Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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Market Update

FED FOMO is the Fear of Missing Out (FOMO) on a rally in the stock market that is believed to be substantially supported by the actions of the Federal Reserve. It is the belief that if anything bad happens to the stock market that the Federal Reserve will be forced to provide stimulus to once again drive the stock market higher. FED FOMO is largely based on the concept of the "Fed Put."

A put option is the obligation of the put seller to sell a security if the buyer "puts" his right to buy the underlying securities at a specified price. The colloquial term "Fed Put" is used to refer to the ability of investors to put their right for stock market support to the Federal Reserve, forcing them to act if the stock market has declined.

The term "Fed Put" was started back in the Greenspan era, when Greenspan bailed out the markets after the Long Term Capital Management fiasco. Successive central bankers have followed suit and have continued to ferment the belief of a Fed Put with loose monetary policy actions.

Powell has established his own version of the Fed Put, with strong policy statements, stating that he will do whatever is necessary, and the Federal Reserve is not thinking about raising rates. In addition, the Federal Reserve has embarked on novel programs such as buying junk and corporate bonds. Investors have cheered the ac-

S&P 500 Technical Status

The S&P 500 uptrend is still intact (barely). It is also above its 3,200 and 3,000 levels of support. On June 8, the S&P 500 closed at 3232. It then pulled back to just above 3,000 and then rallied to its current level. If the S&P 500 breaks below 3,000, increased downward pressure would likely develop, pushing the stock market lower.

The chart to watch is the Nasdaq-100. Recently, the Nasdaq-100 has been underperforming, but its performance relative to the S&P 500 is still in tact. If the uptrend is broken and the relative line moves below the horizontal dotted line, there is a good chance that both the Nasdaq and the S&P 500 are heading lower.

Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **August 31,** 2020

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Bonds	
HBB	Horizons CDN Select Universe Bond ETF	5.5%
HFR	Horizons Active Ultra-Short Term Investment Grade Bond ETF	3.1%
	Commodities	
HUG	Horizons Gold ETF	9.5%
	United States Dollar Exposed Assets	
	Bonds	
HTB	Horizons US 7-10 Year Treasury Bond ETF	20.9%
	Equities	
XLP	Consumer Staples Select Sector SPDR Fund	16.6%
	US Dollar Forwards (September 2020) - Currency Hedge **	0.5%
	Cash, Cash Equivalents, Margin & Other	43.9%
	Total (NAV $235,360,069)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 47.6% 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.

tions of the Federal Reserve and pushed the stock market higher, creating a moral hazard with investors believing that the Federal Reserve has no choice but to support the stock market.

Investors such as Dave Portnoy, aka the guy from barstool sports, is telling everyone that stocks never go down. Sometimes it seems that way, but we all know that is not true. Nevertheless, investors are acting as if Portnoy is right.

There is a growing number of investors that fear that they are missing out on stock market gains that are backstopped by the Federal Reserve. Valuations do not seem to matter. The feeling is that if the Federal Reserve is supporting the stock market what difference do valuations make?

The problem is that investors are acting as if the Fed Put is "at the money" and the Federal Reserve will come in and support the stock market if the stock market drops a few percent. Ironically, the Federal Reserve has helped to support this belief through its actions. In a way, the Federal Reserve is its own worst enemy.

The level of the Fed Put is probably much lower than most investors anticipate, but the mere fact investors believe it the Federal Reserve will step in if the market only declines a few percent is helping to support the markets.

The danger is obviously that if the stock market moves lower and the Federal Reserve is not there to step in and support the market, the stock market could move decisively lower. What if the Federal Reserve sat on the sidelines while the stock market corrected? It seems that many investors do not believe that this is possible, but it is totally conceivable.

As investors are starting to realize, the economy and the stock market are not related in the short-term. In the long-term, they are absolutely related. Currently, the stock market is at all time highs and the economy is far below the level that it was at the beginning of 2020.

