Thackray Market Letter

— Know Your Buy & Sells a Month in Advance —

Published the 10th Calendar Day of Every Month

Volume 8, Number 7, July 2014

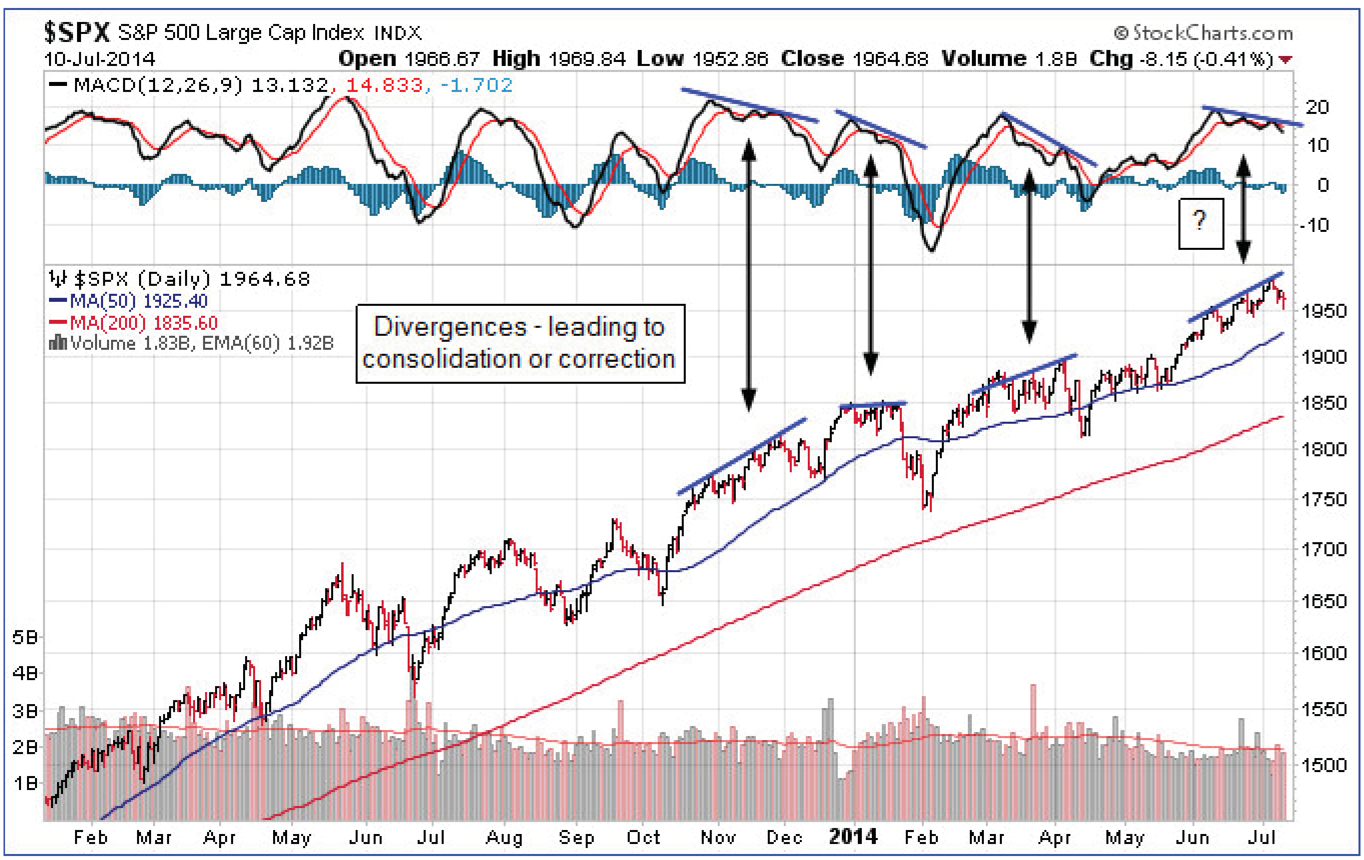
Written by Brooke Thackray

Market Update

As the market moves higher, the media has bifurcated into two camps, one espousing the view that market is due for a correction and the other taking the position that the market is well set-up to move higher. This is typical when the market is setting new highs. The truth is that no one knows if tomorrow is the day that the market starts to turn down, or if it is two months out, or some other time. We can really only use probabilities to tell us market tendencies based upon past relationships. In order to determine the probability of market direction, investors

