Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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WAR & PEACE (TRADE)

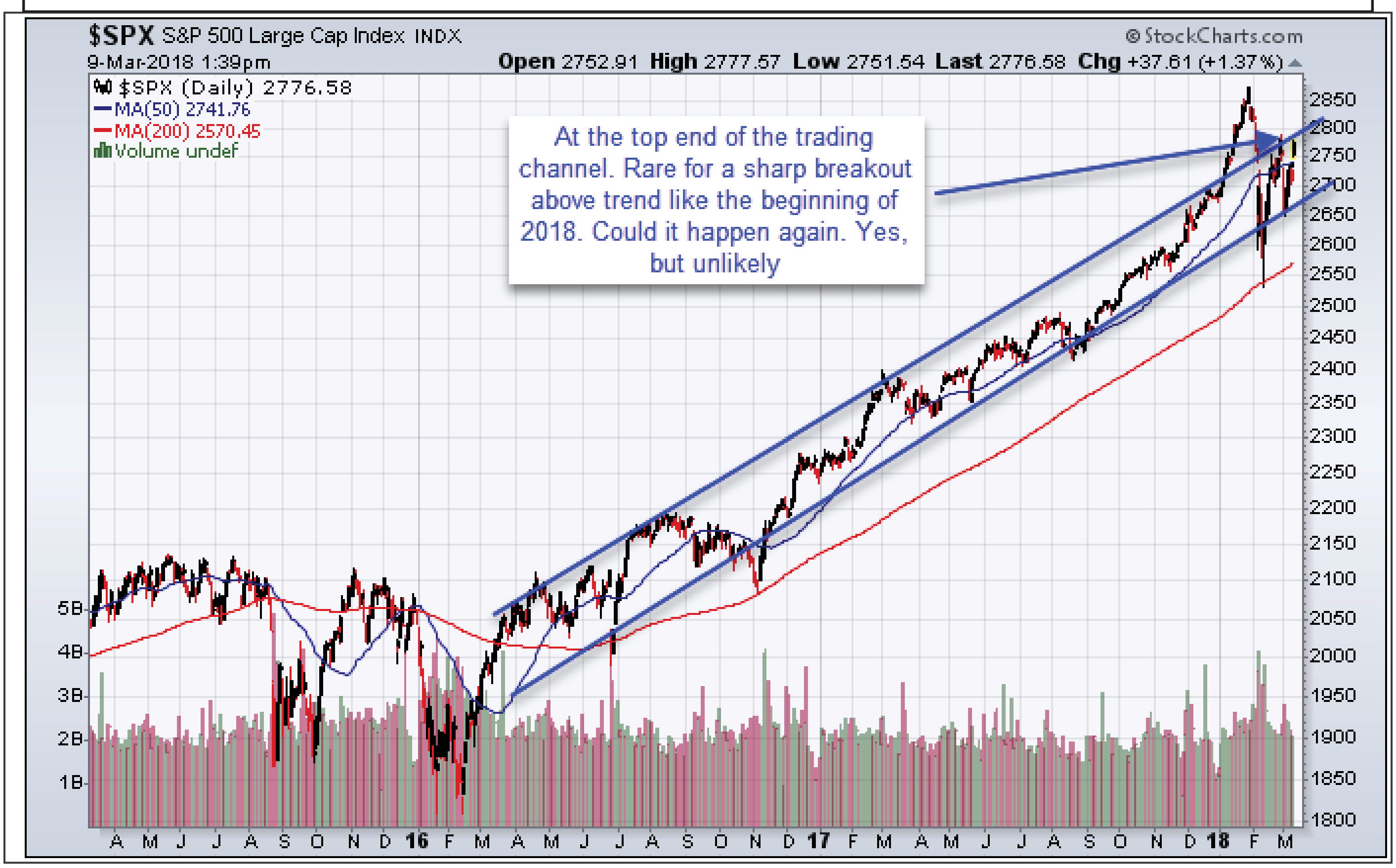
Market Update

I remember reading War and Peace by Tolstoy many years ago. I was fascinated with Russian authors when I was in my teens. My favorite author was Dostoyevsky. Trump is trying to orchestrate his own version of War & Peace, with trade. He threatens a trade war saying that they are easy to win and an hour later says he doesn't want a trade war, he wants peace. A short time later, Trump states that the US is going ahead with steel and aluminum tariffs and there will be no exemptions. A short time later he temporarily exempts Canada and

S&P 500 Technical Status

The S&P 500 is currently in an upwards trend and at the top of its trading channel. It is rare for a sharp prolonged upside breakout above the trading channel, as was experienced at the beginning of 2018. Usually, upward price movements at the top of the trading channel are moderate. It is possible that we could have another repeat of January, but it is not expected.