Yes, I agree that the Federal Reserve has an unofficial third mandate of supporting the stock market to indirectly support the economy through the wealth effect. But it is a stretch to believe that Federal Reserve is going to stop every correction. I know that it is hard to believe, but it used to be quite common for the S&P 500 to have one or more 10% corrections in a year...in a positive year for the stock market.

Investors may be in for a surprise if the stock market corrects and the Federal Reserve sits on the sidelines.

Blackout Period - It Has Started

Black Square

In my newsletter last month, I stated that "once we slip into September, the odds of large Federal Reserve actions decreases substantially." In essence, we are now getting too close to the election for the Federal Reserve to initiate major actions unless very unusual circumstances develop. We are now in the "unofficial" blackout period for the Federal Reserve.

The next Federal Reserve meeting is on September 15 and 16 with its interest rate announcement being made at the end of its meeting on the September 16. Currently, investors are expecting the Federal Reserve to leave interest rates unchanged. It is highly unlikely that the Federal Reserve would move into negative interest rate territory just before the election.

In addition, the Federal Reserve is probably not going to make any large changes to its quantitative easing policy. First, it appears that the economy does not need to be artificially manipulated at this time as it is plodding along on its own. Second, it is unlikely that the Federal Reserve would make any large policy decisions before the election unless absolutely needed.

So what might the Federal Reserve announce on September 16?

The Federal Reserve could give more of a description of how the Average Inflation Target (AIT) policy is going to work. It is also possible that they might hint at Yield Curve Control (YCC). It will probably continue to talk about how the Covid-19 pandemic can still have large economic consequences and how the Federal Reserve will be supportive and it has a lot of tools that it can use if needed. But there probably will not be a dramatic new policy announcement.

The November Federal Reserve meeting falls on November 4 and 5. Although this meeting is not associated with a summary of economic projections, in the past, Powell has made comments after this type of meeting.

The Federal Reserve meeting falls right after the US election on Tuesday November 3. I wonder if this was an oversight by the Federal Reserve committee. Regardless, it is possible that a winner of the election will not be declared until some time after November 3, and even if a winner is declared, there is a possibility that it will be contested by the other party.

It is going to be hard for the Federal Reserve to announce any large moves right after an election. If it were to make a large announcement, being so close to the election would certainly cause many people to openly question if the Federal Reserve is truly independent from the government. It is all about optics.

The next Federal Reserve meeting, after the November meeting, takes place December 15 and 16. This is the time period when the Federal Reserve is more inclined to take action. December is also the preferred month of the Federal Reserve to take action. Both Yellen and Powell have previously pivoted in December.

The point is that for the next few months, the Federal Reserve will probably not step up to the plate with new and large programs, even if the stock market goes through a moderate correction.

Gamma not for your Grandma

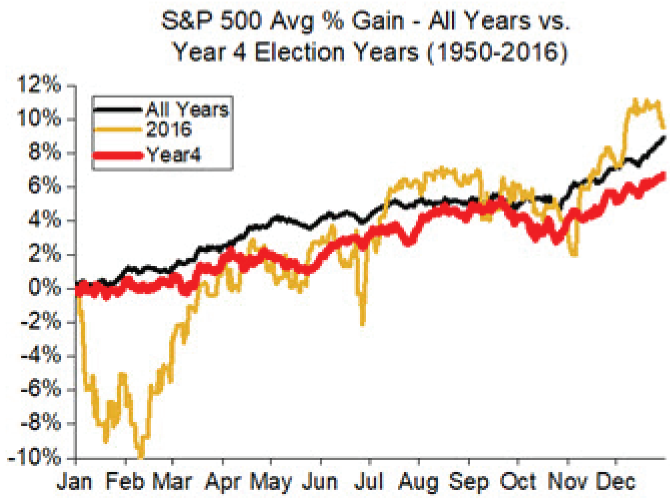
Recently, gamma has been pushing the stock market. When an underlying stock increases in value, the corresponding option contract also changes in value. Gamma is the rate of change of delta on an option's contract.

