Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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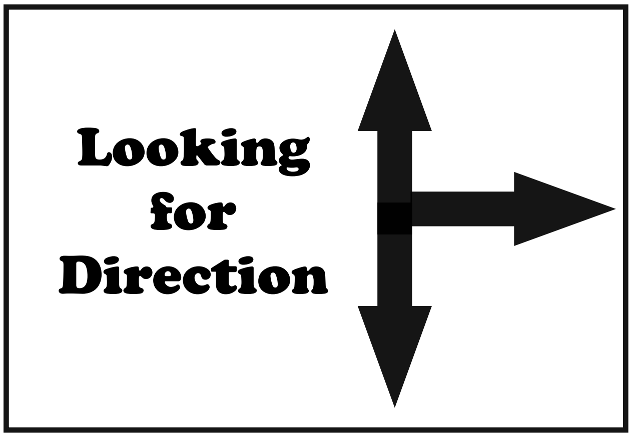


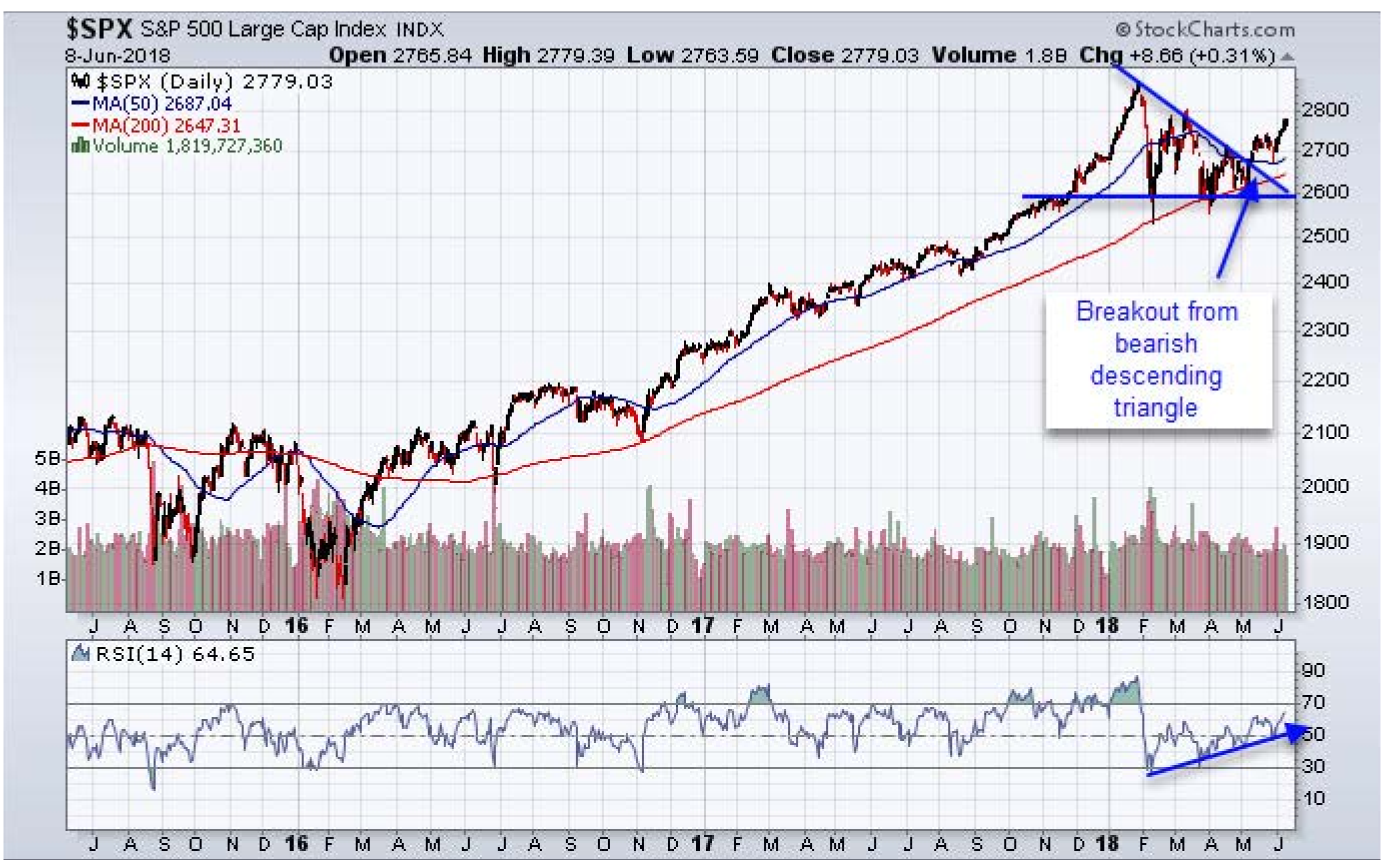
Market Update

Investors & Stock Market Looking for Direction.

Earnings season is finished, for all intents and purposes. The "Italian Situation" is temporarily fixed (emphasis on temporarily). The US economy is stable with a decent GDP growth rate of 2.3% in the first quarter of 2018. Trump is still tweeting, but investors are taking his curve balls in stride. The stock market is floating higher, but failed to respond in April with a strong rally during the busy part of Q1 earnings season. May ended up being a solid month with a good return.

S&P 500 Technical Status

The S&P 500 steadily climbed higher in the month of May. Previously it had formed a bearish descending triangle, but it was able to break above the trendline, which is a bullish development. Currently, the S&P 500 is 2.6% below its high set in January. A break above its January high level would be a bullish development, with no resistance overhead. On the downside, 2600 is a key level of support, which is below the 200 day moving average. The S&P 500 has tried to break below 2600 three times so far this year, and failed. A break below 2600 at this time would put the S&P 500 below the 200 day moving average and subsequently would be bearish. On a seasonal basis, the period from the last few days in June into mid-July tends to be positive for the stock market, due to the *Earnings Month Effect*. A rally may only be temporary as August tends to be a weak month for the stock market.



Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **May 31st,** 2018

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
XST	iShares S&P/TSX Capped Consumer Staples Index ETF	5.2%
	Income	
HBB	Horizons CDN Select Universe Bond ETF	7.6%
	United States Dollar Exposed Assets	
	Income	
HUF	Horizons Active Floating Rate Bond ETF	18.7%