March and April tend to be positive months for the stock market. Large moves in the stock market have been taking place recently. So far this year, the Dow Jones Index has moved 500 points on an intra-day basis more than it did in all of 2017. With increased volatility, one or two days of large moves in either direction, does not necessarily establish a sustainable trend.



Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **February 28th,** 2018

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizons S&P/TSX 60™ Index ETF	17.4%
	United States Dollar Exposed Assets	
	Equities	
HXS	Horizons S&P 500® Index ETF	50.2%
FHF	First Trust AlphaDEX U.S Financial Sector Index ETF	5.1%
XLF	Financial Select Sector SPDR Fund	5.0%
XLB	Material Select Sector SPDR Fund	4.0%
FHM	First Trust AlphaDEX U.S. Materials Sector Index ETF	3.5%
XLI	Industrial Select Sector SPDR Fund	2.5%
XLE	Energy Select Sector SPDR Fund	2.5%
FHE	First Trust AlphaDEX U.S Energy Sector Index ETF	2.5%
FHD	First Trust AlphaDEX U.S Consumer Sector Index ETF	2.5%
FHG	First Trust AlphaDEX U.S. US Industrial Sector Index ETF	2.5%
	US Dollar Forwards (March 2018 2018) - Currency Hedge **	-0.7%
	Cash, Cash Equivalents, Margin & Other	3.0%
	Total (NAV $206,033,020)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 40.1% 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.

Mexico during the NAFTA trade talks. Of course, his actions are a bargaining ploy. Canada and Mexico better behave or there will be a trade war. Please forgive me, but whatever I am writing at this time is sure to be out of date by the time it is published. I just looked up at the TV and Trump is considering giving Australia an exemption.

Although there are some wars (most) where both or all of the countries involved are worse off in the end, with trade wars, everyone is always a loser. The only exception is a small segment of the market, the industries being protected by tariffs. There is also a strong argument that these protected industries do not benefit in the long-term.

On Thursday March 1st, Trump called a meeting with executives from the U.S. steel corporations. Initially, it was rumored that steel tariffs were going to be announced, and then later it was confirmed that discussions only were going to be taking place. At the end of the day, Trump in great bombast announced that he was implementing tariffs on all imported steel (25%) and aluminum (10%). I am sure that there were studies done ahead of time, but one cannot help but get the sense that the policy was in the making during the day. This does not lead to confidence that the full ramifications of the tariffs were thought out properly.

On Thursday March 8th, it was announced that Canada and Mexico were going to be exempt from the tariffs, but if the NAFTA negotiations failed, then the tariffs would be imposed. This is Trump style negotiation, taking everything away and then giving back something to make it seem like he is a "nice guy." Of course, the tariff relief for Canada and Mexico is going to be used as a bargaining chip in the NAFTA negotiations.

In the past, Trump has negotiated away some of his principles that he has stated publicly. In the case of tariffs, I'm not so sure that this will take place at least in the near term. Trump knew that this would cause a huge uproar and that is why there really was no discussion on the implementation of tariffs before March 1st when he announced their introduction. He has doubled down on his position and is talking about increasing tariffs on other products. I'm sure that he thinks he's a genius because he is now using the tariffs as a bargaining tool in the NAFTA discussions. As a result, he is able to accomplish two goals with the tariffs: protecting the steel industry and getting the upper hand in the bargaining talks with Canada and Mexico.

Watching the trade war drama unfold is like watching an episode of the Bachelor, where Trump is handing out exemption roses. As a result, investors are currently in a state of denial and believe that the tariffs will not take place. They believe that the large ground swell of anti-tariff advocates will be able to convince Trump that the tariffs are a bad idea. When the White House Chief Economic Advisor, Gary Cohen, resigned, the stock market plunged on a greater expectation that the tariffs were going to implemented. The fact that investors believed that the tariffs might not be implemented (before Cohen's departure), shows the level of denial.

Trump is not going to change his mind at this point. He ran on the platform that he was going to introduce tariffs; he has to "save face." He can walk back parts of the tariffs (for Canada and Mexico), but he is not going to wake up one day and say, "I made a mistake, we are not doing tariffs." It is not going to happen.

