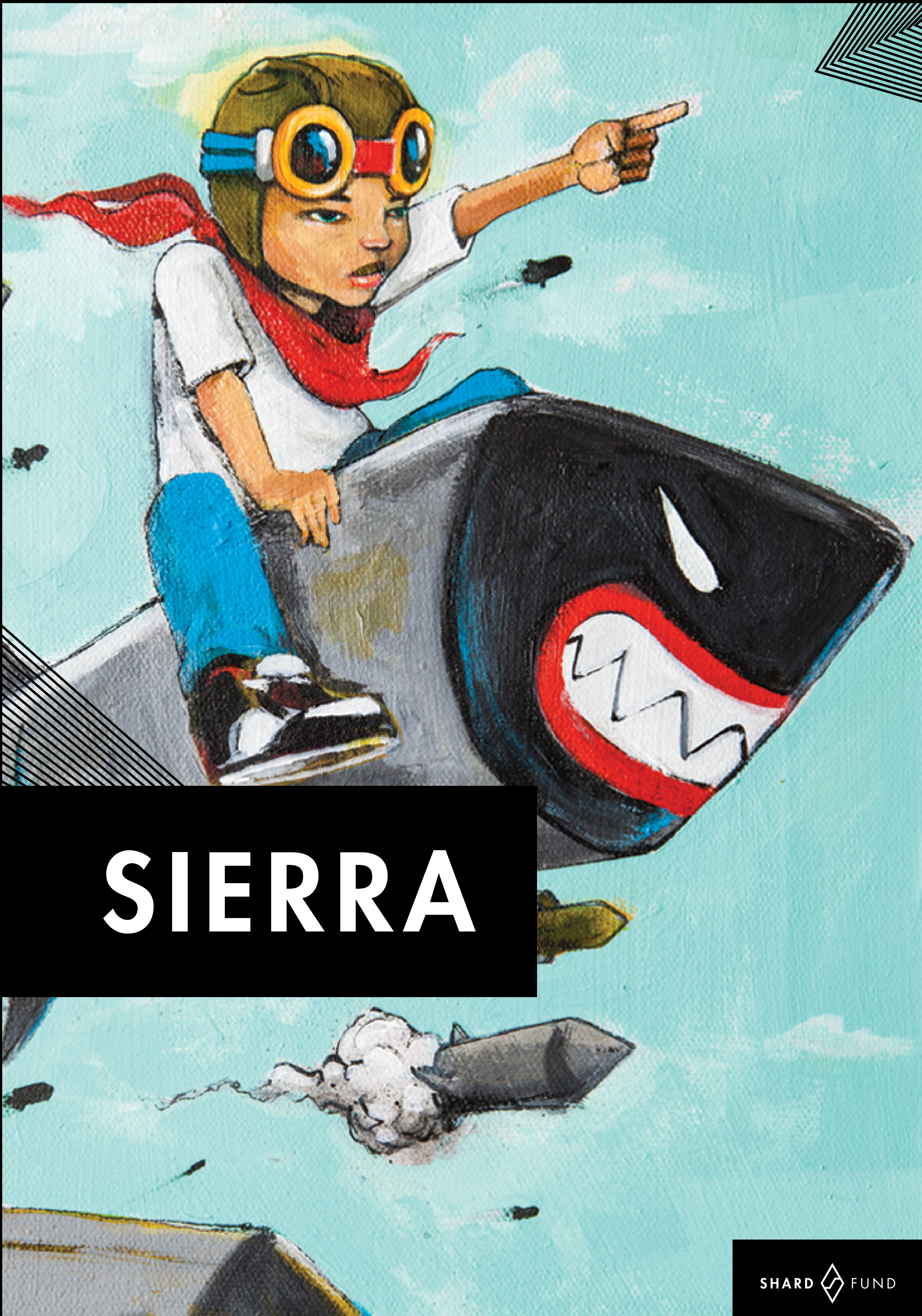

SIERRA

SHARD FUND

A JOURNEY ACROSS FINANCIAL MARKETS

February 1st - February 7th, 2013 | Issue 6

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USA

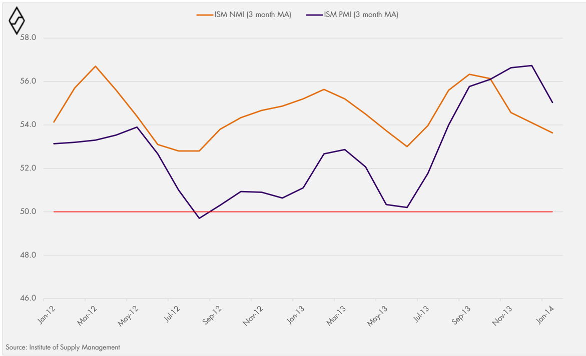
Got growth?

