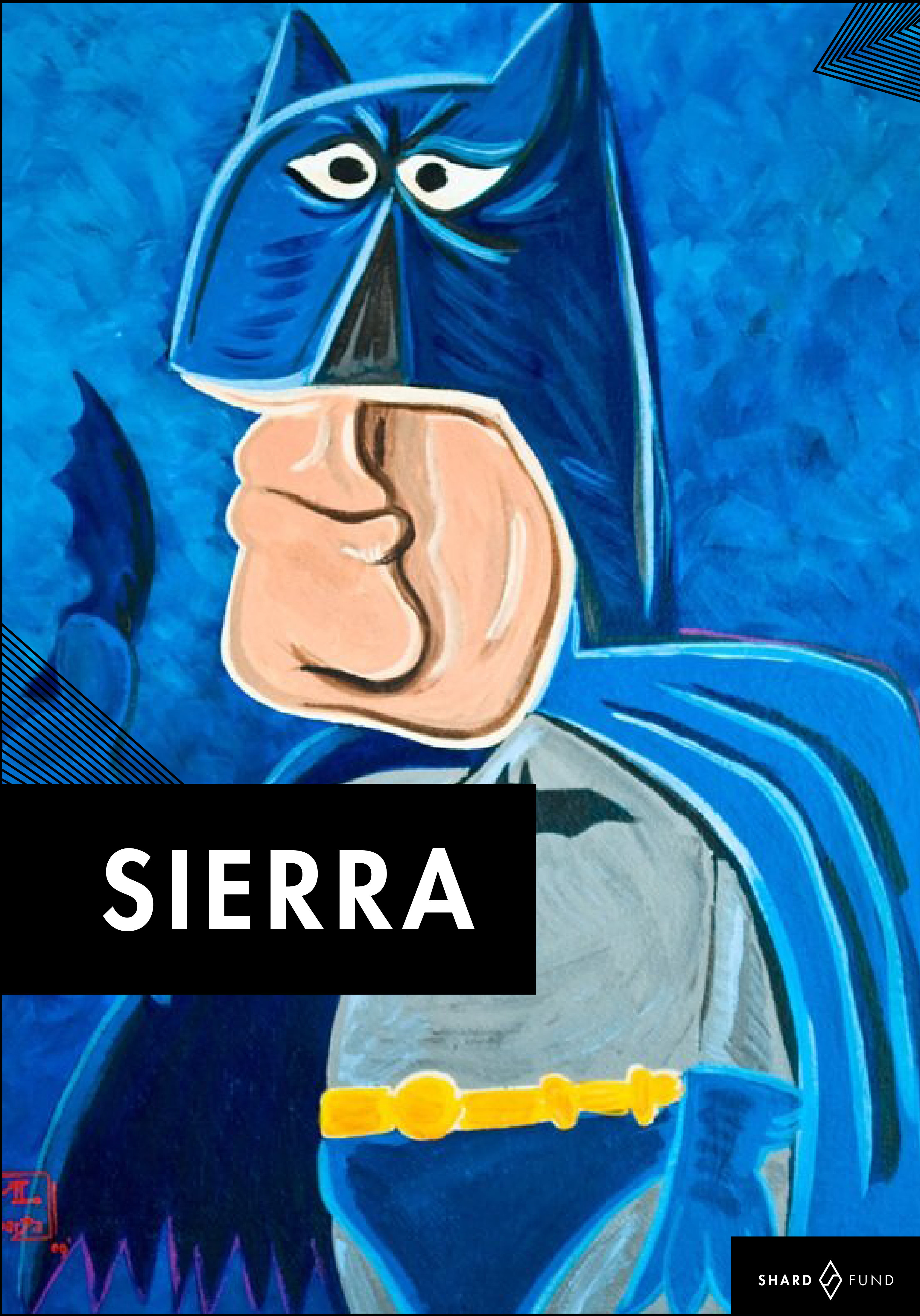

SIERRA

SHARD FUND

A JOURNEY ACROSS FINANCIAL MARKETS

September 13th - September 19th, 2014 | Issue 27

TEAM:

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HIGHLIGHTS

USA

We talked about the potential employment slowdown in the last two issues so we are turning to the next two factors on the table: housing and inflation. On the housing front the situation looks ugly and it's been like that all year, which is a head scratcher for Fed officials given that rates have been falling. Inflation, on the other hand, also look under threat due to the continuing weakness in the EUR, which pushes the dollar higher and commodities lower. In that situation, the remaining months of the year will be quite interesting.

EUROPE

In this issue we look at the Scottish referendum (post factum) and try to put it in the context of the Scottish economy. We look at the growth potential of the country, as well as headwind scenarios that might bring more troubles to the United Kingdom as a union.

ASIA & OCEANIA

Other than the record breaking Alibaba IPO, this week will be remembered for the undercover reserve requirement ratio cut by the PBOC. The central bank indirectly cut the reserve ratio requirement as much as 0.5%, by providing a 500B Yuan liquidity injection to the five largest state-owned banks. Also, we look at an interesting event that happened in China, which did not receive enough attention (it was Alibaba's IPO week after all).

COMMODITIES

Australia's miners face tough times amid a meteoric fall in their cash cow, iron ore, but there are plenty of reasons to believe the rest of the economy can weather the storm and perhaps even profit from it. Meanwhile, an increased foreign production forecast for 2014/2015 and larger beginning stocks boosted world wheat supplies this month. The increase in world wheat supplies is larger than the increase in use, raising projected world ending stocks. US wheat export prospects are slightly down, EU, Canadian and Ukrainian exports are all on the rise.

