Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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Market Update

"Sell Everything" ….Jeff Gundlach of DoubleLine Investments

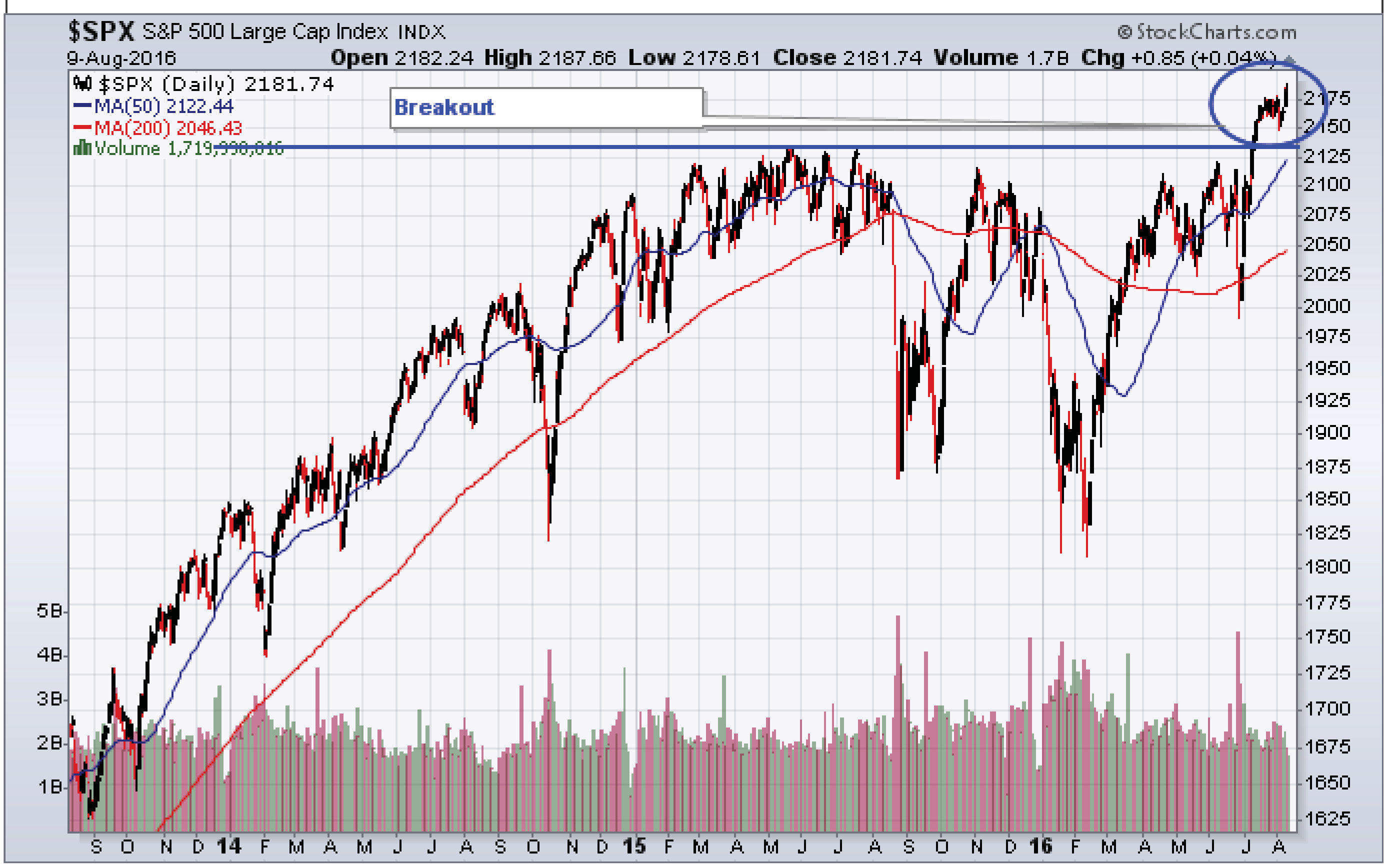
Jeff Gundlach recently joined the Billionaire's Bear's Club when he made a statement to the media, "sell everything"…and then went on to state his feelings by drawing an allusion to the movie Apocalypse Now by quoting the lines "sell the house, sell the car, sell the kids."