The first week of each month is always interesting in the US, as investors leave everything behind to focus on the employment report, released each first Friday of the month. This time, it wasn't different. We also saw the monthly releases from the Institute of Supply Management (ISM), which also (like the employment report) suggested there might be a slowdown in the economy. Of course, markets reacted positively, probably because the new Fed Chairman Janet Yellen is viewed as a significantly less aggressive person compared to Mr. Bernanke.

Consumer Discretionary	2.02%
Healthcare	0.70%
Industrials	0.88%
Financials	1.09%
Energy	0.79%
Technology	0.80%
Consumer Staples	0.42%
Materials	1.50%
Utilities	-0.56%

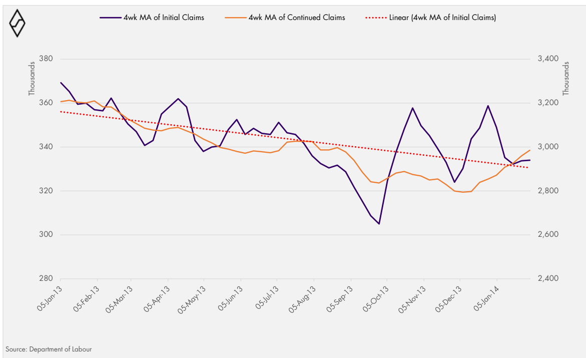
Whether or not those theories are correct will be determined in the near future, when she has her opportunity to 'shine'. The S&P 500 gained 0.81%, with consumer discretionary leading the group and Utilities being the only sector with negative performance. This is the complete opposite to the trend that has been forming year-to-date, so we believe this might be a mere bounce that might act as a 'bull trap'.

In this issue, we would like to decipher what is currently happening in the economy, and how it could influence the next 1-2 quarters (or maybe more). Starting with the ISM indices, the growth momentum we saw last year has clearly been distorted, as indicated by the 3 month moving average of the two indices (Manufacturing PMI and Services NMI).



Additionally, the near futures movements do not look as bright as those seen less recently. New orders for services, a leading indicator for future activity, have barely expanded in the past two months, while those for manufacturing just plunged from 64.4 to 51.2, or, (put historically), the largest drop in 20 years. So, all in all, not a good start of the New Year, which has persuaded market participants to start talking about a halt in tapering.

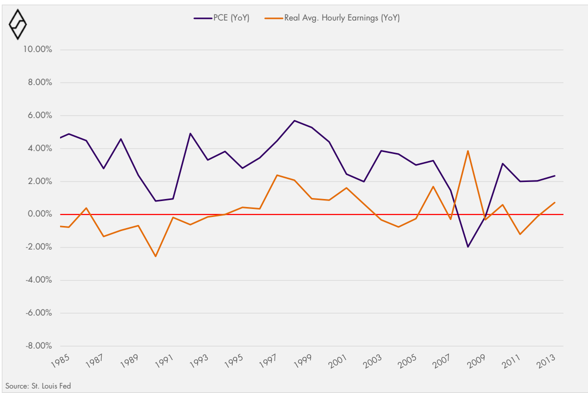
The more interesting part of the report comes with the employment data, released by the Bureau of Labour Statistics. Here we note that we are not interested in the headline number of payrolls added, or the unemployment rate: the



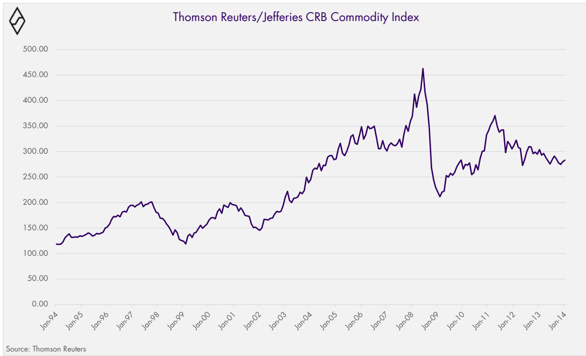
former is a very volatile measure, which can't be viewed in isolation with other employment indicators. The weekly unemployment claims are a good measure to track overall trend in the labour market, and right now that indicator is trending downwards, although it has also showed some volatility in recent weeks. So, until there is stronger evidence for a worsening jobs' market, it is safe to assume that despite the deceleration, the market is getting better and better.

...the big problem we see as a headwind for employment and the economy are average hourly earnings.