Weekly Change	
Indices	
Nikkei 225 (Japan)	2.34%
DAX (Germany)	1.53%
S&P 500 (USA)	1.25%
IBEX (Spain)	1.04%
FTSE 100 (UK)	0.45%
CAC (France)	0.44%
BSE (India)	0.11%
Shanghai (China)	-0.09%
FTSE MIB (Italy)	-0.47%
Hang Seng	-1.18%
S&P/ASX (Australia)	-1.77%
Currencies	
GBP/JPY	1.72%
USD/JPY	1.61%
GBP/AUD	1.33%
USD/CHF	0.81%
EUR/JPY	0.55%
EUR/AUD	0.17%
USD/CNY	0.15%
GBP/USD	0.10%
EUR/CHF	-0.21%
NZD/USD	-0.38%
AUD/NZD	-0.82%
EUR/USD	-1.03%
EUR/GBP	-1.13%
AUD/USD	-1.19%
USD/CAD	-1.27%
Commodities	
Brent Crude Oil	1.28%
Copper	-0.55%
WTI Crude Oil	-0.65%
Gold	-1.15%
Silver	-4.45%

Source: Thomson Reuters

CALENDAR

USA					
Day	Country	Indicator	Actual	Forecast	Previous
Tuesday	United States	Core CPI (MoM)	0.1%	0.1%	0.2%
Thursday	United States	Building Permits	0.998M	1.045M	1.057M
		Housing Starts (MoM)	-14.4%	-4.4%	15.7%
		Philadelphia Fed Manufacturing Index	22.5	23.0	28.0
		Upcoming events		Forecast	Previous
Wednesday	United States	New Home Sales		430K	412K
Thursday		Core Durable Goods Orders		0.6%	-0.7%
Friday		GDP (QoQ)		4.6%	4.2%
		Michigan Consumer Sentiment		84.7	84.6
EU					
Day	Country	Indicator	Actual	Forecast	Previous
Tuesday	Germany	German ZEW Economic Sentiment	6.9	4.8	8.6
	United Kingdom	CPI (YoY)	1.5%	1.5%	1.6%
Wednesday	United Kingdom	Claimant Count Change	-37.2K	-30.0K	-33.6K
		Unemployment Rate	6.2%	6.3%	6.4%
	EU	CPI (YoY)	0.4%	0.3%	0.3%
Thursday	United Kingdom	Retail Sales (MoM)	0.4	0.3%	0.5%
Friday	Germany	PPI (MoM)	-0.1%	-0.1%	0.1%
		Upcoming events		Forecast	Previous
Tuesday	EU	Manufacturing PMI		50.5	50.7
	Germany	Manufacturing PMI		51.2	51.4
	France	GDP (QoQ)		-	-
		Manufacturing PMI		47.0	46.9
Wednesday	Germany	Business Expectations		101.2	101.7
		German Ifo Business Climate Index		105.7	106.3
Asia and Oceania					
Day	Country	Indicator	Actual	Forecast	Previous
Wednesday	New Zealand	GDP (QoQ)	0.7%	0.6%	1.0%
	Japan	Adjusted Trade Balance	-0.92T	-0.99T	-1.02T
		Exports (YoY)	-1.3%	-2.6%	3.9%
		Trade Balance	-949B	-1.209B	-964B
		Upcoming events		Forecast	Previous
Monday	China	HSBC Manufacturing PMI			50.2
Thursday	New Zealand	Trade Balance (MoM)		-1.275M	-692M
	Japan	Core CPI (YoY)		-2.6%	3.9%
		Tokyo Core CPI (YoY)		2.6%	2.7%

Source: Investing.com

USA

September blues

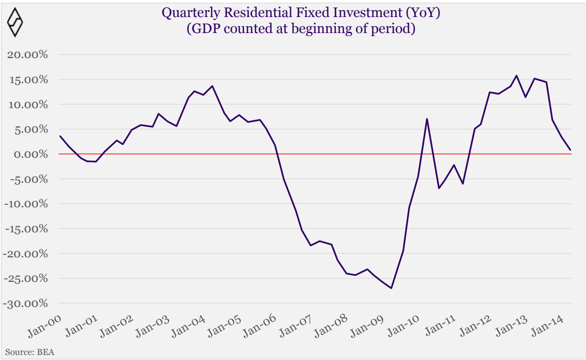
Sectors	5D	1M	3M	YTD
Healthcare	1.68%	3.23%	-3.56%	17.03%
Technology	0.30%	1.08%	5.19%	12.87%
Utilities	0.66%	0.35%	-3.56%	12.04%
Materials	1.39%	0.14%	1.76%	9.13%
Financials	1.11%	4.19%	3.59%	8.19%
Energy	0.25%	-3.68%	-6.58%	5.97%
Consumer Staples	0.84%	1.18%	-0.53%	5.70%
Industrials	0.81%	1.13%	-1.11%	4.15%
Consumer Discretionary	0.20%	0.35%	2.93%	2.48%
Indices				
Nasdaq	0.27%	1.18%	4.85%	9.65%
S&P 500	1.25%	1.45%	2.60%	8.77%
Dow Jones Ind. Avg.	1.74%	1.77%	1.96%	4.24%
Russell 2000	-1.20%	-0.91%	-3.49%	-1.44%

Source: Sectorspdr.com

It was supposed to be a week to remember for a long time as expectations for a very hawkish Fed and potential independence of Scotland played with investors' minds.

Like many other things in macro, housing is also cyclical and right now it looks like everything is going downhill.

