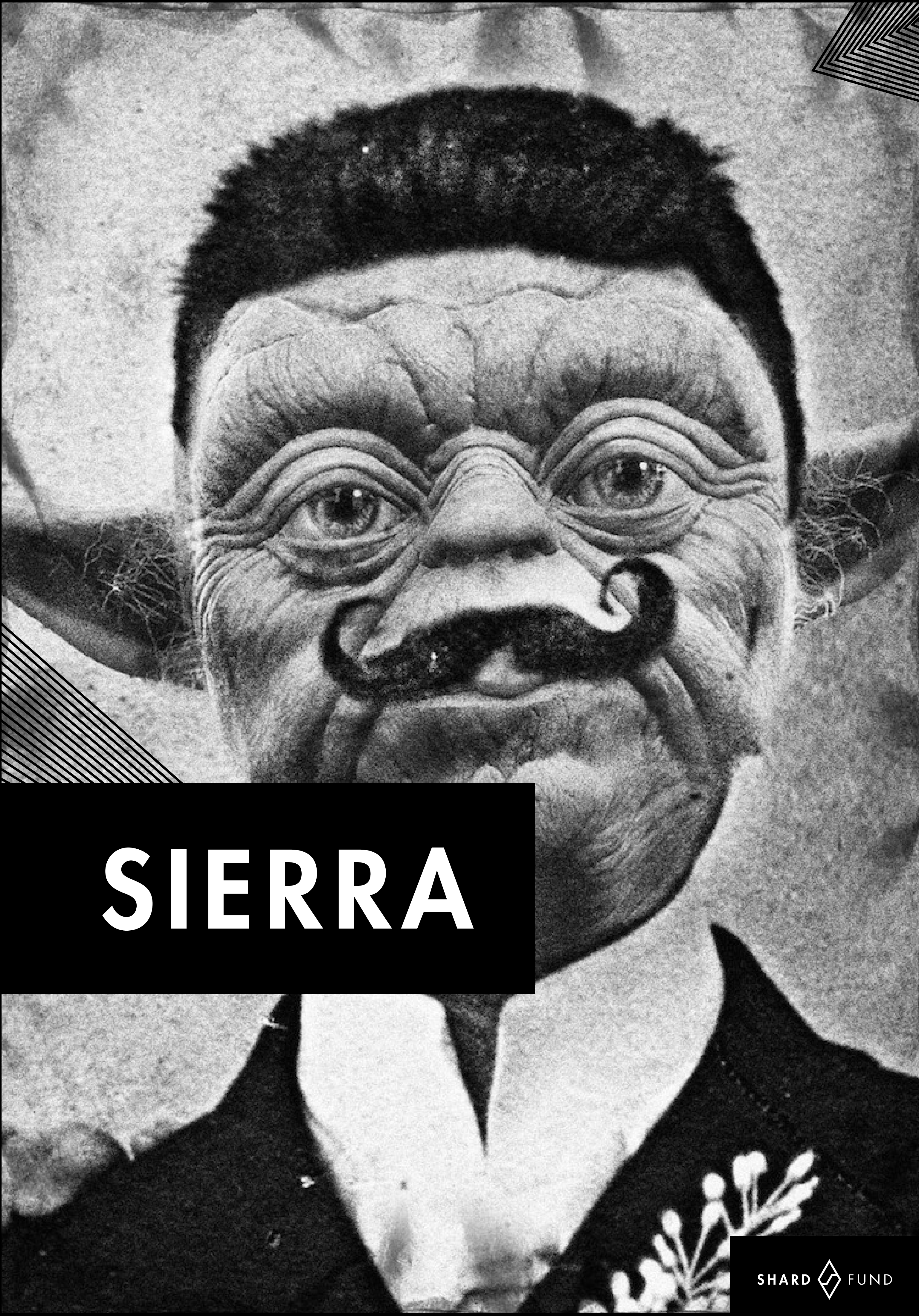

SIERRA

SHARD FUND

A JOURNEY ACROSS FINANCIAL MARKETS

October 18th - October 24th, 2014 | Issue 31

TEAM:

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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

Last week markets (both US and global) took a breather and immediately you could find comments like 'What correction?' etc. As we noted in Issue 25, since the start of the 20th century the average duration of the expansion part of a cycle has been 45 months and right now we are finishing the 65th month of the current expansion. In other words, how much more could this upward move continue, given that there is no single country out there that has been showing stellar growth?

EUROPE

An important report from this week was the results of the ECB's bank asset quality review and the EBA's stress tests. The results came out, and Italian lenders were the ones on the top of the 'bad' list. Other countries whose banks' capital ratios are problematic are Cyprus, Greece, Portugal and Germany. "Overall, the comprehensive assessment identified a capital shortfall of €24.6 billion across 25 participating banks after comparing these projected solvency ratios against the thresholds defined for the exercise." It does not seem like Mr. Draghi has anything to brag about.

