Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

Published the 10th Calendar Day of Every Month

Volume 16, Number 6, June 2022 Written by Brooke Thackray

In late June, into July and August, I will be reducing the amount of content in my publications, as I will be focusing on finishing my next book.

Market Update

Orderly Decline — So Far

S&P 500 Technical Status

The S&P 500 has decisively broken below the neckline of a head (H) and shoulders (LS & RS) pattern. It tried to stage a comeback, but failed at the resistance line and closed at 3900 on Friday June 10.

In April, into May, volume was increasing as the S&P 500 moved lower and decreased when the stock market attempted to rally. This is not a good sign. It shows that investors are not committed to the rally and as such rallies have faded quickly.

The overall trend for the S&P 500 is still lower with the next major level of support at 3600. This would wipe out all of the gains for 2021.

The S&P 500 is still in the six month unfavorable period for the stock market which lasts from early May to late October. Although there may be counter rallies such as around June month end, the overall trend for the S&P 500 is likely lower.

Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **May 31, 2022**

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HCRE	Horizons Equal Weight Canada REIT Index ETF	1.9%
HXCN	Horizons S&P/TSX Capped Composite Index ETF	4.9%
	United States Dollar Exposed Assets	
	Commodities	
HUG	Horizons Gold ETF	4.9%
	Equities	
IBB	iShares Biotechnology ETF	5.9%
XLP	Consumer Staples Select Sector SPDR Fund	8.1%
XLP	Health Care Select Sector SPDR Fund	3.0%
HXS	Horizons S&P 500 Index ETF	46.0%
FHH	First Trust AlphaDEX U.S. Health Care Sector Index	2.2%
XLU	Utilities Select Sector SPDR Fund	6.0%
	US Dollar Forwards (June 2022) - Currency Hedge **	1.6%
	Cash, Cash Equivalents, Margin & Other	15.5%
	Total (NAV $215,006,697)	*100.0%*

*** Reflects gain / loss on currency hedge (Notional exposure equals 79.28% 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.

The stock market has had a relatively orderly decline since early January. I know that many investors will not feel that way when the market is going down, but relative to other declines historically, this has been a relatively orderly decline.

During the decline, since the beginning of the year the VIX has remained relatively calm and has for the most part remained below thirty (see graph above). There has been some spikes, but the VIX has failed to breach forty. Equity investors have been really been sanguine, just waiting for the stock market to stop falling.

It has taken nearly six months for the market to drop approximately 20%. It typically takes less time as there is usually a "washout" bottom where investors capitulate and investors swear to "never again" invest in the stock market. In the 2020 pandemic bottom it took approximately a month for most of the decline. In contrast, the six month decline seems like descending on an escalator.

In the current decline, there have been some rallies along the way, but they have faltered quickly. The only string of large up days was in late May, heading into the Nonfarm Payroll Report in early June. The rally was only a three days on low volume and occurred around month end,. Heading into the May CPI report (released June 10), after a positive Monday and Tuesday, the stock market corrected lower. Although there have been a few large down days, so far, we have not had a capitulation bottom.

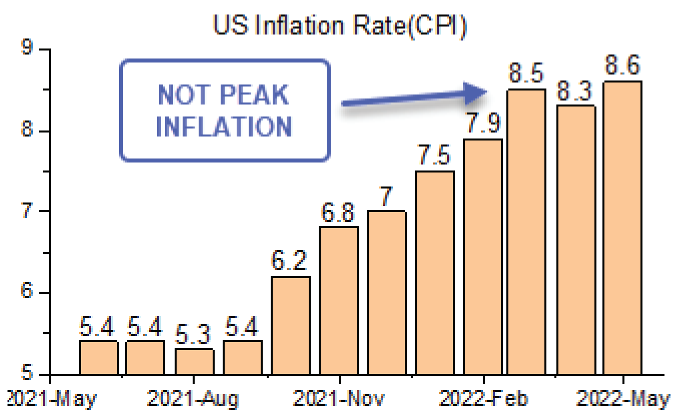
Why is it important for the stock market to string together a large number of big upside days on strong volume?

