SIERRA

SHARD FUND

A JOURNEY ACROSS FINANCIAL MARKETS

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SPECIAL ANNOUNCEMENT

Movember is an annual month-long charity (during November) where men are growing moustaches and raising money for prostate cancer awareness.

ShardFund is a keen supporter of this charity every year. We encourage you to join us and help change the face of men's health together.

To join our team / donate / or simply follow the growth of our moustaches, click the purple moustache on the right, then click *join team*. If you are not from the UK, make a team of your own and join the **Shard Mo** network at the following link: **http://bit.ly/ZB9bKN**

HIGHLIGHTS

USA

There was an interesting performance divergence this week between the S&P 500, down 1% for the week, and the Russell 2000, which was up 2.75%. This is interesting because the two indices are in fact very similar as they represent a broad spectrum of sector and industries, as opposed to the DJIA or the Nasdaq. The Russell 2000 is in principle a higher beta S&P 500, which means that the former should experience the positive or negative performance of the S&P 500 but with a higher magnitude.

EUROPE

It is a fourth consecutive week of negative returns in stocks with the STOXX Europe 600 index closing on Friday at -0.91%. One month results for individual supersectors and the index itself are strongly negative, ranging from -5% to -11%. Sentiment and exports data from Germany reached their lowest point in 5 years, which clearly shows that Mr. Draghi's actions have had zero effect so far.

ASIA & OCEANIA

Going back to Japan, USD/JPY along with the Nikkei have finished a strong rally and now it's the morning after. In this issue we are discussing the costs of having a weaker yen and our views on taking a position in the currency pair.

COMMODITIES

Brent has fallen as much as 29% since June 10th ,hitting $82.72 a barrel this week, getting close to the key support level of $80 before jumping to just over $86 a barrel (the jump largely being attributed to the roll into the December contract). The slump prompted Venezuela to call for an emergency meeting as it struggles due to sensitive margins, but the larger OPEC countries are either fairly comfortable or even raising production... collective action seems fairly unlikely.

Weekly Change	
Indices	
S&P/ASX (Australia)	1.61%
DAX (Germany)	0.70%
Hang Seng	-0.28%
FTSE 100 (UK)	-0.47%
BSE (India)	-0.72%
CAC (France)	-0.99%
S&P 500 (USA)	-1.02%
Shanghai (China)	-1.40%
IBEX (Spain)	-1.91%
FTSE MIB (Italy)	-2.60%
Nikkei 225 (Japan)	-5.02%
Currencies	
NZD/USD	1.32%
EUR/USD	1.08%
EUR/GBP	0.93%
AUD/USD	0.69%
USD/CAD	0.68%
EUR/JPY	0.52%
EUR/AUD	0.35%
GBP/USD	0.16%
EUR/CHF	-0.08%
USD/CNY	-0.16%
GBP/JPY	-0.41%
USD/JPY	-0.56%
GBP/AUD	-0.57%
AUD/NZD	-0.60%
USD/CHF	-1.18%
Commodities	
Gold	1.25%
Silver	-0.72%
Copper	-1.09%
WTI Crude Oil	-3.05%
Brent Crude Oil	-4.82%