Nevertheless, the big problem we see as a headwind for employment and the economy are average hourly earnings. We conducted historical research to establish the connection between hourly earnings and economic activity, which showed a possible threat to US growth in 2014. We used data from 1965 – 2013 and found that real average hourly

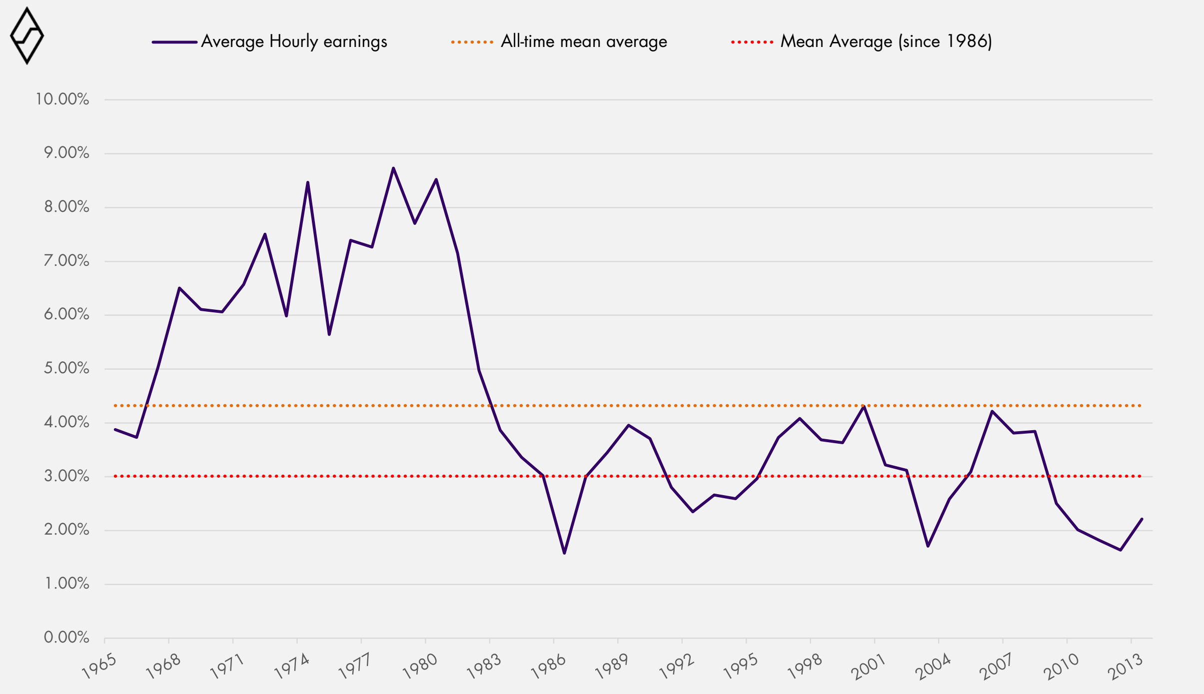


earnings (CPI all items used) are closely correlated to the personal consumption expenditure, which is around 70% of the US economy. Last year, real earnings increased by 0.72%- the highest in 5 years. On the other hand, all-items CPI was 1.5%, the fourth lowest inflation reading in the time frame of our research. No wonder the US experienced such strong growth and an overall positive year. Now let's look at the first decade of the 21st century, but this time we will also consider the Thomson Reuters/Jefferies CRB Commodity Index (a bundle of 19 commodities), which is useful for anticipating inflation.



From 2002 until 2007, the index increased by an average of 15% per year. This brought inflation up, but average hourly earnings didn't catch up, so real earnings fell by an average of -0.12% per year. The same thing happened after the recession, when the CRB index started increasing, which brought inflation up again and from 2009 until 2011, real hourly earnings 'increased' by -0.31% per year. The point we are making is that, from a historical perspective, higher inflation brings down real average earnings, which consequently reduces or decelerates personal consumption expenditure. This is relevant to what is happening today, as it looks like inflation is crawling back, which will inevitably hit purchasing power and the economy. The CRB index is already 3.43% up this year, the 5 year breakeven rate (the difference between nominal 5 year treasury yield and the 5 year TIPS yield), which is used to measure inflation expectations, has also gone up year to date. Moreover, we can see the index measuring prices in both ISM reports (manufacturing and services) has going up significantly in the past

2 months. This potential increase in inflation may cause big problems if nominal average hourly earnings don't increase. Currently, they are situated at the lower end of the trend (since 1986), with the potential of a mean reversal in the upcoming months. We believe that inflation is a much higher threat to the US economy than the modest employment. If you don't believe us, just look at the spread between the Consumer discretionary sector (XLY) and Utilities (XLU) year to date. More importantly, look at some specific industries within the consumer discretionary sector that have margins dependant on certain commodities: they certainly don't like what has been happening in the past 40 days!