DLR	Horizons US Dollar Currency ETF	12.5%
HTB	Horizons US 7-10 Year Treasury Bond ETF	7.5%
HUF.U	Horizons Active US Floating Rate Bond (USD) ETF	4.9%
	Equities	
XLP	Consumer Staples Select Sect. SPDR ETF	9.2%
HXS.U	Horizons S&P 500® Index ETF	5.0%
	US Dollar Forwards (April 2018) - Currency Hedge **	-0.4%
	Cash, Cash Equivalents, Margin & Other	29.9%
	Total (NAV $206,264,754)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 30.0% 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.

The S&P 500 is still 2.6% off its high set on January 29th, 2018. Investors are generally bullish on the stock market but are looking for a catalyst to move the stock market higher. It is interesting to note that the strong Q1 corporate earnings did little to propel the stock market higher in April.

Even when the effects of the US tax reform were factored out of the earnings reports, they were still considered to be strong. As of June 1st, 2018, the companies that had reported Q1 earnings had on average seen an increase of 26% compared to the previous year.

A lot of pundits point to the strong earnings and state that investors will come to realize their significance and push the stock market to all time highs. To me, the fact that the stock market did not rocket higher on strong earnings in April is a concern. Of course, there were the usual litany of geopolitical risks: North Korea, trade wars, NAFTA and others. Overall, the stock market should have moved much higher in April based upon the strength of the earnings. In May, the S&P 500 produced a gain of 2.9% making up somewhat for the muted return in April. Still, the strength of the earnings should have driven the stock market much higher at the time. Maybe it is not what has happened or even happening. The stock market is a forward-looking mechanism. Most analysts postulate that the stock market looks out six to nine months in the future. Despite the strength of Q1 earnings, investors are somewhat concerned about the future.

