Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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Market Update

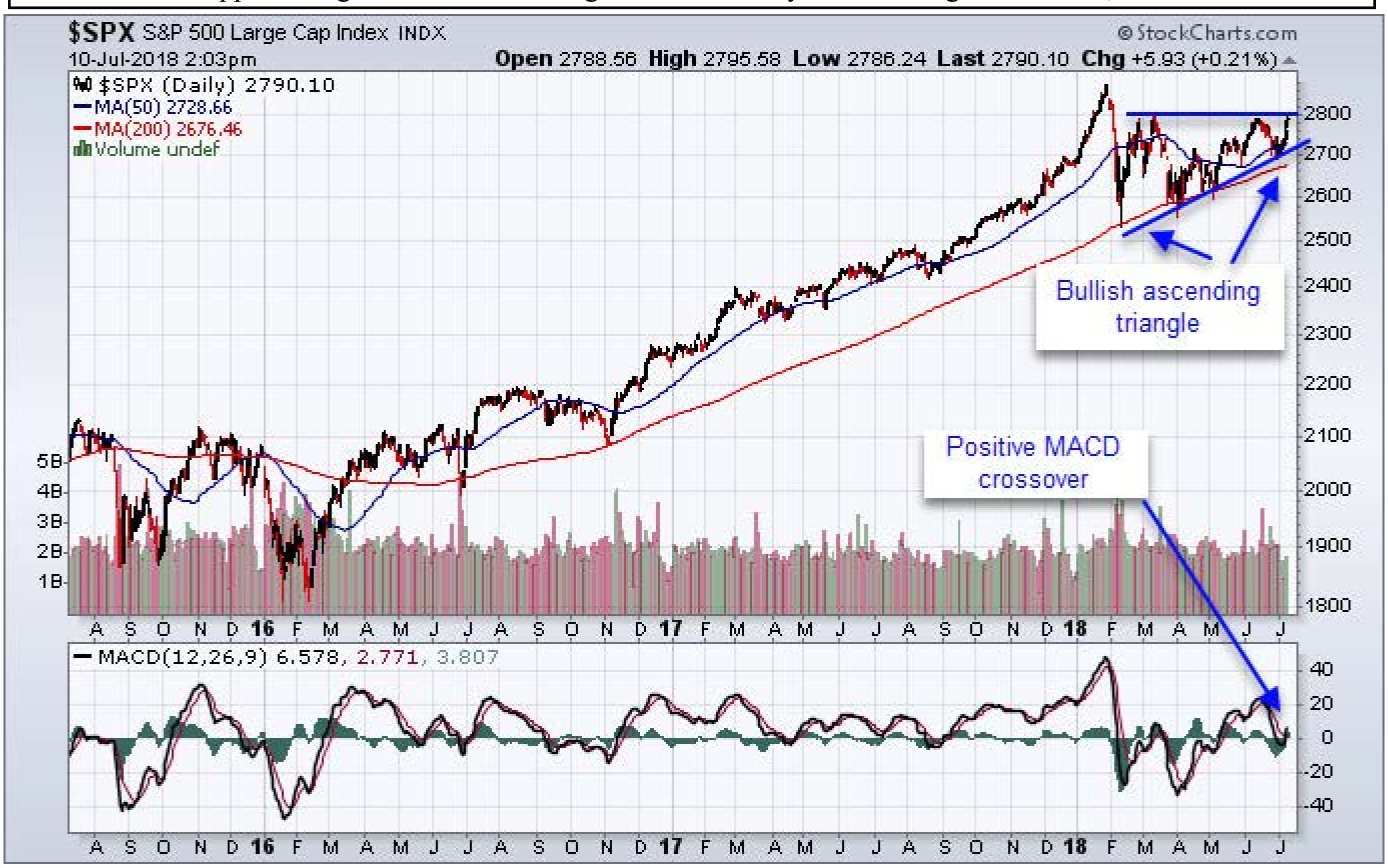
"I Want Some More" (Oliver Twist, Charles Dickens)

Like the Oliver Twist in the book *Oliver Twist,* written by Charles Dickens over 200 hundred years ago– investors want more. They are hungry for returns as the S&P 500 managed to only produce a 1.7% gain in the first half of the year. Despite being hungry, investors should not get greedy at this time.

