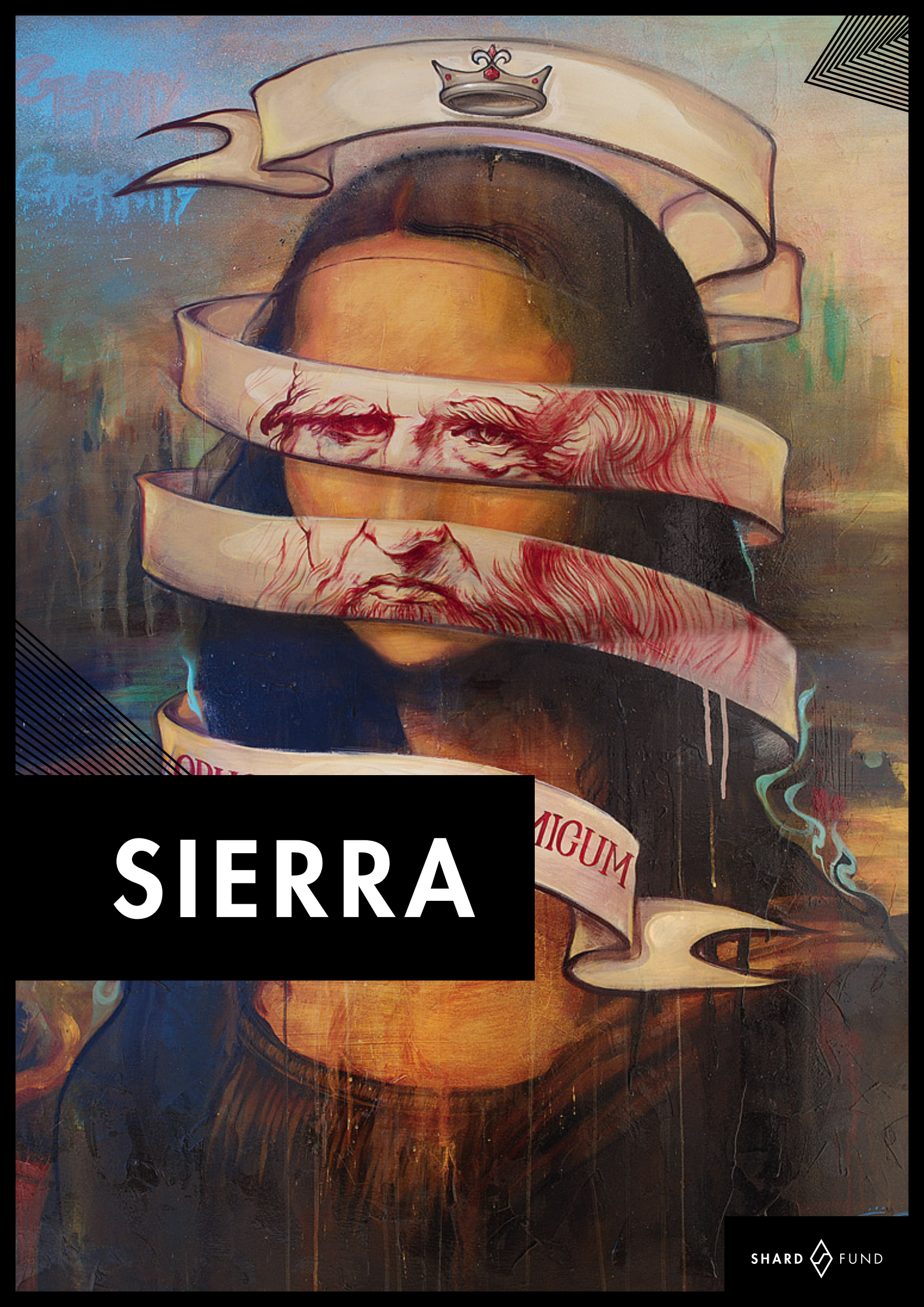


A surrealist painting of a man's face, possibly a historical figure, with a crown on top. The face is partially obscured by a white ribbon that spirals around it. The ribbon has a red beard and mustache drawn on it. The background is a mix of blue, green, and brown tones. The word "SIERRA" is written in large white letters on a black background in the lower left. The word "MIGUM" is written in red on the ribbon. The word "ODI" is partially visible on the ribbon. The word "SHARD" is written in white on a black background in the lower right, next to a logo. The word "FUND" is written in white on a black background in the lower right, next to the logo.

SIERRA

MIGUM

A JOURNEY ACROSS FINANCIAL MARKETS

March 15th - March 21st, 2014 | Issue 12

TEAM:

Georgi Stanoev USA

Petar Tsachev Europe

Stelian Nenkov Asia

Harry Collins Commodities

David Twomey Editor

Jaskiran Mangat Co-Editor

SPECIAL ANNOUNCEMENT

Young Finance Scholars' Conference



The conference provides an opportunity for junior scholars that have little (or no) experience with publishing in academic journals to share their research, debate their methodology and results, network with their peers from other institutions and, primarily, to receive expert comment and advice on publication from leading finance academics.

