# SIERRA

SHARD FUND

# A JOURNEY ACROSS FINANCIAL MARKETS

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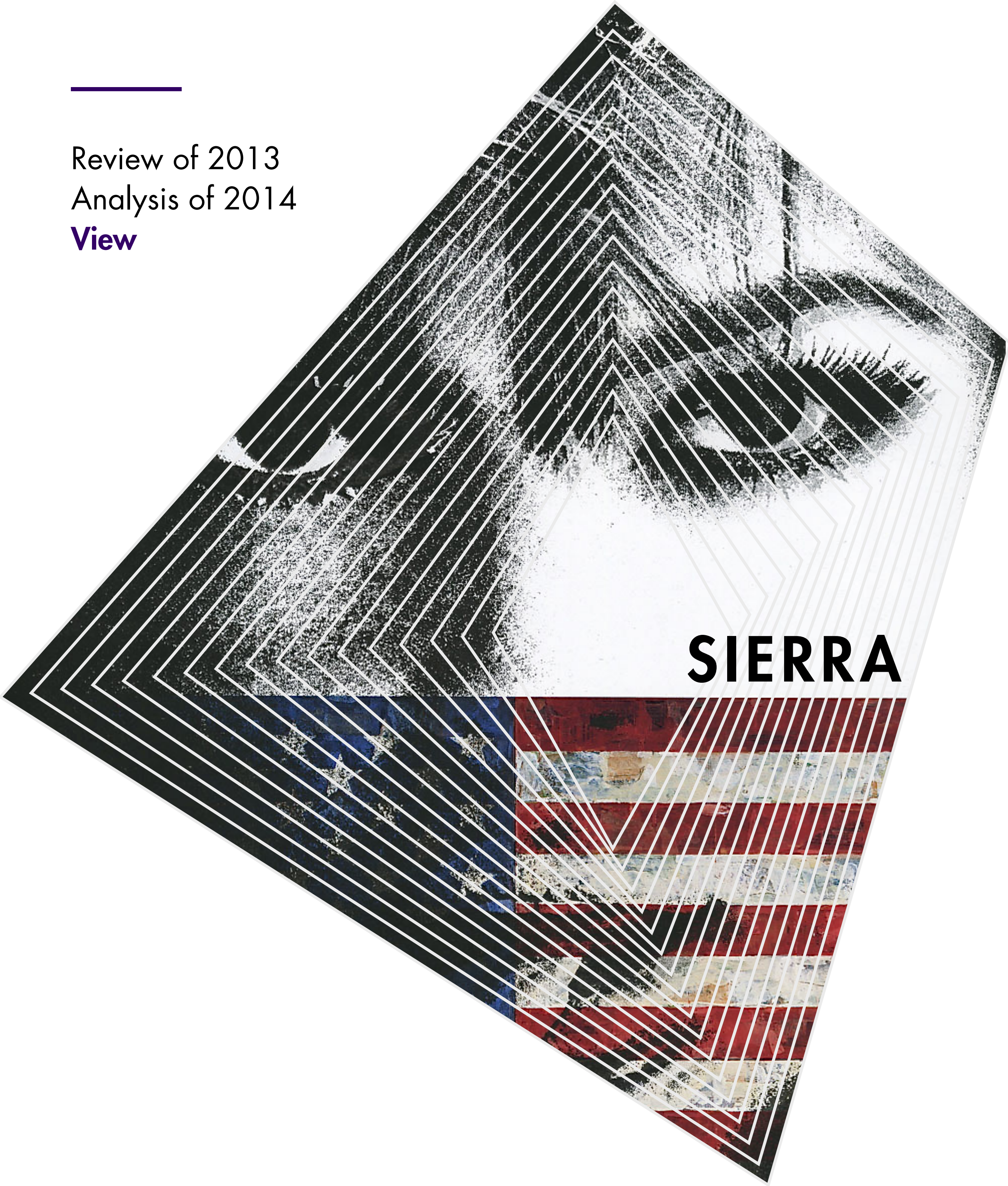
# SIERRA
# End of 2013

Review of 2013
Analysis of 2014
**View**



# USA

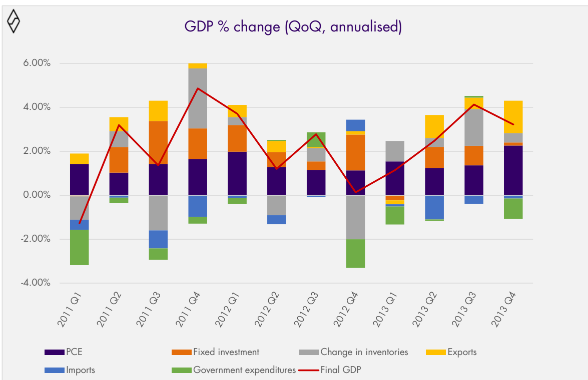
*Au revoir, Ben! Now what?!*

It's been another negative week for the US stock market, which makes it 3 in a row. The S&P 500 declined further by 0.43% to reach a total monthly return of negative 3.56%. The week saw a lot of data, from Q4 GDP to housing, as well as a further USD 10 billion reduction in QE.

| | |
|---|---|
| Consumer Discretionary | -1.07% |
| Healthcare | 0.54% |
| Industrials | 0.44% |
| Financials | -0.24% |
| Energy | -1.13% |
| Technology | -0.88% |
| Consumer Staples | -1.74% |
| Materials | 0.39% |
| Utilities | 2.95% |

But the most important question still remains unanswered — what happens now? Is the correction over or should we be more worried? It is hard to know the answer with certainty but the market is definitely giving us some negative signs.