The lack of successive days of upward moves on strong volume, shows that investors are not committed to the rally. There are always a few investors who believe that "this is the bottom," but they are getting overwhelmed by investors quickly pulling out their money as the rally falters. Investors see the rally as an opportunity to sell their positions rather than the start of a long upward sustained move.

Sorry, "buy the dip," is not working. It worked for so many years, so why is it not working now? Easy, the central bank is draining liquidity out of the system and will not act so fast to save the markets, and investors know it. Investors are on their own, with no help from the government and Federal Reserve.

Buy the dip, did not work at the 10% drop level and it is becoming dangerously close to failing at the 20% drop level. Sure, there will be media articles putting forward the thesis that almost ever 20% correction in the market has proven to be a good buying opportunity. The same articles were put forward at the 10% drop level, just the headline number has changed.

What happened to peak inflation?



Over the last two months, the media has taken up the mantra from the Federal Reserve and Janet Yellen that we are at peak inflation. With a May CPI print of 8.6% growth on a year-over-year basis on Friday June 10, peak inflation has been "delayed." For the record, inflation was 8.3% in April and 8.5% in March. A print of 8.6% for May is the highest in forty years. It should also be noted that the methodology for calculating CPI was changed in January 2022. If last year's methodology was used, the CPI print would have been even higher for May!

Many investors perceive the inflation problem as a temporary one. They perceive that once inflation peaks, it will quickly drop back down to the 2% level - LOL. Sorry to say, even after inflation peaks, we will probably have a persistent inflation problem. Maybe the inflation rate manages to get back to 5% and then the Federal Reserve starts to shift the goal posts. An inflation rate of 5% is still a huge problem.

> Watch for Powell to start using the term "soft landing" as it applies to the inflation rate, rather than the economy. This is coming.

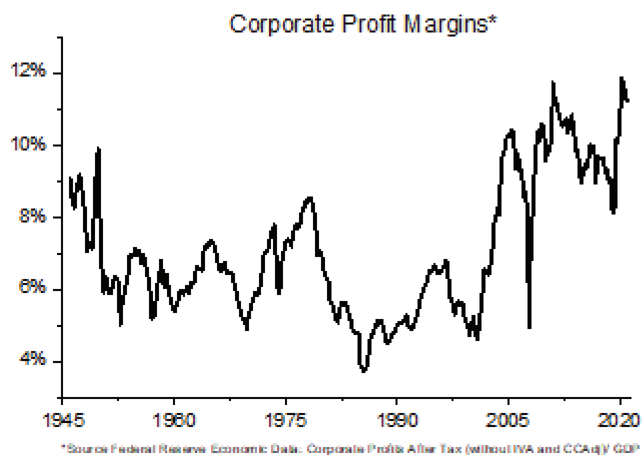
Profit margins - Sorry this is not good !

On May 17, 2022, I released a report *Earnings will Not Save the Day - Profit Margins Declining*. Also, on Friday June 10, I was on BNN Bloomberg *The Street* at 8:00 am discussing the deterioration of profit margins.

