SIERRA

SHARD FUND

A JOURNEY ACROSS FINANCIAL MARKETS

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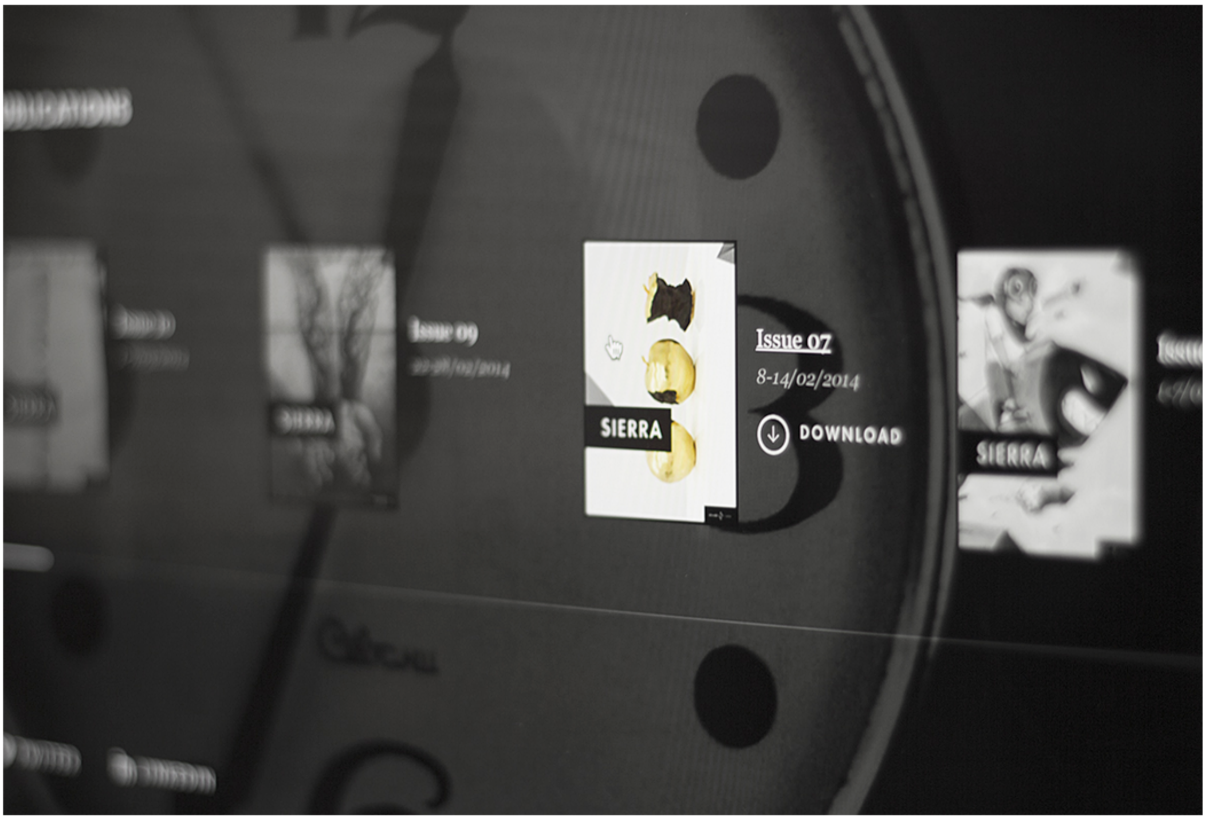
SPECIAL ANNOUNCEMENT

The Shard Fund website is up and running.

www.shardfund.com



View case study: **http://kickflipx.com/work/shardfund**

HIGHLIGHTS

USA

This quarter has not been much different than the previous one in terms of sector leaders and laggards. Utilities are still leading the rally with Energy joining the party in the face of bizarre oil prices. Meanwhile, Financials and Consumer Discretionary are stuck at the bottom, as growth has been officially reported negative and the Fed finally decreased its full year target to 2.1-2.3%. More details in the full text.

EUROPE

Europe is proving to stand firm on its path to recovery, with rebounding domestic demand and falling unemployment, both of which come in the face of a strong currency. Despite of the mainstream view we believe that the strong Euro is in fact a positive sign for the European economy. Furthermore, the marginally looser inflationary policy by ECB will keep markets satisfied for now, however it might harm the fragile recovery. The final outlook of the Continent is rather positive.

