Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

Published the 10th Calendar Day of Every Month

Volume 10, Number 06, June 2016 Written by Brooke Thackray

Market Update

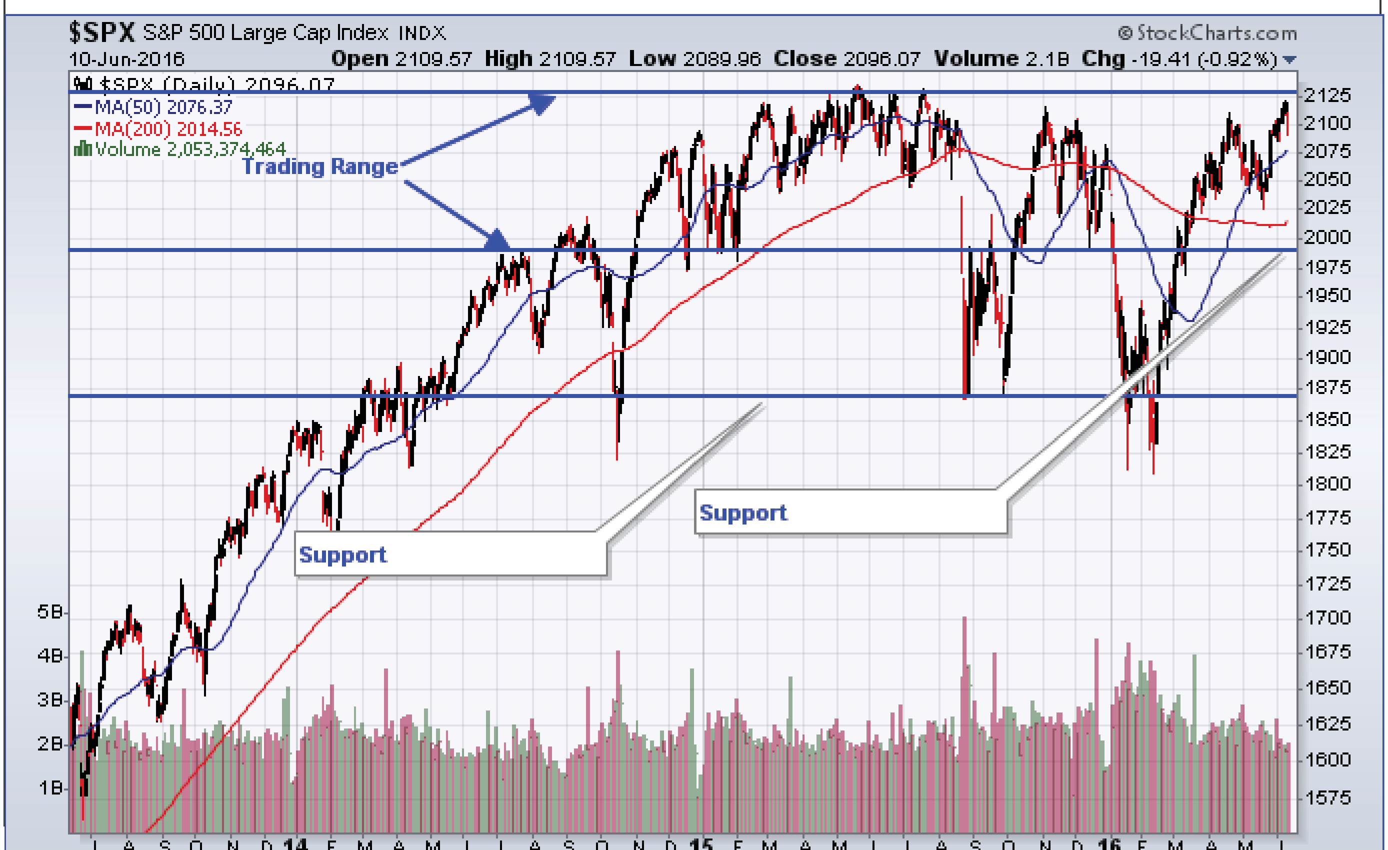
Bearish Billionaires

On June 9th, CNBC did a piece on the Bearish Billionaires (http://video.cnbc.com/gallery/?video=3000524560). In the past we have had the occasional billionaire investor making noises about an overvalued stock market: today there seems to be enough billionaires to have their own bear club. The CNBC video groups together George Soros, Carl Ichan, Sam Zell and Stan Druckenmiller into the Billionaire Bears club. The returning member to the club is George Soros who posited his position in the media this week. The most aggressive bear is Carl Ichan who originally released his bearish viewpoint on the market, via a video, on September 28th 2015. At this time the stock market was in a tailspin. The stock market has since recovered and is higher than when Ichan released his video. In April 2016, Ichan reaffirmed his bearish position by stating that his fund was 149% net short the stock market. Wow. There is no middle ground with this position. His large net short position is made up of a 164% long position with a 313% short position.

Over the last two months, I have stated my cautious views on the stock market in the context of it being overvalued

S&P 500 Technical Status

The S&P 500 is at 2100 again. Technically, the stock market is not broken. It is not possible to say that the price action of the S&P 500 is bearish when the stock market is so close to its all-time high. The problem is that waiting for a negative trend confirmation has a large opportunity cost and will not occur until the S&P 500 crosses below 1981. This is a substantial amount of ground to give up considering the closing low in February was not much lower. Given the weak fundamental backdrop, limited upside potential and the fact that the S&P 500 is currently in its unfavorable six month period, it makes sense from a seasonal period to adjust portfolios to become more conservative.



