Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

Published the 10th Calendar Day of Every Month

Volume 16, Number 3, March 2022 Written by Brooke Thackray

Market Update

War. There is nothing good about war. Nothing. The human cost is immense. The economic cost can be devastating. As Russia and Ukraine and the West, continue to ratchet up their actions against each other, the possibility of some sort of quick resolution appears to be fading.

Inflation is currently roaring higher. War's are inflation-

S&P 500 Technical Status

The S&P 500 has formed and broken a "Head and Shoulders" pattern. The left shoulder was formed in August of 2021. The head was formed in late 2021 and the right shoulder was formed in February. The neckline is at the 4300 level for the S&P 500.

"Head and Shoulders" is a classic bearish pattern. The third rally, or the right shoulder rallied to a lower level than the head, which indicates exhaustion. A break below the neckline or support indicates that the market is poised to move lower. This pattern has played out recently, but it does not mean that the stock market is about to crash. On a technical basis, the stock market is more susceptible to a correction. The next major level of support is 3500.

The longer that the S&P 500 stays below 4300, the higher the likelihood that the S&P 500 will move lower. Investors are cheering for the S&P 500 to climb above the 4300 level. We shall find out shortly.

Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **February 28, 2022**

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Commodities	
HUZ	Horizons Silver ETF	2.2%
	Equities	
HCRE	Horizons Equal Weight Canada REIT Index ETF	1.0%
HEWB	Horizons Equal Weight Canada Banks Index ETF	19.8%
HXCN	Horizons S&P/TSX Capped Composite Index ETF	33.5%
HXT	Horizons S&P/TSX 60 Index ETF	17.8%
	United States Dollar Exposed Assets	
	Commodities	
GLD	SPDR Gold Shares ETF	7.4%
	Equities	
XLB	Materials Select Sector SPDR Fund	3.8%
XLI	Industrial Select Sector SPDR Fund	6.6%
XLRE	Real Estate Select Sector SPDR Fund	4.0%
GDX	VanEck Gold Miners ETF	3.2%
	US Dollar Forwards (March 2022) - Currency Hedge **	-0.1%
	Cash, Cash Equivalents, Margin & Other	0.8%
	Total (NAV $224,132,107)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 24.56% 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.

ary. Wars bring reduced supply of goods and services. Costs increase as supply becomes tight. Prices rise.

The current Russia-Ukraine war is reducing oil and natural gas supply to the world. As oil increases in price, it has a ripple effect and the cost of everything increases. Oil is in everything (transportation costs).

Wars are unpredictable. A cease fire can happen at any time or further escalations can happen at any time. The situation could get much worse very fast despite optimism and hope.

The Federal Reserve has a problem. It should have been increasing interest rates in 2021. Now that inflation has been showing signs of steadily moving higher and war is heating up, the Federal Reserve has made a "pinky promise," to start raising its key interest rate. This is not good timing. Expect volatility.

Oh Oh - Defensives are outperforming

The defensive sectors should not be outperforming at this time of the year. The exception is the utilities sector which can perform well in March. On a seasonal basis, it is the cyclical sectors that tend to be the best performers at this time. When the defensive sectors are the top performing sectors at a time and they should be laggards on a seasonal basis, it is sending a message to the stock market. The message is that investors are concerned about the prospects of the stock market, but still want to stay invested. When this happens, it does not necessarily mean that the stock market is about to crash, but it is often an indicator that the stock market has limited upside and is becoming fragile.

So, when was the last time that the defensive sectors outperformed in a period when they tend to lag the stock market - December 2021. This was particularly pertinent as interest rates were rising at the time, which usually puts a damper on the defensive sectors. In addition, the S&P 500 was positive in December. These two conditions usually ensure that the performance of the defensive sectors underperforms, and yet, the defensive sectors were the leaders. In January, investor sentiment showed itself with declining markets.

