Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

Published the 10th Calendar Day of Every Month

Volume 15, Number 11, November 2021

Written by Brooke Thackray

Answer to Symbol Puzzle — Federal Reserve Behind the Curve

Market Update

The Federal Reserve is behind the curve and the market likes it.

Behind the curve defn: slower about doing something than other people, companies, etc. Merriam-Webster.com Dictionary.

In the financial context with the Federal Reserve, behind the curve refers to not raising interest rates fast enough or not tapering its quantitative easing program as fast as expected. It can also refer to the Federal Reserve not acting fast enough to a steepening interest rate curve. In the context of this discussion, the term refers to the Federal Reserve not acting fast enough to taper its quantitative easing program and raise its federal funds rate.

On November 3, 2021, Powell announced that the Federal Reserve was starting to taper its quantitative easing program of buying $120 billion worth of bonds and mortgage back securities per month. The Federal Reserve is plan-

S&P 500 Technical Status

The S&P 500 reached an all-time-high (ATH) on Monday November 8, 2021. When a stock market is at an ATH there is not much that can be said technically from a price pattern standpoint. Selling just because the stock market is at an ATH is generally foolish.

On the upside, technically it is blue sky as there is not any resistance levels. On the downside, with this particular market, there is minor support at 4300. The key level of support is way back down to 3500.

From a price momentum standpoint, using the Relative Strength Index (RSI), the S&P 500 is overbought with a reading above 70.

An RSI level above 70, does not mean much until the RSI turns down and crosses below 70. This can indicate the stock market is losing strength, but this indicator should not be used alone.

Overall, technically from a price pattern standpoint the stock market is in a positive position.

Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **October 31, 2021**

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
HEWB	Horizons Equal Weight Canada Banks Index ETF	10.0%
	Commodities	
HURA	Horizons Global Uranium Index ETF	4.6%
	United States Dollar Exposed Assets	
	Equities	
HXS	Horizons S&P 500 Index ETF	47.2%
CHPS	Horizons Global Semiconductor Index ETF*	5.1%
COW	iShares Global Agriculture Index ETF	2.6%
XLB	Materials Select Sector SPDR	4.8%
FHQ	First Trust AlphaDEX US Technology Sector Index ETF	2.6%
XLI	Industrial Select Sector SPDR Fund	9.9%
XLK	Technology Select Sector SPDR	7.9%
XHB	SPDR S&P Homebuilders ETF	2.9%
	US Dollar Forwards (November 2021) - Currency Hedge **	0.6%
	Cash, Cash Equivalents, Margin & Other	1.9%
	Total (NAV $229,195,332)	100.0%

** Seeks to hedge the US dollar value of its portfolio to the Canadian dollar at all times*

** Reflects gain / loss on currency hedge (Notional exposure equals 67.22% 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.

ning to taper $15 billion per month and end their quantitative easing program by June 2022. Powell is still insistent that inflation is transitory and that the Federal Reserve will not raise the federal funds rate in the near future.

This is good news for investors. Investors have learned over time that the Federal Reserve is constantly behind the curve, dragging its feet on how much action to take. We just have to remember back to when Yellen was the Federal Reserve chairperson. Yellen was constantly behind the curve. She would jawbone the markets and talk about the need to raise rates, but when it came time for action she was missing in action. Yes, Yellen did raise rates, but she induced speculative action in the markets by dragging her feet. Investors remember and now expect Powell to act in a similar fashion.

In 2018, Powell tried to get ahead of the market by raising the federal funds rate. His goal was to get interest rates up to neutral levels so they could be lowered if the economic stimulation was needed. In December 2018, the stock market was crumbling and Powell changed his mind, and became a "dove."

Investors believe that he will never go back to his hawkish ways. The result is a moral hazard, where investors believe that the Federal Reserve will always be dovish and will always be behind the curve. In fact, investors are counting on it.

"Data dependent" means we can change our minds – but only to taper slower or hit pause

Investors are counting on the Federal Reserve to be slow, to let the economy run hot and not worry about inflation. They love the fact that the Federal Reserve is data dependent. This phrase is only perceived as a possibility of a one-sided adjustment. In theory, the Federal Reserve could either slow or speed up the rate of tapering, but that is not how investors perceive the situation.

The general belief is that if the economy slows down faster than expected, then tapering will be slowed down or paused. The inverse is not true. Investors perceive that if the economy grows faster than expected, that the Federal Reserve will continue on its path, tapering at a mediocre $15 billion per month.