Horizons Seasonal Rotation ETF (HAC :TSX)
Portfolio Exposure as of **May 31st** 2016

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Bonds	
HBB	Horizons CDN Select Universe Bond ETF	10.8%
HFR	Horizons Active Floating Rate Bond ETF	10.6%
	Equities	
HXT	Horizons S&P/TSX 60™ Index ETF	33.5%
HSU	Horizons BetaPro S&P 500® Index Bull+ ETF	16.6%
	United States Dollar Exposed Assets	
	Equities	
XLP	Consumer Staples Select Sector SPDR Fund	10.2%
HXS	Horizons S&P 500® Index ETF	5.6%
	Currency	
DLR	Horizons US Dollar Currency ETF	11.0%
	US Dollar Forwards (June 2016) - Currency Hedge **	-0.9%
	Cash, Cash Equivalents, Margin & Other	2.5%
	Total (NAV $162,982,138)	100.0%

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

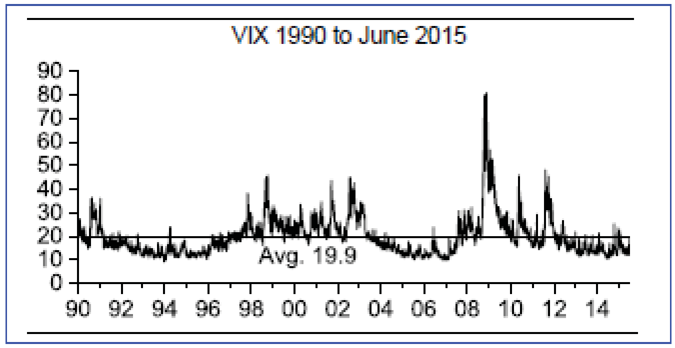
during the weak six month unfavorable period for stocks. On May 5th, the Globe and Mail released an article about HAC's dramatic move of almost exiting the stock market entirely. My general thesis has not changed. The stock market is overvalued and is susceptible to a correction.

I have great difficulty in seeing how the stock market can be propelled substantially higher than its all-time closing high of 2131 set in May 2015. The poor current economic conditions, weak corporate earnings and a highly valued market are not conducive to a strong rally, especially given that we are in the six month favorable period for the stock market (May 6th to October 27th). For more information on this position, please read the report that I published in April, titled, *Stock Markets are in for a Rough Summer*. The report is available at http://bit.ly/1oSL0En and on my website www.alphamountain.com.

Disclaimer: I am not part of the Billionaire Bears. I am neither a billionaire nor a bear. I am not a bear because I believe that positive trading opportunities exist, even in negative market conditions. I do believe that if a market correction were to occur, it is more likely to occur in the six month unfavorable period for stocks.

