Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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Market Update

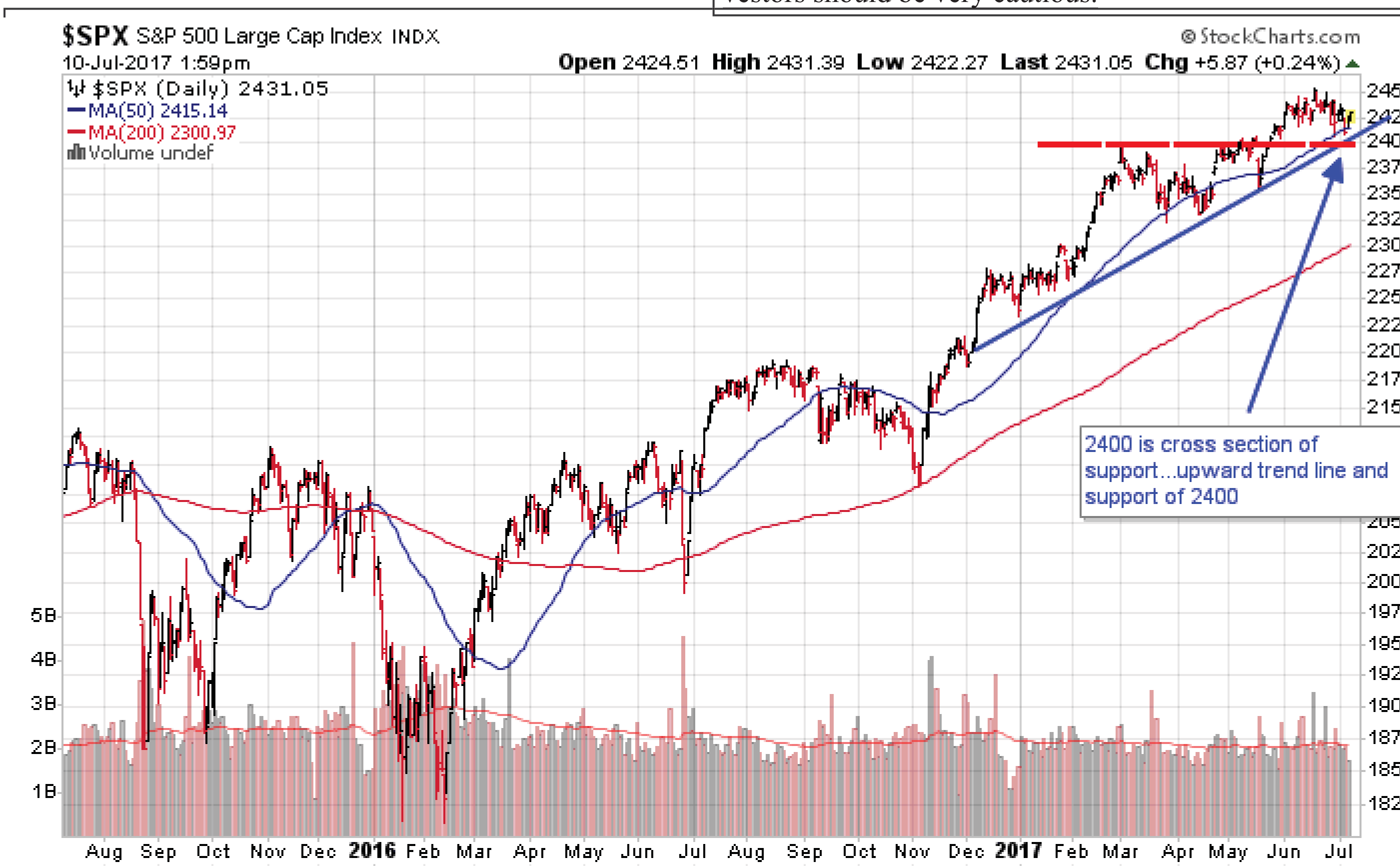
I tweeted the meme on the left “NOT YOUR FRIEND” on July 6th @BrookeThackray.

Maybe the tweet should have said....NOT YOUR BFF!

