

Thackray Market Letter

— Know Your Buy & Sells a Month in Advance —

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Early Edition – This edition is being released early due to holiday schedules.

Please Note – There will not be an August edition due to travelling plans. Regular monthly newsletters will resume in September.

Market Musings

The stock market has had a good run since March 9th. Both the S&P 500 and the TSX Composite have climbed 36%. More recently the S&P 500 has shown signs of tiring and has been bumping up against the 940-950 range. Currently the index sits at 900. This point is at both the 50 and 200 day moving averages, with the market moving sideways for the last while a breakdown at this point would have negative implications in the market. Conversely, if the market is able to break through resistance and the downward sloping channel line on strong volume, the short-term outlook for the market would be positive.

Given that we are in the non-favourable season (beginning of May to the end of October) of the market, a strong run in the index has a low probability of happening. Over the next two weeks it is possible for the mar-

kets to produce positive action as the market can sometimes extend a top into mid-July and the time around Independence Day tends to be positive (discussed later in newsletter). It is the time period after July 19th that will present possible corrections of magnitude.

Another indicator that has recently turned down is the NYSE - BPI. After topping out at 75, the indicator is now sitting at 58 - a negative indication.



The Bullish Percent Index (BPI) is a popular market breadth indicator that is calculated by dividing the number of stocks in a given group (an exchange, an industry, etc.) that are currently trading with Point and Figure buy signals, by the total number of stocks in that group. Bullish Percent levels that are above 70% are considered

S&P 500 - Last 3 Years



overbought, whereas levels below 30% are considered oversold. Strong buy signals occur when the Bullish Percent Index falls below 30% and then reverses up by at least 6%. Conversely, promising sell signals occur when it goes above 70%, and then reverses down by at least 6% (Source: Stockcharts.com).

A Summer Rally – Is It Possible?

In July investors will probably stumble across an article or two discussing the possibility of a summer rally. The articles usually portray the opinion that the market has room to run based upon some good numbers that have come out at the time. July is earnings month and the market can do well in the first half of the month based upon the expectations of good earnings.

The official date for the non-favourable season is May 5th (see Thackray’s 2009 Investor’s Guide). This is typically the time that the market starts to roll over and proceed into the summer doldrums.

Is a summer rally from July 20th possible? Absolutely, but the returns from July 20th to October 27th are well short of spectacular. In fact, the market has only been positive 51% of the time during this period and produced an average gain of -0.8%. Some investors may be inclined to just “wait it out.” Using the average numbers, it is 50/50 that the market will be up and then there is only a loss of less than 1%.

average 5.3% and has been positive 78% of the time. This time period is clearly a better time to focus on equity investments.

Below is a yearly chart that illustrates the returns from July 20th to October 27th, by year, by decade. All the really large returns above 10% in the late summer took place either at the start or the middle of a strong bull market. We are obviously not in the middle of a strong bull market and I doubt we are starting one. Therefore, from a seasonal perspective it is prudent to favour the position of reducing equities.

What To Do ?

Most investors will be asking, “well what should I do with my money?” During the summer there are still opportunities - you just have to be more selective.

For short-term investors there is the Independence Day Trade that occurs from two market days before the end of June to five market days after Independence Day. For sector investors there are a number of possibilities throughout the summer. I will comment briefly on some of the opportunities, including gold and oil.

Independence Day Trade

In my last newsletter, I put forward the short-term Memorial Day Trade. Despite a volatile market the trade

Summer Rally ? July 20 to October 27 (S&P 500 1950 - 2008)

1950	13.9	1960	-3.7	1970	7.0	1980	4.8	1990	-16.6	2000	-6.9
1951	4.4	1961	5.6	1971	-5.2	1981	-8.8	1991	-0.0	2001	-9.1
1952	-3.1	1962	-3.3	1972	4.2	1982	22.2	1992	0.7	2002	5.9
1953	-0.4	1963	8.3	1973	4.5	1983	0.0	1993	4.2	2003	3.8
1954	6.8	1964	1.2	1974	-16.1	1984	9.9	1994	2.6	2004	2.2
1955	0.6	1965	8.0	1975	-3.7	1985	-3.9	1995	5.2	2005	-4.1
1956	-6.2	1966	-7.1	1976	-2.4	1986	1.0	1996	9.7	2006	9.3
1957	-16.4	1967	1.4	1977	-9.3	1987	-25.9	1997	-4.2	2007	-1.1
1958	10.2	1968	3.7	1978	-3.6	1988	3.3	1998	-10.2	2008	-32.7
1959	-3.0	1969	3.2	1979	-1.0	1989	-0.2	1999	-7.9		
Average	0.7%	1.7%	-2.6%	0.2%	-1.6%	-3.6%					
Fq Neg	50%	30%	70%	40%	50%	55%					

In my books these are not good odds. Investors are in the market to make money, otherwise why be there? During this time there is a higher chance of a large downdraft, compared with the rest of the year. Why take the risk?

