Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

Published the 10th Calendar Day of Every Month

Volume 15, Number 5, May 2021

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Market Update

Reflation trade has become crowded

Recently, investors have rushed to one side of the boat, the reflationary trade. In my last month's newsletter, I described how investors were shifting gears and moving away from the cyclical sectors of the stock market. The trend has quickly reversed as investors have once again favored the cyclical sectors of the market. So, what has happened and how long will it last? *Hint: probably not long.*

The Q1 earnings season has been particularly good with 87% of the S&P 500 companies beating expectations (Refinitive, May 10). At the same time, the economic reports being released have generally been good (other than the Nonfarm Payroll Jobs Report released last Friday). The combination has helped to move the stock market to all-time highs and support the view of a rapidly expanding economy. The result has been for investors to shift their

S&P 500 Technical Status

The S&P 500 is close to all-time highs, but is showing signs of weakness. In past news letters I have hi-lighted the divergence between the S&P 500 upwards trend and the declining RSI. It now looks like the S&P 500 is pulling down to meet the declining RSI.

I have included the MACD graph. In the favorable six-month period for stocks from October 28 to May 6, a downward crossover is not that reliable, in the time period before the start of the six-month unfavorable period (May 6 to October 27), or early in the period, it often indicates a weaker market ahead. In April, the MACD crossed lower, possibly indicating further weakness ahead.

The 4000 level is support, and given that it is a key psychological level and if it is broken, there will be more conviction that the stock market could move lower. This is especially true as this is approximately the 50 day moving average, which many investors focus on. Overall, the technical picture for the S&P 500 is becoming increasingly negative.

Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **April 30, 2021**

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizon S&P/TSX 60 Index ETF	5.9%
	United States Dollar Exposed Assets	
	Equities	
HXS	Horizons S&P 500 Index ETF	58.6%
XLP	Consumer Staples Select Sector SPDR	7.8%
XLV	Health Care Select Sector SPDR	6.7%
HSU	Horizons S&P 500 2X Daily Bull	6.7%
HULC	Horizons US Large Cap Index ETF	3.4%
FHH	First Trust AlphaDEX US Health Care Sector Index ETF	3.0%
XLI	Industrial Select Sector SPDR Fund	2.9%
XLU	Utilities Select Sector SPDR	2.0%
	US Dollar Forwards (May 2021) - Currency Hedge **	1.9%
	Cash, Cash Equivalents, Margin & Other	1.0%
	Total (NAV $224,125,166)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 84.6% 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.

focus to the cyclical sectors once again.

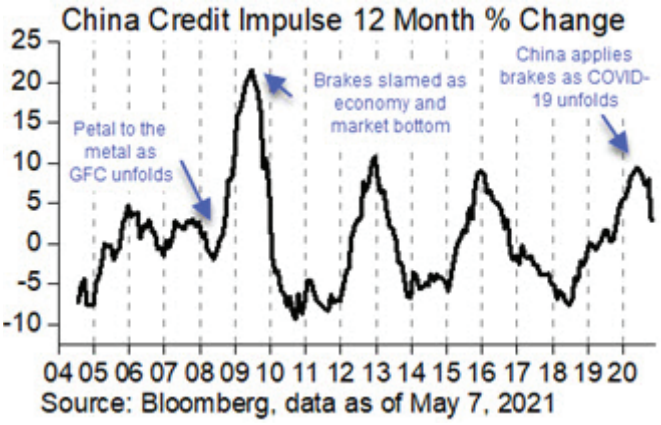
The view that the cyclical sectors of the market will lead the market higher is grounded in the belief that the economy will grow faster than expectations and that inflation is going to rise faster than expected. The reflationary trade has become crowded.

Bond investors are not buying the reflation trade, as interest rates continue to move lower. The yield on the US 10 Year Treasury Note, peaked on March 31 at 1.75. If the economy is performing so well, why are interest rates heading lower? It is not because of the Federal Reserve. They have kept their stimulative policies at a constant rate, without announcing new programs. Interest rates have not moved higher because bond investors do not believe that the economy is recovering at a fast rate.