Cyclical sectors vs Growth sectors - Interest rates are the arbiters of truth

For tracking purposes, I divide the stock market into three groups: cyclicals, growth and defensives. The interplay between these three groups helps to reveal the strength of the market and if one of the groups has momentum to continue to outperform. One of the arbiters of truth, so to speak, is the yield on the 10-Year Treasury Note. Of course, there are other variables at play, such as the strength of the US dollar etc., but understanding how the sectors are reacting to the 10-Year yield can provide valuable insight.

A word of caution: different relationships between the market and sectors and interest rates can exist at different levels of interest rates. However, in today's low interest rate environment, when interest rates are heading lower, this generally benefits the growth sectors of the economy and defensives (the defensives tend to perform well if investors are concerned about market valuation). If interest rates are heading higher this generally benefits the cyclical sectors of the market.

There is a strong argument to say that stronger than expected economic growth drives interest rates higher and the cyclical sectors at the same time. However, monitoring interest rate direction provides real time information on the relative strength of the cyclical sectors and growth sectors.

The diagram below shows the relationship between the yield on the 10-Year Treasury Note and the tech sector versus the industrial, materials and financials sectors. I have not included the energy sector in the cyclical sectors because it is its own beast.

Below are the stages of the yield on the 10-Year Treasury Note movement and the corresponding movement in the technology sector versus the cyclical sectors.

❶ Yield on the 10-Year Treasury Note climbed into April, declined slightly into May. All of the cyclical sectors outperformed the technology sector.

❷ Yield on the 10-Year Treasury Note declined sharply. The technology sector underperformed all of the cyclical sectors.

❸ Yield on the 10-Year Treasury Note was flat. The industrials and materials sectors underperformed the technology sector, while the financial sector was relatively flat compared to the technology sector.

❹ Yield on the 10-Year Treasury Note increased. The technology sector underperformed all of the cyclical sectors.

❺ The yield on the 10-Year Treasury Note has been declining since approximately 2/3 the way through October. In this time period, the technology sector has been outperforming the cyclical sectors.

The good news is that both the cyclical and growth sectors of the stock market are generally in their strong seasonal periods. Using the interest rate direction as an arbiter can help determine the skew of bias between either cyclicals or growth sectors.

Small Caps - also driven by interest rates

There are many reasons that small caps outperform large caps. Small caps typically offer the best leverage, bouncing out of a recession. A stronger dollar also benefits small caps because small companies generally derive most of their revenue domestically. There are other drivers as well. It should be noted that interest rate direction is also a driver of small cap performance. One of the reasons that the small caps tend to outperform when interest rates are rising is due to the sector allocation. The Russell 2000 (small caps) has a higher allocation to financials compared to the S&P 500 and hence tends to have more sensitive to interest rate movement.

The graph below demonstrates the relationship between the small cap sector, compared to the S&P 500 and interest rate movements. Generally, small caps have performed well when interest rates have been rising and vice versa.

In the last week of October, the small cap sector broke above a key resistance point that many traders were watching. This has helped the small cap sector to perform well in the short-term. It is interesting to note that interest rates have been heading lower at the same time the small cap sector has been outperforming the S&P 500. These aberrations occur once in a while, but investors should not expect the divergence to go on for an extended period of time. If interest rates continue to head lower, it would be expected that the small cap sector would start to underperform in the near future.

The good news is that the strong seasonal period for the small cap sector starts in mid-December. Of course, small caps can outperform the S&P 500 before this time, especially if interest rates are rising. Look for interest rates to turn higher in order to support a sustained move of outperformance compared to the S&P 500.

China - Evergrande - A controlled implosion?

The crisis in China is much more than Evergrande, but Evergrande has become the lightening rod for media attention (at least up until recently).

In 2021, China has been taking some unusual steps to wrestle power, money and influence away from the wealthy and to benefit the lower income group. It has made it illegal to have private tutoring companies from making a profit. It has also implemented numerous other regulatory crackdowns in the markets. China is taking the opposite strategy of the US. The US has been dumping all sorts of printed money into the markets and handing out

huge amounts of free money. China has only been providing very little stimulus, if it is absolutely needed.

Most investors have had the perception that China was an unstoppable economic force that was destined to grow at 10%+ per year into the foreseeable future. Fast growth hides many sins. China's growth has been slowing in recent years and for a number of reasons (that would require a lot of ink), China's real estate has become a bubble. Evergrande the largest real estate company in the world, was extremely leveraged before the COVID pandemic and during the pandemic. Evergrande has collapsed in on itself and is currently flirting with some sort of bankruptcy. Evergrande is not the only Chinese real estate company that is in trouble. Other smaller companies have gone into bankruptcy.