ASIA & OCEANIA

This week we cover only Australia with a focus and the CPI performance while we were gone. The inflation did not increase as much as anticipated by investors, which led to the end of the AUD/USD rally and the pair entered consolidation. Next week we will focus on Indian election and will provide a Japan Abenomics update.

COMMODITIES

- The US are talking about ending a trade agreement with Russia that governs imports of hot rolled steel.
- There are fears that Brazil may not be able to produce adequate electricity supply for World Cup.
- Pork prices are poised to increase if a pig virus reappears in autumn.

Weekly Change	
Indices	
Nikkei 225 (Japan)	1.67%
S&P 500 (USA)	1.38%
FTSE 100 (UK)	0.70%
DAX (Germany)	0.67%
IBEX (Spain)	0.37%
S&P/ASX (Australia)	0.16%
CAC (France)	-0.04%
BSE (India)	-0.49%
Hang Seng	-0.54%
FTSE MIB (Italy)	-0.80%
SSE (China)	-1.23%
Currencies	
GBP/USD	0.53%
EUR/USD	0.44%
USD/JPY	0.20%
AUD/USD	-0.17%
AUD/NZD	-0.53%
USD/CHF	-0.56%
USD/CAD	-0.93%
Commodities	
Silver	6.27%
Gold	3.24%
Copper	2.87%
Brent Crude Oil	2.35%
WTI Crude Oil	0.89%

CALENDAR

USA					
Day	Country	Indicator	Actual	Forecast	Previous
Monday	United States	Industrial Production m/m	0.6%	0.5%	-0.3%
Tuesday		Building Permits	0.991M	1.050M	1.059M
		Housing Starts	1.001M	1.034M	1.071M
		Core CPI (YoY)	2.0%	1.9%	1.8%
		CPI (YoY)	2.1%	2.0%	2.0%
Wednesday		Interest Rate Decision	0.25%	0.25%	0.25%
Thursday		Initial Jobless Claims	312K	314K	318K
		Continuing Jobless Claims	2,561K	2,600K	2,615K
		Philadelphia Fed Manufacturing	17.8	14.0	15.4
Upcoming events				Forecast	Previous
Monday	United States	Existing home sales		4.73M	4.65M
Tuesday		CB Consumer Confidence		83.5	83
		S&P/CS HPI Composite		0.8%	0.9%
		New home sales		440K	433K
Wednesday		Durable Goods Orders (MoM)		0.2%	0.6%
		GDP (QoQ)		-1.7%	-1.0%
Thursday		Personal Spending (MoM)		0.4%	-0.1%
Friday		Michigan Consumer Sentiment		-0.2%	1.1%
EU					
Monday	EU	CPY y/y	0.50%	0.50%	0.50%
Tuesday	United Kingdom	CPY y/y	1.50%	1.70%	1.80%
Thursday	United Kingdom	Retail sales m/m	-0.50%	-0.50%	1.00%
Friday	EU	Current Account	21.5B	19.4B	19.6B%
	EU	Consumer Confidence	-7	-6	-7
Upcoming events				Forecast	Previous
Monday	EU	Flash Services PMI		53.4	53.2
Friday	United Kingdom	Current Account		-17.1B	-22.4B
	United Kingdom	Final GDP q/q		0.80%	0.80%
Asia and Oceania					
Day	Country	Indicator	Actual	Forecast	Previous
Tuesday	Japan	Trade Balance	0.86T	-1.01T	-0.88T
Wednesday	New Zealand	GDP q/q	1.00%	1.20%	1.00%
Thursday	Japan	All Industries Activity m/m	-4.30%	-3.70%	1.50%
Upcoming events				Forecast	Previous
Sunday	China	HSBC Flash Manufacturing PMI		49.7	49.4
Monday	Japan	BOJ Gov Kuroda Speaks			
Thursday	New Zealand	Trade Balance			
	Japan	Household Spending y/y		-1.90%	-4.60%
		Tokyo Core CPI y/y		2.80%	2.80%
		Retail Sales y/y		-1.90%	-4.30%