Source: Thomson Reuters

CALENDAR

Day	Country	Indicator	Actual	Forecast	Previous
USA					
Past week					
Wednesday	United States	Core Retail Sales (MoM)	-0.2%	0.3%	0.3%
		PPI (MoM)	-0.1%	0.1%	0.0%
		Retail Sales (MoM)	-0.3%	-0.1%	0.6%
Thursday		Initial Jobless Claims	264K	290K	287K
		Philadelphia Fed Manufacturing Index	20.7	19.9	22.5
Friday		Building Permits (September)	1.018M	1.030M	1.003M
		Housing Starts (MoM)	6.3%	4.8%	-14.4%
Next week					
Tuesday	United States	Existing Home Sales		5.10M	5.05M
Wednesday		Core CPI (MoM)		0.1%	
		Core CPI (YoY)		1.8%	1.7%
Friday		New Home Sales (September)		470K	504K
EU					
Past week					
Tuesday	United Kingdom	CPI (YoY)	1.2%	1.4%	1.5%
	Germany	ZEW Economic Sentiment	-3.6	1.0	6.9
	EU	Industrial Production (MoM)	-1.8%	-1.6%	0.9%
Wednesday	United Kingdom	Claimant Count Change	-18.6K	-35.0K	-37.2K
		Unemployment Rate	6.0%	6.1%	6.2%
	Germany	CPI (MoM)	0.0%	0.0%	0.0%
Thursday	EU	CPI (YoY)	0.3%	0.3%	0.4%
Next week					
Thursday	Germany	Manufacturing PMI		48.5	48.8
	EU	Manufacturing PMI		49.9	50.3
		Services PMI		52	52.4
	United Kingdom	Retail Sales (MoM)		-0.1%	0.4%
Friday	Germany	German Consumer Climate		8	8.3
	United Kingdom	GDP (YoY) (Q3)		3.0%	3.2%
		GDP (QoQ) (Q3)		0.7%	0.9%
Asia and Oceania					
Past week					
Tuesday	China	CPI (YoY)	1.6%	1.7%	2.0%
		CPI (MoM)	0.5%	0.4%	0.2%
		PPI (YoY)	-1.8%	-1.5%	-1.2%
Wednesday	Japan	Industrial Production (MoM)	-1.9%	-1.5%	-1.5%
Next week					
Monday	China	GDP (QoQ) (Q3)		1.8%	2.0%
		GDP (YoY) (Q3)		7.2%	7.5%
		Industrial Production (YoY)		7.5%	6.9%
Tuesday	Japan	Exports (YoY)		6.8%	-1.3%
	Australia	CPI (QoQ)		0.4%	0.5%
Wednesday	China	HSBC Manufacturing PMI			50.2

Source: Thomson Reuters, ShardFund

USA

The Bullard bounce

Sectors	5D	1M	3M	YTD
Utilities	0.16%	0.35%	1.63%	13.25%
Healthcare	-2.68%	-5.25%	1.24%	10.84%
Technology	-1.05%	-6.71%	-3.41%	5.34%
Consumer Staples	-2.15%	-1.93%	-0.27%	3.84%
Financials	-1.15%	-5.34%	-1.46%	2.10%
Materials	0.69%	-7.41%	-6.06%	0.87%
Industrials	2.31%	-5.51%	-4.29%	-1.49%
Consumer Discretionary	-0.95%	-6.51%	-4.40%	-4.32%
Energy	-1.02%	-12.80%	-16.21%	-6.56%
Indices				
S&P 500	-1.02%	-5.74%	-3.64%	2.08%
Nasdaq	-0.42%	-7.29%	-3.92%	1.96%
Dow Jones Ind. Avg.	-0.99%	-5.13%	-4.21%	-1.18%
Russell 2000	2.77%	-6.64%	-6.02%	-6.99%

Source: Sectorspdr.com

Financial media might be filled with mediocrity but sometimes pundits do come up with colourful things to say. This time it was 'the Bullard bounce' quote that caught our attention because of its simplicity and accuracy. It's kind of funny (and sad) to read in the press or listen to economics students talk about how the world has been brought to its knees by free-markets, when at the same time phrases like '**Greenspan put**' and 'Bullard bounce' exist.

The aforementioned bounce refers to the positive market reaction to a comment made by Federal Reserve Bank of St. Louis President, James Bullard. In a speech at the end of the week, he stated that the Fed should extend its QE program beyond the planned conclusion later this October. Of course, the S&P 500 (currently in a correction mode) rallied on such great news. All it takes is a 7-8% correction with a large spike in volatility and a couple of bad economic numbers and the Fed immediately looks for ways to ease money. Imagine what would happen at the FOMC meeting at the end of October, if (god forbid), the correction continues and turns into a slight panic. Since we are playing the 'what if' game, what if Q3 GDP growth (to be released on 30 October) offers downside surprises?

The 'plane' is actually headed towards another crisis (that's how cycles work) and the label on the oxygen masks says: QE 4.

The amount of people talking about QE 4 has actually been growing recently, and while we don't want to say it out loud, this might be where the 'plane' is headed. The 'plane' is actually headed towards another crisis (that's how cycles work) and the label on the oxygen masks says: QE 4.

