the actions taken by central banks and governments. The second definition focuses on the "restoration of deflated prices to a desirable level" (Merriam-Webster).

The term reflation has nothing to do with the stock market and is all about the economy. Investors usurped the term

S&P 500 Technical Status

The S&P 500 is still in an up trend and after breaking briefly below its 50 day moving average, has managed to once again bounce higher.

The S&P 500 is still not far off its all time high and is well above its major support level of just above 3500, which is the middle of the double bottom, or the middle of the "W" that occurred in October. If the S&P 500 were to break below 3500, it is highly likely that investor sentiment would become negative and put further downward pressure on the market.

The RSI has been moving lower, indicating a price momentum deterioration. Nevertheless, this is not a serious worry as the level is still above 50.

Technically, the stock market is in good shape, despite some increased volatility recently.

Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **February 28, 2021**

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizon S&P/TSX 60 Index ETF	36.3%
HEWB	Horizons Equal Weight Canada Banks Index ETF	16.0%
HXE	Horizons S&P/TSX Capped Energy Index ETF	8.8%
	United States Dollar Exposed Assets	
	Equities	
XLB	Materials Select Sector SPDR Fund	9.0%
HXS	Horizons S&P 500 Index ETF	8.2%
XLI	Industrial Select Sector SPDR Fund	7.8%
HEXM	Horizons Emerging Markets Equity Index ETF	3.6%
HULC	Horizons US Large Cap Index ETF	3.2%
FHG	First Trust AlphaDEX US Industrials Sector Index ETF	3.1%
XLF	Financial Select Sector SPDR Fund	3.0%
	US Dollar Forwards (February 2021) - Currency Hedge **	-0.2%
	Cash, Cash Equivalents, Margin & Other	1.2%
	Total (NAV $219,973,965)	100.0%

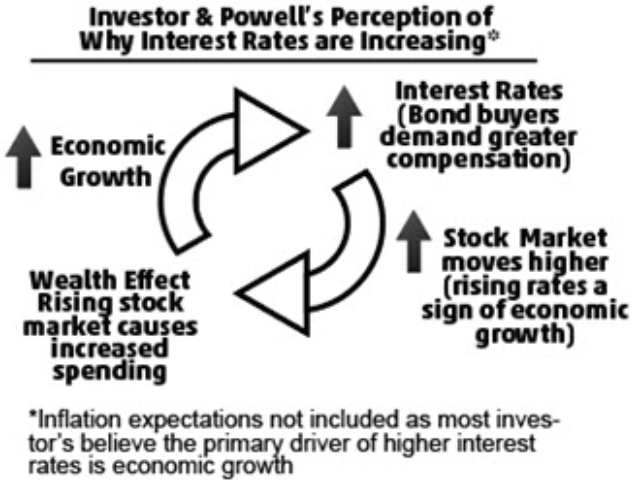
** Reflects gain / loss on currency hedge (Notional exposure equals 28.3% of current NAV)

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.

and morphed it into the reflationary trade: which encompasses the concept of a coincident rising stock market and rising interest rates.

Investors have come to see rising interest rates as a good thing. The standard line is that rising rates are indicative of a stronger economy and a rising stock market. Essentially, economic growth is causing increasing interest rates (setting aside inflation expectations as a cause of inflation). During periods of economic growth or anticipated economic growth, interest rates tend to rise as bond buyers demand higher compensation to buy bonds.

The rising stock market creates a wealth effect where investors feel wealthier and so spend more, causing greater economic growth. And the circle continues.



Obviously, this cannot go on forever. Sometimes, economic growth can slow for a variety of factors, breaking the circle. Other times, there can be an unpredictable catalyst that can break the circle, but in general there tends to be a fair bit of inertia in this process.

