
# SIERRA

SHARD FUND

# A JOURNEY ACROSS FINANCIAL MARKETS

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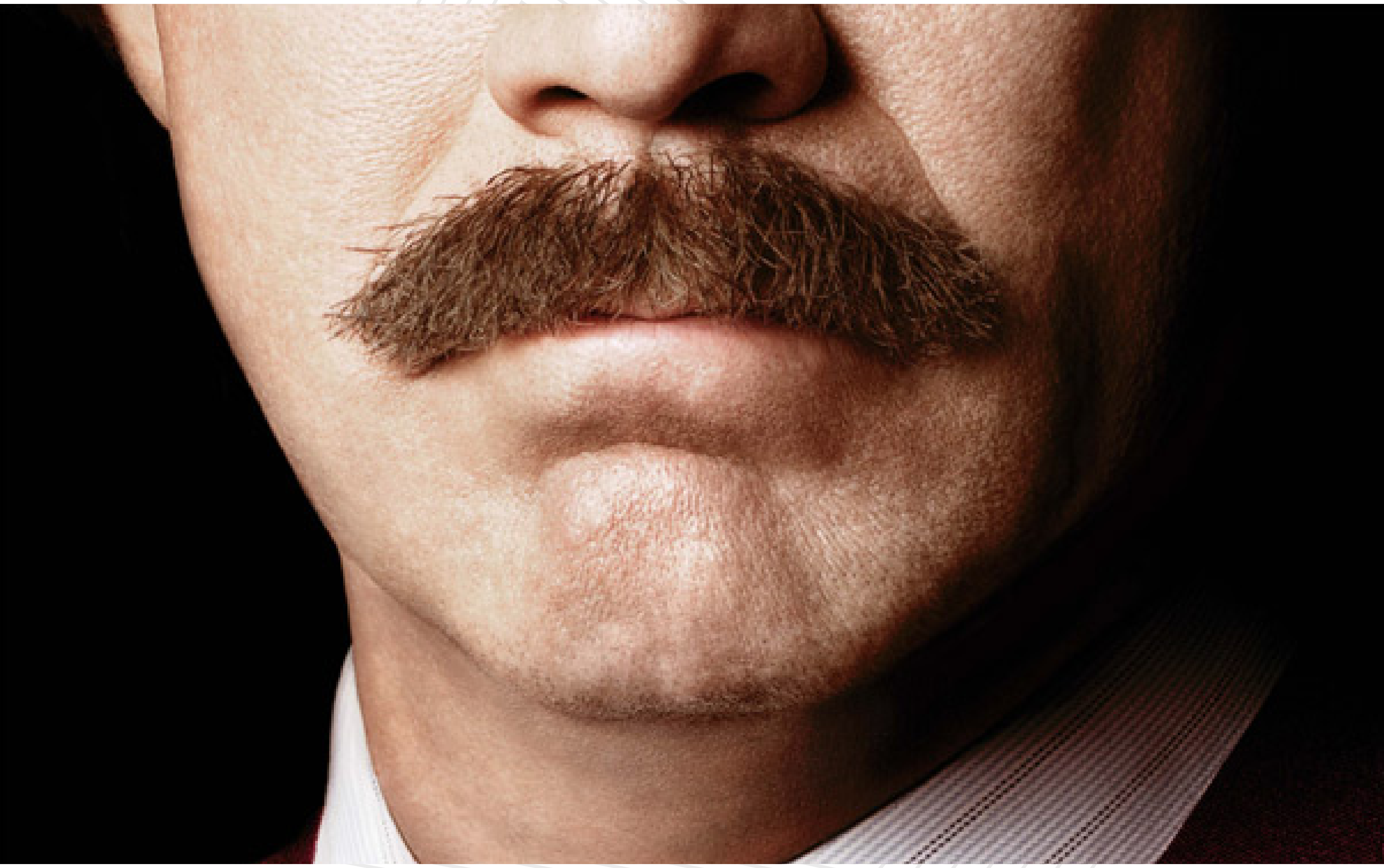
# SPECIAL ANNOUNCEMENT



Movember is an annual month-long charity where men are growing moustaches and raising money for prostate cancer awareness. Shard-Fund is participating in this charity. If you wish to join/donate/follow our progress, click the moustache on the right.