At the end, reason and logic prevailed and neither of those events occurred so the week goes in the books as a slightly interesting one but miles away from 'legendary'. In fact, Janet Yellen did exactly what we discussed (**Issue 26**) she is likely to do (we talked in terms of probability). Nothing major has been said, except that the board lowered (once again) its end-of-year GDP projection to 2.0–2.2%. Regular readers probably remember that we

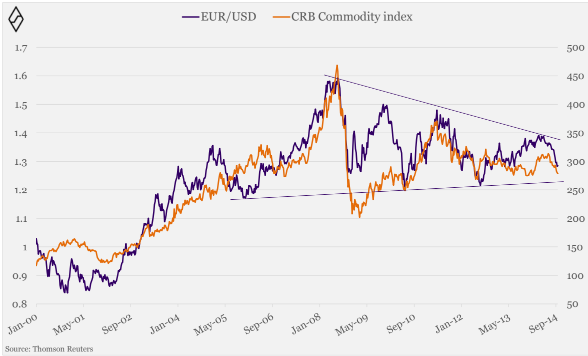


expressed concerns about Fed's projections and expected them to be lowered in both the June and September meetings (for reference — Sierra Issue **12** & **17**). However, what good is it to be right if you fail to benefit from

it?! We've been burnt in our gold ($GLD) and treasuries ($TLT) long positions (the latter due to bad timing), but we've benefited through direct exposure to growth by shorting the Russell 2000 ($IWM) and housing ($ITB). So far the score (performance) on that front is negative but we are looking to add to the latter two positions when the right time comes (for more details regarding those 4 positions and others, check the portfolio section at the end).
Looking ahead, the Fed goes in the shadows for a while (at least 1 month) and market participants have one central bank less to think about. However, things will be piling up until the next meeting and Janet Yellen might have to deal with an unpleasant situation.
We talked about the potential employment slowdown in the last two issues so we are turning to the next two factors on the table: housing and inflation. On the housing front the situation looks ugly and it's been like that all year, which is a head scratcher for Fed officials given that rates have been falling. Like many other things in macro, housing is also cyclical and right now it looks like everything is going downhill. As a reference, look at this graph we published earlier this summer.
We are aware that GDP is a backward looking measure, but monthly housing indicators (permits, starts, sales, prices etc.) do not look any better (weekly mortgage applications are even worse). Just remember to look at the change as opposed to the nominal value of the indicator. Also, when it comes to housing, yearly changes (YoY) are preferred, as there is seasonality in this market, which is not taken into account, when calculating monthly changes. If you are looking for housing exposure, here are two good alternatives:

- iShares U.S. Home Construction ETF ($ITB)
- SPDR S&P Homebuilders ETF ($XHB)

On the inflation front, the situation is quite straightforward — EU is starting to gain advantage in the currency war and this is likely to continue.
Of course, this immediately reflects on commodity prices, which have been deflating since June. Gold was the only commodity holding up, however even the precious metal gave up and has lost USD 100 of its price since mid-August's close of USD 1,315 (-7.6%).



We are not market technicians and we do not take decisions purely based on technical analysis, however the dollar/commodity chart above looks frightening if you are a commodity bull, dollar bear or a politician with a mandate to increase prices in the US. Put this into the context of ECB's recent comments about monetary policy and you should get the proper picture. While we are relatively certain that the Fed will try to talk the dollar down, we do not see how this is going to work unless, god forbid, the economy slows dramatically and another round of QE is initiated.
Exposure to broad baskets of commodities or USD pairs could be achieved through (although we don't hold any of these instruments):

- PowerShares DB Commodity Index Tracking Fund ($DBC)
- PowerShares DB US Dollar Index Bullish Fund ($UUP)

EUROPE

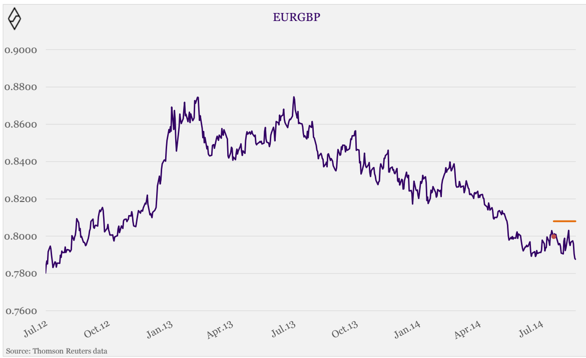
"Scoot"land, its growth potential and THE vote

Indices	5D	1M	3M	YTD
STOXX Europe 600 Health Care	1.86%	7.05%	7.03%	20.45%
STOXX Europe 600 Real Estate Cap	-0.05%	0.43%	2.38%	15.32%
STOXX Europe 600 Food & Beverage	0.84%	2.56%	1.50%	8.83%
STOXX Europe 600 Insurance	2.87%	5.58%	6.17%	6.77%
STOXX Europe 600 Travel & Leisure	2.40%	4.85%	0.33%	6.39%
STOXX Europe 600	1.23%	3.26%	0.70%	6.17%
STOXX Europe 600 Banks	1.61%	5.82%	2.07%	5.15%
STOXX Europe 600 Personal & Household Goods	0.31%	2.85%	-0.96%	5.01%
STOXX Europe 600 Basic Resources	0.21%	-2.41%	0.48%	4.91%
STOXX Europe 600 Oil & Gas	0.80%	0.27%	-7.35%	4.81%
STOXX Europe 600 Technology	0.24%	3.65%	4.66%	3.85%
STOXX Europe 600 Financial Services	1.46%	1.38%	-0.84%	3.82%
STOXX Europe 600 Chemicals	2.11%	4.28%	0.11%	2.98%
STOXX Europe 600 Construction & Materials	-0.17%	-0.66%	-8.26%	2.65%
STOXX Europe 600 Media	1.96%	3.91%	3.73%	1.96%
STOXX Europe 600 Telecommunications	2.01%	3.50%	0.51%	1.79%
STOXX Europe 600 Automobiles & Parts	0.24%	0.38%	-7.44%	-0.03%
STOXX Europe 600 Industrial Goods & Services	0.60%	1.83%	-0.81%	-1.03%
STOXX Europe 600 Retail	1.09%	0.57%	-2.82%	-5.51%

Source: Stoxx; quoted in EUR

Common sense prevailed (with a majority vote of 55.3%) according to our thoughts and perspective since, essentially, Scotland's leaving the UK would have been a major mistake (for Scotland that is). The 'No vote' resulted in a rally for Sterling (Go Pound) and the EUR/GBP pair reflected this result, closing the week at 0.7876. We had positioned ourselves accordingly prior to the vote, however no excess risk was taken as a mean of betting on the outcome of the vote, as we have other, fundamental reasons for that position, which makes it a long-term choice as opposed to one-off gamble.