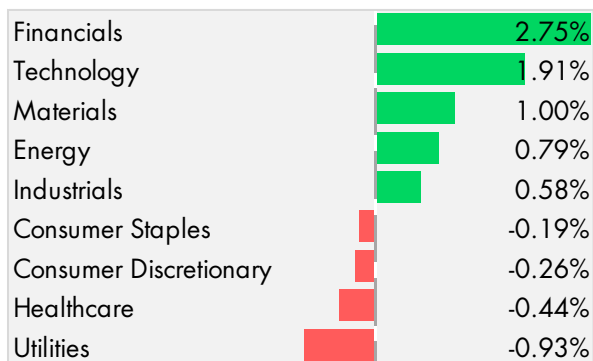
Schedule: <http://bit.ly/1iWEtVd>

To register follow the link or the logo: <http://bit.ly/1gzMYlP>

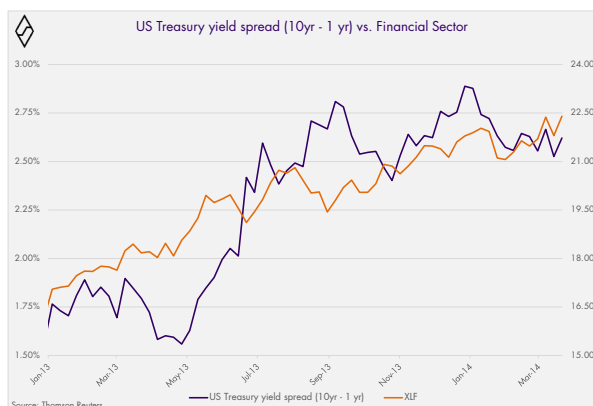
USA

The 'iron' lady

As expected, Janet Yellen's speech, which concluded the two-day FOMC meeting, influenced markets strongly, as participants (and pundits) 'investigated' thoroughly what the poor little woman might have meant by saying 'this and that'. The S&P 500 increased by 1.37% that was mostly due to the bounce on Monday after the slump last week.



The yield on 10 year treasuries increased by 10 bps to 2.75%, while the yield on shorter maturities was mostly unchanged, thus the spread also increased and pushed up financials, which typically benefit from this.



Honestly speaking, we are quite fascinated by the amount of time spent on deciphering the statements of the Federal Reserve's Chairman.

It really is starting to look like one of those Super Bowl or Oscars' parties that people have to commemorate those special occasions. With the best part being that unlike the Super Bowl and the Oscar's, those statements by the Fed chairman occur a lot more than once a year. There was literally a whole round table discussion panel on one of the financial media channels (no name) where 5 or 6 people were discussing the statement word by word. It's laughable really, but hey, who are we to judge.

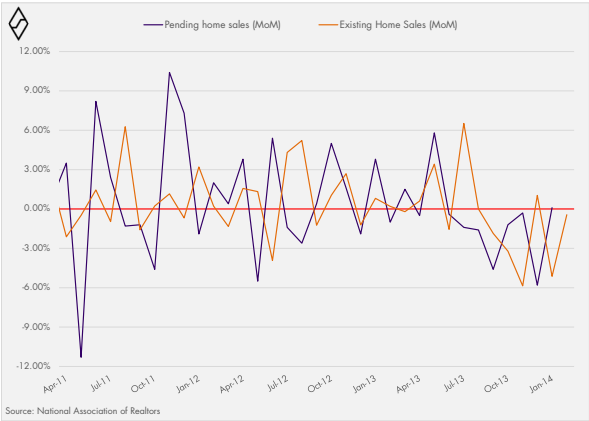
In other words, to achieve the Fed's yearly forecast, the real GDP needs to grow by 3.2—3.6% (annualised) in the next three quarters.

Looking at the Janet Yellen's statement, it is fair to say that it was slightly more hawkish than expected, which created the market overreaction. Basically, the FOMC expects strong recovery this year and almost all members see rates increasing in 2015. The good thing about all the attention and discussions the FOMC meeting attracts is that we get a clear indication about views of policy makers and market participants, and right now we are standing at a tipping

point. At present, the Fed’s forecasts for real GDP growth this year are 2.8—3.0% with an unemployment rate of 6.1—6.3%. This will allow the Fed to finish tapering this year and increase the interest rate roughly in the middle of next year. It sounds almost too good to be true. Although we cannot argue about the unemployment rate, given the underlying variables, a rough approximation of the GDP tells us a lot. It should not come as a surprise that this quarter will most likely be worse than Q4 2013, thus let’s assume a 2% annualised growth rate (optimistic), given the 2.4% preliminary result for last quarter. In other words, to achieve the Fed’s yearly forecast, the real GDP needs to grow by 3.2—3.6% (annualised) in the next three quarters. This is where it gets interesting, as it is clear that policy makers consider the soft data in the past months as nothing more than an outlier in a longer term, strong–growth trend. Then again, what if this assumption is wrong? Given the ‘accuracy’ of past forecasts, it is quite easy for us to imagine alternative scenarios and the reaction of the Fed. You should do so as well. Be prepared, as currently a large part of the market believes the hawkish Fed guidance, so any reversals might come as a surprise. Of course we are not saying such event will definitely occur, we just like being prepared for every scenario, especially when most of the industry is looking in one direction.

The housing sector situation is still not rosy. Building permits finally surprised to

the upside after declining for three months in a row. However, they are related to the market for new houses, which is only around 20% of the overall sector. Existing home sales are a lot more important and it looks like they are not really getting better, as the National Association of Realtors reported another drop in existing homes sold – this time to the lowest since summer 2012.



We started expressing worries about that part of the economy last summer when pending home sales (leading indicator for existing home sales) started decreasing. Since then, both indicators have been declining and so far there is no indication for a reversal. Initially rising rates were blamed, but then at the beginning of 2104, rates went down and the weather took the responsibility. It’s just a matter of time until we see what other excuse is going to come up. Currently, we don’t hold a position in US housing.