Another billionaire bear was also recently added to the club when Bill Gross of Janus funds said that he doesn't like stocks and doesn't like bonds (Bill Gross is a bond manager). Despite the increasing size of the Billionaire Bears Club, the stock market keeps going up.

To set the record straight, I am neither a billionaire nor a bear. Nevertheless, I do believe that the stock market is susceptible to a correction. Given weak economic growth, poor company earnings, high stock market valuations…..and most importantly, that we are in the six month unfavorable period for stocks, there is an increased probability of a market correction. It is all about seasonal probabilities. Given historical tendencies, corrections are more likely to happen in the six month unfavorable period for stocks (May 6th to October 27th) and hence, it makes sense to be more conservative in the markets at this time.

S&P 500 Technical Status

The S&P 500 has recently had a bullish breakout. The stock market keeps moving higher, although recently on low volume. August and September are typically the weaker months of the year, so it is still a time to be conservative. Look for the S&P 500 to test its support level of 2132 over the next two months.



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

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Bonds	
	Bonds	
HBB	Horizons CDN Select Universe Bond ETF	14.0%
HFR	Horizons Active Floating Rate Bond ETF	10.3%
	United States Dollar Exposed Assets	
	Bonds	
HTB	Horizons US 7-10 Year Treasury Bond ETF	9.4%
	Equities	
IBB	iShares Nasdaq Biotechnology ETF	11.0%
XLP	Consumer Staples Select Sector SPDR Fund	9.7%
	US Dollar Forwards (August 2016) - Currency Hedge **	-0.5%
	Cash, Cash Equivalents, Margin & Other	46.1%
	Total (NAV $177,411,341)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 0.0% 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.

Absolutely the stock market can continue to move up from here, but there is a seasonal risk in taking an aggressive position in the stock market in August and September. These two months have historically been the worst two contiguous months of the year. From 1950 to 2015, the S&P 500® has produced average losses in August and September of 0.1% and 0.5% respectively. In the same period, August has been positive 55% of the time and September 44% of the time.

At first blush, the numbers do not seem too bad: small average losses and gains occurring about half of the time. The problem is that from a seasonal perspective, investors are exposing themselves to excessive risk. Compared to the other months of the year, August and September have on average had fewer large rallies and more large corrections. It is not to say that in any one year, a large rally could not occur in August and September, but the long-term tendencies do not support such an outcome. If an investor had to refrain from being invested in the stock market for two months of the year, the choice would be easy: August and September.

Strong absolute performance in the unfavorable six month period for stocks (May 6th to October 27th), is rare and when it does occur, there has been a strong exogenous factor causing the anomaly. Using the threshold of a return of greater than 10%, the S&P 500® has only exceeded this level eight times in the unfavorable six month period for stocks since 1950. Five occurrences were the result of the economy growing strongly after a recession, two occurences were the result of economy moving from anemic growth to extremely strong growth i.e., the rally in the summer of 2002 was concurrent with the GDP moving from a growth rate of 0.3% in 2002 Q4 to 6.9% in 2003 Q3. The last occurrence of strong S&P 500 performance in summer months was the result of the introduction of QE in 2009. Currently the stock market may be rallying, but a super strong rally this summer does not fit the profile of past summer strong rallies.

Deja vu … but the flip side

In January, investors questioned HAC's strategy of staying in the stock market when it was crashing. Investors asked why HAC was not moving to cash. My answer was that it was too risky. Yes, too risky. The risk was that the stock market could bounce and HAC could get caught holding cash at a time when it should be invested. Shortly afterwards, the stock market rallied and HAC was well positioned in the market.

Today, the flip side is occurring, some investors are wondering why we are not 100% invested in equities. As a side note, HAC is currently invested in different sectors of the stock market that tend to perform well at this time of the year, but we are not fully invested. It is too risky for HAC to be fully invested in the stock market. The seasonal risk-reward profile for this time of the year does not support a 100% equity position. If HAC was 100% invested in the stock market at this time and it corrected, HAC would be caught being fully invested at a time when there was not a seasonal justification.