Source: Bureau of Labour Statistics

Day	Country	Indicator	Actual	Forecast	Previous
Monday	United States	ISM Manufacturing Index	51.3	56.4	57.0
Wednesday		ADP Nonfarm Employment	175K	180K	227K
		ISM Services Index	54.0	53.7	53.0
Thursday		Continuing Jobless Claims	2,964K	2,998K	2,949K
		Initial Jobless claims	331K	335K	351K
Friday		Nonfarm payrolls	113K	185K	75K
		Unemployment rate	6.6%	6.7%	6.7%
		Average Hourly earnings	0.2%	0.2%	0.0%

EUROPE

Super Mario 2.0

Last week was one of the "Back on track" weeks. We witnessed the main European indices on green light, led by the Euro Stoxx 50: 2.95% up for the 5 trading days. The FTSE 100 increased by 0.94% and the CAC 40 valued by 1.5%. However, the week was also one of Purchasing manager indices. Eurozone growth continues to gradually accelerate and optimism about the future is growing. The composite PMI was 52.9 in January, up from 52.1 in December.

We believe that with improving PMI readings, Spain could rival Germany in the growth stakes this year.

Spain stands out this month, with the composite PMI reaching a 78 month high of 54.8, close to Germany's 55.5, that is behind Irelands 57.8 reading. But the Spanish services PMI accelerated further ahead of Germany, signaling improving domestic demand. The Eurozone is on-track for a gradually strengthening recovery throughout this year, which we expect to result in Eurozone GDP growth. We believe that with improving PMI readings, Spain could rival Germany in the growth stakes this year.
In the previous Sierra issue, we described the situation about the European CPI concern. Regarding this, during last week we would have needed to receive some more information about the problem from the ECB press conference, however we didn't, it was postponed for March 2014. On Thursday, the president of ECB, Mario Draghi, declared that there is currently no need of extending the monetary policy of the European Union. The decision was dictated by the overall well performing economy of Europe, although we consider that some of the economic figures express different opinion:

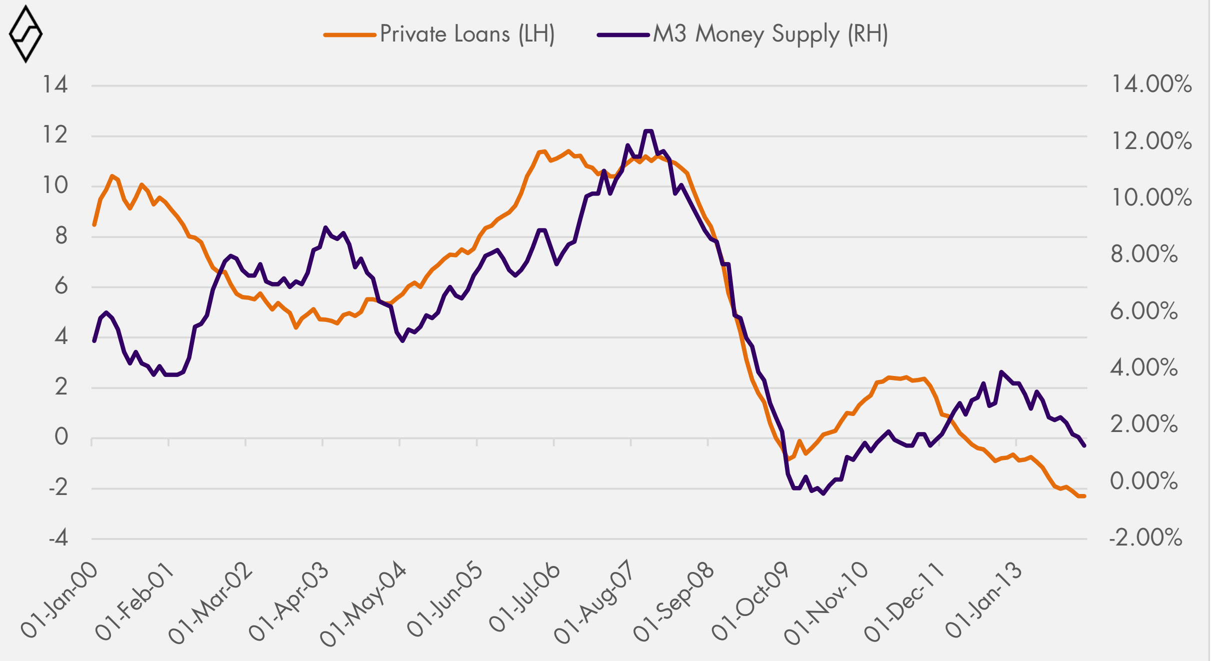
- EU Inflation rate: 0.7% - well below the 2% target (more details at Sierra 05);
- Countries from the Continent have inflation pressure as well:

