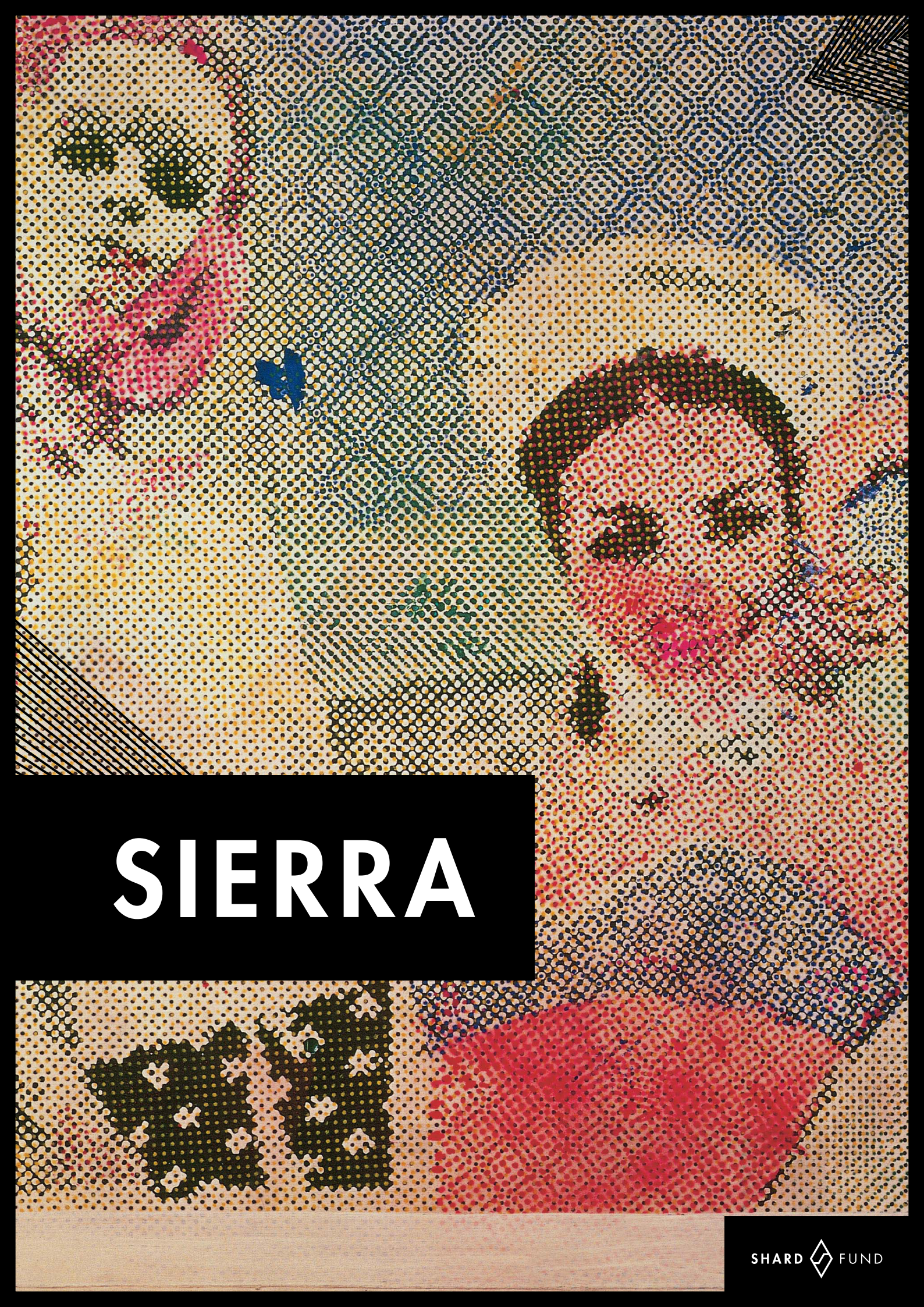




SIERRA

A JOURNEY ACROSS FINANCIAL MARKETS

November 29th - December 5th, 2014 | Issue 37

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HIGHLIGHTS

USA

US data continues to show signs of strength. In manufacturing: while new orders and production continue to perform strongly, prices have fallen off a cliff, thus showing that deflation is making its way along the value chain. We start to observe a similar to summer '13 ISM vs. manuf. PMI divergence.

EUROPE

The DAX made a new all-time high, whilst PMI data was revised lower. EU markets did not reflect the PMI numbers.

Thursday's ECB meeting did not announce the anticipated QE, which led to the EUR appreciating and the DAX depreciating on the day, which was all reverted on Friday.

Italy was downgraded to BBB- (1 level above junk).

ASIA & OCEANIA

Japan was downgraded too to A1 (lower than China and South Korea).

The LD party is likely to take more seats in the coming election (Dec 14) and showed that Abenomics are still strongly supported.

China posted record trading volumes (1 trillion yuan) on Friday and gained 9.54% during the week.

COMMODITIES

The general picture keeps being oil and gas down. Given that steel prices are at their 2008 low due to both under-demand and over-supply, it will not be a surprise if other companies follow though, as many commodity producers are over-leveraged on the Chinese growth story.