Many investors have put Trump's negotiation style down to antics. They think they have him figured out. He comes out negotiating with unreasonable demands and then settles for little gains. The result is that big events such as potential trade wars are readily dismissed by investors. I am not so sure that we have Trump figured out. He has not actually finished negotiating anything with other countries, so we really don't know. It is possible that we are all blissfully heading into a minefield ahead.

When countries line up their armies on their respective borders, purposely threatening each other, there is always the possibility that a war starts from an unrelated event. It has happened many times in history. As countries and trading blocs jostled and threaten each other, the possibility of a trade war increases, despite everyone's desire to avoid one.

It is possible that investors are concerned that global growth is slowing. In 2017, the world was going through a period of synchronized global growth. In 2018, this reversed as the economic surprise indicators turned south sharply and the hard data such as PMIs and GDPs have weakened. It is possible that investors are concerned that the US may follow with slower growth, especially if trade rhetoric heats up and tariffs take their toll.

Interest rates have been rising, which according to many investors is an indication of a strong economy. Although this can be true, it is not necessarily true. Central banks around the world are trying to "normalize" their rates after having emergency rates for many years. They are planning on reducing liquidity despite a slowing economy. As inflation expectations have been creeping up higher in recent months, expectations have increased that the Federal Reserve will become more aggressive making sure that inflation does not get out of hand.

The Federal Reserve is expected to raise rates a number of times over the next two years, despite expectations of moderate growth. Regardless of the reason for the rate increases, the point is that rising rates will hurt the economy at some point, crimping personal and commercial borrowing. Somewhere along the runway of rising rates, the narrative will change and investors will anticipate slower growth ahead. It is possible that the narrative is already changing and investors are already starting to see interest rate increases and have tempered their expectations for the stock market.

No one knows for sure why investors have not responded more enthusiastically to the strong Q1 earnings. The fact remains that the stock market is off its highs despite strong earnings growth. The price action of the stock market is the final arbitrator of all the varying influences at the current time. Investors could become more confident and push the stock market higher, up to all-time highs. This scenario could unfold if geopolitical risks fade and economic reports are "goldilocks." Even if the stock market does move higher, investors should not expect it to rocket upwards as it seldom puts in a strong return in the unfavorable six-month period from May 6th to October 27th. For more details, see last month's newsletter click here.

This week could provide direction for the stock market, pushing it higher or lower based upon the central bank actions and announcements in the US, Europe and Japan. At the current time, an interest rate increase is expected in the US with investors placing a 91% probability of the Federal Reserve increasing its federal funds rate (CME Group, FedWatch Tool, June 9, 2018). The big mover for the stock market is probably the ECB, with an announcement on the Eurozones plans to moderate the current 30 billion euro ($35 billion) monthly buying program that expires in September. Investors will be watching for either a hawkish or dovish bias. A dovish bias, kicking the can down the road, could help push up the stock market in the short-term.

Earnings Season - Again

The stock market tends to perform well in the first eighteen calendar days of all earnings months, January, April, July and October. Investors typically want to be in the stock market before the earnings season gets into full swing in the second half of the month (*Thackray's 2018 Investor's Guide*, page 43). From 1950 to 2016, the S&P 500 in the first eighteen calendar days of July have produced an average gain of 0.9% and has been positive 66% of the time. The earnings rally can start in the last few days of June as investors look to deploy funds before month end and before the Independence Day holiday in early July. This trade could work out particularly well if the stock market corrects sharply into the last few days of June.

What the HAC is going on?

HAC started May with approximately a 100% allocation to equities. HAC reduced its equity position early in the month as the unfavorable six-month period for stocks (May 6th to October 27th) started. At the time, the equity markets maintained a positive momentum bias and as a result, HAC continued to maintain some broad market exposure. During the month, HAC reduced its equity holdings as the stock market oscillated back and forth. In addition, HAC fully exited its energy sector position during the month. It also established initial positions in the bond markets in Canada and government bonds in the US. HAC's net exposure to the US dollar proved to be profitable, although HAC did reduce its exposure at the end of May as the seasonal period ended for US dollar strength. HAC's investment into the consumer staples sector proved to be impediment to performance, as the sector underperformed the S&P 500.