ASIA & OCEANIA

All over the news there are exclamations regarding China's slower growth trajectory. Yes countries do not grow exponentially forever and yes there are cycles. More importantly, China's slowdown in particular may prove to be a good thing rather than a bad thing.

COMMODITIES

Copper is usually seen as a bellwether for the global economy. With that in mind, it might be a good idea to think about why copper prices are down almost 7% year to date. While a plethora of supply is expected to become available due to mining expansions, there are no catalysts for substantial increases in demand any time soon. Coffee, on the other hand, is in the completely opposite state, where lower production in 2014/2015 is likely to result in global deficit and consequently, even higher prices.

Weekly Change	
Indices	
Nikkei 225 (Japan)	5.22%
FTSE MIB (Italy)	4.25%
S&P 500 (USA)	4.13%
IBEX (Spain)	3.84%
BSE (India)	2.84%
S&P/ASX (Australia)	2.67%
CAC (France)	2.37%
DAX (Germany)	1.55%
FTSE 100 (UK)	1.24%
Hang Seng	1.21%
Shanghai (China)	-1.66%
Currencies	
AUD/NZD	1.39%
USD/JPY	1.18%
GBP/JPY	1.12%
USD/CHF	0.62%
AUD/USD	0.55%
EUR/JPY	0.45%
USD/CNY	-0.06%
GBP/USD	-0.06%
EUR/CHF	-0.12%
USD/CAD	-0.31%
GBP/AUD	-0.65%
EUR/GBP	-0.67%
EUR/USD	-0.71%
NZD/USD	-0.78%
EUR/AUD	-1.30%
Commodities	
Copper	1.13%
Brent Crude Oil	0.02%
Silver	-0.34%
Gold	-0.62%
WTI Crude Oil	-2.01%
Rates	
Germany 10Y	3.12%
US 10Y	3.05%
US High Yield	1.11%
Japan 10Y	-1.48%

Source: Thomson Reuters

CALENDAR

Day	Country	Indicator	Actual	Forecast	Previous
USA					
Past week					
Tuesday	United States	Existing Home Sales	5.17M	5.10M	5.05M
Wednesday	United States	Core CPI (MoM)	0.1%	0.1%	
Wednesday	United States	Core CPI (YoY)	1.7%	1.8%	1.7%
Friday	United States	New Home Sales (September)	467K	470K	504K
Next week					
Monday	United States	Pending Home Sales (MoM)		0.5%	-1.0%
Tuesday	United States	CB Consumer Confidence		87.0	86.0
Tuesday	United States	Core Durable Goods Orders (MoM)		0.5%	0.4%
Thursday	United States	GDP (QoQ) (Q3)		3.0%	4.6%
Friday	United States	Chicago PMI		60.0	60.5
EU					
Past week					
Thursday	Germany	Manufacturing PMI	51.8	48.5	48.8
Thursday	EU	Manufacturing PMI	50.7	49.9	50.3
Thursday	EU	Services PMI	52.4	52	52.4
Thursday	United Kingdom	Retail Sales (MoM)	-0.3%	-0.1%	0.4%
Friday	Germany	German Consumer Climate	8.5	8	8.3
Friday	United Kingdom	GDP (YoY) (Q3)	3.0%	3.0%	3.2%
Friday	United Kingdom	GDP (QoQ) (Q3)	0.7%	0.7%	0.9%
Next week					
Monday	Germany	German Ifo Business Climate Index		104.3	104.7
Thursday	Germany	German Unemployment Change		5K	13K
Friday	EU	CPI (YoY)		0.4%	0.3%
Friday	EU	Unemployment Rate		11.5%	11.5%
Friday	Germany	German Retail Sales (MoM)		-1.0%	2.5%
Asia and Oceania					
Past week					
Monday	China	GDP (QoQ) (Q3)	1.9%	1.8%	2.0%
Monday	China	GDP (YoY) (Q3)	7.3%	7.2%	7.5%
Monday	China	Industrial Production (YoY)	8.0%	7.5%	6.9%
Tuesday	Japan	Exports (YoY)	6.9%	6.8%	-1.3%
Tuesday	Australia	CPI (QoQ)	0.5%	0.4%	0.5%
Wednesday	China	HSBC Manufacturing PMI	50.4		50.2
Next week					
Tuesday	Japan	Industrial Production (MoM)		2.2%	-1.9%
Wednesday	Australia	Interest Rate Decision		3.5%	3.5%
Thursday	Japan	Household Spending (YoY)		-4.3%	4.7%
Thursday	Japan	National Core CPI (YoY)		3.0%	3.1%
Sunday	China	Non-Manufacturing PMI			54.0
Sunday	China	HSBC Manufacturing PMI			50.4