S&P 500 Technical Status

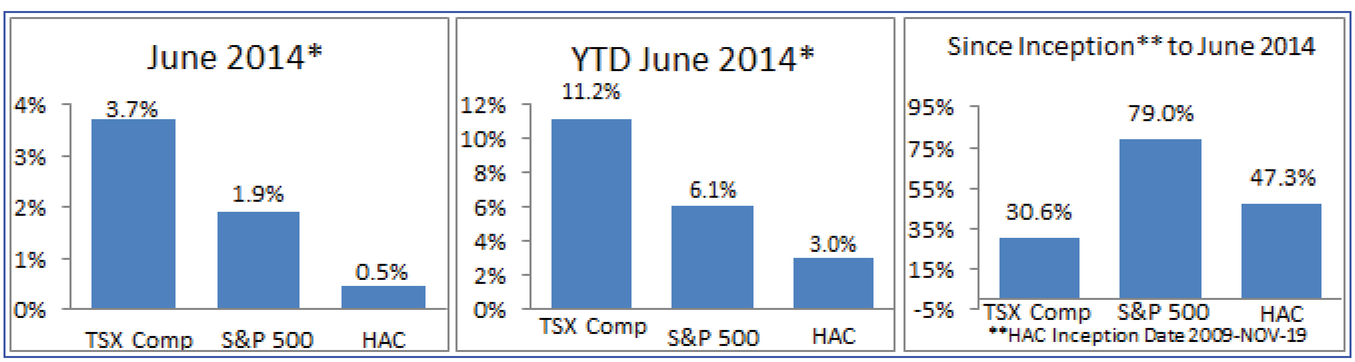
Technically, the S&P 500 is still in good shape, setting higher highs and higher lows. It is difficult to criticize a market that is setting all time highs. As the S&P 500 has been moving higher, the MACD (moving average convergence/divergence, which measures strength, trend and momentum changes) has been moving down. Generally, the MACD moves in the same direction as the stock market. When there is a divergence, it often signals a trend change in the stock market. Currently, the MACD is moving lower and the stock market higher. In the last year there have been a number of these divergences, with the resolution being the S&P 500 consolidating or correcting. Currently, the market looks setup to consolidate or even correct.



Horizons Seasonal Rotation ETF (HAC :TSX)
Portfolio Exposure as of **June 30th**, 2014

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizons S&P/TSX 60™ Index ETF	10.1%
	Fixed Income	
HBB	Horizons Cdn Select Universe Bond ETF	10.6%
	United States Dollar Exposed Assets	
	Equities	
HXS	*Horizons S&P 500® Index ETF*	*49.9%*
HSU	*Horizons S&P 500® Bull Plus ETF*	*9.6%*
IBB	*iShares Nasdaq Biotechnology ETF*	*9.5%*
XLP	*Consumer Staples Select Sector SPDR Fund*	*5.0%*
	Commodity	
GLD	*SPDR Gold Shares*	*4.7%*
	US Dollar Forwards (June 2014) - Currency Hedge **	-0.3%
	Cash, Cash Equivalents, Margin & Other	0.9%
	Total (NAV $118,488,271)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 64.3% 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.

look at valuation metrics, such as the P/E ratios, economy, quantitative momentum indicators and yet others such as myself, look at seasonal trends in the market. From a seasonal perspective it makes sense to become more conservative starting in the second half of July, and continuing into August and September. Overall, this is the weakest time of the year that tends to produce large losses most frequently. Yes, the market can rally in this time period, but any rally is typically predicated on an unpredicted exogenous event, such as a quantitative easing program, or a bounce in the markets after a major correction. Given that we are not coming-off a major stock market correction and the Fed is committed to tapering its quantitative easing program, making a large bet on a late summer rally is not a good proposition.

