Generations ETFs episode 3: Brooke Thackray transcript, recorded February 3, 2015

Introduction

Welcome to Generation ETFs, brought to you by Horizons ETFs Management Canada Inc. This is a podcast series dedicated to the next generation of investing. I'm your host Donna Papacosta, and in this series, Generation ETFs will aim to educate and inspire investors to understand and be active in their portfolios by discussing market trends and investment strategies with the leading experts in the industry.

In this episode of Generation ETFs, you'll meet Brooke Thackray, who is a research analyst at Horizons EFTs Management Canada Inc. Brooke has written nine books on seasonal investing, and his strategies have been featured in newspapers and magazines. He's often interviewed on BNN.

In this conversation, Brooke explains how seasonality works and how investors can benefit from it.

Donna: As an author and leader in the investment thesis of seasonality, can you describe what seasonality is and how it works?

Brooke: Seasonal investing is taking advantage of trends in the broad stock market such as the S&P 500 or the TSX Composite and trends in the sectors of the market that tend to have a repetitive pattern of outperforming at a certain time of the year. Now this outperformance can be based upon a variety of different factors, whether it's conferences in a particular industry or outsize earnings that tend to occur at a certain time of the year, or in the commodity sector it could be supply/demand imbalances that occur at a particular time of the year.

If we take a look at an example that defines or shows how seasonality works, one sector that we can take a look at is the retail sector. Most investors are seasonal investors whether they recognize it or not. If we take a look at the best time, the biggest time for the retail sector is Black Friday in the U.S. A lot of investors will try to get in just before Black Friday to take advantage of any numbers, strong numbers coming out at that time of the year.

Investors following a seasonal discipline actually get in before everybody else, before they try and take advantage of that trend. When all the people jump in, all the investors jump in to that particular sector leading into Black Friday, it tends to drive that sector up, and the best time to exit the sector tends to be when the event occurs. In the case of the retail sector the best time to exit is typically right around Black Friday.

What you want to do is get in before everybody else gets into a sector and then when they try and take advantage of some sort of seasonal tendency, then you get out when the actual event occurs.

Donna: How often, or what percentage of the time, does something need to happen for it to become a trend?

Brooke: In the context of seasonal investing there are certain qualities that you're looking for in making sure that it's an acceptable seasonal trend that you should be taking advantage of or considering as an investment. The first thing is, is that it has to have an absolute return. Obviously, because why would you go into anything. It has to have a high enough absolute return; that's an obvious one.

The second is that over time you want it to have a higher rate of return than the market. Why would you ever go into a sector itself if the market is providing a higher return? You want to make sure that on a frequency basis that you're also outperforming the market on a greater level than 50%. The frequency, really depending on the strength of the seasonal trend, might be anywhere from 70, 60, 70 or 80%, even 90% of the time it outperforms the market.

There's three qualities you're looking for: a high absolute return, outperforming the market on average on a return basis, and outperforming the market on a frequency basis at least greater than 50% and preferably higher up into the 70s and 80s percents.

Donna: What happens when we get surprises like unexpected political events or even weather? Does this affect the power of the seasonal approach?

Brooke: Any time you have a large event taking place, an exogenous event taking place, it can overwhelm any seasonal or investment or technical or fundamental approach. Let's take a look and let's break this down into two parts. Let's take a look at it from a weather perspective and a political perspective separately.

If a large weather phenomenon occurs it might actually benefit a seasonal trend, particularly when you're dealing with the commodity sectors. For instance, in natural gas, which has a strong seasonal period from September into December, which overlays with the hurricane season. That's not why that's the stronger period for natural gas, but if a hurricane does occur at that time then obviously it's going to help boost the returns of that sector. On the other hand, from a broad market perspective, large weather events can overcome the market and overwhelm any type of trend that's taking place, a momentum trend in the market or a seasonal trend, absolutely.

If we take a look at it from a political situation and something's happening politically around the world, whether it's some sort of terrorist act or is the European Union try to decide its future, those events are going to overwhelm any type of seasonal or technical or fundamental trend that's taking place in the market as well. Just like any other discipline, yes, seasonal investing can be overwhelmed by large events outside.

Donna: Brooke, you're part of the Horizons ETFs team that uses seasonality combined with technical analysis to select securities. What is it about the combination of these two strategies that lends itself so well to an ETF?

Brooke: When you're running a seasonal approach in investing what you want to do is you want to have the seasonal mandate to be the first mandate. It's the primary mandate. Let's take a look at this. For instance, certain sectors might have certain seasonal trends, and they outperform the market at a certain time of the year. You may have a selection of let's say five or 10 different sectors that are going to outperform the market at a specific time of the year. That tells you what sectors of the market to be focused on. If it's not the seasonal mandate at that time then you’re not going to be looking at that particular sector.

How would you combine that with technical analysis? Technical analysis allows you to fine-tune the entry and exit dates. The way you want to do it is, for instance, the energy sector has a seasonal period that starts on February 25th and runs until May 9th. That tends to be the strongest time of the year for the energy sector. The four weeks leading into that is the buy window. If you get a strong technical confirmation showing that that sector's picking up in momentum, then you can step in early into that.

Or if it's weak even at its seasonal date you might want to step in a little bit late. There's a window on the buy date. The buy date has a four-week window before and a four-week window after to be getting in, so you can get in early or get in late, and also with the exit date as well. What you're really doing with technical analysis is really fine-tuning or turbocharging the seasonal approach.

Donna: So, in the world of seasonal investing, what are some of the most important trends?

Brooke: The biggest trend, if we take a look for seasonal investing ... There's a lot of major trends and there's some minor trends, but the biggest trend by far is the six-month cycle. I'm not the one that developed the six-month cycle. It's been talked a lot about before. A lot of people know it as “Buy when it snows and sell when it goes” or “Sell May.” It's also in the academic journals – it's called the Halloween Effect.

Basically what it is is the stock market has a long-term historical trend of outperforming from the end of October into April. I have actually a little more specific dates from October 28th until May 5th, but that six-month period tends to be better than the other six months period over the summer months. It's largely caused by money flows going into investments at the time. People become less interested in the summer months, and also to the economy as far as production goes tends to slow down a little bit in the summer months as well.

All of those things wrap up to having the stock market typically be a little bit weaker in the summer months. This phenomenon is definitely a major driver within the seasonal mandate because it's dealing with the broad market overall and affecting all of the sectors of the market.

Now, over the last five years what you've seen is you've seen the Federal Reserve come out and provide a lot of stimulus. All of those stimulus activities have occurred in the summer months helping to give the summer months a little bit of a boost, but right now the Fed has backed off that as far as their bond purchases go, so they're not going to be providing that same stimulus, so we're probably going to go back into seeing that six-month period in the summertime from May into October once again being weaker or even providing negative returns as well.

Donna: Brooke, here's a question we're asking everyone in this podcast series. What's the best piece of investing advice you've ever received?

Brooke: First of all, it doesn't matter what investment discipline you're following. It should be a discipline and it should have a process. That's really, really important. The best piece of advice that I've received is really being able to take your emotion out of it. By definition we're all emotional creatures – being human. That's one thing we all have to overcome. Seasonal investing really is a long-term discipline. It's not going to work all the time, but on average, historically it's actually worked more often than not. You still can become emotionally attached to any investments and you have to make sure that you're following the process, you're following the mandate and acting on that alone without the emotion getting in the way of it. The best piece of advice that I've ever had is to invest based upon process without emotion.

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