The stock market has rallied since the beginning of July, but this is probably just a seasonal head fake. In June,

S&P 500 Technical Status

Technically, from a price action standpoint, the S&P 500 is in a sound position. The S&P 500 has formed a bullish ascending triangle with higher lows. It has stayed above the 200 day moving average and only temporarily breached its 50 day moving average. Using MACD to examine momentum, the trigger line has recently crossed above the MACD line, which is a positive development. As earnings season is just get about to get underway, the S&P 500 is at its resistance level. If the S&P 500 were able to break through its resistance level, it could challenge its January high. Warning: Despite the S&P 500 being technically sound, it is getting to the narrow part of its ascending triangle and could easily break lower through the bottom trend line and the 200 day moving average at 2676. Given that the stock market is approaching the two worst contiguous months of year on average since 1950, caution is advised.



Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **June 30th,** 2018

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
XST	iShares S&P/TSX Capped Consumer Staples Index ETF	5.3%
	Income	
HFR	Horizons Active Floating Rate Bond ETF	4.0%
	Commodities	
HUG	Horizons Gold EFT	4.8%
	United States Dollar Exposed Assets	
	Income	
HUF	Horizons Active US Floating Rate Bond (USD) ETF	10.0%
	Equities	
HXS	Horizons S&P 500® Index ETF	59.6%
XLP	Consumer Staples Select Sect. SPDR ETF	9.7%
IBB	iShares Nasdaq Biotechnology ETF	4.9%
	US Dollar Forwards (July 2018) - Currency Hedge **	0.1%
	Cash, Cash Equivalents, Margin & Other	1.7%
	Total (NAV $206,848,837)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 46.6% 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.

I wrote about the upcoming seasonal phenomenon of the stock market's tendency to perform well for the first eighteen calendar days of July as investors tend to push up the stock market ahead of earnings season getting into full swing. The report was titled, *Summer Sizzler*. Click here.

So far this year, the S&P 500 is rallying strongly in its *Summer Sizzler* seasonal period. Strong earnings for Q2 are expected to come with a growth rate of 20.7% year-over-year (Thomson Reuters, June 29th, 2018). Investors are excited about the prospects of strong earnings pushing the stock market higher.

The third week of July tends to be the busiest week for earnings reports. Investors tend to bid up stocks into he third week of July, as they view earnings as a potential catalyst to move stocks higher. By approximately the third week of July, investors have a fairly good feel for how successful the earnings season will be by the time it finishes. If the first part of earnings season is very positive, the expectation is for the following earnings reports to be approximately equally good and vice versa. In other words, the earnings season effect is baked into the price of the stock market by the third week of July.

After the third week in July, earnings can continually improve or worsen driving the stock market higher or lower, but the later in earnings season it becomes, the fewer surprises that tend to take place and the less of an impact earnings tend to have on stock market direction. The seasonal trade for the first eighteen calendar days of July is really based on the behavioral aspect of investors tendency to anticipate positive earnings. Once earnings get underway, other factors tend to take over.

Historically, the *Summer Sizzler* has been a good tradable rally, but the problem is that the stock market tends to fall apart in August and September. In other words, it is not prudent to fall in love with the stock market rally that tends to take place in the first eighteen calendar days of July.

What the HAC is going on?

In the early part of June, HAC had a small position in equities. In the second half of June, HAC increased its position in equities in order to be positioned for the positive seasonal period for the stock market from late June into mid-July.

Seasonal Opportunities

Gold– Down but not out !

Gold bullion has fallen sharply since the beginning of April. It is well of its January high of $1362.90. The negative trend has been largely the result of a strong US dollar. The good news is that gold bullion is well set up for its seasonal run that starts this week. Gold bullion has a seasonal period that lasts from July 12th to October 9th (*Thackray's 2018 Investor's Guide*). At the beginning of July, gold was oversold with an RSI reading below 30. Just recently, it has crossed above 30, triggering a "buy signal." In mid-June, I released a Sector Report on gold bullion and discussed the buying opportunity in the sector, titled "GOLD...Patience is gold(en)...Upcoming Opportunity?" Click here.