This year a lot of the media has prematurely misjudged the “Sell in May” phenomenon harshly. The S&P 500 has rallied since the beginning of May and the media jury has judged that “Sell in May” has not worked. No so fast! Firstly, the unfavorable six month period for stocks is far from over. The weakest period within the six month unfavorable period is just ahead, starting in mid-July. Secondly, there are opportunities within the six month favorable period for the S&P 500 and TSX Composite, such as, the Memorial Day Trade (Thackray’s 2014 Investor’s Guide, see page 63), Independence Day Trade (Thackray’s 2014 Investor’s Guide, see page 73) and 18 Calendar Earnings Month Effect (Thackray’s 2014 Investor’s Guide, see page 43). These trades typically account for a large protion of the gains in the six month unfavorable period. This year, in May, HAC took advantage of the Memorial Day Trade. In late June, HAC successfully took advantage of Independence Day Trade. Besides investing in sectors that tend to outperform in summer months, HAC will invest in the broad market for shorter periods of time if a seasonal opportunity exists. Unfortunately there is a lack of broad market opportunities in August and September. There is a minor short-term seasonal opportunity for the last three days in July, but this trade hardly compares to the Independence Day Trade or the Earnings Month Effect. In other words, for the average investor, it is time to get defensive.

Back in 1999, I co-authored my first book with Bruce Lindsay, titled, Time In Time Out: Outsmart the Stock Market Using Calendar Investment Strategies. At the time it was the most seminal work on seasonal investing. In examining the six month cycle for the stock market, Lindsay and I discovered that there was a bimodal distribution of market peaks; one occurring in early May and the other in mid-July. The market tends to typically peak in May, but in years when there is a stock market rally with strong momentum, the market will often peak in mid-July. That being said, one of the most constructive ways of taking advantage of this phenomenon is to respect the May date and then invest in the seasonal market opportunities leading up to mid-July. In the end, the message remains the same: we are moving into a time period where the broad market does not have strong seasonal opportunities and investors should focus on seasonal opportunities in the sectors.

What the HAC is Going On?

HAC fell behind both the S&P 500 and the TSX Composite in June, but it still managed to perform positively by taking advantage of seasonal opportunities, including positioning for the Independence Day Trade. June tends to be one of the weaker months of the year and to make things more difficult, different sectors tend to lead the market in different years. In other words, there is a lack of seasonal tendencies in which to capitalize on.

Although HAC did hold some seasonal sector investments in June, for most of the month, HAC was conservatively positioned with large amounts of cash and short term bond allocations. Just before month end, HAC increased the equity portion of the portfolio substantially (as seen by the month holdings on page 2 of this report). This increase in allocation was for the Independence Day Trade and the Earnings Month Effect. At the time, HAC was expecting to take advantage of both of these trades and reduce equity in July when the market started to weaken or the trades finished.

Once we get passed mid-July, the opportunities for HAC in broad market trades are scarce and HAC intends to focus on sector opportunities.

Sector Trends

Gold- A golden window?

Gold showed strength in June, ahead of its seasonal period which starts on July 12th. Based upon gold’s strength, HAC took an early position in the sector in late June with an eye to add to the position in July.

Although gold performed well in June, there is still a lot of room left for it to run. Over the last ten months gold has been trading in a wide range from $1200 to $1400. Gold may have a bit of trouble making it through $1400, but if it is able to break this level there is quite a bit of room for it to continue to run. In June, HAC initiated a position of 5% in GLD. HAC is expecting to add to the gold bullion sector, and the gold stock sector as both of their seasonally strong periods unfold.