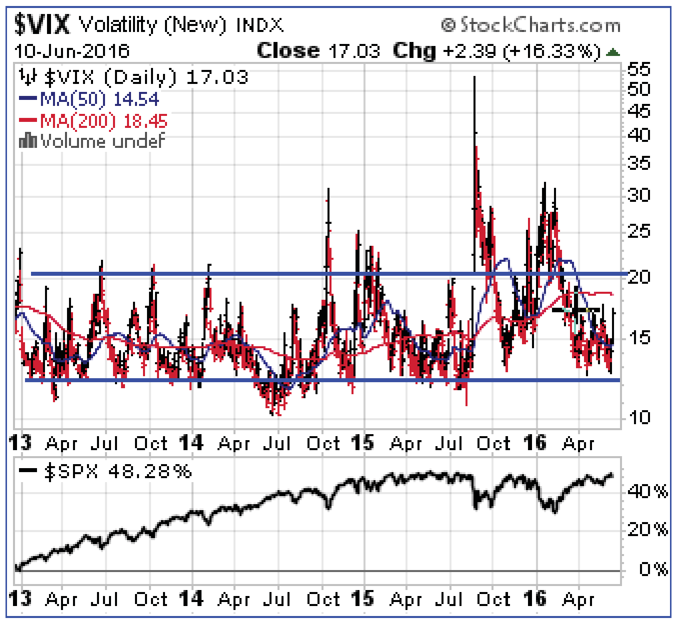
Investors have been seeing economic and corporate developments through rose colored glasses. Recent bad news has been interpreted as good news. The Non-Farm Payroll number released on June 3rd was a disaster, coming in at 38,000 jobs versus an expected 164,000. There is no way to sugar coat this number, even taking into account the impact of the Verizon employees being laid off in May. On the release of the Non-Farm Payroll report, the S&P 500 barely ticked down and the following week investors rationalized that the bad news was good news as the U.S. Federal Reserve would have to delay its "scheduled" interest rate increases. As a result, the S&P 500 resumed its ascent.

Investors have been fairly complacent and have not been expecting the stock market to suffer a large correction. The CBOE Volatility Index® (VIX®) which measures implied volatility has been low compared to historical standards. From 1990 to June 2015 the VIX has averaged 19.9.



The higher the number, the greater the level of investor fear, vice versa. Investors use different levels of volatility to determine if the investors are complacent or in a state of fear. Generally speaking, a VIX number above 20 signifies that investors have become "fearful" of market conditions. On the flip side, a VIX number below 13 signifies that investors have become complacent and do not expect volatile markets.

In early June, the VIX was registering a level of 13. Recently, the VIX has increased to 17, which is still below the "fearful" threshold of 20.



It seems that investors have been dismissing risk until the last possible moment. The situation could change fast with an increasing possibility that Britain may secede from the European Union and also an uncertain U.S. election later this year.

2100– Here we go again

How many times can the S&P 500 cross 2100? Actually, including its first cross on the upside on February 17th 2015, the S&P 500 has crossed 2100 forty-four times. The last cross, was to the downside on Friday June 10th.

The 2100 level has been a significant level of resistance and support over the last year and a half.

It is not that the S&P 500 cannot break free of the 2100 resistance level, for at some point in the future it will. The problem is that with such a strong resistance band (2100-2031), the S&P 500 is going to need a strong positive catalyst. At the current time there does not appear to be a strong enough catalyst to substantially advance the stock market above its previous all-time high.

What the HAC is Going On?

Despite HAC's recent flat performance, HAC has been active in the stock markets. At the end of June, HAC moved from a very conservative position in the stock market, to being substantially invested in equities over the month end and back to a very conservative position of having net "0" equities, with long investments in equities being paired with short sell positions. In addition, HAC has been invested in bond and currency positions. The diversification of the portfolio has led to a flat result for HAC, while the S&P 500® and the S&P/TSX 60™ Composite Index has been oscillating up and down.

HAC expects that it will continue to be conservative, but will possibly adjust its portfolio to increase equities for positive seasonal opportunities, even during the six month unfavorable period for the stock market. The next possible substantial increase in equities for a broad market seasonal opportunity occurs later this month. The stock market tends to perform well in the last few days of June and into July as a result of a positive seasonal tendencies around the end of the month, Independence Day and into earnings season.