# USA

## Until taper do us part

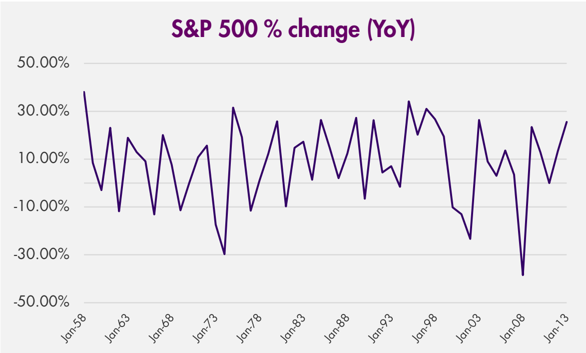
It has been an uneventful week for the US stock market, marked by the testimony of potential Fed chairwoman Janet Yellen. As far as we are concerned, her speech may as well have been included in "The Monetarist Manifesto" — the sequel of Karl Marx's 1848 classic. Of course, investors loved it and US indices closed on a sixth consecutive week of gains, with the S&P 500 increasing by 1.56%. The yield on 10-year treasuries decreased 17 basis points from its weekly peak at 2.78%.

| | |
|---|---|
| Consumer Discretionary | 2.62% |
| Healthcare | 2.18% |
| Materials | 1.67% |
| Consumer Staples | 1.55% |
| Financials | 1.29% |
| Industrials | 1.28% |
| Energy | 1.28% |
| Technology | 1.18% |
| Utilities | 1.07% |

Currently, around 4% of the pilots in US airlines are female and that ratio is probably representative worldwide . However, that proportion is set to increase +1, as Janet Yellen has been nominated to be the next chairman of the Federal Reserve i.e. the pilot of a USD 15.5 trillion plane. The majority of market participants considered her a second Ben Bernanke, but she has turned out to be even more accommodative. In her testimony (released on Wednesday), she mentioned that the economy is still 'far short' of potential, as the unemployment rate at 7.3% is 'still too high' . Meanwhile, Yellen also claimed the inflation rate 'has been running below Fed's target and is expected to continue to do so for some time'. Probably her most supportive quote for prolonged QE was: 'I believe that supporting the recovery today is the surest path to returning to a more normal approach to monetary policy'. Overall, was this a dovish testimony? Yes, it was: but the context should also be taken into account. This was her first statement as the Chair of the Fed (assuming she is chosen), so anyone in her place would have sounded similar. You don't want to scare the market with your first speech. You want to sound supportive and transparent, and that is what she aimed to do. Thus, there is no need to try and decipher her words, because just like in May, the statement is pretty clear.

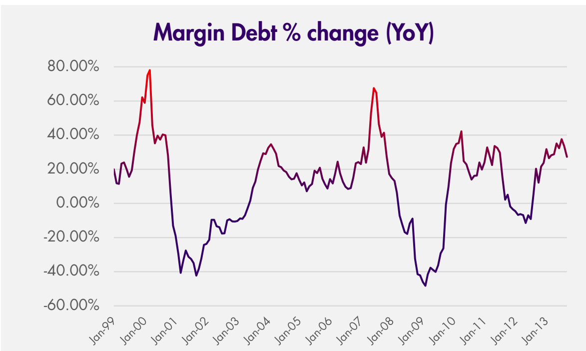
> **"I believe that supporting the recovery today is the surest path to returning to a more normal approach to monetary policy."**

Back then investors made the mistake of thinking too much about Mr. Bernanke's words, and began expecting a taper in September (which we stated numerous times was unlikely). Similarly, there are now a lot of emerging discussions in the media about a prolonged QE beyond 2014, and it seems like




the same mistake has been made once again. There is nothing certain, but it seems like after the comments of Mrs. Yellen, tapering won't start in December. However, we believe that March 2014 is still the most likely period commencing reduced asset purchases. Until then, there are 4 more employment and inflation releases, Q4 2013 GDP release and a ton of other data that could contribute to the 'significant' improvement in the economy that is sought after by the Fed. Of course, those might be negatively affected once again, if the budget and debt ceiling negotiations at the beginning of 2014 turn out as ugly as those in October. In that case, reduction of asset purchases might not be initiated in March.