For those of you without small children, BFF is an acronym for “Best Friends Forever.” This term did not exist before the prevalence of the internet, but with keyboards in young children’s lives it is easy to see

S&P 500 Technical Status

The S&P 500 produced a nominal gain in June and has recently started to show signs of losing momentum. The key level to watch is 2400. It is the next level of support and it is also where the upwards trend line could intersect the S&P 500. If the S&P 500 breaks 2400, the media will really start to chime in and the narrative in the stock market could become negative .... fast. Historically, the stock market has performed well at this time up until mid-July, as earnings season gets underway. After this time....investors should be very cautious.



Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **June 30th,** 2017

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXE	Horizons S&P/TSX Capped Energy Index ETF	5.0%
	Fixed Income	
HBB	Horizons CDN Select Universe Bond ETF	10.2%
HFR	Horizons Active Floating Rate Bond ETF	9.8%
	Commodities	
HUG	Horizons Gold ETF	5.0%
	United States Dollar Exposed Assets	
	Fixed Income	
HTB	Horizons US 7-10 Year Treasury Bond ETF	14.9%
HUF.U	Horizons Active US Floating Rate Bond (USD) ETF	9.3%
	Equities	
HXS	Horizons S&P® 500 Index ETF	39.6%
IBB	iShares Nasdaq Biotechnology ETF	2.9%
	US Dollar Forwards (July 2017) - Currency Hedge **	1.3%
	Cash, Cash Equivalents, Margin & Other	2.2%
	Total (NAV $226,569,708)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 68.4% 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.

how the term has spawned.

For the last eight years, investors have been partying with the U.S. Federal Reserve (and other central banks) providing the punch bowl to keep it going. The U.S. Federal Reserve has expanded its balance sheet to the tune of $4 trillion through its quantitative easing program. Major central banks now have a total of $13 trillion on their balance sheets. Initially the Fed launched its QE programs to provide liquidity to stave off a financial crisis. After a financial crisis was averted, the Fed, like other central banks, has used quantitative easing to try and stimulate the economy back to, or close to full employment. When this target was reached for the Fed, then continued to increase liquidity into the system in order to stimulate the economy up to a 2% target inflation rate. Initially, the rationale for such action was that the economy could slip into an unwanted deflationary mode. More recently, the rationale…well…has changed to helping the economy grow. The problem is that there is a growing consensus that the lion's share of the benefits from increased liquidity has helped "Wall Street" and not "Main Street."

Up until recently, the Fed has been a friend of investors, pumping money into the system which has helped bond prices and stock prices. Investor's thought that Yellen was their BFF. Yellen is not a BFF, she is a fair-weather friend. Investors somehow believe that the Fed can manage the economy into perpetuity without it ever going into a recession. Nobody wants a recession, but they are inevitable.

The longer the economy is engineered so that it does not enter into a recession, the damage from a recession when it does occur, will probably be more destructive. Low interest rates have encouraged large amounts of personal and corporate debt. Consumers have treated debt as free money with very little expectation that it will have to be repaid in the future. Governments have acted similarly.

If interest rates were high and consumers had large amounts of debt and the economy started to stumble, the solution is fairly straight forward….and the Fed would cut interest rates. When interest rates are next to zero, this option is off the table. There are other creative ways to keep pumping liquidity into the system. Japan has been a "hothouse" of experimentation with some of these methods, with limited success. It is running out of options to keep stimulating the economy with huge government debt and low interest rates.

The Fed is trapped. It wants to keep the party going, but it realizes that its actions are creating a misallocation of resources in society and its actions are possibly pushing up the stock market to high levels. It knows that it needs ammunition for the future; it needs to be able to stimulate the economy when it really needs it in order to avoid a recession or make it less severe. On the other hand, it doesn't want to cause a recession.

Many investors were upset with the Fed because they felt that the inflation numbers did not justify a rate increase on June 15th. The Fed basically said that it was looking at a general trend of expansion and was justified in their actions.

The rate increase was a big deal because it showed that the Fed is less data dependent than most investors expected. It raised rates on the faith that the expansion will continue, rather than the data. Investors and the Fed are no longer BFF's. It is not personal. The Fed is trying to sneak in a rate increases when possible to reach a more normalized level.

