

Thackray Market Letter

— Know Your Buy & Sells a Month in Advance —

Published the 10th Calendar Day of Every Month

Volume 8, Number 3, March 2014

Written by Brooke Thackray



NOW AVAILABLE!

The Thackray's 2014 Investor's Guide is now available. It includes new seasonal strategies for Emerging Markets, Disney, Boeing, Harley Davidson.....and many more.



NEW- Sector Spotlight

The Canadian dollar has recent corrected strongly against the U.S. dollar, but the good news is that the strongest month of the year is just around the corner. The Sector Spotlight (at the end of the newsletter) discusses the seasonal trend for the Canadian dollar.

S&P 500 Technical Status

After a dismal January, the S&P 500 bounced back in February, as the emerging market “crisis” seemed to quickly fade from investors memories. The low at the beginning of February kept the integrity of the upward trend for the S&P 500. Technically, the S&P 500 is still in good condition, as it has maintained a trend of higher highs and higher lows. It has also broken above the previous resistance level of 1850, which has now become support. At this time, it is possible for the S&P 500 to correct back to the 1850 level and test support. If it breaks below 1850, it is possible that it could correct back down to its upward trend line. A negative trend would be established if the S&P 500 broke through 1750, which is a major support level, and could also be the 200 day moving average, as the average is increasing with higher recent prices.

On the other hand, if the S&P 500 bounced off its support level at 1850, and moved higher, this would be strongly bullish for the stock market, as the upward trend would be reaffirmed.

Regardless, we are still in the six month favorable period for stocks, which lasts until May 5th, and seasonal investors should not over-react to corrections, especially considering that the stock market still has an upward bias.



An ETF for all seasons

The **Horizons Seasonal Rotation ETF (HAC)**

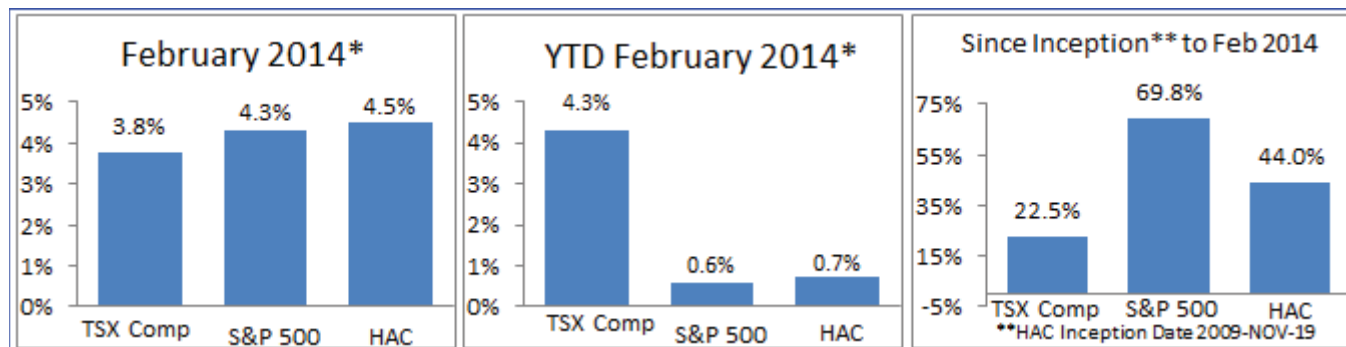
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Horizons Seasonal Rotation ETF (HAC :TSX)
Portfolio Exposure as of **February 28th, 2014**

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizons S&P/TSX 60™ Index ETF	24.9%
HXE	Horizons S&P/TSX Capped Energy Index ETF	4.9%
	United States Dollar Exposed Assets	
	Equities	
HXS	Horizons S&P 500® Index ETF	14.7%
XLB	Materials Select Sector SPDR Trust	9.7%
XLI	Industrial Select Sector SPDR Fund	9.6%
XLF	Financial Select Sector SPDR Fund	9.5%
SMH	Market Vectors Semiconductor	5.2%
OIH	Market Vectors Oil Service ETF	4.9%
XLY	Consumer Discretionary Select Sector SPDR Fund	4.9%
	Commodities	
HUZ	Horizons COMEX® Silver ETF	10.0%
	Platinum Future Exp April*	0.0%
	US Dollar Forwards (April 2014) - Currency Hedge **	0.1%
	Cash, Cash Equivalents, Margin & Other	1.6%
	Total (NAV \$130,610,015)	100.0%

* Reflects gain / loss on futures contracts (Notional exposure equals 2.94% of current NAV)

** Reflects gain / loss on currency hedge (Notional exposure equals 58.4% of current NAV)



* Source: Bloomberg, HAC based upon 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.

