SIERRA

SHARD FUND

A JOURNEY ACROSS FINANCIAL MARKETS

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SPECIAL ANNOUNCEMENT

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 (or this link: **http://bit.ly/1CFzhta)**, 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**

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

HIGHLIGHTS

USA

At 3.5% 3Q GDP sounds solid but that notion quickly disappears as we dissect the number. The growth rate of personal consumption expenditure actually slowed from 2.5% in Q2 to 1.8% in Q3 (QoQ SAAR). The same thing happened to gross private domestic investments — 1% growth (QoQ SAAR), after a 19% surge last quarter.

EUROPE

Although the decline on German inflation did not affect the overall European CPI for October, it is just another clear sign that Europe is slowing. Other negative signs for Germany come from retail sales and business climate. Meanwhile, structural problems in France continue to push the economy further down, despite what the record low French bond yields are suggesting.

ASIA & OCEANIA

Whilst the US was busy removing its remaining asset purchases, the BoJ increased its quantitative and qualitative monetary easing to Y80tn. As a result, the Yen plunged against the dollar on Friday by 2.8%. In China, the Shanghai Composite index closed at a one year high on Friday, boosted by positive earnings results released by domestic banks.

COMMODITIES

Following the export ban by Indonesia, nickel prices spiked and subsequently fell due to stockpiles building up. Taking into account that China is expected to use up its nickel inventories and exports from the Philippines are likely to slow, this looks like a bullish set-up for nickel prices.

Weekly Change

Indices	Weekly change	Current
Nikkei 225 (Japan)	2.84%	16,880.38
S&P 500 (USA)	0.69%	2,031.92
FTSE 100 (UK)	0.32%	6,567.24
S&P/ASX (Australia)	0.24%	5,540.10
BSE (India)	0.01%	27,868.63
Shanghai (China)	-0.04%	2,419.15
DAX (Germany)	-0.38%	9,291.83
CAC (France)	-1.02%	4,189.89
Hang Seng (Hong Kong)	-1.87%	23,550.24
IBEX (Spain)	-3.08%	10,126.30
FTSE MIB (Italy)	-3.48%	19,095.32
Currencies	**Weekly change**	**Current**
USD/JPY	2.02%	114.59
EUR/JPY	1.47%	142.75
EUR/AUD	1.32%	1.4425
GBP/JPY	1.24%	181.9
GBP/AUD	1.08%	1.8378
USD/CAD	0.55%	1.1328
USD/CHF	0.35%	0.966
EUR/GBP	0.26%	0.7849
USD/CNY	0.17%	6.1228
EUR/CHF	-0.17%	1.2037
NZD/USD	-0.50%	0.7754
EUR/USD	-0.56%	1.2455
GBP/USD	-0.77%	1.5873
AUD/NZD	-1.32%	1.114
AUD/USD	-1.88%	0.8633
Commodities	**Weekly change**	**Current**
Gold	0.44%	1177.4
Copper	-0.62%	3.031
Silver	-2.26%	15.762
WTI Crude Oil	-2.55%	78.57
Brent Crude Oil	-3.23%	83.12
Rates	**Weekly change[1]**	**Current**
Spain 10Y	6 bps	2.161%
Japan 10Y	2 bps	0.480%
Italy 10Y	2 bps	2.376%
France 10Y	0 bps	1.188%
Germany 10Y	-2 bps	0.819%
US 10Y	-3 bps	2.301%
UK 10Y	-4 bps	2.210%

Source: Thomson Reuters Note: [1] in basis points (bps)

