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SEASONALITY LIKELY A CATALYST FOR CORRECTION

Will oil, gold, or base metals pull back?


Keith Richards

In my last Investor's Digest column, I noted that – historically - years with better-than-average returns in July were followed by bigger-than-normal sell-offs in August and/or September. I explained that the strong markets we've had this summer, along with certain technical indicators suggesting that markets were overbought, inspired me to move 25 per cent of the ValueTrend Equity Platform into cash in mid-August.

Since that time, we've raised further cash and added a hedge element to our portfolio. We are closer to 30 per cent equivalent in cash at this time. Remember, cash can offset potential downside as, if and when markets decline – and it also can be redeployed when markets offer favoured stocks and sectors at lower prices.

I always get a kick out of buy-and-hold managers who say that a market sell-off is a buying opportunity. Readers with an inkling of logic will no doubt see the conflict of remaining fully invested yet proclaiming a market dip is a buying opportunity. With what capital do these fine folk suggest buying the bargain stocks with – given that they remain fully invested at all times?

I might have a few ideas that readers could add to their watch lists. As you may recall from my prior column, I noted that a pullback in oil, gold, and industrial metals would entice me to consider buying those commodities. Please refer to that column for specific ideas in those areas.

Some new ideas have crossed my path, and I thought I'd present them here this time around. The Shanghai Stock Exchange appears to be breaking out of its small triangular formation. This coincides with a break of its downtrend, and a nice pattern on the intermediate-termed momentum oscillator (RSI) and MACD.

Comparative strength compared to the S&P 500 is pretty flat, indicating it is no longer underperforming the U.S. markets. The Shanghai market consists of both "A" and "B" shares – recall that "A" shares are generally considered of higher quality, given their typically larger market cap and supposedly better standardization of financial reporting.

If you prefer to stay with the A shares, I have traded the **BMO China Equity Index** (ZCH-TSX, $19.90) in the past offering focused A-share holdings. The triangular consolidation pattern has not broken, and the downtrend has not broken. I would suggest that readers wait for a breakout through about $19.50 before investing in this ETF. We have not bought into this position at this time, but will consider it upon a breakout of that price point.

ValueTrend initiated a position in silver recently. Its chart, shown below, suggests a textbook "cup and handle" formation – including the "high-low-high" traditional volume appearance for this basing pattern. I covered how to identify formations and their volume patterns in my book *Sideways*, for those interested in learning more about that subject.

The handle in the current formation on silver is performing a classic test of old resistance (as new support builds). Seasonally, silver can move well between mid-September and February. All of this suggests a reasonably good probability of success in the trade.

Gold, too, has a good chart and has pulled back closely to the "buy" price point I mentioned in my prior column. However, we preferred the silver play in the ValueTrend Managed Equity Platform. We bought shares of **Horizons Comex Silver ETF** (HUZ-TSX, $11.50) recently, and will look to sell it if, as and when it nears $14 a share.

Natural gas looks to have formed a "head and shoulders bottom" in its chart (at bottom) of late. Such a pattern is a reasonably reliable indicator of potential upside. It's done this before, as you can see by my past notations of that same formation in 2012. A perfect head and shoulders bottom will decline in volume as the formation occurs, and then will ramp up in volume when the breakout occurs. It's ideal if you get a neckline test from the sector. It did test the neckline in 2012, and looks to be doing the same right now. Been there, done that – as they say. I'd like to see natural gas prices move above US$3 per million BTUs to confirm a breakout.

According to the *Thackray's Investor's Guides*, and EquityClock.com, natural gas has two seasonal periods to look for. The first is from March to June, followed by another period of strength from September to late December.

In between those periods, the commodity can be a bit weak. It would seem that the seasonal patterns are working quite well this year, having seen the rally occur precisely from March until June, followed by the pullback to the neckline – coincidentally occurring between June to recently.

The exact same pattern and seasonal timing occurred in 2012 when it staged its last head and shoulders bottom. Hey—this seasonal stuff really seems to work! If seasonals play out in conjunction with this chart formation, natural gas could be a "buy" candidate very soon.

If you want to take a position, consider buying a natural gas ETF such as the **Horizons NYMEX Natural Gas ETF** (HUN-TSX, $6.95) as a pure play on the commodity.

Or you could also consider buying one of the producers that are highly levered to the price of natural gas, such as **AltaGas Ltd.** (ALA-TSX, $34.30).

Upcoming appearances with Keith Richards

The MoneyShow Toronto, Sept. 16 to 17 at the Metro Toronto Convention Centre. Keith will be speaking on Friday, Sept. 16 at

12:45 p.m. His topic is, Have your cake and eat it too: Playing the risk/reward trade-off.

Yes, it's still a bull market. No, it's not going to be a simple buy-and-hold ride. The good news is, this type of environment is what investors familiar with technical analysis thrive in!

Attend this seminar and learn how to think and act like a technical analyst by understanding the basics of market realities – and how to position your portfolio to limit your risk in the current investment environment.

Keith on BNN

Keith will appear on BNN's *Market Call* on Wednesday, Oct. 5, at 6 p.m. Phone in with your questions on technical analysis for Keith during the show. Call toll-free at 1-855-326-6266 or email your questions ahead of time (specify they are for Keith) to marketcall@bnn.ca.

Keith Richards, portfolio manager, can be contacted at krichards@valuetrend.ca. He may hold positions in the securities mentioned. Worldsource Securities Inc., sponsoring investment dealer of Keith Richards and member of the Canadian Investor Protection Fund and of the Investment Industry Regulatory Organization of Canada. The information provided is general in nature and does not represent investment advice. It is subject to change without notice and is based on the perspectives and opinions of the writer only and not necessarily those of Worldsource Securities Inc. It may also contain projections or other "forward-looking statements." There is significant risk that forward-looking statements will not prove to be accurate and actual results, performance, or achievements could differ materially from any future results, performance, or achievements that may be expressed or implied by such forward-looking statements and you will not unduly rely on such forward-looking statements. Every effort has been made to compile this material from reliable sources; however, no warranty can be made as to its accuracy or completeness. Before acting on any of the above, please consult an appropriate professional regarding your particular circumstances.