SIERRA

SHARD FUND

A JOURNEY ACROSS FINANCIAL MARKETS

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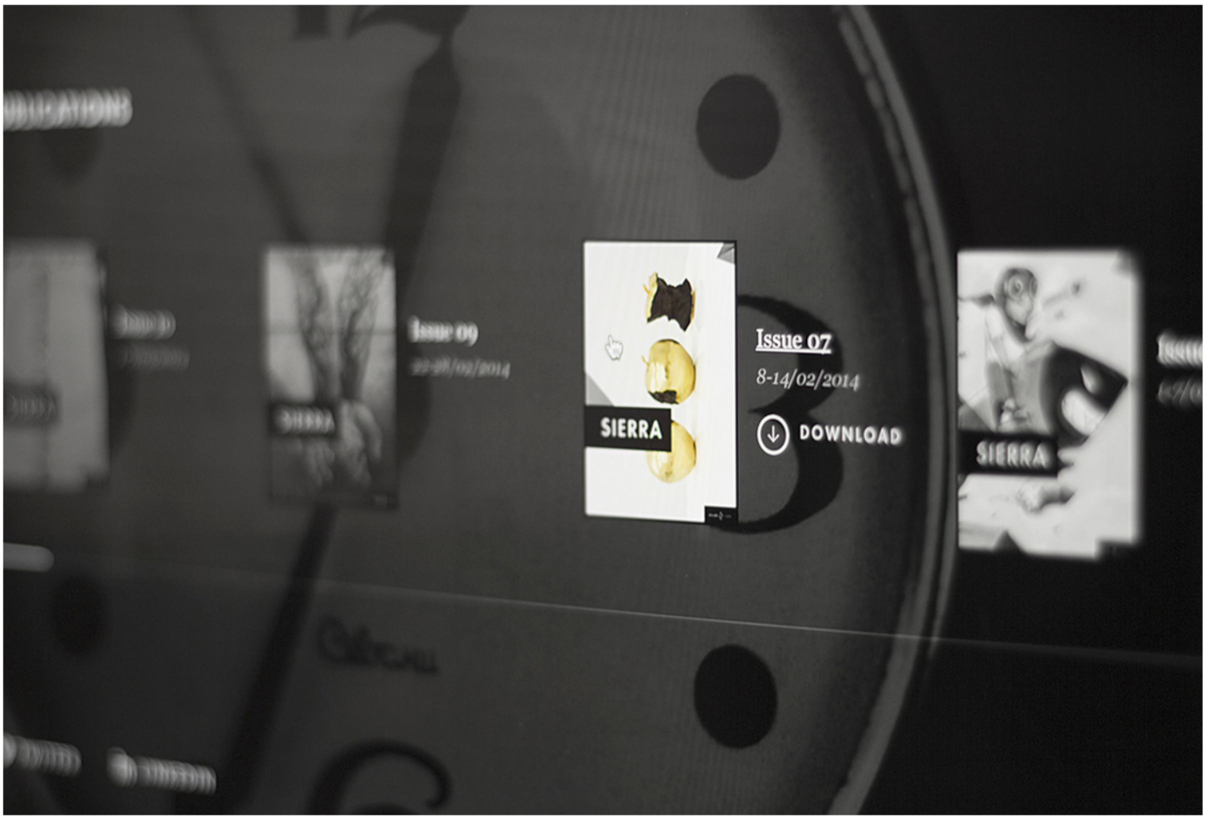
SPECIAL ANNOUNCEMENT

The Shard Fund website is up and running.

www.shardfund.com



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

HIGHLIGHTS

USA

In this issue we compare the first 28 weeks of this year with the same period in 2011 and argue that there is a distinct similarity. The purpose of the experiment is not to call a market top but to raise the curiosity of readers and motivate them to study markets for similarities and signs of distress.

EUROPE

The last week may have been the turning point for the European markets. Major declines in industrial output in May combined with concerns about the holding company of a Portuguese bank have triggered new worries about the Eurozone, with a correction in equity markets and a widening of the core-periphery yield spreads. Thus the investors start to look for safer places to put their money, making interesting movement on the markets.

ASIA & OCEANIA

Chinese trade balance expectations were the highest ever ($37.3b) and the actual number came below the forecast ($31.6b). In this issue we analyse the implications on the Chinese yuan and suggest how this could be played out in the market.

COMMODITIES

Steel is in high demand from the automotive industry. The World Steel Association has forecasted world growth of 3.1% for Crude Steel. OPEC's market share for 2015 is poised to shrink despite demand continuing to grow. The volatile coffee prices appear to be subsiding, with the average June volatility price hitting single figures.