Source: Thomson Reuters, ShardFund

USA

Documentaries

Sectors	5D	1M	3M	YTD
Healthcare	6.60%	-0.09%	5.08%	17.62%
Utilities	3.56%	6.15%	4.09%	17.28%
Technology	4.25%	-2.46%	-1.31%	9.82%
Consumer Staples	2.87%	0.83%	2.09%	6.82%
Financials	3.49%	-1.53%	0.35%	5.67%
Materials	3.56%	-4.74%	-3.48%	4.46%
Industrials	4.33%	0.09%	-0.41%	2.77%
Consumer Discretionary	3.77%	-2.01%	-1.81%	-0.72%
Energy	3.51%	-7.18%	-14.89%	-3.29%
Indices				
Nasdaq	5.28%	-1.57%	0.26%	7.35%
S&P 500	4.12%	-1.69%	-1.18%	6.29%
Dow Jones Ind. Avg.	2.59%	-2.35%	-1.63%	1.38%
Russell 2000	3.37%	-0.84%	-3.24%	-3.85%

Source: Sectorspdr.com

I love watching documentaries about financial markets. There is something about the financial and historical aspect that makes them really appealing to me. I remember watching 'Inside job' a couple of years ago, and while some of the financial jargon was not clear to me, the most puzzling part was actually understanding the psychology behind the crash. How could people (allegedly sophisticated) allow that to happen?! Now that a couple of years have passed and my team and I have gained some experience, we can actually see how things can get out of control, this becomes very clear the further we are in the up move of a cycle. Three weeks in a row the US market was in a correction, with several quite steep daily declines (roughly 2%) of the S&P 500, and there was limited insightful comments about what was happening. Everyone was scared and preferred to stay anonymous. Last week, markets (both US and global) took a breather and immediately you could find comments like 'What correction?'. I used to observe very similar behaviour whilst playing poker years ago, when winning players would just forget about their rules and risk management once the cards started going in their favour.

...things need to get worse before they can get any better — that's how cycles work.

The fundamental theme here is not solely related to the past few weeks. In fact, the market could make new all-time highs by the end of the year but the clock is ticking and very few people recognise that. In issue 25 we talked about economic cycles but I think it is important to mention it once again. Since the beginning of the 20th century the average duration of the expansion part of a cycle has been 45 months and right now we are finishing the 65th month of the current expansion. In the past couple of centuries those numbers have gone far above the average due to the put option provided by Mr. Greenspan and the Fed as a whole (mentioned last week), but the global economy was not as broken as it is today. In other words, how much more could this upward move continue now that both Europe and China are slowing and hopes of US revival could disappear in a couple of days when Q3 GDP is released? Just so we are clear, currently we are net short and we have lost money in the past week but have made money during the three weeks prior to that. While it would be much better for us if the correction continues, we would not change our fundamental long term view, even if the market makes new highs. It is too late to actually start making any changes and expect any meaningful results, as things need to get worse before they can get any better — that's how cycles work.

EUROPE

Banking woes

Indices	5D	1M	3M	YTD
STOXX Europe 600 Health Care	4.34%	-3.43%	2.82%	15.53%
STOXX Europe 600 Real Estate Cap	4.51%	-0.36%	-1.64%	13.65%
STOXX Europe 600 Food & Beverage	1.81%	-3.74%	-3.17%	3.84%
STOXX Europe 600 Travel & Leisure	3.56%	-2.33%	-2.52%	1.61%
STOXX Europe 600 Insurance	2.94%	-4.90%	-1.29%	1.23%
STOXX Europe 600 Banks	4.70%	-3.79%	-1.12%	-0.23%
STOXX Europe 600	2.66%	-4.99%	-4.98%	-0.33%
STOXX Europe 600 Personal & Household Goods	1.02%	-4.38%	-5.59%	-0.57%
STOXX Europe 600 Financial Services	3.78%	-4.03%	-5.79%	-1.32%
STOXX Europe 600 Telecommunications	4.92%	-3.96%	-2.96%	-2.47%
STOXX Europe 600 Construction & Materials	3.35%	-3.74%	-9.69%	-2.54%
STOXX Europe 600 Chemicals	1.14%	-5.88%	-5.56%	-4.04%
STOXX Europe 600 Media	2.53%	-3.97%	-3.22%	-4.20%
STOXX Europe 600 Basic Resources	-0.84%	-7.89%	-14.51%	-4.23%
STOXX Europe 600 Technology	0.19%	-7.88%	-5.86%	-5.66%
STOXX Europe 600 Oil & Gas	1.02%	-10.45%	-14.72%	-7.01%
STOXX Europe 600 Automobiles & Parts	0.64%	-4.75%	-12.96%	-8.08%
STOXX Europe 600 Industrial Goods & Services	2.55%	-5.30%	-7.15%	-8.22%
STOXX Europe 600 Retail	-5.94%	-13.78%	-17.27%	-20.70%