The bond market is much, much bigger than the stock market. When the two diverge, it is usually the bond market that is correct. Recently, the cyclical sectors of the stock market have moved higher as interest rates have been moving lower. This is unusual, as the narrative for the cyclical stocks is that the economy is expanding and inflation is increasing. Without a move higher in interest rates, it is unlikely that the cyclicals will continue to outperform for much longer.

Did China outsmart the West with its COVID-19 response? This is not helpful for the cyclical sectors of the stock market

Recently, the Chinese credit impulse has been turning lower. The Chinese credit impulse is the amount of credit that is issued by banks. The Chinese Communist Party has instructed banks to reign in their loans. The banks have dutifully responded. This is not a positive development for the reflationary trade and the cyclical sectors of the stock market.



During the COVID-19 pandemic, China has been reducing credit. It has also at the same time been fiscally responsible by not dropping "helicopter money" in society. This is in contrast to the West, which has been rapidly expanding its stimulus programs and spraying money into society. Although banks in the West have not been extending a lot of credit, the Federal Reserve has picked up the slack, buying mortgages and corporate bonds.

China has historically adjusted the credit market to create growth or moderate growth in its economy. In 2008, into 2009, China rapidly expanded credit in order to support its economy during the Great Financial Crisis (GFC). When the economy and the markets started to show stability in early 2009, China quickly withdrew credit.

This time around, in the COVID-19 pandemic, China has been reducing credit. It has also not embarked on large free money campaigns for individuals and companies. In other words, China has not done very much to compensate its citizens and companies during the COVID-19 pandemic. It shut down its economy very quickly as the pandemic took hold and then re-opened as the pandemic was brought under control. Instead of spraying money everywhere, China has been fiscally conservative and saving its resources for other uses. The kicker is that China's unemployment rate at 5.3% is almost back to where it was before the COVID-19 pandemic.

Almost everything that China is doing, the US is doing the exact opposite. Sure, the US dumping money into the economy and paying people to stay home will give a boost to the economy in the short-term, but China is playing the long-game and saving its "ammunition" to be used at a better time down the road.

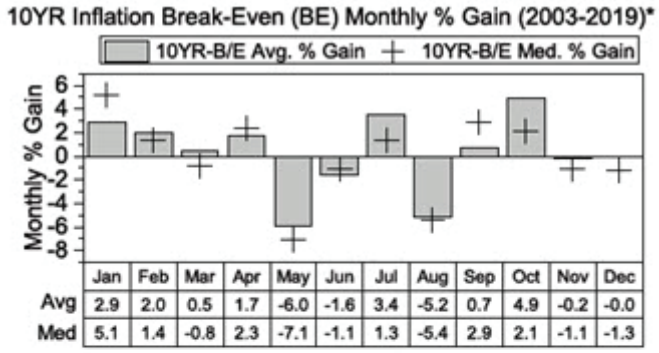
So, why are China's actions important for the stock market? As a country, China is the biggest consumer of base metals. In early stages of the pandemic, China was buying base metals in large amounts increasing its inventory by taking advantage of low prices. As China pulls back its buying, the knock on effect will transfer to the cyclical

sectors of the stock market. In other words, don't count on China to help support the cyclical sectors of the stock market to move higher.

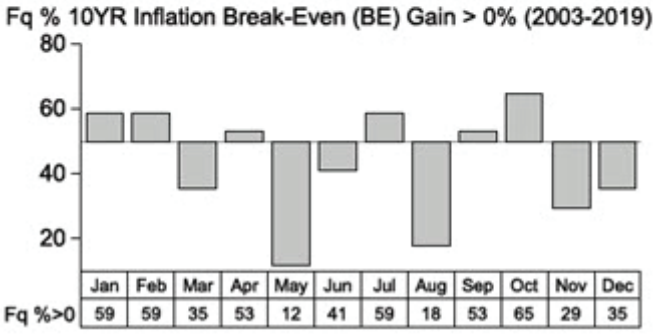
Inflation expectations still moving higher...but seasonally could decline soon

Inflation expectations have been rising since last year, helping to power cyclical sectors higher. It should be noted that inflation expectations tend to turn lower at this time of the year. In fact, inflation break-even expectations have declined in May on a regular basis since 2003.