Weekly Change	
Indices	
Shanghai (China)	-0.60%
S&P/ASX (Australia)	-0.69%
S&P 500 (USA)	-0.90%
Hang Seng	-1.33%
Nikkei 225 (Japan)	-1.77%
FTSE 100 (UK)	-2.56%
CAC (France)	-3.41%
DAX (Germany)	-3.42%
BSE (India)	-3.61%
IBEX (Spain)	-4.27%
FTSE MIB (Italy)	-4.38%
Currencies	
NZD/USD	0.97%
USD/CAD	0.74%
EUR/GBP	0.38%
AUD/USD	0.29%
EUR/USD	0.09%
USD/CNY	0.00%
EUR/CHF	-0.15%
EUR/AUD	-0.21%
USD/CHF	-0.27%
GBP/USD	-0.31%
BTC/USD	-0.52%
GBP/AUD	-0.52%
AUD/NZD	-0.54%
EUR/JPY	-0.61%
USD/JPY	-0.70%
GBP/JPY	-1.10%
Commodities	
Silver	1.46%
Gold	1.38%
Copper	0.06%
WTI Crude Oil	-2.98%
Brent Crude Oil	-3.64%

CALENDAR

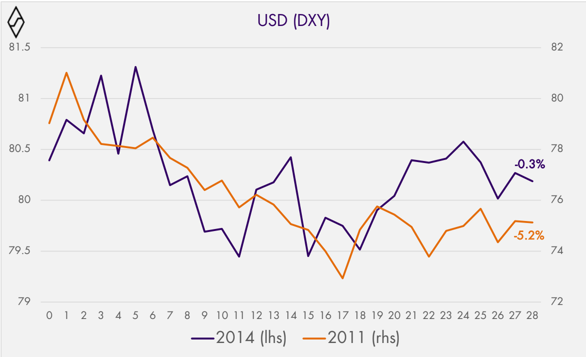
USA					
Day	Country	Indicator	Actual	Forecast	Previous
Wednesday	United States	FOMC Meeting Minutes			
Friday		Federal Budget Balance	71.0B	79.5B	-130.0B
Upcoming events					
Tuesday	United States	Retail Sales (MoM)		0.6%	0.9%
Wednesday		PPI (MoM)		0.2%	-0.2%
Thursday		Industrial Production (MoM)		0.4%	0.6%
		Philadelphia Fed Manufacturing Index		16.0	17.8
		Building Permits		1.040M	1.005M
Friday		Michigan Consumer Sentiment		83.0	82.5
EU					
Day	Country	Indicator	Actual	Forecast	Previous
Monday	France	French CPI (MoM)	0.0%	0.2%	0.0%
Tuesday	United Kingdom	Manufacturing Production (MoM)	-1.3%	0.4%	0.4%
Upcoming events					
Monday	EU	Industrial Production (MoM)		-1.2%	0.8%
Tuesday	United Kingdom	CPI (YoY)		1.6%	1.5%
	Germany	German ZEW Econ. Sentiment		28.0	29.8
Wednesday	United Kingdom	Claimant Count Change		-27.0K	-27.4K
		Unemployment Rate		6.5%	6.6%
Thursday	EU	CPI y/y		0.5%	0.5%
Asia and Oceania					
Day	Country	Indicator	Actual	Forecast	Previous
Tuesday	China	CPI (YoY)	2.3%	2.4%	2.5%
Wednesday	Australia	Employment Change	15.9K	12.0K	-4.8K
	China	Unemployment Rate	6.0%	5.9%	5.8%
		Exports (YoY)	7.2%	10.6%	7.0%
		Imports (YoY)	5.5%	5.8%	-1.6%
		Trade Balance	31.60B	34.99B	35.92B
Upcoming events					
Monday	Japan	Industrial Production (MoM)			0.5%
Tuesday	China	GDP (YoY)		7.4%	7.4%
		GDP (QoQ)		1.8%	1.4%
		Industrial Production (YoY)		9.0%	8.8%

