Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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Market Update

Santa Claus Rally - Don't be surprised if Santa Claus arrives before Christmas and rallies the stock market !

So far, in the beginning of December, the stock market has been anything but festive. Trump's tweets have been pushing the stock market higher and lower (mainly lower). Investors are wondering if Santa is coming to town this year. No one knows for sure, but on a seasonal basis, the probability of the stock market performing well in December is relatively high compared to other months of

S&P 500 - Technical Status

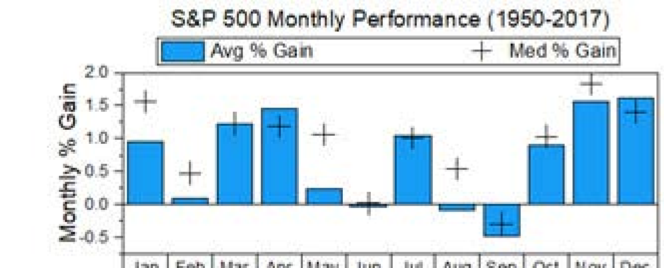
The S&P 500 had a volatile November, but ended positive for the month. Last week, a death cross occurred as the 50-day moving average crossed below the 200-day moving average. Many investors view this as an ominous sign that the overall stock market has changed direction to the downside. Although the stock market may move downwards, investors would be wise not to put too much emphasis on the death cross. The S&P 500 is still above its support level of 2570. If the S&P 500 were to cross this level and remain below it for a few days, the technical picture for the stock market would be increasingly negative. On the positive side, the stock market tends to perform well in the second half of December and any good news might give the stock market a boost at this point.

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

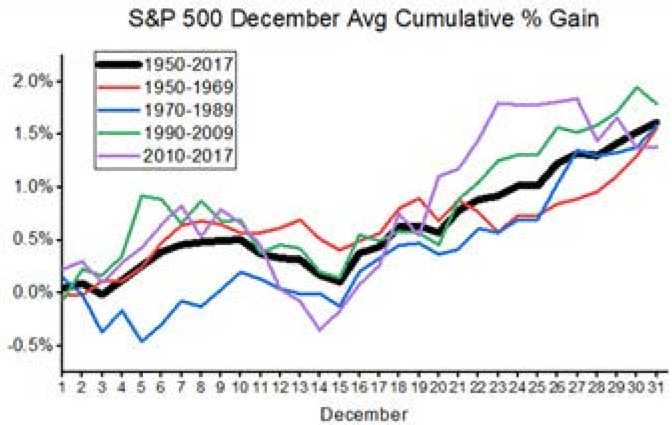
Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
HXT	Horizons S&P/TSX 60™ Index ETF	29.4%
HXF	Horizons S&P Capped Financials ETF	19.5%
	United States Dollar Exposed Assets	
	Equities	
IWD	iShares Russell 1000 Value ETF	12.8%
XLB	Materials Select Sector SPDR Trust	7.9%
FHD	First Trust AlphaDEX U.S. Consumer Discretionary Sector Index ETF	6.9%
FHF	First Trust AlphaDEX U.S. Financial Sector Index ETF	6.5%
XLF	Financial Select Sector SPDR Fund	6.4%
FHG	First Trust AlphaDEX U.S. Industrials Sector Index ETF	6.1%
	US Dollar Forwards (December 2018) - Currency Hedge **	-0.8%
	Cash, Cash Equivalents, Margin & Other	5.4%
	Total (NAV $236,590,689)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 35.6% 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.



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Avg. % Gain	0.9	0.1	1.2	1.4	0.2	-0.0	1.0	-0.1	-0.5	0.9	1.6	1.6
Med. % Gain	1.6	0.5	1.2	1.2	1.1	0.0	1.0	0.5	-0.3	1.0	1.8	1.4
Fq %>0	60	56	65	71	59	51	56	54	44	60	68	75



the year. So far this year, this has not been the case.

Last week, I wrote a report titled "Santa or Tariff Man" (here), discussing the strength of the seasonal trend for the stock market in the month of December. I have included two graphs above from the report. The first graph shows that on average the S&P 500 is one of the strongest months of the year over the long-term. The second graph shows that the trend of the S&P 500 performing well in the second half of December has been persistent over time.