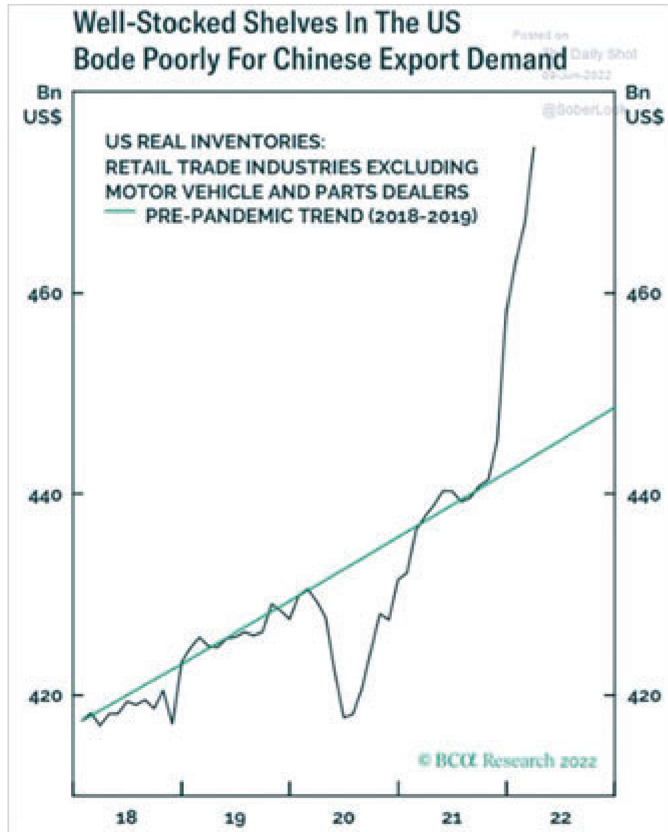
https://www.bnnbloomberg.ca/the-street/energy-sector-susceptible-to-a-decline-despite-strong-fundamentals-research-analyst~2462021

Profit margins increased during the pandemic as excess liquidity was pumped into the system. Consumers become less discriminate with easy money. Recently, profit margins increased to a record just short of 12%. The problem is that the profit margin time series is a regressive data set and tends to revert back to the mean.

It is highly unlikely that profit margins will remain at these extremely elevated levels. With real wages decreasing, it is becoming very difficult for companies to pass on their higher costs.



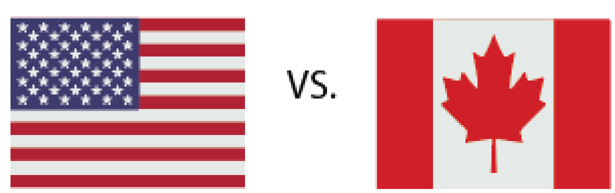
Recently, there has been a spat of retail companies that have reported lower earnings and/or have guided analysts lower in their expectations. Another compounding factor is increasing inventories. When supply disruptions were taking place companies ordered "extra" product just to make sure that they would have some on hand for consumers. As supply bottlenecks were somewhat relieved (we have different bottlenecks now), the goods flowed into the US at the same time consumers were cutting back on their purchases. The result has been increasing inventories. At some point, companies are going to want to get rid of their inventories. They will have to dramatically slash prices of their excess inventories and the result will be downward pressure on profit margins.



The consequence of lower profit margins is lower earnings for companies. Lower earnings means lower P/E's, which typically translates into lower stock prices.

High profit margins that are starting to turn down at the same time companies are going to be "forced" to reduce their inventories does not translate into good news for the stock market.

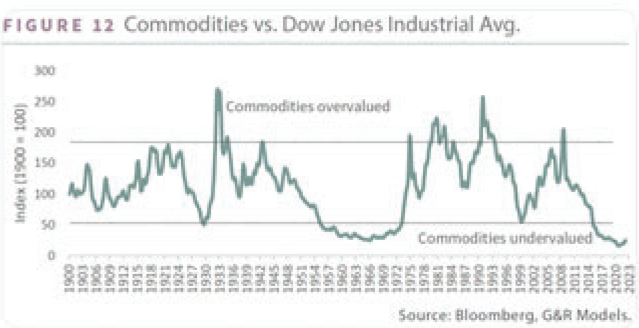
Canada vs US



For years, the S&P 500 outperformed the Canadian stock market, largely on the shoulders of the persistent outperformance of the technology sector. Times have changed. Since the start of 2022 the Canadian stock market has been strongly outperforming the US stock market.

The Canadian stock market has been outperforming the S&P 500 largely due to its larger positions in the energy sector and overall more value stocks.

Did I mention resource stocks? The TSX is a lot more weighted to commodity producing companies. The chart below bodes well for the Canadian stock market.