Gold stocks – Starting Strong

Gold stocks are correlated to the performance of gold bullion, but there are some differences, depending on what is happening in the stock market. If the stock market gets hit hard, gold stocks will suffer significantly. We only have to look back to the summer of 2011 when the market corrected sharply. Gold stocks were one of the first sectors to suffer as many investors fulfilled their margin calls by selling their gold stocks. Gold bullion also suffered, but nearly as much as the gold stocks.

If the market does correct significantly, expect gold stocks to get hit harder than gold bullion. This does not mean that investors should not own gold stocks in the summer months. It is their seasonally strongest period of the year and if the market moves up, goes sideways or has a mild correction, gold stocks generally outperform. They tend to underperform in severe corrections. Typically, the best strategy is to own gold stocks during their period of seasonal strength, but start to exit the position if the market starts to correct severely. HAC deployed this strategy in the summer of 2011, profiting from the gold stock trade and then selling out the positions in late August/beginning of September when investors were selling positions of all sorts in the severe market correction.

The gold stock sector, as represented by the GDX ETF is showing positive technical signs, as it has just broken through resistance. This has strengthened the case to enter the sector early, before the typical late July entry date.

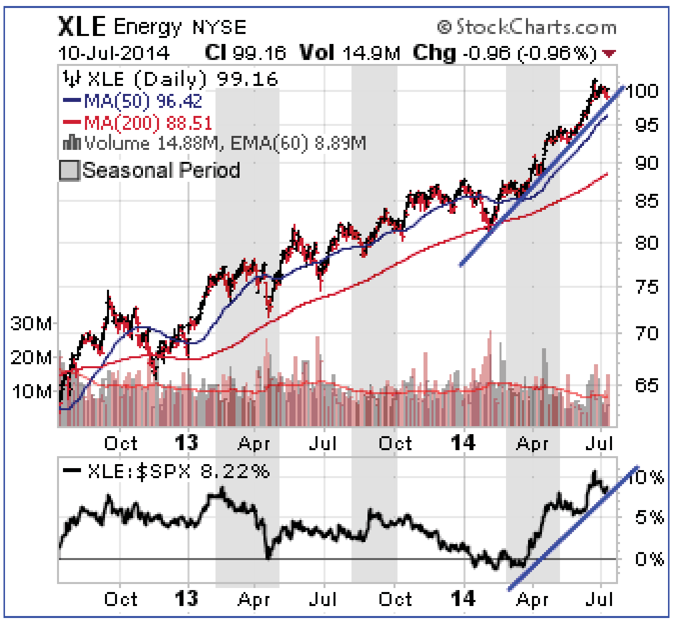
Biotech- Starting and Stopping, but so far okay

HAC has done well with the IBB trade, since June. The sector has been outperforming the broad market. On up days it is outperforming: on down days it is underperforming. IBB tried to climb back to its resistance level of the high set back in February, but has recently been struggling. It is possible that this sector might start to underperform the S&P 500 in its seasonal period. A less volatile option is for investors to move into the health care sector, particularly since the health care sector starts its seasonal period in mid-August.

Energy- Overbought, be patient with this sector

The seasonal period for the energy sector starts on July 27th. Given the recent rally in the sector, investors should be patient in looking for an entry point. The last seasonal period for this sector, February 25th to May 9th worked well. At the end of the seasonal period, the sector paused for a while and then resumed its upward trend because of geopolitical strife in the Middle East. It is difficult to predict geopolitical tensions and their effects on the market. Investors should not base their investment decisions solely based upon future geopolitical events. Currently, the sector is stretched and if geopolitical tensions were to abate, the sector could correct sharply. Investors, should wait at least until July 27th, the start of the seasonal period before taking a position. Investors should also remember that the upcoming seasonal trade for the energy sector is not nearly as strong as the winter seasonal trade and it is not a trade for which to sell the farm.

The uptrend for this sector is still intact, but the trend is being tested. If it were to break, then the sector could fall rather sharply.