Deja vu …. Last summer

Last summer, the stock market peaked in May, and continued to hold up into August. At the time, investors were wondering why HAC was not fully invested as the stock market was not correcting. Later, towards the end of August, the stock market dropped sharply as investors became concerned over global growth, particularly the Chinese economy. The point is that at the beginning of August, everything seemed fine, but a crisis came "out of the blue" dropping the stock market. Yes, this particular crisis could have occurred at any time, causing a disruption to the stock market, but reactions to negative events tend to cause a greater downdraft in the stock market during the six month unfavorable period.

At the current time, investors are in euphoric mood and see good times ahead….just like last summer. I cannot tell you if another event is going to drop the stock market once again this summer. It is not possible to forecast. Nevertheless, the stock market is currently over-valued and very susceptible to a correction. Given that we are in the weaker six month period for stocks, it is prudent to position an investment portfolio conservatively. This is not the time to be making big bets on the stock market.

What the HAC is going on?

HAC has been moving up in the unfavorable six month period for stocks. Why? Investors have been asking, why is HAC increasing in the middle of the six month period for stocks (May 6th to October 28th)? In the unfavorable season, HAC does not just go to cash for six months, it remains active, but generally more conservative than the stock market. HAC remains vigilant in taking advantage of seasonal opportunities during the summer months.

At the end of June, HAC benefited substantially by increasing its equity position in the stock market to take advantage of the seasonal positive trend at the time. The Brexit bounce helped.

HAC has also held a position in the biotech sector since June and has benefitted as the sector has strongly outperformed the S&P 5000.

HAC is currently benefitting from its recent investment in the gold bullion sector.

HAC continues to be active and invest in opportunistic seasonal trends.

Seasonal Opportunities

Biotech - Stellar performance...but might not last long

The biotech sector has so far put in a stellar performance in its seasonal period. After underperforming the S&P 500 since last summer, the sector has been showing signs of strength in recent months. Not only is the biotech sector perceived to be good value, but it has also been helped by rumors of possible mergers and acquisitions.

July is typically the best month for the biotech sector, with an average gain of 6.8% since 1992. This year the sector exceeded its average gain in July. Despite August still being in the seasonal strong period for the biotech sector, the performance of the sector is not nearly as strong. Since 1992 the biotech sector has produced an average gain of 0.7% and has only been positive 49% of the time.

Recently, the sector has been showing signs of growing tired. It has just entered back into its trading range, the full stochastic oscillator is overbought and is turning down and the MACD is turning down.

> *My Call: The biotech sector has benefitted from the risk-on market. The sector will probably underperform once the investment climate switches to risk-off. Investors should consider exiting the position on weakness.*

U.S. Government Bonds - Still okay for now

Initially, U.S. government bonds formed a bullish ascending triangle at the beginning of their seasonal period in May. As the stock market rallied in July, U.S. government bonds pulled back. The sector is still in good shape with the sweet spot of the seasonal trade occurring in August and September.

> *My Call: U.S. government bonds will continue with its positive performance, but the gains will not be substantial.*

Canadian Bonds - Still okay for now

As the Canadian economy struggles, Canadian bonds will continue to perform well.

My Call: Canadian bonds will probably continue to perform well for the next two months.

Utilities - The lights are still on

The utilities sector has performed well since the beginning of the year. The sector strongly benefits from low interest rates. Although it has a strong seasonal period at this time, investors need to determine the proper combination of interest sensitive holdings in their portfolio.

Given the HAC already has exposure to bonds in the U.S. and Canada, HAC has decided to forego exposure to the utilities sector at this time.

My Call: The utilities sector will continue to perform well for August and September. Investors should be looking for this sector to correct in October, particularly if there are increasing calls for the U.S. Federal Reserve to hike rates.

Consumer Staples - Performance fading

Since the rally in July, the consumer staples sector has been underperforming the S&P 500. The performance of the consumer staples sector tends to suffer in risk-on environments.

