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Seasonal weakness provide window of opportunity to redeploy capital in sectors with lower prices

Take advantage of potential volatility

Keith Richards

I'm going to start this column off with a bit of a bearish note, but doing so will hopefully provide some positive guidance on how one might take advantage of any potential volatility that we might see in the fall.

Thackray's Investors Guide and EquityClock show us that August tends to be a relatively weaker month – author Brooke Thackray notes in his namesake guide that it is the fourth weakest month from an historic perspective. September is noted as the weakest month of the year from a seasonal perspective.

Thackray's guide shows us that the average return in those two months is -0.1 per cent and -0.4 per cent since 1950. This may not seem like large losses, but keep in mind they are averages.

Thus, the positive months were factored into those numbers – meaning that the negative August/September periods were far greater in loss than the averages suggest.

Below is the EquityClock chart of the S&P 500 – note the tendency for markets to weaken from August into mid-October.

So much for averages, but how do markets perform after a stronger than normal summer? My observations are that the S&P 500 is prone to an even-greater tendency to selloff if July is strong.

I examined the charts of the S&P 500's performance over the summers of 1997, 1998, 1999, 2000, 2005, 2007, 2010, 2011, 2013, 2014, and most recently, last summer (2015). Each of these summers saw strong markets through July.

The takeaway from this study: Each of those years was followed by bigger than normal selloffs in August and/or September.

Given the strong markets we've had this summer, along with certain technical indicators that suggest that markets are a little overdone at this time, I moved 25 per cent of our equity platform into cash in mid- August.

My battle plan is to use that cash to offset potential downside as, if, and when markets decline – and to act as opportunity capital to be redeployed when markets offer favoured stocks and sectors at lower prices.

On my shopping list are specific commodity plays. If you saw me on BNN in July, you will know that one of my "top picks" was **Vermilion Energy Inc.** (VET-TSX, $48.16). I bought that stock when oil fell below $40 in early August.

We're up nicely on the stock, and feel that any further volatility on oil can be used to pick up similar energy stocks. We also hold the **iShares Capped Energy ETF** (XEG-TSX, $12.61) as a play on what we see to be a broad move by the energy stocks.

An area that I have yet to place capital into is precious metals. I noted on my blog (valuetrend.ca) back in early July that gold and silver were technically bullish from a trend perspective – but overbought from a momentum perspective.

I relayed that the ratio of smart money selling (commercial hedgers) compared to dumb money buying (retail investors) was skewed towards net "smart" redemptions and "dumb" purchases of the metals.

Further, I noted on the blogs that both metals were approaching their respective resistance targets. I expected a bit of a retracement on these metals, and I added that I would like to buy on such a pullback.

The near-termed chart shows us a potential for gold to pullback target in the US$1,290-to-US$1,315-per-ounce area. I will look at buying at that price. Current upside targets are US$1,400 and then US$1,600. If gold can break US$1,400, it could to get to US$1,600.

Silver has a clear upside target at US$22. Buying near the technical support level of US$18 on a pullback and selling near US$22 would be a nice trade by itself.

Whether silver could make it through US$22 is yet to be seen. You can play gold through **Horizons Comex Gold ETF** (HUG-TSX, $12.50), the **iShares Gold ETF** (CGL-TSX, $11.68) or play the producers through the **iShares Global Gold Producers ETF** (XGD-TSX, $14.86). Silver can be played through the **iShares Silver ETF** (SVR-TSX, $10.44).

We don't hold any of those positions at the time of writing – but may enter into any of them if our buy-in targets are met.

Industrial metals are also looking technically intriguing. While they are not as appealing to the doomsday crowd as gold and silver are, the industrial metals group, as illustrated by the $BCOMIN Bloomberg Industrial Metals index (consisting of futures contracts on copper, aluminum, nickel and zinc) is showing technical signs of an exciting turnaround.

A bullish break in the downward trend and a crossing of the 50-day moving average through the 200-day moving average make this chart attractive. The chart shows a base top of 100 at this point and a break of that level could be proof of a bottom.

Copper in particular shows us a higher low in June, but no breakout through the $2.30 lid that has contained it for the calendar year.

Traders may want to keep their eyes open here. Should copper break $2.30 and stay above that level for a few days, you could be seeing the beginning of a recovery–and be catching a Phase 2 breakout (please see my book *Sideways* for more on that subject).

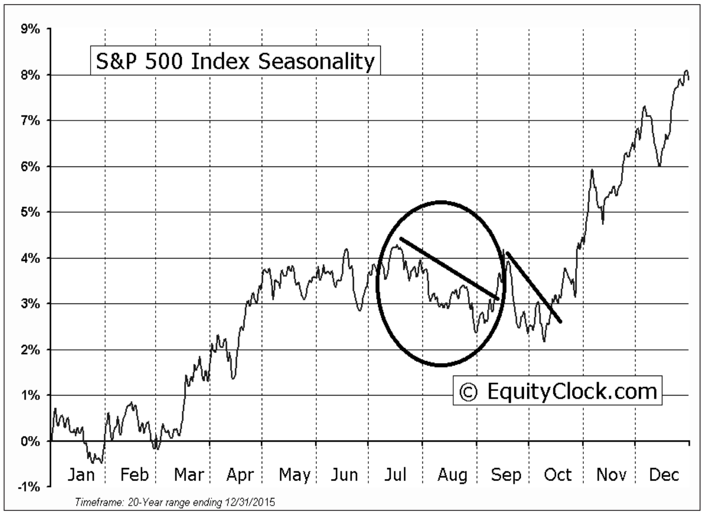
Smart traders will wait patiently for such a breakout. As always, an anxious trader attempting to buy the bottom may get kicked in the bottom instead. Patience is a virtue in the world of the investors.

Upcoming appearances

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 discussion is titled 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 Wednesday, Aug. 24 at 1 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 market-call@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.*