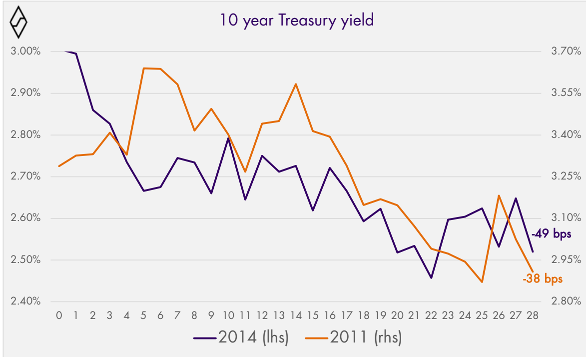
USA

An Experiment

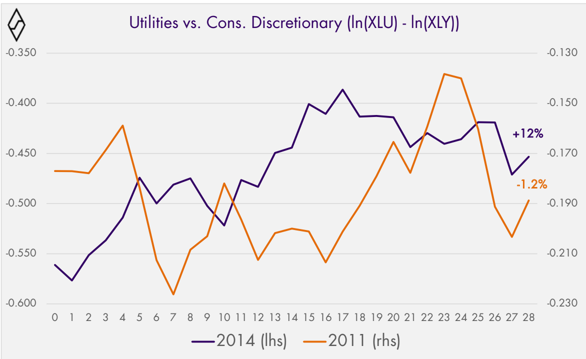
Sectors	5D	1M	3M	YTD
Utilities	0.78%	1.61%	2.73%	12.80%
Energy	-1.98%	1.27%	11.25%	11.17%
Healthcare	-1.12%	2.73%	10.61%	11.15%
Technology	-0.08%	1.78%	10.57%	8.90%
Materials	-1.02%	0.51%	7.82%	7.38%
Financials	-1.52%	-0.22%	6.63%	5.30%
Consumer Staples	0.38%	0.49%	5.87%	3.80%
Industrials	-1.24%	-1.78%	6.23%	3.46%
Consumer Discretionary	-1.00%	1.17%	8.27%	0.84%
Indices				
S&P 500	-0.90%	1.22%	8.36%	6.45%
Nasdaq	-1.57%	2.74%	10.39%	5.72%
Russell 2000	-3.99%	0.05%	4.36%	-0.32%
Dow Jones Ind. Avg.	-0.73%	1.25%	5.72%	2.21%

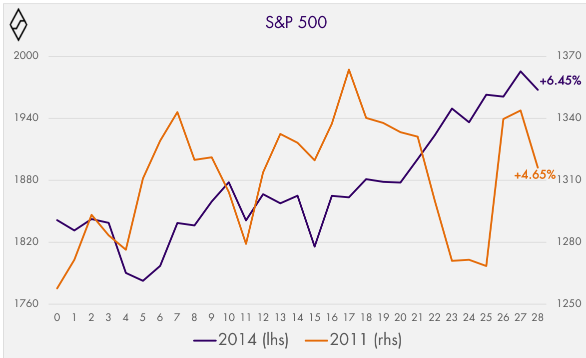
In the face of a quite boring week in terms of data, we would like to do a little experiment. Earlier this year some of us went to an investment conference in one of the top business schools (allegedly) in London. There we had the chance to hear what some managers from the City of London were thinking about the current market environment. The event was in March, so we had already seen well-established investment themes for this year.
This is more or less the back-story you need to know. At one of the panel talks I asked the following question: "Do you think the current US environment (strong bonds/commodities/utilities, weak USD/growth) should be taken as a leading indicator for slow growth, given how much it resembles 2011?"
The speakers at this panel were two economists and a portfolio manager. All of them said there was no reason for panic as this time was different. They blamed the weather and said that it is different because, unlike 2011, Europe is now stronger. It is interesting to mention that the portfolio manager's focus was on Russell 2000 companies, which are smaller in size and have significantly higher betas. I bet this guys had some rough nights this year, given what has happened to the index ever since. He cannot say we did not raise the question.
So, now that we have the question and more than half of the year has passed, it is worth asking the same question. Is 2014 similar to 2011? We will answer it by looking at some of the core indicators (at least to us) — stock market, currency, treasury yields, growth spread. So far 28 weeks have passed this year, thus we will compare them to the first 28 weeks of 2011, where week 0 is the last week of the previous year (for calculation purposes).
Starting with the essentials, both the USD and the 10 year treasury yield are showing some distinct similarities, especially the latter. In terms of performance, the dollar is not that close to the same period 3 years ago, however the downtrend is evident. On a direct basis, the dollar is more than 4% down against the pound and more than 3% down against the yen, both of which have smaller weights in the dollar index. Treasury yield movement is almost identical with slight divergences at the beginning and in the middle of the time period — 49 bps down this year and 38 bps down in the same period in 2011.





Now let's see the broad stock market. Similar to treasury yields, the stock market has also experienced almost identical performance with higher volatility in returns in 2011. On the other hand, the growth spread, which is simply representing a long position in Utilities ($XLU) and a short one in Consumer Discretionary ($XLY), has performed superbly this year, while it decreased slightly in the same period in 2011. One could argue that for the 28 weeks in 2011 this spread had been indecisive rather than in a well-established trend.





In conclusion, the resemblance between the two periods is quite close, although some individual indicators do not have as strong similarities as others. Interestingly, the S&P 500 finished 2011 with a negative performance, following a 15% drop in August. Of course, we are in no way trying to call a market top — we know better. Generally, we do not support Keynesian economics; however we strongly believe in and follow a quote by Mr. Keynes: "Markets can stay irrational longer than you can stay solvent". Having said that, so far we haven't tried to call or trade a market top and we plan to keep things that way. In fact, currently there are no signs of distress and the S&P 500 looks in a solid up trend. However, considering the lack of volume and how quickly risk arises, it is worth studying such similar episodes, such as 2011 and 2014, in order to analyse the market signs that will show potential distress.

