SIERRA

SHARD FUND

A JOURNEY ACROSS FINANCIAL MARKETS

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HIGHLIGHTS

USA

Stemming from the payrolls hype that occurs every first Friday of the month, we undertake a little experiment. We look at employment cycles and business cycles and argue that the clock is ticking for the US economy. It has nothing to do with being too bearish or contrarian, it's simply called mean-reversion. Let's see if this time is different.

EUROPE

The ECB further loosened the Continent's monetary policy by undertaking the more of the same actions: decreasing all the main rates and purchasing a broad portfolio of ABS and bonds. However, it is doubtful that even the current action will yield some result in the future. Thus, the reduction in the main refinancing and marginal lending facility rates are a pretty token-effort at this point. The rates were already at such low levels that the latest reductions won't make any real difference.

ASIA & OCEANIA

Other than the record-breaking IPO announcement of Alibaba (around $21B to be raised on an above $110B valuation), the Chinese stock market has been exceptional for the past month, as well as year to date for that matter. Somewhat stable output data, falling commodity prices and growing exports have contributed to the recent rally in Honk Kong and China. The HSI is up 8.3% YTD and the Shanghai Composite is up 9.95% for the year.

COMMODITIES

Japan is pushing to secure at least 60% of its rare earth needs from outside China within four years, as its increasing efforts to curb its dependence on the world's biggest producer of elements crucial in smart phones, computers and cars.

Weekly Change	
Indices	
Shanghai (China)	5%
FTSE MIB (Italy)	5%
IBEX (Spain)	4%
DAX (Germany)	3%
CAC (France)	2%
Hang Seng	2%
Nikkei 225 (Japan)	2%
BSE (India)	1%
FTSE 100 (UK)	1%
S&P 500 (USA)	0%
S&P/ASX (Australia)	0%
Currencies	
USD/CHF	1%
USD/JPY	1%
AUD/NZD	1%
AUD/USD	0%
EUR/GBP	0%
USD/CAD	0%
EUR/CHF	0%
USD/CNY	0%
NZD/USD	0%
GBP/JPY	-1%
EUR/USD	-1%
GBP/USD	-2%
EUR/AUD	-2%
EUR/JPY	-2%
GBP/AUD	-2%
BTC/USD	-4%
Commodities	
Copper	0%
Silver	-1%
Gold	-1%
Brent Crude Oil	-2%
WTI Crude Oil	-3%

Source: Investing.com

CALENDAR

USA					
Day	Country	Indicator	Actual	Forecast	Previous
Tuesday	United States	ISM Manufacturing PMI	59.0	56.8	57.1
Thursday		ADP Nonfarm Employment Change	204K	220K	212K
		ISM Non-Manufacturing PMI	59.6	57.5	58.7
		Trade Balance	-40.55B	-42.20B	-40.81B
		Initial Jobless Claims	302K	300K	298K
Friday		Nonfarm Payrolls	142K	225K	209K
		Unemployment Rate	6.1%	6.1%	6.2%
Upcoming events				Forecast	Previous
Thursday	United States	Federal Budget Balance		-105.5B	-95.0B
Friday		Core Retail Sales (MoM)		0.2%	0.1%
		Retail Sales (MoM)		0.3%	
		Michigan Consumer Sentiment		81.5	82.5
EU					
Day	Country	Indicator	Actual	Forecast	Previous
Monday	Germany	GDP (QoQ)	-0.2%	-0.2%	-0.2%
		GDP (YoY)	0.8%	0.8%	0.8%
		Manufacturing PMI	51.4	52.0	52.0
	United Kingdom	Manufacturing PMI	52.5	55.0	54.8
Wednesday	Germany	Services PMI	54.9	56.4	56.4
	United Kingdom	Services PMI	60.5	58.5	59.1
Thursday	EU	Interest Rate Decision	0.05%	0.15%	0.15%
Friday	EU	GDP (YoY)	0.7%	0.7%	0.7%
Upcoming events				Forecast	Previous
Monday	Germany	German Trade Balance		16.8B	16.2B
Tuesday	United Kingdom	Manufacturing Production (MoM)		0.3%	0.3%
		Trade Balance		-9.10B	-9.41B
Thursday	Germany	CPI (MoM)			
	France	CPI (MoM)			-0.3%
Friday	EU	Industrial Production (MoM)		0.3%	-0.3%
		Industrial Production (YoY)		1.2%	
Asia and Oceania					
Day	Country	Indicator	Actual	Forecast	Previous
Monday	Australia	Building Approvals (MoM)	2.5%	1.5%	-3.8%
Tuesday	Australia	Interest Rate Decision	2.5%	2.5%	2.5%
		GDP (QoQ)	0.5%	0.4%	1.1%
		GDP (YoY)	3.1%	3.0%	3.5%
	China	Non-Manufacturing PMI	54.4		54.2
		HSBC Services PMI	54.1		50.0
Wednesday	Australia	Retail Sales (MoM)	0.4%	0.4%	0.6%
Upcoming events				Forecast	Previous
Sunday	China	Exports (YoY)		8.0%	14.5%
		Imports (YoY)		1.7%	-1.6%
		Trade Balance		40.00B	47.30B
	Japan	GDP (QoQ)		-1.8%	-1.7%
Wednesday	New Zealand	Interest Rate Decision		3.5%	3.5%
	Australia	Employment Change			-0.3K
	China	CPI (MoM)		0.4%	0.1%
		CPI (YoY)		2.2%	2.3%
		PPI (YoY)		-1.2%	-0.9%
Friday	Japan	Industrial Production (MoM)			0.2%
	India	CPI (YoY)			7.96%
Saturday	China	Industrial Production (YoY)		8.8%	9.0%