Weekly Change		
Indices	Weekly change	Current
Shanghai (China)	9.54%	2,938.78
Nikkei 225 (Japan)	2.64%	17,920.45
IBEX (Spain)	1.21%	10,900.70
DAX (Germany)	1.06%	10,087.12
CAC (France)	0.67%	4,419.48
S&P/ASX (Australia)	0.42%	5,335.30
S&P 500 (USA)	0.38%	2,075.37
FTSE MIB (Italy)	0.36%	20,087.23
FTSE 100 (UK)	0.30%	6,742.84
Hang Seng (Hong Kong)	0.06%	24,002.64
BSE (India)	-0.82%	28,458.10
Currencies	Weekly change	Current
USD/JPY	2.40%	121.45
GBP/JPY	2.04%	189.27
GBP/AUD	1.72%	1.8714
USD/CHF	1.45%	0.9792
EUR/JPY	1.06%	149.25
EUR/AUD	0.94%	1.4781
USD/CAD	0.18%	1.1436
USD/CNY	0.11%	6.1502
EUR/CHF	-0.02%	1.2024
GBP/USD	-0.35%	1.5586
AUD/NZD	-0.67%	1.0777
EUR/GBP	-0.97%	0.7883
EUR/USD	-1.37%	1.2282
NZD/USD	-1.62%	0.7715
AUD/USD	-2.26%	0.8311
Commodities	Weekly change	Current
Silver	5.51%	16.29
Gold	2.29%	1192.5
Copper	2.11%	2.904
WTI Crude Oil	-0.67%	65.62
Brent Crude Oil	-1.89%	68.70
Rates	Weekly change ¹	Current
US 10Y	13 bps	2.307%
UK 10Y	9 bps	2.015%
Germany 10Y	8 bps	0.782%
France 10Y	7 bps	1.036%
Japan 10Y	2 bps	0.435%
Italy 10Y	-5 bps	1.982%
Spain 10Y	-8 bps	1.818%
Source: Thomson Reuters		Note: ¹ in basis points (bps)

CALENDAR

USA					
Day	Country	Indicator	Actual	Forecast	Previous
Past week (29-05 Nov. 2014)					
Monday	United States	ISM Manufacturing PMI (Nov)	54.9		59.0
Wednesday		ADP Nonfarm Employment Change	208K		230K
		ISM Non-Manufacturing PMI (Nov)	59.3		57.1
Friday		Nonfarm Payrolls (Nov)	314K		214K
		Unemployment Rate (Nov)	5.8%		5.8%
Next week (06-12 Dec. 2014)					
Wednesday	United States	Federal Budget Balance			-121.7B
Thursday		Initial Jobless Claims			297K
		Retail Sales (MoM)			0.3%
Friday		PPI (MoM)			0.2%
		Michigan Consumer Sentiment			88.8
EU					
Past week (29-05 Nov. 2014)					
Monday	Germany	Manufacturing PMI	49.5		49.5
	United Kingdom	Manufacturing PMI	53.5		53.5
	EU	Manufacturing PMI	50.1		50.1
	France	Manufacturing PMI	48.4		48.4
Wednesday	EU	Markit Composite PMI	51.1		51.1
	United Kingdom	Services PMI	58.6		58.6
Friday	EU	GDP (QoQ)	0.2%		0.2%
Next week (06-12 Dec. 2014)					
Monday	Germany	Industrial Production (MoM)			1.4%
Tuesday	United Kingdom	Manufacturing Production (MoM)			0.4%
Wednesday	France	Nonfarm Payrolls (QoQ)			-0.2%
Friday	EU	Industrial Production (MoM)			0.6%
Asia and Oceania					
Past week (29-05 Nov. 2014)					
Tuesday	Australia	GDP (QoQ)	0.3%		0.5%
Wednesday	Australia	Retail Sales (MoM)	0.4%		1.2%
Sunday	Japan	GDP (YoY)	upcoming		-1.6%
	China	Exports (YoY)	upcoming		11.6%
		Imports (YoY)	upcoming		4.6%
		Trade Balance (Nov)	upcoming		45.41B
Next week (06-12 Dec. 2014)					
Tuesday	China	CPI (YoY)			1.6%
		PPI (YoY)			-2.2%
Thursday	Japan	Industrial Production (MoM)			0.2%
Friday	China	Fixed Asset Investment (YoY)			15.9%
		Industrial Production (YoY)			7.7%
Source: Thomson Reuters, ShardFund					

USA

Football and markets

Sectors	5D	1M	3M	YTD
Healthcare	1.70%	4.26%	10.32%	27.69%
Utilities	-0.28%	1.54%	5.16%	20.81%
Technology	-0.28%	3.61%	5.29%	17.99%
Consumer Staples	0.16%	3.44%	7.59%	13.45%
Financials	0.90%	2.76%	4.99%	12.53%
Industrials	-0.45%	3.67%	5.50%	9.32%
Materials	1.24%	4.73%	-1.76%	7.68%
Consumer Discretionary	0.59%	6.08%	3.39%	6.79%
Energy	0.58%	-3.58%	-17.31%	-9.30%
Indices				
Nasdaq	-0.24%	3.46%	4.32%	14.47%
S&P 500	-0.04%	5.51%	3.72%	12.10%
Dow Jones Ind. Avg.	0.72%	2.71%	4.79%	8.34%
Russell 2000	0.77%	1.32%	1.05%	1.62%

Source: Thomson Reuters

A typical football season is quite long. The English Premier League (EPL) has 20 teams, which makes 38 games for each team in any given season, since its establishment in 1992. In the history of English football (since 1888) there have been only 2 teams to finish a season without losing a game. The first team was Preston North End at the very beginning of the football league back in 1880s, while the second team was (as much as it hurts to admit it) Arsenal in 2003-04 season. In other words, finishing a season without a loss is an incredibly rare event and teams that have achieved it are actually called “The Invincibles”. In reality, teams almost always have to deal with a loss or a string of consecutive losses. Their approach is what distinguishes champions from average teams. Having said that, I must admit that we have had an awful week. If I have to express it in a football score, this week will definitely be a 3:0 loss. Statistically speaking, it is not unexpected and we have no intention of hiding it. It is what it is. US data continues to show some signs of strength, which does not necessarily undermine our internal research. It simply proves that timing and flexibility are