Recently, a lot of novice investors have been buying call options, speculating that stocks and the stock market will continue to rally. The amount of call options being purchased is setting records due to a huge amount of speculation. Market makers, taking the other side of the contract, typically hedge their position, buying the underlying equity. As the stock market moves higher, market makers are forced to buy the underlying securities to cover increasing gamma, thus pushing the stock market higher. This circular relationship has kept upward pressure on the markets.

The bad news is that if the stock market starts to turn down and investors buy puts, the whole process could work in reverse and market makers could be forced to sell underlying holdings, putting downward pressure on the stock market.

Seasonally - Not a good time

On a seasonal basis, we are in the weakest period of the year. In fact, the last two weeks of September over the long-term has been the weakest two weak period of the year over the long-term. To top things off, we are heading into a very polarized election. On a seasonal basis, the market tends to be weak before the election as investors shy away from risk in an uncertain environment. The result over the long-term on average has been a declining stock market into late October.



Above is a graph that I included in my last month's newsletter. It shows that on average the stock market tends to decline at this time of the year into late October, in election years. Of course, the S&P 500 does not have to follow its previous election trends, but given the amount of polarization in the US and uncertainty around the election, the possibility of a declining market into the election should not be dismissed.

What the HAC?

As August tends to be a seasonally weak month for the stock market, HAC was conservatively positioned. HAC had a fairly large equity position in the consumer staples sector. During August, HAC exited its position in gold miners and slightly increased its position in gold bullion. HAC was also positioned in US government bonds and Canadian bonds.

Seasonal Opportunities

Gold

Gold has a strong seasonal period from July 12 to October 9

There have been two primary drivers for the price of gold over the last few years: real interest rates and the US dollar. In the graph below, I show the relationship between the price of gold and the US dollar and the yield on the US Treasury 10 year note. A falling yield on the US Treasury 10 year is broadly indicative of falling real interest rates over the short-term.

The graph below shows the relationship between gold, and the US dollar and the yield on the 10 year Treasury Note.

❶ In stage 1, gold increased in price as the US dollar was relatively flat. The main driver in this stage was the falling yield on the 10 Year US Treasury Note.

❷ In stage 2, a slightly declining US dollar and rising rates were the drivers for a falling gold price.

❸ In stage 3, at the beginning of the stage, the US dollar was rising (at that same time gold was flat). Overall, in this stage, declining yields and a lower US dollar helped to push the price of gold higher.

❹ In stage 4, the yield on the 10 Year US Treasury Note was flat. The main driver for the rally in this stage was the decline of the US dollar.

❺ In stage 5, the US dollar has been fairly flat, and at the same time the yield on the 10 Year US Treasury Note has also been fairly flat. Concurrently, gold has been falling in price. If either variable increases and the other stays flat, this would still probably have a negative impact on the price of gold. If they both increase at the same time, the price of gold could be substantially impacted.

Note: the seasonally strong period for gold bullion and US government bonds ends soon.

My Call: Gold will probably start to roll over and weaken until late December.

Gold Miners

Gold miners have a strong seasonal period from July 27 to September 25

Gold miners performed well since the bottom of the stock market in March. More recently, the sector has been showing signs of weakness. It should be noted that the seasonal period for gold miners ends shortly.

My Call: The gold miners sector will probably underperform the S&P 500 until late December.

Consumer Staples

The consumer staples sector has a strong seasonal period from April 23rd to October 27th

The consumer staples sector has been performing at market since late 2018. It has had a few ups and downs along the way. Since June, the consumer staples sector has been performing at market.

Currently, the consumer staples sector is one of the more attractive sectors in the market from a seasonal perspective. Over the long-term, the consumer staples sector has been the top performing sector in the month of October.

October has historically been a volatile month as the stock market transitions into the six-month favorable period which starts on October 28.