Source: Stoxx; quoted in EUR

There weren't many major price moves in Europe this week as investors have already factored a lot of bad news. Equities were still trading fairly low, although there was a minor rebound as measured by the wider Euro Stoxx 600. Eurozone companies will need earnings to be higher than expected in the near future, in order for stocks to gain some, if even just mild momentum. The overall index is still flat year-to-date, with healthcare and real estate stocks leading with relatively good performance.

What was more important this week were the results of the ECB's bank asset quality review and the EBA's stress tests. First, this is an important step towards the Eurozone's banking union. This means that the interconnection between sovereign banks and the one supranational bank is becoming tighter and the ECB can now be tougher on banks and be better at assessing their quality and any potential systemic risks that they might pose for the Eurozone.

Cyprus, Greece, Portugal and Italy are the four countries with highest shortfall in % of risk-weighted assets

The results came out, and Italian lenders were the ones on the top of the 'bad' list. Even though Italy's biggest bank – UniCredit is healthy and has 8.7 billion euros of excess capital (Bloomberg), a few other banks have reported capital shortfalls which might diminish their ability to absorb potential losses. "Overall, the comprehensive assessment identified a capital shortfall of €24.6 billion across 25 participating banks after comparing these projected solvency ratios against the thresholds defined for the exercise" (ECB). The comprehensive assessment by country shows that Cyprus, Greece, Portugal and Italy are the four countries with highest shortfall in % of risk-weighted assets (**full report**). It is also important to point out that the Capital Requirements Regulation lists instruments such as intangible assets and goodwill that will have to be removed from calculations of core capital in the upcoming years. The fully loaded ratio, once implemented, will show exactly how stable banks are. It is interesting to see how the bond markets will react to the report as soon as the markets open on Monday, even though last week periphery bonds already sold out quite a bit, in part pricing the potential outcome of the stress tests. However, more banks than expected the banks failed the tests, so there might be some interesting moves in European markets next week.

ASIA & OCEANIA

China's slowdown

Indices	5D	1M	3M	YTD
STOXX Asia/Pacific 600 Health Care	5.56%	0.86%	5.39%	11.54%
STOXX Asia/Pacific 600 Technology	4.53%	-4.45%	-1.55%	10.19%
STOXX Asia/Pacific 600 Food & Beverage	4.35%	0.85%	2.73%	10.06%
STOXX Asia/Pacific 600 Chemicals	4.28%	-4.33%	0.96%	6.24%
STOXX Asia/Pacific 600 Construction & Materials	6.19%	-3.31%	-3.93%	6.05%
STOXX Asia/Pacific 600 Industrial Goods & Services	4.66%	-5.27%	-0.65%	3.65%
STOXX Asia/Pacific 600 Personal & Household Goods	4.90%	-1.27%	-2.62%	3.27%
STOXX Asia/Pacific 600 Utilities	3.21%	-1.43%	1.17%	2.91%
STOXX Asia/Pacific 600 Insurance	4.21%	-1.90%	1.65%	2.54%
STOXX Asia/Pacific 600 Real Estate	3.01%	-0.66%	-1.59%	2.19%
STOXX Asia/Pacific 600 Telecommunications	5.43%	-2.16%	-0.35%	0.93%
STOXX Asia/Pacific 600 Index	4.31%	-2.76%	-1.88%	0.75%
STOXX Asia/Pacific 600 Oil & Gas	2.00%	-6.83%	-9.90%	-0.17%
STOXX Asia/Pacific 600 Banks	4.20%	-0.68%	-2.12%	-1.60%
STOXX Asia/Pacific 600 Media	5.29%	-4.97%	-4.93%	-4.12%
STOXX Asia/Pacific 600 Automobile & Parts	5.39%	-5.59%	-1.17%	-4.36%
STOXX Asia/Pacific 600 Retail	3.04%	-0.78%	-3.08%	-4.48%
STOXX Asia/Pacific 600 Financial Services	3.28%	-5.55%	-3.25%	-8.22%
STOXX Asia/Pacific 600 Basic Resources	2.81%	-4.83%	-12.74%	-10.67%