Seasonal Opportunities

Biotech- one of my favorite trades

The biotech seasonal trade has historically been a strong trade and is one of my favorites. The biotech sector tends to perform well from June 23rd to September 13th. The sector tends to perform well at this time as investors position themselves ahead of the second half of the year when the FDA tends to release most of their drug approvals and before the autumn biotech conferences. In addition, the biotech sector is the risk-cousin of the information technology sector. Investors tend to reduce their information technology risk in the summer months and look to the biotech sector as an alternative.

In its seasonal period, during the years 1992 to 2016, the biotech sector has been positive 84% of the time and has produced an average gain of 1.6%.

This year, the seasonal biotech sector trade appears to have started early as the sector has performed well since the beginning of May. The sector is still below its January high and below the top of its trading range. There is still room to run for this trade.

My Call: The biotech sector will probably perform at market until later in June, when it will probably outperform the S&P 500 over the next two to three months.

Gold Bullion

I recently emailed a report on the gold bullion sector, stating that the sector looks like it might start its seasonal run early. For the report, click here.

The gold bullion sector has a seasonal period from July

12th to October 9th. In this period, from 1984 to 016, gold has produced an average gain of 3.3% and has been positive 64% of the time. Gold, like other commodity trades tend not to be as robust as stock market seasonal trades and have a lower rate of success. Nevertheless, it is a trade still worth considering.

This year, gold is starting to show strength ahead of its seasonal period. It is currently approximately $1,300 and looks to be breaking its downward trend line.

My Call: Gold will probably start to show stability and then start to perform well later in June. A break above $1,350 at the start of the seasonal period would be a positive development.

Gold Miners

Since 2017, gold miners on an absolute basis have been volatile, but the end result has been mediocre performance. Relative to gold bullion, the sector has been outperforming since late March. Generally, gold miners tend to outperform gold bullion when gold is positive and the stock market is positive. The gold miners sector has as a seasonal period from July 27th to September 25th. In other words, it starts later and ends earlier compared to gold bullion.

It is important to note that gold miners can be very volatile, especially if the overall stock market is correcting sharply. Many investors use speculative money to invest in the gold miners sector and as a result, a sharp move down in the stock market produces margin calls in the gold miners sector which tends to exasperate the move downwards in the sector.

Gold miners are currently outside of their seasonal window, which starts on July 27th. The sector is also outside of its one-month window before the start of the seasonal period, which is often a good time to take a position in the sector on strong technicals.

My Call: The gold miners sector will probably start to outperform gold bullion before the start of its seasonal period.

Energy sector

The energy sector has two seasonal periods. The first one from February 25th to May 9th and the second from July 27th to October 3rd. This year the first seasonal period worked very well. It has since ended and the energy sector has pulled back. Recently, I emailed my subscribers a report on the energy sector, click here.

It is important to note that the next seasonal period for the energy sector, starting on July 27th, is the weaker of the two seasonal periods, with a lower average gain and success rate. Generally, this seasonal period is attractive if the first seasonal period from late February to early May has not worked, or the energy sector has corrected sharply into the end of July.

My Call: The energy sector has finished its seasonal period and will probably underperform until later in July, when the sector starts another period of seasonal strength.

Consumer Staples – slow start

The consumer staples sector tends to perform well in the summer months, when investors are seeking the safety of companies that are supposed to have more stable earnings. Unfortunately, the sector has been underperforming since January. A large part of the underperformance has been because of the rising interest rates. The consumer staples sector on average pays higher dividends than the S&P 500, thereby making it more interest rate sensitive. Poor earnings performance and guidance by some of the larger weighted stocks in the index have also contributed to the underperformance. But the sector does appear to be improving and starting to outperform relative to the S&P 500.

My Call: The consumer staples sector will probably start to improve its performance relative to the S&P 500, especially if the stock market has difficulty moving higher.

Government Bonds – report – nobody likes them but…….