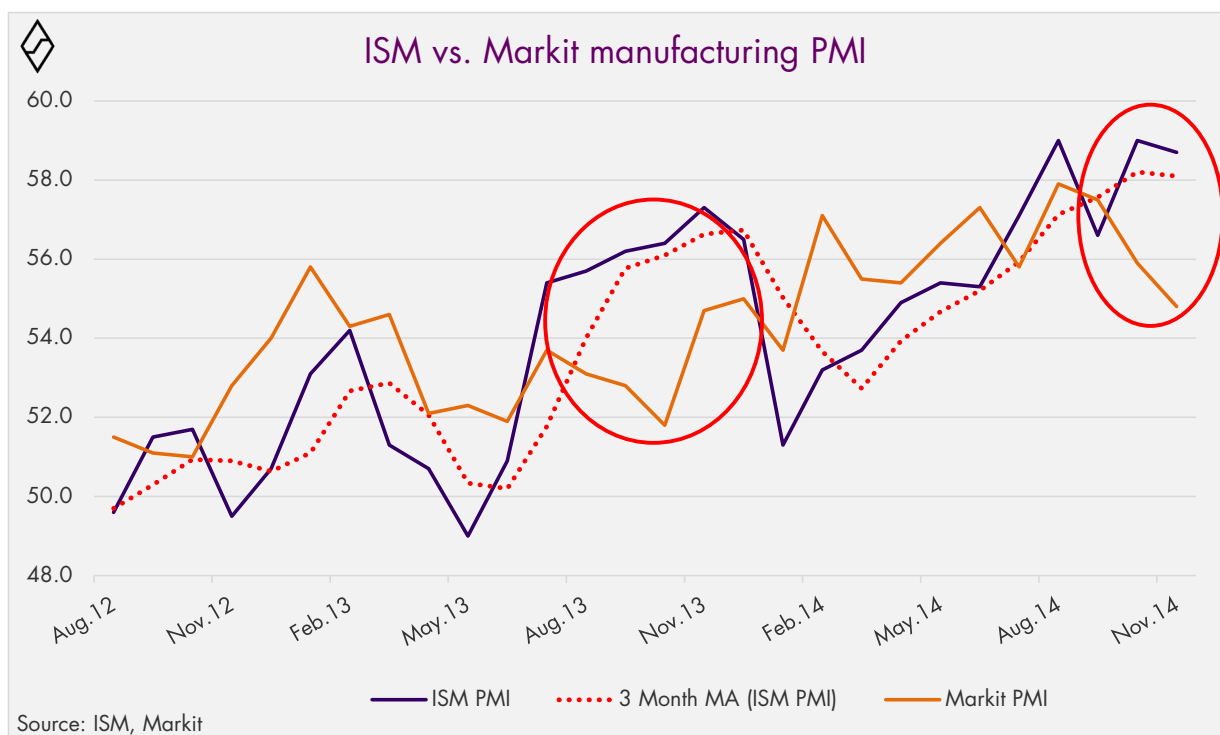
essential. According to the Institute of Supply Management (ISM), manufacturing and services continue to expand at a significantly high rate (high 50s). There are several interesting facts in the manufacturing space. While new orders and production continue to perform strongly with a mid-60 print,

If I have to express it in a football score, this week will definitely be a 3:0 loss.

prices have literally fell off a cliff (from 53.5 to 44.5) in November, confirming that deflation is making its way along the value chain. Another interesting thing to note is the divergence between the ISM and Markit manufacturing

PMIs. We are not trying to undermine the ISM data, it is just worth noting that typically the two indicators are relatively correlated with certain exceptions. The summer of 2013 was the previous divergence, when growth was actually increasing and ISM PMIs, peaking GDP and other indicators were confirming it. However, the ISM survey corrected sharply to catch up with Markit. It is interesting to monitor which one will catch up this time, but bear in mind that back in 2013 the Markit PMI, although lower, was still increasing, while now it has been decelerating rapidly. This momentum in the economy (assuming ISM is right) combined with a rather strong

jobs report (check calendar) on Friday pushed volatility (VIX) down and bond yields up, both of which are part of our portfolio. Also, we were affected quite negatively by a drop in Legg Mason's share price (\$LM) due to announcement by the firm that activist investor Nelson Peltz was stepping down from the board of directors. Fundamentally nothing has changed with the company, so we expect a quick rebound. However, there is also the argument that if nothing has changed and the company is still sound, why would he step down? Only time will tell. For now, we are staying put.



EUROPE

Nothing has changed

Indices	5D	1M	3M	YTD
STOXX Europe 600 Health Care	0.60%	3.89%	4.39%	21.86%
STOXX Europe 600 Real Estate Cap	-0.02%	2.95%	3.86%	21.66%
STOXX Europe 600 Utilities	1.95%	4.32%	6.17%	20.14%
STOXX Europe 600 Travel & Leisure	3.59%	8.92%	11.90%	18.14%
STOXX Europe 600 Food & Beverage	0.19%	4.52%	3.62%	13.35%
STOXX Europe 600 Telecommunications	1.82%	9.63%	11.84%	12.62%
STOXX Europe 600 Personal & Household Goods	0.30%	6.81%	6.27%	11.17%
STOXX Europe 600 Insurance	0.95%	5.01%	5.62%	10.77%
STOXX Europe 600 Financial Services	1.47%	5.93%	6.44%	10.67%
STOXX Europe 600 Construction & Materials	2.91%	6.49%	1.88%	7.32%
STOXX Europe 600 Media	2.04%	7.29%	6.41%	7.17%
STOXX Europe 600 Automobiles & Parts	2.89%	11.56%	4.20%	7.10%
STOXX Europe 600	1.07%	4.34%	0.98%	6.92%
STOXX Europe 600 Chemicals	1.22%	6.58%	4.89%	6.49%
STOXX Europe 600 Technology	1.87%	7.47%	3.18%	6.26%
STOXX Europe 600 Banks	1.38%	3.70%	-1.65%	2.75%
STOXX Europe 600 Industrial Goods & Services	1.17%	3.96%	-0.60%	-0.96%
STOXX Europe 600 Retail	1.30%	6.60%	0.60%	-5.22%
STOXX Europe 600 Basic Resources	-0.98%	-2.12%	-11.85%	-5.36%
STOXX Europe 600 Oil & Gas	-0.03%	-5.55%	-17.64%	-12.07%