In one sense politically, this decision was the correct one not only for Scotland but for the EU as a whole, since it most certainly will drive down secession pressures in other parts of Europe, especially in Spanish Catalonia, Northern Italy and to some extent Flanders and Wallonia (although the situation there is a bit different). It should also result in less uncertainty for the United Kingdom and potentially the broader European market. Furthermore, It may be a deciding factor in the possible future to come UK-EU vote (most Scots are pro-European).



However, it is worth mentioning that certain fundamental changes will occur despite the result, most notably with the Scotland Act of 2012 that introduced the Scottish Rate of Income Tax (SRIT), expected to be implemented in 2016. We are not going to delve into this right now since it's not the purpose of this commentary. Back to our analysis, the vote was essentially a political matter and wider spread economic consequences of any kind are unexpected, however long-term implications regarding the United Kingdom itself are large and should be acknowledged.

First and foremost, it is the devolution from the London-centric market, and most importantly the meaning of this devolution for Scotland's economy which presents a problem. The three major cities in Scotland are Glasgow, Edinburgh and Aberdeen, and all three have incredible growth potential based on young and qualified workforce - students who have chosen the universities in Scotland to those in England due to lack of tuition fees and the relatively good education they get, especially at the prestigious universities in Edinburgh and Glasgow (of course, assuming that these students actually work in Scotland after they graduate). This is supported by the fact that the University of Edinburgh leads the table in numbers of spinouts with 255 spinouts since the year 2000 (**for reference the second University in this table is Cambridge with 149**). This staggering lead is due to the good work of Edinburgh Research and Innovation (ERI) and other such endeavors that aim to promote entrepreneurship and the development of new ideas and technologies.

In Aberdeen's case it is its oil industry, by recent estimates accounting for as much as 30% of the workforce in the city, which offers potential. In fact, about 85% of the oil in the North Sea lies in Scottish waters, which also contain the largest oil reserves in the EU. Oil is a leading industry in the country with revenues accounting for around 17% of GDP (2011 figures). Scotland is also the EU's largest petroleum producer. Although fears have been expressed that income from oil would plunge after 2018 due to oil reserves getting tapped out, it is important to say that Scotland is blessed with some of the best energy resources in Europe and is a net exporter of electricity. Even if oil reserves numbers have been exaggerated and incomes from the industry do drop, one of the leading universities in renewable energy research, the one in Aberdeen, has a number of initiatives that support the exploration of alternatives and complements to the oil industry. All in all, Scotland should try to diversify its revenue sources, as even with so much reliance on a strong oil industry, Scotland has been a net drain on the rest of British taxpayers for the last generation; it has received greater benefits than it has paid in taxes (**New York Times**). What if oil revenues do start to plunge sooner rather than later? In fact, many large producers of oil are looking to exit the North Sea due to rising costs for finding and development (**Washington Post**). We are in no way experts on UK politics but we do know that people don't like paying more than they get in return, so what if in 10-20 years, with considerably less oil surrounding Scotland, the country is able to contribute even less? It might sound ridiculous now but we could actually see an British referendum on "Should we keep Scotland in the United Kingdom?".

To sum up, the vote represents the clear desire for change for good in terms of devolution of power, which, if used correctly, may result in even greater long-term benefits for the Scottish economy. However the country should look to gain more leverage as oil may not be an influential enough factor in the not so distant future.

Here are some additional interesting readings about the Scottish independence situation that we recommend:

- **The Economist**
- **Bloomberg**

ASIA & OCEANIA

China's not so secret QE and the news that no one talked about

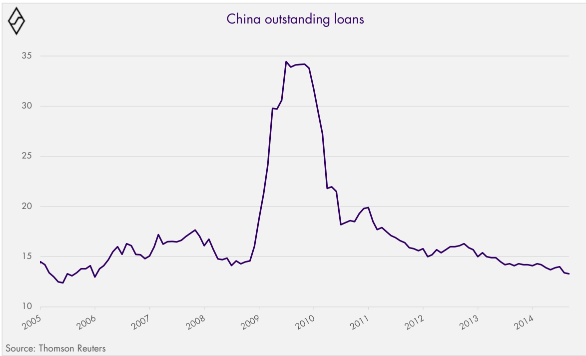
Indices	5D	1M	3M	YTD
STOXX Asia/Pacific 600 Technology	1.29%	2.71%	5.93%	16.14%
STOXX Asia/Pacific 600 Health Care	0.07%	0.48%	7.58%	11.38%
STOXX Asia/Pacific 600 Industrial Goods & Services	1.11%	3.25%	6.31%	8.89%
STOXX Asia/Pacific 600 Construction & Materials	-1.24%	-3.46%	0.49%	8.81%
STOXX Asia/Pacific 600 Food & Beverage	-0.15%	-2.26%	4.58%	8.70%
STOXX Asia/Pacific 600 Chemicals	1.85%	2.99%	8.86%	8.66%
STOXX Asia/Pacific 600 Oil & Gas	-1.27%	-3.09%	-1.16%	7.66%
STOXX Asia/Pacific 600 Telecommunications	0.34%	3.62%	8.78%	6.11%
STOXX Asia/Pacific 600 Insurance	0.15%	2.34%	6.85%	5.87%
STOXX Asia/Pacific 600 Personal & Household Goods	-1.14%	-2.40%	0.99%	5.26%
STOXX Asia/Pacific 600 Index	-0.17%	0.05%	3.51%	4.01%
STOXX Asia/Pacific 600 Utilities	-1.23%	-0.58%	5.04%	3.90%
STOXX Asia/Pacific 600 Real Estate	-1.80%	-2.54%	2.09%	3.73%
STOXX Asia/Pacific 600 Automobile & Parts	1.69%	5.06%	6.35%	1.14%
STOXX Asia/Pacific 600 Media	0.73%	-3.77%	0.40%	0.26%
STOXX Asia/Pacific 600 Banks	-1.64%	-0.99%	-0.57%	-0.14%
STOXX Asia/Pacific 600 Financial Services	-0.60%	0.00%	2.54%	-1.92%
STOXX Asia/Pacific 600 Retail	0.12%	-3.32%	-0.43%	-3.79%
STOXX Asia/Pacific 600 Basic Resources	-0.80%	-5.83%	-1.43%	-4.37%