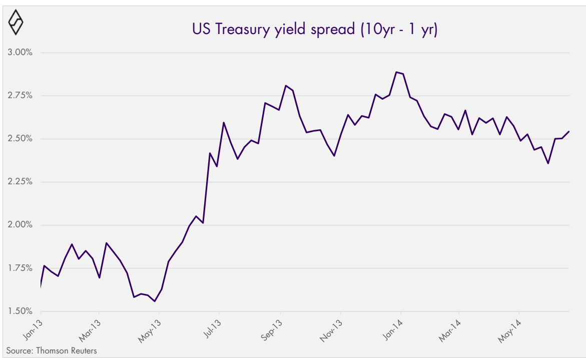
USA

Two months later, same old USA

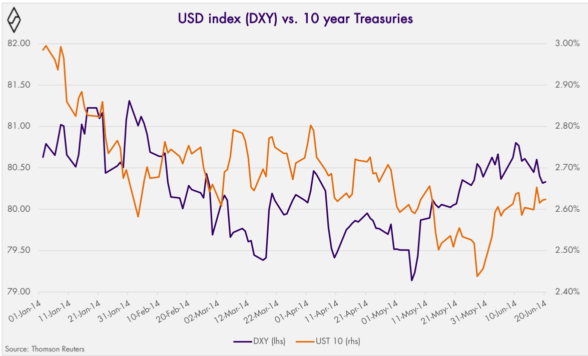
Sectors	5D	1M	3M	YTD
Utilities	2.16%	4.77%	7.23%	14.19%
Energy	2.55%	8.04%	15.68%	14.03%
Healthcare	1.76%	4.37%	2.05%	9.45%
Materials	1.00%	3.76%	3.94%	7.40%
Technology	-0.10%	3.76%	3.93%	6.58%
Industrials	0.95%	4.62%	6.07%	5.28%
Consumer Staples	1.14%	2.70%	5.80%	5.21%
Financials	0.97%	5.06%	1.56%	4.44%
Consumer Discretionary	0.44%	4.13%	-0.35%	-1.12%
Indices				
S&P 500	1.38%	4.81%	4.85%	6.20%
Nasdaq	1.33%	5.72%	2.13%	4.58%
Dow Jones Ind. Avg.	1.02%	2.50%	3.95%	2.23%
Russell 2000	2.21%	7.68%	-0.44%	2.13%

We are back! It feels good to get back behind the keyboard. It's business as usual at our headquarters and in the next 2 issues (this one and the next one) we will review what has happened in the world economy and financial markets in the past quarter (yes, half of the year has already passed and we are as shocked as you).

Let's get the party started with some no-brainers. This quarter has not been much different than the previous one in terms of sector leaders and laggards. Energy stocks have crushed the competition as Brent Crude Oil prices have spiked by almost USD 10 this quarter (to USD 114.74). Thank god natural gas prices have stayed mostly flat this quarter otherwise someone might have suspected that the Core CPI measure is a scam. Next on the list ate the almighty Utilities, which are already more than 14% up this year. With Q1 GDP in a negative territory and treasury yields falling (contra-consensus move) it is only logical to chase the high dividend yields that those slow-growth stocks provide. In the bottom of the quarterly performance list we find (not surprisingly) the high beta sectors no one should touch — Financials and Consumer Discretionary. Those two sectors are at the bottom year-to-date as well. The composition within financials is also fascinating. Leaders of the sector are all the REITs and property related companies that benefit from rising rent and house prices. Meanwhile the big boys (largest banks) are at the bottom of the list in red, with the exception of Wells Fargo. Banks make money from the net interest margin (the spread) and there is not much to say but just show you the following graph we use to track the spread:



As for consumer discretionary stocks, they are falling because growth is slowing and inflation is skyrocketing, which provides consumers with less willingness and disposable income to spend on discretionary shopping. Even the government measure of inflation, which is significantly inaccurate, has surprised the consensus to the upside and is now 2.1%. With livestock prices (S&P GCSI livestock index) at all-time high, Oil ripping and lack of help from the dollar, there is not much willingness from the 80% to go out and spend like there is no tomorrow. As I am writing this, I am also indulging in a nice weekend breakfast with lots of bacon and coffee and I am thinking how great it is to be protected by the strong pound. Truly awesome.