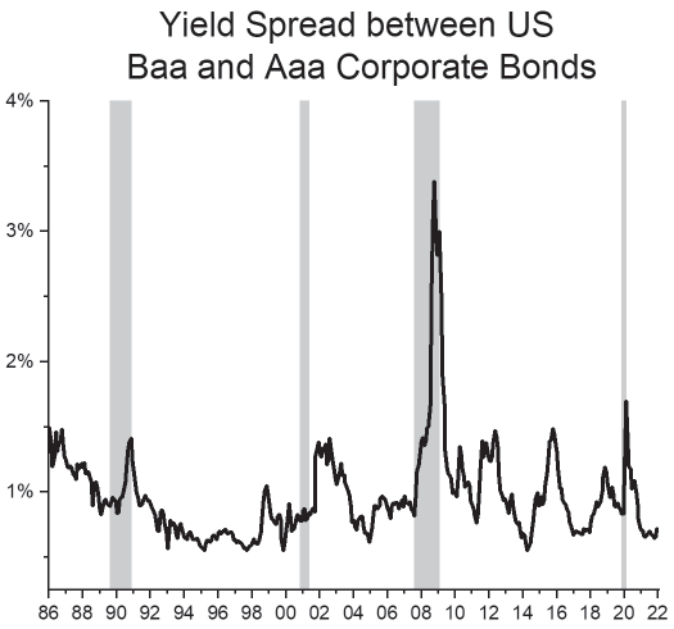
This time is "different." The stock market has been heading lower. I will be the first one to admit that a declining stock market can help support the defensive sectors on a temporary basis. In addition, the yield on the 10 Year US Treasury Note has been heading lower, which is also supportive for the defensive sectors. However, even on "up" days in the market, the defensive sectors are performing well. In other words, the signal of the defensive sectors outperforming at this time is not as strong as it was in December, but nevertheless it should be respected. If the defensive sectors start to underperform the S&P 500, this would be a good indication that stock market sentiment is shifting and the stock market is poised to move higher.

Bond Yield Credit Spread

The bond yield credit spread is a measure of how much extra payment investors demand for taking the credit risk of buying high risk corporate bonds. There are several methods of measuring the credit spread. The most common is the interest rate differential between Aaa corporate bonds (the highest rated corporate bonds) and Baa corporate bonds (the lowest investment grade bonds).

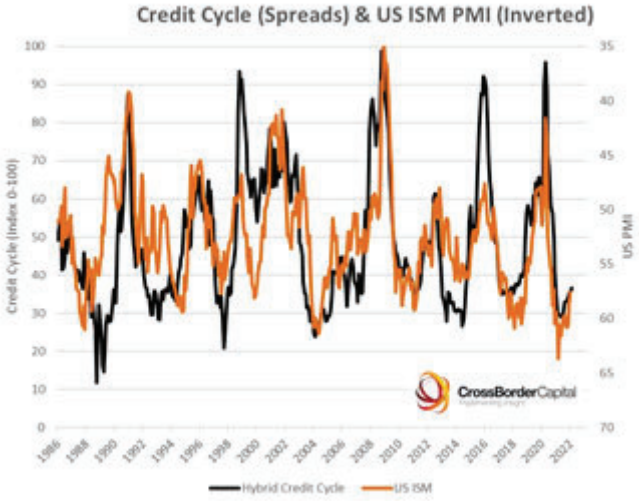
In tough economic times, more companies go bankrupt and as a result investors demand a higher interest payment on their Baa bonds. In other words, the credit spread widens as the probability of bankruptcy increases.

In the graph below (data source: Federal Reserve), when the line is rising, credit spreads are widening as investors fear an increased probability of companies going bankrupt and vice versa. Notice that credit spread tends to widen at the onset of a recession (grey bars). The exception to this occurred in 2001. The stock market crashed in early 2000, but credit spreads did not react until late 2021, after a recession started in early 2021. This could be an indication that in speculative markets, stocks lead down and credit spreads follow later by widening. In the Great Financial Crisis (GFC), credit spreads did not widen until the "Lehman Moment."