Country	Inflation annual rate Jan.2014	Inflation annual rate Dec.2013
Greece	-1.70%	-2.90%
Cyprus	-2.90%	-2.30%
Latvia	-0.40%	-0.40%
Portugal	-0.20%	0.20%
Ireland	0.20%	0.30%

Source: Eurostat

- Money-supply data are further indicators of weak inflationary pressures. The three-month average of M3 money-supply growth fell to 1.3 % YoY in December from 1.6 % in November. Bank lending of the private sector remained at the lowest level since at least 1992 at minus 2.3 %;
- The Retail sales indicator performed worse than forecasted, declining 1.6% on an annual basis. This speaks about the declining domestic demand which would put some pressure on other indicators, such as: manufacture production, services, etc;
- Overall eurozone unemployment remains stuck at a record high of 12%.

Looking at these facts, we consider that it is very likely to witness a cut of the interest rate in the future. But after all, the decision needs to be backed up with strong arguments, and those arguments are scheduled to be received at the press conference during March 2014. We consider that if growth disappoints, the current emerging market turbulences, domestic problems such as economic pressure in France or political turbulences in Italy or elsewhere set off new financial market turbulences, the ECB will act forcefully.



Source: ECB

Day	Country	Indicator	Actual	Forecast	Previous
Monday	EU	Final Manufacturing PMI	54	53.9	53.9
	United Kingdom	Manufacturing PMI	56.7	57.1	57.2
Tuesday	Spain	Unemployment Change	113.1K	-21.3K	-107.6K
	United Kingdom	Construction PMI	64.6	61.6	62.1
Wednesday	United Kingdom	Services PMI	58.3	59.1	58.8
	EU	Final Services PMI	51.6	51.9	51.9
Friday	United Kingdom	Manufacturing Production m/m	0.3%	0.6%	-0.1%

ASIA & OCEANIA

Chinese options

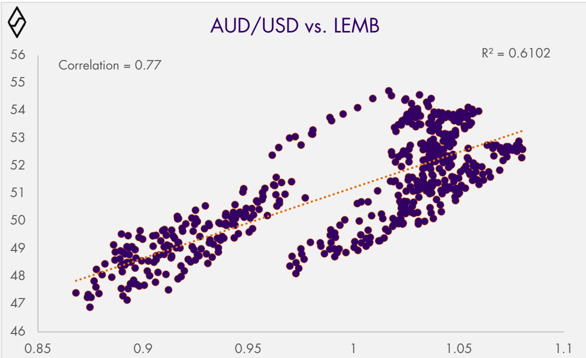
AUSTRALIA

We very much enjoyed reading Glenn Steven's Monetary Policy statement, because he seems like a person with a long term global outlook for the economy (not to be compared with Paul Volker just yet though). The notes he makes are based on big trend observations and yet not ignoring the current economic affairs. Here are the highlights from his final statement (**full** Monetary Policy Statement):

- "Commodity prices have declined from their peaks but in historical terms remain high."
- "...some emerging market countries conditions are considerably more challenging than they were a year ago"
- "...firmer consumer demand and foreshadows a solid expansion in housing construction." Which seems somewhat controversial as he also notes that "demand for labour has remained weak and, as a result, the rate of unemployment has continued to edge higher. Growth in wages has declined noticeably."

