# Thackray Market Letter

**— Know Your Buy & Sells a Month in Advance —**

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Written by Brooke Thackray


Brooke Thackray is a Research Analyst along wth Don Vialoux for the Horizons AlphaPro Seasonal Rotation ETF that trades under the symbol HAC on the Toronto Stock Exchange. 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 descibing many of the trades and strategies in HAC.

## *Market Comment*

After a dismal Nonfarm Payroll report on June 4th where only 41,000 new private sector jobs were created out of the announced 431,000 jobs, the market briefly corrected and then once again took on a positive outlook. The market managed to push up to 1117, its 200 day moving average and then was turned back. The mid-June minirally was somewhat expected as the market had become oversold. In my last newsletter published on May 10th I mentioned that the market had become "oversold and could bounce up to 1150 (S&P 500)."

Once again the stock market corrected in the latter part of June as the economic reports continued to disappoint. Often the stock market can do well at the end of June and the beginning of July as the results of the earnings season is anticipated. This year the effect of the negative reports that seemed to stream in one after another dampened enthusiasm in the market and the market performed poorly into the beginning of July. In the U.S., the Durable Goods Orders remained negative, GDP came in at 2.7% under the expected 3.0%, New Home Sales came in at a dismal 300k versus expected 450k, U.S. Consumer Confidence gauge came in at 52.9 versus an expected 62.5, and so forth. Canada has started showing signs of following the U.S. with unimpressive economic reports, including retail sales falling 2.0% month-over-month in April and Real GDP coming in flat in April.

### S&P 500 Technical Status

The S&P 500 has currently recovered from breaking through support @1040. The 1040 level is significant and it is important that the market remains above this level. Resistance is just overhead @1110. The 1150 resistance level is fairly significant and the 1200 level would be very difficult for the market to penetrate. The S&P 500 has just registered a "Death Cross" (50 Day Moving Average crosses down below the 200 Day Moving Average), which is long-term bearish. Look for the market to continue its correction starting mid to late July.

Horizons AlphaPro Seasonal Rotation ETF (HAC :TSX)
Portfolio Exposure as of **June 30th**, 2010

| Symbol | Holdings | % of NAV |
|---|---|---|
| United States Dollar Exposure | | |
| XLP | Consumer Staples Select Sector SPDR Fund | 9.6 |
| XLY | Consumer Discretionary Sector SPDR Fund | -9.0 |
| IHI | iShares Dow Jones US Medical Devices | 4.9 |
| IBB | iShares Nasdaq Biotechnology Index Fund | 4.8 |
| | | 10.4 |
| Canadian Dollar Futures (June 2010) Currency Hedge ** | | -1.0 |
| Cash and Equivalents & Other | | 90.6 |
| Total (NAV $16,589,675) | | 100.0 % |

** Actual exposure reflects gain / loss on hedge

More recently, the stock market has shown signs of coming back to life as the economic reports rolling in from the U.S. and Canada are generally better. On Friday July 9th, Canada announced a whopping 93,200 jobs for the month of June, bringing down the unemployment rate to 7.9%. This effectively wipes out the job losses that have occurred since the fall of 2008. There is no doubt that these are impressive numbers. Despite this renewed positive spirit on both sides of the border, investors should be cautious as the same underlying economic conditions that provided a catalyst for the recent market correction are still unresolved, i.e., over-leveraged debt at multiple levels in society. When investors refocus on the macro economic issues, the chances of the market slipping once again will increase.

Before investors start to focus on the economic reports, they will be looking at the earnings numbers coming out shortly. Last quarter's numbers were exceptional with almost 80% of S&P 500 companies surprising to the upside, but even with these great results the market peaked just two weeks after the season started. This quarter the profits for the S&P 500 companies are expected to rise by 34% year-over-year (Bloomberg). Despite this being bullish for the stock market, investors should reflect on the last quarter's experience and not become too enthralled with a possible bull market.

## *Summer Rally – Myth*

In last month's newsletter I stated that I would write about the myth of the summer rally. At this time of the year the media often gets carried away with the prospect of a summer rally in the stock markets, creating fear with investors who get concerned that they are going to miss the next rally. This type of media coverage supports the old adage of buy, hold and close your eyes; and that it is always best to be in the market no matter what.