Market Update

All things considered, the stock market has been acting well recently. It has managed to push through resistance (once again) and reach all-time highs (S&P 500). Despite the geopolitical conflicts, the stock market has been fairly resilient. The Russia-Crimea situation only managed to rattle the markets for one day. Of course that could all change, as Russia makes efforts to annex the Crimea Peninsula. So far, the market has not been looking for an excuse to sell-off and after a slight dip has moved higher – this is a sign of strength.

Whenever we reach all-time highs, it seems that investment gurus come out of the woodwork and call for a market correction. The reasoning appears to be that they equate news highs with being overvalued. The media helps promote these forecasts, as many media-outlets do not publish market levels unless they are at all-time highs, or there is a very big move in the stock market.

Below is a graph of the margin debt vs. the S&P 500 performance. This graph was embedded in an article posted on stockwatch.com on March 9th, titled, *Caution urged as margin debt levels hit new highs*. There is no doubt that there is a correlation to the stock market level and the level of margin debt. The author of the article Wallace Witkowski raises a good point and it is indeed a troubling situation. The problem is that the both the S&P 500 and the margin debt have continued higher since the graph was originally published by Factset. Investors should not be making radical investment decisions just on the basis of whether the market is at a new high, or if the market is overbought or if margin debt is at an all-time high. It is very difficult, if not impossible to time the market using such information. Perhaps it is best to heed the author's advice and act with caution.



We are still in the strong six month seasonal period for the stock market. Although there is typically some volatility in this time period, from October to the beginning of May,

the market tends not to have severe corrections, at least without a strong cause. From a seasonal standpoint, it is still time to be allocated towards stock market.

Looking forward, the stock market tends to be flat at the tail-end of the March and then perform strongly in the first half of April, as we head into the earnings season.

We are at the tail-end of the 2013 Q4 Earnings season and the results have been acceptable but not overwhelmingly so. According to Thomson Reuters (February 28th): “Of the 482 companies in the S&P 500 that have reported earnings to date for Q4 2013, 65% have reported earnings above analyst expectations. This is higher than the long-term average of 63% and below the average over the past four quarters of 66%. 61% of companies have reported Q4 2013 revenue above analyst expectations. This matches the long-term average of 61% and is higher than the average over the past four quarters of 55%.”

The market has a bias to performing positively coming into earnings season. I have written about this phenomenon in *Thackray's 2014 Investor's Guide*, page 43, with the strategy that I developed quite a few years ago, and named, 18 Day Earnings Month Effect. The strategy is based upon the stock market performing well in the first eighteen calendar days of the earnings months, January, April, July and October. Why does the stock market have a tendency to perform well in the first part of the earnings months?

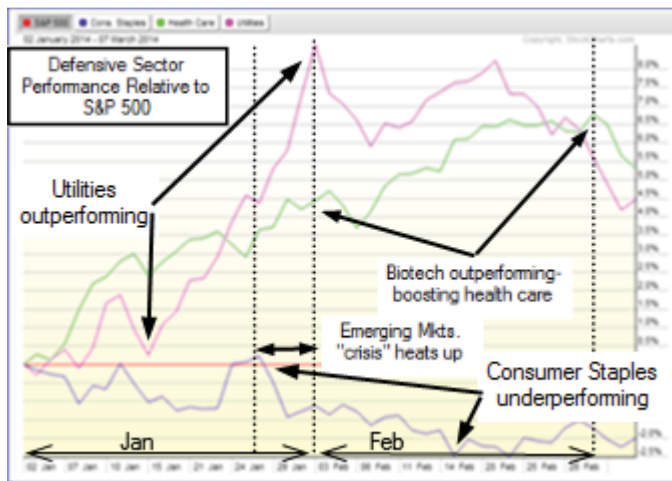
The reason is fairly straight forward; investors are an optimistic group of people that want to take advantage of possible good news in the stock market. As a result, they tend to bid up stock prices before the earnings season gets well under way in the third week of earnings months. Although companies, such as Alcoa, release their earnings earlier in the month, the earnings season gets into full swing in the third week of the month when a large number of companies report. In keeping with the philosophy behind seasonal investing, it is best to enter into a position before the event and exit/lower exposure when the event starts. In the case of the earnings months, it is best to enter/increase equity positions at the beginning of the earnings month, or a few days before the previous month end, and then exit/reduce equity positions approximately eighteen calendar days into the month.