The TSX will likely continue to outperform in the near-term as value stocks tend to perform better at this time of the year. The risk to the Canadian stock market versus the US stock market is largely the performance of the energy sector. If the energy sector starts to perform poorly, the Canadian stock market's better performance will likely mitigate.

My Call: CAUTION - The strongest seasonal period for the US stock market versus the Canadian stock is in October to December.

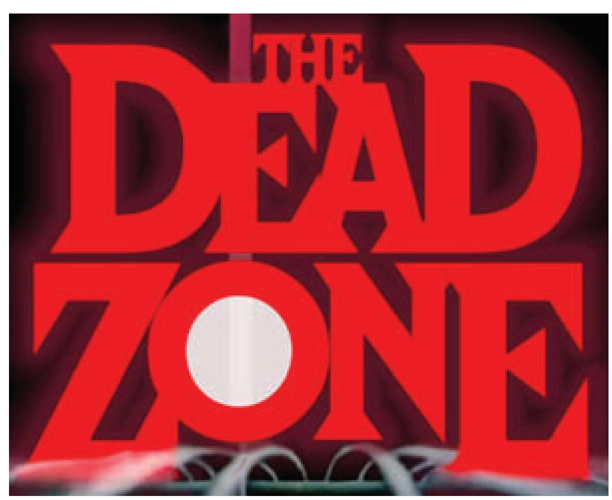
Good News —Summer Sizzler — End of Month Rinse and Repeat

The stock market rallied hard in the last days of May (with volatility). The primary reason for this rally was the the end-of-the-month effect with market bouncing after a steep decline during the month. The stock market has a tendency to perform well in the last few days of the month and the first few days of the next month as investors and money managers reallocate their portfolios and deploy cash ahead of month end statements. I have written about this effect numerous times in the past.

June looks like it is following the same monthly trend as May, so far. If the stock market continues to decline during the month, it is possible that we could have the same setup for June month end with the stock market rallying in the last few days of the month and into July.

There is one difference with the June month end. The positive effect tends to last longer, potentially into mid-July. This is primarily caused by investors entering into the stock market ahead of Q2 earnings season, which starts mid-July (see *Thackray's 2022 Investor's Guide*).

Bad News —Dead Zone —



There is one caveat of which investors should be aware: the months following the Summer Sizzler, August and September, are known as the dead zone (at least in my books). August and September, on average over the long-term are the worst two contiguous months of the year. If there is a major correction in the markets it usually takes place at this time of the year. I will write more about this over the next two months.

Ok, to end on a positive note. The end of September can represent a good opportunity to enter into the market in mid-term elections years.

Seasonal Opportunities

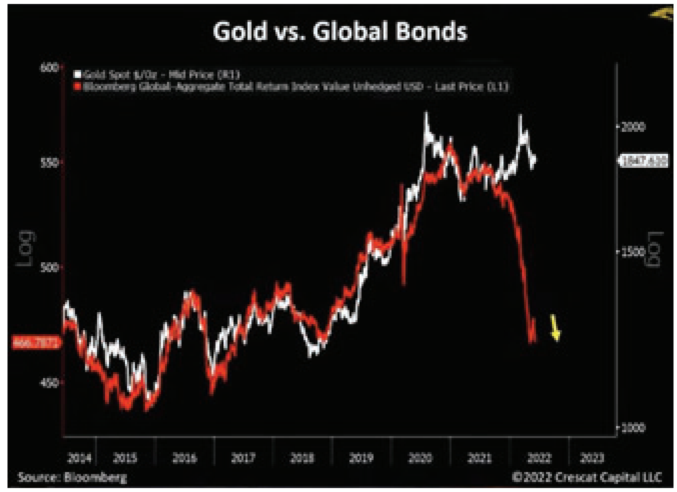
Gold Bullion

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

Recently, on some days when the US dollar has moved higher and yields have followed suit, gold has been showing increasing signs of strength. This is a sign of strength. It is possible that June could provide an early seasonal opportunity for gold.