But what does this mean for the stock market, because currently it looks like nothing can stop it. The S&P 500 is up 26% this year-to-date already and assuming there will be no tapering in December, there isn't any other catalyst that could act as a resistance. There are many people that wait eagerly for a turn in the market, so their 'bear case' can finally be justified but they may be disappointed (once again this year). Although it is worth




considering, how much more can the market really rise until the end of the year? Even with the current performance stays unchanged, this would be one of the top 10 best years for the index. Do we accept it? Is it justified? Does it look unfair? It doesn't really matter, as the market does what it does, whether we like it or not. That is why we rarely mention our opinions. They simply don't count, so we try to focus on what is really happening on the market. Having said that, we do believe that stocks deserve some rest, but we don't really see a significant spur until the end of the year. Moreover, confidence looks solid but not ecstatically exuberant. Margin debt,


i.e. the amount borrowed by customers to purchase securities, on NYSE reached an all-time high of USD 401 billion in September. The figure is more than during the past two boom markets, which might be seen as a very negative factor. However, what matters here most is momentum, because if margin debt is increasing significantly from a year earlier, this would suggest extreme confidence and risk taking. This was the case in the last two bull markets, when margin debt increased year-on-year by close to 80% in 1999 and 70% in 2007. Currently, the rate of change in margin debt is 27%, and it has actually decreased by 10% since July. All this would suggest that, despite the great performance in the market, people are still cautious and reluctant to take on more leverage: which should be taken as a positive sign.

However, the problem isn't in the stock market. Eventually, when tapering starts, stocks will probably correct, but overall it shouldn't be a big problem, as it would signal that the economy has become healthier. The case in the bond market would be quite different. According to the Treasury's Borrowing Advisory committee, trading declined by 14% in Q2, after tapering speculation began in May . Also, there have been numerous cases of investors complaining in the media that liquidity is low and they can't exit their positions. And this becomes an increasingly known fact. Even with tapering in March 2014 (assumption), who would like to start buying bonds, knowing that he/she might end up in a situation with no bidders? This is the main problem that has to be tackled by the Fed, but if we have to be honest, we don't envisage a pleasant resolution.

| Day | Country | Indicator | Actual | Forecast | Previous |
|---|---|---|---|---|---|
| Wednesday | United States | MBA Mortgage Applications (WoW) | -1.80% | | -2.80% |
| Thursday | | Initial Jobless Claims | 339K | 330K | 341K |
| | | Continuing Jobless Claims | 2,874K | 2,870K | 2,874K |
| | | Janet Yellen Testimony | | | |
| Friday | | NY Empire State Manuf. Index | -2.21 | 5.00 | 1.52 |
| | | Industrial Production | -0.1% | 0.2% | 0.7% |

# EUROPE

## Mess around

One particularly doubtful week has passed for the European markets. The confusion came mainly from mixed macro indicators from the leading countries in EU and the big amount of weaker than forecasted corporate earnings, which made the investors more insecure putting some pressure on the consensus for the Continent's recovery. In relation to that, the inflation concern has continued spreading all over Europe. After last week's decrease in the EU MoM inflation figure, Sweden unexpectedly returned to deflation this week, Norway's inflation slowed to 2.4 % in October from 2.8 % the previous month and U.K. inflation slowed more than economists forecasted. However, while some people might consider that the decline in the inflation figure might have a positive result on the EU's economy, the rest of the indicators, which came out this week, are as negative as possible. The Euro – area GDP rose by only 0.1% in the three months through September, down from a 0.3 % expansion in the previous quarter. The Euro-area industrial output declined, more than economists forecasted in September and industrial production in Germany and Italy's work-day adjusted industrial output performed weaker than forecasted. So, we believe that the weak indicators might be transferred into strong headwinds for the future recovery of the Continent, some more proof is still needed surrounding this.

In relation to the market performance of the main European indexes, investors reacted consistently to the macro indicators, but by the end of the week European equities were supported by loose monetary policies announced across the developed world. As you can read in the US section of the wrap Fed chairman designate Janet Yellen on Thursday defended the central bank's $ bond-buying program, which has stoked investor demand for riskier assets such as equities. Concluding the week, the DAX increased by 1%, CAC 40 valued by 0.75% and the EuroStoxx 50 improved by 1.5%.