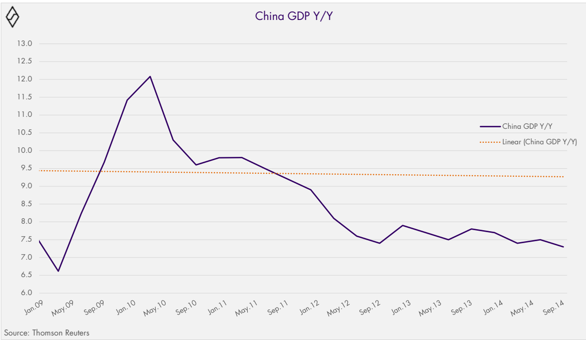
Source: Stoxx; quoted in EUR

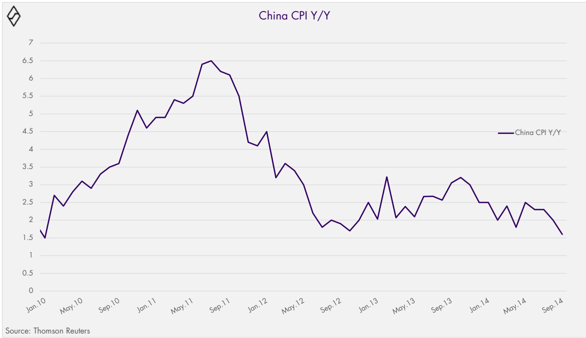
CHINA

All over the news there are exclamations regarding China's slower growth trajectory. Although it may be bad for the stock market in the short term, it may not be so bad for the economy.

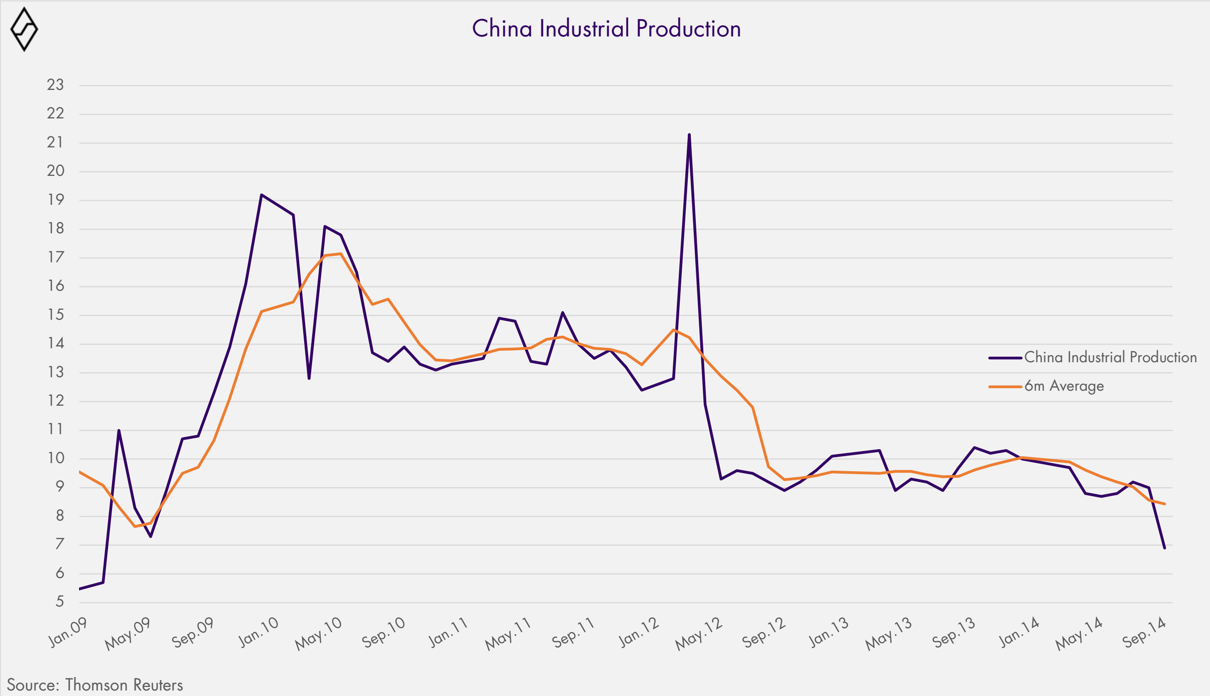
You shouldn't listen only to short-sighted masochists, instead try and think about the issue. Yes countries do not grow exponentially

Yes countries do not grow exponentially forever and yes there are cycles.





forever and yes there are cycles. More importantly, China's slowdown in particular may prove to be a good thing rather than a bad thing. China has a property bubble and an overextended and unregulated debt burden. So it better slow down, or the problems would grow bigger (wink wink US). After all, the problem is not that China is not growing strong enough in general, the deep problems stem from structure, politics, demographics etc. and the slowdown of other countries around the world.