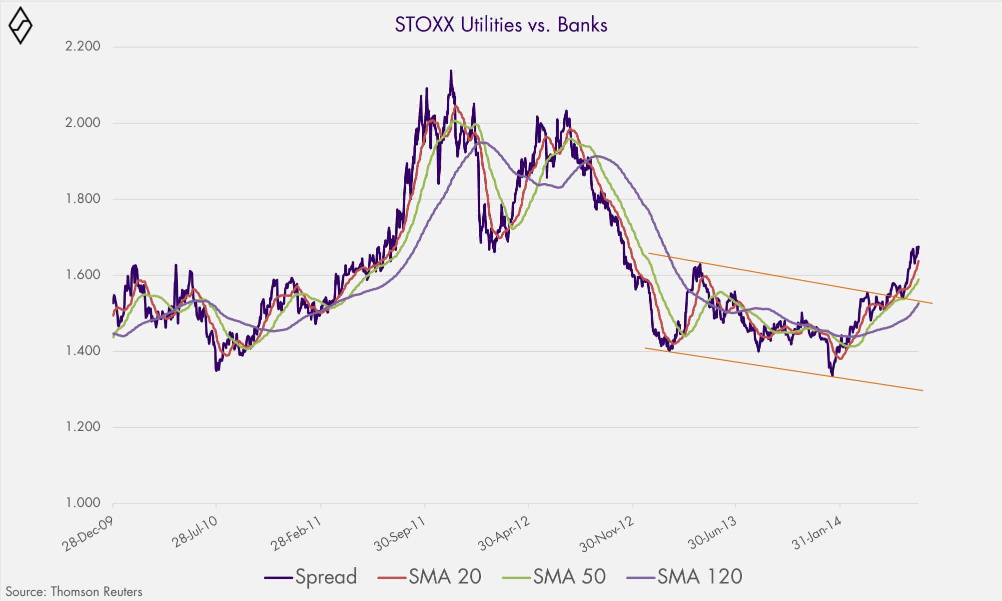
EUROPE

Frozen

Indices	5D	1M	3M	YTD
STOXX Europe 600 Real Estate Cap	-1.27%	-2.48%	6.34%	13.62%
STOXX Europe 600 Health Care	-1.78%	-0.01%	9.11%	11.58%
STOXX Europe 600 Oil & Gas	-4.32%	-1.20%	7.12%	7.60%
STOXX Europe 600 Construction & Materials	-4.96%	-7.86%	-4.16%	5.73%
STOXX Europe 600 Basic Resources	-2.46%	2.77%	2.06%	5.58%
STOXX Europe 600 Food & Beverage	-2.40%	-1.50%	3.98%	5.52%
STOXX Europe 600 Automobiles & Parts	-3.91%	-4.01%	-1.79%	4.94%
STOXX Europe 600 Personal & Household Goods	-1.92%	-1.19%	5.09%	4.41%
STOXX Europe 600	-3.17%	-3.21%	2.42%	2.64%
STOXX Europe 600 Travel & Leisure	-5.31%	-5.84%	1.18%	2.54%
STOXX Europe 600 Financial Services	-4.25%	-3.89%	2.99%	2.41%
STOXX Europe 600 Insurance	-2.24%	-1.69%	2.15%	0.59%
STOXX Europe 600 Chemicals	-3.85%	-3.35%	0.66%	0.53%
STOXX Europe 600 Telecommunications	-3.16%	-4.44%	2.32%	-1.99%
STOXX Europe 600 Banks	-4.13%	-9.32%	-5.04%	-3.09%
STOXX Europe 600 Industrial Goods & Services	-3.49%	-4.75%	-1.77%	-3.20%
STOXX Europe 600 Technology	-3.63%	-3.04%	-0.78%	-4.41%
STOXX Europe 600 Retail	-3.56%	-3.69%	0.56%	-5.02%
STOXX Europe 600 Media	-4.59%	-4.88%	-0.05%	-5.26%