“Sell in May and walk away” proved to be a rather wrong strategy, which is not a surprise given that it was coined by the media. Having missed the correction in momentum stocks in March and April, consensus media pundits thought they could generate alpha by calling the correction in the general market, however, as usual they were late for the party. The S&P 500 rose 2.1% in May, 10 year treasuries bottomed out at the beginning of the month and gained roughly 30 bps in the next month, while even the Russell 2000 bounced up. So May and June have been kind of positive, despite 7 consecutive weeks (throughout May and June) of outflows from domestic equity mutual funds and inflows into Bonds mutual funds (ICI data). And now that the Fed has finally reduced its end of year GDP target to 2.1-2.3% (more on that next week) without any prospects of getting hawkish, both the USD (DXY) and the 10 year treasury yield will probably be going down. This is also supported by the fact that they have reached their trend resistance lines. Chances are the media will start calling the summer rally any time now, which automatically makes them wrong, as ever. It’s been a ‘buy low, sell high year’ so at this point it might be good idea to buy treasuries, sell USD, buy commodities (Gold already ripped 3.24% this week).

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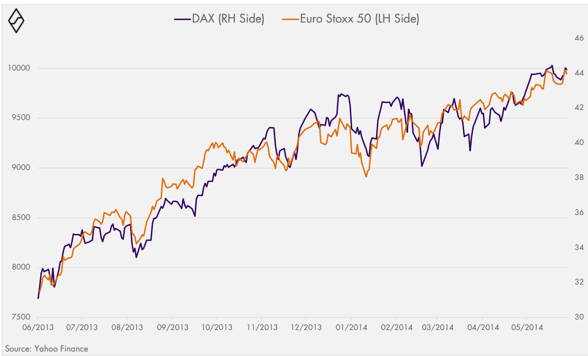
In conclusion we want to leave you something to think about. It’s rather bizarre but the only positive thing about the USA at the moment is the prospect of qualifying for the final stages of the World Cup. Who could have thought that football (that’s what it’s called, not soccer) will be the only thing to look forward to in the summer of 2014.

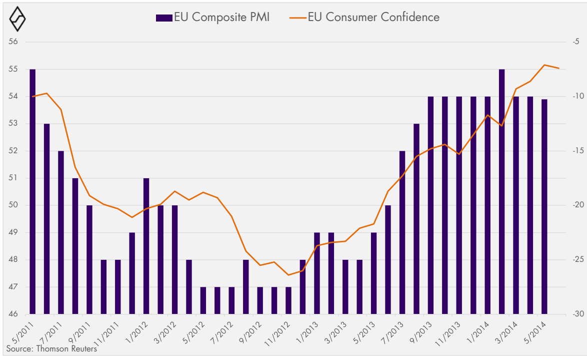
EUROPE

The ECB, the Euro and what it all means

This week we will not go into much detail about the tensions in Ukraine, which have been taking place for the last few months, since the media has flooded the news with speculation and disinformation. The uncertainty about Ukraine developments has been a significant drag to global markets, with major political pressures across the board, but the situation seems to be cooling off. Most of the stock indices in Europe are up for the past month and half, with the Euro Stoxx 50 up 2.62% and the DAX up 3.73%, since the beginning of May. Interesting developments taking place in the UK will be discussed in next week's Sierra, so hang in there.



Europe is proving to stand firm on its path to recovery, with rebounding domestic demand and falling unemployment, both of which come in the face of a strong currency. The Euro might be putting downward pressure on exports, but also suggests an increased appetite for investments in the EU continent by foreign investors. To be more precise, Europe saw capital inflows up 19% or $51bn in Q1 2014. In terms of economics, even though the first quarter GDP print came at 0.2% QoQ, composite PMI figures have been largely positive. Eurozone consumer confidence has reached its highest level since 2007.



We believe, somewhat contrarian to mainstream view, that the strong Euro is in fact a positive sign for the European economy. The marginally looser inflationary policy by ECB will keep markets satisfied for now, however it might harm the fragile recovery. So it is a fragile game of balance that central banks are playing because deriving price stability (the holy grail of central banks) is a trade-off between the exchange rate and purchasing power of consumers. The main issue that the ECB is facing is getting these lower interest rates to benefit SMEs, where the majority of employment is.

In light of this problem, the ECB cut its deposit rate and main refinancing rate to -0.10% and 0.15% respectively. The rationale behind this cut is to pressure banks to ease lending standards, by having cheap liquidity and disincentive to hold excess reserves. The negative deposit rate, a lot of people are hyped about, implies a charge on banks for parking their funds in the central bank. Instead, they are incentivised to find better use of the funds, through loaning it to the economy. More importantly the ECB introduced targeted long term refinancing operations (TLTRO), aimed at providing banks with long term financing, in order to provide more lending to EU non-financial institutions. These measures will take place in September and December of 2014, providing an allowance equal to 7% of the outstanding loans to non-financial institutions to banks' clients.