Source: Stoxx; quoted in EUR

There were many cheers this week as the DAX made a new all-time high and yet, there was nothing to get excited about. Europe actually gets worse month after month and it is not the periphery driving this slump. It is zee Germans (yet another movie reference — ‘Snatch’). Last week we mentioned there was risk of PMI data being revised lower and that is exactly what happened. France’s less negative November stayed in the record for about 2 weeks, as their composite PMI was revised to the lowest number since summer 2013. While that is no surprise at all, Germany leading the losses is an awful sign, given its status in the union. The country’s composite PMI fell by the most since mid-2011 (to 51.7) as manufacturing actually recorded second month of contraction in the last three. Unlike other services oriented western countries (US, UK) the economy of Germany is heavily reliant on manufacturing. The industry adds around 22% to GDP (World Bank), which combined with positive spillovers is a very

solid number. However, Germany does not exist in a vacuum. In fact, it exports most of this manufacturing output to other countries.

We live in a globalised world with one complex market system, don’t forget that.

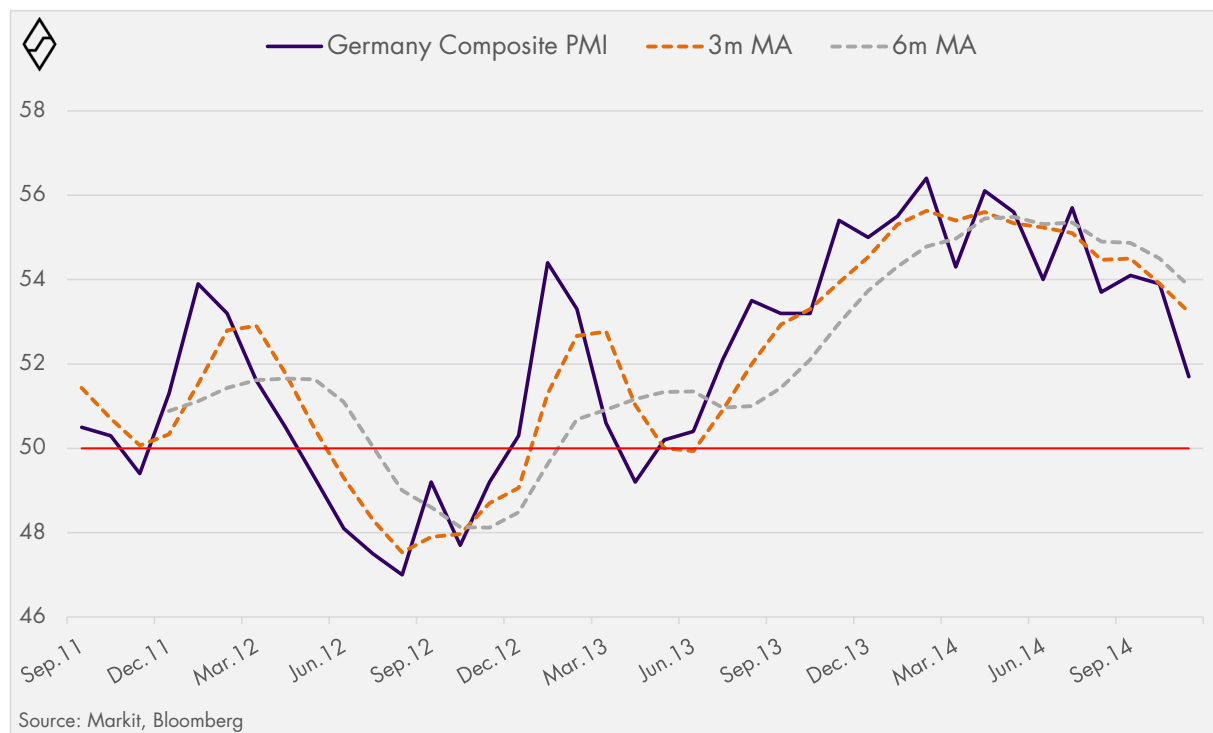
All that steel and iron ore, all the BMWs and other high-precision machinery. There is less demand for all that, therefore there is less activity in the manufacturing plants, which is reflected in the plunging PMIs. We live in

a globalised world with one complex market system, don't forget that.

The most interesting event of the week was the market reaction. We said that we will decrease our commentary on central banks' actions so I will keep it short, but it is essential to recognise the fact. EU markets didn't even reflect the PMI numbers.

Thursday), no one actually noticed that Italy's rating has been decreased to BBB- (1 level above junk) by S&P and the 10-year yield of the country fell to 1.94%. Risk premiums should be forever excluded from every economics/finance text book.

Now that we can hear the clock ticking, the game becomes increasingly interesting.



EUROSTOXX kept on climbing, while the DAX was flat to positive until the Thursday ECB meeting. Meanwhile the EUR depreciated in an anticipation of a potential QE. Long story short, there was no QE on Thursday, markets collapsed (DAX -1.5%), the EUR appreciated (EUR/GBP +1.0%). However, then Draghi told the public once again that everything necessary would be done. Unlike other times, however, he put an informal date for potential action by saying that if environment did not change by beginning of next year, officials would act. In all the excitement on Friday (EU markets reverted the negative move from

Any EU weakness until the next ECB meeting (22 January) should be potentially bad for the EUR and good for indices. Given that scenario, the meeting provides a very good risk reward opportunity for a small contrarian positioning for no QE. Have in mind that Draghi (assuming he strongly desires more easing) is facing a great opposition in the face of zee Germans (I actually managed to use it 2 times), who are reluctant to splash more of their stash of cash. In other words, all of us need to have a solid 2 week holiday, as January will be hot!