Trump is right in one aspect. There is a problem with international trade and in some circumstances the US is being unfairly treated. Threatening a trade war is not the best way to solve it.

The tariffs are set to be activated in two weeks. When Europe has its steel taxed, and they start to threaten the US, investors will start to see the ramifications of a trade war. Right now the tariffs are surreal and distant. If a can of pop costs an extra cent, in the minds of consumers, "so what." The real costs to society are a lot more than a cent on a can of pop (see my rant at the end of the newsletter). When US products start to get blocked through taxes and inflation starts to increase, it will not be a "so what." It might be a couple of months before the damage of the tariffs start to be realized, but when the extent of the damage is realized, it will be worse than a can of pop that has gone flat. It will be another reason for the stock market to turn down.

What the HAC is going on?

In the month of February, HAC was fully invested, with investments largely in the US. Based upon the strength of the US stock market, HAC only had 17% of its assets invested in Canada. On a seasonal basis, Canada tends to slightly outperform the U.S. at this time of the year, but not enough to compensate for stronger momentum in the US.

HAC was also partially exposed to the US dollar as the U.S. dollar tends be stronger than the Canadian dollar in February. Note: the Canadian dollar has a seasonal track record of performing well in April. Consideration should be given to making the appropriate adjustments.

So far, HAC has maintained a larger weight in broad market positions compared to previous years. The seasonally valid sectors have not presented a trend of strong enough outperformance to justify overweight positions in the sectors of the stock market.

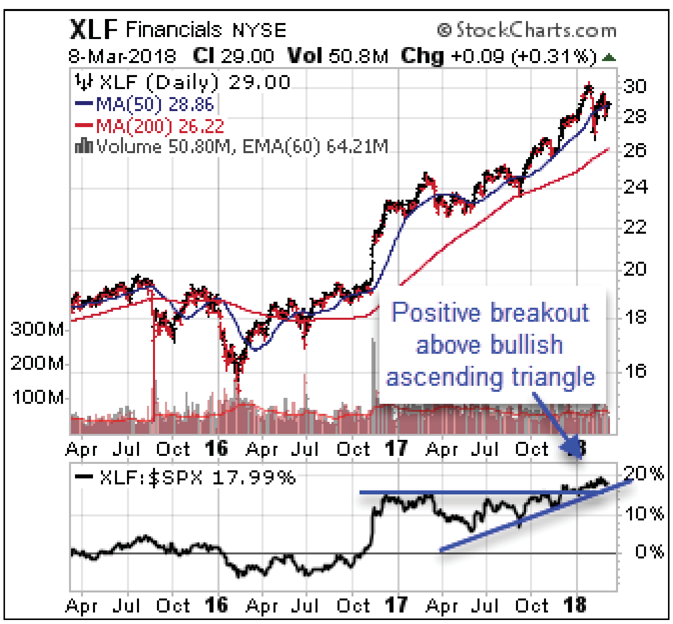
Seasonal Opportunities

U.S. Financials

The U.S. financial sector benefited from rising interest rates. As the yield curve steepens, US banks are able to make more money, accepting loans at the short end of the curve (banks pay you next to nothing in interest on your deposits) and making loans further along the yield curve. In late February and early March, the yield on the 10-year US Treasury Note stabilized and pulled back slightly. Just recently, the yield has started to increase slightly again. On Friday March 9th, the yield was higher, but investors were busy celebrating the ninth year of the bull market on the back of stronger than expected Non-farm payroll numbers.

On a technical basis, the US financial sector broke above an ascending bullish triangle. This is a bullish indication.

The seasonal period for the sector lasts until mid-April, still leaving some time for the sector to continue its strong performance.



My Call: The US financial sector will probably continue to outperform the S&P 500 into mid-April.

Industrial Sector

The industrial sector has traded in a consolidation box (relative to the S&P 500) from late 2016 to late 2017. In 2018, the sector broke above the consolidation box and then turned down back into the consolidation box when the Trump tariffs were introduced. On Friday March 9th, the sector responded sharply upwards on stronger than expected Non-farm payrolls and weaker than expected increase in average hourly wages.

The sector is susceptible to the impact of the Trump tariffs on steel and aluminum. Although Trump has backed away from full blanket tariffs with no exceptions, the sector is still vulnerable to the reduced tariffs, with higher steel costs for many of the companies in the sector and the possibility of the sector being the target of retaliatory tariffs.