Investors are attracted to the consumer staples sector when they are concerned about stock market valuations, but are still mildly bullish.

Given that the stock market has been rallying strongly in the six month unfavorable period for stocks, it is likely that if it corrects it will probably be a broad based correction also including the consumer staples sector.

My Call: At some point in August and September the consumer staples sector will pull back with the S&P 500 and investors should be prepared to exit the sector on weakness.

Agriculture -Poised, but might want to wait

Overall, the agriculture sector has been performing at market since the beginning of the year. Recently, it has been showing signs of strength. Nevertheless, investors should be cautious with this sector at this time. If the stock market were to have a substantial correction, this sector could be hit particularly hard. At this point, it might be better to wait for the seasonal sweet spot of the trade in October before taking on a position.

> *My Call: The agriculture sector will probably perform at market until October, and then start to outperform in its seasonal sweet spot.*

Gold - Shining but performing at market

There is no doubt that gold bullion has been performing well since the beginning of the year, particularly in January and February. But over the last few months, with all of its ups and downs, it has been performing at market.

After a rapid increase at the beginning of the year, gold bullion consolidated for the next few months, ratcheted higher and is now consolidating once again.

We are in the seasonal period for gold bullion and it will probably continue to perform well unless there is a large shift by investors expecting the U.S. Federal Reserve to become more aggressive in raising interest rates.

> *My Call: Gold bullion will provide positive performance up until the beginning of October. The sweet spot for gold's seasonal period is September.*

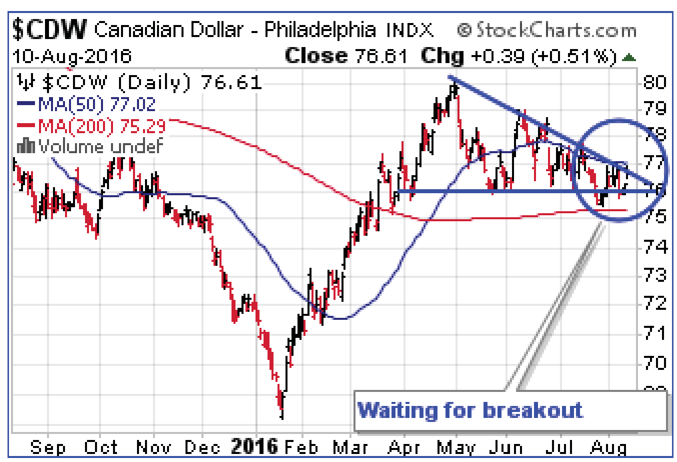
Gold Miners - Rocketing upwards

Gold miners have been solidly outperforming the stock market since the beginning of the year. The big question is how much longer can it go on? Technically, the sector is positive as it is still in an uptrend. The problem with the sector is that it has attracted a lot of speculative investors riding the momentum trade. The risk lies in the stock market performance. If the stock market has a correction, this sector will sell off sharply. Typically, when this sector heats up, a lot of leveraged money goes into the sector and on a major correction, margin calls tend to hit the sector hard.

> *My Call: Gold miners will perform positively, but will get correct sharply if the stock market corrects. Investors need to be prepared to sell this sector if its upwards trend is broken.*

CAD/USD - Waiting for breakout...up or down?

The U.S. dollar typically outperforms the Canadian dollar in the summer months until late August. Currently, CAD/USD has been forming a bearish descending triangle. CAD/USD is going to breakout one way or another. Once the breakout occurs, a better sense of direction should be able to be determined.



> *My Call: The U.S. dollar will probably have mild outperformance over the next few months.*

Energy - Minor seasonal trade

The energy sector has a minor seasonal trade starting in late July that runs until early October. From a seasonal perspective, it is not nearly as strong as the main energy trade from late February to early May.

In most years, HAC has foregone the minor energy seasonal trade.

At this time, the trade is not technically setup for entry.