So far, the Chinese government has stood aside and largely let Chinese real estate companies falter.

Given that China's real estate has become a bubble of epic proportions and the Chinese economy is stumbling, it looks like China is trying to deflate the real estate market in a controlled demolition. The Chinese government wants real estate to be affordable for the common person. It looks like China is trying to master a controlled demolition in the real estate sector in order to help lower prices and price expectations.

Real estate is approximately 29% of the Chinese economy. This is a huge figure. In comparison, real estate in the USA makes up 6.7% of the GDP as of April 2021 (source: FRED). Pre-COVID pandemic real estate made up approximately 3 to 4% of GDP. The problem with the Chinese situation is that it could start to unravel faster than the Chinese government can control. A lot of investors believe that the Chinese government can step in at any time and dump money into the real estate companies to keep them afloat. That viewpoint could be naive. The problem could be bigger than the ability of the Chinese government to solve.

The real problem could be if a contagion occurs, and rolls into other countries and markets. A lot of investors believe that the US and Europe would not be affected. I am not convinced of this position. If China's economy does slip into a recession, this would lower demand for resource products. Currently, investors in the US are of the belief that stimulus solves all in their own country "solves all." There is no question, it has artificially boosted the economy, but printing money does not lead to long-term wealth. If China does slow down, it will probably have a bigger impact than most investors anticipate in the US and other countries. This could be the developing story of 2022.

On a Seasonal basis

Currently, we are early in the month of November, which is one of the strongest months of the year. In addition, December also tends to be a strong month. Given that the S&P 500 is at all time highs, it is possible that the market may stumble higher into yearend. In other words, gains may not be as strong compared to a rally bouncing from a dip. Nevertheless, the seasonal trend is positive at this time of the year.

Seasonal Opportunities

Materials–

The materials sector has a strong seasonal period from October 28 to January 6 and then from January 23 to May 5.

The materials sector has been underperforming the S&P 500 since May. Recently, the sector has shown an uptick in performance compared to the S&P 500. So far it has not made a significant move higher and if interest rates move lower, the sector could continue to struggle.

The recent strong Nonfarm Payroll report for October gave the materials sector a boost, which did not last long. It might take a couple more strong economic reports for this sector to get into gear. Currently, economic growth is slowing, so it is possible that we might see the materials sector moderately outperform the S&P 500 in this current leg of its seasonal period.

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

Industrials –

The industrial sector has a strong seasonal period from October 28 to December 31 and then from January 23 to May 5.

The industrial sector has been underperforming the S&P 500 since May (similar to the materials sector). On an absolute basis, it has broken above its high in May, but is still underperforming the S&P 500. Look for this sector to perform well if stronger than expected economic reports are released. Currently, the sector is struggling.

My Call: The industrial sector will probably perform at market or moderately outperform the S&P 500 until the end of the year.

Financials –

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

The financial sector has been consolidating relative to the S&P 500 since March. It has been forming a consolidation box. Recently, as interest rates have headed lower, the financial sector has lagged the S&P 500. This sector typically gets a strong bounce if interest rates start to move higher. It is often a leading sector in this regard.

My Call: The financial sector will probably perform slightly above market and accelerate its performance starting in mid-December.

Uranium –

The uranium sector has a strong seasonal period from October 4 to January 24

The uranium sector has been benefitting from a number of events all taking place at the same time.

♦ *Introduction of physical uranium ETFs. The EFTs have been sucking uranium off the market away from utility consumption, which equates to a supply curve shift to the left for uranium and higher prices.*

♦ *Environmentalists are finally realizing that nuclear power has to be part of the solution. For too long environmentalists have stood against nuclear power and maintained that the only solution is wind and solar and*

reducing our carbon footprint. At the COP26 in Glasgow, there was a lot of discussion about how nuclear was a key part of the future.

♦ *China announcing that it has plans to build 150 nuclear power plants in the future. Yes, China keeps building a huge number of coal plants, but it knows that it cannot kill its own citizens with air pollution on an ongoing basis. It is just going green at its own pace.*

The uranium sector has performed well as the fundamental case for the sector has improved. The sector still remains in an uptrend, with a positive technical profile.

My Call: The uranium sector will probably continue to outperform the S&P 500 (with volatility) until the end of the year.