Another Theory-

I have not read this anywhere else...but I believe that Yellen's career risk is playing a part in the decision making....not that she would ever admit it.

There is a significant chance that Trump may replace Yellen next year when her term expires. If this is the case, she will not want to go out like Alan Greenspan. While Greenspan was the chairperson of the Federal Reserve, he was cheered like a rock star for stimulating the economy with low interest rates. When the stock markets collapsed he was vilified for not implementing a tight monetary policy much sooner.

Yellen could suffer the same fate as Greenspan if she hangs on too long with low rates. It is better to start the process and at least get the ball rolling with higher rates. At least she will not be ostracized for letting the party go on too long.

Another Theory-

Given that governors need to be instated next year, to the Fed, Trump is going to help determine the future direction of the Fed. Given that Trump has shown a liking for debt, there is a good probability that he would push forward governors that would support such policies, which could mean lower interest rates. Yellen may be trying to get ahead of such action by raising rates now.

Eye of the Storm-

It seems that every investor is familiar with the saying "Sell in May," which applies to the six-month period from May to October where the stock market tends not perform as well as the other six months of the year. What is less well known is that the stock market tends to perform well in the last few days of June, into mid-July. I have written about this phenomenon previously and I included it in my latest book ("*Thackray's 2017 Investor's Guide*," *page 80*).

Despite the stock market being at high valuation levels, the stock market can still perform well in the *Eye of the Storm*. Investors should take note that a rally in this period does not necessarily lead to a sustained rally in August and September, which have been the two worst contiguous months of the year. Investors beware.

What the HAC is going on?

HAC started June in a conservative position as the six-month unfavorable period for stocks was unfolding. HAC held a large position in cash and bonds. Towards the end of the month, HAC increased its equity holdings to take advantage of the stock market's seasonal tendency to perform well in the last few days of June, into mid-July.

Seasonal Opportunities

Biotech– jump out of the gate

On Monday June 19th, I distributed a video on the seasonal trend for the biotech sector which typically performs well from June 23rd to September 13th. I outlined the trade using the biotech sector ETF (IBB), illustrating that the technical setup for the trade was positive with resistance just overhead at $300 (see video here).

It looks like a lot of investors watched the video, or they were watching the same $300 level of resistance. Once IBB passed $300, it shot up like a rocket to over $320. From a fundamental point of view, the sector also benefitted from rumors that the Republicans were set to pass a health care bill. It is possible that the biotech sector may digest its gains for a brief stint or even settle back to its support level of $300 (old resistance level). The sweet spot for this seasonal trade is July. Once past July, investors should consider exiting the position if it is underperforming the S&P 500.

My Call: The biotech sector will probably moderately outperform the broad market in its seasonal period, particularly in the sweet spot of the trade in July. The failure to come up with a health care plan could mitigate gains for the sector.

Energy - Flash in the pan?

The driver for the energy sector is the price of oil, which bounced off the bottom of its trading range towards the end of June and looked to be starting its summer seasonal period early. After a quick bounce, the price of oil came under pressure because of larger than expected oil inventories. It is possible that the summer seasonal period may not be successful. This seasonal period is considered a secondary period as the seasonal period from February to May has historically been much stronger. Investors should be cautious with this trade.

Energy stocks have not well for many months. Towards the end of June, the sector bounced showing some technical strength, possibly leading to a rally just before the start of its seasonal period. Since then, the sector has faltered. Investors should be cautious with this trade.

My Call: The energy sector will probably struggle in the summer seasonal period.

Gold– Will it Shine ?

Like oil, gold looked to start its seasonal run early, bouncing off the bottom of its trading channel. It has since faltered. There is still time for gold to perform well in its seasonal period. The sweet spot for the gold seasonal period is August and September. If gold slips below $1200, this could spell trouble for the yellow metal and for gold mining companies.

If global central banks continue with surprise hawkish comments, then this could affect the price of gold negatively. At this point it is difficult to determine how much of an impact monetary policy statements will have on the price of gold.

My Call: Gold bullion will probably perform well in the sweet spot of its seasonal trade. Up until the sweet spot, gold bullion could struggle as the current narrative of rising rates could provide downward pressure on the yellow metal.

U.S. Government bonds– Central bankers secret phone call?