Source: Stoxx; quoted in EUR

CHINA

Other than the record breaking Alibaba IPO, this week will be remembered for the undercover reserve requirement ratio cut by the PBOC. The central bank indirectly cut the reserve ratio requirement as much as 0.5%, by providing a 500B Yuan liquidity injection to the five largest state-owned banks. Such lower-visibility action by the PBOC (instead of cutting the RRR itself), is timely and will probably push demand for the now lower-priced homes and commodities. Additionally, the repo rate was cut to 3.5%, the lowest since 2011.

Interestingly the 500B Yuan loan term is three months long from the Standing Lending Facility, hence the stimulus gives the market incentive to act quickly, while leaving the door open for further monetary measures afterwards. Nevertheless, China is very aware it should be careful with money injections and should focus on structural reforms, since housing and debt are extremely sensitive issues.



The big issue, that structural issues cannot be solved by cyclical monetary measures, namely the slowdown in Europe and Japan, in addition to extreme domestic inefficiencies are a significant headwind for China. China is very dependent on global demand and faces difficulties in domestic market development. Housing, which accounts for approximately 15% of GDP, is slowing down exponentially this year and a self-perpetuating spiral of slowdown in investment and production,

China is aware it should be careful with money injections and should focus on structural reforms

can pull the 7.5% Chinese GDP target growth rate much lower. Building houses does contribute to GDP significantly, but nobody living in them is more of a waste than creation of wealth. Foreign direct investment was down 14% YoY, industrial production was down 2.5% from one year earlier, in negative territory for the first time in 5 years. 30 months of falling producer prices, suggest little appetite for new investments. Iron ore and copper continue to edge lower, mainly due to the stronger USD and implied weakening demand in China. We are now more cautious in our view for China, than that we gave for the better part of this year. But who knows, maybe we will have a continuous US-like stock market psychopathy, of bad news being good news for stocks.

General exposure to China could be gained through:

- iShares China Large-Cap ETF ($FXI)

China, the world's largest gold market since last year, is launching the Pilot Free Trade Zone, where Yuan denominated gold contracts will be sold to worldwide investors. This did not get the news coverage Alibaba got (nothing even close), but we believe it is a much bigger deal. Next week's Sierra will provide a more in-depth analysis on Chinese presence in the gold market and its consequences, so stay tuned in.