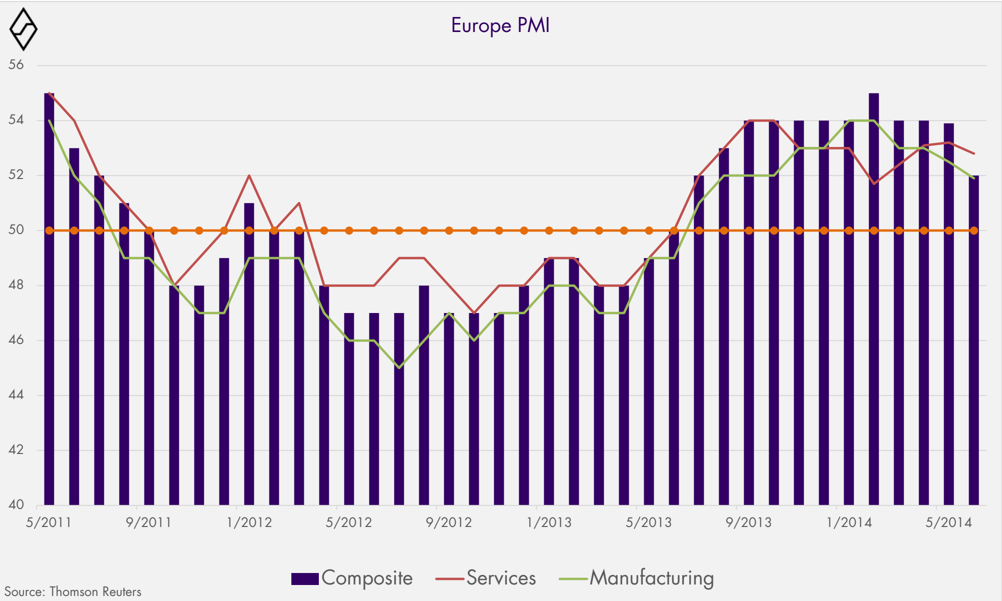
Looking at the last 5-trading days, concerns landed in our heads regarding the so called "recovery" on the Continent. Last week was marked by bad economic figures, but the main driver of panic on the markets came from the Portuguese banking system tension. Espirito Santo International SA was unable to pay its bonds, which triggered new worries about the Eurozone, with a correction in equity markets and a widening of the core-periphery yieldspreads. The pressure plunged the bonds to record lows after a parent company of the bank delayed payments on short-term notes. More importantly, given the divisively dependent nature of the domestic sovereign bond market (and hence the health of the EU) and its banking system, it is noteworthy that Portuguese bond risk has surged to 4 month highs with the biggest 2-day spike in a year.
However, the important question which needs to be answered is: Is this the turning point of the market performance on European equities, or not? During the past week all of the major indexes have finished on red territory: the DAX declined by 3.42%, the FTSE 100 went down by 2.56% and EuroStoxx 50 decrease by 3.77%, affected by the up-stated reasons.
Knowing this, it is worth a mention that exactly 1 year ago, everybody had started to speak about the European recovery and the bullish sentiment had begun to price on the market. However, at this current point in time, the overall condition of the Continent's economy appears to be frozen in one place- neither improving, nor worsening.
However, the week started with very disappointing data from the core of the Union- Germany. Industrial production went into reverse, with the third successive monthly decline in May, taking Q2 average output so far 1.5% below the Q1 average. Thus, the total industrial output shrank by 1.8% MoM after a down revised 0.3% contraction in April. Construction output fell by 4.9% MoM, the biggest decline of the major sectors. This was only partially offset by a 1.0% MoM increase in energy output. Some of the slowdown echoes the recent softening of business sentiment surveys such as the IFO and PMI surveys. The PMI manufacturing had declined from an

average of 55.0 in Q1 to 52.8 in Q2. Thus, the slowdown of the export-orientated Germany is speaking volumes about the whole economic situation in Europe.
Furthermore, examining the leading numbers of PMI for the whole Continent, things are not much brighter. Looking at the graph, the last figures on the Composite, Services and Manufacturing PMI are staying pretty comfortably above the expansion minimum of 50, but the trend starts to slow over the last few months. This gives us strong evidence to say that the European Union is far from a stable and recovered state.



Source: Thomson Reuters

Moreover, looking at the investors' sentiment regarding this, the stock market performance is telling us the same thing. The spread of the sectors Utilities/Banks is showing that the money is flowing strongly into more defensive stocks, looking for robust gains during choppy or adverse market conditions. At the end of the day, it looks like the expectations are beginning to be negative for the Continent. But is it backed-up by the fundamentals?



Source: Thomson Reuters

ASIA & OCEANIA

When will the yuan break free?

Indices	5D	1M	3M	YTD
STOXX Asia/Pacific 600 Technology	-0.74%	2.43%	11.13%	10.93%
STOXX Asia/Pacific 600 Construction & Materials	-1.05%	1.68%	7.27%	9.04%
STOXX Asia/Pacific 600 Oil & Gas	-0.86%	-0.81%	6.22%	8.91%
STOXX Asia/Pacific 600 Food & Beverage	0.49%	2.76%	8.98%	7.84%
STOXX Asia/Pacific 600 Personal & Household Goods	-0.80%	2.64%	9.90%	6.30%
STOXX Asia/Pacific 600 Health Care	-0.50%	2.37%	8.29%	5.89%
STOXX Asia/Pacific 600 Industrial Goods & Services	-1.63%	2.79%	7.84%	3.75%
STOXX Asia/Pacific 600 Real Estate	-0.04%	0.52%	6.51%	2.89%
STOXX Asia/Pacific 600 Index	-1.19%	1.38%	6.74%	2.06%
STOXX Asia/Pacific 600 Utilities	-1.30%	2.20%	6.46%	1.78%
STOXX Asia/Pacific 600 Chemicals	-1.44%	3.91%	7.37%	1.60%
STOXX Asia/Pacific 600 Media	-1.80%	0.68%	7.99%	1.04%
STOXX Asia/Pacific 600 Telecommunications	-0.19%	1.87%	11.04%	0.96%
STOXX Asia/Pacific 600 Banks	-1.50%	-0.55%	3.40%	0.43%
STOXX Asia/Pacific 600 Basic Resources	-1.22%	3.40%	2.02%	-0.38%
STOXX Asia/Pacific 600 Insurance	-1.71%	-2.17%	3.28%	-0.97%
STOXX Asia/Pacific 600 Retail	-1.24%	0.29%	3.05%	-1.51%
STOXX Asia/Pacific 600 Automobile & Parts	-1.84%	1.58%	9.02%	-3.46%
STOXX Asia/Pacific 600 Financial Services	-3.61%	-0.20%	6.72%	-4.92%