**The weak indicators might be transferred into strong headwinds for the future recovery of the Continent.**

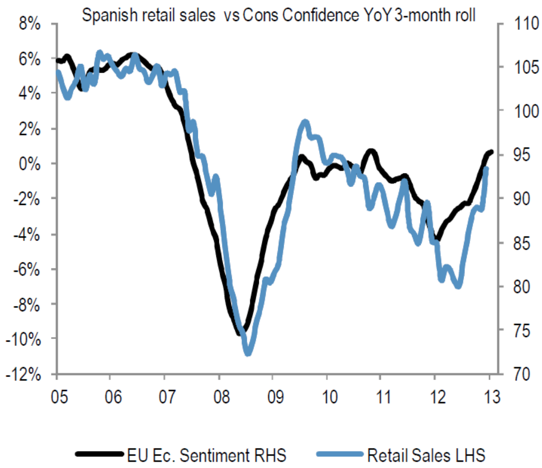
In the United Kingdom the situation starts to get more and more complicated with the BoE stimulus program. As you can see from the calendar, the economic indicators (decline in the inflation and the unemployment rate) start to show that we could witness soon the Bank of England lift its benchmark interest rate from the current record low of 0.5%. That, of course, was priced in the market, thus the FTSE 100 declined by 0.22%.

# LA CORRIDA (THE BULLFIGHT)

Okay... After all that mess, which is enlarging throughout the Continent we would like to quickly summarize the recovery of Spain. As we mentioned before, the investment confidence is growing at quick rates and the Spanish equities are continuing to attract more and more local and foreign financiers, despite some huge gaps in the economy of Reino de España. Let's examine why!

In recent months the Spanish economy has been showing clear signs of recovery, although somewhat minutely. The most recent positive signals are as follow:

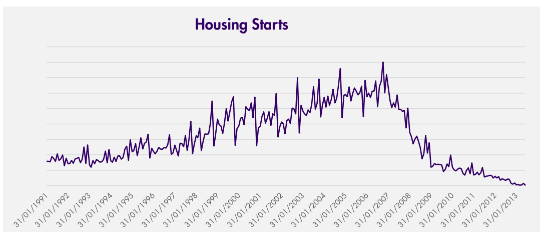
- GDP forecasts are finally stabilizing, even improving. Related to that, the exports have been increasing as a percentage of GDP to a record 35% in 2012. Taking into account that 73% of Spanish exports are having EU destination, a recovery in the Eurozone would certainly help Spain (our call here is related to some exporting retailers and automotive companies).
- Retail funding costs have plummeted in 2013. Spanish banks' deposits have been very stable in 2013 benefiting from regulations and the macro environment. Spanish household deposits increased in 2013 in line with their historical average, a good sign, in contrast with the situation 2012. Customers have also been moving cash from commercial paper and mutual funds to deposits, while the risk of cross-contamination has been reduced, even with the restructuring process underway.
- The car industry is showing positive signs, the first time in years. As you can see at the **chart** the large drop took place despite the industrial incentive policy "PIVE", but with the growing of the economy the situation is starting to improve. Related to the car sales, Spain is experiencing slower rate of increase comparing to the other EU countries. Thus, that might create some investment opportunities, because the Spanish automotive equities are still performing weaker that the stocks of the other EU countries. However, we expect a boom in the sales if the economy is keeping developing at the same direction.
- Consumer confidence is coming back. That indicator is strongly correlated with the retail sales performance in Spain. Making the Spanish people more confident would be vital for the retailers (one more call from us).




- And of course, one of the main industries in Spain is the tourism. The tourism is still booming mainly supported by UK, France and Germany, which are representing 50% of the tourism inflow in the country. So, the recovery of the continent would affect the industry.

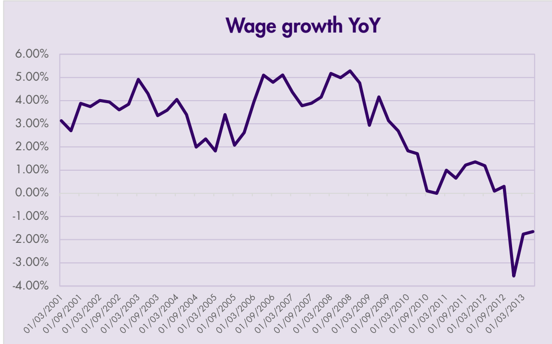
And now, let's have a look at the negative flip-side of the coin:

- The housing market condition is strongly struggling. The house prices are still falling, the housing starts have already fallen well below the early 1990s levels and the outlook for the mortgage demand is still very weak.