Source: Investing.com

USA

"I don't believe this data" – Mark Zandi, CNBC

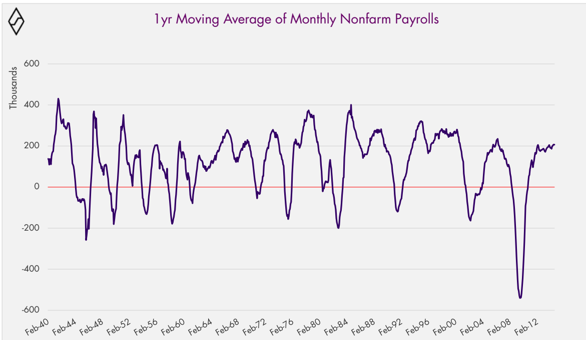
Sectors	5D	1M	3M	YTD
Energy	-1.68%	1.84%	1.10%	15.75%
Healthcare	0.49%	5.84%	6.56%	14.88%
Utilities	0.79%	7.20%	0.90%	12.73%
Technology	0.02%	4.11%	5.97%	9.68%
Materials	0.26%	3.90%	2.38%	9.61%
Financials	0.43%	5.82%	3.58%	7.32%
Consumer Staples	1.00%	4.97%	1.04%	6.05%
Industrials	0.57%	5.19%	-0.79%	3.96%
Consumer Discretionary	0.64%	5.21%	4.10%	3.64%
Indices				
Nasdaq	0.97%	5.29%	6.67%	9.73%
S&P 500	0.22%	4.56%	3.47%	8.62%
Dow Jones Ind. Avg.	0.78%	4.31%	1.79%	3.38%
Russell 2000	0.86%	4.33%	1.40%	0.56%

Source: Sectorspdr.com

Feelings, beliefs, hopes...the type of things one should leave at home every morning before the market opens. At least that is what every book on investing advises, but maybe we've been reading the wrong books. The quote above is in regards to Friday's payrolls number, which came well below estimates (see weekly calendar). Maybe Mr. Zandi (allegedly an experienced professional) forgot to leave his hopes and beliefs (etc.) at home or he should catch up on some reading. Whatever the case, the video of him live on CNBC is rather hilarious (watch **here**).

However, the problem seems more philosophical, and similar to the data we are about to show you, it is also cyclical. The failure to learn, which evolves into sharp complacency in the later stages of every cycle, is probably the worst thing out there. Here, the failure to learn is expressed in two distinct ways. First of all, people fail to learn that the payrolls data is a lagging indicator, which is also incredibly volatile and revised. Thus, all the estimates and talk shows focused on that (holy) number are absolutely pointless and by now people should know better. People are so obsessed and most of the times so wrong about the payrolls number that there is a rumour on the street that Goldman traders have the following saying: "The first move in the 30 minutes after the payrolls report is the wrong one". Open a chart of the S&P 500 and test it for yourself; you will be surprised.