Gold has been performing well - given the circumstances. A rising yield on the 10 year note and a rising US dollar. Although gold has moved lower since March, the overall upward trend is intact.

From 2014 to 2021, gold tracked global bonds closely (see graph below)



Starting in late 2021, global bonds fell precipitously, but gold has managed to move higher (with some volatility). The fact that gold has held up in such an environment, is as testament to gold. If interest rates do manage to decrease, watch for gold to perform well.

My Call: Volatility in gold bullion will probably provide a good entry opportunity in June, before the start of the strong seasonal period for gold bullion.

Gold Miners

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

Gold miners have been range bound. Using the GDX ETF, gold miners have had a $30 level of support. Recently, the sector has bounced off this level. If gold bullion performs well and the stock market also performs well, gold miners could perform very well.

Although gold miners have not started their strong seasonal period, it is possible that June could provide a good early entry opportunity.

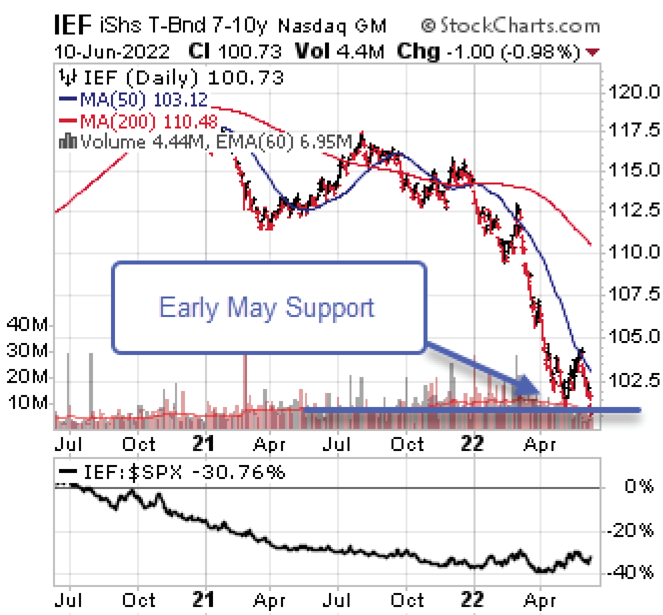
My Call: The gold miners sector will probably start to perform well in June.

US Government Bonds

US government bonds have a strong seasonal period from May 6 to October 3 with the sweet spot of the trade.

After performing poorly from the beginning of 2022 into the end of April, US government bonds showed a burst of strength in early May. Since that time, US government bonds have retreated back to levels just above the early May level.

This week, it is expected that the Federal Reserve will raise interest rates once again. This does not mean that interest rates cannot go lower. It all depends on Powell's press conference post the interest rate announcement. A more dovish tone than expected tone in the meeting could help the yield on the 10 Year Treasury Note move lower.



My Call: US government bonds will probably perform moderately well into July before performing particularly well in August and September.

Energy

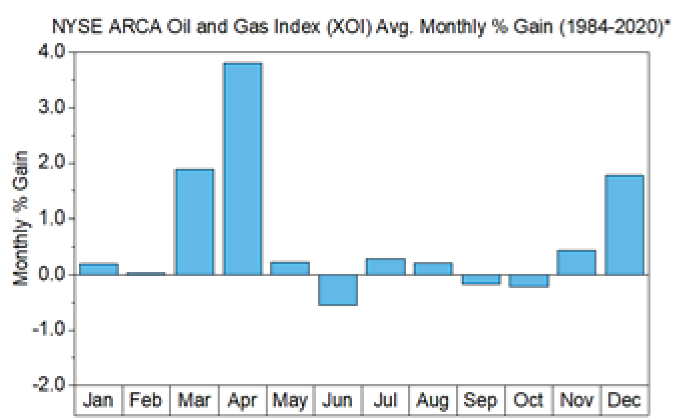
The energy sector has a strong seasonal period from February 25 to May 9.