CHINA

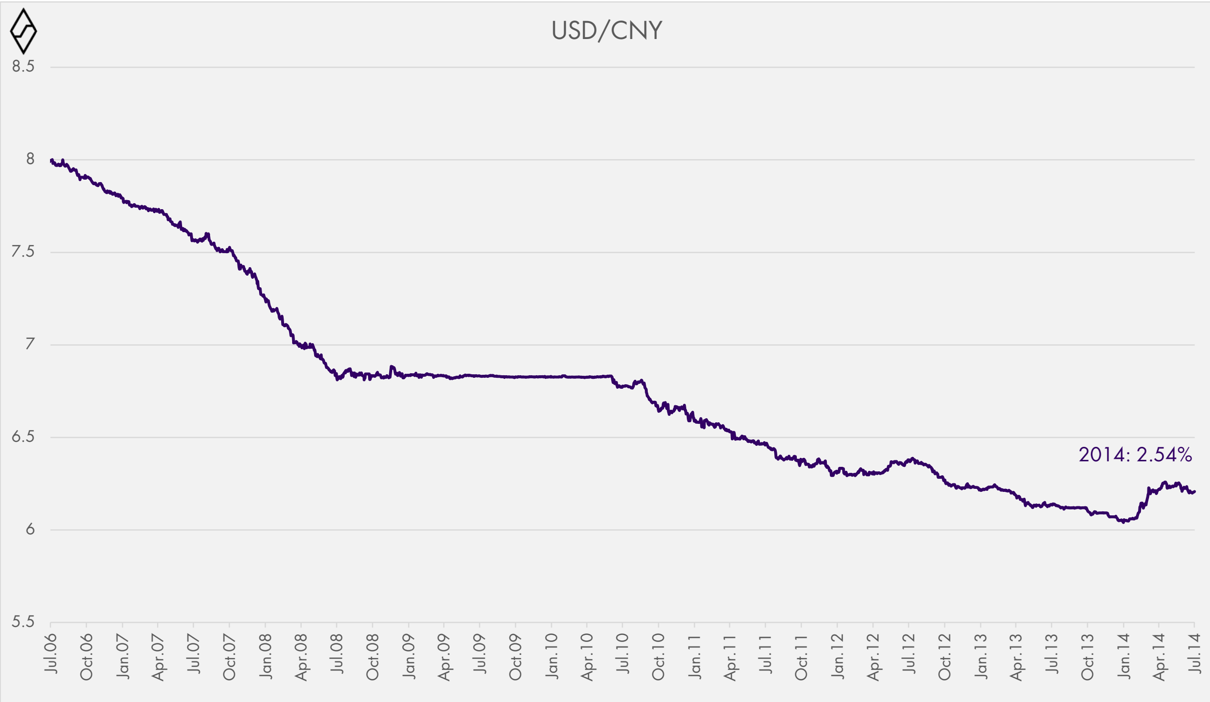
This past week China's data undershot experts' forecasts.
The trade surplus came to $31.6 billion, well below the $37.3 billion forecast, even though it's worth noting that the forecasted value is the highest forecast for the Chinese trade balance ever made. When broken down to exports/imports, we see that each increased by 7.2% and 5.5% respectively. We interpret this as further pressure for China's economy reaching the 7.5% growth and a signal that (as noted a thousand times before), the Chinese economy is still struggling to create strong domestic demand.
We are always interested in examining the FX impacts, however, before any conclusions are made, we need to understand how the Chinese yuan currently operates. Here is an extract that paints a good picture on how and why the currency is strongly manipulated by the Chinese government.

"When a consumer in the U.S. buys a Chinese product, Chinese manufacturers are paid in US dollars. These U.S. dollars are then deposited in a U.S. bank account. At this point, the Chinese exporter needs to convert dollars into yuan. Through its commercial bank it sells the U.S. dollars to the Chinese central bank, the People's Bank of China. Since the trade between the United States and China does not balance, there is a shortage of yuan and a surplus of U.S. dollars in the Chinese central bank (therefore the Yuan must be 'created'). The usual remedy to this situation used in international trade would be for the Chinese central bank to sell its dollars on international currency markets and buy yuan in exchange, resulting in a self-correcting system: the U.S. dollar weakens and the Chinese yuan strengthens, until equilibrium is restored and the trade gap closes.