In my report, I refer to a dual moving average cross over potential buy signal, which has not occurred yet. Nevertheless, a crossover of RSI moving above 30 can lead to a good entry position just before the start of the seasonal period.

Up until May, gold bullion was in a bullish ascending triangle formation. Many pundits discussed this technical formation in their reports and prognosticated that gold was set for a sharp rally higher. Unfortunately, gold bullion was too far away from its seasonal period. Also, the strength of the US dollar helped pushed the price of gold down. In June, gold broke below the support line of the ascending triangle and continued to decline into July, becoming oversold.

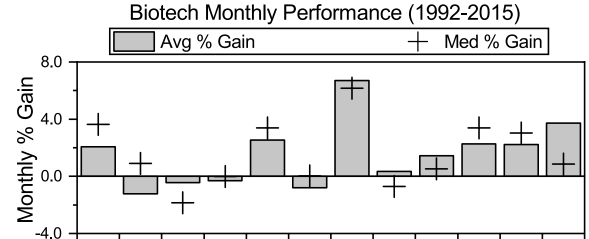
When gold has corrected sharply into the beginning of July and has become oversold, it often represents a good seasonal entry opportunity. In 2017, gold followed this pattern with a correction into the beginning of July and then rallying for the rest of the month and into the beginning of September.

My Call: Gold bullion will probably start to outperform the S&P 500 shortly and continue its outperformance into September.

Biotech– hot start

Biotech is off to a roaring start in its seasonal period. Last month in my newsletter I called the biotech trade, "one of my favorite seasonal trades." The month of July is on average the strongest month of the year for the biotech sector. From 1992 to 2015, in the month of July, the biotech sector had the highest average and median monthly gains, the highest frequency of positive gains and outperformance of the S&P 500.

Biotech Monthly Performance (1992-2015)



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Avg. % Gain	2.1	-1.2	-0.4	-0.3	2.5	-0.8	6.7	0.3	1.4	2.3	2.2	3.7
Med. % Gain	3.6	0.9	-1.8	-0.0	3.4	0.0	6.2	-0.7	0.5	3.4	3.0	0.9
Fq %>0	63	54	46	50	71	50	79	46	54	58	54	58
Fq %>S&P 500	54	50	38	38	71	50	83	58	63	50	46	50

Source: Thackray's 2017 Investor's Guide

The sector has started its seasonal period on a positive note, outperforming the S&P 500. The sector received a strong boost from Biogen when it released positive trial results on its Alzheimer's drug on Friday July 6th. The sector has just started its seasonal period and has a long way to run. Extra caution should be heeded towards the end of the seasonal period in September if the stock market is in a correction mode. In this circumstance the sector can start to underperform the S&P 500 before the end of its seasonal period. For now, the sector is technically strong and could perform particularly well if it breaks above its January high, which is just overhead.

My Call: The biotech sector will probably continue to outperform the S&P 500 into late September.

Consumer Staples– starting to show some improvement

The consumer staples sector has been underperforming the S&P 500 since 2016. In June, in its seasonal period, the consumer staples sector outperformed the S&P 500.

The sector has been trading in an alternating risk-on / risk-off mode. Generally, when the stock market moves to a risk-on mode, the consumer staples sector has underperformed the S&P 500 and vice versa. In June, the volatile nature of the stock market generally produced gains in the consumer staples sector when the stock market was slightly negative or flat on the day. When the stock market was sharply higher on a daily basis, the consumer staples sector underperformed the S&P 500 or was even negative. Overall, the net result was the consumer staples sector outperforming the S&P 500 for June. Towards the end of June, the consumer staples sector started to show better performance on days when the S&P 500 was rising. This is a good sign for the sector.

My Call: The consumer staples sector will probably continue with its outperformance in August and September.

Utilities– might have to wait

The utilities sector has a seasonal period from July 17th to October 3rd. The sector often benefits at this time from both falling bond yields that occurs on a seasonal basis and investors rotating out of more aggressive sectors of the stock market.