The graph below, from *Thackray's 2021 Investor's Guide*, shows the frequency of how often inflation expectations have declined on a monthly basis. From 2003 to 2019, not including 2008 and 2009, inflation expectations have declined 88% of the time in May (second panel of graph). June has fewer declines, but inflation expectations are still lower more often than naught.

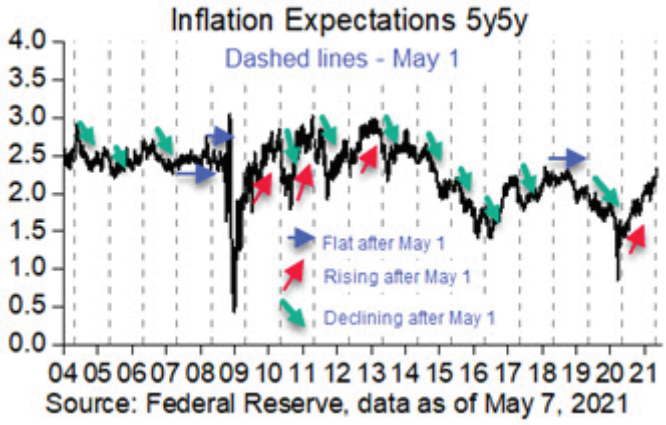


	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Avg	2.9	2.0	0.5	1.7	-6.0	-1.6	3.4	-5.2	0.7	4.9	-0.2	-0.0
Med	5.1	1.4	-0.8	2.3	-7.1	-1.1	1.3	-5.4	2.9	2.1	-1.1	-1.3



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Fq %>0	59	59	35	53	12	41	59	18	53	65	29	35

The graph below shows inflation expectations at the 5 year level. The dashed lines represent May 1 of each year. The arrows show the trend after May 1.



The green arrows represents a decline in inflation expectations after May 1. The graph shows the decline of inflation expectations on a fairly regular basis at this time of the year.

It seems that so many investors are "all in" to the cyclical trade and the reflationary trade. Yes, inflation has been increasing despite the official reports that use hedonistic adjustments that inevitably lower the rate. Investors have noticed prices rising of many every day things that they purchase. As a result, it is only natural to focus on the sectors of the stock market that perform well in an inflationary environment. Investors have been shifting their focus to the cyclical sectors of the stock market which has become a crowded trade.

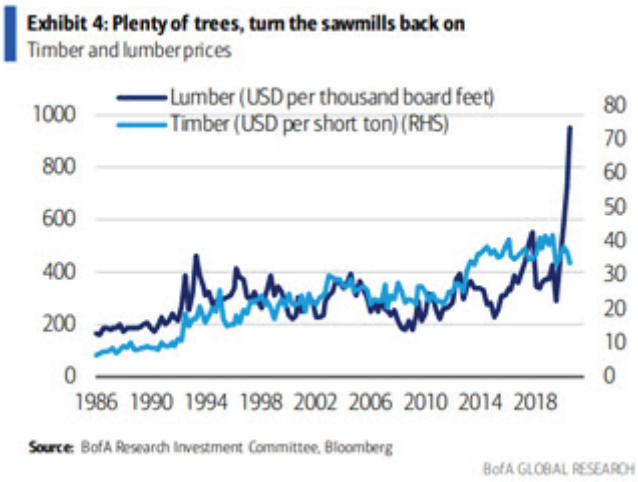
Investors love narratives. The stories help investors feel good about their holdings and provides emotional support. For the longest time, investors kept piling into the technology sector because it was the way of the future, etc. Recently, the consensus narrative in the stock market is the "reflationary trade." Given that we are currently at a point in the inflation seasonal cycle that inflation expectations tend to subside, investors should probably not over commit to the reflationary trade.

Lumber - Trees don't climb to the sky

Lumber has been skyrocketing in price since the bottom of the COVID-19 pandemic in March 2020. Before the pandemic, lumber was selling at $400, today it is $1600. The rising cost of lumber has added upwards of $24,000 to a new home.