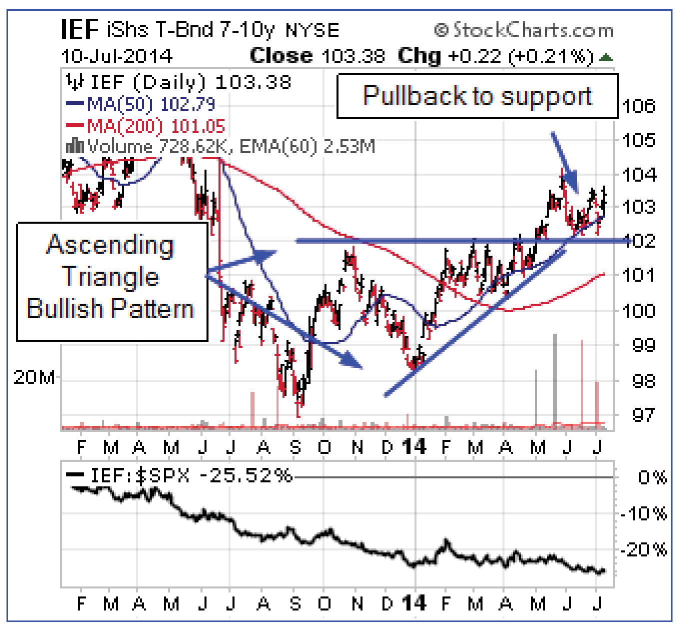
Health Care- Seasonal period starts next month

Over the last year the health care sector has been on an uptrend and outperforming the S&P 500. In the beginning of the year, the sector benefited from mergers and acquisitions rising rapidly, but the froth was quickly pulled back out of the sector, as it corrected back to its uptrend line.

This sector is currently setting up well for its seasonal period which starts on August 15th.

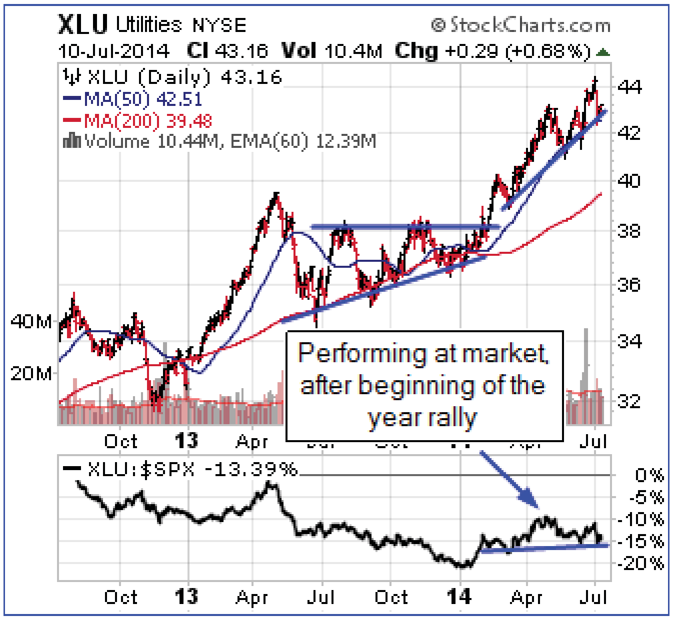
Government Bonds – Seasonal sweet spot ahead

Government Bonds started their seasonal run on cue this year at the beginning of May. Since that time the sector has oscillated up and down, but so far it has provided positive gains. The good news is that the sweet spot for the trade starts toward the end of July and lasts until October 3rd. The stock market tends to peak in mid-July and bonds start to rally approximately two weeks later. If the stock market peaks early, then investors should be looking to enter into a bond position earlier.