There is no question that economic growth and the future expectations of economic growth have been contributing tor rising interest rates. The big question is how much has higher inflation expectations contributed? In one of my recent videos, *March - What's Hot & What's Not*, in part of the video I discuss the seasonality of inflation expectations (I also do this in last month's newsletter). Approximately in the middle of the video I also discuss the ramifications for the backwardation of the inflation expectations curve.

https://www.youtube.com/watch?v=7jiK3lHasG0

I also discuss the concept of inflation expectations on my latest BNN Bloomberg Market Call Appearance on March 1, 2021.

https://www.bnnbloomberg.ca/video/brooke-thackray-s-market-outlook~2150896

Basically, the inflation expectations curve has become "backwardated," with inflation expectations higher in the short end of the curve compared with the longer end of the curve. This situation typically resolves with declining inflation expectations.

Given that inflation expectations tend to wane at this time of the year and the current state of backwardation of the inflation expectations curve, it is possible to see inflation expectations stabilize and perhaps recede at this time. This in turn could lead to changes in both the bond market with lower yields and stock market dynamics in the near future. I would argue that investors are not ready for this shift.

Although the S&P 500 has been moving higher with rising interest rates since last August, historically there are times when this correlation changes, such as in late 2018. A lot depends on the stage of the business cycle at the time.

Rising interest rates and a positive stock market are indicative of the period coming off of a stock market bottom at the same time as coming out of a recession with

low growth. We are clearly not at a market bottom at this juncture. Nevertheless, rising rates and a positive stock market are generally a good thing.

The graph below shows the relationship between the S&P 500 and the US Treasury 10 year yield. The (1) panel is the S&P 500, (2) US Treasury 10 year yield (3) Correlation between the S&P 500 and US Treasury 10 year yield on a 20 day trading basis.

The concurrent rise in the S&P 500 and the US Treasury 10 year yield since last August is clearly evident. The bottom panel shows the shorter-term correlation. There are some zigs and zags, but generally when the S&P 500 and the US Treasury yield become inversely correlated to a high degree, approximately at the level of -0.75 such as today, the relationship tends to regress back to a greater degree of correlation.

In the above graph, we have to go back to early 2018 to get a situation similar to today, where the stock market was rallying and the yield on the US Treasury 10 year was also rising for an extended period and then the correlation turned negative and reached approximately -0.75. In this case, the stock market turned down lower before the yield followed. At the time, rising rates were a large concern.

The stock market does not have to turn lower before the yield turns lower. In the current regime, it is more likely that the yields will turn lower first. Lower yields, other than manipulated by the Federal Reserve, would indicate that expectations of economic growth are waning. The stock market would likely follow.

Why is this important? If you are looking for a sign that changes are afoot in the stock market, it is important to follow the relationship between interest rates and the stock market.

Reopening of the economy - four factors pushing it along

We will probably not get back to "normal over the next year or so. Not everyone will be lining up to go on a cruise or to travel internationally. A lot of people will wait to see how things play out.

Nevertheless, there are signs that the economy is getting back on track and is re-opening faster than anticipated.

- ♦ The number of COVID-19 cases around the world have been dropping substantially, as have COVID-19 deaths. When COVID-19 cases were increasing at a dramatic rate, governments and the news media let everyone know, but now the news media barely mentions the number of cases or deaths. This is not a political statement. I believe that governments are trying to be extra cautious, especially with the narrative of mutations. Nevertheless, cases and deaths have been declining.
- ♦ This is the time of year in the northern hemisphere when viruses tend to wane. It is also possible that COVID-19 will somewhat follow the flu cycle and similarly wane as we head into the summer months.
- ♦ Major economies such as the US will likely get close to herd immunity at some point in the near future. Governments and health organizations keep changing the percent of people that have either have to be vaccinated or have to have developed some immunity from infection. Nevertheless, society will move closer to some form of herd immunity.
- ♦ Both the Federal Reserve and the US government have clearly stated their position that they will err on the side of over stimulating the economy and are expected to continue stimulus even after the economy gains traction. They have stated that they are not worried about any future damage that they are causing to the economy. They are acting like "rookie firefighters" who believe that the more water on a fire the better. Ask any experienced firefighter and they will tell you applying too much water on a fire is not the ideal solution for a number of reasons, including causing too much water damage. Anyhow, what matters is that both the Federal Reserve and government are expected to continue to stimulate the economy.