CALENDAR

USA					
Day	Country	Indicator	Actual	Forecast	Previous
Past week (1-8 Nov. 2014)					
Monday	United States	ISM Manufacturing PMI (MoM)	59	56.5	56.6
Tuesday		Trade Balance	-43.0	-40.0	-40.0
Wednesday		ISM Non-Manufacturing PMI	57.1	58.2	58.6
Friday		Nonfarm Payrolls	214K	231K	248K
		Unemployment Rate	5.8%	5.9%	5.9%
Next week (8-14 Nov. 2014)					
Friday	United States	Retail Sales (MoM)		0.2%	-0.2%
		Michigan Consumer Sentiment		87.5	86.9
EU					
Past week (1-7 Nov. 2014)					
Monday	Germany	Manufacturing PMI	51.4	51.8	51.8
	France	Manufacturing PMI	48.5	47.3	47.3
	United Kingdom	Manufacturing PMI	53.2	51.2	51.6
	EU	Manufacturing PMI	50.6	50.7	50.7
Tuesday	United Kingdom	Construction PMI	61.4	63.5	64.2
	United Kingdom	Services PMI	56.2	58.5	58.7
Thursday	United Kingdom	Manufacturing Production (MoM)	0.4%	0.3%	0.1%
	Germany	Germany Factory Orders (MoM)	0.8%	2.3%	-5.7%
Next week (8-14 Nov. 2014)					
Monday	Italy	Industrial Production (MoM)		0.20%	0.30%
	EU	Sentix Investor Confidence		-6.9	-13.7
Wednesday	United Kingdom	Unemployment rate		5.90%	6%
	EU	Industrial Production (MoM)		0.60%	-1.80%
Thursday	Germany	Final CPI (MoM)		-0.3%	-0.3%
Friday	France	Prelim GDP (QoQ)		0.1%	0.0%
	Germany	Prelim GDP (QoQ)		0.1%	-0.2%
	EU	Final CPI (YoY)		0.4%	0.4%
		Flash GDP (QoQ)		0.7%	0.7%
Asia and Oceania					
Past week (1-7 Nov. 2014)					
Monday	Australia	Retail Sales (MoM)	1.2%	0.4%	0.1%
Tuesday	New Zealand	Employment Change (QoQ)	0.8%	0.7%	0.4%
Friday	China	Exports (YoY)	11.6%	10.6%	15.3%
		Imports (YoY)	4.6%	5.5%	7.0%
		Trade Balance	45.41B	42.00B	31.00B
Next week (8-14 Nov. 2014)					
Monday	Australia	Home Loans (MoM)		-0.3%	-0.9%
	China	CPI (YoY)		1.6%	1.6%
	China	PPI (YoY)		-1.9%	-1.8%
Tuesday	Japan	Current Account		0.3T	0.13T%
		Consumer Confidence		40.6	0.399
Thursday	China	Industrial Production (YoY)		8.0%	8.0%
		Retail Sales (YoY)		11.6%	11.6%

Source: Thomson Reuters, ShardFund

USA

PMI Primer

Sectors	5D	1M	3M	YTD
Utilities	1.72%	8.87%	13.83%	21.81%
Healthcare	-0.36%	6.25%	12.05%	20.91%
Technology	0.74%	4.80%	6.30%	14.27%
Consumer Staples	2.21%	5.64%	9.92%	11.07%
Financials	1.30%	5.84%	8.98%	10.48%
Industrials	1.63%	9.25%	9.08%	7.37%
Materials	0.50%	2.23%	-0.10%	5.24%
Consumer Discretionary	-0.14%	3.67%	4.07%	1.76%
Energy	0.42%	0.77%	-7.60%	-0.81%
Indices				
Nasdaq	0.03%	5.64%	6.86%	10.92%
S&P 500	0.69%	5.00%	6.41%	9.93%
Dow Jones Ind. Avg.	1.04%	5.11%	7.37%	6.02%
Russell 2000	-0.03%	9.01%	4.78%	0.83%

Source: Sectorspdr.com

For the past few weeks we have focused our attention mostly on central banks and the speeches or actions of their members. This has never been the goal of Sierra but unfortunately, it was necessary, which simply illustrates the type of markets we have centrally planned (god forbid we call them 'socialist'), as opposed to free. Enough on that! To conclude the topic I will refer back to the president of the Federal Reserve Bank, St. Louis James Bullard, who 3 weeks ago at the bottom of the correction said "it would be logical to delay the end of QE" (**Issue 30**). This week at the new all-time highs in S&P 500 he expressed his satisfaction with the current state of the US economy and said no more QE is needed for now...

In this issue we will forget about all of these controversies and focus on something educational that is also directly applicable to markets, business cycles and investing. Since the start of Sierra, roughly a year and a half ago, we have talked about the Purchasing Managers' Index (PMI) numerous times and in this issue we are going to explore it in more detail. Basically, the PMI report tracks the economic activity in a given broad sector of the economy. In the US there are two PMI reports — manufacturing and non-manufacturing (services). The two institutions releasing PMI numbers are the **Institute of Supply Management (ISM)** and **Markit**.