The second failure to learn is concerned with cycles and the inability of people to learn that if something has happened more than 10 times in the past 100 years, chances are it will happen again, and no, this time is not different. Call us old-fashioned, or whatever



Source: Bureau of Labour Statistics

you want for that matter, but we often rely on history to prepare ourselves for the uncertain future. In the current case history tells us a rather interesting story.
For the graph we use a 1 year moving average of the monthly payrolls number to smooth the data, which, as we mentioned, is quite volatile. It is evident that the indicator is procyclical and it was only a matter of time to measure each individual period. In regards to measurement, we count from the first month after the indicator has made a top (bottom) until (including) the next lowest (highest) bottom (top).

	Contraction	Expansion
Months	401	494
Occasions	13	14
Mean (per occasion)	31	35
Current (in months)	40	60

The results are quite conclusive. In the sample (February 1940 to August 2014) there are a total of 401 months of contraction in the nonfarm payrolls number (1y average) and 494 months of an expansion. Given the number of occasions when an expansion or contraction has occurred, this gives us a mean average months that payrolls have contracted and consequently expanded. Knowing all that allows us to look at the current cycle with a certain degree of confidence and say: "It's high time this thing mean-reverted". For the sake of not letting people have an easy first argument against our analysis, we do acknowledge that the contraction in 2006-2009 has been above average, therefore we should expect an above average expansion.
What really matters is that we are above the average (monthly) expansion on both the payrolls data as well as the overall business cycle data (2nd table). We know better than to argue which specific month will be the tipping point, however, the important thing is that after a certain point (the mean average), every subsequent month adds additional probability in favour of a reversion. Just

Peak	Trough	Contraction *Peak to Trough*	Expansion *Last trough to this peak*
Sep/2014	#N/A	#N/A	*62*
Dec/2007	Jun/2009	18	73
Mar/2001	Nov/2001	8	120
Jul/1990	Mar/1991	8	92
Jul/1981	Nov/1982	16	12
Jan/1980	Jul/1980	6	58
Nov/1973	Mar/1975	16	36
Dec/1969	Nov/1970	11	106
Apr/1960	Feb/1961	10	24
Aug/1957	Apr/1958	8	39
Jul/1953	May/1954	10	45
Nov/1948	Oct/1949	11	37
Feb/1945	Oct/1945	8	80
May/1937	Jun/1938	13	50
Aug/1929	Mar/1933	43	21
Oct/1926	Nov/1927	13	27
May/1923	Jul/1924	14	22
Jan/1920	Jul/1921	18	10
Aug/1918	Mar/1919	7	44
Jan/1913	Dec/1914	23	12
Jan/1910	Jan/1912	24	19
May/1907	Jun/1908	13	33
Sep/1902	Aug/1904	23	21
Max		43	120
Min		6	10
Median		13	37
Mean		15	45
Source: NBER			

like after a certain slope a sand pile becomes unstable and every additional grain of sand increases the probability of a collapse, until a random one causes it (Bak et al., 1988).
All this makes us wonder, what will Janet Yellen, a woman that follows 25+ employment indicators, do if some distress in employment occurs? (Feel free to email us your answer, comment or feedback)