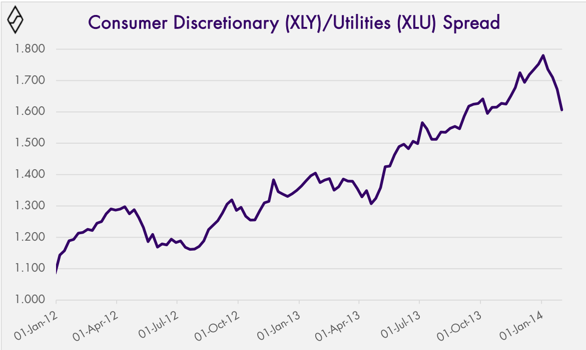
Unlike the past three quarters (especially Q3) analysts really nailed the Q4 GDP print.



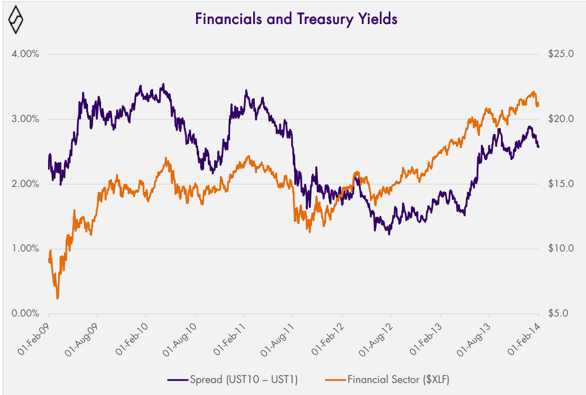

The economy grew at a 3.2% annualised rate, to conclude an overall strong year for the United States. Just as we suspected, the inventory build-up decelerated, while personal consumption expenditure came closer to its all-time mean average contribution of 2.4%. Moreover, real sales (GDP change – inventory change) increased for a third quarter in a row, this time by 2.8%, possibly suggesting healthier growth.

**The economy grew at a 3.2% annualised rate, to conclude an overall strong year for the United States.**

Many people in the media and on twitter are trying to find justification and excuses for every constituent, but the truth is that it is what it is. Factors that affect GDP in one quarter should not be looked at in a vacuum, as they will probably influence in some way following quarters as well. The bad weather that spread around the US in December has probably put a downward pressure on PCE and will do so in Q1 2014 as well. All of this is expressed by the market but it seems like there are very few people who notice it. Let's take for example the consumer discretionary sector (XLY), which captures cyclical growth stocks that performed exceptionally in 2013, when the economy was growing significantly. The index is the worst performer so far this year with a negative return of 6%, meanwhile the top performer is the slow growth, high dividend yield sector tracking Utilities (XLU).




long term yield as the Fed tapers for a second time is not a healthy sign. Of course, it's not a surprise that financials are down by close to 4% this month, even though many financial institutions released good results.




Is this a coincidence? Another indicator might be the spread between long term and short term treasuries. When financial conditions are strong, this spread tends to get wider, which also increases the profitability potential of financial institutions, thus they outperform the market. This year, the spread has decreased by 32 bps since its previous period high on the NYE. Furthermore, a decreasing

What about the housing market? Yes, no-one buys a house when it is freezing cold outside, but pending home sales have been decreasing for the past 7 months and new home sales have also experienced some difficulties. All in all, current factors make us believe that it is going to be a tough quarter, with many people left disappointed.

| Day | Country | Indicator | Actual | Forecast | Previous |
|---|---|---|---|---|---|
| Monday | United States | New Home Sales | 414K | 457K | 445K |
| Tuesday | | Durable Goods Orders | -4.3% | 1.8% | 2.6% |
| | | Core Durable Goods Orders | -1.6% | 0.5% | 0.1% |
| | | CB Consumer Confidence | 80.7 | 78.1 | 77.5 |
| Thursday | | GDP (QoQ) | 3.2% | 3.2% | 4.1% |
| | | Initial Jobless Claims | 348K | 330K | 329K |
| | | Continuing Jobless Claims | 2,991K | 3,020K | 3,007K |
| | | Pending Homes Sales | -8.7% | 0.3% | -0.3% |
| Friday | | Chicago PMI | 59.6 | 59.0 | 60.8 |
| | | Michigan Consumer Sentiment | 81.2 | 81.0 | 80.4 |