In the six month unfavorable period for the stock market (May 6th to October 27th), the portfolio at the end of the month is not necessarily indicative of portfolio during the month. HAC will often adjust its holdings substantially for end of month exposure to the stock market. For those investors that are interested in following HAC's portfolio during the month, HAC writes a weekly commentary on the market and its positions. The report is typically published on Tuesdays and can be found at http://horizonsetfs.com/horizons/media/pdfs/Commentaries/HACUpdate.pdf.

Seasonal Opportunities

Biotech– This time it could be different

The biotech sector trade has been a very effective seasonal trade over time. From 1992 to 2014, during the period of June 23rd to September 13th, the biotech sector has produced an average gain of 12.6%, has been positive 87% of the time and has outperformed the S&P 500®, 87% of the time. For more information on the seasonal trade, see *Thackray's 2016 Investor's Guide*, page 69.

Although the biotech seasonal trade is still a viable trade this year, investors should use caution with this trade as the biotech sector has the potential to become a political football prior to the U.S. elections. U.S. drug prices are some of the most expensive in the world and there appears to be a systemic flaw that allows generic drugs to be jacked up in price by 5000% without merit and at will. These situations are political fodder and can have a negative impact on the biotech sector.

The biotech sector has been underperforming since last summer when Martin Shkreli of Turing Pharmaceuticals obnoxiously flaunted his ability to raise off patent drug prices at will. Presidential nominee, Hillary Clinton, quickly made this an election issue. Right now, Hillary Clinton is bogged down in defending her actions for previously using a personal server for all of her State Department email. You can bet that she will want to get off this topic and try and provide a forward focus on policy as we move close to the elections. Drug pricing is an easy target.

Investors should wait for an opportune time to enter the sector and use a tight stop loss. Currently, the biotech sector is not set up for entry. The sector has still not shown a breakout from its downtrend line on a relative basis compared to the S&P 500® and is showing negative momentum.

> *My Call: The biotech sector will start its seasonal period with strong performance (if Brexit votes remain). The sector will probably start its seasonal period a bit late and finish early. Investors should be looking to exit as early as late July or August*

Gold– Volatile and getting ready to shine

Gold performed spectacularly well at the beginning of the year. It has been trading off the decreased expectations of the U.S. Federal Reserve raising rates in the near future. Recently, gold received a large boost on weaker than expected Non-Farm Payrolls report. Gold has been benefitting from low interest rates and the large amount of international government bonds trading in negative territory.

Gold is currently at the lower edge of its resistance band from $1275 to $1300. The U.S. Federal Reserve's policy statement on June 15th will probably have a fairly large impact on the direction of gold.

Recently, the price of gold has been holding up even when the stock market has had negative moves. This trend has been supported by investors expecting the U.S. Federal Reserve to stand pat on interest rates and increasing odds of Brexit occurring on June 23rd.

Gold's strong seasonal period starts on July 12th. It is possible for gold to perform well before its seasonal period. Nevertheless, investors should use caution entering into the gold trade early, especially since gold can be very volatile in June.

> *My Call: Gold will probably pull back a bit before its seasonal period in July, and then rally into August. Investors should not necessarily expect huge returns as the U.S. has limited abilities for monetary stimulus other than delaying, once again, possible interest rate increases.*

Gold Miners– Outperforming gold since January

Buying gold miners is somewhat like buying leveraged gold, especially when the price of gold is close to the cost of production. When gold miners are outperforming gold bullion, it is often a sign that investors expect a rally in gold to continue. Gold miners tend to outperform gold when gold is increasing in environments of positive equity performance or mildly negative equity market conditions. The relationship breaks down in severe market corrections and gold miners can drop significantly. The gold miners sector is one of the main sectors of the stock market where investors speculate on margin and when the stock market unravels, gold miners unravel.

Gold miners start their seasonal period after gold bullion. It is a positive sign if gold miners are outperforming gold, when gold's seasonal period starts. The gold miners sector strong seasonal period starts on July 27th.