My Call: The industrial sector will probably perform at market or moderately underperform the S&P 500 in its seasonal period that finishes early in May.

U.S. Materials

The materials sector has followed a similar fate as the industrials sector and has dropped back into its consolidation box relative to the S&P 500.

My Call: The US materials sector will probably perform at market or moderately underperform the S&P 500 during the remainder of its seasonal period, which finishes in early May.

Consumer Discretionary

The consumer discretionary sector substantially outperformed the S&P 500 starting in late October. The sector has recently started to show weakness relative to the S&P 500 as it has broken its upward trend line.

My Call: The consumer discretionary sector will probably perform at market or moderately underperform the S&P 500 in the remainder of its seasonal period, which finishes in mid-April.

Canadian Banks

What's up with the Canadian banks. All six of the major Canadian banks beat expectations on their earnings. It might be expected that the sector would take-off like a rocket. It did not happen. The sector has performed well relative to the Canadian stock market, but it has lagged the U.S. stock market.

Why are Canadian banks acting in a sanguine manner? Investors are looking at the possible headwinds for the sector. Canadians are heavily indebted, with a ratio of approximately 170% of their disposable income to debt. In addition Canada has an overvalued house market making the banking sector susceptible to an economic slow down. The most recent report on house prices was negative for the housing industry as house prices were down from a year ago and fewer units were sold in Canada.

Should Canadian banks be ignored? Not necessarily. They are still attractive in the sense that they have an oligopoly and pay attractive dividends which should help provide stability in a volatile market.

Technically, they are in an upward trend relative to the Canadian stock market and have outperformed since early in 2017. If this trend is broken, then consideration should be given to reducing exposure in the sector.

My Call: Canadian banks will probably moderately outperform the Canadian stock market over the next month. The seasonal period for the sector finishes mid-April.

Oil - WTIC

Oil has pulled back recently, but it has not broken its upward trend. Oil has been whipped around in February and March as the IEA weekly inventory numbers have oscillated back and forth showing both increases and decreases in inventory. Recently, oil has started to get some traction and could possibly head higher in its seasonal period which finishes on May 9th.

My Call: Oil will probably move higher in its seasonal period.

US Energy Sector

The US energy sector has been performing poorly since early February and underperforming oil. The seasonal period for the energy sector starts on February 25th and lasts until May 9th. Recently, energy stocks have just started to show an uptick from an oversold position. When an oversold position starts to improve just before the start of a seasonal period, this often develops into a good seasonal opportunity.

My Call: The US energy sector will probably outperform in the remainder of its seasonal period, but look for a possible early finish if economic numbers start to show softness.

Canadian Energy Sector

The Canadian energy sector has been an unloved part of the stock market. Western Canadian Select oil is being sold at a $25 to $30 discount to West Texas Intermediate Crude due to supply restrictions. Canadian oil generally sells at a discount to US oil, but supply issues, including a leak in the Keystone oil pipeline has driven a wide gap between Canadian oil prices and US oil prices. If this gap narrows and the price of oil increases, then the Canadian energy sector could be poised to outperform its American counter part.

My Call: The Canadian energy sector will probably outperform in late March and into April.

Natural Gas

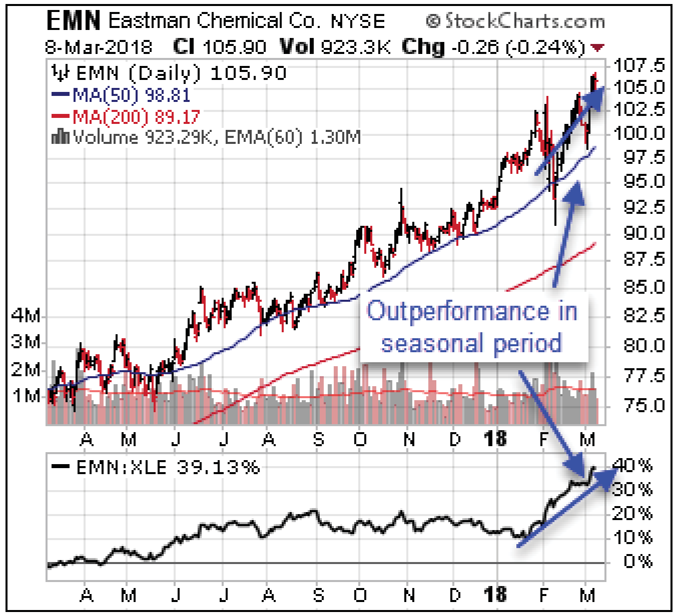
Natural gas typically performs well from mid-March until mid-June. Currently, natural gas is at the lower bound of its trading range, before the start of its seasonal period. Being oversold is often a good starting point for a seasonal trade. Natural gas is a very volatile commodity and could have a large move in either direction.