...employment is a late-cycle indicator that peaks at the top of the upward economic move.

So far ISM reports have more relevance for US markets but Markit might soon catch up. The latter is a global organization with reports for numerous countries, which makes the numbers directly comparable. They also provide 2 additional PMI reports (construction and retail), as well as surveying

20,000+ companies for each release, which makes the data more accurate.

Looking at the US PMI data from this week, the momentum is starting to slow, mostly because of a slowdown in services. Generally, services represent around **70%** of the US economy but in the ISM reports the economy is divided only into manufacturing and services, so agriculture and construction are actually put into the latter category, which pushes the services share (in ISM terms) of the US economy to around 88%. All of this is important to know in order to understand the economy-weighted PMI we have built.

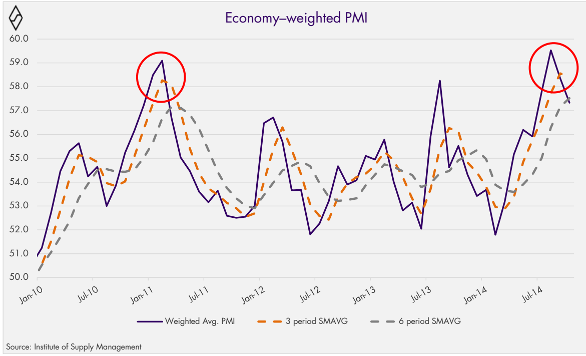
In terms of economic indicators, I always go back to a very important quote:

Historically, what is important to the market is not whether growth is good or bad, but whether it is getting better or worse.” (Hedge Fund Market Wizards, pp.24)

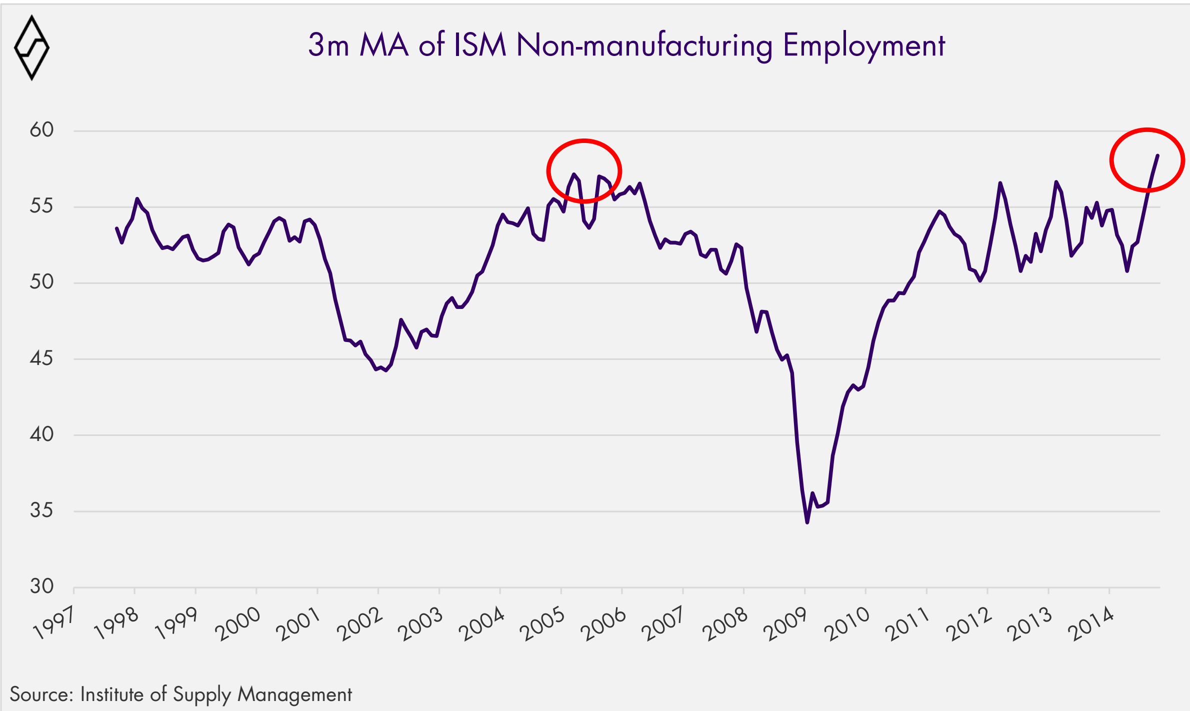
The level ‘50’ is basically a 0 in ISM standards, meaning there has been no change from the prior month. Above 50 indicates a positive change, whereas a reading below 50 marks a slowdown compared to the previous month.