# EUROPE

*There and back again*

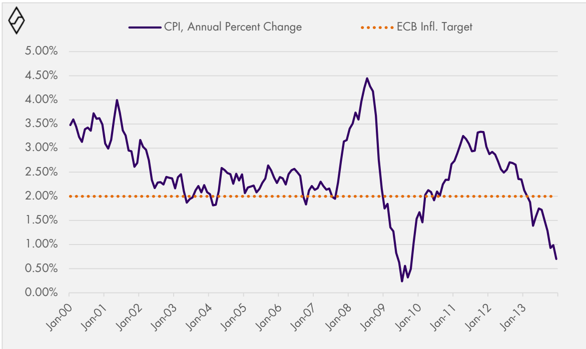
European stocks marked second the consecutive week finishing in the red. Due to the huge exposure of European companies to emerging markets, their poor performance pressured a sink in the indexes. According to data from MSCI, European companies have a much bigger exposure to non – developed markets than U.S. or Japanese companies: about 24 % of revenues overall for firms listed on Europe, versus 15 % for the United States and 14 % for Japan.

**...we believe that the current correction should bring some interesting buying opportunities for the short/ medium term, although we're not there yet.**

This is now providing some doubts for next week's performance of the European equities, especially regarding the unstable situation surrounding the emerging markets. Nonetheless, we believe that the current correction should bring some interesting buying opportunities for the short/ medium term, although we're not there yet.

In terms of macro data, the calendar week was full! Focusing on the figures implications, the week was rather positive. Starting with the consumer confidence indexes, all over Europe customer certainty is growing. Even the struggling economies of the Continent, France and Italy, marked a rise in the confidence index. Another positive figure comes from Spain. Spanish growth accelerated in the last quarter of 2013. GDP expanded 0.3 % in the quarter ending Dec. 31 from the previous three months, increasing for a second straight quarter for the first time since 2011. This figure follows growth of 0.1 % in the third quarter. That proves our opinion for an improving Spain, which might attract more and more funds in the near future.

On the flip side, the only big concern comes from the inflation data of EU. Euro-area CPI remained below 1 % for a fourth month in January.

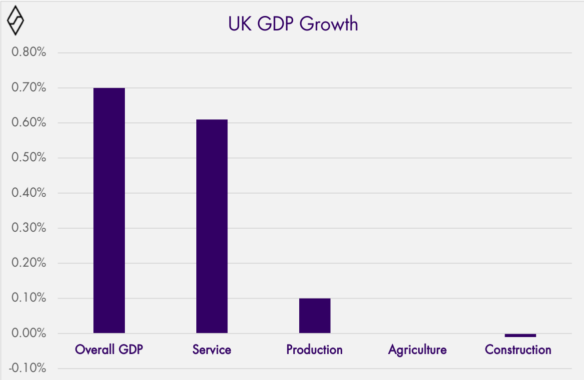



A larger than expected deceleration in German inflation resulted in a CPI reading of 0.7 % in January instead of the 0.9 % predicted. The ECB forecasts average price growth of 1.1 percent this year and 1.3 percent in 2015. Despite this, we do not expect to see the

Continent progress into deflation: the euro zone is becoming increasingly vulnerable to such an outcome in case of a new unexpected demand shock. At next week's meeting the ECB might take action to ease monetary policy even more, because of that treat.

# THE TRIPLE A ECONOMY

Last week was extremely meaningful for the UK's economy. On the positive side we saw figures that underlined the stable GDP growth, while on the pressure side mortgage approvals jumped by new highs.



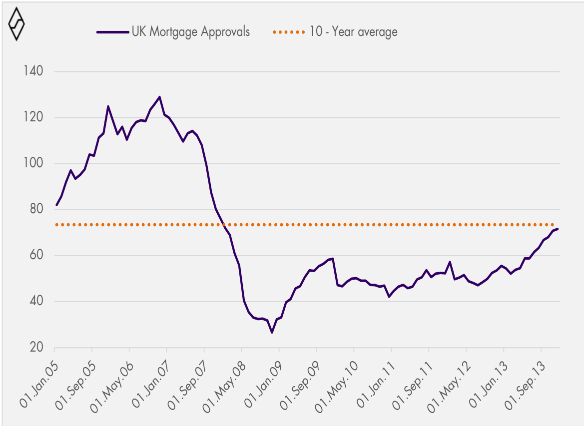

However, last year was the strongest UK growth since 2007 – (1.9 % growth as a whole), and the first full year of continuous growth since the same year. GDP rose 0.7 % QoQ in-line with consensus. Moreover, the service sector accounted for most of the expansion, contributing 0.61 percentage points to the increase in GDP. While the service sector is 1.3 % above its level in 2008, the U.K. economy remains 1.3 % below the level in 2008.

Looking at the big picture, 2013 data shows that the BoE monetary policy is working:

- credit is flowing;
- uncertainty is down;
- confidence is returning;
- employment is booming;
- inflation is back to target levels.

There is no reason why monetary policy will not keep driving the UK forward. In any case, the headwinds encountered this year should ease as productivity begins to rise, wages finally starting increasing in real terms, businesses pull the trigger on investment and the Eurozone gradually recovers.