Precious Metals – Dark Horse?

Gold and silver have languished since August 2020. Investor interest has been focused on other parts of the stock market and Bitcoin. It almost seems that gold and silver are the forgotten sectors of the market. That could change in the near future as the seasonal periods for both gold and silver are about to start shortly. This is especially true if interest rates head lower. In addition, higher than expected inflation reports would help to boost gold and silver. Watch for gold and silver to start performing well before the start of their seasonal periods in late December.

Gold Bullion –

Gold bullion has a strong seasonal period from December 27 to January 26

Gold tends to perform well from late December until late January. Of course it can start its seasonal run early and run later as well. In fact, in recent years, gold has been starting its seasonal rally more often in November.

On the fundamental level, Basel III regulations are set to be implemented in London at the end of the year. As gold gets reclassified from a Tier 3 asset to a Tier 1 asset, gold banks are going to be required to hold 85% of the value of gold as collateral. The collateral has to be Tier 1, meaning cash or gold. As this ruling is implemented it is going to reduce the number of gold contracts by making them more expensive, which should help to boost the price of gold.

Gold is well off its high from August 2020. Over the last two years gold has closely followed interest rates. As interest rates moved higher, gold moved lower and vice versa. In October (red box in graph) the yield on the US 10-Year Treasury has moved lower and gold has ticked higher. If interest rates move lower, this could be the trigger to get gold to start its seasonal rally early.

My Call: Gold bullion will probably continue its positive performance into January.

Gold Miners –

Gold miners have a strong seasonal period from December 23 to February 14

Gold miners have bounced recently. They have benefitted from both gold and the S&P 500 increasing in price. In the graph below, the second panel of gold miners vs S&P 500 and the third panel gold miners vs gold, illustrates that gold miners tend to outperform gold bullion when the stock market is rising and underperform when the stock market is falling. This is particularly true if gold is rising and falling at the same time as the S&P 500. In other words gold miners are a leveraged bet on gold bullion, but the strength of its outperformance or underperformance is somewhat dependent on the strength of the S&P 500.

My Call: Gold miners will probably start to outperform the S&P 500 in November.

Silver –

Silver have a strong seasonal period from December 27 to February 22.

Silver is part precious metal part industrial metal. Silver, like gold, peaked in August 2020. It did manage to put in another top in June of 2021. In comparison gold lost ground from August 2020 to June 2021 (bottom panel of graph below). At the same time, the metals and mining sector outperformed the S&P 500. This is shown in box 1. In other words, silver got a boost compared to gold because the metals and mining sector was outperforming the S&P 500. In box 2, the metals and mining sector initially underperformed the S&P 500. At the same time silver underperformed the S&P 500. From August 2021, the metals and mining sector performed at market and so did silver and gold.

In summary, watch for the relative strength of the metals and mining sector, to help gauge the relative strength of silver compared to gold.

Silver starts it strong seasonal period in late December. It often starts its seasonal rally after gold. If silver pulls back in December, it often leads to a good buying opportunity in late December.

My Call: Silver bullion will probably start to outperform the S&P 500 in November.

Homebuilders –

Homebuilders have a strong seasonal period from October 28 to February 3

The homebuilders sector pulled back in May 2021, relative to the S&P 500. In July, it started to show stronger performance, pulled back down and then started to outperform once again at the beginning of October. Recently, falling interest rates have helped to boost the sector. On an absolute basis, the sector has broken above its resistance level. The sector is performing well, but investors should monitor the sector carefully. If the stock market does turn lower and there are one or two weaker housing reports, the sector could start to underperform the S&P 500. This is especially true if interest rates turn higher.

My Call: The homebuilders sector will probably outperform the S&P 500 for the month of November and weaken in December.

Transportation –

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

The transportation sector has been performing well and outperforming the S&P 500. On an absolute basis, the transportation sector is up against resistance. If the transportation sector continues to perform well past the end of its strong seasonal period, this will be a positive sign for the stock market.

My Call: The transportation sector will probably start to fade its performance relative to the S&P 500 in the near future.

Canadian Banks –

The Canadian banking sector has a strong seasonal period from October 10 to December 31 and then from January 23 to April 13.

Canadian banks have been consolidating relative to the S&P/TSX Composite Index since April 2021. The sector has not managed to break out of its consolidation box. Canadian banks could start to perform well heading into their earnings. Recently, the regulators have lifted the restrictions on Canadian banks paying dividends, making the sector more attractive to investors. Look for Canadian

banks to perform well into their earnings releases, especially if interest rates move higher.