It seems that nobody likes government bonds. Everybody is repeating the mantra that "bonds are dead." In fact, there is a relatively large short sell position against US Treasuries. Recently, I emailed out to my subscribers a written piece on bonds and why they might be a good idea over the next few months click here. After falling precipitously at the beginning of the year and consolidating into May, US government bonds started to show some strength in mid-May as the yield on the 10-year Treasury Note slipped. Government bonds have a seasonal period from May 6th to October 3rd. The seasonal sweet spot for government bonds is in August and September.

My Call: US government bonds performed well at the end of May, but have since had a pullback with the approaching FOMC meeting on June 13th. The sector will probably move slowly higher into August, when there is an increased chance of bonds performing well on a seasonal basis.

Canadian bonds

Canadian bonds are still digesting the more than expected hawkish statement by the Bank of Canada last week. Canadian bonds could start to perform well once this news has been fully digested and the possibility of a rate hike in July is fully accounted for in the price of bonds.

My Call: Canadian bonds performed well in the later part of May. The sector pulled back on hawkish comments by the Bank of Canada at their last meeting. Canadian bonds will probably float around current levels waiting for direction from the US bond market and more clarity on potential trade issues with the US.

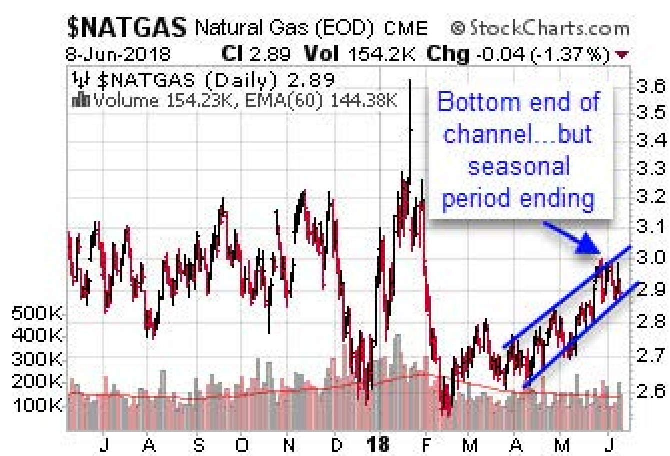
Utilities

The utilities sector doesn't start its seasonal period until July 27th. The sector struggled at the end of 2017 and the beginning of 2018. It is negative on a year-to-date basis. Currently, the sector has a negative technical profile. If the sector becomes oversold before the start of its seasonal period, and then starts to pick up on a relative strength basis, this could represent a good buying opportunity.

My Call: The utilities sector will probably perform at market in over the next month and half, before outperforming the S&P 500 in August and September.

Natural Gas

Natural gas has two seasonal periods, one from mid-March to mid-June (ahead of air-conditioning season) and the other from early September to late December (ahead of heating season). The September to December seasonal period is the stronger of the two seasonal periods. Nevertheless, the spring seasonal period is still worthy of consideration. The spot price of natural gas has been very quiet (but positive) in its spring seasonal period. As it is coming in to the end of its seasonal period natural gas is showing some strength. Seasonal investors should look to exit the sector upon weakness.



My Call: Natural gas will probably peak sometime shortly and correct heading into September, setting up for a positive winter trade.

Currency Corner

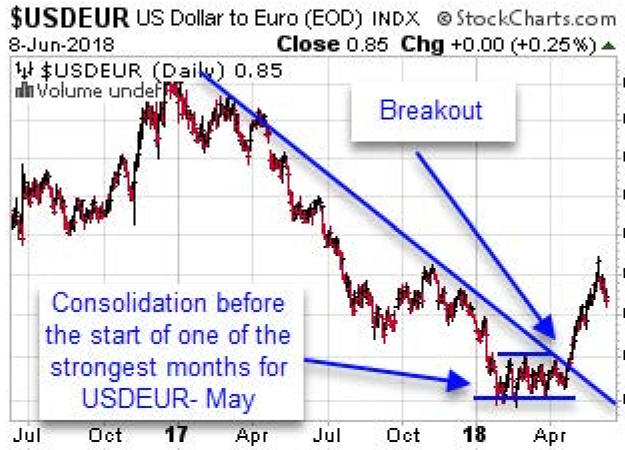
Canadian dollar vs US dollar

The Canadian dollar relative to the US dollar has followed its seasonal trend this year including weak performance in May. The overall technical trend currently supports a strengthening US dollar. The Canadian dollar has formed a series of declining tops (bearish). There is resistance for the Canadian dollar at 77.50 and if the Canadian dollar were able to strengthen past this level it would indicate a stronger technical profile for the Canadian dollar.