Sometimes the best way to illustrate the validity of an approach is to make a comparison. If the subsequent period of October 28th to January 31st is used (a similar time frame), the return profile is much better, to say the least. During this time period the market has returned an

ended up producing a 6% return. The Independence Day Trade is similar to the Memorial Trade and is based upon the premise that the market tends to do well around major U.S. holidays because of the lack of institutional involvement in the markets at this time, and therefore the markets are generally pushed higher by the bullish retail investor. The dates for the Independence Day Trade this year are: buy at the end of the trading day on Friday June 26th and sell on July 10th. Sometimes the

market can extend its momentum into mid-July (July 19th), but this usually occurs in strong bull markets. Given that we are not in a strong bull market it would be seasonally prudent to exit on the standard Independence Day Trade date, or start to leg out earlier depending on market conditions at the time.

Below is a performance table for Independence Day Trade by year, by decade. The Independence Day Trade has worked 71% of the time since 1950 and has produced an average return of 1%. Interestingly, the trade worked very well in the 1950's, 60's and 70's, on a frequency basis. In the 1980's the trade was flat and did not vary by more than 2.6%. In the 90's the trade worked very well, although some of the positive results must be attributed to the strong bull of the 90's. Since 2000, the trade has suffered its greatest losses in the bear markets of 2001, 2002 and 2008. Overall, the trade presents a fairly good short-term seasonal opportunity.

Sector Opportunities

In general, it is better to be defensive during the summer months, but even for the defensive sectors there is a good seasonal time to enter a trade. In this newsletter I am going to present three sector opportunities that are shaping up to be a good trade - gold, oil and utilities. In my latest book, Thackray's 2009 Investor's Guide, I call this the triple combo.

Golden Opportunity

Gold usually does well from the end of July to the end of September. This seasonal trade is based upon the increase in demand for gold from the gold fabricators buying gold to make jewelry for the Indian wedding and festival season that occurs in the autumn (67% of gold produced is used for jewelry and India consumes the most gold).

Independence Day Trade (S&P 500 1950 - 2008)

1950	-4.4	1960	-0.1	1970	1.5	1980	1.4	1990	1.7	2000	1.8
1951	1.5	1961	1.7	1971	3.2	1981	-2.4	1991	1.4	2001	-2.6
1952	0.9	1962	9.8	1972	0.3	1982	-0.6	1992	2.8	2002	-4.7
1953	0.8	1963	0.5	1973	2.1	1983	1.5	1993	-0.6	2003	1.2
1954	2.9	1964	2.3	1974	-8.8	1984	-0.7	1994	0.4	2004	-1.7
1955	4.9	1965	5.0	1975	-0.2	1985	1.5	1995	1.8	2005	1.5
1956	3.4	1966	2.1	1976	2.4	1986	-2.6	1996	-2.8	2006	2.1
1957	3.8	1967	1.3	1977	-0.6	1987	0.4	1997	3.7	2007	0.8
1958	2.0	1968	2.3	1978	0.6	1988	-0.6	1998	2.7	2008	-3.4
1959	3.3	1969	-1.5	1979	1.3	1989	0.9	1999	5.1		
Average	1.9%	2.3%	0.2%	-0.1%	1.6%	-0.5%					
Fq Pos	90%	80%	70%	50%	80%	56%					



The ideal seasonal trading dates have been from July 27th to September 25th. From 1984 to 2008 the XAU (PHLX Gold/Silver Sector) has produced an average return of 7.9% in its seasonally strong period. Even during its strong seasonal time period, gold's returns can be very volatile. From 1984 to 2008 the seasonally strong period had twelve periods of greater than 10% performance (five periods of greater than 20%), and three periods of a loss greater than 10% (see Thackray's 2009 Investor's Guide for more details).

Despite all of the volatility in the gold market, in Canadian dollar terms the metal has been range bound. The XGD ETF has generally oscillated between \$16.50 and \$22.00. Recently XGD has pulled back with gold prices: this is the season for weakness in gold. Having an investment pull back before a seasonally strong period is usually favourable. It sets the trade up for positive bounce at the right time.