My Call: Natural gas will probably outperform in its seasonal period, ending in mid-June. Colder weather could extend the seasonal period and warmer weather could shorten the seasonal period.

Stocks

Eastman Chemical

Eastman Chemical is one of my favorite seasonal trades as it a strong track record of outperformance in its seasonal period from January 23rd to May 5th. So far, Eastman has been performing well in its seasonal period and is not showing signs of breaking down.



My Call: Eastman Chemical will probably perform slightly above market for the remainder of its seasonal period which ends May 5th.

Chevron

Chevron started to outperform at the beginning of its seasonal period in early February and has continued its outperformance into March. It is still well below the high it set at the beginning of the year.

My Call: Chevron will probably continue to outperform the stock market with rising oil prices helping to support higher prices.

Hasbro

Hasbro started its outperformance just after its seasonal period started. More recently it has performed at market and is starting to show weakness.

My Call: Hasbro will probably underperform the stock market from this point on in its seasonal period and consideration should be given to exiting the position.

TJX

TJX has performed very well in its seasonal period, especially after releasing strong earnings. It has become overbought and consideration should be given to exiting the position as weakness is starting to show. The seasonal period finishes at the end of March.

My Call: TJX will probably perform at market for the remainder of its seasonal period.

Brooke's Rant

I try not to be political in my writings. When I wade in on an issue, I try to analyse the facts. I apologize in advance if anything I say can be construed as political. Now that is said and done- the tariffs that Trump implemented on Thursday were the stupidest idea that I have seen in a long time. The potential damage to the American economy is huge, especially if the potential impacts of retaliatory tariffs are considered.

I had to chuckle at Wilbur Ross, the US Commerce Secretary, being interviewed on CNBC on Friday March 2nd. Ross went shopping first and brought with him a can of soup, a Coke and a can of beer. He held up these props in the interview in order to trivialize the increase in the cost of steel and its impact on American consumers. His disingenuous approach was dead wrong as it underestimated the costs of higher steel prices.

He totally missed how companies pass on rising cost to the consumers and all of the downstream costs. Firstly, when companies have been increasing costs not only do they try to pass on the cost to the consumer but they try to make a profit above costs. It's true in the short-term companies may pass on just the increased cost of an input, but this will lower their margins and is not viable option over the long term. If companies did not pass on the cost of their materials and make a profit it would be difficult for them to stay in business. Higher costs means higher risk as inventories becomes more expensive. Car companies do not give away their cars, they ultimately need a certain percentage return on their costs. If costs go up, companies raise prices, not only on the amount of the actual cost increase, but also to compensate for their gross margin profit expectations. If this were not the case their profit margins would decrease.

Secondly, as businesses are integrated, the downstream costs of all products increases. Wilbur Ross in his example of a car having its cost by $175 dollars on average as a result of the tariffs, did not incorporate any downstream costs. A car company uses machinery to make its cars and this machinery is largely made of steel. With an increase in the cost of steel, machinery becomes more expensive. Once again, this forces car companies to increase their prices independent of the cost of steel going into the production of cars. Auto companies use a lot of steel in making their factories. An increase in steel prices from tariffs, increases the cost of making factories for auto companies, which ultimately once again increases the cost of cars. The list of examples for input costs for car manufacturers is extensive. But unfortunately, the full ramifications of increased steel prices do not stop with car companies, it goes on and on.

Businesses buy or lease cars and trucks in order to provide their functions and make a profit. An increase in the cost of cars and trucks increases the cost for those businesses to operate which means higher prices for other businesses and consumers. The bottom line is that an increase the cost of a basic material that is so widely used in society has huge cost implications which are ultimately inflationary.

The above analysis focuses just on steel, but imagine if a trade war does break out, the full impact of rising prices, and lower exports with all countries involved is much more negative. Wilbur Ross either skipped his first-year economics classes, or he consumed too much soup, Coke and beer before his interview on CNBC.