So what’s happening right now? After hitting an all-time high (ISM non-man. data exists since 2008) of 59.5 in August, our composite PMI is deflating and is below both the 3m MA and the 6m MA. In other words, the momentum is slowing. If that continues, keeping in mind this year’s GDP results and the corresponding PMI numbers, it would be logical to expect a Q4 GDP of well below 3%.

On the employment front, roughly **80% of US jobs are in services**, so it is reasonable to monitor the Employment index in the ISM Non-manufacturing report. Right now that index is at its all-time high (employment data for ISM non-man. collected since 1997), which further supports our thesis for a cyclical slowdown in employment. After all, employment is a late-cycle indicator that peaks at the top of the upward economic move. In a similar fashion initial jobless claims are at a multi-year low, which from a historical perspective is unsustainable.



Source: Institute of Supply Management



Source: Institute of Supply Management

EUROPE

...PMI continued

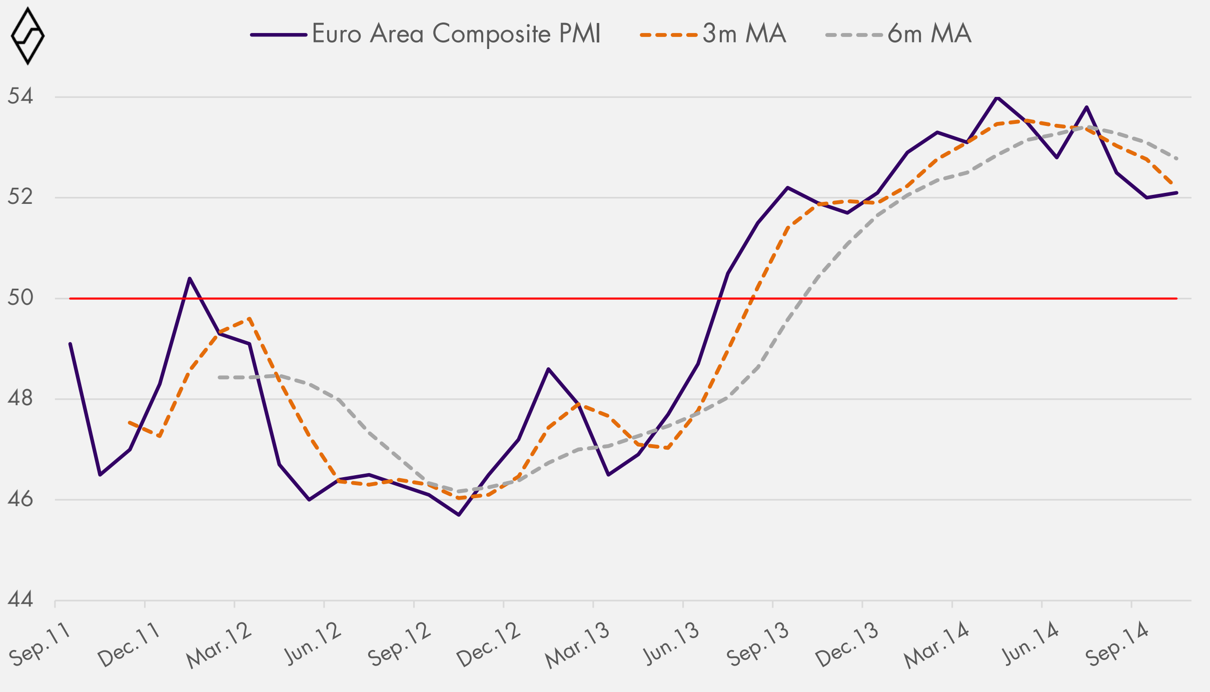
Indices	5D	1M	3M	YTD
STOXX Europe 600 Real Estate Cap	-0.97%	5.32%	5.06%	16.29%
STOXX Europe 600 Health Care	-0.57%	-0.37%	6.83%	16.15%
STOXX Europe 600 Food & Beverage	-0.15%	2.98%	4.62%	8.03%
STOXX Europe 600 Travel & Leisure	1.04%	6.57%	8.08%	7.13%
STOXX Europe 600 Insurance	0.16%	1.91%	6.79%	5.06%
STOXX Europe 600 Personal & Household Goods	0.60%	3.01%	4.35%	4.50%
STOXX Europe 600 Financial Services	0.71%	5.71%	5.29%	4.22%
STOXX Europe 600	-0.46%	1.12%	1.79%	2.13%
STOXX Europe 600 Telecommunications	-0.59%	3.15%	6.91%	1.44%
STOXX Europe 600 Construction & Materials	0.93%	4.72%	1.24%	1.37%
STOXX Europe 600 Media	0.55%	3.37%	3.84%	0.07%
STOXX Europe 600 Chemicals	-0.12%	2.72%	2.89%	-0.36%
STOXX Europe 600 Basic Resources	1.73%	0.28%	-10.37%	-1.46%
STOXX Europe 600 Technology	-0.02%	0.51%	1.16%	-1.52%
STOXX Europe 600 Banks	-2.99%	-3.04%	0.88%	-2.85%
STOXX Europe 600 Automobiles & Parts	-0.06%	4.97%	-1.12%	-4.13%
STOXX Europe 600 Industrial Goods & Services	0.26%	2.74%	1.00%	-4.35%
STOXX Europe 600 Oil & Gas	-0.50%	-2.60%	-8.41%	-5.18%
STOXX Europe 600 Retail	1.98%	3.27%	-2.14%	-10.34%