Seasonal Trends - Rotation providing opportunities

Currently we are in a seasonal period when the cyclical companies tend to perform well, such as industrials and materials. Most of the cyclical sectors tend to perform well into late April or the beginning of May. The overall stock market on average, tends to weaken in May. Last year was one of the exceptions as the Federal Reserve and governments were providing enormous stimulus. Some investors may say that the same condition applies this year. I will address this in the next couple of monthly newsletters.

We have seen a major rotation from technology/growth to value/cyclical. Although the value/cyclical sectors could outperform on a multi-year basis, there will be periods where other parts of the market dominate. Even in a secular shift to value/cyclicals, when the economy slows or the stock market corrects, there will be other sectors of the stock market that will outperform. In this environment, seasonal trends become even more important.

Coming up shortly, on a seasonal basis, the cyclical sectors of the stock market tend to fade in their performance compared to the S&P 500. So, which part of the stock market is going to benefit from the next transition?

For the last few years, the growth sector of the stock market outperformed the S&P 500. As interest rates have been rising since last summer, the cyclical sectors of the stock market have been outperforming. If and when interest rates moderate and start to decline, it is totally conceivable to see the growth sectors, including technology outperform on a short-term basis, before giving way to the defensive sectors of the stock market that tend to outperform on a seasonal basis in late spring into summer.

The consumer staples sector has been left for dead by many investors. And yet, the sector is starting to show signs of outperforming the S&P 500. This is happening when interest rates have been increasing. If interest rates start to decrease this would likely increase the relative performance of the consumer staples sector.

The consumer staples sector is not the only "boring sector" that is starting to shine. The REIT sector has started to outperform the S&P 500. Ironically, this sector has just started its seasonal period.

Despite the stock market starting to show some fatigue, there is still areas of the market that are providing opportunities.

What the HAC?

In February, HAC was substantially invested in equities. During the month, HAC increased its exposure to the energy sector, industrials, and Canadian banks. On average, HAC had a larger weighting in the broad Canadian stock market versus the US stock market.

Seasonal Opportunities

Energy

The energy sector has a strong seasonal period from February 25 to May 9

The energy sector has been on fire. It started to rise at the beginning of February, a bit ahead of its average seasonal start date. The graph below illustrates the strength of the US energy sector as it has continued to rise after breaking out of a double bottom in early 2021.

Demand for oil has been increasing as the world has been opening up, at the same time supply has been constrained, forcing oil prices higher. OPEC+ has shown some signs of control and has recently agreed to extend their cuts to production. There is still a lot of runway for the energy sector to perform well in its seasonal period.

The graph below illustrates the Canadian energy sector, like the US energy sector it has recently broken out of a double bottom pattern.

There are some risks to the energy sector performing well, including a slowing of re-opening expectations and a slowing Chinese economy. Recently, China's credit impulse has been declining, which is usually not good for commodities in the short-term, including oil.

My Call: The energy sector will probably moderately outperform the stock market with increased volatility and finish its seasonal period early, starting to underperform the stock market in April.

Consumer Discretionary

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

The consumer discretionary sector has been underperforming the S&P 500 since the beginning of February. As investors have shifted to the cyclical sectors, they have avoided the consumer discretionary sector. Some investors have maintained that if the economy is picking up, then the consumer discretionary should also benefit.

On a seasonal basis, the consumer discretionary sector is on average the strongest major stock market sector in the month of March since 1990. Given that the sector has become oversold, it is quite probable that the sector could bounce and outperform in March and the beginning of April.

My Call: The consumer discretionary sector will probably bounce and outperform the S&P 500 over the next few weeks.

