SIERRA

SHARD FUND

A JOURNEY ACROSS FINANCIAL MARKETS

April 11th - April 17th, 2015 | Issue 3

TEAM:

Georgi Stanoev Positions

Stelian Nenkov Positions / Edit

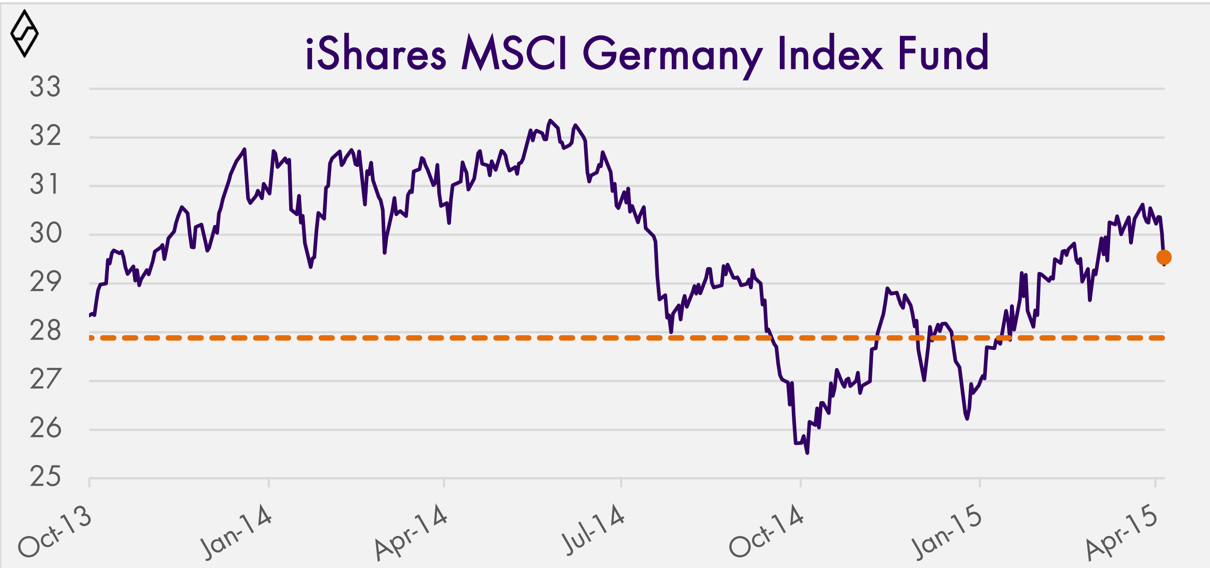
iShares MSCI Germany Index Fund ($EWG)/ NEW

Direction: LONG
Open price: 29.54
Stop loss: 27.88 / -5.62%
Weekly performance: -3.77%

Date taken: 17 Apr 2015
Target 1: 32.4 / 9.69%
Target 2: 34.2 / 12.81%
Inception performance: -0.54%

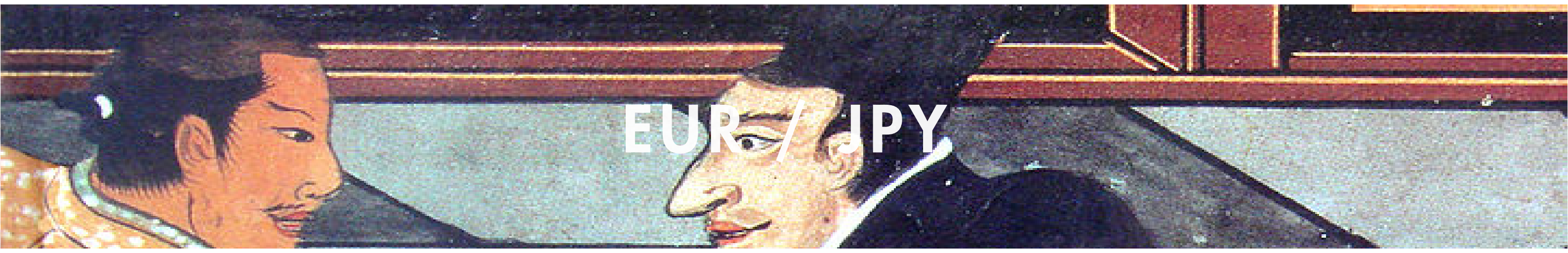
Playbook trade. As we have seen before, numerous times in history and sufficiently so in recent history, QE is bullish for equities and bearish for the printed currency. So, we see that the push from QE and lower euro are factors that will be significant tailwinds for the German economy, which is also the strongest in the region. While the fundamentals of QE could be discussed in hours and days, a cheap Euro is actually quite good for Germany, which has almost 50% of its economy in exports. Meanwhile, the DAX and other EU indices have lagged significantly its US counterparts and now it is time to catch up with the help of the flying squad from Frankfurt.