Does this strategy always work? No, but on average over the long-term, it has added value. Over the long-term from 1950 to 2012, the S&P 500, in the first eighteen calendar days of April has produced an average gain of 1.5% and has been positive 70% of the time. It should also be noted that the strategy in April has not worked in the last three years, but previously has had a strong track record.

As well as tracking performance of different sectors that are potential seasonal candidates, I track a number of different sectors that indicate the sentiment of the market at different times of the year. I am particularly interested in sectors that perform well outside of the period of their seasonal strength. When sectors perform well at this time, it indicates an increased potential for gains or losses, depending on the situation. Some of the indicators that I track are the ratio of liquid corporate bonds to junk bonds, the performance of small caps in the summer and the performance of the defensive sectors relative to the market during favorable season for stocks.

Examining the recent performance of the defensive sectors, indications are that the market has not yet moved into a full risk-off mode. Typically, the defensive sectors, utilities, health care and consumer staples do not outperform the S&P 500 during the favorable six month period for stocks from the end of October to the beginning of May. In 2012 and 2013, I wrote about how the defensive sector outperformed the S&P 500 in the late winter and early spring, signaling a possible correction in the spring as the market was becoming more defensive, despite its positive performance.

This year the utilities and health care sectors did outperform the S&P 500 in January, as the emerging markets mini-crisis unfolded. The consumer staples sector did not perform as well, as it has a very large exposure to the emerging markets. The utilities sector reversed its outperformance trend at the beginning of February, signaling an increased appetite for risk. Although the performance of the defensive sectors at the beginning of the year is not a fool proof indicator of stock market performance, it does indicate the overall health of the stock market. So far there are not any signs of impending doom and the market still has an appetite for risk.



What the HAC is Going On?

Energy– Monitor Closely

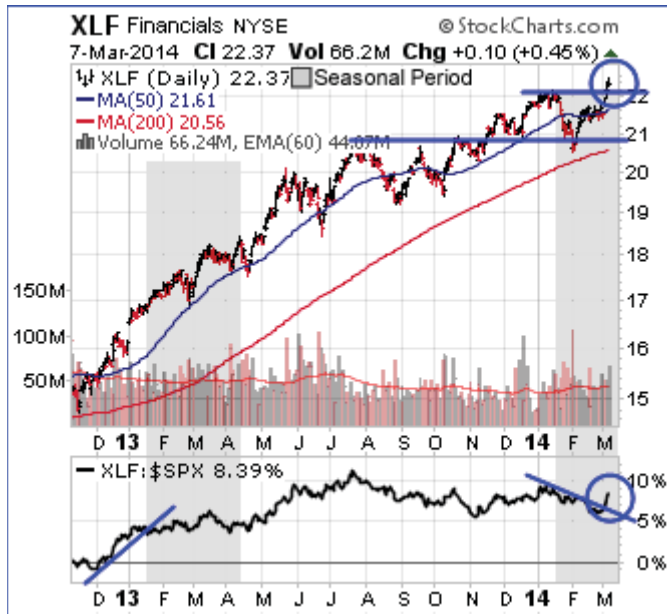
The energy sector has been performing slightly below market recently, using the Energy Select SPDR ETF (XLE). Its slight underperformance does not require action at this point, as the sector has not broken any critical support levels. XLE is currently at a resistance point and the top of its trading band. If the sector were to turn down and underperform the S&P 500, investors should consider exiting/reducing their position. In the last two years the sector has started to underperform the S&P 500 early in its winter seasonal period and is something that needs to be watched, once again.



HAC held Horizons S&P/TSX Capped Energy Index ETF (HXE) and Market Vectors Oil Service ETF (OIH) at the end of February.