The ECB cut its deposit rate and main refinancing rate to -0.10% and 0.15% respectively.

This is expected to incentivise banks to step up their lending streams towards such entities. In 2015 the amount of TLTRO availability to European banks will reach an allowance 3 times larger than the amount of loans to non-financial institutions, conducted in quarterly tranches. While the effect of the program on the overall economy is questionable, one thing is for sure – EU banks will find a way to benefit from the circumstances, just like they did during the previous LTRO program. So we will be looking in that direction.

What came as a surprise to current European leaders, were the results of the European Parliament elections. There is an increasing social position against the status quo, as parties supporting protectionism, nationalism and anti-union ideologies have gained traction. Such trends, in the long term anyway, may be a materializing difficulty for politicians. If Europe does not manage to deal with structural issues and return the continent on a sustained path of growth, these movements will only grow stronger.

ASIA & OCEANIA

CPI, they almost guessed you

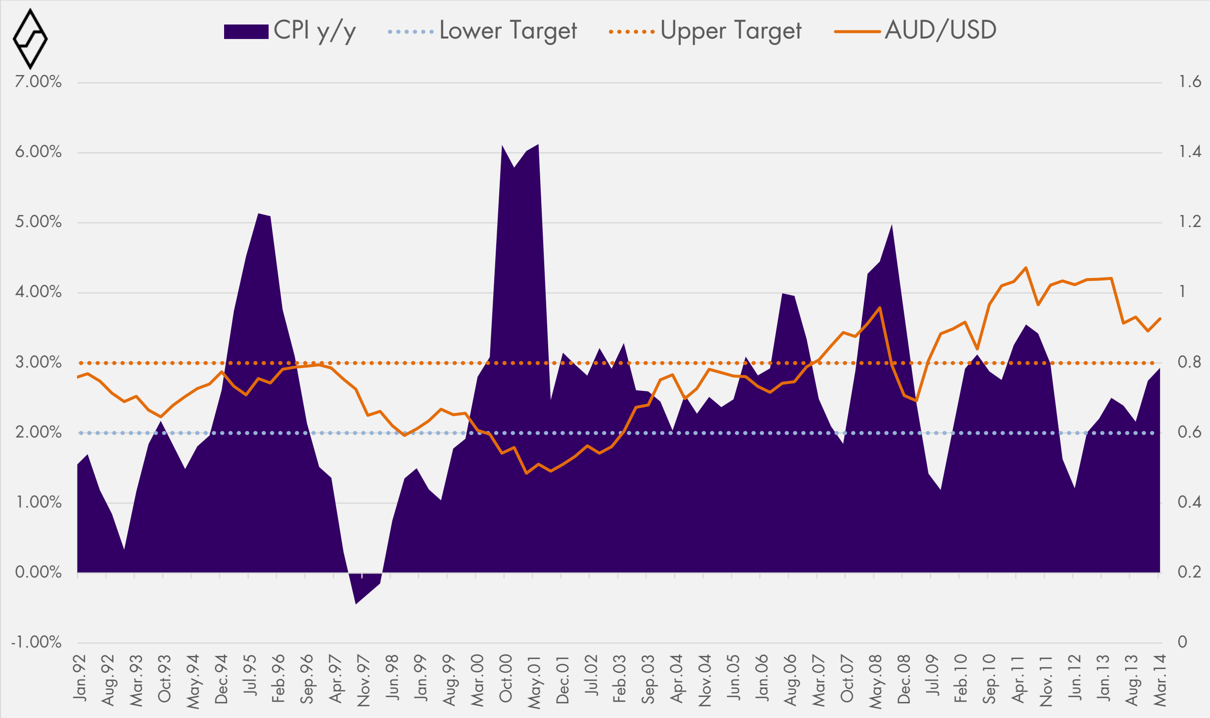
AUSTRALIA

Sectors	5D	1M	3M	YTD
All Ordinaries Gold	7.74%	6.55%	-1.38%	22.73%
Utilities	1.16%	-0.13%	6.93%	10.08%
A-REIT	1.14%	2.41%	7.52%	9.73%
Energy	-1.14%	2.16%	7.68%	5.86%
IT	-0.17%	0.24%	-0.84%	5.63%
Financial-X-A-REIT	-0.03%	1.70%	3.92%	3.49%
Industrials	0.55%	-0.57%	1.11%	2.41%
Health Care	-0.28%	-0.12%	-2.01%	-0.68%
Telecommunication	-0.60%	-2.28%	3.44%	-1.04%
Resources	1.24%	-1.54%	2.26%	-2.84%
Consumer Staples	-2.04%	-3.86%	-0.84%	-3.04%
Consumer Discretionary	2.12%	-0.85%	-3.37%	-3.17%
Materials	2.11%	-2.59%	-0.66%	-5.12%
Metals & Mining	2.43%	-2.85%	-0.14%	-6.04%