Day	Country	Indicator	Actual	Forecast	Previous
Tuesday	United States	CPI (YoY)	1.10%	1.20%	1.60%
		Building Permits (MoM)	1,018K	960K	945K
		Housing Starts (MoM)	907K	910K	909K
Wednesday		Interest rate	0.25%	0.25%	0.25%
Thursday		Initial Jobless Claims	320K	325K	315K
		Continuing Jobless Claims	2,889K	2,868K	2,848K
		Philadelphia Fed Manufacturing Index	9.0	3.8	-6.3
		Existing Home Sales	4,600K	4,600K	4,620K

EUROPE

Green light

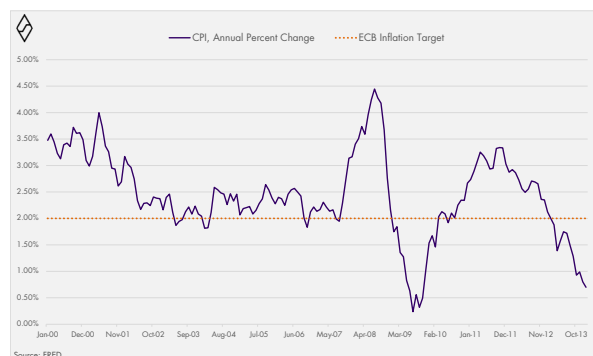
Finally we witnessed the best week in a month for the European stock exchange. The Crimean events have partly cooled, which returned investors' confidence in the Old Continent. The German DAX climbed some 3.15% over the last 5 trading days, the FTSE 100 increased by 0.45% and the French CAC 40 boosted by 2.82%.

...the low inflation is a broad-based phenomenon and the ECB may still be forced to ease policy again.

Looking backward, after the onset of the Ukrainian crises, there was a huge backstage game being played by the US, Russia and the EU. After the dust of military conflict settled we saw some really interesting results: Russia got Crimea (which has been Russian territory historically), EU got Ukraine and the FED has quietly received 33 tons of the Ukrainian gold reserves as partial "collateral" for a fresh round of IMF, US FED, and ECB paper debt that is currently being organised for dumping into the Ukraine's economic

black hole. Surely, this is a good contract at the end of the day, for everybody, and we hope that there will not be further military conflicts any time soon (we just don't like the pressure it puts on the markets!). Anyway, that is enough geopolitical issues.

Back on to the macro environment, Euro-area inflation slowed again in February. The CPI reading— 0.7 % year-over-year, was just 0.1 % point below the consensus forecast — is unlikely to immediately alter the monetary policy stance of the ECB. The core reading remained unchanged at 1 %.



However, the low inflation is a broad-based phenomenon and the ECB may still be forced to ease policy again. For example, 12 of the 18 countries of the monetary union saw a decline in the YoY rate of inflation. 10 of the 18 countries registered rates under 1 % and 4 of the 18 countries registered negative numbers. The largest "core country" — Germany — saw its inflation rate decline to 1 % from 1.2 %: this should be a good reason for further action of the monetary policy from ECB.

ITALIAN FISCAL REFORMS

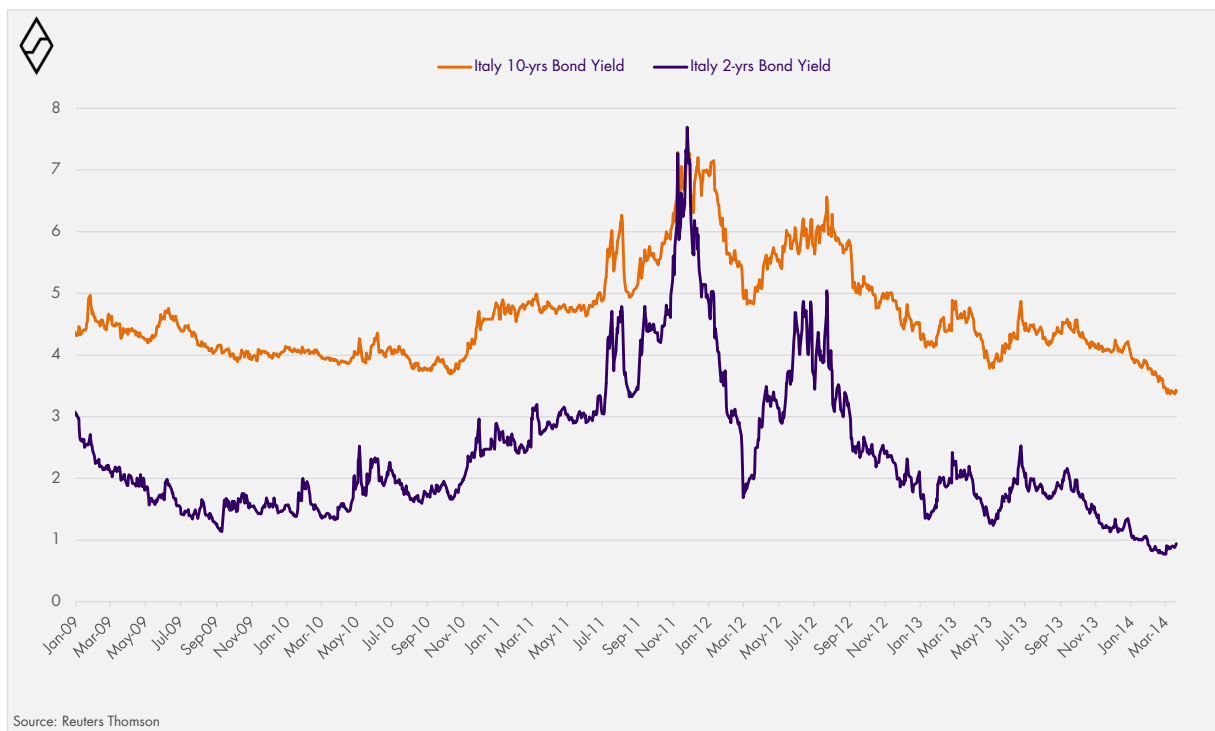
On Wednesday of last week, the new wave of political and economic reforms took place within one of the struggling European country members. Italian Prime Minister Matteo Renzi presented a sweeping package of tax cuts, saying they could help economic recovery in the euro zone's third largest economy without breaking EU budget deficit limits. The cuts will be achieved by reductions in central government spending, extra borrowing and by resources freed up thanks to the recent fall in Italy's borrowing costs "This is one of the biggest fiscal reforms we can imagine" Renzi stated.