From 1950 to 2017, the S&P 500 has produced an average gain of 1.6% and has been positive 75% of the time. Most of the gains for the S&P 500 have occurred in the second half of the month (see graph above- S&P 500 December Avg. Cumulative % Gain).

The conditions for a rally at yearend are fairly strong. Most money managers have fallen behind the stock market and are in the red. If the S&P 500 ends up in positive territory and a money manager ends up negative territory for the year….that is not a good thing. If the stock market starts to rally later in December, money managers holding cash are going to feel the urge to chase it higher. If a rally were to occur, it may be a race to the finish line, the end of the year. The danger is that the stock market could exhaust itself at the beginning of the next year.

Last year we had a similar circumstance with the stock market rallying in December and then continuing the rally for most of January. At the time there was a sense of euphoria and that the US tax reform was going to propel the stock market higher for the rest of the year. In the last few days of January, investors "looked in the mirror" and determined that the rally was unsustainable and started to bail out of the stock market. I am not saying the same process is going to happen, but if a rally were to occur, the stock market could start to turn down in late December (as it did it did in 2015), or it could start to turn down in late January (as it did in 2018).

There are several major possible "Grinches" for a year-end rally scenario. Powell could release a more hawkish commentary than expected when the Federal Reserve meets on December 19th. The Federal Reserve often has a pattern of being more hawkish in one meeting, more dovish in the next and then more hawkish in the next.

The Federal Reserve wants to provide clarity to investors, but at the same time have a bit of doubt over its actions. At the beginning of October, Powell, in a presentation announced that the current fed rate was a long way from neutral and was more hawkish than expected. In late November, Powell then gave a well followed speech that was more dovish than expected, stating that the fed rate was just below the neutral rate. If the pattern holds true, the expectation would be for a more hawkish announcement in the near future, perhaps on December 19th.

Another stumbling block for the stock market is Trump, who at any time could release an errant tweet that could drive the stock market lower. Trump's tweets on the state of negotiations with China have caused a lot of volatility in the stock market.

It is not just Trump's tweets that are driving volatility in the stock market. Recently, the trade war rhetoric increased once again as Canada, on behest of the US, arrested the CFO of Huawei for possibly breaking sanctions laws against Iran. China sees this action as an aggressive maneuver in the trade negotiations. So far, China has not retaliated, but such an action cannot be good for trade dialogue on a go-forward basis. At best, the trade discussion will probably pause at this point. Of course, things could heat up with more action, especially if China decides to retaliate somehow against the US.

Negative influences on the stock market now could lead to a good buying opportunity towards the end of December. Seasonally, a good opportunity for the stock market often comes towards the end of December

Tax loss selling

This year the stock market is setup well for tax loss selling to take place as most major markets around the world are negative for the year and below their peak levels for the year. Typically, it is best not to wait until the last few days of the year to take on new positions as part of a plan to benefit from tax loss selling. Investors very often try to front run the tax loss selling trade and enter positions in mid-December.

Sectors, such as the energy sector, that have underperformed the stock market are good candidates for investors to consider for the tax loss selling strategy. If the price of oil were to increase at the end of December, then the energy sector could respond strongly to the upside.

January - sorting hat month

January is sorting hat month (analogy from Harry Potter). Investors try to figure out which are the preferred sectors of the stock market to lead the new year. January is characterized by a lot of sector rotation. The leaders of the last year, or even over the last few months, may not necessarily be the strongest sectors for the new year. It is often best not to take large sector bets relative to the portfolio until later in January. This is true for some of the cyclical sectors that tend to perform well in December, such as the industrials and materials sectors, which tend to perform well in December, and then perform poorly for most of January and then perform well from late-January until April or May.

What the HAC is going on?

In the month of November, HAC was generally fully invested in equities. During the month, HAC adjusted its portfolio from being predominately in US equities to a large position in Canadian equities, including Canadian financials. This action was taken to reflect the increasing strength of the Canadian stock market relative to the US stock market at the time. For the month of November, the Canadian stock market moderately outperformed the US stock market.

In November, HAC sold its position in the retail sector as the sector underperformed the S&P 500, due to a number of earnings results from retail companies that were poorer than expected. HAC entered into a position in the US financial sector before the start of its seasonal period in mid-December. HAC held a position in natural gas for most of November. The position was very profitable as natural gas increased in price substantially in November. HAC exited its position in natural gas in late November. The strong seasonal period for natural gas finishes on December 21st. HAC benefited from being exposed to the USD in November as the Canadian dollar declined in value.