This is not going to be popular with most investors, but on BNN Bloomberg *The Street*, I put forward the position that the energy sector could be susceptible to a decline. I know, the energy sector has been on a relentless rally since the beginning of the year. I know that there are strong fundamentals supporting a higher energy price.

https://www.bnnbloomberg.ca/the-street/energy-sector-susceptible-to-a-decline-despite-strong-fundamentals-research-analyst~2462021

There are two reasons that investors should be careful in extrapolating the oil price to sky. First, demand destruction will take place with the combination of high inflation and declining real wages. Consumers are starting to make the decision to drive less because it is getting too expensive. The spending habit has been hard to break for consumers as they were beneficiaries of "free money" during the pandemic. The easy come - easy go attitude is facing reality as the government is no longer giving out "free money." Consumers are having to accept the reality that living is more expensive.

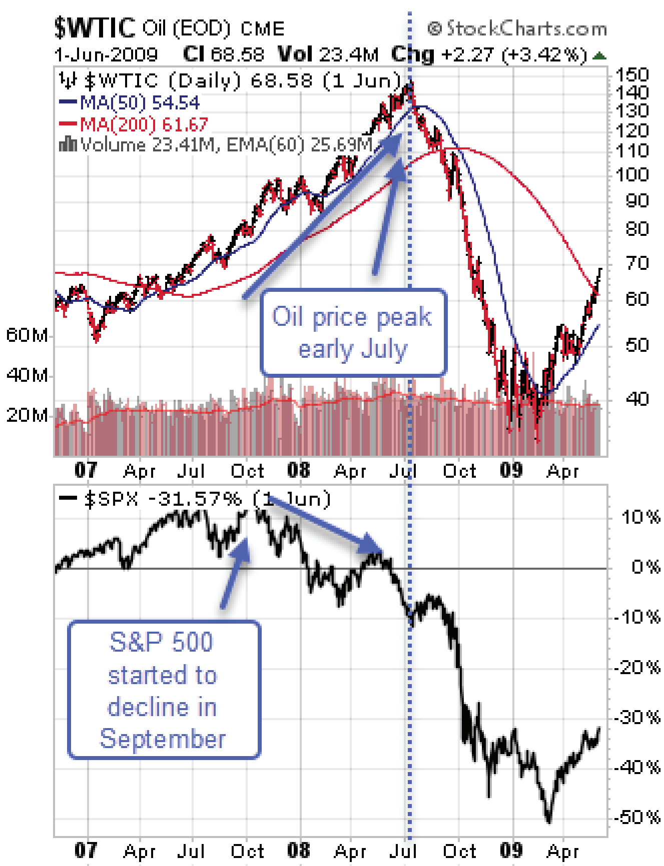
Second, the energy sector has entered into a period of weak seasonality. It should be noted, on average, June is the worst month of the year for the energy sector.



In war, anything is possible, including peace. It is totally possible that Russia and Ukraine will reach a negotiated settlement. In fact, it is likely at some point. If the narrative changes and the media increasingly discusses the possibility of a negotiated settlement, the price of oil could decline substantially. I am not saying that this is going to happen, but rather I use this scenario to show how fast things can change. In a period of weak seasonality, exogenous factors tend to have a large impact on prices.

At this time, the price of oil seems to be headed higher and indeed it could move much higher. I remember back in May 2008, I was on BNN TV being interviewed and warned that the price of oil could correct shortly, despite its relentless rise at the time. Oil peaked at $145 on July 3 and then proceeded to move down to less than $40 (see graph below).

It is important to note that the stock market peaked in September 2007, months before the price of oil peaked. Is it possible that the S&P 500 peaked on January 3, 2002 and the peak in oil is next?



My Call: The energy sector will probably start to falter shortly.

US REITS

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

The US REIT sector compared to the S&P 500 has pulled back since April. Despite its pullback, the REIT sector is still in an uptrend relative to the S&P 500.