Source: Stoxx; quoted in EUR

It is not a secret that at the end of last year and the beginning of this year, we (among others) were bullish on Europe. Unlike the decelerating US, Europe seemed to be on the right track with positive slopes in most major indicators. Car sales were something we specifically focused on, given the increasing number of new car registrations. Valeo SA was our top pick with a performance of around +80% from September 2013, when we bought it, until the end of Q1 2014. However, it is not Q1 2014 anymore.
New passenger car registrations, as well as overall economic activity, have slowed ever since March this year. Even France managed to see positive data (in PMI terms) at the beginning of the year, only to continue its slump after that. Notice the slope of the PMIs of Germany and the Euro Area. Although both have positive PMIs, meaning expansion, the slope has turned negative which suggests a shift in economic trends. The current month's numbers are below the 3m MA, which is below the 6m MA — a clear sign of a confident downward trend.

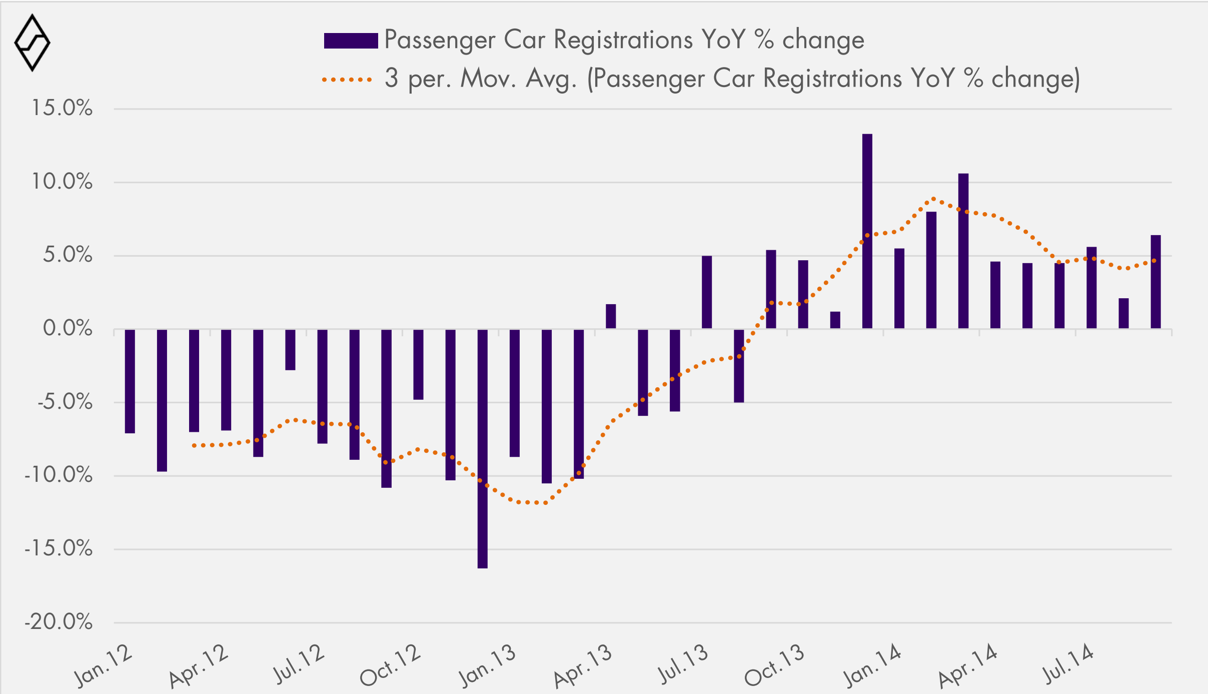
Even France managed to see positive data (in PMI terms) at the beginning of the year

One of the reasons why Markit PMI data might be considered superior to ISM is the representation of industry performance. While ISM only divides industries into



Source: Markit, Bloomberg