Seasonal Opportunities

Small Caps – Seasonal period starts soon

The small cap sector has had an up and down ride this year, more than the S&P 500. From February to June, the small cap sector outperformed the S&P 500 as the US dollar gained in strength and the trade war with China heated up. In November, the small cap sector started to consolidate relative to the S&P 500.

Consolidation before the start of a seasonal period is often a good setup. The small cap sector has a strong seasonal period from December 19th to March 7th (Thackray's 2018 Investor's Guide).

If the stock market manages to rally into the end of the year, it would be reasonable to expect the small cap sector to start to outperform the S&P 500. The small cap sector has a higher beta than the S&P 500 and in a strong rally will typically outperform, particularly in its seasonal period.

It is a good sign that the small cap sector has managed to perform at market over the last few weeks, as the S&P 500 has suffered volatility and moved lower.

My Call: The small cap sector will probably start to outperform the S&P 500 at the start of its seasonal period.

Gold – Starting to Shine

Gold tends to perform from December 27th to January 26th. This seasonal trend is largely based upon the Chinese buying gold ahead of their Chinese New Year. Twenty years ago, it was extremely difficult for Chinese individuals to buy gold. Over time the regulations have been removed and the Chinese middle class has expanded. As a result, Chinese citizens have been purchasing increasing amounts of gold particularly in the period leading up to the Chinese New Year. In recent years, China has been vying for the title of the biggest gold consumer.

Recently, gold bullion has been showing improving relative performance compared to the S&P 500. This is typically a good setup right before a strong seasonal period. It is possible that gold could be starting its upward move early this year.

My Call: Gold will probably start to outperform the S&P 500 in the very near future and outperform in the strong seasonal period that lasts until late January.

Gold Miners – Digging better returns

Gold miners have been outperforming both the S&P 500 and gold bullion. This is a good sign, particularly as the S&P 500 has suffered some volatility. When the gold miners are outperforming gold bullion, it often indicates that both the bullion and gold miners are set to perform well. Gold miners have a seasonal period December 23rd to February 14th.

Gold miners have been positive since September and are still below their trading range that they established in 2017 and early 2018. Recent positive performance makes this an attractive sector.

My Call: Gold miners will probably continue to perform well and outperform the S&P 500 in its strong seasonal period.

Silver – Better than gold?

Silver has a similar seasonal period as gold. It benefits from being both a precious metal and industrial metal. Industrial metals tend to perform well in the beginning part of the year. Given that silver has two seasonal factors helping to push it higher, very often it can outperform gold at the end of the year and the beginning of the new year.

Silver corrected sharply from July into October. Since the beginning of October, silver has been consolidating and setting up for a bounce in its upcoming seasonal period. Silver has a strong seasonal period from December 27th to February 22nd. Currently, silver is set up to perform well in its seasonal period.

My Call: Silver will probably continue to perform well and outperform the S&P 500 in its seasonal period.

Financials – Last chance this year

The financial sector has underperformed the S&P 500 since early this year. The sector started to show some strength in November, relative to the S&P 500, but has recently pulled back as economic growth expectations have faded and the 3yr-5yr government bond yield curve has inverted. The sector is under pressure relative to the S&P 500 as investors continue to expect the Federal Reserve to become more dovish and decrease the amount of interest rate hikes in 2019.

My Call: The financial sector will probably perform at market in the near future and possibly outperform in the new year.

Industrials – Not benefiting from China

The industrials sector typically starts to outperform the S&P 500 in late October, into the end of the year. Recently, the sector has been slipping relative to the S&P 500 as investors are concerned about the trade war heating up and the possibility of increasing tariffs impacting the sector.

My Call: The industrials sector will probably outperform the S&P 500 over the next few weeks into the end of the year when it finishes its seasonal period.

Materials – Lackluster performance and seasonal period ends soon

Similar to the industrials sector, the materials sector has been lagging based upon increasing concerns of a trade war with China.

My Call: The materials sector will probably perform at market until yearend.

Energy – In down trend, but seasonal period starts soon

The energy sector has been under pressure over the last few months, particularly since October. Supply has been strong and demand weak, which has led to lower prices for oil. The next strong seasonal period for the energy sector starts in late February.