However, regarding the bubble concern of the housing market, mortgage approvals rose in December to the highest level in almost six years. Lenders granted 71,638 loans for house purchase, the most since January 2008. That is putting pressure on the economic situation and the domestic financial market but we do not expect any negative development in the near future.




| Day | Country | Indicator | Actual | Forecast | Previous |
|---|---|---|---|---|---|
| Monday | Germany | German Ifo Business Climate | 110.6 | 110.2 | 109.5 |
| Tuesday | United Kingdom | Prelim GDP q/q | 0.7% | 0.7% | 0.8% |
| Wednesday | EU | M3 Money Supply y/y | 1.0% | 1.7% | 1.5% |
| Thursday | Germany | Prelim CPI m/m | -0.6% | -0.4% | 0.4% |
| | United Kingdom | Mortgage Approvals | 72K | 73K | 71K |
| | Spain | Flash GDP q/q | 0.3% | 0.3% | 0.1% |
| Friday | EU | Unemployment Rate | 12.0% | 12.1% | 12.0% |
| | EU | CPI Flash Estimate y/y | 0.7% | 0.9% | 0.8% |

# ASIA & OCEANIA

*Chinese options*

## CHINA

A study by Li Gan (**original**) made some interesting observations in regards to the Chinese transition.
The consumption in China is low because:
- China's poor don't have money to spend
- China's rich are already spending what they need, and pocketing most of the rest.
- Income inequality is the key reason for China's low consumption rate

| Total Income | % families saved | Saving rate | Share in total saving |
|---|---|---|---|
| Top 5% | 93.6% | 73.5% | 50.0% |
| Top 10% | 88.1% | 66.5% | 66.2% |
| Top 25% | 83.2% | 56.4% | 83.5% |

The Gini coefficient, can be used to measure the income inequality in the economy. The current ratio is 0.61 (China Household Finance Survey, CHFS), meaning that there is a relatively high inequality in income distribution.
The question that Prof. Gan is imposing is: How to narrow the income gap? Or as we see it: What are the actions/signal to look for, before we can be more certain that China enters a more consumption driven growth.
A 100% minimum wage seems to have absolutely no impact on the Gini coefficient
• Taxing income has a minimum amount of change (0-0.1 points decrease)
Looking back at developed countries' data, the Gini ratio there fell from between 0.4-0.55 to 0.25-0.4 due to payment transfers. Therefore, this is what China needs to do in order to reduce the income distribution inequality and thus help boost consumption. The current status however is as follows:
- 71% poor families have no Gov. subsidies
- 45% poor families have no retirement insurance
- 30% unemployment insurance coverage rate is only with 17% payment from local average salary.
- 95% of population is covered by various health insurance plans, but reimbursement rates vary: First - Rural insurance reimbursement rate is 26%. Second -Urban employee insurance reimbursement rate is 50%.

In the short run China can improve by imposing programs such as:
- CCT (Condition Cash Transfer)
- EITC (Earned Income Tax Credit) or said in more comprehensive language – tax the working population

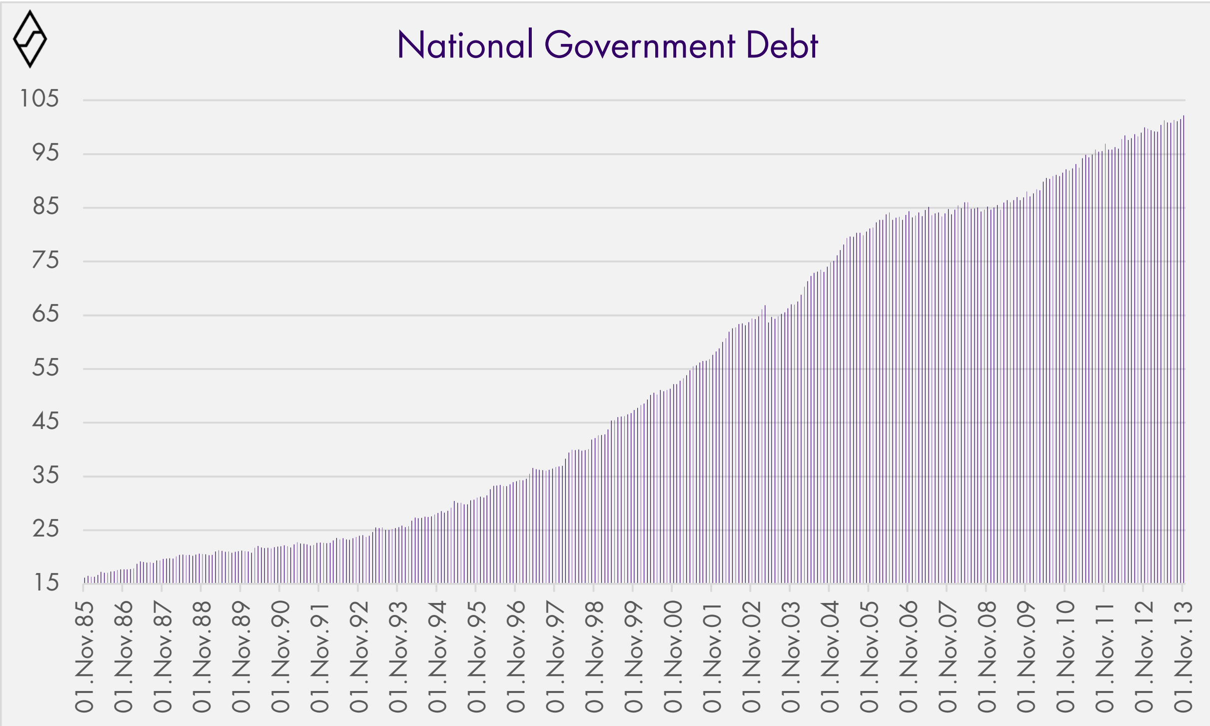
In the long run it is found that the income gap decreases when education levels increase.
To conclude, in the short run transfer of payments are more likely to help stimulate the Chinese consumption by reducing the inequality gap. Wage increases and income tax changes do not have much effect. For the long run, a strong education system is the key.