We did not enter that trade at the very beginning in January and then it was hard to find the right timing, given that there was barely any correction. However, the DAX was down 5.5% this week and roughly 3% down for the last month, which we see as a good timing to jump in. A major risk might be the development of the Greece discussions, so we shall see how that plays out.



Source: Thomson Reuters data

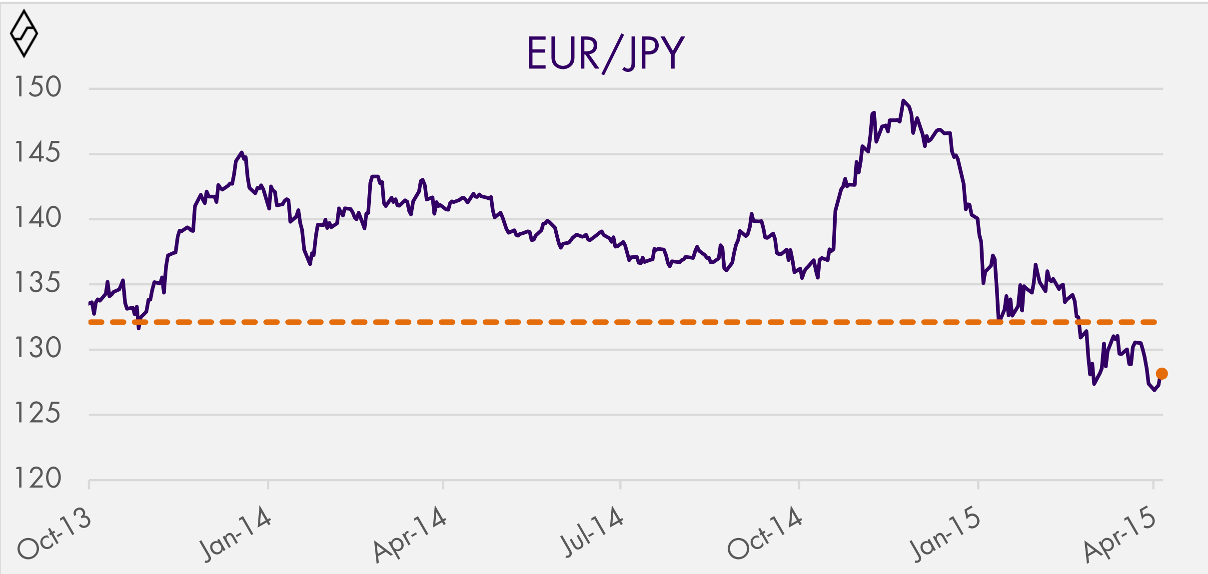
Euro/Japanese Yen June 2015 (EURJPYRYJUN15)/ NEW



Direction: SHORT
Open price: 128.56
Stop loss: 132.10 / -5.21%
Weekly performance: 0.84%

Date taken: 17 Apr 2015
Target 1: 120.00 / 6.66%
Target 2: 114.00 / 11.33%
Inception performance: -0.33%

The first of two FX trades we took this week concerns the weak currencies of the global currency war between the 3-4 major players. While both the ECB and BoJ are in a 'full steam ahead' QE mode, we believe the JPY will end up marginally stronger. Recently there have been indications from Japan that there will not be any accelerations in the current pace of monetary policy at this point. While the chance for this being a lie is not small, the JPY has held quite strongly this year (discussed in **Issue 2**) and we believe that might continue. Looking at the commitment of traders released by the Commodity Futures Trading Commission, usually net exposure and FX go hand in hand. However, this year net shorts in the yen have fallen from roughly 100,000 contracts in January to around 30,000 at the moment (detailed charts on my **twitter**). In the same period the yen has stayed more or less passive against the dollar and has appreciated vs EUR mostly because of the European QE. At some point this divergence (net exposure and fx) could close down with the yen appreciating. How this could influence our USD/JPY long is yet to be seen, however, tempted by a relatively good entry point we initiated our short in EUR/JPY on Friday.