So what happened? In 2018 and 2019 (before the COVID-19 pandemic) the pine beetle epidemic caused many saw mills to shut down. Pine beetles eat into pine trees making them worthless after a few years to harvest. Governments have been trying to control the spread of the pine beetle, but have been losing the war. In addition to pine beetle destruction, much of the lumber industry was shut down in BC as the result of forest fires that raged in the summers of 2018 and 2019. Before the pandemic, supply was being dramatically reduced. As the pandemic struck, the saw-mills were closed down, further crimping supply. The industry was caught off guard with roaring demand as home-owners used their time at home to renovate. A perfect storm for prices.

Will the price of lumber continue to skyrocket? Probably not. Saw-mills in BC and other areas and Canada are working 24/7 to output lumber. More capacity is being brought back on line. At some point, rising supply will correct the situation. Lumber production is not like greenfielding a mine that could take five to ten years before being brought online. Lumber production can be ramped up fairly quickly.



It is interesting to note that the price of timber (the feed stock for lumber) has been fairly flat while lumber has skyrocketed.

In the last three weeks, lumber has doubled in price. Did demand double? No. Did supply drop in half? No. A lot of the price of lumber is speculation.

So why am I bringing up the price of lumber in my newsletter. When the speculative phenomenon diminishes in lumber, and it's parabolic rising curve corrects downwards, it will probably be a good sign that speculation is receding in other markets such as the stock market. Given that on a seasonal basis lumber tends to perform poorly at this time of they year, we could see a correction in the price of lumber in the near future.

Watch lumber— Timber!

On a seasonal basis

There is typically a raft of articles at this time of the year on the concept of "Sell in May." This year there is a much smaller number of articles on the topic. The stock market has been rallying for over twelve months and investors are getting used to the stock market hitting all time highs. Who wants to miss out on that? Nobody wants to step off an escalator moving higher.

A lot of media articles discussing the "Sell in May" concept that are typically published at this time of the year, focus on the concept that this "Time is Different," and that "Sell in May" this year will probably not work. There is typically a litany of reasons, such as improving economy, or strong earnings. The reasons do not change from year to year.

Last year the stock market rallied during the six-month unfavorable period for stocks and it kept rallying to date. So, what happened? A little history first. There has only been nine times that the S&P 500 has rallied 10% or more during the six-month unfavorable period from May 6 to October 27 from 1950 to 2020. In all nine times, either the economy was bouncing off a recession or was bouncing off an economic slowdown and had GDP growth rates of greater than 5%. This includes last year. Although we were not bouncing off a recession, the economy was growing at very fast rates as the economy was opening up much faster than expected. Of course, flooding the system with stimulus from the central banks and governments helped.

Is it possible that the stock market could have a similar strong rally, but not probable. Last year was an unusual situation. Investor's should not necessarily let recency bias create their position.

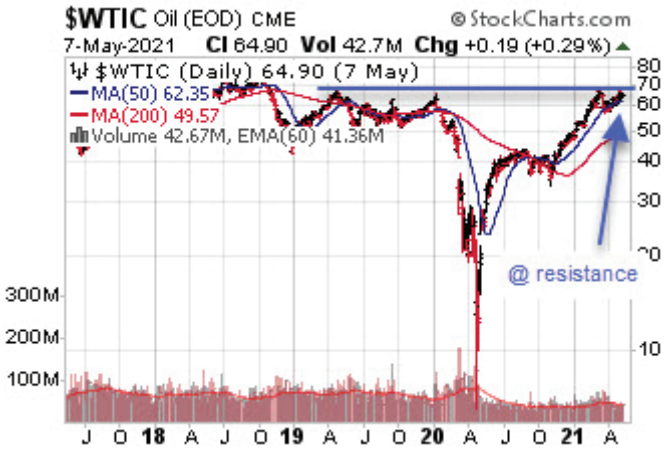
Yes, I know that Federal Reserve will keep its foot to the floor as it has constantly stated. Yes, Janet Yellen will keep pumping money into the economy. This does not mean that the stock market cannot correct. Investors look out six-months. Investors are already expecting the current liquidity to be maintained. It has already been baked into the price. Unless, the programs are ratched up in the short-term (with short-term effects), the stock market is susceptible to a correction, despite the current exceptional liquidity being pumped into the system.