Leaving central planning aside, there was an interesting performance divergence last week between the S&P 500, down 1% for the week, and the Russell 2000, which was up 2.75%. This is interesting because the two indices are similar as they represent a broad spectrum of sector and industries, as opposed to the DJIA or the Nasdaq. The Russell 2000 is some kind of a higher beta S&P 500, which means that the former should experience the positive or negative performance of the S&P 500, but with a higher magnitude. We read some interesting **research** on that matter, which found that the three day (Monday to Wednesday) performance divergence of the two indices (+4.11%) is actually the 19th largest such divergence since 1990. Interestingly, most of those occurrences have happened in quite volatile years like 2000 and 2008. To top it all off, the average returns for the S&P 500 and the Russell 2000 up to a month after such occurrence has been negative. Makes you go: hmmm...

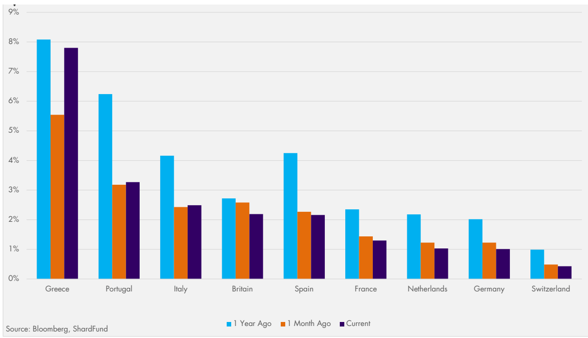
EUROPE

Red October

Indices	5D	1M	3M	YTD
STOXX Europe 600 Health Care	-2.82%	-7.04%	-1.04%	10.72%
STOXX Europe 600 Real Estate Cap	-0.30%	-4.81%	-5.17%	8.75%
STOXX Europe 600 Food & Beverage	-1.53%	-5.59%	-4.41%	1.99%
STOXX Europe 600 Personal & Household Goods	-0.38%	-5.77%	-6.07%	-1.58%
STOXX Europe 600 Insurance	-2.04%	-5.54%	-3.20%	-1.67%
STOXX Europe 600 Travel & Leisure	1.33%	-5.27%	-5.66%	-1.88%
STOXX Europe 600	-0.91%	-7.47%	-6.20%	-2.92%
STOXX Europe 600 Basic Resources	2.37%	-7.95%	-11.26%	-3.42%
STOXX Europe 600 Banks	-2.10%	-8.07%	-2.73%	-4.71%
STOXX Europe 600 Financial Services	-0.02%	-6.87%	-8.32%	-4.91%
STOXX Europe 600 Chemicals	1.27%	-5.70%	-5.82%	-5.12%
STOXX Europe 600 Construction & Materials	2.09%	-7.69%	-11.42%	-5.69%
STOXX Europe 600 Technology	-0.25%	-8.76%	-2.31%	-5.84%
STOXX Europe 600 Media	-0.55%	-6.81%	-3.37%	-6.56%
STOXX Europe 600 Telecommunications	-2.71%	-6.72%	-6.22%	-7.05%
STOXX Europe 600 Oil & Gas	-0.97%	-11.46%	-14.41%	-7.94%
STOXX Europe 600 Automobiles & Parts	4.77%	-7.97%	-13.70%	-8.66%
STOXX Europe 600 Industrial Goods & Services	-0.18%	-8.92%	-8.33%	-10.51%
STOXX Europe 600 Retail	-0.05%	-9.43%	-12.48%	-15.69%

Source: Stoxx; quoted in EUR

October is a very notorious period for the markets - sort of a transitional month between autumn and winter. Three of the biggest crashes on Wall Street (if not globally) have happened during October: the Panic of 1907, Black Tuesday (or the 1929 crash), and Black Monday (the crash of 1987). The October Effect is clearly just a psychological one and a pattern is unjustified, but it seems that this particular October has proven to be quite black (or red, if you're a fan of P&L graphs) for European equities. It is a fourth consecutive week of negative returns in stocks with the STOXX Europe 600 index closing on Friday at -0.91%. One month results for individual supersectors and the index itself are strongly negative, ranging from -5% to -11%. This week, however, was particularly bad for Germany. ZEW Economic Sentiment fell to -3.6 from a previous of 6.9. Industrial production has been very weak and the August export results are down -5.8% (MoM) – both of these indicators are at their lowest in 5 years. Volatility in the Euro Area (as measured by the VStoxx) is up 54% for the month and almost 10% just this week. We talked about the uncertainty in the Euro Area in our previous Sierra when