However, in order to avoid this situation (which would decrease Chinese exports), the Chinese central bank chooses a different solution: it slows the appreciation of the Yuan, or in some cases effectively pegs the CNY against the USD. The central bank net buys USD, then sterilizes the excess dollar flows by buying dollar-denominated assets, such as U.S. treasuries. This has the effect of keeping the excess dollars out of the currency exchange markets, where they would cause a correction in the exchange rates. Thus, the Chinese central bank manipulates the exchange rates by creating yuan and buying U.S. debt. This "printing" of Chinese Yuan by the central bank is not without consequence, however, since in excess (if yuan are created faster than domestic economic output) it would eventually lead to inflation, causing consumer prices to rise."

To read further on FX manipulation view the paper: **Exchange Rate Manipulation to Gain an Unfair Competitive Advantage: The Case Against Japan and China (Preeg, 2003)**.

Having explained the CNY situation, we believe that it's a good idea to buy CNY as a long term move. The timing from a technical perspective seems good (even though technicals are not very well used in a highly manipulated environment).



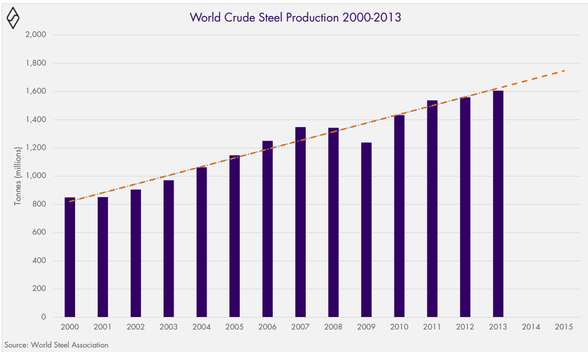
Source: Thomson Reuters

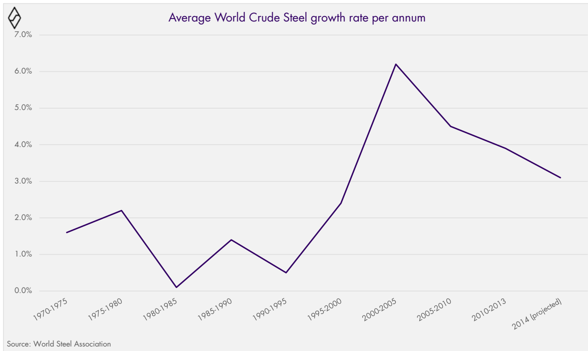
COMMODITIES

The volatility reduction

METALS

Steel is in high demand, particularly from the automotive industry in the USA. In recent editions of the ISM the fabricated metal products sector has said the following “The strength of the automotive industry continues to drive the high demand for steel”. The World Steel Association has forecast world growth of 3.1% for Crude Steel, down slightly from the 2013 figure of 3.6%.





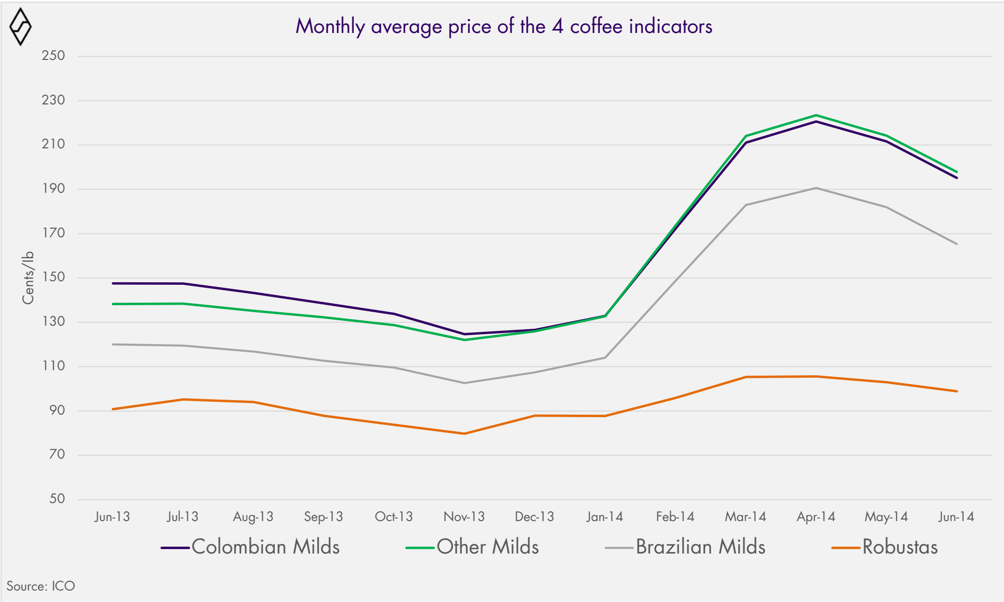
Our own basic trend line differs from the World Steel’s forecast, showing slight growth, however, the bars don’t follow a perfectly linear relationship, and thus our assumption does contain error. Furthermore US steel producers have challenged the 15-year trade deal, spoken about in previous editions of Sierra. In a submission to the Commerce Department Nucor Corp, US Steel Corp, USA LLC and others said the agreement hasn’t stopped Russian producers from undercutting local prices or flooding the US market with a 1,400% shipment increase compared with a year ago. Therefore making the deal seem even more likely to end, and thus steel supply to the markets to fall, bringing our forecast further in line with the World Steel Associations.