Historical data does not support buy and hold through the late summer months as a good investment practice. A summer rally is rare and if there is one, it typically ends mid-July, on average July 19th. It is rare that large returns are made from July 19th to October 27th.

Being in the market during the summer months, particularly the late summer, early autumn months has not been rewarding. In the past I have written a lot about the six month cycle of how it is better to be invested in the market for the favourable six months between October 28th to May 5th, rather than for the unfavourable six months from May 6th to October 27th. For more information please refer to Thackray's 2010 Investor's Guide, page 57.

In the April Newsletter I wrote about the risk-reward relationship of a 10% gain or loss during both the favourable and unfavourable six month periods.

S&P 500 Gains & Losses (1950 to 2009)*

| | Gains>10% | Losses>10% |
|---|---|---|
| Unfavourable 6 Months | 8 out of 60 | 8 out of 60 |
| Favourable 6 Months | 24 out of 60 | 2 out of 60 |

In summary, from 1950 to 2009 the S&P 500 for the favourable six months from October to May has produced 24 gains of 10% or more and 2 losses of 10% or more. In contrast, the unfavourable six months has produced 8 gains of 10% or more and 8 losses of 10% or more. Clearly, the October to May time period is a better time period to be in the market, having bigger gains more often and smaller losses less often.

S&P 500 Gains & Losses
July 20 to October 27 (1950 to 2009)

| | | Gains | |
|---|---|---|---|
| | Performance % | >5% | >10% |
| 1950 | 13.9 | | ♦ |
| 1951 | 4.4 | | |
| 1952 | -3.1 | | |
| 1953 | -0.4 | | |
| 1954 | 6.8 | ♦ | |
| 1955 | 0.1 | | |
| 1956 | -6.2 | | |
| 1957 | -16.4 | | |
| 1958 | 10.2 | | ♦ |
| 1959 | -3.0 | | |
| 1960 | -3.7 | | |
| 1961 | 5.6 | ♦ | |
| 1962 | -3.3 | | |
| 1963 | 8.3 | ♦ | |
| 1964 | 1.2 | | |
| 1965 | 8.0 | ♦ | |
| 1966 | -7.1 | | |
| 1967 | 1.4 | | |
| 1968 | 3.7 | | |
| 1969 | 3.1 | | |
| 1970 | 7.0 | ♦ | |
| 1971 | -5.2 | | |
| 1972 | 4.2 | | |
| 1973 | 4.5 | | |
| 1974 | -16.1 | | |
| 1975 | -3.7 | | |
| 1976 | -2.4 | | |
| 1977 | -9.3 | | |
| 1978 | -3.6 | | |
| 1979 | -1.0 | | |
| 1980 | 4.8 | | |
| 1981 | -8.8 | | |
| 1982 | 22.2 | | ♦ |
| 1983 | 0.0 | | |
| 1984 | 9.9 | ♦ | |
| 1985 | -3.9 | | |
| 1986 | 1.0 | | |
| 1987 | -25.9 | | |
| 1988 | 3.3 | | |
| 1989 | -0.2 | | |
| 1990 | -16.6 | | |
| 1991 | 0.0 | | |
| 1992 | 0.7 | | |
| 1993 | 4.2 | | |
| 1994 | 2.6 | | |
| 1995 | 5.2 | | |
| 1996 | 9.7 | ♦ | |
| 1997 | -4.2 | | |
| 1998 | -10.2 | | |
| 1999 | -7.9 | | |
| 2000 | -6.9 | | |
| 2001 | -9.1 | | |
| 2002 | 5.9 | ♦ | |
| 2003 | 3.8 | | |
| 2004 | 2.2 | | |
| 2005 | -4.1 | | |
| 2006 | 9.3 | ♦ | |
| 2007 | -1.1 | | |
| 2008 | -32.7 | | |
| 2009 | 13.1 | | ♦ |
| AVG. | -0.6 | | |

What is not evident in the returns for the May 6th to October 27th period, the unfavourable six months, is that a rally can occur in stock markets, but it often falters in mid-July. When I co-authored my first book with Bruce Lindsay, Time In Time Out, Out Smart the Market Using Calendar Investing, we analyzed when the market had a tendency to peak in the six months from May to October. What we found was that there was two different dates, May 5th and July 19th.

We ended up calling the May 5th date the conservative date and the July 19th date the aggressive date. In summary, in average market conditions, the May 5th date was average peak for the market and the July 19th date was a better peak date in strong bull markets such as in the 1990's.