EUROPE

ECBet

Indices	5D	1M	3M	YTD
STOXX Europe 600 Real Estate Cap	0.58%	6.11%	0.33%	17.14%
STOXX Europe 600 Health Care	1.37%	5.11%	6.26%	16.73%
STOXX Europe 600 Food & Beverage	1.69%	6.26%	4.15%	9.39%
STOXX Europe 600 Basic Resources	0.71%	-1.21%	4.92%	7.37%
STOXX Europe 600 Oil & Gas	0.52%	2.58%	-2.13%	6.76%
STOXX Europe 600	1.63%	5.58%	0.08%	5.88%
STOXX Europe 600 Travel & Leisure	2.27%	6.73%	-3.88%	5.58%
STOXX Europe 600 Construction & Materials	0.89%	6.02%	-8.40%	5.34%
STOXX Europe 600 Insurance	2.14%	7.18%	2.21%	4.88%
STOXX Europe 600 Personal & Household Goods	1.64%	4.28%	-0.07%	4.61%
STOXX Europe 600 Banks	2.89%	8.05%	-1.90%	4.48%
STOXX Europe 600 Financial Services	-0.13%	5.27%	-2.28%	3.97%
STOXX Europe 600 Technology	1.47%	6.95%	4.78%	2.99%
STOXX Europe 600 Automobiles & Parts	3.82%	7.04%	-6.87%	2.78%
STOXX Europe 600 Chemicals	1.29%	5.53%	-2.67%	1.51%
STOXX Europe 600 Media	1.22%	5.36%	1.87%	0.71%
STOXX Europe 600 Telecommunications	0.58%	3.19%	-2.72%	0.70%
STOXX Europe 600 Industrial Goods & Services	1.72%	6.03%	-2.50%	-0.36%
STOXX Europe 600 Retail	0.78%	3.42%	-2.98%	-5.78%

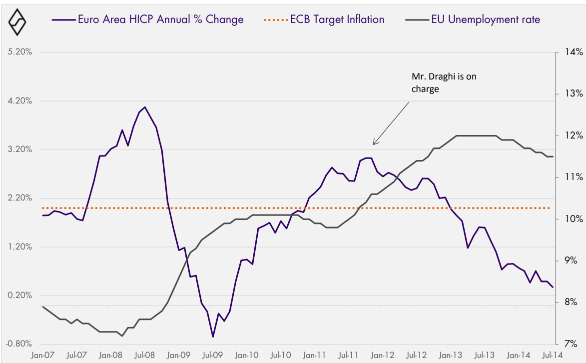
Source: Stoxx; quoted in EUR

September 4, 2014 will be remembered as the day the ECB made their move and told the Fed and BOJ: "It's your turn". During its meeting that day, the ECB loosened the Continent's monetary policy by undertaking the following actions:

- Decreasing the main refinancing operations rate to 0.05% from 0.15%
- Decreasing the marginal lending facility rate to 0.30% from 0.40%
- Decreasing the deposit facility rate to -0.20% from -0.10% (i.e. banks pay the ECB 20 basis points to park reserves there)
- Purchasing a broad portfolio of euro area non-financial sector asset-backed securities; and
- Purchasing a broad portfolio of euro-denominated covered bonds

Looking at the data and considering the worldwide view of economics, it is obvious that Mr. Draghi didn't have a lot of other options, although allegedly he is a pro-gold economist who fancies a strong currency. With the inflation rate falling further since the ECB's last meeting and euro area real GDP remaining unchanged (QoQ), Mr. Draghi (willingly or not) opened the jar of honey and let everyone have a sniff.

However, it is doubtful that even the current action will yield some result in the future, knowing the success of Mr. Draghi's previous



Source: Eurostat

monetary policy decisions (refer to the graph). Thus, the reduction in the main refinancing and marginal lending facility rates are a pretty token-effort at this point. The rates were already at such low levels that the latest reductions won't make any real difference. Taking the deposit facility rate deeper into negative territory is designed to spur lending, but if banks weren't opening the credit lines at -0.10%, it's doubtful that another 10 basis points will do the trick when worries about deflation are in the air. Moreover, there is an embedded disincentive for European banks to lend to anyone other than the highest-quality borrowers since the ECB is only going to be buying senior tranches of asset-backed securities and mezzanine tranches with guarantees.

Mr. Draghi (willingly or not) opened the jar of honey and let everyone have a sniff.

Of course, the markets reacted in their own way:

The euro (EURGBP) fell more 1%, trading below 0.793.

The Stoxx Europe 600 rose 1.1% to 348.89, touching intraday highs after the ECB announcements. Italy's FTSE MIB and Spain's IBEX 35 surged 2.8% and 2%, respectively, as investors bought up Spanish and Italian stocks as well as bonds. Germany's DAX 30 index rose 1% to 9,724.26. France's CAC 40 rose 1.7% to 4,494.94, as only two components finished lower in Paris trade.

ASIA & OCEANIA

When will the yuan break free?