we mentioned the Goldman note about a potential Asian-like recession in Europe. Expanding on that, it seems that Mr. Draghi's recent actions have been all but effective. In fact, uncertainty is so high that the Greek 10 year bond yield went up by 2.26% this week only and all other periphery yields were up by significant amounts, with the German Bund hitting it's all time low at 0.85% (down 101 bps year-on-year). It is important to mention that Europe has been deleveraging for the past 2-3 years, essentially because it hasn't experienced a QE like the one in USA, which might prove to be more beneficial in the long run.

...it seems that Mr. Draghi's recent actions have been all but effective.

Last week has been quite volatile in general, not only in Europe, with certain markets opening a single day at a couple of hundred points below and closing a few hundred above (more so in the US). This of course is going to keep rates low for longer, keeping the possibilities for profitable carry trades, with a potential in borrowing dollars or euros and investing in places like Turkey or India (not immediately). Also, markets have been moving up on relatively low volume, while the downward swings have had higher volume. That, plus the geopolitical risk which seems to finally be affecting Germany's economic indicators, will add up to the uncertainty in the upcoming weeks, potentially pushing core European yields down even further and volatility indices up higher. It comes down to seeing how next week's PMIs in Europe will end up and, eventually, in what direction they might push future expectations.

ASIA & OCEANIA

Hello Japan... again

Indices	5D	1M	3M	YTD
STOXX Asia/Pacific 600 Health Care	-4.17%	-4.58%	-0.37%	5.67%
STOXX Asia/Pacific 600 Food & Beverage	-3.31%	-2.34%	-1.20%	5.47%
STOXX Asia/Pacific 600 Technology	-5.06%	-7.65%	-5.42%	5.41%
STOXX Asia/Pacific 600 Chemicals	-4.57%	-5.80%	-2.32%	1.88%
STOXX Asia/Pacific 600 Construction & Materials	-4.00%	-8.15%	-8.40%	-0.13%
STOXX Asia/Pacific 600 Utilities	-2.26%	-4.01%	-2.13%	-0.29%
STOXX Asia/Pacific 600 Real Estate	-2.11%	-3.85%	-3.59%	-0.80%
STOXX Asia/Pacific 600 Industrial Goods & Services	-4.01%	-6.88%	-4.59%	-0.97%
STOXX Asia/Pacific 600 Personal & Household Goods	-4.84%	-6.89%	-7.23%	-1.56%
STOXX Asia/Pacific 600 Insurance	-3.11%	-4.88%	-0.29%	-1.61%
STOXX Asia/Pacific 600 Oil & Gas	-2.17%	-8.88%	-10.20%	-2.13%
STOXX Asia/Pacific 600 Index	-3.38%	-5.96%	-5.35%	-3.41%
STOXX Asia/Pacific 600 Telecommunications	-3.12%	-9.25%	-6.00%	-4.27%
STOXX Asia/Pacific 600 Banks	-1.79%	-4.11%	-5.17%	-5.57%
STOXX Asia/Pacific 600 Retail	-2.59%	-2.96%	-5.49%	-7.30%
STOXX Asia/Pacific 600 Media	-5.22%	-8.05%	-9.26%	-8.94%
STOXX Asia/Pacific 600 Automobile & Parts	-6.55%	-7.89%	-6.35%	-9.25%
STOXX Asia/Pacific 600 Financial Services	-3.18%	-8.45%	-6.15%	-11.14%
STOXX Asia/Pacific 600 Basic Resources	-0.06%	-9.66%	-13.76%	-13.11%