Earlier in this newsletter, I discussed how interest changes have not been supportive of the cyclical rally continuing. I also discussed how inflation expectations tend to recede at this time of the year. It is also important to note that many of the cyclical sectors of the stock market finish their strong seasonal period around this time of the year, including industrials, materials, financials and energy. Given that these are the sectors that are leading the stock market very recently, if they start to turn lower and underperform the market, this could be a bad sign for the overall market and that it is living on borrowed time.

Seasonal Opportunities

Energy –

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



The price oil has advanced back to 2019 levels. Demand for oil has been increasing as the economy has been reopening. The current price level is not just about demand, but also supply. A lot of production was shut down as the COVID-19 pandemic unfolded last year. In addition, OPEC+ curtailed its production and has been disciplined in bringing production back on line, with small amounts of cheating from its members.

The energy sector has reached its resistance level. At this point, we could start to see the energy sector start to have trouble moving higher.

The Canadian energy sector is close to its resistance level that it established in late 2019 and early 2020. The Canadian energy sector fell a lot more than the US energy sector as COVID-19 unfolded. The main reason that the Canadian energy sector fell a lot more than the US energy sector, due to its less integrated and smaller companies, resulting in higher torque to the price of oil. The end result is that the Canadian energy sector fell more than the energy sector and has risen more as the economy has recovered.

Energy stocks have performed well, especially small cap companies as they are highly levered to the price of oil. Demand for oil will probably continue to grow as econ-

omies continue to open up. Although this is a positive for the price of oil, it does not necessarily mean that the price of energy stocks will move higher. If the narrative is all that counts, then oil at $100 is justifiable and energy stocks a double. To take it one step further, why not $150 for the price of oil. You get the point. The current price already reflects the economic growth.

My Call: The energy sector will probably underperform the stock market over the next few months.

Biotech –
Underperforming - but getting ready for its seasonal period

The biotech sector has a strong seasonal period from June 23 to September 13

The biotech sector has been underperforming the S&P 500 since last May. It managed a period of outperformance from September until January, but the overall trend has been down.

After Biden was elected, investors have become concerned that the new administration would regulate drug prices, which has hurt the sector. In early May, Biden said that he might waive the patents on the COVID-19 vaccines. The health care sector responded negatively to the possibility.

It is going to be very difficult for Biden to "null" the patents and would take a long time. It would probably be counter intuitive. Why null the patents when most Americans have been vaccinated and everyone will have the opportunity by July 4? What would this mean for Europe? It probably will not happen, but it does show that he is willing to go against big pharma. Nevertheless, the biotech sector is basing and could represent a good opportunity in the near future as the seasonal period of strength starts.

My Call: The biotech sector will probably continue to base before starting to outperform before its seasonal period starts on June 23.

Consumer Staples –

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

The consumer staples sector has done a round trip starting in 2018 relative to the S&P 500. The sector is expensive, at 21.5 P/E, but so is the market. Investors are generally attracted to the sector in volatile times, particularly at this time of the year, due to the earnings stability of earnings in the sector.

My Call: The consumer staples sector will probably continue to outperform the S&P 500 into July.

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 February. As the sector finished its seasonal period of strength in April, the sector turned down once again relative to the S&P 500. The sector has been forming a series of lower highs relative to the S&P 500. Given that the sector has finished its strong seasonal period and its technical structure is weak, the sector is not a preferred sector.

My Call: The consumer sector will probably continue underperform the S&P 500 over the next few months.

Industrials –

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

The industrial sector has just finished its strong seasonal period. Very recently, the sector has performed well as investors have rushed back into the reflationary trade. Its recent uptick relative to the S&P 500 has helped break above its resistance level. Nevertheless, the strong seasonal period of the industrial sector has finished and its outperformance is probably on borrowed time.

My Call: The industrial sector will probably start to perform poorly in the near future.

Transportation –

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

The transportation sector has been outperforming the S&P 500 since April 2020. It makes sense that the transportation sector has outperformed as economy has re-opened. Like the industrial sector, the transportation sector has finished its seasonal period and its outperformance is probably on borrowed time.