My Call: The Canadian dollar will probably underperform relative to the US dollar over the next few months as Canadian trade issues with the US continue to play out and the Federal Reserve is on a tighter schedule to raise its rates compared to Canada.

US dollar – Euro

One of the strongest months of the year for the US dollar relative to the Euro is the month of May. This year, the US dollar strongly outperformed the Euro in May. The seasonal trends were helped by a slowing economy in Europe and recent problems in Italy. The seasonal period is over for the USDEUR trade and the US dollar has started to lose its upward momentum.



My Call: The US dollar relative to the Euro will probably stabilize over the next few months.

Brooke's Rant

Spending money we don't have!

Individuals and countries alike that have gone deeply in debt and do not have a realistic plan to extricate themselves from the situation. Today, we want it now, and we will pay for it later. Individuals have racked up record amounts of debt. Normally conservative Canadians have an astounding level of personal debt (171% debt compared to disposable income). At some point, the debt will be unsustainable unless action is taken. It is not just individuals spending their way to happiness, companies have also jumped into the fray and have also racked up huge amounts of debt.

Of course, citizens expect governments to act like themselves and spend money now. The electorate has voted parties into to power who will give them the most "free stuff"and as soon as possible. This is not a political comment, as both Democrat and Republicans, left and right-wing parties and ideologies across the political spectrum have acted in a similar fashion, wantonly spending money with total disregard for deficits and debt.

The causes of such precarious action can be debated, but low interest rates are definitely part of it. For consumers and governments alike, it is only the payment that seems to matter. Taking on more debt is not painful when interest rates are low and payments can be amortized over a long period of time.

In the US, Trump railed against Obama's policies that increased debt substantially. Once in power, Trump increased spending and forecast increasing deficits. In

Canada, the current Prime Minister Justin Trudeau campaigned on having a “small deficit” of only $10 billion in the first year in office. Three weeks after taking office, he increased his deficit projection to $30 billion followed by years of consistently higher debt. Okay, essentially Trudeau purposely deceived the people. Many other countries have also increased their debt levels in order to “please” the people.

Italy has a debt to GDP ratio of 132%, and climbing. It as followed in the footsteps of Greece with similar problems. Italy has created a socialist society that cannot afford to pay for its programs. Its labor laws are a disincentive for any company to locate in Italy. Companies that are located in Italy and are expanding their operations very often look to locate their operations in other countries such as Poland. Productivity in Italy is abysmal. And of course Italy has the disadvantage of having a common currency with Germany, which means they cannot devalue their own local currency to increase exports.

The situation is not good for Italy. The country recently had an election that ended up with two euro-skeptic parties being able to forge an alliance to run the country– for now. Italy’s politics have always been a mess and amusing. Although they have a democracy, they use a system of popular vote, rather than first past the post. Which ends up producing a large number of political parties that can never seem to work together and it seems that they have an election almost yearly as their governments collapse. Italian politics seems to function at the same level as the countries economic operations.

A bad political situation is normal in Italy. They have learned to live with it, but what makes the current situation different from previous disasters is that the parties that have joined together to govern Italy are right wing and left wing parties. They have little in common, but they both have a euro-skeptic bias and believe that the ECB should forgive part of Italy’s debt and provide them more money. Forgiving Italian debt is a non-starter with Germany and many other countries, at least not at this point in time.

The Italian governing coalition has stated that they will pay down national debt as one of their main goals. Although this sounds good, it may not be realistic as the coalition tries to please both the right and left wings of the parties. It is difficult to see how this coalition will stay together with a mix of right and left wing policies, including instituting a flat tax, raising the minimum wage, creating a universal income scheme and others. In time, they may succumb to the pressure of increasing spending as their constituents and special interest groups make their voices heard. Their words stating that they would like to pay down debt, may in fact be just that, words.

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