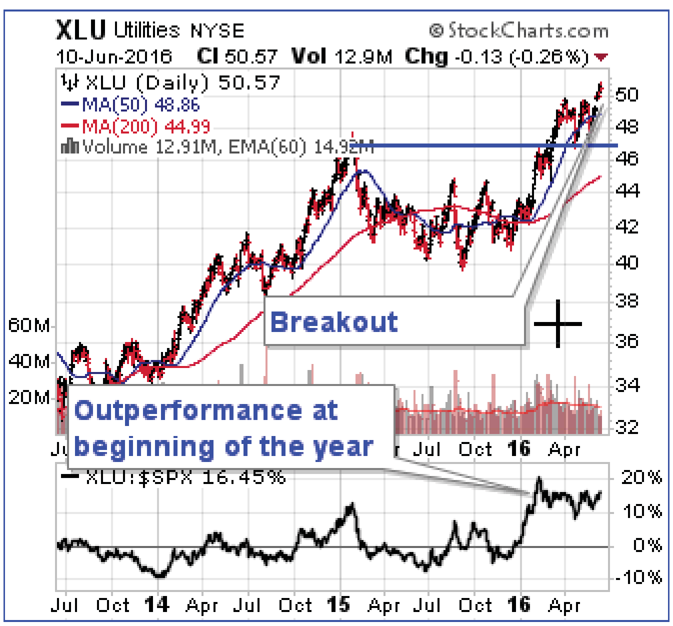
Typically, it is best to enter into a position in gold before entering gold miners.

Gold miners have been outperforming gold since the beginning of the year. The strong performance puts it back to 2014 relative levels over a three year time period. If gold were to correct, gold miners would perform worse than gold.

My Call: Gold miners should perform well in their seasonal period, but the seasonal run could be cut short if the stock market has a substantial correction.

Utilities– Signaling a defensive market

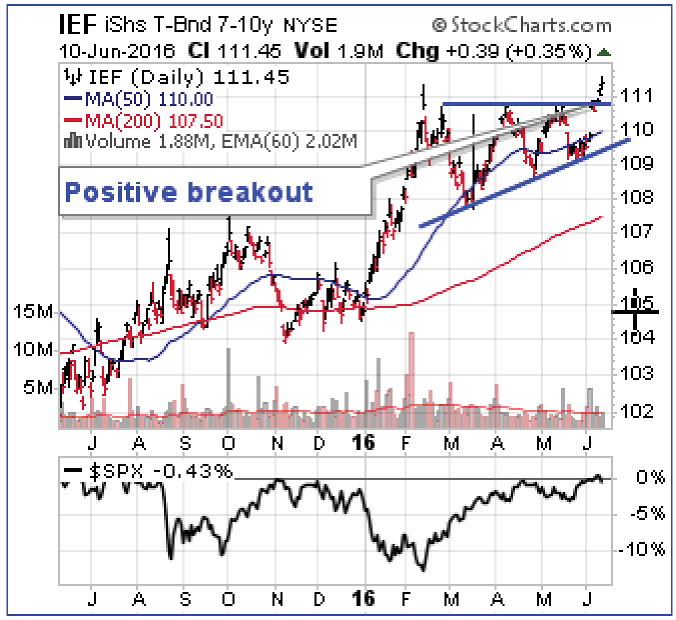
The utilities sector has its strong seasonal period from July 17th to October 3rd. This seasonal period overlaps with the sweet spot for the U.S. government bond sector that occurs from late July into October 3rd.



My Call: The utilities sector will probably perform well in its seasonal period, with the biggest uptick in performance in August and September.

U.S. Government Bonds

U.S. government bonds have a strong seasonal period from May until October 3rd, with the sweet spot of the trade starting in late July.



My Call: U.S. government bonds are expected to perform positively. The returns may not be large at this point given the recent strong performance in bonds, but the trade is still a good hedge to the market.

Summer Triumvirate– A positive seasonal time in the unfavorable period

End of Month Trade & Independence Day & Earnings Month Effects Convergence

Although the stock market is in its six month unfavorable period, there is one interim period where the stock market tends to perform well: the last few days in June, into mid-July. There are three seasonal influences that tend to have a positive impact on the stock market at this time. First, the End of the Month Effect helps to support the stock market with the tendency of positive performance in the last four days of the month and the first three days of the next month, performing significantly better over time compared with the rest of the month. Second, the days surrounding Independence Day on average have historically been positive as retail investors tend to push the stock market up as institutional investors head for the Hamptons. Third, investor optimism in earnings months tends to push up the stock markets, as they seek to be in the stock market to benefit from positive earnings surprises (see *Thackray's 2016 Investor's Guide*, page 43).