U.S. Financials– In the sweet-spot

The U.S. financial sector performs well at this time of the year, into mid-April, when the sector starts to release its Q1 earnings (U.S. banks are one of the first sectors to release their earnings). Although, the U.S. financial sector starts its seasonal trend in mid-January, the sweet-spot for its outperformance relative to the S&P 500, starts in March and lasts until mid-April. If investors are looking to hold onto their U.S. financial positions past mid-April, a tight stop is a good idea as the sector has a tendency to underperform in the second half of the month.



HAC added to its U.S. financial sector position in mid-February by increasing its stake in the Financial Select Sector SPDR Fund (XLF).

Canadian Banks

Although the Canadian sector has a seasonal period lasting until mid-April, the trend is not as strong as the U.S. financial sector.

From a technical basis, the trend for the Canadian bank sector is not as strong as that of the U.S. The Canadian sector has “put-in” lower lows and has only managed to make it back up to its resistance level.



Investors should consider exiting/reducing a position in the sector if the sector turns back down from its resistance level. From a fundamental basis, the Canadian banking

sector’s performance is largely affected by the performance of the Canadian housing sector, given its larger exposure to the real estate market, compared with the U.S. Last spring and early summer the Canadian banks underperformed as there was a concern that the Canadian housing market was overvalued and many articles were written in the press predicting a housing crash or correction. When the sentiment changed in late summer and the correction concern dissipated, the Canadian market rallied once again.

HAC did not hold a position in the Canadian financial sector at the end of February.

Consumer Discretionary– Starting to Show Strength

The consumer discretionary sector had a strong run since the summer of 2012, outperforming the S&P 500. After poor retail reports, questionably based upon bad weather in December, investor sentiment changed in January and the sector started to underperform. Investors were concerned that consumers were starting to tighten their wallets and purses. By the end of the month, the sector improved its performance and moved into a market perform scenario. It has recently started to turn positive relative to the S&P 500 and on a technical basis, the sector has broken above its high set at the end of 2013. Relative to the S&P 500, the seasonal period of strength for the consumer discretionary sector ends on April 12th. It is possible that the sector continues its outperformance past mid-April, but investors should be prepared to exit the sector on signs of weakness.

HAC held a position in Consumer Discretionary Select Sector SPDR® Fund (XLY) at the end of February.



Retail– Bouncing back, but seasonal run finishes soon

The retail sector fell sharply at the beginning of 2014 along with the consumer discretionary sector. Towards the end of February, the sector started to outperform the S&P 500, based upon earnings releases. Many retail companies have their year-end at the end of January, or at least their quarter-end. They avoid the typical calendar year-end as they are too busy selling products. As a result, the companies tend to report towards the end of February. This year, a number of companies produced better than expected earnings in late February, helping to drive the sector higher. Currently, the sector is still below its December 2013 high and has some room to “grow.”

HAC did not hold a position in the retail sector at the end of February.



Materials– Very strong recently

The materials sector underperformed the S&P 500 in the first few weeks in January, as it often does on a seasonal basis. Since January 23rd, the start of its second seasonal leg, it has performed very well and has outperformed the S&P 500. This is good news, as the sector is often one of the first cyclicals to turn down and can act as a canary in the coal mine. In both 2012 and 2013, the sector started to underperform in January, and signaled the downturn in the industrial sector. So far, the sector is outperforming the S&P 500, which is a good sign for the overall health of the market.

HAC held a position in the Materials Select Sector SPDR® Fund (XLI) at the end of February.

Industrials– Recent new highs and showing positive strength

The industrial sector outperformed the S&P 500 in its first seasonal leg, from October 28th to December 31st. In its second seasonal leg, starting on January 23rd and lasting until May 5th, the sector began with slight underperformance relative to the S&P 500, as it was impacted by the weakness in the emerging markets. Recently, it has returned to outperformance as the economy has continued to show signs of improving. Although this sector has been performing well, investors need to monitor this sector for signs of underperforming the S&P 500.



In the last two years the sector has started to underperform the S&P 500 in March. Although this does not necessarily indicate that the same trend will occur, it is something to

monitor. Currently this scenario is not expected, as a rotation into the defensive sectors is not taking place.

HAC held a position in the Industrial Select Sector SPDR Fund (XLI) at the end of February.