According to Reuters, the tax cuts would mean an extra 80 euros per month in the pay packets of workers earning up to 1 500 euros, and income tax would be reduced by a total

of 10 billion euros (\$14 billion) annually for 10-million low and middle income workers from May 1. Furthermore, Renzi has also said the budget deficit goal would be raised while remaining below the EU's ceiling of 3 % of output. Italy is currently targeting a deficit of 2.5 % of GDP this year after 3.0 % in 2013.

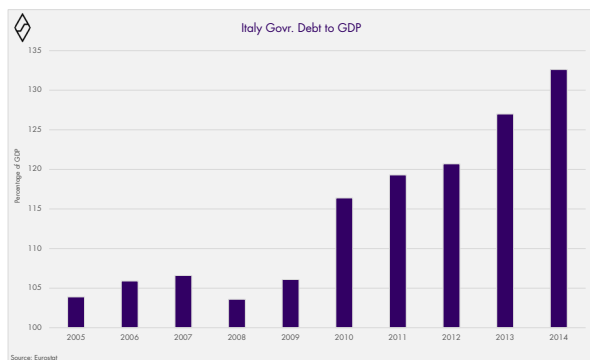
We opine that the fiscal action of the new Prime Minister of Italy is the right thing to do in the current struggling economic environment. Moreover, we believe that it might transfer Italy into a more favorable investment area, raising the confidence in the capital markets of the country.

Regarding the yield on Italian government debt, things are almost going too well at the moment. Consider e.g. the 2-year bond yield depicted below:

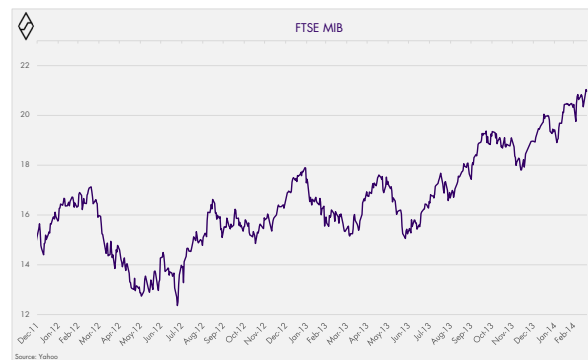
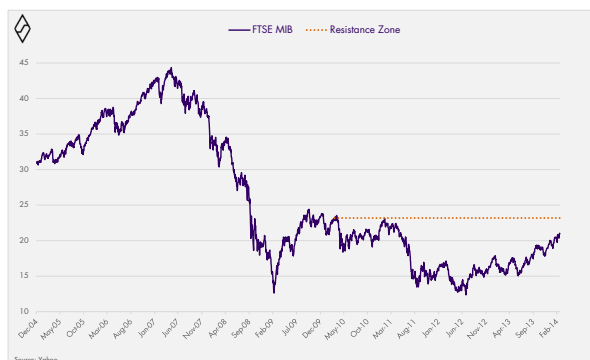


10-year bonds, meanwhile, are yielding about 3.4%, which is also a multi-year low. In short, the markets are currently in quite a forgiving mood, especially considering the next data series. Italy's debt-to-GDP ratio has increased by over 13 percentage points since the crisis peak:

Obviously, any unexpected increase in funding costs would be a lot more painful today than it was a few years ago and that is why bringing debt down should therefore remain a major priority. This is another very good reason to further cut spending.



Looking at the Italy's stock market, it has performed quite well of late. Investors have decided to ignore the geopolitical tension that have upset markets elsewhere, instead preferring to focus on the improvement in Italy's domestic economy, tentative though it may be so far. Putting things into perspective, a lot of investment opportunities have shown up lately, but it might be better to wait to pass the resistance zone, indicated below, first.



Day	Country	Indicator	Actual	Forecast	Previous
Monday	EU	CPI y/y	0.7%	0.8%	0.8%
Tuesday	Germany	ZEW Economic Sentiment	46.6	52.8	55.7
Wednesday	United Kingdom	Unemployment Rate	7.2%	7.2%	7.2%
Friday	EU	Current Account	25.3B	18.4B	20.0B
		Consumer Confidence	-9	-12	-13