'growing' and contracting', Markit actually reports a **PMI index** for every industry in the Euro Area. Such quantification allows for assessment of rates of change, which is impossible in the simple ISM division. If we look at the last Markit report we find out that 'Automobiles & auto parts' are the worst performing industry right now. Even Valeo SA, this unstoppable winner of the near past, is breaking down from a trend perspective and is making lower highs and lower lows — in line with the slowing trend in new car registrations and Markit data. Soon the stock may end up as a short in our portfolio.



Source: ACEA

ASIA & OCEANIA

Hello Japan... again

Indices	5D	1M	3M	YTD
STOXX Asia/Pacific 600 Health Care	-0.27%	3.79%	8.36%	15.47%
STOXX Asia/Pacific 600 Technology	1.83%	0.82%	2.75%	14.88%
STOXX Asia/Pacific 600 Food & Beverage	0.02%	3.56%	5.81%	13.99%
STOXX Asia/Pacific 600 Chemicals	1.69%	3.64%	9.27%	12.62%
STOXX Asia/Pacific 600 Utilities	1.95%	7.54%	10.31%	9.76%
STOXX Asia/Pacific 600 Personal & Household Goods	1.40%	4.70%	4.08%	9.19%
STOXX Asia/Pacific 600 Industrial Goods & Services	0.97%	3.46%	5.77%	8.97%
STOXX Asia/Pacific 600 Construction & Materials	-0.18%	2.32%	-1.03%	8.70%
STOXX Asia/Pacific 600 Insurance	0.32%	5.67%	8.39%	8.45%
STOXX Asia/Pacific 600 Real Estate	-2.19%	4.74%	3.14%	5.78%
STOXX Asia/Pacific 600 Index	0.25%	4.21%	4.05%	5.30%
STOXX Asia/Pacific 600 Telecommunications	-1.40%	4.16%	5.67%	4.06%
STOXX Asia/Pacific 600 Banks	-0.57%	4.49%	4.13%	2.14%
STOXX Asia/Pacific 600 Automobile & Parts	3.53%	3.72%	6.97%	1.84%
STOXX Asia/Pacific 600 Financial Services	3.10%	8.23%	6.32%	0.48%
STOXX Asia/Pacific 600 Media	-0.05%	2.02%	-1.83%	-0.58%
STOXX Asia/Pacific 600 Retail	-0.61%	4.10%	1.90%	-0.68%
STOXX Asia/Pacific 600 Oil & Gas	-1.94%	-3.56%	-7.91%	-0.75%
STOXX Asia/Pacific 600 Basic Resources	-0.38%	2.18%	-8.27%	-8.48%