> *My Call: The energy sector will probably underperform over the next few months.*

How long will the S&P 500 rally last....watch the small cap sector for indications that the rally is coming to an end

The small cap sector has been outperforming the S&P 500 since early in the year. Typically, it underperforms the S&P 500 during the unfavorable six month period for stocks. When it outperforms at this time, it often indicates that the stock market is in a risk-on mode and has momentum to carry higher. Currently, the sector is still outperforming the S&P 500. If and when the sector breaks its upward trend line relative to the S&P 500, it is an indication that the S&P 500 is likely to correct.

> *My Call: At some point over the next two months, the small cap sector will probably start to underperform the S&P 500 and the broad stock market will suffer a correction.*

Brooke's Rant

Side Note:

Last month I got taken to task by a subscriber whom basically said that I had overstepped by bounds on my Brexit comments stating the position that Britain's vote could be serendipitous if the EU were to disintegrate in the upcoming years. It is possible, like most people, the reader had a desire to for Britain to remain part of the EU. Fair enough.

My comments, or rants, at the end of my newsletters try to provide a different perspective on current topics, typically on economic policies. Why economic policies, beside the fact that they are easy to criticize? There is a loose relationship between economic policies and the stock market. The current rally in the stock market, starting in 2009 has been mainly the result of financial engineering by the central banks. It is highly doubtful that the current bull market would have lasted as long as it has without the stimulus from central bank quantitative easing programs. Central bank policies will continue to drive the stock market in the foreseeable future.

Back to the rant….everyone spend more money

The next answer to our problems is to spend more money. Now that central banks are starting to get close to the end of the end of their monetary tool arsenal and the effectiveness of the tools such as quantitative easing is being called into question. New ways of stimulating the economy are being examined. It seems that most governments at all levels are purporting the solution of spending more money to stimulate the economy. Japan and the EU are floating the possibility of increased government spending. Canada is planning on racking up an ever increasing debt. Regardless of which presidential candidate wins in the U.S. election, watch for huge infrastructure projects to be announced. It is not just federal governments that are planning on ratcheting up the spending, state and provincial governments are following suit. The province of Ontario, in Canada, now has a debt of over $300 billion and plans to continue its largesse.

There is a time and place for everything. Keynesian economics is based on the premise that governments increase their spending during economic slowdowns and decrease it during periods of expansion. In other words, the governments should act as a buffer, helping to mitigate economic cycles. Governments used to follow this protocol. Today, governments get into power and increase spending regardless of the economic situation. It is as if they reason that cutting spending will not provide any political capital, so why take action. The last of the fiscally responsible leaders, an anomaly in our time, Stephen Harper, the previous Prime Minister of Canada was tossed from his position last year. One of his main achievements was running a balanced budget at the end of his term. The electorate did not really care, and elected a new prime minister who promised to rack up an additional 120 billion dollars in federal debt over five years. We are in a new era…spend now and let our grandchildren pay later.

In so many countries, it seems that the electorate and investors have become addicted to low interest rates. Average people have created a culture of not caring about being able to afford a house or a car, but rather financing it on a monthly basis. There are too many stories of couples making moderate incomes and buying a house for $900k. Low interest rates have been around for quite some time and it seems that people are acting like they will be here forever. You don’t have to be a mathematical genius to understand the risk of rising rates starting at a low interest rate. If you have a mortgage of 2% and it increases to 3%, your monthly payments will increase approximately by approximately 50% (depending on amorization schedules etc). If you were already house poor, you will be in trouble if interest rates increase by 50%.

Governments are no different, they have basically been living on free money. The size of government debts is generally large, but with so little cost to carry the debt, government’s don’t really care. Why should they be seen as the “meanie” that cut of spending. What difference does extra debt make when money is so cheap? In the short-term, with low interest rates, it probably does not matter much. In the long-term, the consequences could be dire. Eventually, we will find out.

Investors should prepare for the next version of kicking the can down the road....increased government spending. It is possible that this already extended bull market will become extended once again as goverments announce new fiscal “investments.” One of the many problems with government spending is that it is slow to work, so even if governments announce all sorts of spending programs, the stock market could still suffer. Nevertheless, it does not mean that governments will not try to solve their problems by spending more. Let’s hope that they do not stub their toe as they try to “kick the can down the road once again.”

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