- **Tax increases** have put some pressure on the consumption. And they could be increased further in 2014, depending on the economic situation. The Government could announce further measures to try contain the budget deficit target set by Brussels, including increases in wealth tax, VAT, further civil servants' wages or lower fiscal deductions (amongst many others).

- Everybody is aware what is the labor market condition in Spain (unemployment at 26%), so we would not give a special attention to that data. It is still big!
- The deflation disease that is spreading all over the Europe is a main concern in Spain. The deflation is back and that could be a real risk for economic growth.




Furthermore, it could be observed cut of the wages from the private companies, thus the disposable income would decrease, affecting the consumption in Spain. That might be a deadly combination for the Spain economy.

| Day | Country | Indicator | Actual | Forecast | Previous |
|---|---|---|---|---|---|
| Monday | Italy | Industrial Production m/m | 0.2% | 0.2% | -0.2% |
| Tuesday | Germany | Final CPI m/m | -0.2% | -0.2% | -0.2% |
| | United Knigdom | CPI y/y | 2.2% | 2.5% | 2.7% |
| Wednesday | United Knigdom | Unemployment Rate | 7.6% | 7.6% | 7.7% |
| | EU | Industrial Production m/m | -0.5% | -0.2% | 1.0% |
| Thursday | United Knigdom | Retail Sales m/m | -0.7% | 0.0% | 0.6% |
| | EU | Flash GDP q/q | 0.1% | 0.2% | 0.3% |
| Friday | Italy | Trade Balance | 0.79B | 1.63B | 1.07B |
| | EU | CPI y/y | 0.7% | 0.7% | 0.7% |

# ASIA & OCEANIA

Reform, Reform, Reform!

## CHINA

From the 9-12 November, the 18th National Congress of the Communist party of China (CPC) held its third plenary meeting in Beijing. This, according to us, was an extremely big event for the future of China. Before we examine its outcomes, let's first see what the National Congress is and what it does during those plenary meetings.

The CPC National Congress (to see structure click **here**) usually holds meetings every five years (17th—Oct. 2007 / 16th—Nov 2002) and elects a Central Committee which becomes the ruling body of China. This committee holds a number of plenary sessions during its term and usually the First and Second Plenums are more focused on the Party and State arrangement issues (e.g. First: Nov 2011—elected members; Second: Feb 2013—State's administrative body was nominated). The third Plenum is important because it unveils the new leadership's ideas on reforms and historically it has proven to have had a serious impact.

The third plenum gathered more than 350 top officials, to discuss the introduction of policy-shift in order to improve China's growth. The major topics were:

- Financial Sector
- State-Owned Enterprises (SOE)
- Public Finance
- Corruption
- Property
- Hukous
- Land Reform

### FINANCIAL MARKETS

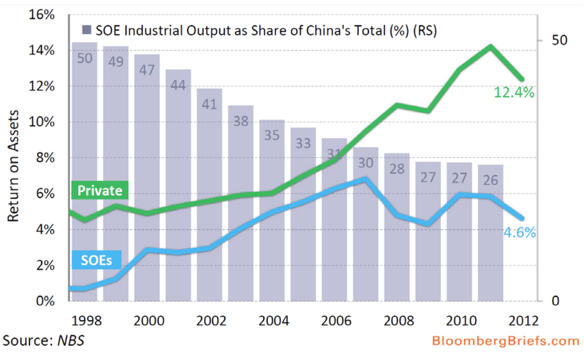
It was noted that Chinese financial markets would play a much stronger role, meaning that parameters such as energy prices and capital allocation will be taken more strongly into account when reforms are devised. There was some disappointment (to speculators anyway) in regards to financial reforms, as barely anything was mentioned.

**The third Plenum is important because it unveils the new leadership's ideas on reforms**

Our view is that in order for China to shift towards a domestically driven growth, Beijing must liberalize the interest and exchange rate. We have seen this happening slowly and we expect this pace to continue further down the line. The PBoC will, of course, maintain its daily fixing of the CNY/USD, however it might expand the fluctuations from 1% to 2%-3%.