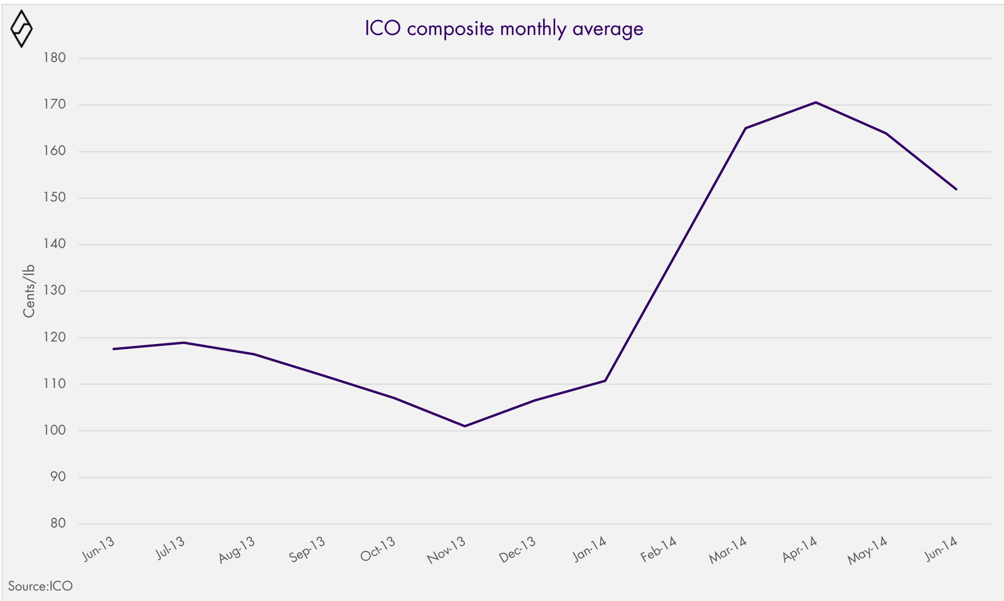
ENERGY

OPEC’s oil market is poised to shrink in 2015, despite growing demand. OPEC expects its share of the market to shrink in 2015, for a third year running, partly due to the US shale oil boom. Making its first 2015 forecasts in a recent report, OPEC estimated demand for its oil to average 29.37 million bpd, down 310,000 bpd from 2014. The report points to ample supplies next year, particularly if outages in Libya, Iran and Iraq can be sorted. These production issues have curbed supply this year and helped elevate prices above the $100 mark.

AGRICULTURE

With no consensus on the size of the Brazilian crop, and adequate stocks to cover current demand, the past two months has seen all four group indicators for coffee decline, with Colombian Milds, Other Milds, Brazilian Naturals and Robustas down 7.8%, 7.6%, 9.1% and 4% respectively.
In addition the ICO composite index also declined, although when looking at the daily prices the composite did rally in June, increasing from a low of 145.87 cents on June 9th to 157.22 cents on June 25th, however this range is narrower than previous months. Finally the volatile swings observed over the past few months are subsiding, with the average price volatility in June reaching single figures.





FOREX

Pair	Open	Close	Weekly %	Trend w/w	Monthly %	YTD
NZD/USD	0.8733	0.8807	0.85%	1	3.84%	7.32%
AUD/USD	0.9362	0.9389	0.29%	1	0.89%	5.34%
GBP/USD	1.7157	1.711	0.27%	1	2.17%	3.35%
EUR/JPY	138.71	137.84	0.63%	3	-0.61%	3.14%
USD/CNY	6.2105	6.2038	0.11%	1	-0.39%	2.48%
USD/CAD	1.0647	1.0731	0.79%	1	-1.01%	1.05%
USD/CHF	0.8938	0.8918	0.22%	1	-0.36%	-0.11%
GBP/JPY	175.06	173.37	0.97%	1	1.74%	-0.50%
EUR/USD	1.3592	1.3605	0.10%	2	-0.18%	-1.02%
EUR/CHF	1.2159	1.214	0.16%	2	-0.48%	-1.40%
GBP/AUD	1.8326	1.8232	0.51%	1	1.38%	-1.46%
AUD/NZD	1.0714	1.0656	0.54%	2	-2.77%	-1.83%
USD/JPY	102.04	101.29	0.74%	1	-0.41%	-3.81%
EUR/GBP	0.792	0.7946	0.33%	1	-2.31%	-4.22%
EUR/AUD	1.4517	1.4486	0.21%	1	-0.86%	-6.43%
BTC/USD	627.53	632.03	0.72%	1	-1.09%	-13.48%

REFERENCES

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

DISCLAIMER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