Typically, there is a one month window for an early entry opportunity, but this depends on a number of variables including the success rates for early entries on a seasonal basis. Sometimes there can be a nominal difference between an early date (one or two months before the start of the seasonal period) and the actual start of a seasonal period. Other times, there is a big difference and one or two months before the start of the seasonal period has a profile that is significantly weaker than the start of the seasonal period. In this case it is typically better to remain fairly tight to the seasonal buy date. In the case of the energy sector, although the seasonal buy date falls in late February, the energy sector can start its seasonal run in January, and even in late December.

In other words, it is possible to see the energy sector set up for a strong run starting in late December, especially since it has under performed the S&P 500 for an extended period of time and has been suffering from tax loss selling.

My Call: The energy sector will probably start to outperform the S&P 500 in late December and continue to outperform into April.

Energy – Canadian energy poised for a bounce?

The Canadian energy sector has the same seasonal trends as the US energy sector. There are some differences between the two sectors, such as the Canadian sector tends to have smaller companies, less integrated companies and a greater amount of natural gas production.

In addition to the production differences, the Canadian energy sector has an extra burden of lower oil prices due to land locked oil and a lack of support from the Federal government. The current Federal government has increased regulation and created policies that have scared away investments in the energy sector.

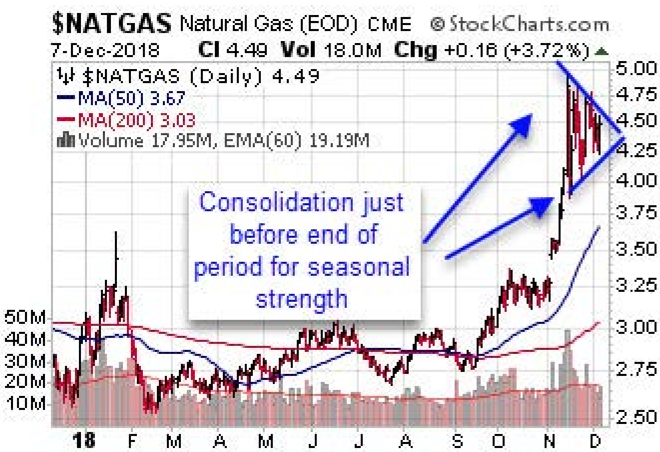
Despite the long-term negative situation for the Canadian energy sector, at times the sector will be an attractive investment. This is particularly the case when the energy sector is in its seasonal period of strength.

In early 2017, the Canadian energy sector was performing poorly, especially in Canada. The discount of Western Canadian Select was much larger than average. When the price of oil started to rally at the start of its seasonal period in February, the Canadian energy sector performed particularly well. Currently, the situation is similar to the beginning of 2017, as the Canadian energy sector has experienced a steep decline before the start of its strong seasonal period.

My Call: The Canadian energy sector will probably start to outperform in late December and continue to outperform until April.

Natural Gas – Seasonal period ends soon

The natural gas seasonal period worked well this year starting in early September. Over the last few weeks, the sector has been consolidating in a wedge pattern. A breakout of this pattern could move natural gas higher or lower in a new trend from the current levels. Given that the seasonal period of strength for natural gas ends December 21st, it is prudent to consider exiting a position in natural gas on a seasonal basis.



My Call: Natural gas will probably correct sharply in late December, before consolidating until its next seasonal period which starts in mid-March.

Technology – Comeback sector?

In my last newsletter, I stated that the technology sector was acting as a canary in the coal mine and sector's underperformance was an indication of a weaker stock market ahead.

Nevertheless, the technology sector has a seasonal trend of performing well in the second half of December. It would not be unreasonable to expect the technology sector to perform well in the last part of December into January and then at some point once again fade if the overall stock market starts to suffer.

The technology sector has been underperforming the S&P 500 since early October. On a seasonal basis, the sector often underperforms for a week or so at the beginning of December, but then tends to outperform the S&P 500 in the last half of December. If there is a stock market rally into the end of the year, it would be reasonable to expect this sector to perform well and outperform the S&P 500.

My Call: The technology sector will probably start to outperform the S&P 500 shortly and perform well into yearend.