Source: The ASX Group www.asx.com.au

The Australian inflation rate as measured by CPI is released quarterly. For Q1 2014 it rose by 0.6% compared to the expected 0.8% rise, which was going to push the annual inflation above the current 2.9%, and thus potentially above the upper 3% threshold of the RBA (as shown on the chart on the next page). The Australian dollar hit its lowest level against the US dollar since 2010 at about 0.866 and since then, for the whole of Q1 the AUD has been trending upwards on rate increase expectations. However as investors overestimated the CPI, the trend has stopped and the pair has been consolidating between 0.954 and 0.920. We conclude this by observing the AUD/USD movement and seeing that most falls were when expectations missed the real CPI number and when the RBA announced that there is no Cash Rate change. The unemployment stayed unchanged from March for both April and May at 5.8%.

The Australian stock index S&P/ASX has been hitting post crisis highs during mid-April. When broken down into sectors, we see that similar to US, Utilities are a top performer along with All Ordinaries Gold, which is including companies from the Gold sub-industry (therefore heavily commodity sensitive, as it can be seen from its strong 5D performance, in-line with the jump in gold and silver). The worst performer, as numerously mentioned has been metals and mining, due to the strong decrease in investments that has been observed and discussed by the RBA over the past months, however, this sector has been the second best performer in the past week and overall quite flat in Q1, suggesting a slow reversal or a consolidation. Maybe mining has fallen down enough already.



source: RBA, Thomson Reuters

COMMODITIES

Pig wars episode 2: The virus strikes back

METALS

The US steel industry is considering challenging a trade deal with Russia that governs imports of hot-rolled steel, potentially reviving a decades old dispute amid mounting tensions over Russia's actions in Ukraine.

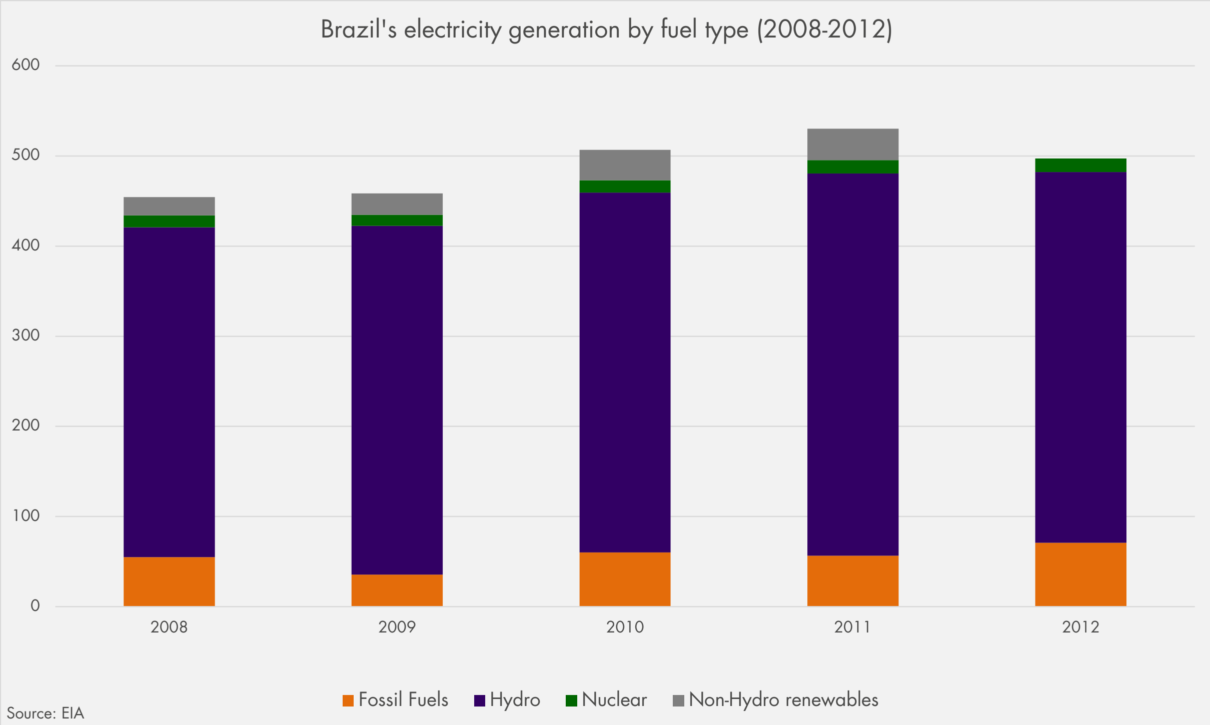
The US steel industry is considering challenging a trade deal with Russia...