ASIA & OCEANIA

Buried in paper from central banks

JAPAN

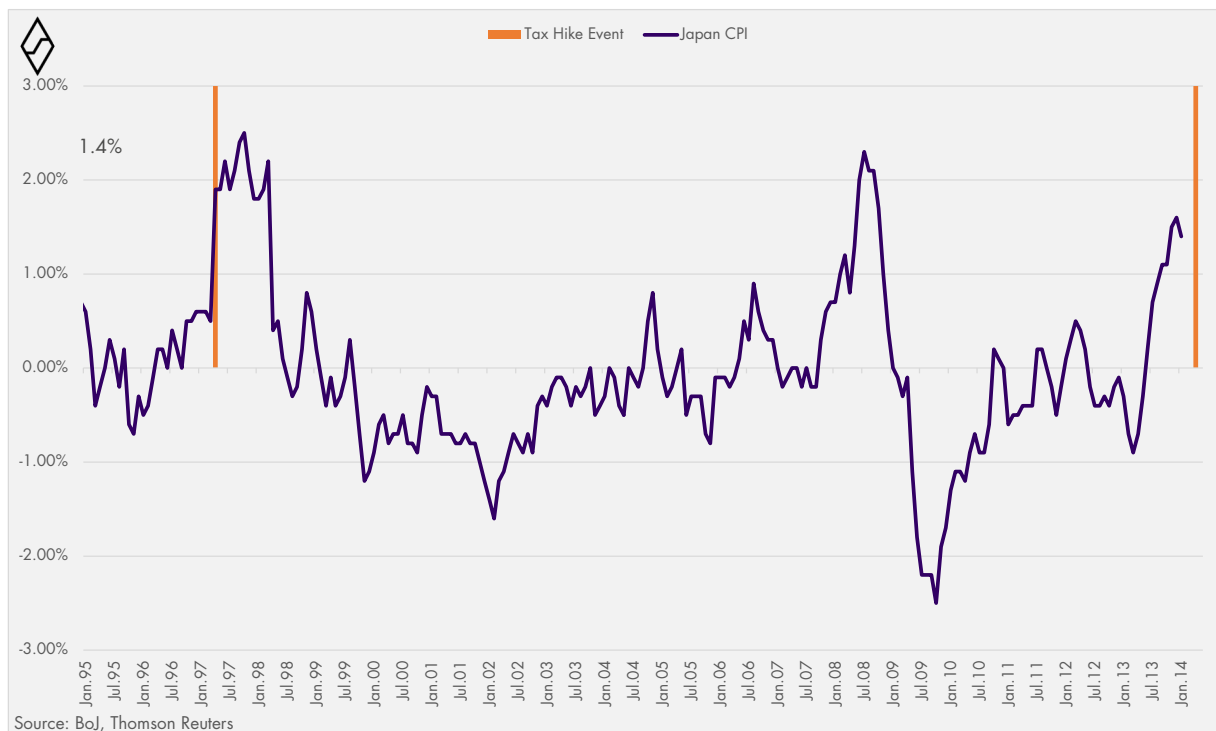
A week full of economic speeches by the BoJ. Haruhiko Kuroda – Governor of the BoJ spoke on *Overcoming Deflation with Quantitative and Qualitative Monetary Easing (full speech)* & *Aiming at 2 Percent Inflation. Why? (full speech)* & *How to Overcome Deflation? (full speech)*.

In *Aiming at 2% Inflation*, he puts forward three main reasons for targeting 2% inflation:

- Upward bias in the CPI
- Ensuring room to reduce interest rates: the so-called buffer
- 2% as global standard

What we found as another interesting point put forward was the implications of the consumption tax hike on the CPI.

The expectations are for CPI (excl. fresh foods) to go above 2% during 2014, but the gain to be quickly erased for 2015. This is precisely the situation in April 1997 when the tax rate was raised from 3 to 5%. The graph below shows how the CPI was 0.5% in March 1997 and it increased to above 2% for 1 year. The orange bars are indicating the timing of the tax hike. In *How to overcome Deflation? & Overcoming Deflation with Quantitative and Qualitative Monetary Easing* – the main point was that the Japanese economy is currently at the midpoint of the inflation target and BoJ is focused on keeping the trend created by pursuit of stable QQE (Quantitative and Qualitative Easing).



Takahide Kiuchi – Member of the Policy Board of BoJ, spoke on *Recent Developments in Economic Activity, Prices and Monetary Policy* (**full speech**).

The idea is that once deflation ends, nominal growth will increase, which in turn will generate higher tax revenue.

Here Mr. Kiuchi outlines the importance of showing a government commitment for fiscal consolidation (debt reduction). The idea is that once deflation ends, nominal growth will increase, which in turn will generate higher tax revenue. If however this doesn't happen, declining excess savings along with a current account deficit will make it harder (if not impossible) for the government to finance its debt with domestic saving. This in turn means that there needs to be finance from overseas – a much more expensive practice.

Takehiro Sato – Member of the Policy Board, spoke on *Quantitative and Qualitative Monetary Easing: Importance of Fiscal Consolidation* (**full speech**).

AUSTRALIA

The week was not much different for Australia. The RBA uploaded a ton of papers (their March Quarter Bulletin – view **full here**), which touch upon topics such as housing, exchange rate, inflation etc. Obviously they are full of lagging data analysis, however it's good for an overall view of the Australian economy and an appreciation for RBA's POV of their economy and the world.

Some of the more interesting things pointed out were:

China and India are the main factors

behind steel, iron ore and coal. China's fast urbanization, decreasing household size and strong income growth have led to a growing demand in high-quality housing. In contrast India has been having administrative difficulties which postpone the housing development (the long-awaited elections are coming up this year) and as a result, the demand for steel, iron ore and coal has been way below its potential. Those who manage to position themselves well in India and catch the upcoming trends will certainly benefit.