## SOE

The main point of the Plenum was to establish a unified, open and competitive market. Linking this to the above mote on Chinese financial markets, we conclude that they will be the main driver between the Private and SOEs divergence since 2007 as seen on the chart. If this has been going on in the past years, it's likely to continue as the government will have less market intervention, therefore all SOEs somewhat more reliant on the government would struggle.




## PUBLIC FINANCE

The communique (document outlining the minutes of the meeting) enforces the continually increasing spending on health, education and social security, which is of course a trend that has been going on for a while. It also doesn't yet outline all the steps that will be taken and again, we will be waiting from more information to come. It would be good to see a better developed municipal bond market and thus more equality in-between local governments.

## CORRUPTION

It's vital that China goes up in the Corruption Perceptions Index (CPI) (meaning corruption decreases) in the upcoming years, as this will increase the transparency and thus boost confidence in foreign investors. The promises was a greater judicial independence (a change in the control of the local court system), which theoretically should strengthen the rule of law. There's not much we can take from this statement, except monitor the CPI index of China (not to be confused with inflation here).

## PROPERTY

One of the scariest areas of Chinese research. Empty cities are being created thus contributing towards a global iron ore and other commodities demand and at the same time housing prices are rising once again thus creating a potential housing bubble. We've been short on a Chinese housing REIT ETF on the basis that potential property taxes and changes in land policy might cut the price growth. However by allowing the markets to steer the mast, it's harder to say what the outcome may be and the anticipated by us changes may not come anytime soon.

## HUKOU SYSTEM

The Hukou system is the record of household registration required by law in the PBoC. The main way to steer the Chinese ship toward a consumption driven economy is the urbanization of migrants. This means (in a simple context) a future strengthening of the CNY for example, which consecutively changes the game for China in general.
A four day meeting however does not bring a full reform, so there is yet more date to come on the specifics of the areas that were touched on.

## LAND REFORM

Under the current land laws, farmers have very limited right on their lands. The main point were:

- creating a unified land market for rural and urban construction land
- using land as source of capital and funding

In previous year however, former Premier Wen Jiabao promised to put this reform on the top priority list, however the idea never really took off, so this time may be no different. One this was different though, the anticipating for this reform is more hyped up, due to its failure before.

| Day | Country | Indicator | Actual | Forecast | Previous |
|---|---|---|---|---|---|
| **Saturday** | China | Industrial Production y/y | 10.3% | 10.1% | 10.2% |
| **Sunday** | Japan | Current Account | -0.31T | -0.10T | 0.35T |
| **Monday** | Australia | NAB Business Confidence | 5 | | 12 |
| **Wednesday** | Japan | Prelim GDP q/q | 0.5% | 0.4% | 0.9% |

# COMMODITIES

Further fall of Gold?

## METAL

This week has seen an increase in the price of Iron, one of the key metals used for construction. Furthermore, Iron ore for immediate delivery at the Tianjin port climbed by 0.4% bringing the weekly gain to 0.5%. One of the reasons for this could be, as mentioned last week, China's potential increase in economic growth next year: this is given credence by the fact demand usually slows in Winter because of the colder weather.
Despite Gold's decline of 22% this year the World Gold Council is maintaining that gold demand is still strong. The total supply of gold in Q3 was down 3% from last year as well as an 11% contraction in recycling, as lower than average prices failed to attract investors to sell; however we did see modest growth of 4% in gold mining production. The average price represented by the council in the third quarter of 2013 was $1,326 per ounce, which is a fall of 20% compared to the price of $1,652 in the third quarter of 2012. There has also been a decline in each quarter of 2013, with prices being $1,631 and $1,414 on average for quarter 1 and quarter 2 respectively.
SPDR Gold Shares, the world's largest gold trust were at $123.57 per unit at the end of this week, down from $128.18 on September 30th. Whilst initially this may not seem too bad, especially if we take into account the fact its price was actually lower at the end of the second quarter at $119.11, and that it was at $154.45 at the end of the first quarter. The fact remains that it has contracted to 865.71 tonnes, and the value is now down to $35.4 billion. The 52-week range of the trust is $114.68 to $170.01.
Despite these falls, jewelery demand was shown in the council's report to be up by 5% to 487 tonnes. This is most likely due to lower prices encouraging a shift to higher carat pieces. Also, the demand for gold from the technology sector was up by 1% in the third quarter, reaching 103 tonnes, driven again by lower prices and improved economic conditions.