The XGD graph uses an upwards green arrow to show the seasonal buy date and a downwards red arrow to show the sell date. XGD has performed relatively well over the last three years including last year. In the autumn of 2008 gold stocks sold off substantially, as hedge fund managers liquidated their positions in gold to cover their margin.

Look for XGD to pull back to \$15.50 or \$16.50 over the next month. Although this would be an excellent price point to enter the sector, a higher price does not exclude the trade from performing well. It is possible that the seasonal trade will take XGD to \$22. If the ETF crosses this point early in its seasonal period on good volume the \$22 should act as support and be considered for a partial stop-loss position.

Oil, Oil Everywhere

My favourite seasonal trade is oil stocks from February 25th to May 9th. Although this sector underperformed the broad market because of the strong rally in March, the sector once again produced a positive rate of return. The sector has been positive 24 of the last 26 winter seasonal periods. In the XEG chart I have illustrated the success of this trade over the last three years with green and red arrows with circles around them - green for the buy date and red for the sell date. This seasonal trade is considered to be very strong because of its past success rate.

There is another seasonal trade for oil that lasts from July 24th to October 3rd. This trade has produced an average gain of 2.9% and has outperformed the S&P 500, 63% of the time. Neither the gain nor the frequency is as strong as the winter oil trade. In managing a portfolio with this trade, a lower equity amount should be used



and more attention to technical action in the markets should be considered. For more details on the year by year performance of the oil sector, see Thackray's 2009 Investor's Guide.

Oil and oil stocks tend to do well at this time of year because refineries are preparing winter by switching over some of their capacity to produce heating oil. Because heating oil it is typically shipped in autumn, extra demand from the refineries tends to push up the oil prices in the late summer and early autumn.

If we take a look at the XEG performance over the last three years, it is evident that XEG has been range bound for two and a half years and then the sector melted down with the stock markets and the expectation of slower global growth. Towards the end of September the XEG had a death cross (50 Day MA crossing over the 200 Day MA). As this bearish condition occurred just before the end of the seasonal trade, it was an indication that the trade should be exited early.

would be for a run up to \$18. At this point investors should consider capturing some profits.

Utilities - Not Just For the Widows and Orphans

Well, actually utilities have not been ever really been for the widows and orphans as a conservative investment. A lot of investors have a misconception that this sector is too conservative and boring. This sector has its seasonally strong period that has produced above market returns from July 17th to October 3rd.

Generally, utilities are a bit of a hybrid sector - they are stocks but they also have an interest rate sensitivity component and hence have an element of a bond trade.

Utilities tend to do well in the late summer as investors look for a safe place to hide and they benefit from a positive bond trade that can take place at this time of year. A few months ago I included a picture of Bernanke blowing bond bubbles and suggested that investors should stay away from the long end of the bond curve because



The line at \$18.25 had previously acted as good support when XEG was range bound. Now the ETF is below this line, the same line is providing resistance and hampering progress past this point. The sector has turned down from this point and looks to be heading lower. At the start of the seasonal trade look for XEG to be at \$14 and possibly \$13. A very bullish scenario, although unlikely,

of the probability of rising rates. Long rates have since gone through the roof, as predicted. Despite this climb in rates, on a seasonal basis there can be reprieve during the summer. For more detail on the bond trade see Thackray's 2009 Investor's Guide. Please note that in the next edition of my guide, I plan on using a bond index rather than a percentage change in yields. The result will be a

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more accessible analysis of bond trends.

The reason that I point this trend out is that it provides a positive impetus for utilities to perform in the late summer.

The chart of the XLU ETF (Amex Select Spyder- Utilities) illustrates the success of the last three seasonal trades and illustrates three classic technical patterns.

On the technical side the utilities sector had a left shoulder (LS) and then a head (H) and then a right shoulder (RS), which then broke through the neckline in September of 2008. The reason that I point this pattern out is that after two successful seasonal trades in 2006 and 2007, investors should have noted the breakdown in 2008 and considered at least a partial reduction in the sector position when the neckline was penetrated. A head and shoulders pattern is considered to be bearish and is usually recognized by a lot of investors.

The next pattern in the graph is a failure of a bullish ascending triangle. Usually this pattern is exited with an upwards move. Not all patterns are a success. In this case the pattern failed and the sector moved lower.

The most recent technical pattern is an ascending wedge, which is considered bearish. Look for this pattern to exit downside and possibly take the XLU to \$25 at the start of the seasonal trade. This would be a good entry point for the sector.

Summer Musings

In my May Market Letter, I suggested that investors should consider using the 3 R's: Reduce equities, Redeploy positions to favourable seasonal trades and readjust risk by selecting more conservative investments within sectors. The message has not changed.

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