Overall, if you had to choose only one date to reduce equity exposure, the May 5th date is a better date. The May date also allows investors to enter the market for strategic trades such as Memorial Day or Independence Day and sector trades.

Currently we are down significantly from the May 5th exit date. Should we expect the market to rally significantly from mid-July to the end of October — No.

The return-risk reward relationship for the July 19th to October 27th is poor. On average from 1950 the S&P 500 has produced a loss of 0.6% and has been negative approximately half the time.

So far this time period receives a failing grade, but the risk of being out of the market is that you miss a large gain. Overall this time period has produced few large gains. It has only produced a gain greater than 5%, one quarter of the time and a gain greater than 10%, only four times. Hardly exciting results.

It is also important to note that the gains above the 5% threshold have almost all occurred in strong bull markets and typically the market performed extremely well into the following year. Most investors would agree that we are currently not in a strong bull market, greatly reducing the chances for strong gains.

In the last sixty years there has only been four occurrences of the market producing a gain of greater than 10%. The first two gains took place in the 1950's bull market. The next gain took place in 1982 at the start of the greatest bull market of all time. Twenty-seven years later, in 2009, the market made a gain of 13.1%.

The gain that took place in 2009 occurred in the bull market that started in March and was propelled upwards by "Helicopter Ben Bernanke" dumping liquidity into the market at an unprecedented rate the government stimulating the economy with large expenditures. This is unlikely to happen again.

Many governments around the world are reigning in their spending and ending their stimulus programs. This is particularly true over in Europe where they are doing the math on their debt and deficit ratios and trying to keep the levels under control, in order to avoid a "Greek Tragedy."

Many U.S. municipal and state governments also have debt problems and are reducing their expenditures in order to remain solvent. Combining reduced government expenditures with incentive programs that have ended for cars and houses, produces a lot less stimulus for the economy moving forward.

The underlying conditions for a rare summer stock market rally are extremely poor. We are not in a bull market, the economic conditions have deteriorated and the government has very little room to stimulate the economy. The probability of a strong late summer rally is low and investors should be extremely cautious in the months of August and September.

## *HAC : TSX UPDATE*

After being in mostly cash for the month of May, HAC took advantage of the Memorial Day trade by being almost 100% in equities at the end of June. The trade was very positive for HAC and portfolio was adjusted to mostly cash again before the dismal employment report at the beginning of June.

During the month of June HAC was mostly in cash and was able to sidestep the market slide once again. At the end of June, HAC was still mostly in cash and based upon technical indicators decided not to adjust the portfolio to take advantage of the positive trend that can occur around Independence Day.

In the month of June, HAC initiated two small positions in the biotech sector and medical devices and supplies sectors. These two positions were based upon seasonal trends for the sectors. See details in the next section.

The portfolio remained fairly flat during the month despite having a position of approximately 10% net long. When the market was moving up the positive performance of the biotech sector and medical devices and supplies sector tended to offset the loss on the pair trade of short the Consumer Discretionary sector and long the Consumer Staples sector. When the market was in retreat, the gain on the pair trade tended to offset the loss on the two health care sectors. In the end the portfolio remained fairly flat while the market gyrated downwards.

## *HAC : TSX – Buys and Sells in June*

### *SELL - SPDR S&P 500 ETF (SPY)*

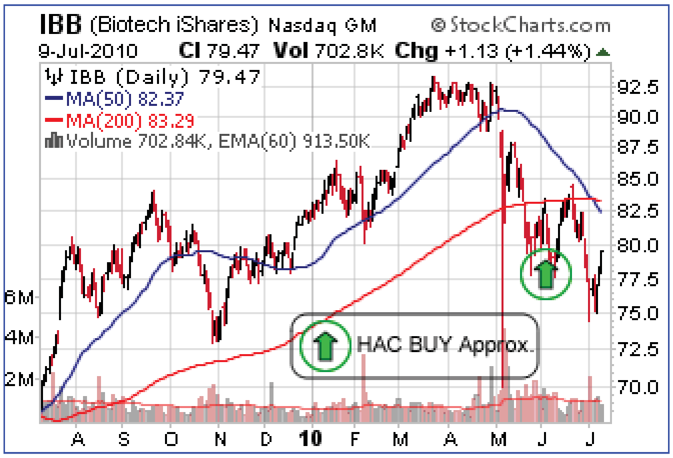
Selling SPY was a major part of closing out the Memorial Day Trade that was initiated at the end of May and then exited at the beginning of June. This trade ended up being very successful for HAC.