Silver– Starting to fade, look to exit/reduce

In my last newsletter I said that “if silver were able to break above its \$20.40 resistance level, then this would be very positive for silver and investors would be wise to ride the momentum until the sector starts to underperform the S&P 500.” Silver managed to break above \$20.40 and enjoyed a good boost once it broke through resistance. More recently, it has started to turn back down and underperform the S&P 500. It has also just broken below its old resistance level, which was previously its support level. The seasonal period for silver finishes at the end of March, but given that it has started to show weakness, investors should be looking to exit/reduce their silver positions. Although silver has not broken its upward trendline relative to the S&P 500, its price momentum has shown a negative trend as the Full Stochastic Oscillator has crossed below 80. This is often a sign to exit a seasonal position when a security is close to the end of its seasonal period.

HAC held a position in the Horizons COMEX® Silver ETF (HUZ) at the end of February.



Gold– Seasonally performs poorly in March

Although silver can perform well in March, it tends to be a weaker month for gold. Since 1990 to 2013, gold has produced an average loss of 1.0% and has only beaten the S&P 500, 38% of the time in March. Recently there has been an increase in geopolitical risk as the Russians make a move for the Crimea Peninsula. In the past, this would have propelled gold much higher, at least in the short-term. But this time gold has barely reacted. This is not a sign of strength for gold.

For a more detailed response for gold and gold stocks, please see my March sector video.

HAC did not hold any gold or gold stock positions at the end of February.

Platinum– Performing well but at resistance

Platinum, the “other” white precious metal can have a seasonal run into May if the commodity complex is having a strong run, but at other times it can finish its run in March. Recently, platinum has had a good run, but it is up against a fairly significant resistance level. The Full Stochastic Oscillator is currently above 80, and if it crosses below 80, investors should consider exiting/reducing their platinum positions.

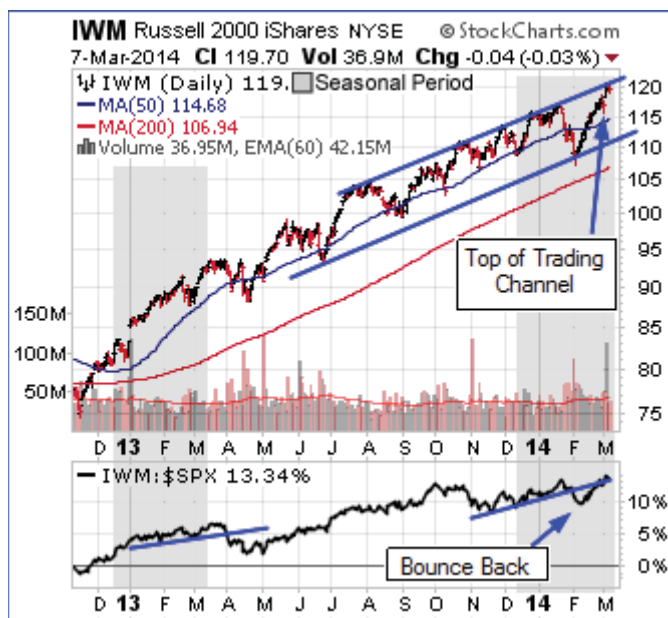
HAC held a small position in platinum at the end of February.



Small Cap Sector– Bounced back, but seasonally finishing

The small cap sector started its seasonal run in mid-December, right on seasonal cue. In January, when the market moved into a risk off mode because of concern for the emerging markets, the sector started to correct and underperform the S&P 500. The small cap sector violated a key support level and its trading channel, and broke through its 200 day moving average. As a result, HAC sold its position in iShares Russell 2000 ETF (IWM). Shortly afterward the stock market moved back to a risk-on mode and IWM started to outperform once again. In the end, it would have been better to stay in IWM, but the decision was made for the right reasons. For investors still in the small cap seasonal trade, the seasonal trade ends on March 7th and investors should be putting a tight stop on their positions.

HAC did not hold a position in the small cap sector at the end of February.



Stocks

Dupont– Performing well in its seasonal period

Dupont has been successfully restructuring its operations and in January released earnings that were stronger than expected. The stock has performed very well since. Currently, the stock is well above its December 2013 high. Given the magnitude of its recent move, it is possible for Dupont to pull back in the short-term. It still has a fairly long time remaining in its seasonal period and given that this stock can often put-in a strong seasonal finish, it is still a favored trade.

HAC did not hold Dupont at the end of February.