In late 2017 and early 2018, the utilities sector got crushed as investors became hyper concerned that inflation was rising out of control and as a result borrowing costs for utilities were going to become dramatically more expensive and that bonds were starting to be a good yield alternative to the utilities sector. The utilities sector became oversold. More recently, in June, as investors have started to back-off their aggressive forecast for inflation and economic growth, the utilities sector started to outperform. After a relief rally, the sector is now at the top of its trading range relative to the S&P 500 and has become overbought in early July on an RSI basis (not shown in graph). Usually, an overbought scenario before the start of a sector's seasonal period indicates that it is best to wait for a better technical opportunity before entering the sector.

My Call: The utilities sector will probably underperform the S&P 500 in the short-term, but start to outperform later in August.

Oil (Energy)– secondary trade not set up well

The energy sector has two seasonal periods (1) February 25th to May 9th and (2) July 27th to October 3rd. The first period, starting in the winter and lasting into springtime is by far the best seasonal trade. The second seasonal trade from late July into the beginning of October is a relatively minor seasonal trade and typically best undertaken when the sector has sold off sharply before the start of the seasonal trade. This is currently not the case. Oil performed well in its first seasonal period and after a pull-back has once again rallied to year-to-date highs.

There is a strong bullish thesis for oil prices to move higher over the long-term period and recent supply constraints in Iran, Libya, Venezuela and Canada have helped to move the price of oil higher.

Nevertheless, caution should be used at this time investing in the energy sector. Under the current circumstances it is typically best to hold-off befor entering into positions in both the oil (commodity) and the energy sectors.

My Call: Oil (energy) will probably pull back at this point, despite an upcoming minor seasonal trade.

US Government Bonds– performing well - possible pause before performing well again

Since mid-May, US government bonds have moved higher. The move has largely been the result of investors subduing their inflation expectations and tempering their growth expectations for the economy. US government bonds have a seasonal period from May 6th to October 3rd. The sweet spot for the seasonal trade starts in the last few days of July and lasts until the end of September.

Many investors have been warning (for years) that the bonds market is dead. Although they could be right at some point, if there is one time of the year when seasonal investors should consider bonds, it is their seasonal summer of strength.

My Call: US government bonds will probably pause at this point and then rally starting in late July or early August into September.

Canadian Bonds– pausing before more positive performance

Canadian bonds have performed well since the start of their seasonal period in early May. Currently, the sector is at its resistance level and may pause before moving higher. The sweet spot for the Canadian bond trade starts in late July and runs into late September.

My Call: Canadian bonds will probably pause at this point and then rally starting in late July or early August into September.

Small Caps - Short Sell – strong outperformance set to wane

Small caps have performed strongly since early in the year. The main drivers of this trend have been international trade tensions and a stronger US dollar. On a seasonal basis, July is the weakest month of the year for small caps.

The technical setup for small caps to underperform the S&P 500 is well set up with an extended rally on an absolute basis and relative to the S&P 500.

My Call: Small caps will probably start to underperform large caps at this point and continue with the trend into August.

Currency Corner

Canadian dollar vs US dollar– temporary strength is not forever

The Canadian dollar has bounced off the bottom of its trading channel relative to the US dollar. In June, it also became oversold on a RSI basis and has now crossed above 30, registering a “buy signal.” Resistance for the Canadian dollar is at 77.50.

It is possible for the Canadian dollar to move higher at this time, but it would probably have trouble moving above its resistance level or breaking through the top of the trading channel in the high 77’s. At this time the seasonal trend is fairly neutral.

My Call: The Canadian dollar will probably strengthen to 77.50 relative to the US dollar before turning down.

US dollar vs. Euro– looking for direction

There are a lot of macro factors effecting the value of the US dollar versus the euro: Brexit, trade tensions, quatitative tightening in the Eurozone and the US and many other drivers. At this time of the year, there is not a strong seasonal trend in the USDEUR trade.

The US dollar is typically strong versus the euro in the month of May and this year was no exception. The US dollar has since recently paused with a resistance level just overhead at USDEUR $0.87. A break above this level would indicate that the USD has further to rally. Weakness in the US dollar could possibly take the dollar down to $0.82.

My Call: The US dollar will probably weaken relative to the Euro at this point.

US dollar vs. Yen– consolidating in a trading range

The US dollar had a strong run relative to the Japanese yen in April and May. It has since paused and is consolidating within a trading range.