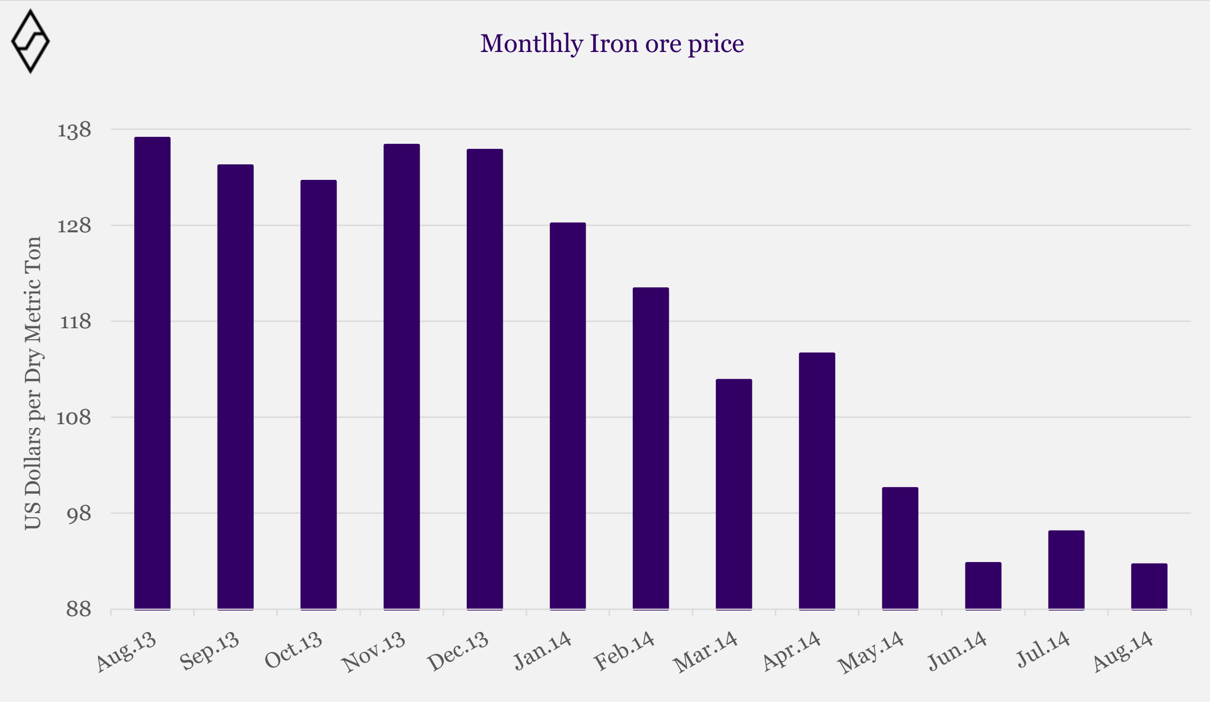
COMMODITIES

The storm down under

METALS

Australia's miners face tough times amid a meteoric fall in their cash cow, iron ore, but there are plenty of reasons to believe the rest of the economy can weather the storm and perhaps even profit from it. The cool down in mining offers breathing space for the rest of the economy that doesn't involve digging up resources - much of it sucked up by China, Australia's major export market. The rest of the economy can rebalance, rates have been relieved, debt servicing costs are down, home prices are up, and over time the Aussie Dollar should ease. Not to belittle the contribution of mining, or China's importance to the economy; the hundreds of billions spent on resource projects is helping to raise export volumes tempering the drag from iron ore prices which has shed 37% this year.

Shipments of the steel-making mineral to China from Australia's port Hedland reached all-time highs in August, having climbed 62% in just 12 months. The fact the gains come despite an economic slowdown in the Asian giant suggests Australia's lower cost producers are taking market share from competitors.

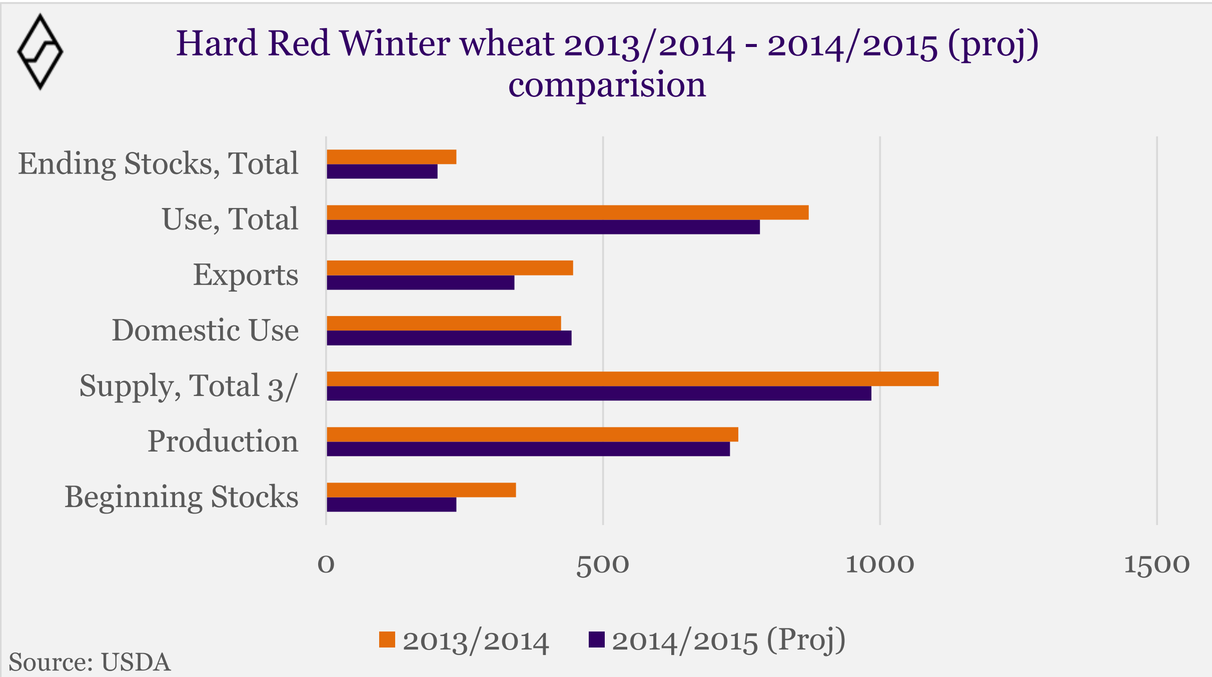


Source:Indexundi

AGRICULTURE

An increased foreign production forecast for 2014/2015 and larger beginning stocks boosted world wheat supplies this month. The increase in world wheat supplies is larger than the increase in use, raising projected world ending stocks. US wheat export prospects are slightly down, EU, Canadian and Ukrainian exports are all on the rise, and for a second consecutive year the EU is expected to be the world's largest wheat exporter. Projected US wheat supplies for 2014/2015 has been raised 10 million bushels with higher expected imports of hard red spring (HRS) wheat from Canada. This reflects higher stocks in Canada as well as the strong shipment pace. Hard red winter (HRW) wheat exports are lowered 15 million bushels due to the slow pace of sales and shipments to date.

...for a second consecutive year the EU is expected to be the world's largest wheat exporter.



PORTFOLIO

CORTEZ

Security	Ticker	Entry date	Long/Short	Entry	Current	Weekly	Inception
Legg Mason Inc	LM	21.Jul.14	Long	50.4	50.8	0.4%	2.4%
T.Rowe Price Group	TROW	21.Jul.14	Short	81.4	80.1		
Maxim Integrated Products Inc	MXIM	21.Jul.14	Long	34.2	31.0	0.0%	-5.7%
Linear Technology Corp	LLTC	21.Jul.14	Short	47.3	45.5		
Lazard Ltd	LAZ	31.Jul.14	Long	53.2	54.0	1.2%	-1.1%
SPDR KBW Regional Banking ETF	KRE	31.Jul.14	Short	38.6	39.7		
iShares STOXX EU600 Utilities (DE)	EXH9	31.Jul.14	Long	32.4	33.0	-0.5%	1.0%
PowerShares DWA Developed Markets Momentum	PIZ	01.Aug.14	Short	18.8	19.7		
Wisdom Tree India Earnings ETF	EPI	04.Aug.14	Long	22.0	22.8	-0.5%	0.7%
EURGBP	EURGBP	18.Aug.14	Short	0.8	0.8	1.1%	1.5%
iPath S&P 500 VIX ST Futures ETN	VXX	22.Aug.14	Long	27.8	27.2	-4.9%	-2.1%
iShares US Home Construction ETF	ITB	08.Sep.14	Short	23.9	23.7	-1.0%	0.5%
iShares Russell 2000 ETF	IWM	08.Sep.14	Short	115.9	114.0	1.2%	1.6%