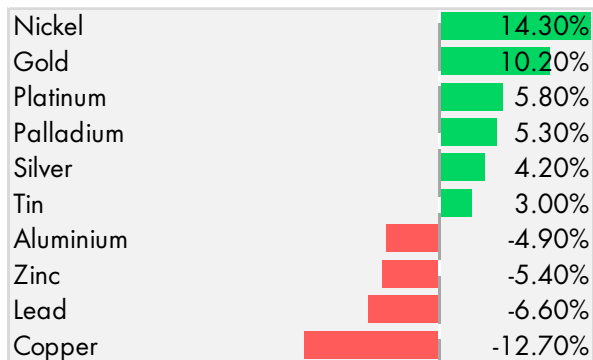
Day	Country	Indicator	Actual	Forecast	Previous
Tuesday	China	Foreign Direct Investment ytd/y	4%		16.10%
	New Zealand	Current Account	-1.43B	-1.44B	-4.88B
Wednesday	Japan	Trade Balance	-1.13T	-0.89T	-1.76T
Friday	Australia	CB Leading Index m/m	0.20%		0.80%

COMMODITIES

China's bizarre move

METALS

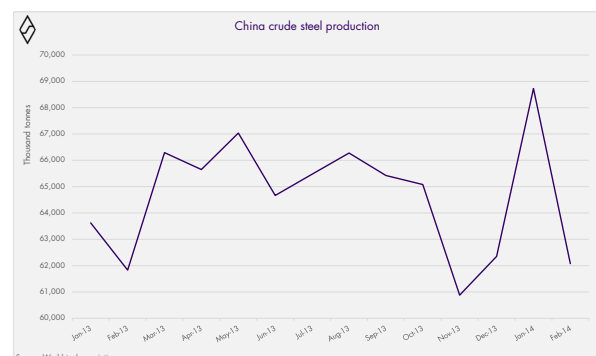
London Copper steadied but still closed down for a fourth week running, as worries about China's economy have clouded the outlook for demand. Recently copper has been pummelled by fears of spreading defaults in China, (the world's top user of the metal). This could damage demand, but prices appear to be finding their feet, aided by reassurances from Beijing. According to Premier Li Keqiang, China will speed up investment and construction plans to ensure domestic demand expands at a stable rate; implying authorities are considering practical measures to support slackening economic growth. However, the question remains; will this be enough to keep prices settled?



A worsening outlook and a potential appreciation of the USD suggests that the downward trend will continue, but at a slower rate. The three month LME copper edged up by 0.1% and the most traded June copper contract on the Shanghai Futures Exchange rose by 0.4%, reflecting an improved outlook for supply which has continued to suppress prices. It appears China has their work cut out for them in order to keep prices steady.

...worsening outlook and a potential appreciation of the USD suggests that the downward trend will continue, but at a slower rate.

Crude Steel production saw an increase in February by 0.6% (to 125 million tonnes) year-on-year. Chinese steel output, the world's top producer and consumer of the alloy rose by 0.4% to 62.1M tonnes relative to last year. As can be seen Crude Steel production for China is approaching the low that occurred in November 2013.



ENERGY

The prices of Middle East Crude oils being supplied by Asia appear to be too high this week given the recent increased supply. The Brent-Dubai exchange for swaps fell to \$3.75 a barrel this week, down from the year-high of \$4.44.

...oil prices for Asian refiners are likely to fall in coming months.

This shows the benchmark of Middle East grades have been rising relative to Brent, which stands at odds with signs that the Asian market remains well-supplied amid what can be described as steady demand. Due to seasonal maintenance starting in Asia soon and refining margins being fairly weak, it's hard to see demand for crude rising in the next few months. Whilst maintenance

of refineries may boost profit margins, it is likely to have the opposite effect on crude prices. Simultaneously supply appears to be rising, with Iran taking full advantage of its new relations with Western nations over its disputed nuclear programme to boost exports. Iran's four major Asian buyers: China, India, Japan and South Korea, took a combined 1.16 million bpd in February up from 994,669 bpd in January. Factoring in shipments of just over 100,000 bpd to Turkey and Iran is easily exceeding its 1 million bpd limit. With extra oil available and demand growth struggling in the face of slower-than expected economic growth in China and India, it appears that oil prices for Asian consumers should be based lower. What's interesting to note is it is almost as if there is a permanent risk premium built into oil prices, all that shifts is the geographic location of the current crisis, with the last year having seen concerns over Libya, Syria and now Russia. The risk is that this geo-political premium decreases, thereby lowering oil prices. It seems likely that in the absence of any new geo-political crisis, oil prices for Asian refiners are likely to fall in coming months.

AGRICULTURE

In what seems to be a bizarre move China has approved 15 genetically modified corn varieties for import. Since November last year China has officially rejected 887,000 tonnes of US corn, after detecting Syngenta's unapproved MIR162 in incoming shipments. The genetically modified strain is designed to offer enhanced protection against crop-

damaging insects. Due to these previous regular rejections of US corn China could face a premium on future corn purchases, the US department of Agriculture said. Initially it might be tempting to think that due to the economic slowdown it's being bought in anticipation China is going to slow further, however, China's stocks of corn are ample.