# JAPAN

2013 was a record breaking year for Japan in terms of trade deficit – reaching ¥11.5T ($113B) and increasing the national government debt to a new all time high. Even though the JPY is becoming more attractive, the Japanese trade balance is still negative. This week's data posted the 18th straight negative month (another record for Japan).

On the other side, Japanese retail sales have posted a 5th straight increase before the much anticipated tax hike this April. This is likely to continue up to and including March, as it's possible that households are looking to buy products a few months earlier in order to avoid the tax. In addition, major firms are raising wages in April (Hurray!), so sales in other sectors such as automotive are likely to remain stable as well.

As mentioned numerous times we are still bullish on equities due to the government's determination and as a result of the factors mentioned above the firms, where spending is skewed prior to the hike, might come with stronger than usual Q1 results.




| Day | Country | Indicator | Actual | Forecast | Previous |
|---|---|---|---|---|---|
| Monday | Japan | Trade Balance | -1.15T | -1.33T | -1.29T |
| Thursday | Japan | Retail Sales y/y | 2.6% | 3.9% | 4.1% |
| | New Zealand | Trade Balance | 523M | 550M | 183M |
| Friday | Japan | Household Spending y/y | 0.7% | 1.2% | 0.2% |
| | Japan | Prelim Industrial Production m/m | 1.1% | 1.3% | -0.1% |
| | Australia | Private Sector Credit m/m | 0.5% | 0.4% | 0.3% |

# COMMODITIES

Troubles in Congo

## METAL

The Democratic Republic of Congo is owed approximately $3.7 billion in unpaid customs duties and fines by companies operating in the copper rich provenience of Katanga from 2008 - 2013 according to an unpublished report by the prosecutor's office. The report is part of an ongoing investigation into suspected malpractice by customs agents and companies in the South Eastern province.

**Republic of Congo is owed approximately $3.7 billion in unpaid customs duties and fines for copper**

The report accused companies of under declaring the value of imports and exports and some of avoiding tax altogether, often with the collusion of customs officials. Congo's mining production has been limited by energy and infrastructure problems, and the government is under pressure to maximise revenues from the sector if it's to help get its people out of poverty. The report found that 11 companies were liable to pay $741 million in unpaid taxes and fines, including Mutanda Mining, a copper miner 69% owned by Glencore Xstrata plc. Furthermore 252 cases are outstanding, and it's estimated the total amount owed to the state from these is $3 billion. International mining firms have invested billions in recent years to tap into Katanga's vast copper and cobalt reserves. Mining made up 15.4% of Congo's GDP in 2012.

Glencore Xstrata is planning to sell its majority stake in the $5.9 billion Tampakan copper and gold project. This potentially paves the way for Glencore's partner in the project, Indophil, for a full takeover. There are several reasons why Glencore could exit the project. Firstly exiting Tampakan would help Glencore meet a requirement to sell down copper stakes, imposed by China, a condition placed on the company following the approval of Glencore's takeover of Xstrata last year, as Beijing feared they could gain too much power in copper. In line with this argument is the fact that Glencore has been attempting to sell its $5.9 billion Las Bambas copper project in Peru and has agreed to sell its majority stake in its copper project in Papa New Guinea for $125 million. Secondly, there have been numerous setbacks to the Tampakan project due to a ban on open-pit mining since 2010; as a result the start plan for the Tampakan project has been pushed back to 2019. Finally there is the whole issue with Katanga as explained above, so by selling Glencore could be attempting to get the funds needed for potential payments.