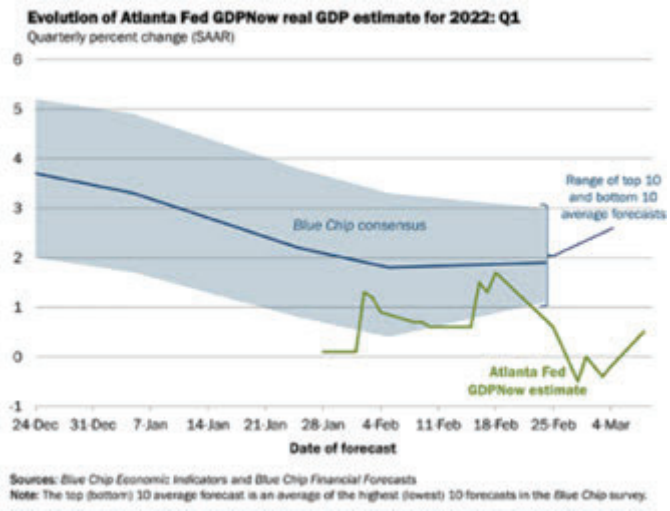


Credit spreads can rise at other times, outside of a recession, particularly when the stock market is under stress. Currently, credit spreads are at the low end of the range, indicating that investors perceive a low risk of corporate defaults. Even recently, as the stock market has declined, credit spreads have not budged very much.

The graph below shows that the ISM PMI (inverted) is rising, which leads credit spreads. The ISM PMI tends to move in cycles and seldom stays at the extremes. As the ISM PMI is falling (rising in graph), it should be expected that the ISM PMI should continue its trend and that credit spreads should widen.



The latest reading for upcoming GDP by the Fed GDPNow as of March 8, 2022 is 0.8%. Although the Fed GDPNow is a quantitative model, it is not the only metric that is forecasting weak economic growth.



After bouncing from the bottom of the pandemic in March 2020, the economy looks like it is at an inflection point and is slowing down. This is occurring at a time when the Federal Reserve has made "pinky promise" to raise its interest rate and consider quantitative tightening. It is also a time when governments have essentially ended their pandemic stimulus and free money programs. To top it all off, the Russia-Ukraine war is pushing inflation higher and creating demand destruction.

Credit spreads may not have reacted yet, but investors should not expect this to be the case for the foreseeable future.

Back to the Future - Markets are moving backwards – Yikes!

Europe - back to 2020 (almost 2019)

Over the last few weeks, the European stock market has lost "2021," as all of the gains made last year have evaporated. For investors, this is not good news.

Due to its proximity and trading relationships with Russia and Ukraine, the future prospects of economic growth have dimmed for Europe. This has occurred at the same time that Europe is suffering from high inflation. Europe will probably be the first region to officially enter into the realm of stagflation. Stagflation is a clever portmanteau (compound word) that defines a particularly troubling economic situation. Stagflation is defined as stagnant growth with high inflation. Typically, when the economy has weak economic growth, the central bank lowers its interest rate in order to stimulate the economy. The problem is that lowering interest rates is inflationary. In an already high inflation environment, lowering interest rates pushes inflation even higher. In other words, Europe is in trouble.

Nasdaq - back to 2020 and a bear market

The Nasdaq has also lost all of its gains from 2021 and is in bear market territory, after declining more than 20% from its peak in 2021.

Ark Innovation Fund - back to pre-pandemic level

Cathie Wood's Ark Innovation Fund has been hammered in late 2021 and in 2022. It is now back to pre-pandemic levels. In 2021, Cathie Wood actively maintained a strategy to sell big tech companies and buy small, illiquid tech companies when the market declined. In other words, Cathie Wood doubled down when the stock market headed lower. Sorry, the strategy did not work.

The Slow Reopen - Covid sticker shock!

Now that Omicron is largely in the rearview mirror and most countries have dropped all of their restrictions, travel restrictions and mandates, economies are reopening. As the economy is opening up, not only are some people still hesitant to get out and about, but people are experienc-

ing Covid sticker shock. Inflation has affected the price of everything. Dining out is more expensive. Travel is more expensive. Clothing is more expensive and the list goes on. People do not have the same appetite or the resources to spend the money that they were spending before the pandemic. Overtime, sticker shock will dissipate in a healthy growing economy, but we have a long way to go.

Slowing economy

Unfortunately, there are signs that the economy is slowing down, even with the reopening.