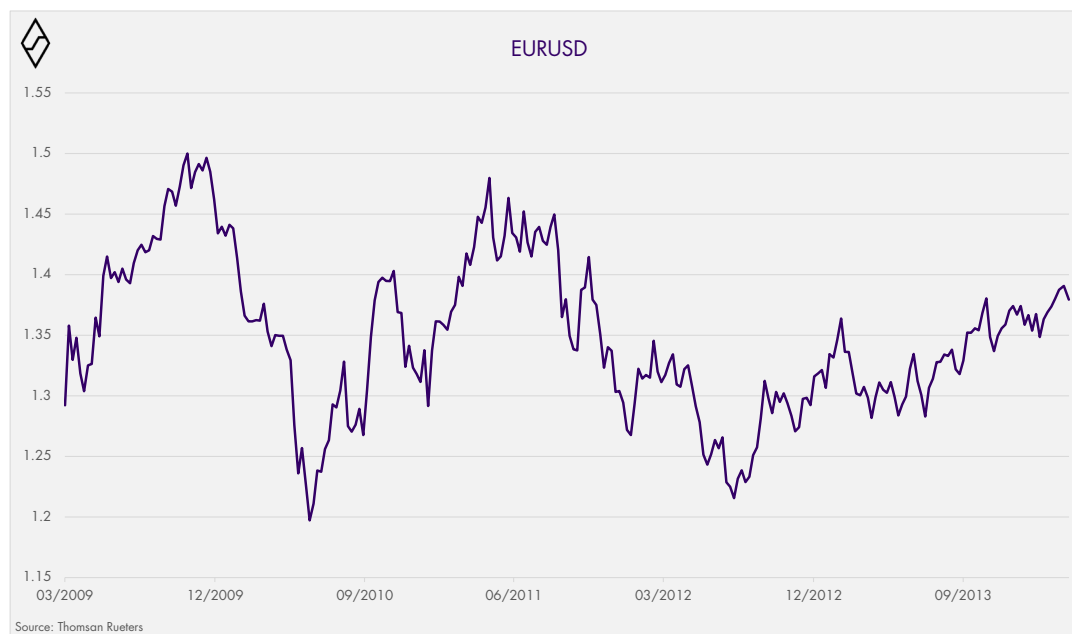
FOREX

Pair	Open	Close	Weekly %	Monthly %	YTD
EUR/USD	1.3907	1.3793	-0.82%	-0.04%	0.35%
USD/JPY	101.32	102.19	0.86%	0.43%	-2.95%
USD/CHF	0.8721	0.8824	1.18%	0.35%	-1.16%
USD/CAD	1.1095	1.1217	1.10%	1.41%	5.62%
AUD/USD	0.9025	0.9078	0.59%	1.74%	1.85%
NZD/USD	0.8527	0.8529	0.02%	1.80%	3.94%
USD/CNY	6.1502	6.225	1.22%	1.30%	-1.49%
GBP/USD	1.664	1.6488	-0.91%	-1.49%	-0.41%

EUR

We are changing our medium-term outlook for the Euro-area currency into bearish. Looking at the last week's events, we are recognising the threat which the strong Euro put over the Continent regarding deflation and growth pressure. Consequently, the ECB might take further action by transferring into a more

aggressive stance regarding monetary policy. At the same time, the Fed continues its slow move towards tightening, indicating a rate hike by mid-2015, (Yellen's implied message is that it may come sooner if US data surprises on the upside. This give some further support to our opinion.



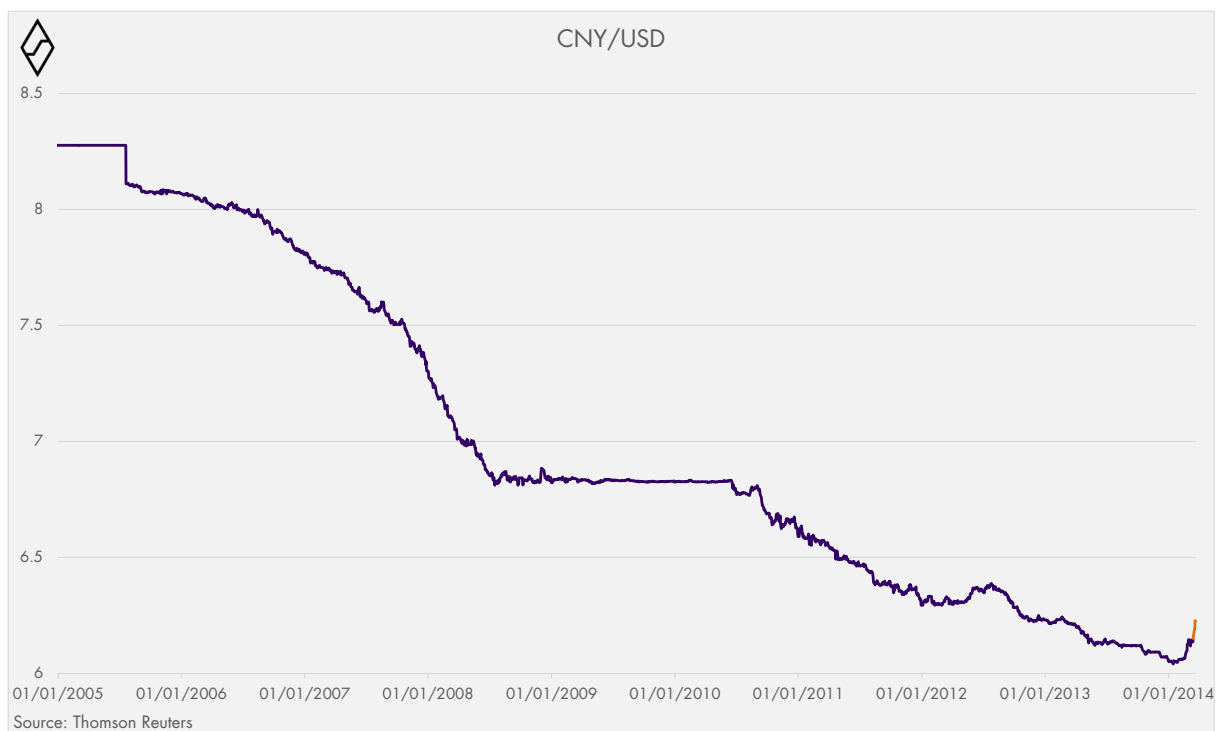
CNY

On Saturday, PBoC doubled the renminbi trading band in order for market forces to determine the value of the otherwise tightly controlled currency (the same argument as the one in April 2012 when the band was also doubled). The range will be 2% above and below the fixing rate set each morning. This is pretty much similar to setting it free, as 2% movements are not seen every day on the FX markets. As a result the weekly change of

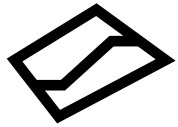
the CNY/USD was 1.22%. In other words, the Renminbi depreciated by 1.22% against the dollar. In the past 12 years, there have been 3 weekly depreciations of the renminbi higher than the one this past week.