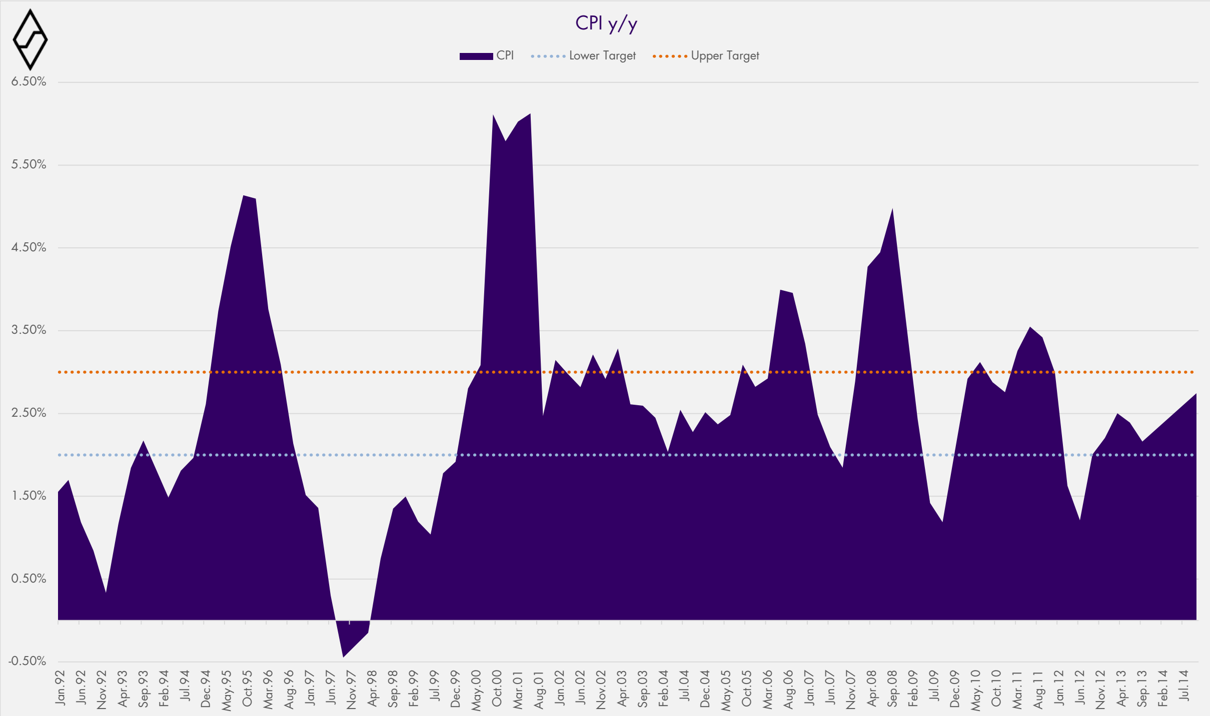
What he did not note this time however, is that the Australian dollar is still at "uncomfortably high levels". In regards to the current decline, he did mention that "...if sustained, will assist in achieving balanced growth in the economy." A few weeks ago the CPI number for December was released and the Y/Y inflation rose from 2.16% (close to RBA's lower target bound) to 2.75% (close to RBA's lower target bound - chart on the next page).

This, plus the lacking statement about the "AUD being at uncomfortably high levels" puts our idea from the **End of 2013 Sierra** about the RBA cutting rates further in the bin. To put the cherry on the top, the RBA has also raised its economic growth and inflation forecasts, projecting inflation at 3% (at the top of the target).



source: Thomson Reuters

This however does not necessarily also put the short AUD/USD idea in the bin. For the graph (INSERT) we can see a strong co-variation and correlation between the AUD/USD and the LEMB (**Local currency-denominated emerging markets bonds**). If there is more downside potential for Emerging Market currencies, the AUD will most likely be joining the group (at least until the RBA increases rates, which we do not see).



CHINA

The Chinese PMI figures came out this Saturday, although not great, were almost in line with forecasts. This is it's second decrease M/M, indicating a growth slowdown (but growth nonetheless). Both domestic and export demand have slowed (what a pickle for China that must be). It's worth noting that the price index has fallen below the 50 level, showing a reversal in its upward trend. Further, the non-manufacturing PMI has been slowing down its growth as well. Business expectation seems to be higher than the previous month and optimism has taken over for some reason.

Day	Country	Indicator	Actual	Forecast	Previous
Saturday	China	Manufacturing PMI	50.5	50.6	51.0
Monday		Non-Manufacturing PMI	53.4		54.6
	Australia	Building Approvals m/m	-2.9%	-0.3%	-0.3%
Tuesday	New Zealand	Unemployment Rate	6.0%	6.0%	6.2%
Thursday	Australia	Retail Sales m/m	0.5%	0.5%	0.7%
		Trade Balance	0.47B	-0.27B	0.08B
		NAB Quarterly Business Confidence	8		5