Harley Davidson- Get ready to ride



Harley Davidson (HOG) is a new seasonal strategy in my 2014 book. Harley Davidson tends to perform well from March 9th to April 18th and then from June 22nd to July 18th. Both of these seasonal periods start a month before Harley Davidson's earnings in the spring and summer months before "riding" season. This is the time of the year when Harley Davidson attracts the greatest interest from investors. Like so many other seasonal strategies, it is best to enter into the trade one month prior to the seasonal event (in this case, Harley Davidson's earnings release), and then exit approximately at the time of the event (earnings release).

Since the beginning of March, HOG has started to perform well and outperform the S&P 500. There is still over a month left in the trade, and if the stock market performs reasonably well, it is expected that HOG will outperform.

HAC did not hold Harley Davidson at the end of February.

TJX– Uptick just in time

TJX started to outperform the S&P 500 at the end of January, just after its earnings release. It has since returned to market performance. The seasonal trade ends in a few weeks (March 30th) and it is still expected that TJX will perform well, but investors should look to exit the position if it starts to underperform the S&P 500.

HAC did not hold a position in TJX at the end of February.



Royal Bank– Technically weak

After a strong run from the middle of 2013, until the beginning of November, Royal Bank has been underperforming both the S&P 500 and the TSX Composite. From a technical position, it has put in a series of lower highs and lower lows (a weakening trend).

The U.S. banks are preferred at this time (see U.S. Financials earlier in the newsletter). HAC did not hold a position in Royal Bank at the end of February.



Last Minute Thoughts

So far the stock market has been performing relatively well, given the situation in Russia and the Crimea Peninsula. It seems that every day the Russians are deliberately ratcheting up the pressure, with only the occasional easement. The response from the west has been weak, which has encouraged Russia's belligerent stance. In such a "fluid situation" anything is possible and the results could have a dramatic impact on the markets.

I often get asked: what in the stock market keeps me awake at night? To answer the question in one word – China. For so long, investors have marveled at China's growth and its apparent ability to manipulate its economy. In the west, it seems that we have given China's command government a lot more credit than they deserve in managing their economy. There seems to be a general feeling that if China gets into trouble, the government will be able to do whatever is necessary in order to engineer a soft landing. Somehow, we believe that the command structure is better able to accomplish this task than a democracy. Sorry.....I don't believe this. What I do believe is that the Chinese government has an equal ability in "kicking the financial can" down the road, compared to the western governments.

I believe that the free market, unfettered by government influence is the best way for an economy to operate. Yes, there are times, such as 2009 when the Federal Reserve had to step in to prevent the financial system from locking up, but outside these rare times, government action creates a moral hazard and a misallocation of resources.

As China learns its way through the process of creating a hybrid of a capitalist and communist market, distortions will occur and eventually collapses will occur. For the last few years, some analysts have pointed to some of the problems in the Chinese economy, such as building projects that do nothing to increase the productivity of the nation, such as, whole cities being built without anybody to live in them. The difficulty is that it is very difficult to determine when a major correction could occur in a malfunctioning economy. It can stay that way for years as the bubble grows.

Recently, we have seen more problems developing in the Chinese shadow banking system that has built an infrastructure of bad loans. So far, China has managed to massage the system to keep everything working, but if global growth starts to slow, particularly the emerging markets, the Chinese economy will become very difficult to prop up, which could lead to dire consequences. The recent emerging markets mini-crisis was a warning, that investors seem to have forgotten already, but it is something

that could happen once again, at any time. Although investors cannot trade off “warnings”, it is something to be respected.

Although the market can correct at any time, the market tends to suffer its biggest corrections in the time period from May to October. As a result, seasonal investors should still be favoring the equity markets, but given the backdrop this year, it would be wise for investors to consider reducing the risk in their portfolios in April/May.