Source: Stoxx; quoted in EUR

JAPAN

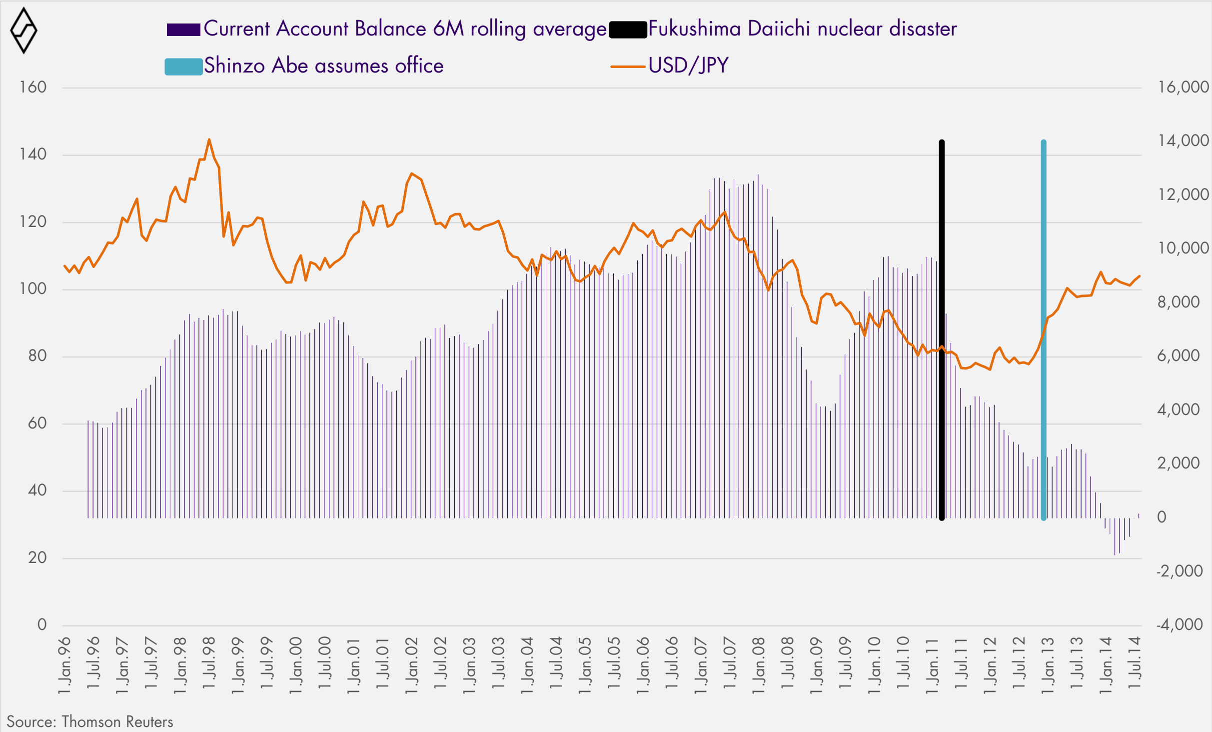
We have not been writing about Japan for a while, so it's time to get back on track here, because developments are very interesting and they have the potential of yielding serious returns to some.

A few months ago, we were discussing whether the BoJ would at all increase their stimulus, so that the USD/JPY could gain yet another rally. Well, the BoJ's stimulus scenario did not really happen, however the rally did: the prospect of a stronger USD (as previously discussed) was an extremely easy trade when looked at retrospectively. We decided to stay away from this trade at the time. Now, we're again re-examining the situation that Japan faces and this week, we're asking ourselves the question, whether a weaker Yen would actually be more beneficial than costly for the Japanese economy?