**Despite gold's decline of 22%, this year the World Gold Council is maintaining that gold demand is still strong**

## ENERGY

WTI crude headed for a sixth weekly decline, the longest in 15 years, due to supplies rising in the US in response to the speculation that the Fed will maintain its bond buying program. This speculation comes after Janet Yellen the nominee for Fed chairman said that 'Quantitative-easing was needed to spur growth.' The Energy Information Administration showed that US crude stockpiles climbed yet again, making it 8 consecutive weeks, as output expanded to the highest levels since January 1989. As a result futures have fallen 0.8% this week. The US Environmental protection agency proposed a range of 15-15.52 billion gallons of renewable fuel in 2014. The fuels consist of products such as corn-based ethanol and biodiesel. This could see the price of corn and similar goods increase due to a demand influx.

## SEEDS AND GRAINS

Robusta coffee jumped by its biggest move in 15 months this week as signs of dwindling supplies of coffee beans to back futures contracts appeared in London. Robusta stockpiles which are monitored by the NYSE Liffe fell 8% in the last 2 weeks. Due to rain in Vietnam, the world's largest grower, there may be harvest delays which would also drive prices up.

Palm-oil has seen an increase, as Malaysia the world's second-largest producer of palm-oil has increased tax on exports of the commodity. Cargoes are set to be taxed at 5% in December. One of the potential impacts of this slight increase is that it could stimulate short-term demand within the spot market so investors can reap the benefits of the current tax rate of 4.5%. Futures for delivery in January rose as much as 1.2% on the Malaysian Derivatives Exchange following the export tax announcement.

Rubber climbed to a two-week high, heading for its best weekly rally in five weeks, as Japan's currency breached the 100 dollar mark for the first time since September boosting the appeal for yen-denominated futures. Futures gained 1.9% this week which is the best performance since the week through October 11th. Demand for haven assets weakened on confidence that US policy makers will remain committed to economic stimulus.

**Rubber climbed to a two-week high, heading for the best weekly rally in five weeks.**

# FOREX

| Pair | Open | Close | Weekly % | Monthly % | YTD |
|---|---|---|---|---|---|
| EUR/USD | 1.3361 | 1.3493 | 0.99% | -0.23% | 3.29% |
| USD/JPY | 99.07 | 100.17 | 1.11% | 2.00% | 13.62% |
| USD/CHF | 0.9211 | 0.9146 | -0.71% | 1.09% | -1.07% |
| USD/CAD | 1.0476 | 1.0438 | -0.36% | 1.28% | 5.78% |
| AUD/USD | 0.9382 | 0.9367 | -0.16% | 0.56% | -10.65% |
| NZD/USD | 0.8241 | 0.8328 | 1.06% | 0.39% | 0.16% |
| USD/CNY | 6.0905 | 6.0922 | 0.03% | -0.48% | -1.49% |
| GBP/USD | 1.6013 | 1.6113 | 0.62% | -0.44% | 0.33% |

## USD

The dollar devalued against most major currencies due to the comments made by the newly nominated Fed Char —Janet Yellen. In addition, weak Friday data supported Mrs. Yellen's comments about more QE, which further devalued the currency. EUR/USD closed the week with 1% gains at 1.3493, while GBP/USD ended 0.62% higher at 1.6113. USD/JPY finally crossed the 100 territory after moving between 97 and 99 for the past two months. The pair closed at 100.19 but its weekly peak was at 100.42.

## GBP

GBPUSD increased by 0.62% from the previous week.  Hence, the strengthening of the pound extended to a second weekly advance against the dollar. Furthermore, the rise was boosted by speculations regarding the faster than officials predict U.K. economic recovery. This current development came to support our opinion, stated few wraps ago. We expect that the economic situation from the Island will continue to perform in the same direction, which could justify a new strengthening by Pound against its main counterparts.