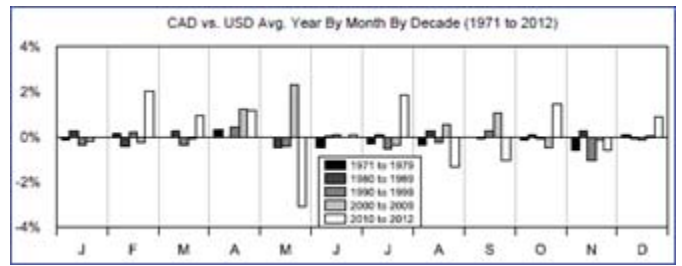
Canadian Dollar

Recently, the Canadian dollar has come under strong pressure. It has been in a strong down trend since the beginning of 2013, except for a few minor rallies along the way. The performance of the Canadian dollar is affected by many different variables, including Canada's economic outlook. Rightly or wrongly, Canada is still perceived as a resource country and as a result the dollar can rise and fall with the ebb of commodity prices and in particular the price of oil. All other things being equal, ceteris paribus, the higher the price of oil, the stronger the outlook for the Canadian economy. The world tends to look at the Canadian currency as a petro-currency and as a result, favors the Canadian dollar when the price of oil rises.

Seasonal Performance

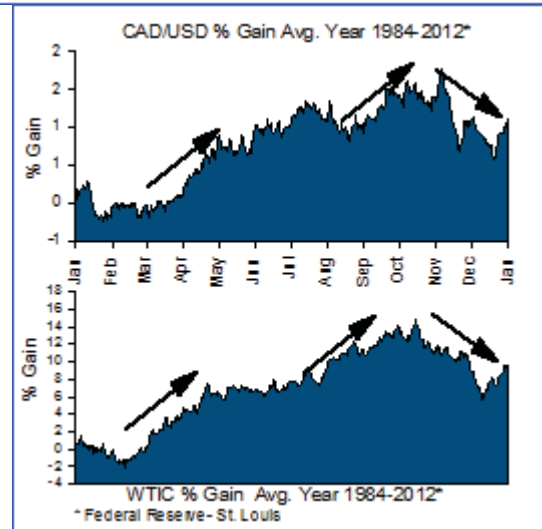
The Canadian dollar has a strong seasonal period in the month of April, relative to the U.S. dollar. In fact, April has historically been the strongest month for the Canadian dollar. From 1971, the Canadian dollar has had the most consistent gains and the lowest drawdowns in April, compared to the other eleven months of the year. April is also one of the strongest months of the year for West Texas Intermediate Crude (WTIC). It is uncanny how the average seasonal performance of the Canadian dollar has been similar to the seasonal cycle of oil on average from 1984 to 2012. Of course there will be differences from year to year, but there is a general trend. Referring to the graph to the right, it is shown that both the Canadian dollar and WTIC rise together in late winter/early spring, flatten out, rise once again in the late summer, and then correct in the last two months of the year.

Interestingly, the Canadian dollar has still performed well in April, even when commodities and oil have not corroborated its strength, such as the last two years. It is possible that there are other factors at play to help boost the Canadian dollar in April.



CAD vs USD Apr % Gain 1971-2013

1971	-0.10%	1980	0.44%	1990	0.44%	2000	-2.09%	2010	-0.26%
1972	0.53%	1981	-0.74%	1991	0.65%	2001	2.65%	2011	2.70%
1973	-0.41%	1982	0.88%	1992	-0.48%	2002	1.74%	2012	1.18%
1974	1.08%	1983	0.36%	1993	-1.02%	2003	2.80%	2013	1.01%
1975	-1.56%	1984	-0.62%	1994	0.09%	2004	-4.58%		
1976	0.55%	1985	0.04%	1995	3.17%	2005	-3.81%		
1977	0.91%	1986	1.68%	1996	-0.15%	2006	4.62%		
1978	0.09%	1987	-2.38%	1997	-0.97%	2007	3.99%		
1979	1.61%	1988	0.41%	1998	-0.78%	2008	1.73%		
		1989	0.60%	1999	3.42%	2009	5.88%		
Avg.		0.30%	-0.02%	0.44%	1.25%	1.18%			



Technical / Seasonal Strength

The Canadian dollar is typically weak against the U.S. dollar in January, and this year has been no exception. The Canadian dollar has started to put-in a consolidation base at approximately \$0.89-\$0.91. As April approaches, investors should be watching for the Canadian dollar to start to show sustained strength. If the Canadian dollar breaks above \$0.91 before the beginning of April, investors should consider entering with an initial position.

*Investors should note that the fundamentals do not support a sustained bull market for the Canadian dollar and investors should consider exiting the position at the end of April, or when the position starts to turn down shortly afterwards. Investors should also note that the Quebec provincial election on April 7th could dampen the trade this year, as a separatist referendum is a possibility later this year if the PQ party wins a majority.

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