In the past, HAC has taken advantage of interim positive period from the last few days in June into mid-July, but has exited the trade early. If the stock market corrects into the end of June, this could present a short-term investment opportunity.

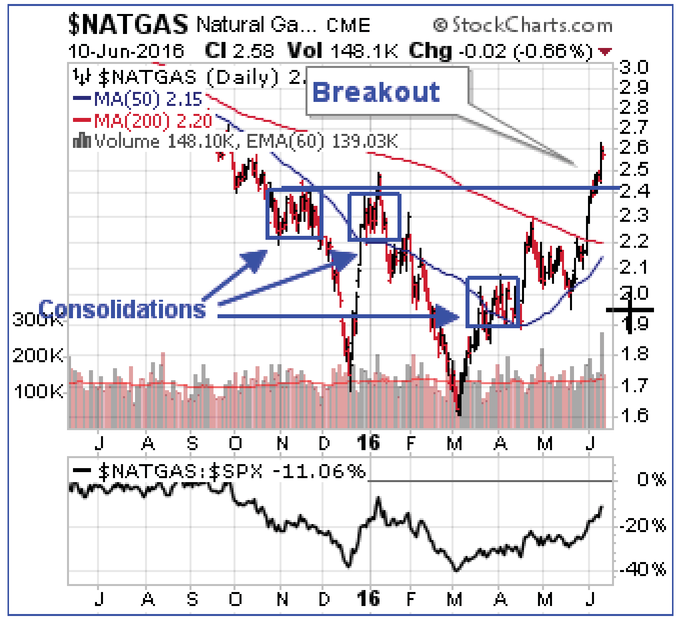
Oil (West Texas)– Hard to break $50 in short-term

HAC sold its energy sector positions in late April as the sector started to show weakness at the time. The sector has received a second wind and has since climbed a bit higher, crossing the $50/bbl. threshold. The problem is that the rig count in the U.S. has started to increase.... barely, but it is increasing. If U.S. energy companies are using $50 oil as a trigger to produce more oil to cover their cash flows, it is going to be hard for oil to move substantially higher. A positive economic back drop would help, but so far that is not in the cards.

> *My Call: Oil will start to struggle at this point and will be susceptible to a downside correction on any "bad" news.*

Natural Gas– Strong rally, but is it almost over?

The seasonal period for natural gas lasts from March until mid-June. HAC was unfortunately stopped out of its position in mid-May. Natural gas has since climbed in price. It is always easy to look back and wish that the position was not stopped out, but stops are in place for a reason.



> *My Call: The price of natural gas has performed positively in its seasonal period. Part of the move has been the result of the echo effect of oil rising in price. Momentum is still positive, but investors should be looking to exit on weakness.*

Canadian bonds– Bounding higher

As the Canadian economy has sputtered, Canadian bonds have increased in price. Positive bond performance in the U.S. has also had a knock-on effect, helping to push up Canadian bonds.

Canadian bonds are not as exposed to central bank statements as the U.S. As a result, the performance should be less volatile.

> *My Call: Canadian bonds should continue to perform well over the next few months.*

Short Sells (for pair trades)

U.S. Materials– Seasonally underperform into October.

Note: The U.S. materials sector (mostly chemical companies) is substantially different than the Canadian materials sector (mostly gold miners).

Chemical companies have a seasonal tendency to perform poorly in the summer months. On the stock side, one of my favorite trades is long Eastman Chemical from January 28th to May 5th and then short sell the stock from May 30th to October 27th. The seasonal trade has a remarkable track record and once again is working very well this year. For more information on the trade, see *Thackray's 2016 Investor's Guide*, page 21).

The U.S. materials sector is substantially made up of chemical companies and tends to underpeform the S&P 500 in the summer months.

Note: The U.S. materials sector has approximately 7% gold miners. If the gold miners sector were to perform well, this would have a positive impact on the U.S. materials sector. Given that the gold miners seasonal period is approaching, caution should be used.