On a seasonal basis, in the month of July the US dollar tends to be flat relative to the yen. But investors should note that seasonally strong period for the Japanese yen starts in late July / early August.

My Call: The US dollar will probably continue to consolidate relative to the Japanese yen for the remainder of July, before turning down in August and September.

Brooke's Rant

Investor's have become desensitized to trade conflict…and this is dangerous !

Desensitization is a natural human trait. If something happens over and over again, we can better access the outcome of the action over time. The desensitization process allows humans to reduce fear and stress. It also allows for focus to be placed on other potential dangerous situations and opportunities.

I first realized this process taking place in the stock markets in the 1990's. After the US-Iraq war, the US set up safe zones and checkpoints in Iraq. The first time that two soldiers were killed by terrorists using an improvised explosive device (IED) the stock market fell sharply over the next few days. Investors were unsure of further possible action by either the US or the terrorists. The next time it happened the stock market fell, but not by as much. The process kept repeating, and eventually the death of US soldiers at checkpoints produced no measurable impact on the stock market. It is not that investors valued the lives of the heroic soldiers any differently, but rather they believed that based upon past experiences there would not be significant military escalation by either side and therefore the events should not have a significant impact on the stock market.

Similar to the terrorist activity in Iraq, investors have become desensitized to the current trade conflict taking place. At the beginning of March, Trump introduced tariffs on steel and aluminum on countries around the world. As a result, the stock market fell. Since March, the US has introduced more tariffs and other countries have responded counter tariffs. When tariff announcements have been made, the stock market has reacted negatively, but as more and more announcements have been made, the effect seems to be less and less. Investors have become desensitized.

It seems that everyone thinks that they have Trump figured out: make a lot of noise with big demands and then settle for a small win. I am not sure how anyone can have Trump figured out as he has not negotiated a single international trade deal yet. The prevailing logic is that a trade war is not in the best interest of the US, China, or anyone else and as a result will not happen. I agree it is not logical, but logic is not the only paradigm. Emotions are dominant in this situation and therefore a relevant paradigm. Many military wars have been started based on emotion. Trade wars are no different.

Maybe, everything gets sorted out with all the currently imposed tariffs being removed and everyone goes away happy. But this is highly improbable. There is no question that China has taken advantage of trade agreements with the US that are grossly skewed in their favor. Nevertheless, there is little hope for China to walk back from its position. Through the use of strong rhetoric, the US has backed China into a corner. Generally, the Chinese have been moving slow and implementing counter tariffs without much bluster. In the Chinese culture it is necessary to save face, so rule out a massive cave-in by the Chinese.

Similarly, Europe and Canada have announced counter tariffs to the US. They are not going to walk back their counter tariffs. One of the only ways that this situation can be solved is if the US makes some concessions, but this is unlikely. The US may offer to walk back its tariffs, but it would expect something in return, the counter country to walk back more of its retaliatory tariffs. This is difficult, because everyone wants to save face. Another plausible scenario is for Trump to move forward and induce pain to a point where other countries would be willing to consider removing all of their tariffs. The US would not be against this scenario as they would be the beneficiaries in world-wide free trade agreement. Nevertheless, this is not a likely scenario as many countries will fight to keep special interest tariffs that protect favored parts of their economy.

The longer that the trade conflict goes on, the harder it is going to be to resolve. There may be a small window to turn the trade disputes around, but it is closing fast.

Initially, tariffs are not going to have much of an impact as the higher cost products have to work their way through the system. The damage to the economy is hard to calculate, but it will not be trivial. There are so many knock-on effects, with the cost of goods increasing affecting the cost of other goods and services. No one knows the total damage that will be done in a protracted trade war. There are a lot of guesses, but no one really knows.

Just because there has not been a material impact on the stock market or the economy from all of the trade conflicts and tariffs, it does not mean that there will not substantial negative consequences in the future. We have become desensitized to possible negative outcomes from the constant trade war rhetoric. So far, the stock market has not had an extended downturn based upon the threat or the implementation of tariffs. US investors have not priced in the possibility of significant damage that would ensue in an extended trade war. At some point, this reality will probably change and the stock market could correct sharply. There is more downside risk with the trade wars being implemented than upside benefit of the tariffs being negotiated away. Caution is advised.