The graph above shows the relationship between the US GDP YoY change (red line) and University of Michigan Consumer Confidence Expectations (black line). The rate of GDP change crashed during the pandemic and rose sharply in most of 2021 and has started to decline in late 2021 and into 2022. The UMich Consumer Confidence Expectations fell sharply in 2020 as the Covid pandemic developed. As GDP rebounded, UMich Consumer Confidence bounced a bit, but nothing of significance. It quickly moved sharply lower and currently reflects very poor expectations.

Seasonal Trends

March is in the six-month period favorable period for stocks, but tends to be one of the weaker months. The development of war between Russia and Ukraine, has pushed the stock market lower. It is possible that the stock market could bounce in March, particularly if there are positive developments in the war between Russia and Ukraine. The good news is that the first half of April is one of the strongest seasonal periods for the markets.

Seasonal Opportunities

Energy

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

The energy sector has been on fire since the beginning of the year. This happened before the start of its strong seasonal period. Does this mean that the energy sector will not perform well during its strong seasonal period? No. Like most commodities, the energy sector can have extended rallies due to large exogenous factors.

Investors should be careful. When oil peaks, it can crash hard and fast, especially if the price has become extended.

My Call: The energy sector will probably continue to perform well into April.

Materials

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

The materials sector has been consolidating on an absolute basis for most of 2021 and the beginning of 2022. Relative to the S&P 500, the sector has been outperforming the S&P 500 since October 2021. The outperformance trend has been a gradual slope.

My Call: The materials sector will probably continue to outperform the S&P 500 into April.

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 since the beginning of the year. The industrial sector has benefitted from investors fleeing the growth sectors of the stock market. The sector is in a consolidation phase. A break higher out of the box would help to indicate a resumption of the positive trend.

My Call: The industrials sector will probably outperform the S&P 500 into early May.

Technology–

The technology sector has a strong seasonal period from December 15 to January 17

The technology sector has been underperforming the S&P 500 since late 2021. Recently, falling interest rates should have supported the technology sector, and yet the technology sector did not outperform. The fact that the technology sector did not perform well when rates were falling, is an indication of the weakness of the sector.

US 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 the beginning of 2021. The sector has recently turned lower in its consolidation box relative to the S&P 500. The sector has been heading lower while the interest rates have been heading lower. This is normal. However, a reduction in economic growth expectations is also contributing to the weaker performance of the US financials.

My Call: The financial sector will probably continue to underperform the S&P 500 in the near term.

Canadian Banks

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

The Canadian banking sector performed well in January as the stock market declined and the volatility increased. Recently, the sector has been pulling back relative to the S&P/TSX Composite Index as interest rates have been heading lower. If the markets move to a risk-on mode and interest rates fall, it is possible to continue to see the Canadian banking sector underperform the market.

My Call: The Canadian banking sector will probably perform at market in the near term and start to underperform before mid-April.

Gold Bullion

Gold bullion has a strong seasonal period from December 27 to January 26. Gold can perform well into March.

Nice breakout!

Gold bullion is in overtime with its strong performance. It is getting close to an all-time high and it is possible that gold could start to pull back in the near-term. On a fundamental basis, gold was performing well before the start of the Russia-Ukraine invasion. Commodities are affected by many large exogenous factors which can overwhelm the seasonal trends. Gold is no different. Although gold could pull-back on the establishment of a meaningful cease fire or end to the war, longer term fundamentals are supportive of price appreciation.

Gold has been a beneficiary of a "war premium." Investors are attracted to gold when there is geopolitical risk. In addition, the LMBA (the world's largest gold market) has banned Russian refined gold, which limits the supply of gold, and helps to push the price higher.

Gold has also benefitted from falling interest rates. If peace breaks out, gold could lose its war premium. The further that we get from the end of the seasonal period, the more susceptible that gold is to a price correction.

My Call: Gold will probably perform well into March and maybe the beginning of April.

Gold Miners

Gold miners have a strong seasonal period from December 23 to February 14. The seasonal period for gold miners can last into March.

Gold miners have been performing well. The bottom panel of the graph below shows the relative performance of gold miners versus gold bullion. Gold miners have been outperforming gold bullion, which is a good sign for both gold bullion and gold miners. Gold miners have been rising at the same time that the stock market has been falling. This is also a good sign. It is possible to see a correction in gold miners if the stock market moves to a risk-on mode and gold bullion starts to decrease.