CHINA

Last week was relatively mellow in terms of economic data. **Flash PMI** (85-90% of official PMI survey) came slightly higher than expected and the **all industries activity**, which publishes the regional performance was more or less unchanged, with only Tohoku "recovering moderately as a trend". Finally, the **trade balance** was released posting yet another deficit.

The more interesting take from this week in our view is the **FT's interview** with Prime Minister Shinzo Abe, where he seems to have hinted that the consumption tax hike could possibly be delayed. In the interview he notes that the tax increase from 8% to 10% was in order to help secure pensions as well as health benefits for the coming generation, but "On the other hand, since we have an opportunity to end deflation, we should not lose this opportunity."

To understand the seriousness of such a hint, one should know the other reason behind the tax hike: that primarily, Japanese debt needs to be tamed. This is of course supported by the BoJ, large businesses and the IMF. If untamed and interest rates shoot up, then Japan really is between a rock and a hard place. To read up more on Japanese debt, check this **article**.

What Mr. Abe notes is that: "By increasing the consumption tax rate if the economy derails, and if it decelerates, there will be no increase in tax revenues so it would render the whole exercise meaningless."

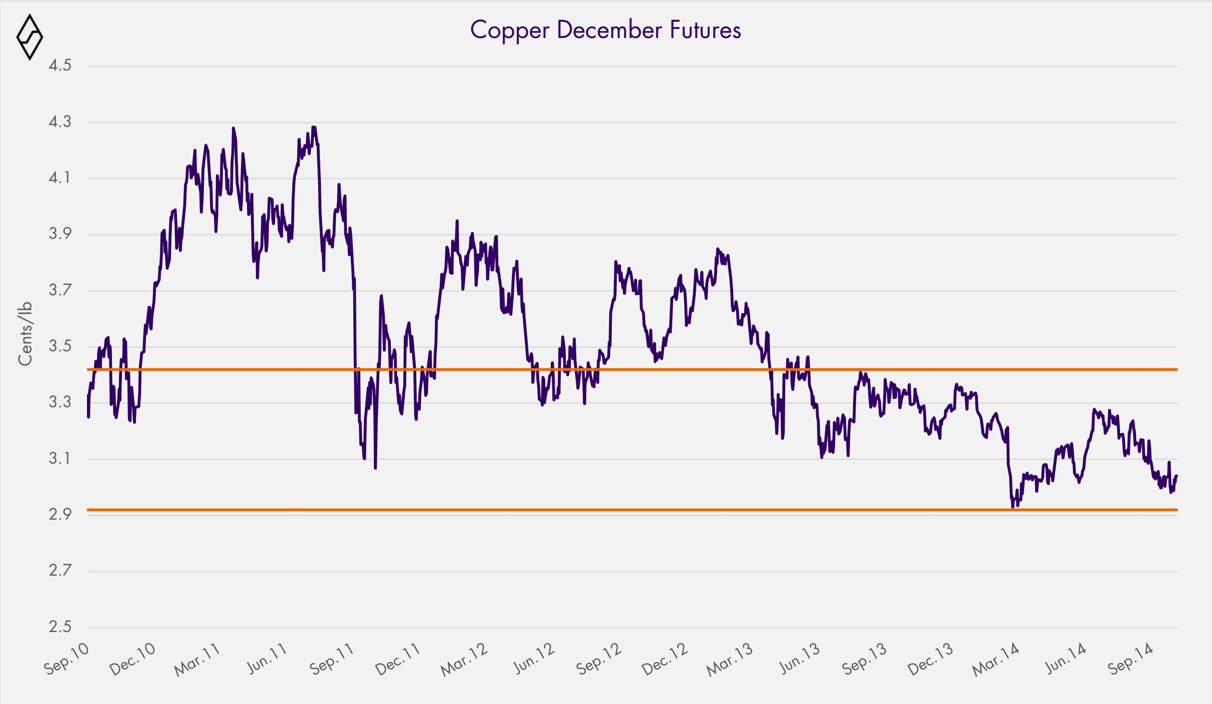
... something to think about.

COMMODITIES

I need a meeting to bring me back to life

METALS

Copper is usually seen as a bellwether for the global economy. Yet despite the global economy accelerating, (albeit slower than previously), copper prices are down almost 7% year to date (YTD). European economic weakness and less than stellar growth in China have seen the red metal range between $2.92 and $3.35 on active month COMEX futures recently..
Whilst short term fundamentals don't seem too bad, projecting ahead reveals a different story. A plethora of supply is expected to come online due to mining expansions; with market consensus expecting copper supply to increase more than 6% in 2015, almost 5% in 2016 before levelling off in 2017 [source: Deutsche Bank]. Thus it would seem only demand can push prices up. Given that China remains the biggest consumer of copper, and the recent slump in the Chinese housing market, this also seems somewhat unlikely. In short, copper appears to be in for a difficult time.