ASIA & OCEANIA

Up, up and away

Indices	5D	1M	3M	YTD
STOXX Asia/Pacific 600 Chemicals	4.68%	10.57%	11.89%	23.48%
STOXX Asia/Pacific 600 Technology	1.46%	2.79%	1.54%	17.80%
STOXX Asia/Pacific 600 Food & Beverage	1.32%	1.47%	2.84%	14.71%
STOXX Asia/Pacific 600 Health Care	1.85%	-2.08%	0.88%	13.72%
STOXX Asia/Pacific 600 Insurance	2.31%	2.79%	4.89%	11.81%
STOXX Asia/Pacific 600 Personal & Household Goods	1.04%	1.54%	2.43%	11.32%
STOXX Asia/Pacific 600 Industrial Goods & Services	1.46%	1.53%	1.77%	10.47%
STOXX Asia/Pacific 600 Automobile & Parts	4.29%	6.45%	9.73%	8.25%
STOXX Asia/Pacific 600 Travel & Leisure	-1.79%	-1.85%	-0.31%	6.56%
STOXX Asia/Pacific 600 Real Estate	0.19%	-0.15%	-1.79%	6.53%
STOXX Asia/Pacific 600 Construction & Materials	1.42%	-1.97%	-8.44%	5.46%
STOXX Asia/Pacific 600 Index	0.85%	-0.16%	-0.70%	5.10%
STOXX Asia/Pacific 600 Utilities	-0.34%	-3.72%	-1.16%	5.09%
STOXX Asia/Pacific 600 Media	0.99%	0.13%	-1.44%	0.33%
STOXX Asia/Pacific 600 Telecommunications	-1.67%	-3.69%	-4.48%	-0.16%
STOXX Asia/Pacific 600 Banks	-0.10%	-2.59%	-4.05%	-0.30%
STOXX Asia/Pacific 600 Financial Services	2.82%	-1.05%	-1.20%	-0.54%
STOXX Asia/Pacific 600 Retail	-1.41%	-3.56%	-4.83%	-5.20%
STOXX Asia/Pacific 600 Basic Resources	-0.54%	-3.99%	-12.34%	-13.30%
STOXX Asia/Pacific 600 Oil & Gas	-3.38%	-11.87%	-23.95%	-13.63%

Source: Stoxx; quoted in EUR

JAPAN

Moody's got moody and decided to downgrade the government of Japan from **Aa3** to **A1** (their 5th highest rating). The arguments given were:

1. "Heightened uncertainty over the achievability of fiscal deficit reduction goals;
2. Uncertainty over the timing and effectiveness of growth enhancing policy measures, against a background of deflationary pressures; and
3. In consequence, increased risk of rising JGB yields and reduced debt affordability over the medium term."

Japan is now positioned as a riskier borrower than China or South Korea (of course China has almost as much capital markets' growth during the past week as Japan has YTD... weird, right? I thought Japan was riskier?) Anyway, joking aside, the capital markets did not reflect much of what Moody's had to say and why would they? Rating agencies have

not really regained any investor confidence and don't seem to be as forward looking as investors are. The rally this week was caused by the election's poll, which was published on Thursday. The data suggested that the Liberal Democratic party (LDP or Abe's party) is likely to win 300 of the 475 seats (63%) in the lower house parliament, thus marginally increasing its current seating share: 294 of the 480 (61%). However, we don't see the increase from 61% to 63% as a significant enough to give investors a boost. We see investor confidence coming from an under-estimated seating poll data. As discussed in **Sierra issue 35**, the support of Abenomics from the Japanese nation has deteriorated since late 2012, but it seems like this is not true. I always like putting things into perspective, so here's what we have:

- A Japanese nation that still supports Shinzo Abe (hence Abenomics – the three arrows)
- The three arrows being fiscal stimulus

(done), monetary easing (done) and structural reforms (working on it)
From my point of view, the structural reforms is the hardest arrow to implement and one

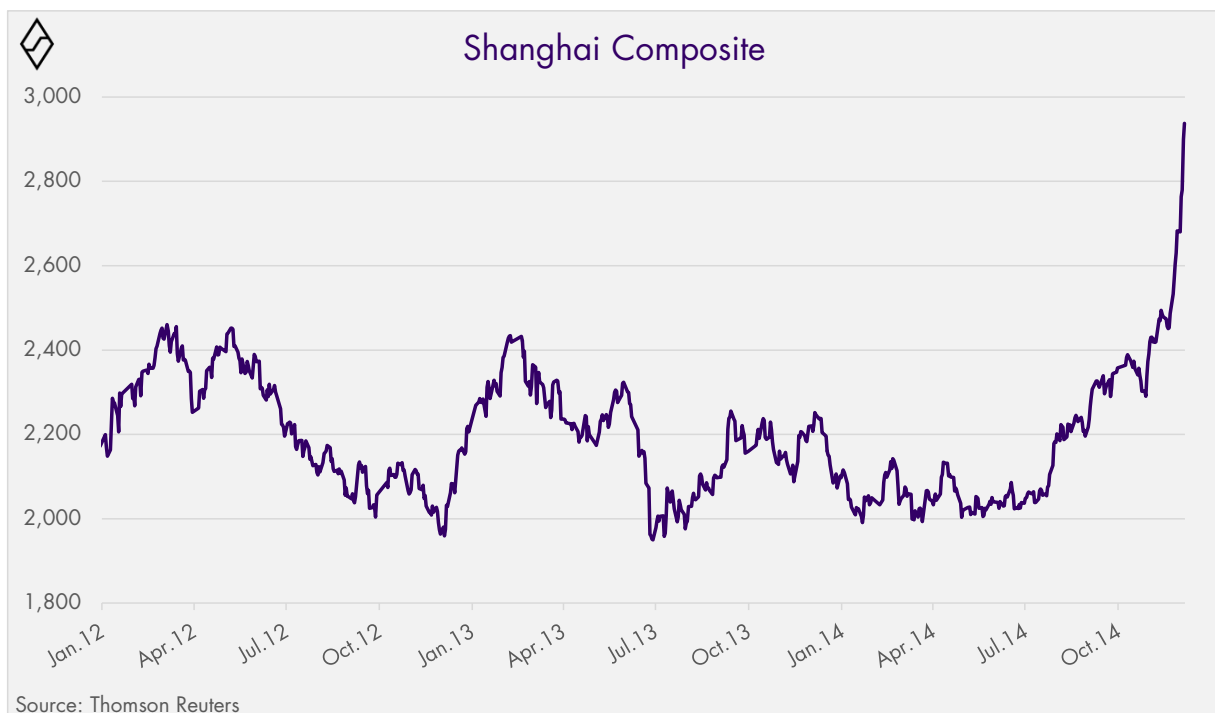
whose results are still pending... This will be the biggest topic of discussion in the final year Sierra edition.