China has found an inadvertent ally in its efforts to reduce a bloated aluminium sector, with Indonesia's ban on exporting metal ores set to boost costs of the raw material bauxite and pile more pressure on struggling smelters. In the aluminium sector aging and inefficient smelters are already grappling with rising power prices, but now face potential bauxite shortages after Indonesia halted ore shipments, as part of efforts to make miners process minerals at home. China is the world's biggest aluminium producer and curbing expansion may help ease a global surplus of the metal and even lead to the country resuming sizeable imports of refined aluminium (It's also likely to provide support to the price of the metal). China's production of aluminium is expected to grow at 8% to 26.5 million tonnes this year, accounting for half of the global output. Despite having large stockpiles ahead of the ban by Indonesia, Chinese aluminium makers may struggle to find alternative supplies at similar prices. China could possible get some bauxite from Australia, where Rio Tinto is closing its loss-making alumina refinery in northern Australia. The firm expects to be able to export between 7-8 million tonnes a year. This still leaves China short of approximately 10 million tonnes that would have to be filled by mines in Brazil, Guinea, Ghana and Jamaica. Sourcing imports from further afield could add extra costs per tonne, as well as physical surcharge for delivery, due to the logistical costs. This is likely to put pressure on Eastern seaboard smelters, and could potentially lead to closures, and thus China importing refined material again.

## ENERGY

US Crude oil edged upwards due to spread trading this week, and the cold weather sapping distillate supplies. As a result, the price difference between European Brent and US crude settled at its narrowest point in more than two-and-a-half months. The price was further helped by the news that GDP in the United States grew by a 3.2 percent annual rate, and expectations that the southern leg of TransCanada Corp's keystone pipeline will begin to drain major amounts of oil from the hub at Cushing.

Wild volatility of natural gas prices this winter could soon become a regular feature as growing demand begins to test supply, potentially curbing plans to increase exports and switch power plants from coal to gas. Despite ample reserves having depressed prices since 2008 in the United States, sudden surges in consumption could jolt the market. Signs of strain have already begun to emerge, with the winter pushing natural gas prices to four year highs. Exports of natural gas to Mexico are expected to double in the next two years, as companies begin shipping liquefied natural gas from new projects to Europe and Asia.

**Wild volatility of natural gas prices this winter could soon become a regular feature...**

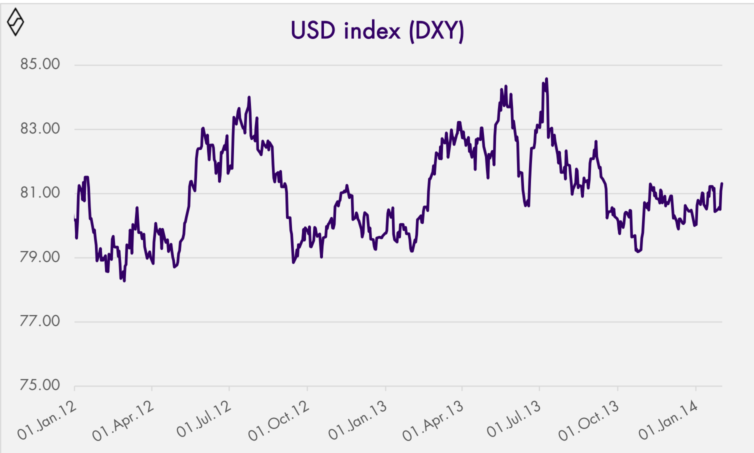
# FOREX

| Pair | Open | Close | Weekly % | Monthly % | YTD |
|---|---|---|---|---|---|
| EUR/USD | 1.3675 | 1.3485 | -1.39% | -1.89% | -1.89% |
| USD/JPY | 102.28 | 102.05 | -0.22% | -3.09% | -3.09% |
| USD/CHF | 0.8945 | 0.906 | 1.29% | 1.48% | 1.48% |
| USD/CAD | 1.1087 | 1.1128 | 0.37% | 4.78% | 4.78% |
| AUD/USD | 0.8681 | 0.875 | 0.79% | -1.83% | -1.83% |
| NZD/USD | 0.8211 | 0.8078 | -1.62% | -1.56% | -1.56% |
| USD/CNY | 6.0486 | 6.0608 | 0.20% | 0.12% | -1.49% |
| GBP/USD | 1.6481 | 1.6434 | -0.29% | -0.74% | -0.74% |