# EVENTS

## USA

- CPI
- Retail Sales
- Existing Home Sales
- FOMC Meeting Minutes

## EUROPE

- EU Flash PMI
- German Final GDP q/q
- EU Consumer Confidence

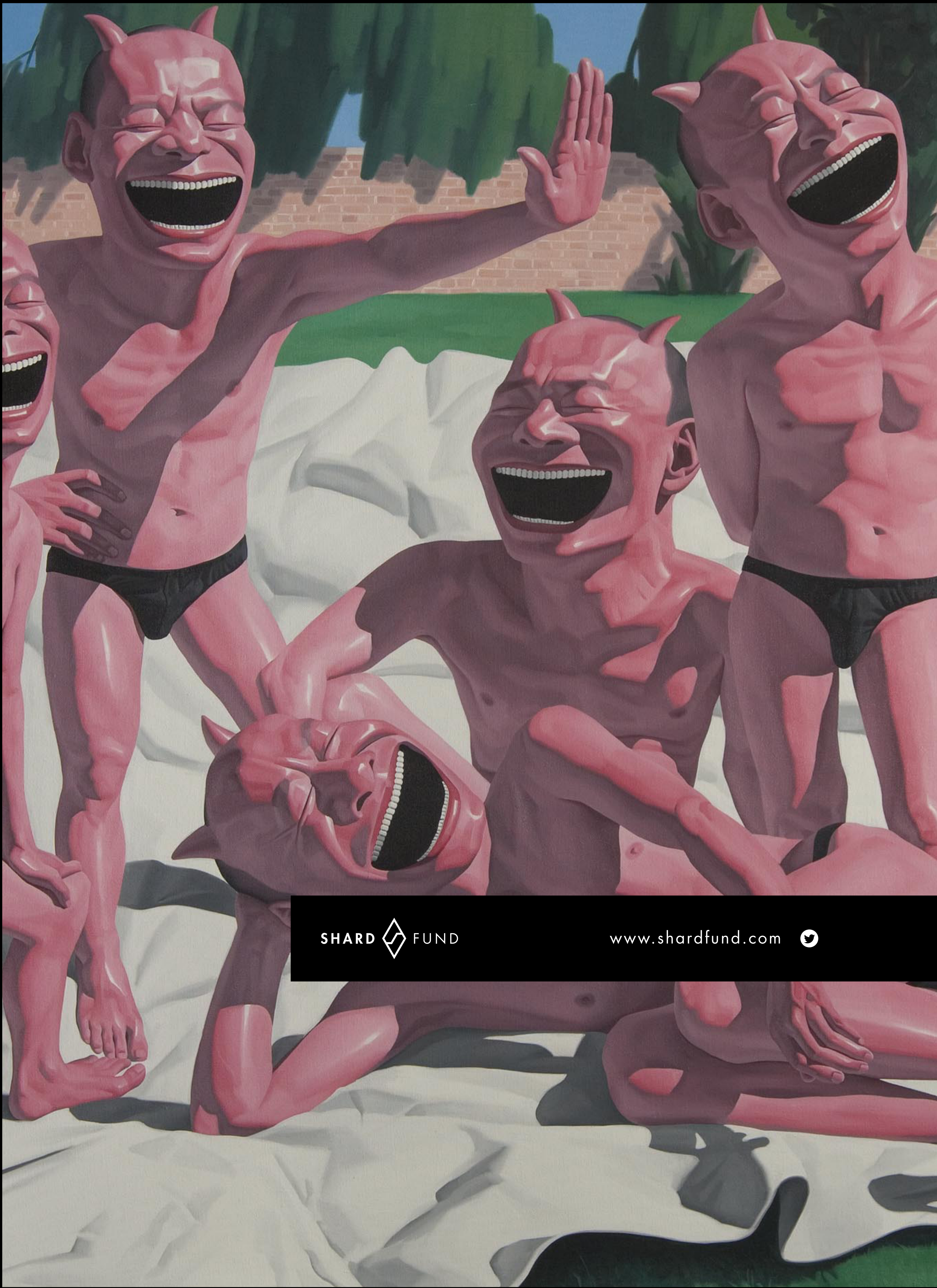
## ASIA & OCEANIA

- Japan: Monetary Policy Meeting Minutes
- Japan: National Core CPI y/y
- Australia: RBA Rate Statement
- Australia: GDP q/q
- China: Manuf. & Non-Manuf. PMI

## REFERENCES

Reserve Bank of Australia, Bank of Japan, Bloomberg, National Bureau of Statistics, China Federation of Logistics and Purchasing

## DISCLAIMER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