CHINA

What a week for the Chinese market. Record volumes of 1 trillion yuan on Friday and new multi-year highs. The Japanese downgrade did not seem to bother China or the US. Large daily swings took place with a 4.2% daily gain on Thursday, the largest in the past 15 months. This was largely due to central bank stimulus speculation, surprise, surprise. From Europe to China, where more is expected from the central authorities.

We like to talk about, or rather follow the development of the Chinese liberalization and global presence. Since this is a long term trend, which will affect our world significantly in our lifetime, attention should be paid.

Most of the western media, however, does not. Maybe it was blindsided by Europe and Draghi, who knows. Anyways, the Industrial and Commercial Bank of China (ICBC) has opened doors to its first London branch. This is the first Chinese bank to be set up in Britain since the emergence of The People's Republic of China. So if you think about that and keep in mind that cash is king, you can see the possibility of China using its own banks for worldwide finance rather than American or British ones. Also there is the opportunity to international credit denominated in yuan, once the Chinese currency and financial system establishes itself in the west.



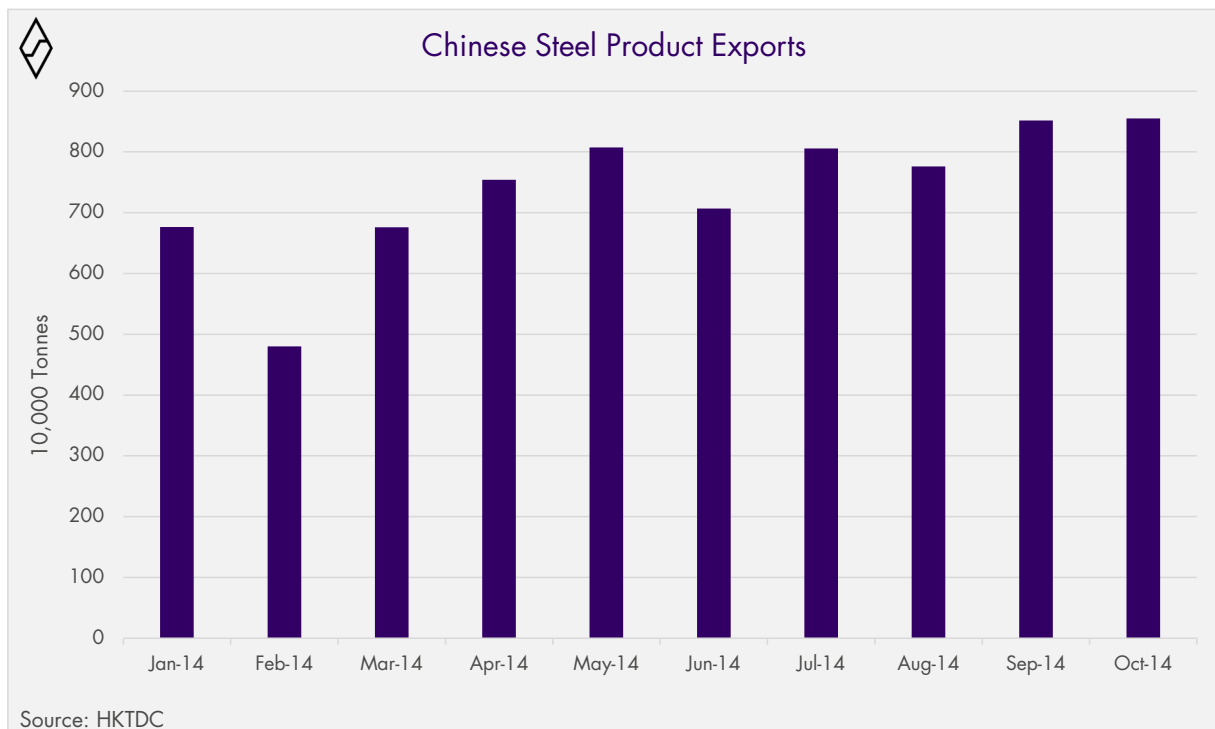
COMMODITIES

The golden age of gas

METALS

A plethora of Chinese steel into the global market has other Asian nations considering proactive measures and could trigger trade friction. Chinese Steel exports have increased significantly since the start of the year, while demand has been declining. In fact, quite recently the Chinese steel producer Haixin Iron & Steel bankrupted. Given that steel prices are at their 2008 low due to both under-demand and over-supply, it will not be a surprise if other companies follow. Many commodity producers are overleveraged on the Chinese growth story. However, you don't have to look further than Rio Tinto's stock price to understand how overinvestment in producing capacity (iron ore in the case of Rio Tinto) ends if it relies on wrong assumptions.