## USD

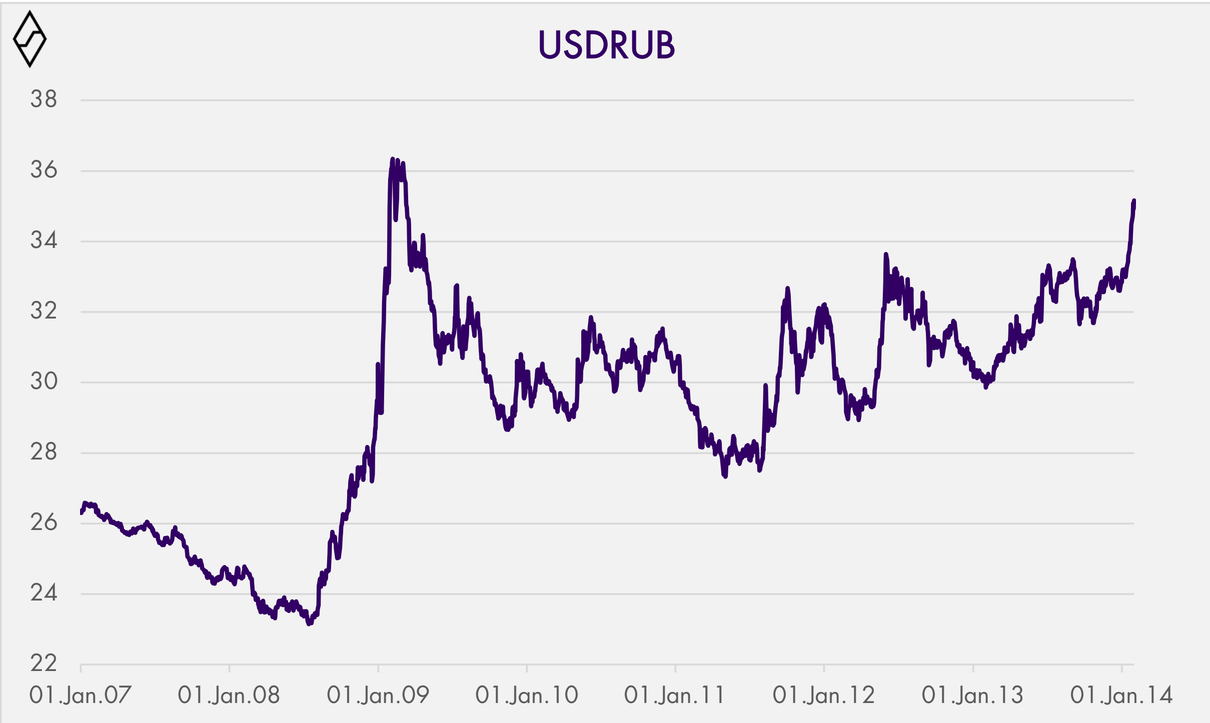
The dollar has had a surprisingly strong month given the overall sell-off on the market. The USD index (DXY) rose 1.6% in January, marking its strongest month since the Federal Reserve mentioned for the first time the possibility of tapering back in May 2013. We believe that overall strength in the USD will continue, given the ongoing reduction of QE and outflows from EM.

If you haven't followed the markets recently you might think that given the strong month, USD/JPY has probably reached 110 already. In fact, the situation is 'slightly' different. The pair are both already 3.1% down this year and has formed a strong support around 101.7 in the past couple of days. This strength originates from a higher than expected CPI reading in Japan, as well as an overall shift of capital from EM currencies to JPY. Also, given the strong positive correlation between the Nikkei and USD/JPY, this move in the FX pair is not surprising if we consider the negative 8.45% return on the main Japanese index this year.



# RUB

The whole tension around the emerging markets sank the Russian ruble to record low against the baskets of main currencies. On Wednesday the ruble depreciated 1.2 % to 40.9632 versus the central bank's dollar-euro basket. A weaker ruble encourages Russians to withdraw and convert local- currency deposits, Sberbank's main source of funding, which of course is hurting retailers by making imports more expensive in ruble-denominated prices. At the same time the investors are getting scary about the devaluation of the currency, which might cause stock markets fall, especially in countries where the devaluation is not controlled. The situation in Russia is likely the same.



# PORTFOLIOS

## MAVERICK

| security | L/S | date |
|---|---|---|
| Volkswagen AG | Long | 03.Sep.13 |
| Datang International Power Generation Co. I | Long | 03.Sep.13 |
| ENN Energy Holdings Ltd | Long | 03.Sep.13 |
| China Longyuan Power Group Corp. Ltd | Long | 03.Sep.13 |
| Tracker Fund of Hong Kong | Short | 03.Sep.13 |
| Nike Inc | Long | 15.Oct.13 |
| SPDR Financials Sector | Short | 28.Oct.13 |
| Corning Inc. | Long | 23.Oct.13 |
| INR/USD | Long | 04.Nov.13 |

| security | L/S | date |
|---|---|---|
| CNY/USD | Long | 04/11/2013 |
| BMW | Long | 07/11/2013 |
| ProShares UltraShort Lehman 20+ Yr(ETF) | Long | 04/11/2013 |
| Tracker Fund of Hong Kong | Short | 17/12/2013 |
| SPDR Utilities Sector | Short | 17/12/2013 |
| Hengan International Group Co Ltd | Long | 24/12/2013 |
| Orange SA | Short | 02/12/2013 |
| Telefonica SA | Long | 02/12/2013 |
| iShares MSCI Emerging Markets | Short | 24/1/2014 |
| SPDR Consumer Discretionary Sector | Short | 27/1/2014 |

## CORTEZ

| security | L/S | date |
|---|---|---|
| Pandora A/S | Long | 03.Sep.13 |
| Valeo SA | Long | 03.Sep.13 |
| Aspen Technology Inc | Long | 03.Sep.13 |
| Prudential Plc | Long | 30.Sep.13 |
| USD/JPY | Long | 07.Oct.13 |
| Aeropostale Inc | Long | 15.Oct.13 |
| OZ Minerals | Long | 15.Oct.13 |
| Greenhill and Co. Inc. | Long | 20.Oct.13 |
| Easyjet plc | Long | 20.Oct.13 |

| security | L/S | date |
|---|---|---|
| Chico FAS | Long | 15.Oct.13 |
| H&M | Long | 15.Oct.13 |
| Claymore/AlphaShares China Real Est ETF | Short | 04.Nov.13 |
| Claymore/AlphaShares China Real Est ETF | Short | 17.Dec.13 |
| Royal Caribbean Cruises Ltd. | Long | 13.Jan.14 |
| Carnival Corp | Long | 13.Jan.14 |
| Red Robin Gourmet Burgers Inc | Short | 13.Jan.14 |
| Bloomin' Brands Inc | Short | 13.Jan.14 |
| SPDR S&P Emerging Latin America | Short | 24.Jan.14 |