The US REIT sector tends to outperform the S&P 500 when the economy is expanding and underperforming when the economy is slowing. The US REIT sector is at the point where it could break its uptrend. If it does, this would make the sector less favorable.

My Call: The US REIT sector will probably perform at market in the near term.

Consumer Staples

The consumer staples sector has a strong seasonal period from April 25 to May 31 but can outperform into October.

The consumer staples sector has pulled back relative to the S&P 500 since May. This is after strong outperformance relative to the S&P 500 in April. The sector is still above its relative trend line relative to the S&P 500.

The sector suffered as Walmart and other retailers either missed earnings expectations and/or offered poor forward guidance. Both the consumer staples and discretionary sectors suffered on the news.

The consumer staples sector is not immune from correcting when the stock market corrects sharply. Nevertheless, the sector can still offer better performance in a major pullback in the stock market.

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

Consumer Discretionary

The consumer discretionary sector tends to underperform the market in the summer months.

The consumer discretionary sector has been underperforming the S&P 500 as consumers have suffered under rising inflation. Consumers have been shifting their purchases away from discretionary items as they can afford less to spend as a result, the consumer discretionary sector has been underperforming. In addition, rising interest rates are also a detriment to the sector.

My Call: The consumer discretionary sector will probably continue to underperform the S&P 500 into late June.

Health Care

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

The health care sector started to outperform the S&P 500 at the beginning of 2022. Recently, after outperforming the S&P 500 in late April, the sector has been pulling back on a relative basis.

My Call: The health care sector will probably perform moderately well into August.

Utilities

The utilities sector has a strong seasonal period in the summer months.

The utilities sector has been performing well since the beginning of the year. Recently, the sector has had a minor pullback relative to the S&P 500, but is still in an uptrend.

If interest rates start to head lower soon and the stock market is stumbling, the sector could perform well.

My Call: The utilities sector will probably outperform the stock market until early July.

Biotech

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

The biotech sector has been performing at market in recent months. For a bit, it looked like the sector was starting its strong seasonal rally early, but it resumed its market performance. The strongest month of the year for the biotech sector is July. The sector has been building a base relative to the S&P 500, which could set up the sector to perform well in July.

My Call: The biotech sector will probably outperform the S&P 500 in the month of July.

Rants

Rant #1

The first steps to recovery for an alcoholic is to admit that they have a problem

– politicians are having trouble admitting that they have been the main cause of inflation along with the central banks. Until politicians admit their role in creating inflation, we will continue to see economic negative consequences

I will avoid naming names and posting pictures of political figures in order to not to be political.

Either US and Canadian politicians do not understand very basic economics, or they are not telling the truth. It is probably a combination of both.

Politicians are blaming everyone, but themselves for the inflation problem that they have created. First, it was the pandemic, then it was supply chains, then it was greedy corporations and now they are trying to blame Putin.

This is really simple. You print 40% of all currency in existence in two years and distribute it through reckless government spending, you will get inflation. Sure, supply chain issues have been a contributing factor, but supply chain issues have been a very minor factor. Most recently, everyone seems to be blaming Putin. Inflation was a raging concern long before Russia invaded Ukraine. The war will have an increasing inflationary effect over time, but so far the contribution has been relatively minor.

Because politicians cannot admit they have been part of the problem, they are proposing really "goofy" (to be kind) solutions. What do politicians think should be done - spend more money. Yes, they think that spending more money will solve inflation. Some politicians are advocating giving away gas cards, others just sending out free money. All of this is nonsense. It will only exasperate the situation. Unfortunately, an economic mess has been created by the central banks and governments. There is no way to solve this except through the pain of dramatically lowering inflation.

I believe that at some point if inflation persists, government will introduce price controls. They have never worked anywhere in the world at any time and have only made the situation worse in the long-term. Nevertheless, governments will probably implement them in North America. Time will tell.