- 7 Jan. 1994 – 50.2%
- 4 Dec. 1992 – 1.59%
- 20. Nov. 1992 – 1.54%

Hopefully this paints a better picture of the importance of this week's change.



PORTFOLIOS



MAVERICK



CORTEZ

UNDER CONSTRUCTION

EVENTS

USA

- GDP q/q
- Pending Home Sales
- Michigan Consumer Sentiment
- Durable Goods Orders
- CB Consumer Confidence

EUROPE

- EU: Flash PMI
- UK: CPI y/y
- EU: M3 Money Supply

ASIA & OCEANIA

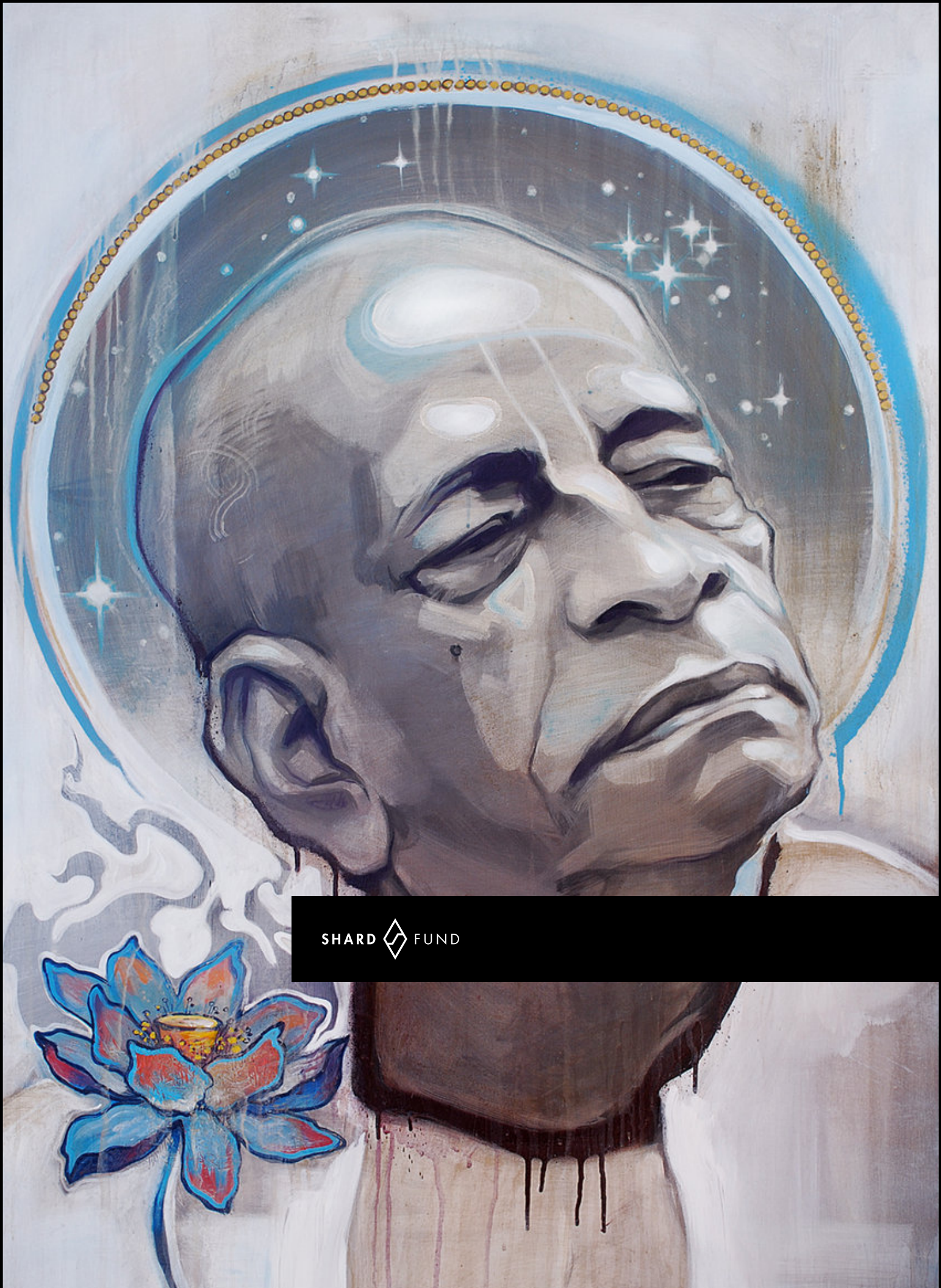
- China: HSBC Flash Manuf. PMI
 - Australia: RBA Gov Stevens Speaks
 - Australia: Trade Balance
 - Japan: Tokyo Core CPI y/y
-

REFERENCES

Reserve Bank of Australia, Bank of Japan, Bloomberg, Thomson Reuters, Markit, Eurostat, ECB, Bloomberg, Reuters, Berenberg, Seeking Alpha

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