The risk of holding gold miners in the materials sector can be more than offset by holding a long position in the gold miners sector directly.

> *My Call: The U.S. materials sector will underperform the S&P 500 in the upcoming months as concerns of a slowing U.S. economy grow.*

U.S. Banks– Don't bank on them in the summer months

The U.S. bank sector has performed well off the bottom of the stock market in February, but has started to show some weakness. The sector has turned back down from its resistance level. The sector has yet to break its upward trend line, but given that June tends to be a weak month for the sector, taking an early short sell position makes sense.

> *My Call: U.S. banks will underperform over the next few months. They may get a boost from hawkish talk from the U.S. Federal Reserve, but a slowing economy will have a greater counter balance negative impact.*

Nikkei Trending down, but not ripe for picking

The Nikkei tends to underperform from May 6th to November 13th, but the real sweet spot to the short sell seasonal trade starts in mid to late July. Currently, the Nikkei is consolidating within its down trend. Investor's should wait for more negative confirmation before entering the trade. In addition, foreign exchange considerations should be taken into account. This trade will be discussed further in the next newsletters.

My Call: The Nikkei will start its underperformance in July after the U.S. earnings season gets under way.

My Call: U.S. small caps will start to underperform the S&P 500 shortly, before the end of June. Without a rescue package from the U.S. Federal Reserve, the sector is expected to continue to underperform into October.

Small Cap Sector - Wait for the short sell trade

The small cap sector has been outperforming since the bottom of the stock market in February. Its outperformance reflects a risk appetite for investors. The problem is that the sector tends to perform poorly in July. Investors prefer to "play" the earnings season effect with large caps. As a result, July has historically been the worst month of the year for the small cap sector. The sector is overbought and at resistance. The price momentum of small caps is also starting to turn down, indicating a possible start to underperformance.

Brooke's Rant

Can anyone say snowball

A snowball starts with a small amount of snow formed into a ball and when it is rolled over other snow it accumulates into a larger ball.

Brexit could be the initial ball of snow that starts the snowball. If Britain does leave the EU, watch for citizens of other European countries demand their own "leave" referendums. The EU is a large bureaucracy that seems to fail in representing its constituent's interests. A lot of Europeans believe that the Brussels bureaucrats have their own political agenda that does not reflect the interests of their own individual countries.

The EU seemed to work satisfactorily in the positive growth economy of the 1990's and 2000's. In recent years the overspending by governments in a slow growth environment has caused the systemic problems of the union to surface. When times are good, a lot of bad is swept under the carpet. When times are bad, the carpet is lifted and questions are asked. Citizens are now asking questions.

In Britain, the airwaves are dominated by economists forecasting the position that Britain will suffer irreparable damage if it leaves the EU. On the whole, it seems that

British citizens have tuned them out. They either don't believe them, or they don't care.

This phenomenon is symptomatic of populations growing weary of the establishment and are looking for solutions that are different. They do not believe that established politicians will provide anything other than status quo.

What is interesting is the sudden increase in British voters moving to the "leave" side. This is non-congruous to what took place when the Scottish were recently voting on whether or not to secede from Britain. At the very end of the campaign, before the vote, a lot of undecided voters seemed to take the position that it is better to dance with the devil that you know than the one that you don't. As a result, the Scottish "remain" side increased into voting day. Although this is still possible in the British vote, the recent swing to the leave side diminishes the chances of this occurring.

I am not sure how the Brexit vote will play out. If the vote is to leave, the stock market will probably have a large setback based upon the expected uncertainty on how the unravelling of Britain's linkage with the EU will occur. In the end, the stock market will be able to adjust to Britain's decision. Britain is in a fortunate position of using its own currency, which will make the divorce proceedings with the EU a lot easier compared with the scenario if Britain was using the euro as its currency. The concept of the European Union will be severely challenged if a country such as France or Italy decides to leave.

If on June 23rd, Britain votes to leave the EU, watch for other EU member countries to lash out and try to punish them for their decision. Not that the countries have anything against Britain, but they will want to send their own citizens and other EU member countries a strong message that they should not dare consider leaving.