Source: Stoxx; quoted in EUR

JAPAN

This was one of those mellow weeks in terms of economic data coming for the land of the rising sun. After having a week to think about BoJ stimulus increase, here is a thought: The two weeks prior to the purchases increase, were probably the toughest for Mr Shinzo Abe (a topic we have not yet discussed). There were two cabinet resignations and two ministers were mixed up in scandals related to inappropriate donations. It is at all possible that this pressure was a tipping point (not the main reasoning) for BoJ to increase stimulus? Even though they are two separate institutions (that is the government and BoJ), the timings seems somewhat appropriate.
Next month (December) Mr Abe will be deciding whether to keep the tax rate increase as planned or keep it at 8% as it is now and delay the raise in order to support the economy further. The key factor for this decision will be the Q3 GDP. It's very hard to see this as an accurate factor though, because Japanese GDP fell 1.8% in Q2 due to the tax hike in April (knowing about the tax increase, people bought prior to it... obviously). Having this in mind, Q3 GDP (preliminary on 16th Nov.; final on 8th Dec.) will most likely be positive and above the current average growth rate, hence why it will be a tough indicator for Abe and market participant as well.
To further link the BoJ's decision with Abe's future decision, one can look at the bank's increase in purchases as a move in order to make the tax increase a rosier fiscal contraction and hence have a lower impact on growth.

CHINA

A somewhat quiet week took place in China, while the market hit fresh intraday highs for the year.

The relatively bad data for services and manufacturing activity was shrugged off with all eyes on the BOJ and ECB trying to boost activity in their economies. The desired confirmation of the benefits coming from worldwide stimulus and the US "safe haven", came in when exports surprised to the upside for 4th consecutive month. Nevertheless, when you look at the numbers closely, exports are growing at a slower rate, which means that the Chinese bright spot is dimming. Exports in October grew by 11.3% YoY and the trade balance better at 45.4B compared to 31B the month before. However, if we think in rate of change terms, exports' growth is slowing and the trade balance is boosted by low imports. In October imports grew by 4.6% YoY, which still points to the possibility that China is slowing down again, with imports' growth rate pointing down, significantly slower than September. HSBC manufacturing was 50.4, hovering around the 50 area for 6 straight months. While the HSBC services index rebounded strongly in August, it has declined ever since coming in at 52.9 for October. More stimulus from the central bank is very much on the table.