My Call: Canadian banks will probably perform slightly better than market in November and into December.

Metals and 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 has been consolidating relative to the S&P 500 since July. In this consolidation period the metals and mining sector has had rapid short bursts of outperformance. Despite performing well for a day or two relative to the S&P 500, the sector has offset its sudden bursts with declines to stay in a consolidation box.

The strong seasonal period for the metal and mining sector starts shortly. A break out of its consolidation box will indicate that the metals and mining sector is set to perform well.

My Call: The metals and mining sector will probably perform at market, with volatility until the end of the year.

Rants

Rant #1
$150 Trillion isn't what it used to be!

The Great Financial Crisis (GFC) desensitized investors to the term "billion." At the time, the Federal Reserve was spending hundreds of billions of dollars to support the economy. The term "billion" was being thrown around on a regular basis: fifty billion here, 100 billion there. It was mind boggling, but investors started to believe that huge stimulus in the hundreds of billions was normal and did not carry a cost.

"Trillions is the new "billions." In the COVID-19 pandemic, the term trillions has been used on a regular basis. For so many people, there is no difference between the government spending one trillion or three trillion; it sounds about the same. Governments and central banks have ratched up the use of the word "trillion" and investors have become numb to the word.

Now, Yellen says that $150 trillion is needed ($5 trillion a year over 30 years) to significantly impact climate change. To put this in perspective, the US GDP per year is approximately $20 trillion a year.

Here is an easy solution to finance the projects. The government should just mint 150 trillion dollar coins and deposit them at the Federal Reserve. Problem solved (sarcasm).

The question has to be asked, when do we start talking in quadrillions?

Rant #2
Government spending is not inflationary – LOL

Yellen says that Biden's latest government and infrastructure spending package will not be inflationary. It seems that every spending proposal the government puts forward will not be inflationary. The basic laws of economics

have not changed. I could put together a few simple first year college supply and demand graphs and show you that government spending by its very nature is inflationary.

Now that Yellen et al are talking about spending $150 trillion, you can expect them to all sing the same chorus that either the inflationary impacts will be minimal or non-existent. LOL.

I am sorry, but the government cannot just decree that the laws of economics are no longer valid.

Rant #3

Zillow House Flipping – A stupid idea – lists 93% of its properties in Phoenix at a loss

Zillow is a digital real estate company. One of the business divisions of Zillow is buying residential properties, fixing them and selling them. Zillow has some advantages in having a massive database of home values.

Something went wrong. Zillow started to loose money on the houses that it was buying and selling – big time. When Zillow started to realize that the monster that they had created was falling apart, they shut it down and said they were understaffed. More likely is that the company could not take the sustained losses that it was suffering from house flipping. If you look at their own database of the houses they were buying and selling, they were buying houses at high prices than they were selling them for a loss on a regular basis.

In Phoenix, they listed 93% of the houses that they owned for sale – at a loss. They have been exiting the market quickly. Did their Frankenstein AI program that was calculating the buy and sell prices run amok, or does Zillow know something that most others have not realized?

Could the housing market be in trouble?

Rant #4

MMT- Money printing could be on its way big time

On Monday November 8, 2021, Biden interviewed Lael Brainard for the position of Fed Chair, with the possibility of replacing Powell.

Last year, I stated that Lael Brainard had a possibility of becoming the Fed Chair in 2022. This would be an unmitigated disaster. She cannot be classified as an uber-dove, she is in a class of her own. A dovish Fed Chair at least holds out hope that there will be tightening in the near future and tries to provide a path. Brainard is MMT(Modern Monetary Theory) extraordinaire. I make these statements based upon her previous comments made in public.

Brainard believes in big government spending and that the Federal Reserve should standby to monetize the government debt on an on-going basis. If Brainard became the Fed Chair, the lines between the Federal Reserve and the government will become very "blurry," much more than they have become under Powell.

The irony is that if Brainard were to become the Fed Chair, in the short-term, this could give the stock market a boost. More government spending, low interest rates for longer, how can anyone complain? Of course, nothing is free and more government spending financed by the Federal Reserve will only increase the fragility of the system and increase inflationary pressures.

If Brainard does become chair, I believe that she would initially hide her MMT tendencies. There is some shuffling currently going on in the Federal Reserve. There is a good chance that Brainard will be given the number two spot at the Federal Reserve. This would be much better than if she were given the chair, but it is still moving in the wrong direction.