Being desperate to unload excess inventory, Chinese Steel producers have added small quantities of Boron to ordinary steel without consulting customers. This allows the steel to be sold as an alloy and receive a refund on any VAT for products going overseas. In addition many Asian nations keep import duties low, or none at all. This provides further incentive, if exporters can receive the tax refund in China and export to countries with no import duties they can reduce prices by as much as 30% [source: Reuters]. This influx, however, is squeezing steelmakers in other nations. As a result a solidarity group is being pushed for between Chinese, Japanese and South Korean steelmakers to abolish unfair trading.

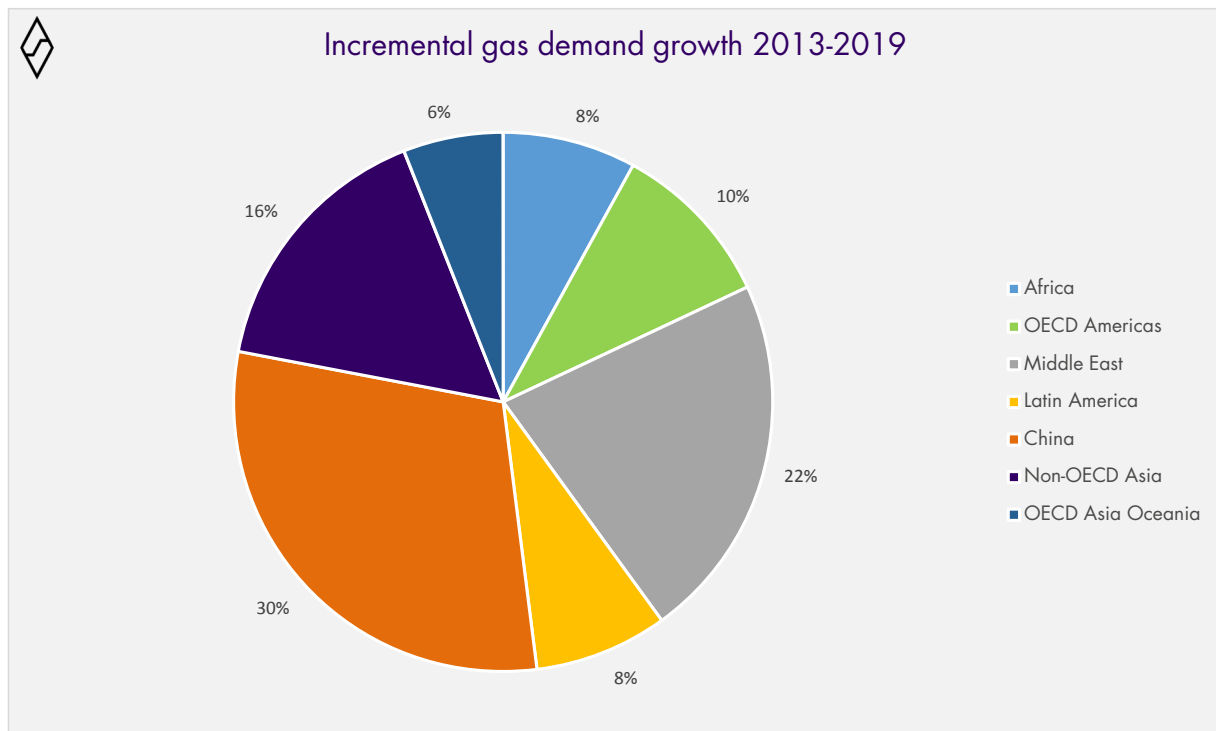


ENERGY

The Golden Age of Gas, a concept introduced by the IEA looks most golden in Asia. By 2035, the IEA expects the continent's demand to grow by as much as the USA's current total production, therefore most of the investment wave in Liquefied Natural Gas (LNG) is focused on this region.

As can be seen above Asia is poised to account for over 50% of demand. This surge in growth

is largely due to the significant gap between US and Asian gas prices of USD/MBtu, and also why Asian countries are attempting to find ways to diminish their gas bills (due to the large premium). Asian pricing of LNG is crucial since it will determine future supply/demand prospects as well as liquidity into Asian markets.



AGRICULTURE

Christmas is fast approaching and what better way to celebrate it then by the possibility of a superbug caused by US farmers misusing antibiotics on cattle?! The US Food and Drug Administration cautioned that ceftiofur could “pose a high public health risk”, its highest risk warning. The concern is that ceftiofur in animals could spawn antibiotic-resistant bacteria, superbugs that can infect people

and defeat orthodox medical treatment. Furthermore analysis carried out by Reuters indicates the risks may be more significant than previously thought. This has several effects: Firstly it could reduce US exports of meats, hogs etc, secondly it could cause another health scare like Ebola. Finally it could affect Zoetis, the world's largest animal health company.