Retail

The retail sector has a strong seasonal period from January 21 to April 12

The retail sector has been underperforming the S&P 500. Its underperformance is similarly being caused investors focusing on the cyclical sectors of the market. The small

cap companies in the retail sector are performing better than the large caps.

My Call: The retail sector will probably bounce and outperform the S&P 500 in the second half of March.

Industrials

The industrial sector has a strong seasonal period from January 23 to May 5

The industrial sector has been outperforming the S&P 500 as the economy has been reopening. Despite its recent run, the industrial sector is still well below its relative performance level at the beginning of 2020. In addition, the industrial sector is even further below its relative performance peak at the beginning of 2018. In other words, the industrial sector could move much higher.

My Call: The industrial sector will probably continue to outperform the S&P 500 until late April.

Transportation

The transportation sector has a strong seasonal period from January 23 to April 16

The transportation sector has had a rapid rally recently and has managed to break above its relative level compared to the S&P 500 in November 2020.

The fact that the transportation sector is performing well helps to support the belief that the economy is opening up faster than expected, which in turn helps to support the stock market to move higher.

My Call: The transportation sector will probably continue to outperform for one more month.

Materials

The materials sector has a strong seasonal period from January 23 to May 5

The materials sector had a huge rally relative to the S&P 500 in the beginning of January and then corrected sharply and has recently bounced once again. Some of this erratic behavior was the result of changes in the performance of the gold miners and the metals and mining sector.

My Call: The materials sector will probably outperform the S&P 500 in March and most of April.

US Financials

The US financial sector has a strong seasonal period from December 15 to April 13

The US financial sector have been outperforming the S&P 500 recently as interest rates have been rising, which helps improve the net interest margin of the banks.

The US financial sector has become a play on interest rates for investors, outperforming as interest rates head higher and underperforming when they head lower.

Note: The US financials sector finishes its seasonal period in mid-April. Interest rates tend to peak in early May on a seasonal basis. Watch the direction of interest rates to see if US financials are finishing their seasonal period early.

My Call: The US financial sector will probably start to weaken relative to the S&P 500 in the near future.

Canadian Banks

The Canadian banking sector has a strong seasonal period from January 23 to April 13

Similar to the US banks, the Canadian banks have been outperforming the broad stock markets, benefitting from rising interest rates. Nevertheless, Canadian banks are different from US banks on a number of levels. One of the major differences is the dividend yield, with Canadian banks paying a higher yield, which in part puts downward pressure on the sector as interest rates increase. In the end, the difference between the positive effect of rising interest rates currently outweighs the negative effect of making the dividend stream less valuable. Given that US banks pay lower dividends they tend to be more levered to the direction of interest rates. In addition, US banks are more highly levered to economic growth.

My Call: Canadian banks will probably continue to outperform the market until early to mid-April.

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 outperformed the S&P 500 at the end of 2020 and into 2021, underperformed in the second half of January and then started to outperform once again starting in early February.

The metals and mining sector has benefitted from the reflationary trade. Relative to the S&P 500, the sector is

back to its resistance level. The sector has become overbought at this point, and could start to weaken on any sign of a slowing in the economy.

My Call: The metals and mining sector will probably start to underperform the S&P 500 in the near future, before the end of its seasonal period.

Small Caps

The small cap sector has a strong seasonal period from December 19 to March 7

Small caps have been on fire. They have benefitted from multiple positive influences, including: the re-opening of the economy and a steepening of the yield curve which has helped its banking constituents. Recently, a strengthening US dollar has helped to push the small cap sector to outperform the S&P 500, as almost all of the small cap sector revenue generated is domestic and does not suffer from a higher US dollar hurting exports compared to the large cap sector. The small cap sector has really benefitted from investors being in a risk-on mode.

Note: The small cap sector has just finished its period of seasonal strength. This does not mean that the sector will necessarily underperform. The sector has mixed seasonal performance until July, where it tends to underperform large caps fairly significantly.

My Call: The small cap sector will probably start to moderate its performance and start to underperform large caps in the near future.