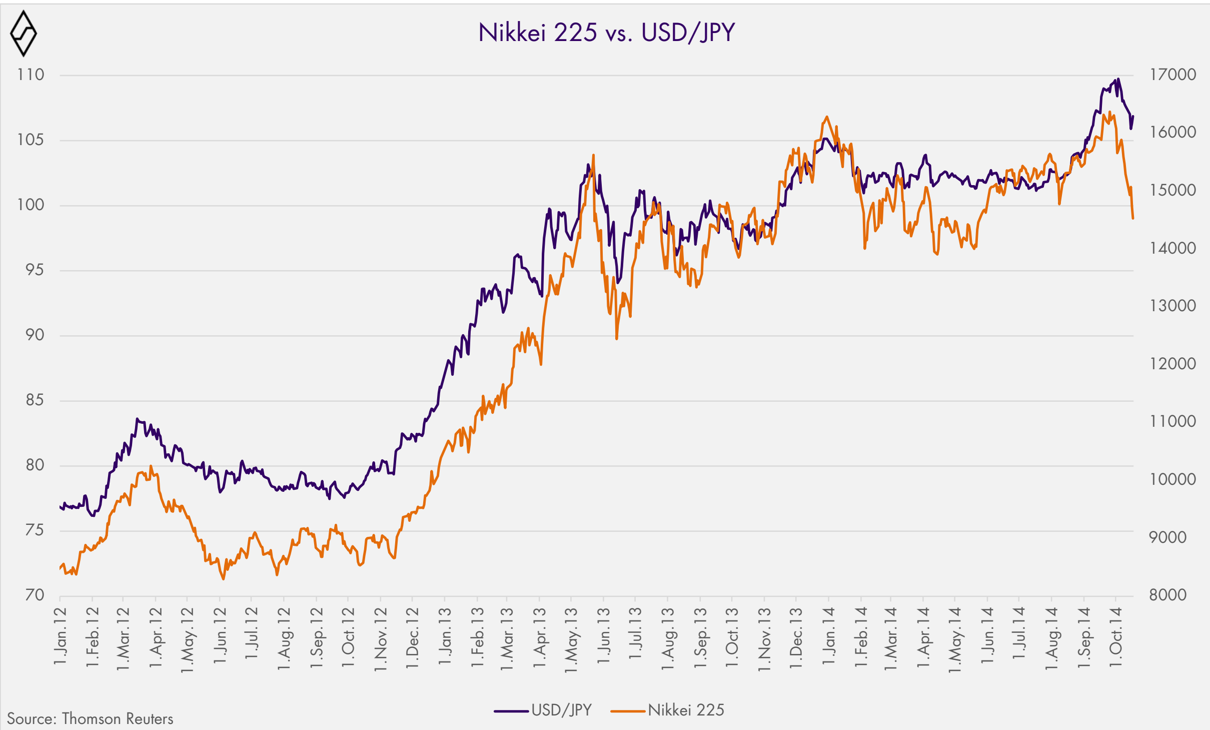
The benefits are quite clear of course (and widely discuss), they seem to be also quite well priced when they occur too. The costs on the other side seem to be less discussed for some reason.

After the Fukushima disaster in 2011, Japan has closed all 48 nuclear reactors and, as a result, the economy has a climbing energy bill. A weaker yen certainly put more oil in this fire. Recently the H1 current account data came out and, for first time since data began to be collected, there has been a deficit for H1 (or H2 for that matter). We calculated the rolling 6 months account balance and it dips negative in January, even after the USD/JPY has settled from its initial rally in 2012/2013.

Another reason for the lower Yen not being able to benefit that much from the Japanese economy is that exports actually account for 15% of the output (Germany: 51%, South Korea: 54%).



After a strong rally for the Nikkei 225, which just about broke its previous all-time high of 16,320.22, recording the new one 0.33% higher (at 16,374.14) and a strong rally for the USD/JPY pair, which reached 110.08 (No, technical don't matter at all...), both are now on a steep slide, having fallen 11.27% and 2.92% accordingly. We were looking to possibly open a USD/JPY short position if a better timing situation presents itself.



COMMODITIES

I need a meeting to bring me back to life

METALS

Fresh from court, the London Metal Exchange (LME) now has yet another hurdle, to convince US lawmakers its reforms over its warehousing policy are sufficient, but critics such as Senator Sherrod Brown may have other plans in mind: “Sources say Brown is pushing for the most drastic action yet... cap rent warehouse operators can charge on metal stored in their sheds, discouraging stockpiling by putting a limit on the money to be made from storage” [source Thompson Reuters]. It looks like there is still no light at the end of the tunnel for the LME.