PORTFOLIO



CORTEZ

Security	Ticker	Entry date	Long/Short	Price		Performance	
				Entry	Current	Weekly	Inception
Legg Mason Inc	LM	21.Jul.14	Long	50.4	54.6	-5.2%	4.1%
T.Rowe Price Group	TROW	21.Jul.14	Short	81.4	83.7		
iShares STOXX EU600 Utilities (DE)	EXH9	31.Jul.14	Long	32.4	32.6	1.5%	4.0%
PowerShares DWA Developed Markets Momentum	PIZ	1.Aug.14	Short	25.2	24.9		
iPath S&P 500 VIX ST Futures ETN	VXX	22.Aug.14	Long	27.8	26.1	-4.7%	-6.2%
iShares 20+ Year Treasury Bond ETF	TLT	23.Sep.14	Long	115.0	121.1	-1.1%	5.3%
iShares Russell 2000 ETF	IWM	25.Nov.14	Short	118.3	117.7	-0.9%	0.5%

Source: Thomson Reuters as of 28.Nov.14 close prices

FOREX

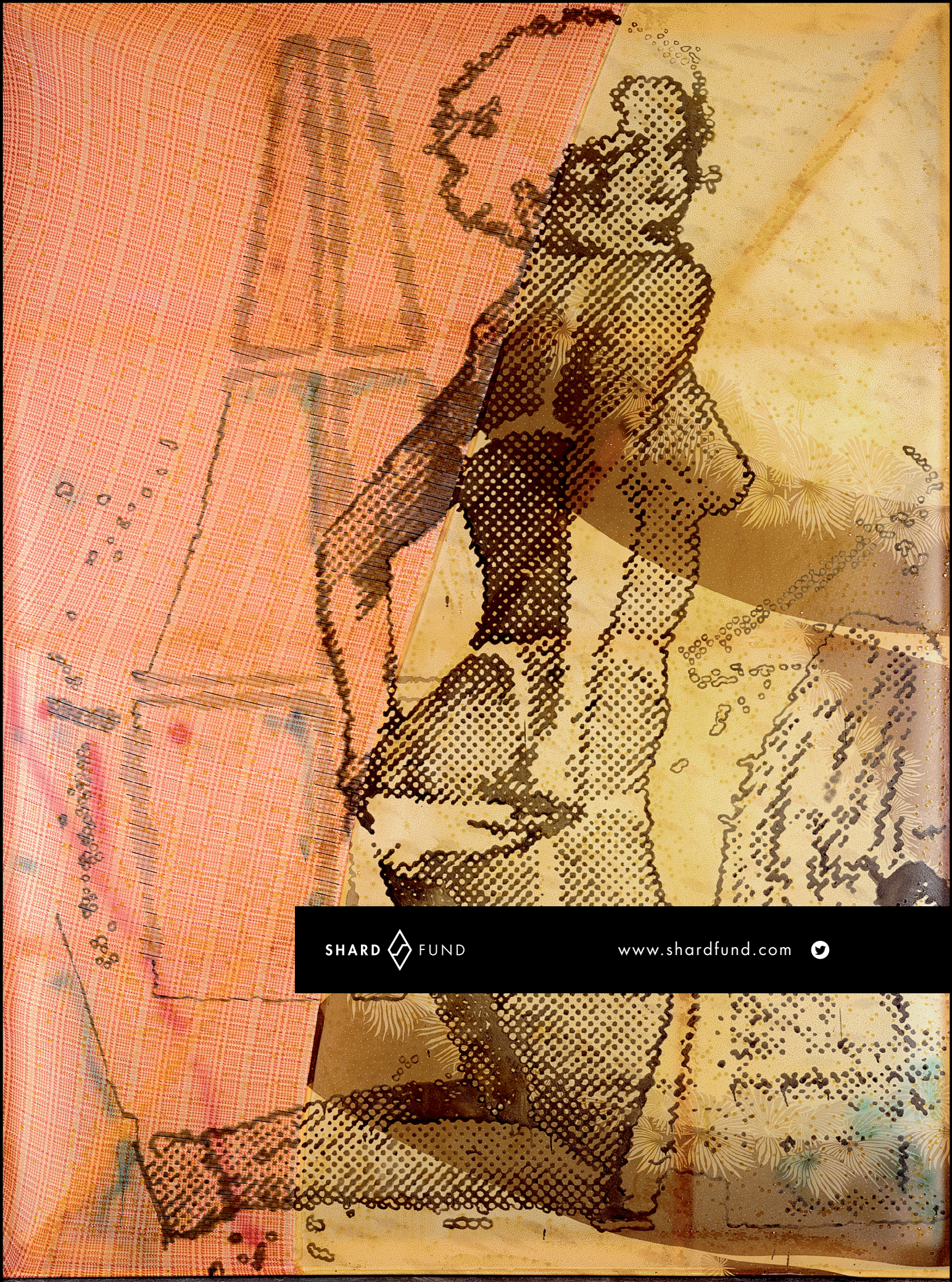
Pair	Open	Close	Weekly %	Trend w/w	Monthly %	YTD
USD/JPY	118.6000	121.4500	2.40%	7	10.75%	15.34%
EUR/JPY	147.6800	149.2500	1.06%	2	7.75%	11.68%
USD/CHF	0.9652	0.9792	1.45%	1	2.51%	9.68%
GBP/JPY	185.4900	189.2700	2.04%	7	6.46%	8.63%
USD/CAD	1.14	1.14	0.18%	2	2.12%	7.68%
USD/CNY	6.1432	6.1502	0.11%	2	0.19%	1.59%
GBP/AUD	1.8398	1.8714	1.72%	3	1.03%	1.14%
AUD/NZD	1.0850	1.0777	-0.67%	5	-3.79%	-0.72%
EUR/CHF	1.2026	1.2024	-0.02%	1	-0.36%	-2.34%
EUR/AUD	1.4643	1.4781	0.94%	3	2.31%	-4.53%
EUR/GBP	0.7960	0.7883	-0.97%	1	1.18%	-4.98%
GBP/USD	1.56	1.56	-0.35%	7	-3.87%	-5.86%
NZD/USD	0.7842	0.7715	-1.62%	3	-1.19%	-5.98%
AUD/USD	0.8503	0.8311	-2.26%	3	-4.97%	-6.75%
EUR/USD	1.25	1.23	-1.37%	1	-2.77%	-10.64%

Source: Thomson Reuters

DISCLAIMER

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