COMMODITIES

Asia, the Robusta coffee producer

ENERGY

Saudi Arabia's decision to cut March oil prices for Asian customers by more than expected seems to be a three-pronged move to maintain its market share, boost refining margins and stave off demand destruction. Saudi Armco the world's biggest oil exporter cut the official selling price for its benchmark Arab Light grade to a premium of $1.75, down from $2.45 in February. The question remains, however, have the Saudi's done enough? The main risk is that demand in Asia disappoints given slower economic growth in the region, stemming from worries over capital flight from emerging markets and the possibility of demand destruction in some of the region's top consumers as weakening currencies boost domestic fuel prices. Take for example India, Asia's second largest oil importer, whose retail prices rose as the rupee weakened. The price of the global benchmark Brent Crude (in rupees) has retreated from last August's record high of 8,022 rupees a barrel to close to 6,643 rupees, but this still isn't higher than the 6,304 rupees Brent cost in July 2008. I.E Brent is 5.4% more expensive in rupee terms than in 2008 whilst in dollar terms it's 27% cheaper. Rising retail fuel prices and slower economic growth may curb India's growth in oil imports which rose 7.8% in 2013. Cutting the official selling price may allow refiners to boost margins and lower fuel costs and therefore mitigate the possibility of demand destruction in economies such as India's. India also poses another problem insofar as they are looking to import more from Iran this year after tensions over Tehran's nuclear program eased. The possibility of increased Iranian shipments as well as from neighbouring country Iraq is also a likely factor in the Saudi's decision. Furthermore, increased Russian oil via the ESPO pipeline is providing Asian refiners with a lot more suppliers then they have had previously.

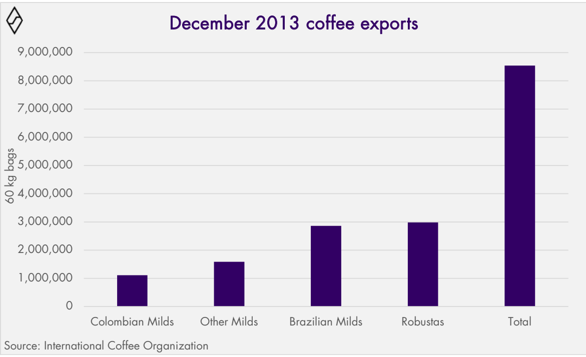
Rising retail fuel prices and slower economic growth may curb India's growth in oil imports...

On the topic of increased Russian oil: Rosneft is set to export an additional 9 million tonnes of oil to China this year, and talks are continuing to increase eastbound crude supplies further. President Vladimir Putin has made more cooperation with energy-hungry Asia a priority for Russian companies as their business with fragile European economies falters and as nascent deposits in East Siberia are being developed. The company will increase deliveries by 2 million tonnes to China National Petroleum Corp (CNPC) via a spur of the East Siberia-Pacific Ocean (ESPO) pipeline. It will also ship 7 million tonnes to CNPC via Kazakhstan in 2014.

AGRICULTURE

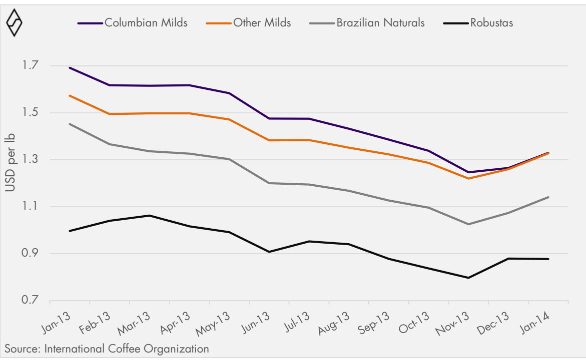
The recent publication by Conab of the official Brazilian estimates for the 2014/2015 crop year, which is due to start in April, suggests that output could fall for the second consecutive crop year, giving an initial forecast between 46.53 and 50.15 million bags. This uncertainty is further exacerbated by the recent dry weather in key coffee producing countries such as Brazil, and could continue to give support to coffee prices. The total exports of 60kg bags for December 2013 came in at just over 8.5 million, a 5.8% decrease compared to 2012. This brings the total exports for Q1 of the coffee year 2013/2014 (October to December) to 24.9 million bags, down 9.8% on 2012/2013.

The graph below shows the break-down of coffee types contributing to the total export figure as well as the overall total:



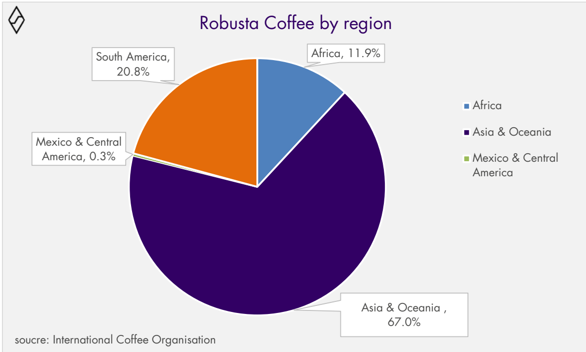
Source: International Coffee Organization

Whilst at first glance Robusta may look like the best choice given there large proportion to the total December 2013 exports, the ICO Composite paints a different picture.