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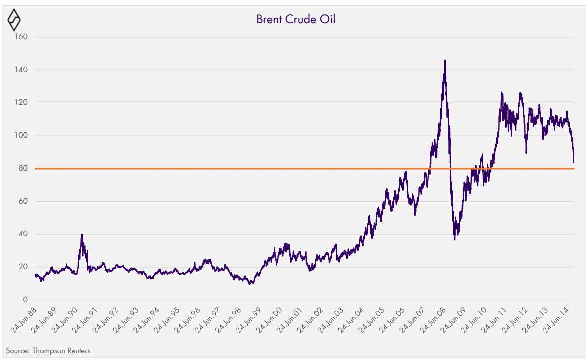
ENERGY

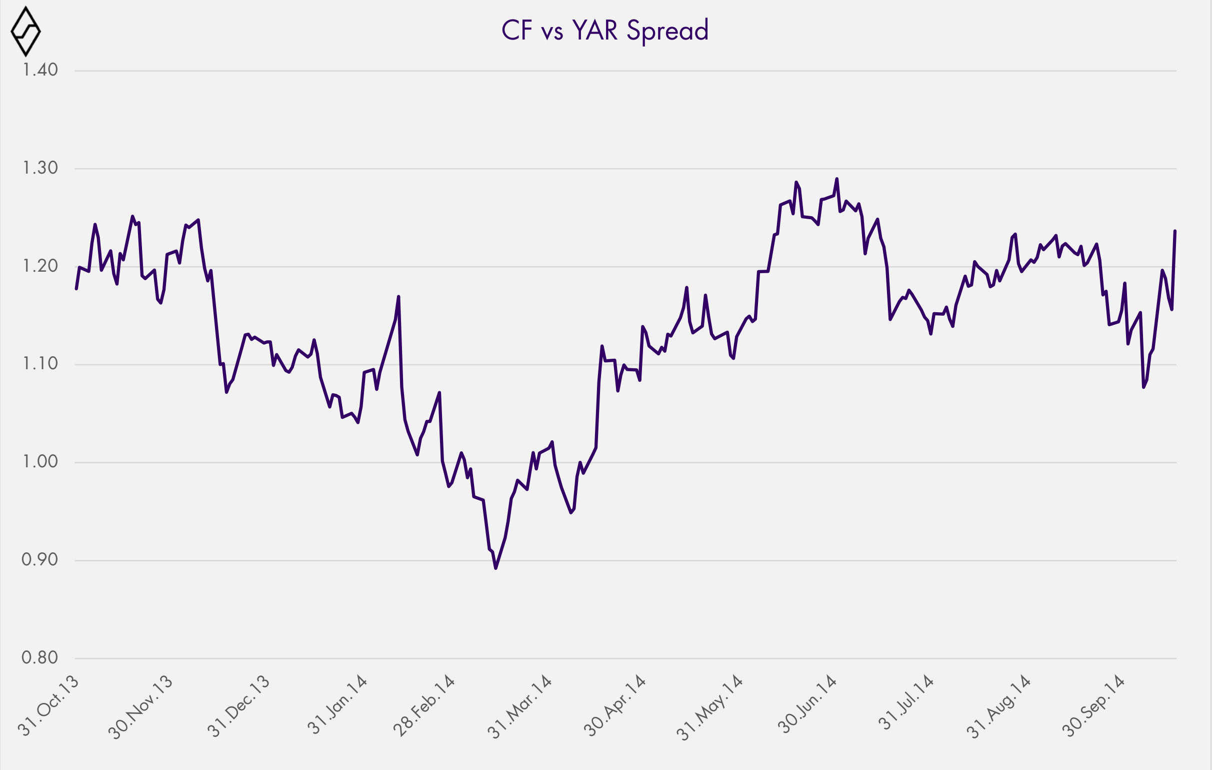
Along with natural gas, oil has been dominating the energy markets. Brent has fallen as much as 29% since June 10th ,hitting $82.72 a barrel this week, getting close to the key support level of $80 before jumping to just over $86 a barrel (the jump largely being attributed to the roll into the December contract).

The slump prompted Venezuela to call for an emergency meeting as it struggles due to sensitive margins, but the larger OPEC countries are either fairly comfortable or even raising production, thus collective action seems unlikely. There are 3 key reasons why Saudi Arabia is maintaining its production levels: to maintain market share (particularly in Asia where deep discounts are being given), it hurts rivals Russia and Iran and it slows the US Shale Boom. Furthermore, unless an agreement is made at the OPEC meeting (Nov 27th) it seems Saudi Arabia will continue to pursue this strategy, since it needs $83.70/barrel to balance its budget and the Central Bank has $734.7 billion in reserve assets [source IMF].