My Call: The transportation sector will probably start to perform poorly in the near future.

Materials –

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

The materials sector is similar to the industrial sector and the transportation sector in that its seasonal period has recently finished.

My Call: The materials sector will probably start to perform poorly in the near future.

Canadian Banks –

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

The Canadian banks have been outperforming the Canadian stock market since last May. The sector is still in an uptrend relative to the Canadian stock market. The sector has recently been performing at market.

As I have mentioned in previous newsletters, the Canadian banking sector is unique sector with its high dividends and its tendency for growth, operating in an oligarch industry. The result is that the sector can perform well when the economy is expanding and interest rates are moving higher. It can also perform well when the stock market is flat or slightly negative as investors hide in the sector because of the high dividends. If the economic growth starts to slow significantly, the Canadian banking sector will probably underperform the stock market.

My Call: The Canadian banking sector will probably start to underperform the stock market in the near future.

Small Caps –

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

The small cap sector was the "darling" sector of the stock market in late 2020 and early 2021. On a seasonal basis the small cap sector finishes its strong seasonal period in March, which is the same time that the sector started to underperform this year.

I have included the small cap sector in this newsletter, because it shows how fast a sector leading the market can start to underperform. In addition, the underperformance of the small cap sector indicates that investors have moved to more of a risk-off mode. Overall, this is not a good sign for the stock market.

On a technical basis, the small cap sector has been consolidating in a wedge formation. A break out of this wedge to the downside will probably indicate a new down trend.

My Call: The small cap sector will probably continue to underperform the S&P 500.

Emerging Markets – Continues to underperform

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

The emerging markets sector has finished its seasonal period. The sector has been underperforming the S&P 500 since February.

A lot of investors believe that since the S&P 500 is extended in valuation, the emerging markets is a good alternative.

Typically, the emerging markets sector outperforms when either or both the commodities sector and technology sector are outperforming. Many investors do not realize that many emerging market ETFs have increased the weighting of technology companies over time and now have a greater influence in the emerging markets sector. This has happened naturally as technology companies have expanded in emerging markets countries.

The recent underperformance of the emerging markets sector is partly the result of the technology sector underperforming. Given that the emerging markets sector is not in its strong seasonal period, it is not a preferred sector.

My Call: The emerging markets sector will probably continue to underperform the S&P 500.

Utilities

Recently, the utilities sector has been showing signs of strength relative to the S&P 500. On an absolute basis, the utilities sector is at a resistance level. If the sector is able to break above this level this would be a positive for the sector. Look for sector to outperform if interest rates decline, especially if the market trends downward.

My Call: The utilities sector will probably outperform the S&P 500 over the next few months.

Health Care –

The health care sector has a strong seasonal period from May 1 to August 2

The health care sector outperformed the S&P 500 in April. On average, typically, the sector waits to outperform un-

til May when the stock market often suffers volatility. It is interesting that the health care sector outperformed the S&P 500 when the broad market was increasing in April. This is a positive development and bodes well for the sector.

On a technical basis, the health care sector is poised to break above its downward trend line relative to the S&P 500. A break above this trend line will be a positive development.

My Call: The health care sector will probably outperform the S&P 500 into August.

US Government Bonds –

The US government bond sector has a strong seasonal period from May 6 to October 3

US government bonds have been performing well since April as interest rates have been heading lower. If investors back off on their reflationary theme as inflation expectations decrease, it would be expected that interest rates could continue to move lower.

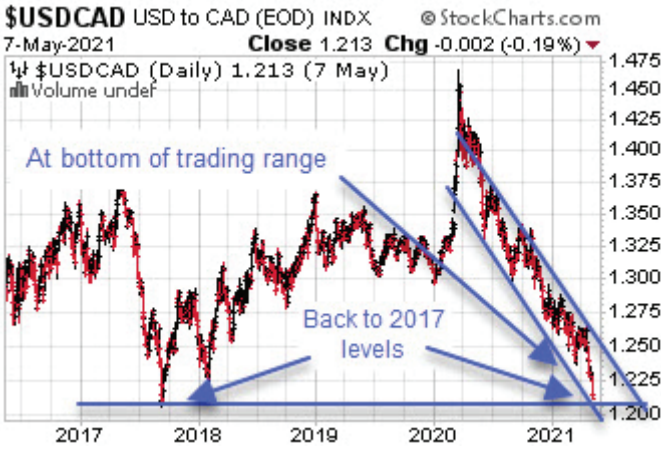
If the stock market starts to head lower, investors, on the margin, will probably rotate into government bonds, especially if the economy starts to falter.