Emerging Markets

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

The emerging markets sector has done a round trip, outperforming the S&P 500 in January, underperforming in February and into March and is now back to its level at the beginning of the year.

Recently, a strengthening of the US dollar relative to world currencies has hurt the sector. The sector tends to perform well in the first half of April, so it is possible to see a bounce from this level.

My Call: The emerging markets sector will probably moderately outperform the S&P 500 for the next few weeks.

Consumer Staples

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

The consumer staples sector has performed very poorly relative to the S&P 500, but that may be about to change. As the stock market has shifted from growth to the cyclical sectors, the consumer staples sector has been the third-wheel in the relationship (not part of investor's conversation). If interest rates start to decline at the start of the seasonal period for the consumer staples sector, investors may become interested in the "third-wheel." Stay tuned.

My Call: The consumer staples sector will probably start to outperform the S&P 500 in the near future.

US REITS –The Contrarian Trade

The US REITS have a seasonal period from March 8 to September 20

The US REIT sector has underperformed the S&P 500 since early-March last year. It is interesting to note that REITs outperformed as the pandemic unfolded in 2020. In March of 2020, investors started to figure out that the high distributions from REITs did not offset the prospects of non-paying tenants.

Investors are starting to show interest in this sector again. Look for it to perform well if interest rates start to decline.

My Call: The US REIT sector will probably start to moderately outperform the S&P 500 in the near future.

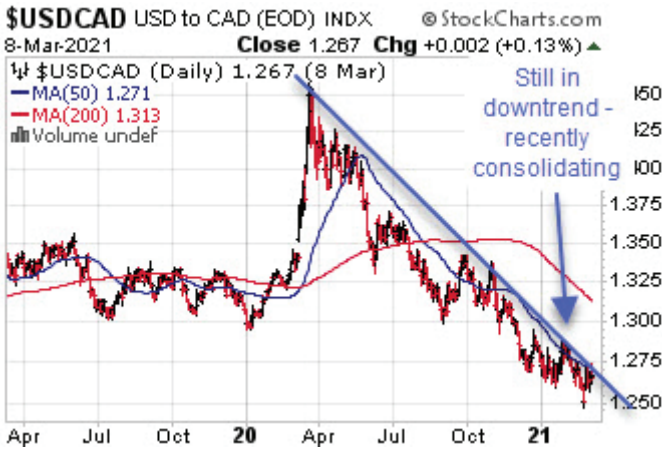
Currencies

USDCAD

The US dollar has been performing well recently against world currencies, but not against the Canadian dollar. One of the major reasons that the Canadian dollar has performed so well is that it has benefitted from the rising price of oil.

The US dollar has remained in a downtrend relative to the Canadian dollar. Recently, it has shown signs of consolidation, but has still not been able to break out of its downtrend.

The bad news for the US dollar is that April is the strongest month of the year for the Canadian dollar on a seasonal basis. However, given that the US dollar has become so oversold, it could bounce at the current level. This year, investors should be cautious investing in the Canadian dollar in the month of April.



Brooke's Rant(s)

Rant #1

News Flash: Brooke Thackray launches new ETF (Anti-Buzz)

The Anti-Buzz fund is designed to front run the new fund by Dave Portnoy, which is designed to front run social media trends. To be clear, I am being sarcastic.

On Thursday March 4, 2021, VanEck partnered with Dave Portnoy to launch the VanEck Vectors Social Sentiment ETF (NYSE:BUZZ).

The Buzz ETF is designed to use an algorithm to scrape the internet and invest based upon the hottest chatter trends on social media sites such as Reddit. The fund is being portrayed as retail investor friendly, but an argument could be made that it is ultimately designed to take advantage of the small investor. On the sell side of the equation, the goal of the fund will be to exit when retail investor interest starts to decline, which indirectly will hurt the retail investors that have been pushing up the stocks on the social media boards.