Source: Thomson Reuters, ShardFund updated: 21.Sep.14 close prices

OUT

Long iPath S&P 500 VIX Short Term Futures TM ETN ($VXX)

Performance: 3.55%
This position is only partially closed — we sold ¾ of it on 15 September as we expected a rally at the end of the week due to a dovish Fed and a 'No' vote in Scotland. As a result, we locked in a good profit and lost a lot less at the end of the week when our expectations were justified.

Long Spain ($EWP) vs. Short Italy ($EWI)

Performance: -0.60%
WWe decided to cut our small losses here due to potential outperformance of Italy in the event of any kind of stimulus from ECB. Fundamentally, Italy is still one of the worst economies in the EU and Spain has been releasing much better data. However, ever since we opened the position, Italy has performed better and we assume that is because of the "bad data = uplifted market" effect that comes with monetary stimulus. Also, the potential repetition of the independence referendum, this time in Catalonia, has persuaded us to stay away from Spain for now.
Fundamentally, we still like the position and we might re-enter it in the future.

Long Gold ($GLD)

Performance: -5.69%
Although we are sending the update now, we exited this position at USD 119.00, where we had a stop loss order. With the dollar getting increasingly higher and relatively easing geopolitical risk, gold might be on track to experience a terrible second half of the year. The situation surrounding ISIS is expected to escalate and that might support gold for a while. Bear in mind that this update is written on 20-21 September.
Our stop loss was placed slightly below the first notable support level (around USD 120) and sooner rather than later the ETF will test the next important support at USD 115. After that it gets quite ugly.

Long iShares 20+ Year Treasury Bond ETF ($TLT)

Performance: -2.65%

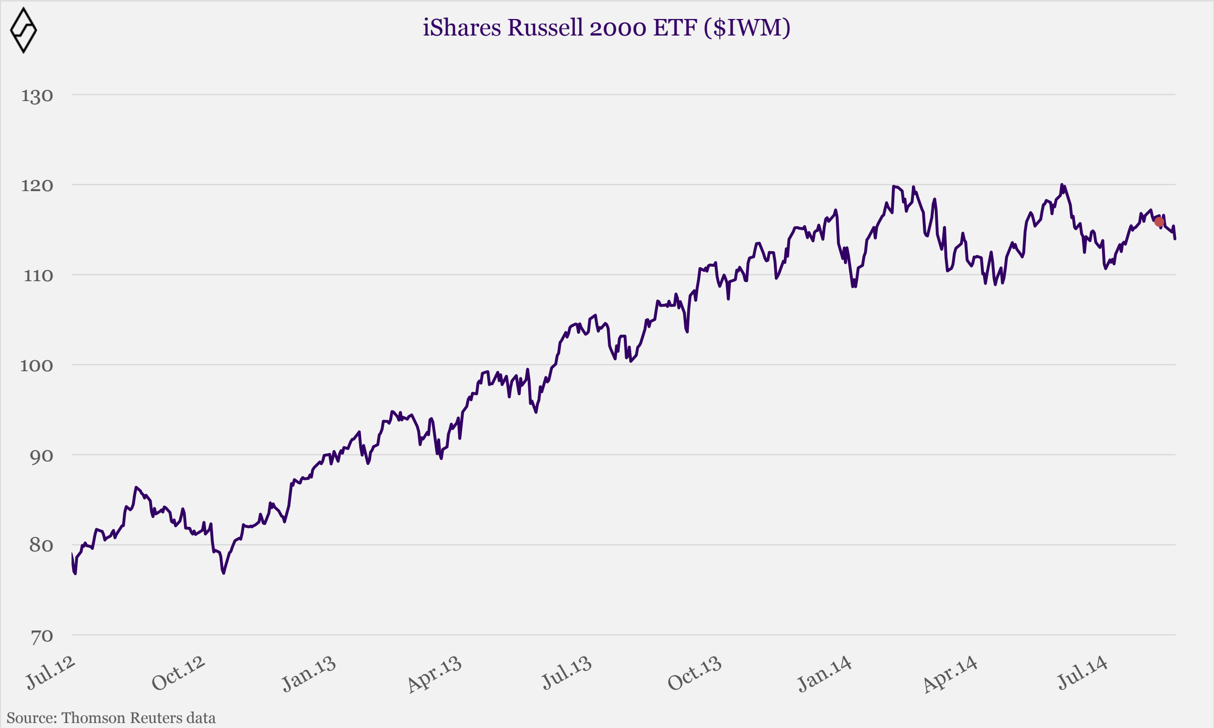
It is not a secret that we had looked to enter into a bond position for almost a month, but the moment we decided to do so was definitely the worst one. After initiating the position, the ETF had a five consecutive down days and then our stop loss was broken during the FOMC speech this week. Even worse, $TLT bounced less than 0.5% below our stop loss and now it looks like it is starting to trend up once again. It was definitely a bad timing and an inaccurate stop loss level, which resulted in the exit from this position. We still like its fundamental meaning and might reenter it soon.