COMMODITIES

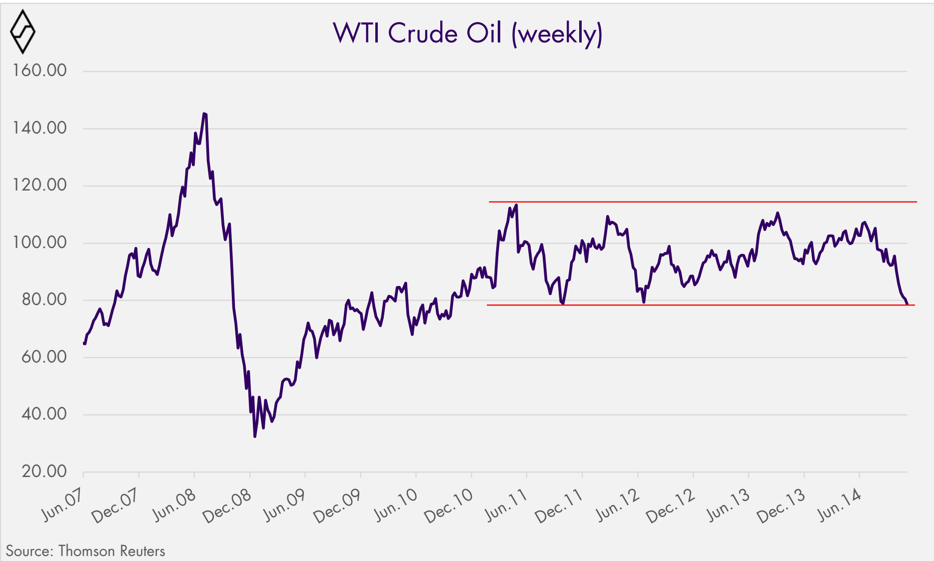
Catching the falling knife

METALS

Copper, Zinc, Nickel all finished the week in red after weaker China PMI data and imports demand confirming the slowdown of the world's major growth engine.
Industrial metals have been underperforming against other asset classes following weaker global growth, which has persuaded the ECB and BoJ to go for monetary easing. By doing so, the USD has appreciated significantly since the beginning of 2H 2014, hence commodities have been deflating.
Gold futures edged higher on Friday closing at $1169.70; bouncing off the four-year low of $1132 after weaker than expected US jobs data and rising tension between Russia & Ukraine. The situation there escalated again on the news of over 200 pro-Russian rebels being killed by military.

ENERGY

Crude oil continues its seventh weekly decline; with WTI & Brent futures closing at $78.43 and $83.39 respectively. Oil prices have lost over 27% since its July peak on the back of a stronger dollar, seasonality, lower global demand and increasing alternative supply.
WTI futures went below $76 per barrel on Wednesday after OPEC cut its supply price to US and lowered production forecast. To deepen the free-fall mode, Libya stated the production will be resumed after recent disruption. Given the underlying supply/demand dynamics, this could mean the recent low is the new "normal".
As we can see, WTI has been trading in a quite strict range for the past 4 years. This provides us with great risk/reward opportunities, as the price is likely to either mean-reverse or break down the range. Currently we do not own a position but it will be interesting to discuss this potential opportunity and take advantage of it.



PORTFOLIO

CORTEZ

				Price		Performance	
Security	Ticker	Entry date	Long/Short	Entry	Current	Weekly	Inception
Legg Mason Inc	LM	21.Jul.14	Long	50.4	54.5	2.9%	5.2%
T.Rowe Price Group	TROW	21.Jul.14	Short	81.4	82.5		
iShares STOXX EU600 Utilities (DE)	EXH9	31.Jul.14	Long	32.4	31.8	-1.5%	0.8%
PowerShares DWA Developed Markets Momentum	PIZ	1.Aug.14	Short	25.2	24.3		
EURGBP	EURGBP	18.Aug.14	Short	0.8	0.8	-0.1%	2.1%
iPath S&P 500 VIX ST Futures ETN	VXX	22.Aug.14	Long	27.8	29.0	-4.3%	4.3%
iShares Russell 2000 ETF	IWM	8.Sep.14	Short	115.9	116.7	-0.1%	-0.7%
iShares 20+ Year Treasury Bond ETF	TLT	23.Sep.14	Long	115.0	119.8	0.4%	4.1%

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

FOREX

Pair	Open	Close	Weekly %	Trend w/w	Monthly %	YTD
USD/JPY	112.32	114.59	2.02%	3	4.50%	8.82%
USD/CHF	0.9626	0.9660	0.35%	2	1.13%	8.20%
EUR/JPY	140.6800	142.7500	1.47%	1	3.05%	6.82%
USD/CAD	1.1266	1.1328	0.55%	2	1.15%	6.67%
GBP/JPY	179.6700	181.9000	1.24%	3	2.31%	4.40%
AUD/NZD	1.1289	1.1140	-1.32%	1	-0.54%	2.63%
USD/CNY	6.1127	6.1128	0.00%	1	-0.42%	0.98%
GBP/AUD	1.8182	1.8378	1.08%	1	-0.78%	-0.68%
EUR/CHF	1.2057	1.2037	-0.17%	5	-0.25%	-2.23%
AUD/USD	0.8798	0.8633	-1.88%	1	-1.29%	-3.14%
GBP/USD	1.5996	1.5873	-0.77%	3	-2.10%	-4.13%
EUR/GBP	0.7829	0.7849	0.26%	1	0.74%	-5.39%
NZD/USD	0.7793	0.7754	-0.50%	3	-0.69%	-5.51%
EUR/AUD	1.42	1.44	1.32%	1	-0.15%	-6.83%
EUR/USD	1.25	1.25	-0.56%	3	-1.40%	-9.39%

Source: Thomson Reuters

DISCLAIMER

Interview: The views expressed in this interview are purely those of the author; they do not pretend to reflect any views that may prevail at Sussex University nor should they be taken as investment advice.

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