AGRICULTURE

The merger deal between CF Industrial Holdings Inc. (CF) and Yara International ASA (YAR) to expand into North America and create the world's largest fertiliser supplier has failed. The talks fell apart largely due to Norwegian politicians applying pressure to keep the headquarters in Oslo whilst maintaining the size of the state's shareholding. As a result CF fell 3.4% and Yara rose 3.2%.



Source: Bloomberg

PORTFOLIO

CORTEZ

				Price		Performance	
Security	Ticker	Entry date	Long/Short	Entry	Current	Weekly	Inception
Legg Mason Inc	LM	21.Jul.14	Long	50.4	48.4	-2.2%	3.7%
T.Rowe Price Group	TROW	21.Jul.14	Short	81.4	75.4		
iShares STOXX EU600 Utilities (DE)	EXH9	31.Jul.14	Long	32.4	29.4	-4.5%	1.7%
PowerShares DWA Developed Markets Momentum	PIZ	1.Aug.14	Short	25.2	22.7		
EURGBP	EURGBP	18.Aug.14	Short	0.8	0.8	-1.0%	0.9%
iPath S&P 500 VIX ST Futures ETN	VXX	22.Aug.14	Long	27.8	38.6	7.6%	38.7%
iShares US Home Construction ETF	ITB	8.Sep.14	Short	23.9	22.9	-5.0%	4.3%
iShares Russell 2000 ETF	IWM	8.Sep.14	Short	115.9	107.5	-2.6%	7.8%
iShares 20+ Year Treasury Bond ETF	TLT	23.Sep.14	Long	115.0	121.1	0.8%	5.3%

Source: Thomson Reuters as of 3.Oct.14 close prices

OUT

Long India ($EPI)

Performance: -7.90%

As mentioned last week, India's long term rebuilding has little to do with current market dynamics and indeed our long position in this ETF became a victim of the current sell-off. The starting position in the ETF was well implemented with very good timing, which immediately brought us 8-9% in this position. However, the consequent addition was the complete opposite — wrong timing, wrong size.

Long $MXIM vs. Short $LLTC

Performance: -9.92%

Nothing much to say about that spread trade, which broke our stop loss and confirmed that it is not working. Looking back at it, the thesis was probably not strong enough and trading started negatively almost immediately as we entered the positions slightly before their earnings, which turned out two times more negative for our long choice.

Long Lazard ($LAZ) vs. Short Regional Banks ($KRE)

Performance: -6.81%

Similar to the previous spread, this idea was just not implemented well enough. Horrible timing combined with incorrect hedging made this position doomed. On top of all, it looks like the trend itself has shifted, thus we closed the position at a relatively small loss.

FOREX

Pair	Open	Close	Weekly %	Trend w/w	Monthly %	YTD
USD/CAD	1.1200	1.1276	0.68%	1	4.01%	6.18%
USD/CHF	0.9573	0.9460	-1.18%	2	5.70%	5.96%
EUR/JPY	135.69	136.40	0.52%	1	-1.65%	2.07%
AUD/NZD	1.1112	1.1045	-0.60%	2	0.78%	1.75%
USD/JPY	107.49	106.89	-0.56%	4	5.09%	1.51%
USD/CNY	6.13	6.1215	-0.16%	2	-1.71%	1.12%
GBP/AUD	1.8510	1.8404	-0.57%	1	2.34%	-0.54%
GBP/JPY	172.74	172.03	-0.41%	4	0.96%	-1.27%
AUD/USD	0.8684	0.8744	0.69%	2	-6.04%	-1.90%
EUR/CHF	1.2086	1.2076	-0.08%	2	-1.01%	-1.92%
GBP/USD	1.6067	1.6093	0.16%	2	-3.91%	-2.80%
NZD/USD	0.7814	0.7917	1.32%	2	-6.65%	-3.52%
EUR/GBP	0.7856	0.7929	0.93%	3	-2.52%	-4.42%
EUR/AUD	1.4539	1.4590	0.35%	2	-0.14%	-5.76%
EUR/USD	1.2624	1.2760	1.08%	2	-6.38%	-7.17%

Source: Thomson Reuters

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