### *SELL SHORT - Consumer Discretionary SPDR (XLY)*

Once again, selling short the consumer discretionary sector was the closing out of the Memorial Day Trade. HAC covered its short sell at the end of May and then re initiated it at the beginning of June. This allowed HAC to increase equity exposure during the favourable Memorial Day Trade. This trade was also very successful for HAC. The portfolio benefited from being short XLY during the month of June as the sector, like the rest of the market continued to slide. (value of a short position increases as the security price decreases).


### *BUY - iShares Nasdaq Biotechnology (IBB)*

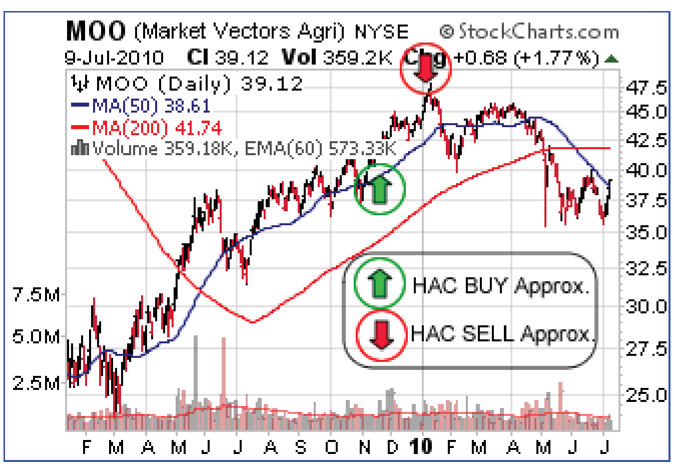
Typically the biotech sector does well seasonally from June 23rd to September 13th. This year the sector showed technical signs of bottoming early, so HAC initiated a very small position in the sector at the start of June. So far the sector has been performing at approximately market. July tends to be a very good month for the biotech sector.




## *Sectors Looking Good*

### *Agriculture Sector*

Last year when HAC was launched on November 19th the fund initially had a position in the Agriculture sector via the ETF, MOO. The position was sold at the end of the year and the overall trade performed very well for HAC. I am mentioning this because the typical seasonal strength for the sector starts at the beginning of August and runs until the end of the year. Sometimes it can start a bit later or earlier. Last year the run started in July and lasted to yearend.




This year the sector has already started to show signs of strength and is currently developing a positive profile.

### *Gold and gold stocks*

Gold typically has a period of seasonal strength from July 12th to October 9th, and gold stocks from July 27th to September 25th. Both sectors are starting to show technical strength. During the overlapping period of seasonal strength, usually gold stocks outperform as they are more highly levered to the price of gold.


GDX , Market Vector Gold Miners ETF, has just bounced off the bottom of its trend line. It is possible that it will climb to $55 at the time when it typically starts is seasonally strong period. If this occurs it is very bullish for gold stocks as they will have a higher likelihood of breaking out of a bullish ascending triangle, which would then provide support. Gold stocks (ETFs) are currently looking very attractive and investors should consider an early entry date.

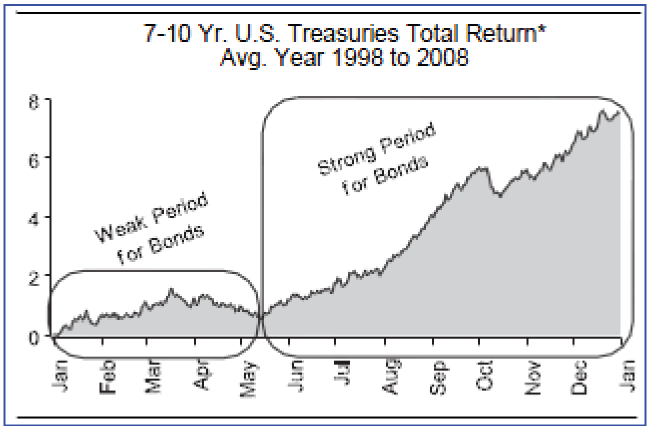
### *Utilities*

The utilities sector usually does well, on average, from July 17th to October 3rd. It is a defensive sector and when the market corrects, investors tend to favour the sector because of the stable earnings and dividends.