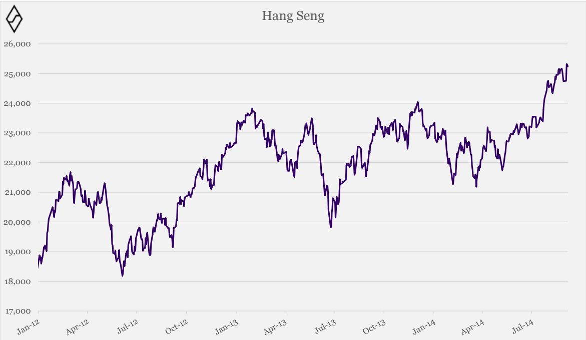
Indices	5D	1M	3M	YTD
STOXX Asia/Pacific 600 Technology	2.39%	4.12%	9.97%	16.01%
STOXX Asia/Pacific 600 Construction & Materials	0.97%	5.57%	9.99%	15.18%
STOXX Asia/Pacific 600 Oil & Gas	1.66%	4.74%	6.29%	13.57%
STOXX Asia/Pacific 600 Health Care	-0.08%	5.55%	11.10%	12.73%
STOXX Asia/Pacific 600 Food & Beverage	0.66%	3.09%	8.45%	11.54%
STOXX Asia/Pacific 600 Personal & Household Goods	1.33%	3.90%	8.96%	8.68%
STOXX Asia/Pacific 600 Industrial Goods & Services	2.77%	4.77%	9.50%	8.55%
STOXX Asia/Pacific 600 Real Estate	2.15%	5.42%	8.26%	8.47%
STOXX Asia/Pacific 600 Chemicals	1.60%	5.25%	13.79%	8.36%
STOXX Asia/Pacific 600 Insurance	2.86%	6.97%	9.08%	6.60%
STOXX Asia/Pacific 600 Utilities	2.98%	5.80%	9.00%	6.33%
STOXX Asia/Pacific 600 Index	1.85%	4.07%	7.88%	5.85%
STOXX Asia/Pacific 600 Telecommunications	1.64%	5.93%	4.60%	4.53%
STOXX Asia/Pacific 600 Banks	1.74%	4.40%	6.20%	3.91%
STOXX Asia/Pacific 600 Media	-0.54%	1.00%	4.49%	1.80%
STOXX Asia/Pacific 600 Financial Services	2.55%	6.33%	8.00%	0.67%
STOXX Asia/Pacific 600 Retail	1.78%	1.56%	2.77%	-0.39%
STOXX Asia/Pacific 600 Basic Resources	-0.19%	-1.74%	4.67%	-1.10%
STOXX Asia/Pacific 600 Automobile & Parts	3.25%	2.72%	7.02%	-1.35%

Source: Stoxx; quoted in EUR

CHINA

While a lot of people are sceptical about the possibility of China showing and moreover keeping growth rates at current or higher levels, now there seems to be more upside than in developed markets. This is partly due to the overextended, Central Bank induced bull market and risk disregard in the US and to some extent the EU. Even though there is major government involvement and stimulus in the Chinese economy, there is a lot of room for organic growth in consumption, investment, exports etc. The PBC is more prudent and "conventional" with its interest rate policy, but government stimulus and credit expansion are very much present. The main purpose being to keep the system liquid and prevent debt issues and money expansion declines. China has a few core principles and targets, to achieve its economic superiority in the long run. This is something that we very much see as an advantage for the Chinese people – they are more long-term focused than our fellow politicians in the EU and especially US. So, in terms of monetary policy, the strategy of China to preserve itself and prosper revolves around the fragile balance of its currency and money supply in relation to economic growth and structural development. In other words, as China's economy grows at its rate of above 7%, it needs to expand money supply so that it can keep its currency low, so that it can export cheaply. As we have explained in our previous issue of Sierra, China has numerous tools to keep its currency undervalued. All this is complemented by the aim of liberalization and development of the domestic market. The other side of the currency devaluation coin is, as Frederick Neuman, HSBC co-head of Asia economic research, says:

"I think it's really important to lay the groundwork for a sustained increase in consumption and remember that for 15-20 years, consumption has been restrained by certain policy settings as the government focused on industrialization, now has to reverse that. It's not about having a one-time shopping trip, it's really about giving people the means to have sustained consumption growth over the next 10, 15 years. And that's part and parcel of this policy but patience is really needed here,".