Source: Thompson Reuters

ENERGY

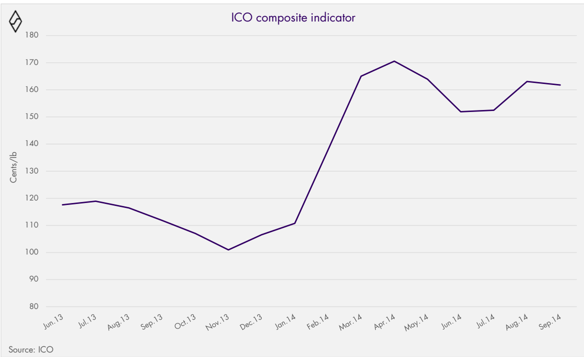
Shipments of Bakken crude oil from North Dakota to California by barge have overtaken those by train for the first time, demonstrating refiners are using any means necessary to tap into the shale boom. From January to June, California received 940,500 barrels from barges loaded in the Pacific Northwest, the highest rate ever [source: Thompson Reuters]. Thus, despite the environmentalists concerns, refineries show no sign of slowing in their use of Shale.

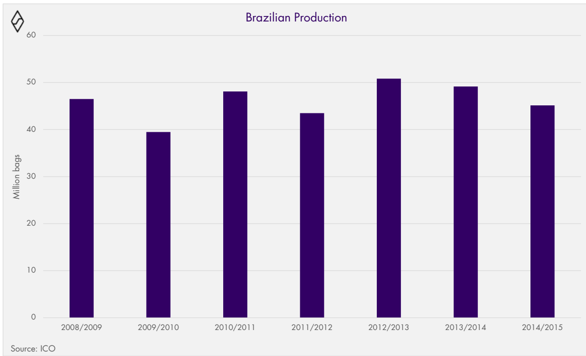
AGRICULTURE

Coffee prices were volatile in September mostly reacting to weather news from Brazil, with reports of dryness exacerbating concerns over next year's crop year.

Conab estimate total production for all exporting countries for the 2013/2014 crop year to be 145.2 million bags, whilst world consumption is estimated at 145 million bags leaving the market relatively balanced, but lower production expected in 2014/2015 is likely to result in a global deficit next year. The most significant issue is production in Brazil, which is forecast to be at the lowest level since 2011/2012.

> **lower production expected in 2014/2015 is likely to result in a global deficit next year.**





PORTFOLIO

CORTEZ

Security	Ticker	Entry date	Long/Short	Entry	Current	Weekly	Inception
Legg Mason Inc	LM	21.Jul.14	Long	50.4	50.6	1.7%	5.5%
T.Rowe Price Group	TROW	21.Jul.14	Short	81.4	77.3		
iShares STOXX EU600 Utilities (DE)	EXH9	31.Jul.14	Long	32.4	31.0	-0.8%	1.0%
PowerShares DWA Developed Markets Momentum	PIZ	1.Aug.14	Short	25.2	23.8		
EURGBP	EURGBP	18.Aug.14	Short	0.8	0.8	0.7%	1.6%
iPath S&P 500 VIX ST Futures ETN	VXX	22.Aug.14	Long	27.8	33.2	-14.0%	19.2%
iShares US Home Construction ETF	ITB	8.Sep.14	Short	23.9	24.1	-5.4%	-1.0%
iShares Russell 2000 ETF	IWM	8.Sep.14	Short	115.9	111.1	-3.3%	4.3%
iShares 20+ Year Treasury Bond ETF	TLT	23.Sep.14	Long	115.0	119.7	-1.1%	4.1%