Utilities- Seasonal period starts soon

At the beginning of the year the utilities sector performed very well on an absolute basis and a relative basis compared to the S&P 500. Typically, utilities do not perform well at the beginning of the year. This was a positive sign for the sector as it showed that investors have a pent up interest. When a sector performs well at the beginning of the year, very often it is earmarked by investors as a sector of interest to perform well later in the year when the circumstances are right, or during its seasonal period. Recently, the utilities sector has been performing at market. Given the previous interest in the sector, look for investors to get back into the sector, particularly in its seasonal period from July 17th to October 3rd.



Consumer Staples- hanging in but underperforming

Although the consumer staples sector has been producing a positive return, it has been underperforming the S&P 500. If the market starts to correct, it is reasonable for investors to expect that the sector would start to outperform the S&P 500. The real sweet spot for the consumer staples trade starts on September 24th. Although it is a core position in the summer months, do not expect great things from this sector until early autumn.

Fertilizer Sector

The fertilizer sector typically performs well from late June into the beginning of the New Year. This year the price of grain has been getting crushed (pun intended), as displayed by the JJG ETF below. There is a strong correlation between grain prices and fertilizer prices. So far this summer the downward price of grains has hurt the fertilizer stocks.

PotashCorp

PotashCorp has been trading in an upwards range, but has just broken down below this range. As we have just started the seasonally strong period for this stock, it is possible for PotashCorp to turn around quickly and start to perform well. On the other hand, the real sweet spot for the trade starts in September. At this point investors should wait to see PotashCorp start to show signs of strength before entering a position. A word of note: if the market corrects severely, then investors should expect PotashCorp to come under pressure and also perform poorly.

Agrium

Agrium has a similar seasonal period to PotashCorp. Recently, the stock has been underperforming and has broken through a support line. Investors should wait for Agrium to start to show signs of strength relative to the S&P 500 before stepping into the position.

Transportation – Short coming up

The transportation sector has been outperforming the S&P 500 for the last few months....setting up well for a pullback at the start of its seasonal period for a short sell which begins in August. More recently, the sector has started to show signs of deteriorating performance as it has started to perform at market. If the market starts to correct, this sector should be a good short in August.

Last Minute Thoughts

On Wednesday July 9th, it was interesting to see that when the Fed released their minutes from the last meeting stating that they are targeting October to end their quantitative easing program, the stock market responded positively. Last May, when the Fed introduced the concept of tapering, it "dropped" the stock and the bond markets significantly. With the tapering program well under way, everything seems to be fine... as long as the Fed does not mention raising rates. How times have changed: or, have they?

The markets have been rising as the tapering process has been taking place and investors are quite comfortable with the results. After all, if it has not affected the stock market in a negative manner, who can complain. So far the fear of tapering has had a negative impact, and not the tapering process. Everyone is expecting the tapering process to end with a whimper and not a bang.

Removing liquidity out of the system is going to have an impact, any way the spin masters wordsmith it. There is a danger that once the tapering process ends, investors will wake up and realize that the good times have finished. It will be like the Coyote chasing the Road Runner off the cliff, and as he hangs in the air, he quickly realizes the predicament that he is in, and falls to his death (once again). Likewise, investors may hang on to the good times and only realize their predicament once the tapering program stops.

Many investors will beg to differ with my viewpoint, saying that the real trouble will occur when the Fed starts to raise interest rates. I do not disagree that raising interest rates will be problematic, but the Fed not pumping money into the system will also be troublesome. It was only at the beginning of this year that the "Fragile Five" Emerging markets had a mini-crisis based upon their currencies losing value as an indirect result of the Fed tapering. In the end the results were not catastrophic for the world economy and we have moved on. Nevertheless, this was a warning sign and the next time that the results could be much worse.

There is no question that the Fed is trying to "jawbone" the process. In its July minutes, the Fed was emphasizing the strength of the economy to justify its continued tapering. No doubt they will do the same again as the tapering continues. Of course they always state a caveat, saying that they will adjust their plans as they see necessary based upon circumstances. This gives them more wiggle room and a greater opportunity to "jawbone" the markets for a muted response to their actions.

Contact: For further information send an email to brooke.thackray@alphamountain.com