Source: Thomson Reuters

In summary, we see China as a growth country that achieves its high growth rate by a symbiosis of trade surpluses and domestic market development. Therefore the PBC is trying to boost exports, keep the financial system on a path of sustainable expansion and in the same time control inflation and improve structural problems. And let's not forget about the amounts of Gold China has accumulated over the past 5 years. It estimated that the Chinese government has over 5000 tonnes of the precious metal (around 2000 is the official number). While there are significant difficulties, like the enormous indebtedness of some sectors in the economy and shadow banking, like education or healthcare, China will become only stronger in our lifetime.

Other than the record-breaking IPO announcement of Alibaba (around $21B to be raised on an above $110B valuation), the Chinese stock market has been exceptional for the past month, as well as year to date for that matter. Somewhat stable output data, falling commodity prices and growing exports have contributed to the recent rally in Honk Kong and China. The HSI is up 8.3% YTD and the Shanghai Composite is up 9.95% for the year.

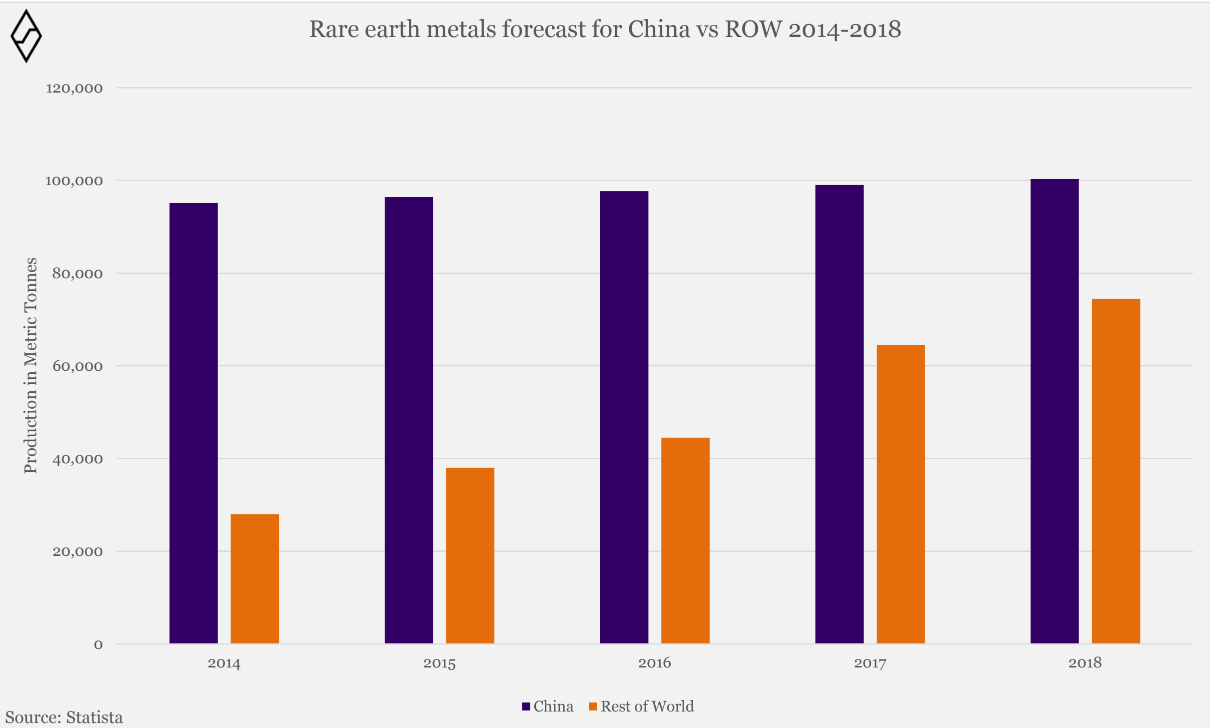
The PBC is more prudent and "conventional" with its interest rate policy, but government stimulus and credit expansion are very much present.