A so called suspension agreement, following the Cold-war, has sheltered Russian Steel-makers from steep anti-dumping duties on hot-rolled coil, instead setting a cap on HRC imports, and a minimum price that many in the US feel is too low, despite a revision in 2012. As a result, pressure is likely to be applied to the US administration from steel companies urging these exemptions to be adjusted or even dropped. The discussions come at a sensitive time for US relations with Moscow, following Washington's decision to impose travel bans and asset freezes on Russian officials, following the Crimea debacle. The move also reflects weak global prices, over supply and sluggish demand for hot-rolled steel, which is used in appliances and autos. If the deal is revised or cancelled, then companies such as; United States Steel Corp, Nucor Corp and possibly AK Steel could benefit. Furthermore if the agreement from 1999 is ditched, Russia's Serverstal would be hit with anti-dumping duties of 73.59% and other Russian producers, such as Novolipetsk Steel and Magnitogorsk Iron and Steel Works, would face duties of 184.56%.

ENERGY

There has been a lot of talk of Brazil lately, with the ongoing draught and affects it has had on coffee prices to hosting the 2014 world cup. Brazil is the second largest producer of hydroelectric power in the world, trailing only China. Brazil depends on hydroelectric power for approximately 75% of its electricity generation as can be seen below (figures in billions of kilowatt-hours).

Much of the hydroelectric power that Brazil produces lies in the Amazon River basin in the north, whilst Brazil's population centres are primary along the eastern coast. This reliance on one resource for most of the country's electricity generation, in conjunction with the distant and disparate locations of its population centres, has presented electricity reliability challenges. Furthermore the draught (the worst in 40 years) has been contributing to electricity blackouts in many regions, causing concerns as to whether electricity supply will be adequate to meet the increase in demand associated with the World cup.



AGRICULTURE

A deadly pig virus could potentially climb this autumn following a summertime hiatus. Stress tests of the virus have forecasted around 2.5 million pigs over the next 12 months to die, amplifying pork prices. However concern might be for nothing as Tom Vilsack (US Agriculture Secretary) pointed out the first vaccine available to farmers has been approved, potentially providing protection. If the virus does return, it is likely to mean even tighter restrictions on imports by export markets, China, Japan and Russia have already restricted imports of live US pigs.

FOREX

Pair	Open	Close	Weekly %	Trend w/w	Monthly %	YTD
NZD/USD	0.8661	0.8691	0.35%	2	2.48%	5.91%
AUD/USD	0.9399	0.9383	-0.17%	1	0.83%	5.27%
EUR/JPY	138.09	138.76	0.49%	1	0.05%	3.83%
USD/CNY	6.2095	6.2273	0.29%	1	-0.01%	2.87%
GBP/USD	1.6921	1.7011	0.53%	3	1.58%	2.75%
USD/CAD	1.0853	1.0752	-0.93%	2	-0.82%	1.24%
USD/CHF	0.8998	0.8948	-0.56%	1	-0.02%	0.22%
AUD/NZD	1.0853	1.0796	-0.53%	2	-1.50%	-0.54%
GBP/JPY	173.11	173.01	-0.06%	3	1.53%	-0.71%
EUR/USD	1.3537	1.3597	0.44%	1	-0.24%	-1.08%
GBP/AUD	1.8045	1.8121	0.42%	2	0.76%	-2.06%
USD/JPY	102	102.2	0.20%	2	0.48%	-2.94%
EUR/GBP	0.7976	0.7989	0.16%	1	-1.78%	-3.70%
EUR/AUD	1.4376	1.4484	0.75%	1	-0.87%	-6.45%

REFERENCES

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

DISCLAIMER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