My Call: US government bonds will probably perform well into late September or early October.

Currencies

USDCAD

The US dollar has been underperforming the Canadian dollar since the bottom of the pandemic. On a seasonal basis, the US dollar tends to perform well for most of May. If the cyclical sectors of the stock market start to perform poorly and stock markets start to turn lower, the US dollar will probably start to outperform the Canadian dollar.



Brooke's Rants

The Land of Stupid

"There's a single New Jersey deli doing $35,000 in sales valued at $100 million in the stock market" CNBC April, 15, 2021

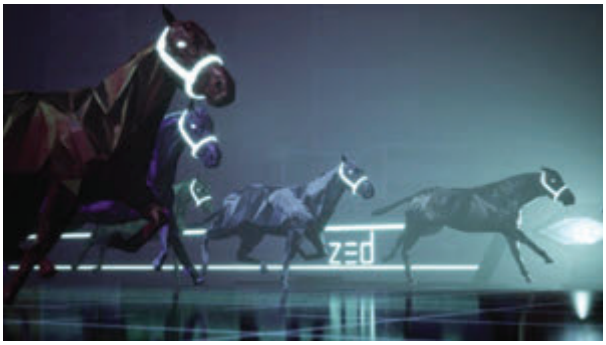
In a sign that some people have too much money and not enough brains, a publicly traded entity whose only asset is a deli with sales of $35,000 is valued at $100 million. That is sales not earnings. The company earnings must be next to zero after all costs. I was thinking of doing a discount cash flow analysis to find the true value of the company, but that would be a waste of my time. Let's call it next to nothing.

Investors viewed the company as some sort of SPAC (special purpose acquisition company), hoping the company could some how get ahead. According to CNBC, the largest shareholder was the CEO/CFP/Treasurer and a Director, who also happens to be the wrestling coach of the high school next door. Busy guy.

This type of stupidity is not endemic to Post COVID-19 investing, but there seems to be more of this foolishness. Did I mention that is was not just individuals that have been suckered. Duke and Vanderbilt universities were among the largest shareholders of the "deli company."

People are Breeding Digital Horses, and Spending Real Money- Sportico April 20, 2021

One horse just sold for over $125,000



The title says it all: people are bored and are using their free money "stimi" checks to gamble in the digital realm.

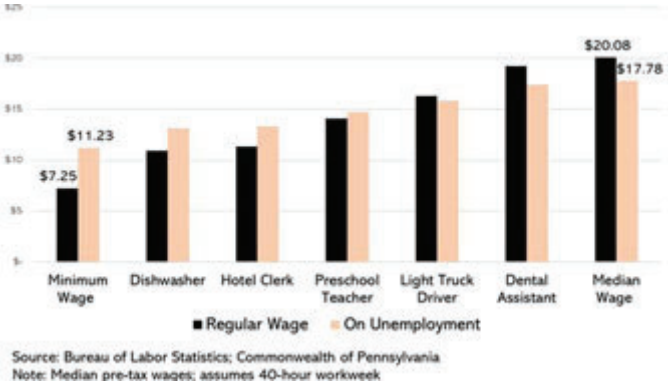
When my kids were young and bored, they would games online where acquire accessories for their animals by either getting to certain levels in the game or purchasing with money. Now adults are raising horses and spending money on digital horses. When they race their horses, they have no idea what the algorithm is determining what happens. It is just gambling with money.

I am having trouble getting into the logic of spending $125,000 on a digital horse. Oh, I missed something, you can breed your horse and sell the foals to stupid people.

Unemployment is high, but companies cannot get people to work

As the economy opens up in the US, signs are everywhere—Help Wanted. Companies are begging people to work, but there are not enough takers. Some companies are offering people money just to come in and apply. So what is happening? It is really simple. People are getting more money staying home rather than working.