COMMODITIES

Clash of the Asian Titan's

Japan is pushing to secure at least 60% of its rare earth needs from outside China within four years, as its increasing efforts to curb its dependence on the world's biggest producer of elements crucial in smart phones, computers and cars. A number of measures are in place or set to occur including but not limited to: aims to sign a deal as early as this month which would give it four types of light rare earths from India; using an Australian rare earths mine and Malaysian processing plant built by Australia's Lynas Corp it helped to fund; recycling earth metals from batteries and motor magnets, and even exploring the rare earth metals in the Pacific Ocean seabed. Below is a historic look at the major countries production levels.

Given the vast majority of volume coming from China it may, at first glance, seem overly ambitious for Japan to source over 60% of rare metals from outside China. However, it's estimated that Japan's demand for 2018 will be approximately 18,000 tonnes, putting the assumption into a whole new light. Furthermore, when we consider the rate of growth of China's rare metal production versus the Rest of the World (ROW), ROW is growing considerably faster throughout the 2014-2018 forecast. Factoring in the Indian deal providing roughly 15% of Japan's needs, suddenly the deal appears to becoming more and more achievable.



Source: Statista

PORTFOLIO

CORTEZ

				Price		Performance	
Security	Ticker	Entry date	Long/Short	Entry	Current	Weekly	Inception
iPath S&P 500 VIX ST Futures ETN	VXX	22.Aug.14	Long	27.82	27.45	-2.35%	-1.33%
EURGBP	EURGBP	18.Aug.14	Short	0.800	0.794	-0.37%	0.75%
iShares MSCI Italy Spain (ETF)	EWP	11.Aug.14	Long	39.07	41.64	-0.42%	-0.92%
iShares MSCI Italy Index (ETF)	EWI	11.Aug.14	Short	15.32	16.48		
SPDR Gold Trust ETF	GLD	14.Jul.14	Long	125.52	122.06	-1.45%	-2.76%
Wisdom Tree India Earnings ETF	EPI	04.Aug.14	Long	22.00	23.54	3.38%	7.00%
Lazard Ltd	LAZ	31.Jul.14	Long	53.19	54.22	-1.49%	0.40%
SPDR KBW Regional Banking ETF	KRE	31.Jul.14	Short	38.63	39.22		
Legg Mason Inc	LM	21.Jul.14	Long	50.39	48.73	-1.41%	-3.05%
T.Rowe Price Group	TROW	21.Jul.14	Short	81.38	81.17		
Maxim Integrated Products Inc	MXIM	21.Jul.14	Long	34.17	31.30	0.79%	-4.41%
Linear Technology Corp	LLTC	21.Jul.14	Short	47.33	45.35		
iShares STOXX EU600 Utilities (DE)	EXH9	31.Jul.14	Long	32.37	33.37	1.32%	1.58%
PowerShares DWA Developed Markets Momentum	PIZ	01.Aug.14	Short	18.79	19.92		

updated: 05.Aug.14 close prices

FOREX

Pair	Open	Close	Weekly %	Trend w/w	Monthly %	YTD
AUD/USD	0.9338	0.9377	0.42%	3	0.76%	5.21%
USD/CHF	0.9184	0.931	1.37%	2	4.02%	4.28%
AUD/NZD	1.117	1.1259	0.80%	2	2.73%	3.72%
USD/CAD	1.0877	1.0881	0.04%	1	0.37%	2.46%
EUR/JPY	138.6800	136.1	-1.86%	1	-1.87%	1.84%
NZD/USD	0.836	0.8328	-0.38%	2	-1.80%	1.49%
USD/CNY	6.1434	6.1405	-0.05%	2	-1.40%	1.43%
USD/JPY	104.0800	105.0900	0.97%	2	3.32%	-0.20%
GBP/USD	1.66	1.6325	-1.64%	1	-2.52%	-1.40%
GBP/JPY	172.77	171.56	-0.70%	1	0.68%	-1.54%
EUR/CHF	1.21	1.21	-0.01%	3	-1.14%	-2.05%
EUR/GBP	0.7912	0.7934	0.28%	1	-2.46%	-4.36%
EUR/USD	1.3132	1.2952	-1.37%	3	-4.97%	-5.77%
GBP/AUD	1.7774	1.7410	-2.05%	3	-3.19%	-5.91%
EUR/AUD	1.4064	1.3811	-1.80%	3	-5.48%	-10.79%
BTC/USD	500	478.99	-4.20%	3	-17.08%	-34.43%