# EVENTS

## USA

- ISM Manufacturing/Services PMI
- Nonfarm Payrolls report
- Unemployment rate

## EUROPE

- UK Construction PMI
- ECB Press Conference
- EU Flash Manufacturing PMI

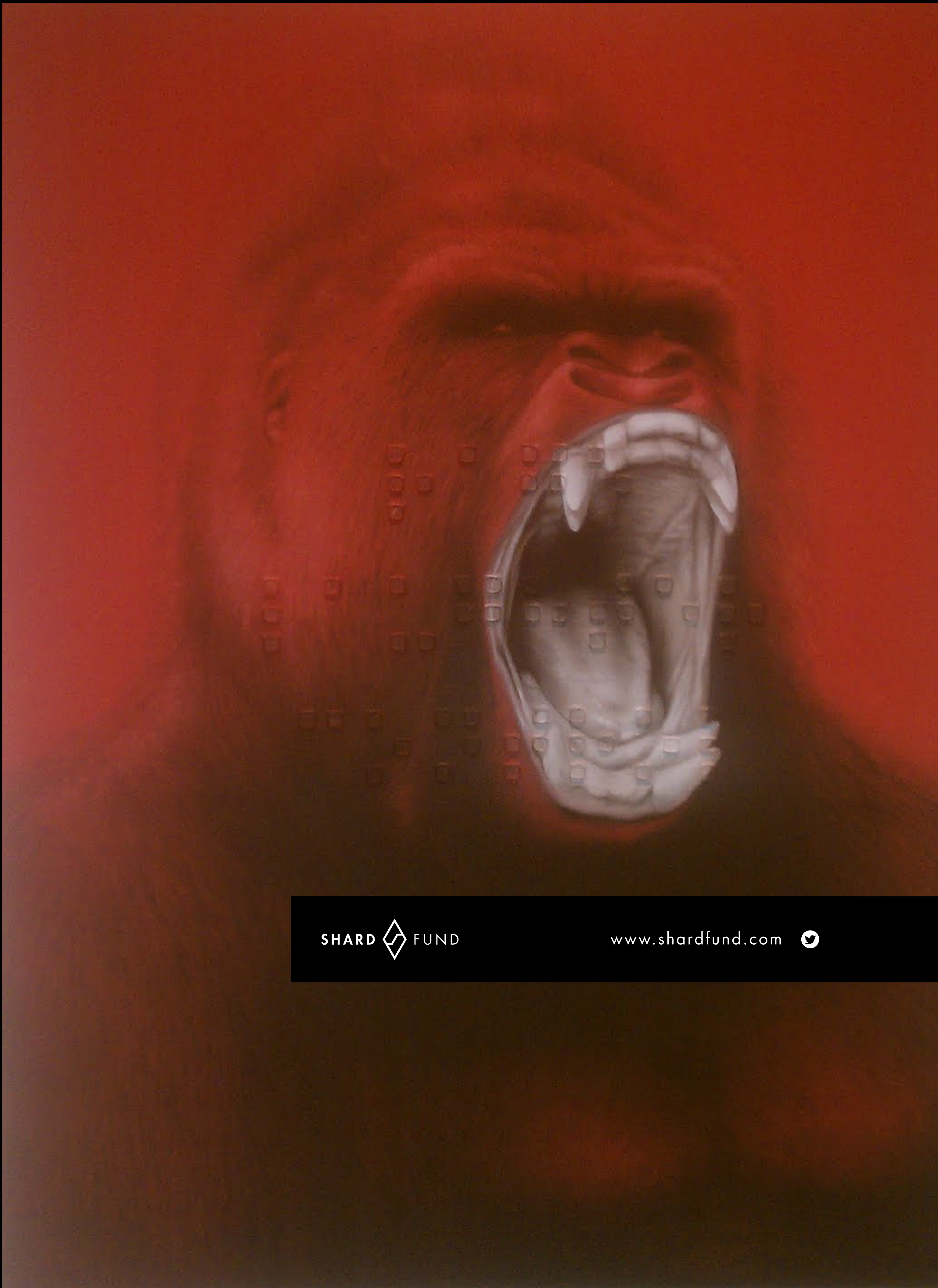
## ASIA & OCEANIA

- Australia Retail Sales m/m
- Australia Trade Balance

## REFERENCES

Reserve Bank of Australia, Bank of Japan, Bloomberg, National Bureau of Statistics, China Federation of Logistics and Purchasing, Thomson Reuters, CHFS (http://www.chfsdata.org/)

## DISCLAIMER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