Yup, the fund is a machine designed to profit off the small retail investor. Someone has to take advantage of the novice retail investors that are investing based on "news" from the social media investment boards. It might as well be a machine.

There is a bit of irony in the situation. Dave Portnoy was using his social media accounts to encourage retail investors to buy GameStop and other meme stocks. His tweets were racking up millions of views. Shortly after encouraging investors to buy and hold GameStop, Dave Portnoy sold all of his meme stocks including GameStop. Evidently, this seems to be okay with the security regulators. Despite his claims, Dave Portnoy is no friend to the small retail investors.

I am not sure what Dave Portnoy will be able to tweet about in the future, given that BUZZ will be actively investing in many of the stocks that Dave Portnoy has promoted in the past. I guess, Dave Portnoy has an answer for the retail investors that could potentially be hurt from the BUZZ ETF, just buy BUZZ.

So, you want an idea for a new ETF, create an Anti-Buzz ETF. Let machine battle machine. The Anti-BUZZ ETF should be designed to front run the BUZZ ETF. By looking at the holdings of BUZZ, publicly available online, and determining the social media trends at the time, it is possible to determine the algorithm that Buzz is using, or close to it. Once this has been established, the Anti-BUZZ ETF should create an algorithm to front run the Buzz algorithm. The danger is that someone could come along and create an algorithm to front run the Anti-BUZZ algorithm and on and on.

Rant #2

News Flash – Brooke Thackray selling recent video as an NFT (Non Fungible Token) for $2 million

Instead of watching my recent videos on Youtube, you can buy them for $2 million as an NFT. Please contact me to arrange payment (sarcasm).

For Sale – $2 Million

If you are interested in the NFTs and how to buy one, or put one up for sale (seriously):

https://wskg.org/npr_story_post/whats-an-nft-and-why-are-people-paying-millions-to-buy-them/

A Non Fungible Token (NFT), pronounced "nifty" is a digital authentication stamp that is traceable on blockchain. It establishes provenance that cannot be lost. It is ideally suitable for collectors. NFTs have become quite the rage and people are paying outrageous sums to buy an NFT.

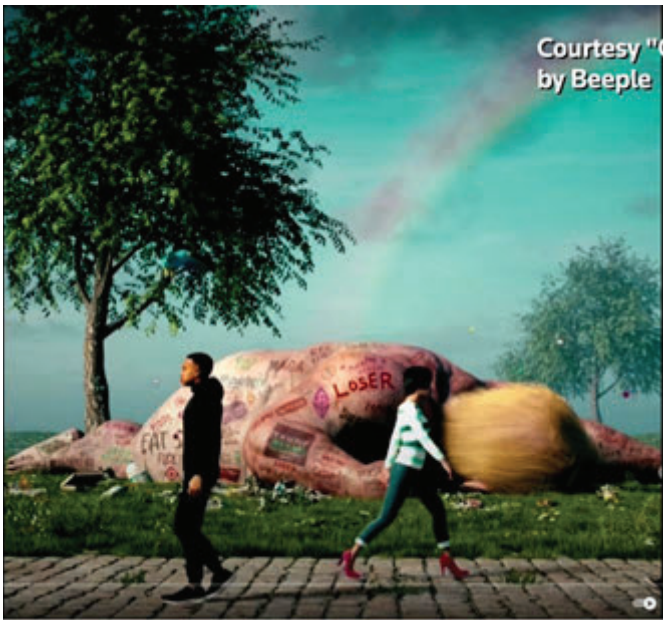
Surely, this must be some kind of signal that a top is in for stupidity.

Before I critique the stupidity of what is happening with NFTs I want to state that I do believe that the process of tokenization is going to increase. There are some good practical purposes to establish ownership through blockchain. Totally makes sense. For example, the ownership

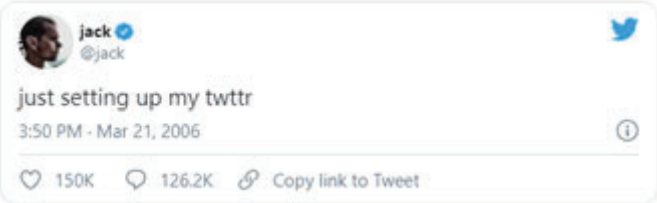
of a car or house should be kept on blockchain.