Nasdaq – Do the "Naz" with Santa

The Santa Claus rally tends to work particularly well for the Nasdaq. From 1971/72 to 2017/18, in the period from December 15th to January 23rd, the Nasdaq has produced an average gain of 4.0% and has been positive 72% of the time. It has also outperformed the S&P 500, 81% of the time. In a similar pattern to the technology sector, the Nasdaq has underperformed the S&P 500 since September. It has just started to show some improving relative strength compared to the S&P 500. It is reasonable to expect the Nasdaq to perform well if the S&P 500 performs well into the end of the year.

My Call: The Nasdaq will probably start to outperform the S&P 500 shortly and continue its trend into the new year.

Currency Corner

USDCAD - USD outperforming for now !

USDCAD has been performing well since the beginning of October (seasonally the US dollar is strong at this time of the year up until mid-December). Currently, the US dollar is at the top of its trading range and at resistance.

The second half of December (starting December 19th) tends to favor the Canadian dollar. The Canadian dollar strength tends to be for a short time period as the US dollar once again garners strength relative to worldwide currencies, including the Canadian dollar in early January.

EURUSD - The Euro is flat relative to the US dollar

Typically, towards the end of the year, the US dollar underperforms the euro. This year, the euro is flat to the US dollar as problems abound in Europe. Italy is fighting with the EU over its budget, Macron in France is trying to put down a carbon tax revolt which has morphed into an anti-government protest. The Brexit vote is having problems, et al. The result is that the euro is struggling to outperform the US dollar at this time. On a seasonal basis, the US dollar tends to outperform the euro at the beginning of the year. It is possible that this could be the more important trend over the end of the year and into the new year.

Brooke's Rant

All I want for Christmas is a translator (a central bank translator)

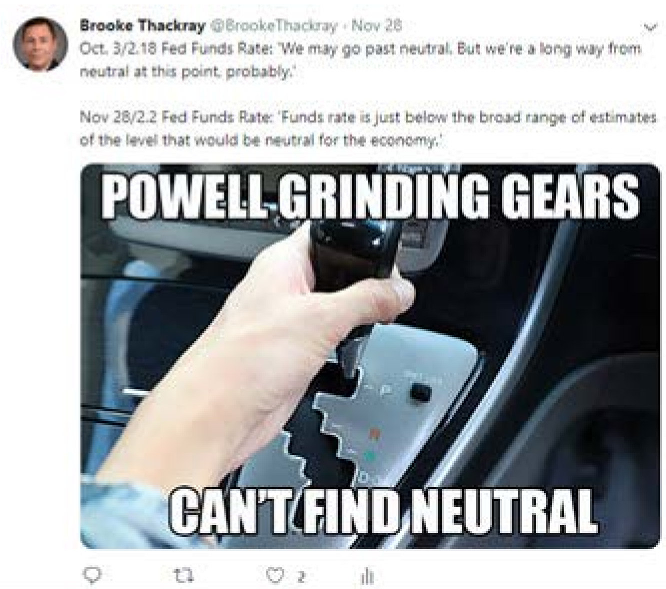
Poloz, the Governor of the Bank of Canada, has been the target of my criticism on a number of occasions in my rants. I have been critical of his poor communications regarding the Bank of Canada's policy direction and reasons for possible action. In October, Poloz stated that global growth was on solid footing, which allowed him to justify an aggressive rate hike schedule. Everyone was looking at the same economic numbers, I have no idea where he came up with the idea that global economic growth was strong. It just ain't so.

In his next Bank of Canada meeting, Poloz became decidedly dovish. Of course central bank decisions are data dependent and subject to revision. I read the text of his speech and I cannot figure it out. I must be missing something in the translation.

Like many others, I believed that Powell was a straight shooter and would stick to a pre-determined path unless circumstances changed significantly. In other words, he would not let a minor dip in the stock market or economic reports that showed a gradual slowing of the economy, substantially alter his guiding policy statements. I was wrong.

In October, Powell stated that the Federal funds rate was a long way from neutral, a rate was which is neither stimulative nor restrictive. In addition he stated that the Federal Reserve could purposely overshoot the neutral rate. His comments spooked the stock market. In November he changed his tune and stated that the Federal funds rate was just below the neutral rate, although he did not know where the neutral rate was exactly. This was a huge reversal from his previous position, which was not grounded on any substantial changes in the economy.

I tweeted the tweet below, sarcastically poking fun of Powell's reversal in position.



I am not sure where Powell stands any more. He could change his mind once again at the next Federal Reserve meeting on December 19th. All I want for Christmas is central bank translator.

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