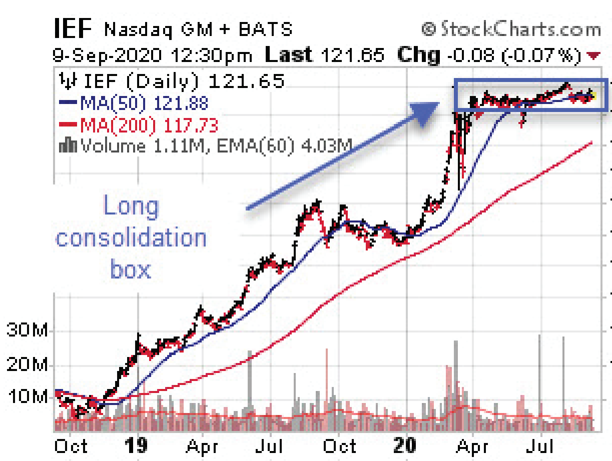
My Call: The consumer staples sector will probably outperform the S&P 500 over the next month and a half.

US Government Bonds

US government bonds have a strong seasonal period from May 5 to October 3

US government bonds have been relatively flat in their seasonal period that started in early May. This is an unusually long consolidation period. Once government bonds break out of their consolidation box, it is likely that US government bonds will establish a new directional trend.

It should be noted that the seasonal period for US government bonds ends on October 3. Based on previous seasonal trends, government bonds can finish their seasonal rally abruptly in October.



My Call: US government bonds will probably start to roll over and trend down in the near future.

Industrials

The industrial sector has a strong seasonal period from October 28 to December 31

The industrial sector has been rising in an ascending bullish triangle relative to the S&P 500, which is a bullish formation of higher lows.

The industrial sector is important to watch, as it represents a possible future rotation from the technology sector to the cyclical sectors.

My Call: The industrial sector will probably stumble in the near future and set up for a good entry point in late October or in November.

Materials

The materials sector has a strong seasonal period from October 28 to January 6

The materials sector tends to track the industrials sector to a certain degree as they are both cyclical sectors dependent on economic growth. Recently, the sector has started to outperform the S&P 500.

Like the industrials sector, the performance of the materials sector potentially represents a rotation from the technology to the cyclical sectors.

My Call: The materials sector will probably underperform the market until November.

Canadian Banks

The Canadian banking sector has a strong seasonal period from October 10 to December 31

The Canadian banking sector has been performing well relative to the S&P/TSX Composite Index since June, forming a pattern of higher lows. More recently, the sector has been performing well as the result generally stronger earnings than expected in August.

In the past, when Canadian banks have released strong earnings in the summer, the sector has tended to outperform over the next few months, including the time leading up its seasonal period.

Investors should note that when Canadian banks have outperformed after its summer earnings release, they are susceptible to losing steam when they release their next earnings towards the end of November / the beginning of December, which is before the end of their seasonal period. In my *Thackray's 2020 Investor's Guide*, I mention this phenomenon and break out the performance of the Canadian banks in December separately.

My Call: Canadian banks will probably outperform the S&P/TSX Composite until the end of November.

Technology

The technology sector has a strong seasonal period from October 9 to December 5 and a second seasonal period from December 15 to January 17

The technology sector has been leading the stock market higher since late 2018. It has been forming a higher trend line since 2019, relative to the S&P 500. This trend is still in tact. On an absolute basis, the up trend is still in tact.

The technology sector has been the "darling" sector of the stock market and attracted a lot of money. If the sector decisively breaks its up trend line and the overall market heads lower, this could be an indication that the overall stock market is in trouble.

My Call: The technology sector will probably underperform the stock market over the next month.

Currencies

USDCAD

The US dollar has been under pressure since March, compared to world currencies and the Canadian dollar. The short position against the US dollar has become a very crowded trade. As a result, the US dollar could move sharply higher if the sentiment against the US dollar becomes positive.

On a seasonal basis, the USD tends to outperform the Canadian dollar from late September until mid-December.