Source: Investing.com

REFERENCES

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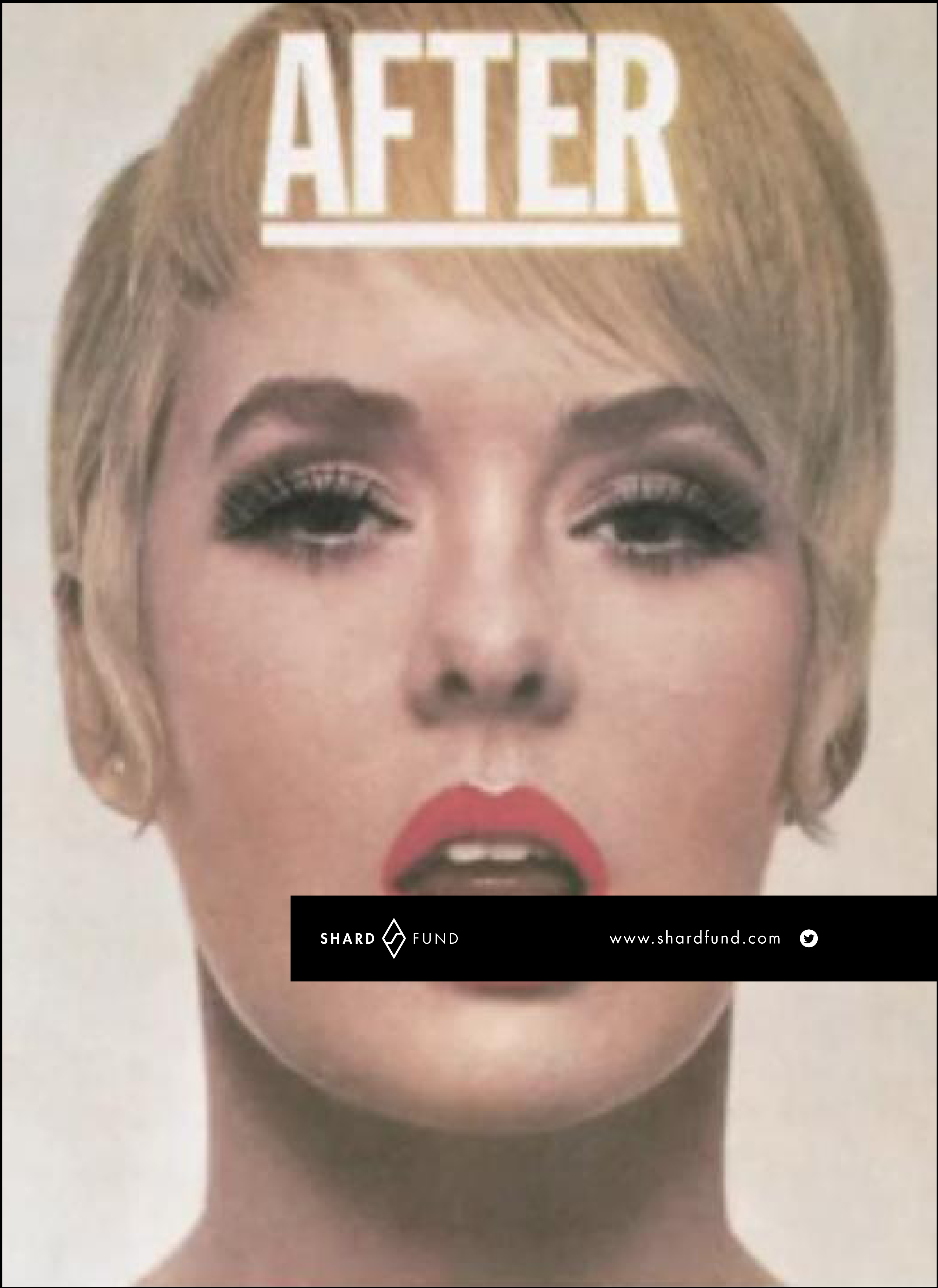

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