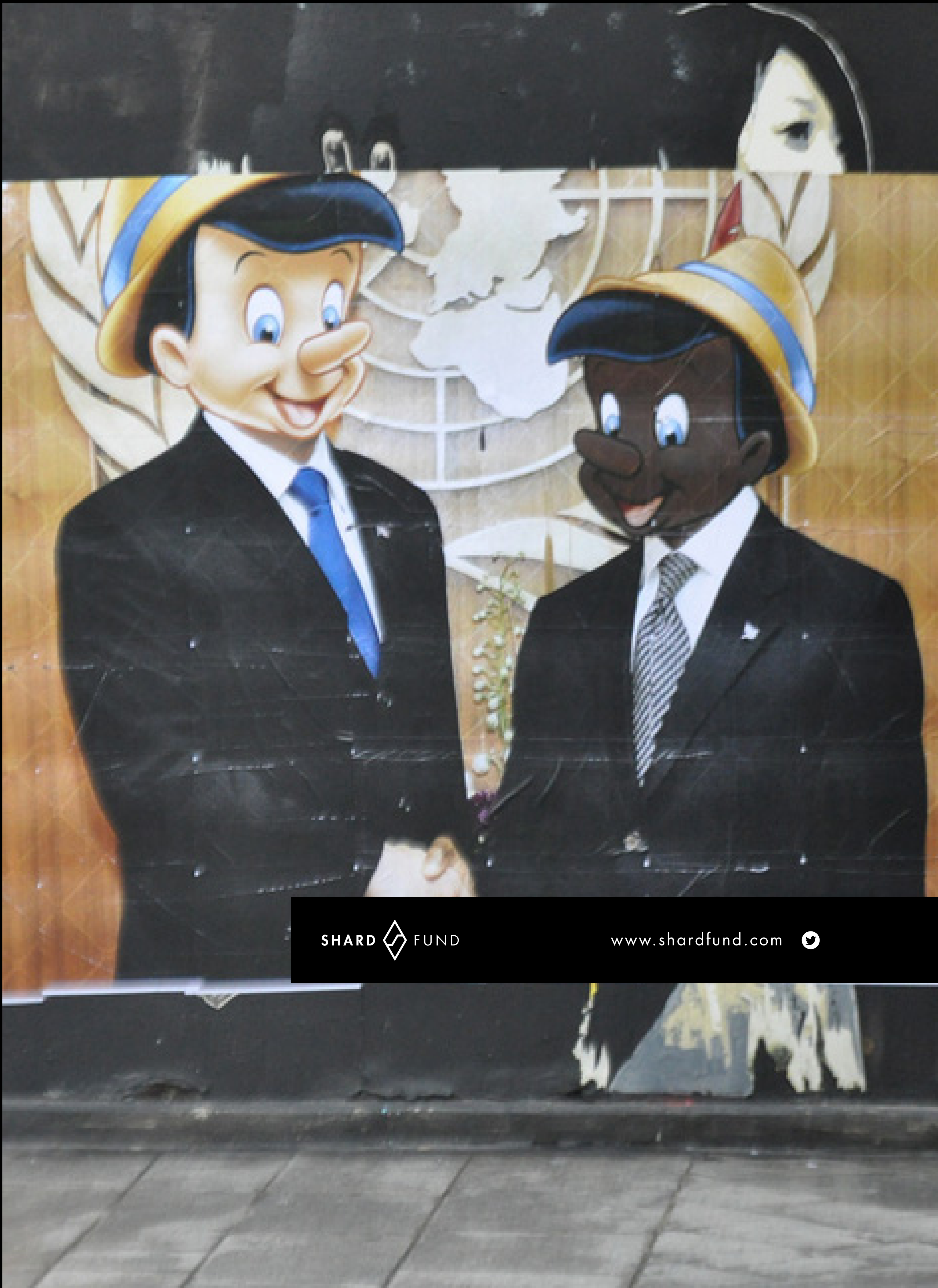
Source: Thomson Reuters as of 3.Oct.14 close prices

FOREX

Pair	Open	Close	Weekly %	Trend w/w	Monthly %	YTD
USD/CHF	0.9460	0.9519	0.62%	1	-0.35%	6.62%
USD/CAD	1.1276	1.1241	-0.31%	1	0.38%	5.85%
AUD/NZD	1.1045	1.1198	1.39%	1	-0.03%	3.16%
USD/JPY	106.89	108.15	1.18%	1	-1.38%	2.71%
EUR/JPY	136.40	137.01	0.45%	2	-1.09%	2.52%
USD/CNY	6.1215	6.1180	-0.06%	3	-0.33%	1.06%
GBP/JPY	172.03	173.95	1.12%	1	-2.16%	-0.17%
GBP/AUD	1.8404	1.8284	-0.65%	2	-1.29%	-1.18%
AUD/USD	0.8744	0.8792	0.55%	3	0.53%	-1.36%
EUR/CHF	1.2076	1.2061	-0.12%	3	-0.05%	-2.04%
GBP/USD	1.6093	1.6083	-0.06%	1	-0.81%	-2.86%
NZD/USD	0.7917	0.7855	-0.78%	1	0.60%	-4.28%
EUR/GBP	0.7929	0.7876	-0.67%	1	1.09%	-5.06%
EUR/AUD	1.4590	1.4401	-1.30%	1	-0.32%	-6.98%
EUR/USD	1.2760	1.2669	-0.71%	1	0.29%	-7.83%

Source: Thomson Reuters

DISCLAIMER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