The chart below from the Commonwealth of Pennsylvania, with data from the Bureau of Labour Statistics, shows that a significant percent of the population is better off not working compared to going back to work.



Small businesses are having trouble filling job openings. This was the case before COVID-19, but the dispersion of free money has boosted the NFIB Small Business Openings Hard to Fill to an all time high.

Both Yellen and Powell are constantly denying that the stimulus is having an impact on keeping unemployment higher than desired. But it is obvious, they just do not want to admit it. They are in denial.

Most of the jobs that people are opting out of are lower paying jobs. Some people do need the stimulus money; nevertheless, there needs to be a plan to get people back into jobs.

According to the Business Insider, the National Owners Association (NOA) which is an independent group of McDonald's franchisees, have stated in a recent letter that "when higher wages, signing bonuses, paid interviews no longer work, we have a problem."

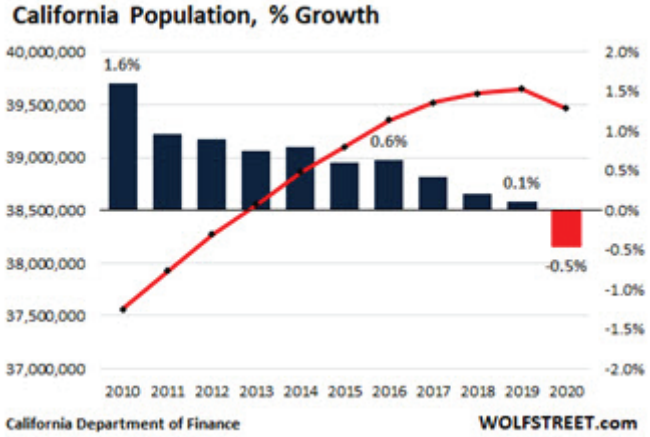
It is possible that the ultimate goal of the government and the Federal Reserve (yes the Fed who has started to take on social mandates) is to lift wages, by making companies pay more in order to compete with government free money. If this is the case, then we can expect unemployment

to be around for some time yet as companies reluctantly have to increase their wages. There are huge costs to this methodology, such as driving asset bubbles higher and increasing the wealth inequality gap.

Am I missing something, the solution seems obvious, target stimulus to people and companies that actually need the stimulus. This is definitely not the case currently. Spraying money around everywhere is not the solution, the costs are way too high for society.

Leaving California - Not Homebuilders...not yet!

California is a high tax poorly run state. Don't take my word for it. People in California are voting with their feet. After decades of the net number of people moving to California, because it was the place to be, people are leaving in droves and causing net outward migration. A fun statistic to track the exodus is the cost of a U-Haul rental one way out of California versus into California. It will cost you double to rent a van to move out of California compared to moving into California. Someone has to return all of the rental vans leaving.



The irony is that buying a home in California is becoming cheaper. This is good news for a lot of people trying to get into the housing market to settle down in a home.

It is not just individuals that are moving out of California, businesses are exiting at a fast pace. California used to be and still is a vibrant place to work and develop companies particularly in the tech field. This is changing. California is fading and other parts of the U.S. are starting to become hot spots of innovation.

As people and companies are leaving California, homebuilders are increasing the amount of homes they are building. You may ask why? The answer is simple. It takes time to acquire land, develop plans and apply for permits. The housing being built this year were planned a few years ago. Homebuilders have no choice but finish off the projects that they have started.

It is only natural to expect that over time the homebuilders will follow the people and start to move their resources to other states where the population is growing. It is sad to see what is happening to California, but not unexpected.

This is a Joke

Really, it is a joke

Dogecoin was started as a joke. It languished for years as no one cared about the joke. Recently, investors have been piling into Dogecoin as a speculative play. The value of Dogecoin ($87 billion) has now surpassed the value of Kelloggs, Campbell Soup, Dominos Pizza, Dunkin Donuts and Beyond Meat—combined. Yup, this is a joke.

Some of the biggest critics of Dogecoin are Bitcoin holders, who believe that the joke coin is detracting from a "legitimate" cryptocurrency. This is the definition or irony.