My Call: The US dollar will probably outperform the Canadian dollar over next few months.

Brooke's Rant - What is Etsy?

A lot of Tesla investors are asking what the ... is Etsy? Many investors were speculating that Tesla was going to be added to the S&P 500 index given that it met the requirements for the index. After the stock market closed on Friday September 4, the S&P 500 selection committee announced that they were including an number of companies, including Etsy into the S&P 500 index. Notably, Tesla was not included.

Tesla is many times bigger than Etsy. Many Tesla investors took to social media and complained. If Tesla is so much bigger than Etsy and also meets all of the requirements for the S&P 500 index, it is obvious (at least to them) that Tesla should have been included in the index.

The index selection process is not just a quantifiable requirement and once a company passes the hurdle it is in the index if there is an open spot. One of the problems for Tesla is also one of the reasons that the stock has reached such high levels - it has a small float. If there are not enough shares on the market, it is difficult for investment companies that have to buy the stock as part of their portfolio because it has been included in the index. Tesla may be on the sidelines for now, but it could be included in the index in the not so distant future if it issues more stock into the market. The irony of this is that issuing more stock will increase the coffers of Tesla at nose bleed valuations.

BTW: Etsy is an American e-commerce website focused on handmade or vintage items and craft supplies.

Average Inflation Target (AIT) - The Federal Reserve is going to have a diet problem

In 2012, the Federal Reserve announced its policy of targeting 2% inflation. It later clarified its approach discussing its symmetry policy, stating that it "defines symmetry around this objective in terms of intent by stating that persistent deviations of inflation from 2 percent in either direction would be of concern to the Committee"

On August 28 of this year, the Federal Reserve announced at its virtual Jackson Hole symposium that it was altering its policy to average inflation targeting. In other words, because inflation had remained below 2% for so long, it was willing to let inflation run hot (above the 2% threshold), before taking any action.

This is equivalent to saying because I have been on a diet for the last three months, I can now gorge myself on chocolate cake for the next three months.

We all know what happens when you break a diet, there is always another exception before you get back to the plan. Diet breakers often rationalize their choice to delay getting back on track by saying such things as... "one more piece of chocolate cake, tomorrow I will start" etc. I know, mea culpa.

Do you really think the Federal Reserve is going to be any different than a someone who has broken their diet. The Federal Reserve may have good intentions, but it will find ways to make exceptions, to eat one more piece of chocolate cake before it takes the appropriate action. It will come up with one more excuse to let inflation run "hot." And then one more excuse, and probably one more.

The problem is not one of averages, but convexity. Once inflation moves higher (particularly above 4%), it becomes very difficult to control and requires greater and greater measures to reduce its effects. I do not think that the Federal Reserve will have the appetite to take the appropriate action.

In recent years, investors have viewed the Federal Reserve as all-powerful, able to control the economy through monetary policy and if it has the will to overcome any situation. This is false. If bond investors loose faith in the Federal Reserve and start to push up the long end of the curve the Federal Reserve may loose control of the situation.

The good news is that inflation is currently not a problem and the US economy has not breached the 2% threshold. Due to demographics and other factors, it may be some time before inflation becomes a problem. Nevertheless, it is scary that the Federal Reserve is setting the path for something that could be a problem down the road.

In the meantime, let Powell eat chocolate cake!

How Stupid Can You Be? Hotel California.

California has a problem....its residents are fleeing the state for a number of reasons including increasing taxes. Its latest high profile resident to leave is the popular podcaster Joe Rogan.

California has come up with a solution. Introduce a wealth tax and an exit tax. Yup, you heard it correctly. California wants to introduce an exit tax to discourage people from leaving. They are seeking to tax people up to ten years after they leave the state. I am not a lawyer, but I am not sure that this is legal...but I know it is stupid.

I have an idea, make the place a better place to live and attract people to your state. This is a much better idea than turning your state into a "tax prison."