My Call: Gold miners will probably perform well into March and maybe into the first part of April.

Silver

Silver has a strong seasonal period from December 27 to February 22

Silver has been performing well recently and is on the verge of a double bottom breakout. Silver has benefitted from gold moving higher and also the metals and mining sector having a strong rally.

If the metals and mining sector continues to perform well, it would be expected that silver would also perform well. Silver is still below the recent high that it set in 2021. It would not be surprising to see silver move above the current levels.

My Call: Silver will probably outperform the S&P 500 into late March or early April.

Homebuilders

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

The homebuilders sector has finished its strong seasonal period. Even before it finished this period, it was showing signs of weakness. There may be days when the home-

builders sector outperforms, but given its poor performance and being outside of its strong seasonal period, the probability of the homebuilders sector performing well is reduced.

Consumer Discretionary

The period of seasonal strength for the consumer discretionary sector ends mid-April.

The consumer discretionary sector has been underperforming the S&P 500 since November 2021. Relative to the S&P 500, the consumer discretionary sector has reached a support level and could be set to bounce.

Over the long-term, on average, the consumer discretionary sector has been the top performing major sector in the stock market.

My Call: The consumer discretionary sector will probably perform well into mid-April.

Metals and Mining

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

The metals and mining sector was in a consolidation box until early February and then quickly exploded higher. The metals and mining sector can be very volatile and despite being in its strong seasonal period, could pull back to the top of its consolidation box on an absolute basis.

My Call: The metals and mining sector will probably perform well into mid-April.

US Real Estate

The US Real Estate sector has a strong seasonal period from March 8 to September 20

The US real estate sector has been performing at market since late June 2021. Recently the sector has had an uptick relative to the S&P 500, as the market has become volatile. The real estate sector has just started its strong seasonal period.

The real estate sector has attracted investors who want to stay in the stock market and benefit from growth. The sector can continue to perform well as long as investors

perceive that economic growth is still robust.

Investors need to be careful with the real estate sector. Although it can provide a haven when volatility increases, if investors perceive that growth is slowing faster than previously thought, then the sector could start to underperform. So far, the conditions have been favorable for the sector.

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

Small Caps

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

The small cap sector has been underperforming the S&P 500 since March of 2021. Recently, the sector did manage to pick up a bit relative to the S&P 500, but has not managed to break its downward trend line.

Continued underperformance of the small cap sector relative to the S&P 500 is a sign of a weak stock market. Investors need to see the small cap sector break its downtrend line relative to the S&P 500 in order to be convinced that the stock market is in good shape. So far, this has not happened.

Rants

Rant #1

This is getting ridiculous - Cryptopunk sells for $24 million

In mid-February a NFT Cryptopunk was sold for $24 million. Ok, I get it, NFT's are going to be the method of commerce and record keeping in the future. But the value of the "thing" has to have some inherent value. For example, homes will eventually be sold on the blockchain using NFT, but it is the house that has value, not the transactions. A few pixels drawn on Microsoft paint is not worth $24 million. In the next recession, this will not happen.

Rant #2

War - Everything is going to be blamed on the war

Yes, war is inflationary, but the inflation that we are suffering from today has nothing to do with the Russia-Ukraine war. The media is trying to incorrectly blame the current inflation on the Russia-Ukraine war. The Russia-Ukraine ware will help to move inflation higher, but the effects will take time to ripple through the economy.

Rant #3

Macklem - shifting goal posts - leaving a back door open to a dovish narrative

In early March, Bank of Canada Governor Tiff Macklem stated that "Canada's hiking path hinges on business investment." What? Since when is business investment a measure for Bank of Canada should consider in raising interest rates. What about inflation?

Macklem is shifting goal posts - once again. He is trying to leave a back door open in order to continue to have a dovish stance. Macklem should have been raising rates in 2021. Although the Bank of Canada has started to raise its overnight rate, Macklem is looking for an excuse to slow the rate of increases. The Bank of Canada is already behind the curve. Stop looking for excuses.