Source: International Coffee Organization

As can be seen Robusta's were the only category to fall between December 2013 and January 2014 (falling 0.2%). This compares with Columbian Milds, Other Milds and Brazilian Naturals, which rose 5, 5.4 and 6.2% respectively. The fall in Robusta is likely due to several factors. Firstly, given the economic climate in Asia recently, with some fairly poor economic numbers and protests (e.g. Thailand), production may have slowed. Furthermore, production in Mexico and Central America has been hit recently by coffee leaf rust. The news isn't all bad though, with Asia & Oceania's production set to rally; largely due to increased output in Vietnam. As a result, the region as a whole is set to produce over 2/3rds of Robusta production



soucre: International Coffee Organisation

as shown below.

In other news Chinese importers once again cancelled purchases of corn, after one cargo was diverted to Vietnam, as the dispute over the unapproved genetically modified strain of corn rages on. The department of Agriculture in the United States has confirmed the cancellation of 220,000 tonnes of corn by China for shipment in the current year.

FOREX

Pair	Open	Close	Weekly %	Monthly %	YTD
EUR/USD	1.3485	1.3635	1.11%	1.11%	-0.80%
USD/JPY	102.05	102.3	0.24%	0.24%	-2.85%
USD/CHF	0.906	0.8974	-0.95%	-0.95%	0.52%
USD/CAD	1.1128	1.1032	-0.86%	-0.86%	3.88%
AUD/USD	0.875	0.8957	2.37%	2.37%	0.49%
NZD/USD	0.8078	0.8288	2.60%	2.60%	1.00%
USD/CNY	6.0608	6.0634	0.04%	0.04%	-1.49%
GBP/USD	1.6434	1.6408	-0.16%	-0.16%	-0.89%

EUR

As it was written at the Eurozone part of Sierra, the markets were waiting to see if the ECB would take any action on Thursday, regarding the inflation concern - lowering the interest rate. Such a move would likely hurt the euro due to investors dumping their euros in favor of other currencies. When this didn't happen, the euro jumped, gaining about a cent after Draghi's press conference. Draghi then reiterated what we've heard many times over, which is that for the foreseeable future interest rates will stay at their current levels or could go even lower. What action, if any, the ECB takes when it sets rates in March will be heavily influenced by the inflation situation in the Eurozone. If inflation weakens further, the ECB will be under strong pressure to make a move, such as lowering deposit rates. That of course would affect the euro negatively. However, until that moment we keep our neutral/ bullish opinion.

JPY

The current JPY depreciation has reflected more on higher import cots, instead of increase in exports and as a result the Japanese current account is continuing to suffer. An increasing current account deficit may put some further downward pressure for the Yen and in the long run we are still holding our long USD/JPY position.

PORTFOLIOS

MAVERICK

security	L/S	date
Volkswagen AG	Long	03.Sep.13
China Longyuan Power Group Corp. Ltd	Long	03.Sep.13
Tracker Fund of Hong Kong	Long	03.Sep.13
SPDR Consumer Discretionary Sector	Long	07.Jan.14
Corning Inc.	Short	23.Oct.13
CNY/USD	Long	04.Nov.13

security	L/S	date
ProShares UltraShort Lehman 20+ Yr(ETF)	Long	04.Nov.13
Orange SA	Long	02.Dec.13
Telefonica SA	Short	02.Dec.13
iShares MSCI Emerging Markets	Short	24.Jan.14
SPDR Consumer Discretionary Sector	Long	27.Jan.14
PowerShares DB	Short	03.Feb.14

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
USD/JPY	Long	07.Oct.13
Aeropostale Inc	Long	15.Oct.13
OZ Minerals	Long	15.Oct.13
Easyjet plc	Long	20.Oct.13
Chico FAS	Long	15.Oct.13

security	L/S	date
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
Claymore/AlphaShares China Real Est ETF	Short	03.Feb.14

EVENTS

USA

- Retail Sales
- Michigan consumer sentiment
- FOMC member speeches

EUROPE

- EU Industrial Production
- EU Flash GDP
- EU Trade Balance

ASIA & OCEANIA

- Japan Current Account
- Australia NAB Business Confidence
- Australia Home Loans
- China Trade Balance
- Australia Unemployment Rate
- China CPI

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