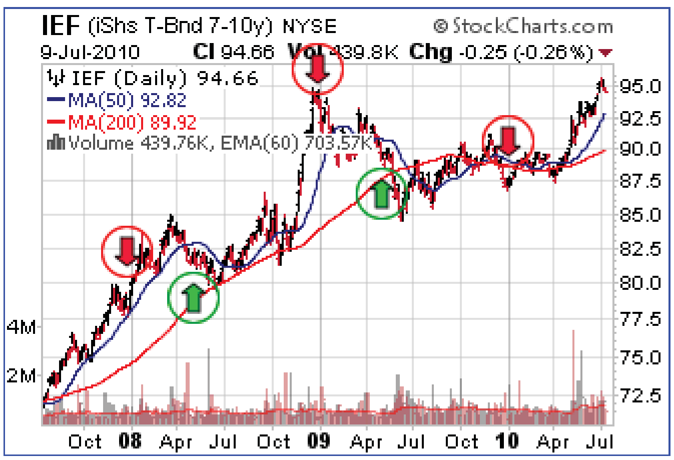

Currently the sector is trading in a range and should provide relative outperformance compared to the S&P 500 if the market suffers a correction. Investors must remember that if the market suffers a major correction that utilities will also correct, typically not as much, but nevertheless they will go down in value. The utilities sector is usually an attractive choice when the market is flat or slightly negative in the summer months.

*U.S. Bonds (7-10yr.)*

U.S. Bonds have a seasonally strong period from May 1st to December 31st. The bulk of this period occurs in the summer months when investors are looking for defensive investments other than stocks. The real sweet spot for U.S. bonds occurs in the months of August and September.




In the graph below (IEF) the buys and sells do not represent HAC trades, but are used to illustrate the success of the strategy over the last three years.

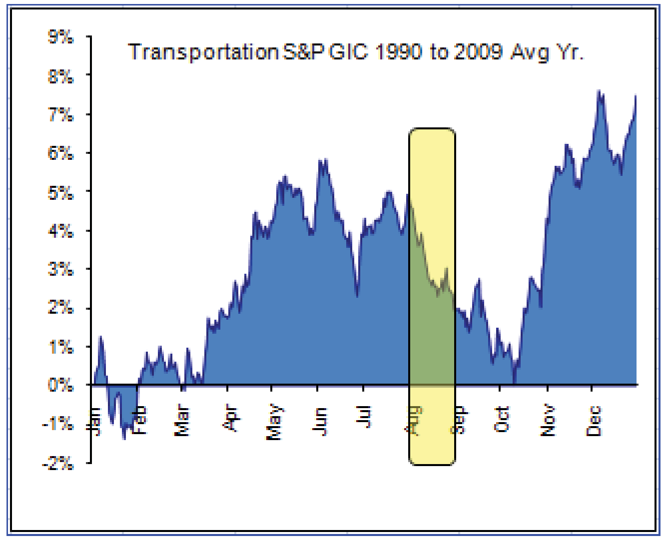



Although the real sweet spot for U.S. bonds is approaching, investors should consider macro economic factors and technicals in making an allocation to bonds. Investors should be cautious in transferring bond trends between the U.S. market and the Canadian market as the economic policies of the two nations will lead to different trends in the short-term. That being said, the Canadian bond market also has a period of seasonal strength during the summer months.

*Transportation (Short)*

If you are looking for a short position to match up against a favoured long position, the transportation sector can provide a good mate in August and September, particularly August.

The transportation sector has lost an average of 2.8% in the month of August since 1990 and has been negative 60% of the time.




The transportation sector tends to slide during the month of August as investors question the pace of the economic growth. Once the July earnings season is well underway, investors start to focus on the economy at the same time as the overly optimistic assumptions for economic growth are adjusted downwards for the second half of the year. Slower growth translates into less transportation needed to move goods and people.

In addition, oil prices in August and September can climb because of the demand for heating oil that has to be produced for later in the winter.

Together, anticipation of slower economic growth and rising energy prices can dampen the transportation sector. The largest gain during the month of August for the transportation sector (S&P GIC) since 1990 is 2.9% (1996). The largest loss during the same time period is 13.7% (1998). Overall, being short the transportation sector in the month of August makes much more sense than being long.

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