IN

Short Russell 2000 ($IWM)

Unlike the bad timing in the bond position, we believe we entered short positions in the Russell 2000 and housing (explained afterwards) at very good spots. The former consists of small-cap companies (market capialisation of up to USD 2 bn), which benefit from growth because of their higher beta (risk), and a large majority of revenues come from the US (more than 75%). For instance, last year in the strong economic environment in the US, the Russell 2000 (the index not the ETF) gained 40% compared to the 32% of the S&P 500. Similarly, this year in the opposite environment, the S&P 500 is up around 8%, while the Russell 2000 is down around 2%. We are not as optimistic as consensus on the growth potential in the second half of the year, so this is a good way to express our view (i.e. by shorting growth).

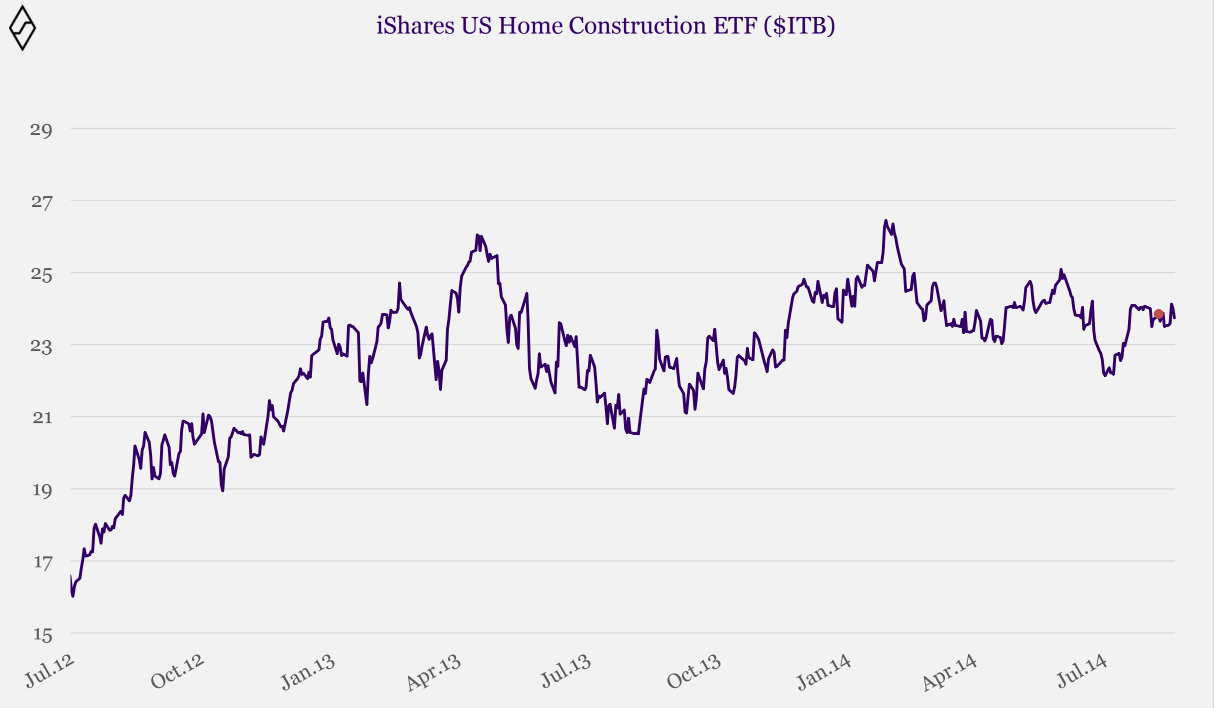
Also, we are increasingly starting to find read about illiquidity in the small-cap space, as investors shift to large-cap companies in times of uncertainty (liquidity is king). We are not a multi-billion dollar fund to know for sure what the liquidity situation is out there, however, if we take the S&P 500 volume as a proxy (not a perfect one), the situation does not look rosy. This makes us believe the illiquidity thesis that is starting to pick up pace in the media, which, if true, could only be beneficial for our position.



Source: Thomson Reuters data

Short iShares U.S. Home Construction ETF ($ITB)

As mentioned earlier in the US section, as well as in other issues, we do not like American housing and this view is not just a hunch, just look at every housing indicator out there. The only indicator that trends positively is the NAHB HMI, reflecting on the homebuilders' confidence. So far there is no indication that we should trust this one outlier as opposed to other major monthly and weekly readings, especially 6 years into the expansion cycle.



Source: Thomson Reuters data

FOREX

Pair	Open	Close	Weekly %	Trend w/w	Monthly %	YTD
USD/CHF	0.9332	0.9408	0.81%	4	5.12%	5.38%
EUR/JPY	139.19	139.95	0.55%	2	0.91%	4.72%
USD/JPY	107.34	109.07	1.61%	4	7.24%	3.58%
USD/CAD	1.1093	1.0952	-1.27%	1	1.02%	3.13%
GBP/JPY	174.62	177.62	1.72%	2	4.24%	1.94%
USD/CNY	6.1340	6.143	0.15%	4	-1.36%	1.48%
AUD/NZD	1.1084	1.0993	-0.82%	2	0.30%	1.27%
AUD/USD	0.9038	0.893	-1.19%	2	-4.04%	0.19%
NZD/USD	0.8152	0.8121	-0.38%	4	-4.24%	-1.04%
GBP/AUD	1.7999	1.8239	1.33%	2	1.42%	-1.43%
GBP/USD	1.6268	1.6285	0.10%	1	-2.76%	-1.64%
EUR/CHF	1.2099	1.2074	-0.21%	1	-1.02%	-1.93%
EUR/GBP	0.7969	0.7879	-1.13%	1	-3.13%	-5.03%
EUR/USD	1.2965	1.2831	-1.03%	1	-5.86%	-6.65%
EUR/AUD	1.4344	1.4369	0.17%	2	-1.66%	-7.19%

Source: Thomson Reuters

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