Did the central bankers have a secret conference call of which investors were not aware (sarcasm)? It seems that they all became more hawkish at the same time. The U.S.

was not the exception, with more discussion on the possibility of faster rate increases and discussion about working its balance sheet down. The result was that U.S. government bonds corrected. Although the technicals started to weaken as the upward trend line was crossed and the sector has become oversold. At this point, investors are looking for the sector to be able to make it to the seasonal sweet spot which occurs in August and September.

My Call: U.S. Government bonds will probably perform well in the sweet spot of their seasonal period. It is possible that the sector could have some volatility up until the seasonal sweet spot starts in late July.

Canadian bonds– Poloz was on the phone call

In a matter of a day or two, Poloz, the chairperson for the Bank of Canada, went from being extremely dovish to very hawkish. Initially, it was Senior Deputy Governor Carolyn A. Wilkins that signaled an abrupt shift in policy. After Wilkins' hawkish comment that Canada was ready to raise rates, Poloz came out the next day and reaffirmed the position and has continued to do so since.

The majority of analysts think that Poloz will raise rates on Wednesday July 12th. After Canada's abrupt shift in policy, it is going to be hard for him not to raise rates. The only other alternative is to not raise rates and talk tough for the future, but I don't think that this will pass muster.

Canadian bonds are oversold and may bounce at this point. Also, even if Poloz raises rates, unless he talks about aggressively hiking rates in the future, Canadian bonds could find support. The seasonal sweet spot for Canadian bonds is in late July into September. It is possible that Canadian bonds could recover, particularly in its seasonal sweet spot.

My Call: Canadian bonds will probably perform well in the sweet spot of their seasonal period. It is possible that the sector could have some volatility up until the seasonal sweet spot starts in late July.

Technology– Leading the market?

At the beginning of June, I published a special report illustrating that the technology sector could correct in the month of June and possibly lead the market lower (Click here). Ok, I had half of the equation right, the technology sector did correct in June, the market on the other hand was able to squeak out a nominal gain.

I will say that it will be difficult for the stock market to have a substantial rally without participation from the technology sector. The tech sector has been the market leader for quite some time, and when the market leader falters, the broad market often follows.

My Call: The technology sector will probably continue to underperform over the next two to three months..... leading the stock market lower.

Emerging markets– Now is not the time

Emerging markets have performed well this year, mainly from the fact that the U.S. dollar has been weak, global growth has been improving and the risk-on nature of the stock markets. The graph below shows the relationship of the emerging markets relative performance, compared to the S&P 500 and the performance of the U.S. dollar relative to a basket of foreign currencies. The relationship is obvious, when the U.S. dollar performs well, emerging markets have underperformed. When the U.S. dollar performs poorly, emerging markets have outperformed.

It is currently not the season for emerging markets to outperform.

The big question, is what will happen to emerging markets if the U.S. dollar starts to gain strength. I think that I have already answered the question.

My Call: The emerging markets sector will probably start to underperform the S&P 500 shortly, as the U.S. dollar starts to gain strength relative to worldwide currencies.

Brooke's Rant

Yellen: "Would I say there will never, ever be another financial crisis....I hope that it will not be in our lifetimes, and I don't believe it will be."

In a recent speech, Yellen said, that she did not expect another financial crisis in our lifetimes. These words could come back to haunt Yellen sometime in the future, hopefully not in the near-term. Statements such as this could define her stewardship of the U.S. Federal Reserve.

Yellen has come a long way speaking as the Chairperson of the Fed. When she gave her much anticipated first speech a few years ago, she was visibly uncomfortable and appeared timid. Now she is asserting claims that we will not have another financial crisis in our lifetimes. This is a bold statement. Probably too bold. Such overconfidence, although designed to placate the masses, ironically does little to instill confidence in investors. If you are too overconfident, you are going to miss the next elephant in the room. She will not be the first Chairperson that is not a good "elephant" spotter.

I could spill a lot of ink about the many ways the U.S. financial system could fail. It has failed a few times in the past and will probably fail again in the future. I will go out on a limb and state that the financial system will fail within my lifetime. I am just hoping to live a long time so the can will be kicked down the road......very far.....before I kick the bucket.

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