On the other hand.... if you thought the world was going nuts in 2019, when at an art show in Miami an attendee ate an art exhibit worth $120,000 (a banana taped to the wall), you will think the world has not redeemed itself with NFTs.

Recently, an NFT of a ten minute video sold for over $6 million dollars. Don't worry if you did not get a chance to bid on the video, you can watch it on youtube. The only thing is that you will not have the token of ownership but you will save $6 million.



Jack Dorsey has put up his first tweet for sale as an NFT and the current bid is $2.5 million. If you do not want to go through the hassle of buying the tweet, I have an image of the tweet below.



Ok, so you are not on Twitter and don't really care about the original tweet. You can buy an NFT of a Cryptopunk for $2 million. It is a simple pixilated image. If you have a spare two minutes, you can draw it yourself using Microsoft Paint.

One of the arguments that the NFT'ers put forward is that they own the original. Yes, you can watch the same clip on Youtube, but that does not matter because the NFT'er holds the original. They make the comparison to someone buying a hockey card vs someone having a photograph of the card. I agree with the concept, but holding an NFT of a digital asset that everyone else has access to, is not the same. With the hockey card, it is physical, you can pick it up and hold it. It is not a representation of something. Yes, the video that sold for over $6 million is the original, but you cannot pick it up and hold it, any more than someone else who has a Youtube copy. There is no difference other than you can say that you own the NFT. Not worth $6 million.

There is nothing like the original. In a world where our capabilities to produce objects increases over time, we have made great strides in being able to copy objects, but nothing beats the original.

I remember years ago when the first CD came out. It was supposed to be the best sound ever. It was a digital copy of the sound track. It was not long until music aficionados turned their thumbs down on CD's because they were "too tinny or too pure." The music industry went back

to the drawing board and created overlapping tracks to make CD's sound more natural. They have spent several decades improving the digitizing process, and yet more vinyl records are sold today than CD's because people like the warm more natural sound of vinyl compared to CD's. The digital copy is not the same as the sound at the recording studio. You cannot make a digital copy of an analogue on an inanimate object and make it better than the original in an artistic sense. It could be better as it is has more features or is more durable, but the copy is not the same as the original.

If you ever get a chance to go to the Louvre in Paris, walk by Mona Lisa and stare at her eyes, her gaze will follow you across the room. Maybe a digital copy can do the same, but ultimately there is something about the original that just cannot be replicated.

A bunch of morons disagree with me

On March 3, a bunch of morons decided to burn an original Banksy screenprint that they had purchased for $95,000 (there are 500 prints in existence). Ironically, the screenprint was titled "morons" and depicted the record breaking sale of Van Gogh's Sunflowers in 1987. In Banksy's work was written, "I can't believe you morons actually buy this sh*t."

First, the group that purchased Banksy's work made a digitized copy of the painting. They claim that they made an exact copy, but because they are morons they do not realize that they cannot make an exact copy, it is impossible. So, they made an approximate digital copy and then they burned Banksy's original art work on a live social media broadcast. They turned the approximate digital copy into an NFT and sold it for $400,000.

I do not know who the moron was that bought the NFT, but they now have an approximate copy of an artwork that used to exist. Of course they can say that they have the rights to the approximate copy.

In the end, I am not sure who is the biggest moron, the group that burnt the artwork (but they made a profit), the buyer of the NFT (but maybe they can sell it for a higher price to another moron), or me, for not realizing that I could have made money off other morons if I had gotten into the game early enough. Still time, check out my upcoming website to sell my NFT's "greatermorons" (sarcasm).

To quote Banksy: "I can't believe you morons actually buy this sh*t."