Source: Thomson Reuters data

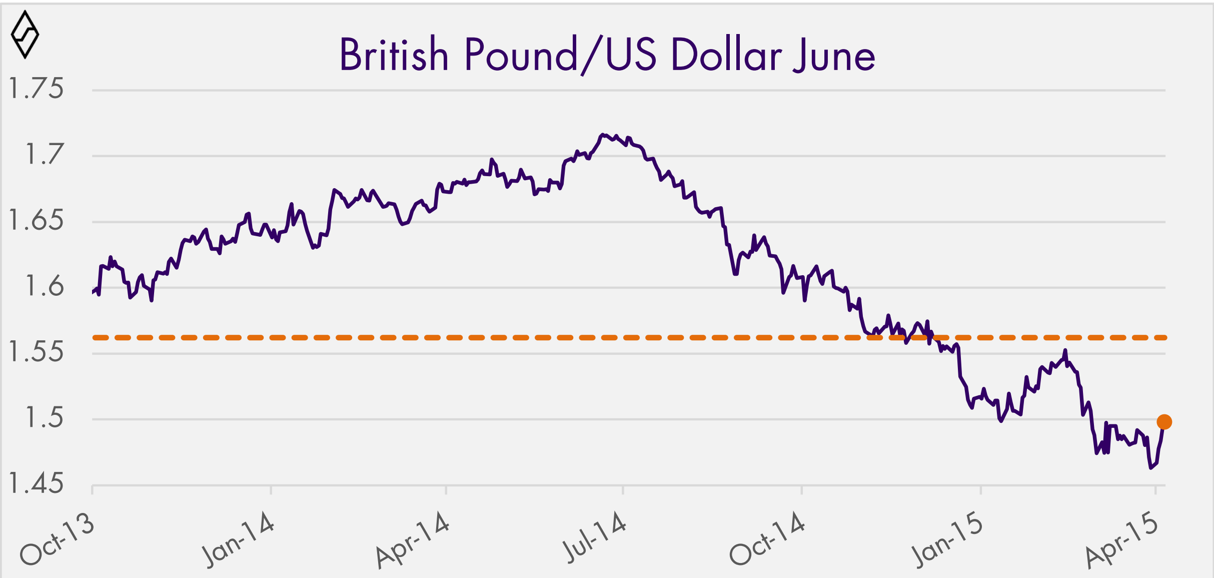
British Pound/US Dollar June 2015 (GBPUSDBPJUN15)/ NEW

Direction: SHORT
Open price: 1.4979
Stop loss: 1.5620 / -4.10%
Weekly performance: 2.26%

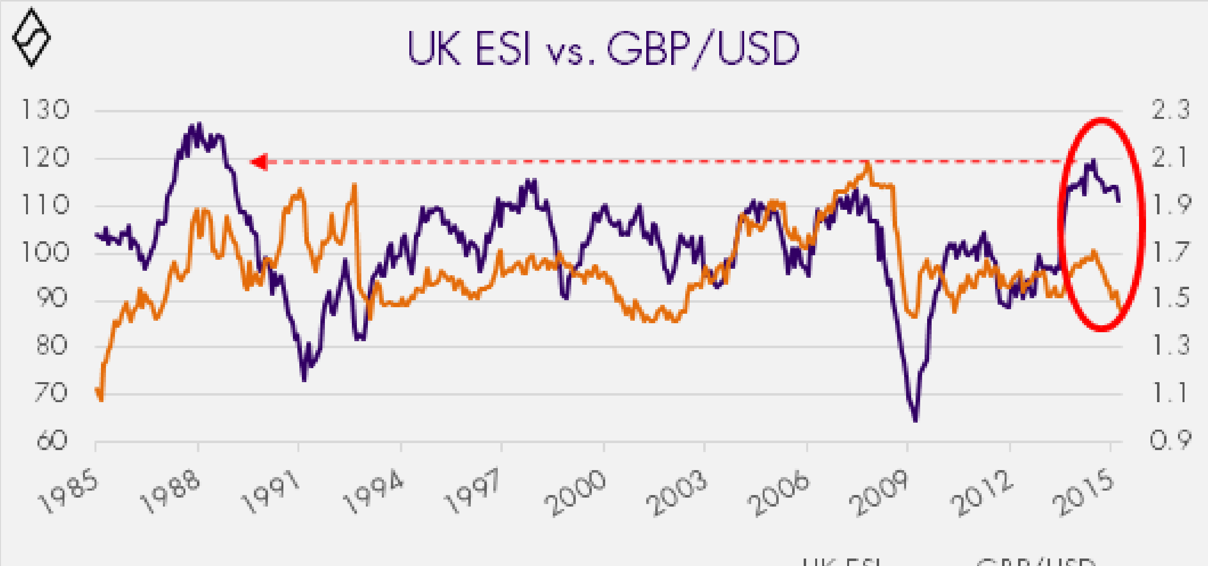
Date taken: 17 Apr 2015
Target 1: 1.4531 / 2.99%
Target 2: 1.4332 / 4.32%
Inception performance: 0.11%

Turning to the marginally tighter central banks and their currencies, we believe the GBP will suffer due to mean reversion in sentiment created by the economy and political uncertainty.

Just take a look at one particular chart of the Economic Sentiment Indicator (ESI) - a weighted average of industrial, services, consumer, retail and construction confidence indicators. It is graphed alongside the GBP/USD since 1985 and excluding the initial mismatch, the directional similarities between the two are startling. It is very clear that the indicator is mean reverting and it reached the top (highest since end of 80s) end of the range and rolled over in the summer of 2014. Yet, there is still a long way down and given that the FX pair has just broken a multi-year support line (1.486) and retraced back up, we believe it is a good time to enter the position and target around 1.25. On the dollar side, there is not much to be afraid of (seemingly) except some short-term bounces, for example before the Fed meeting next week. Yet, Fed funds rate are already pricing a rate increase no sooner than September, discussed even on



Source: Thomson Reuters data



Source: Eurostat, Thomson Reuters

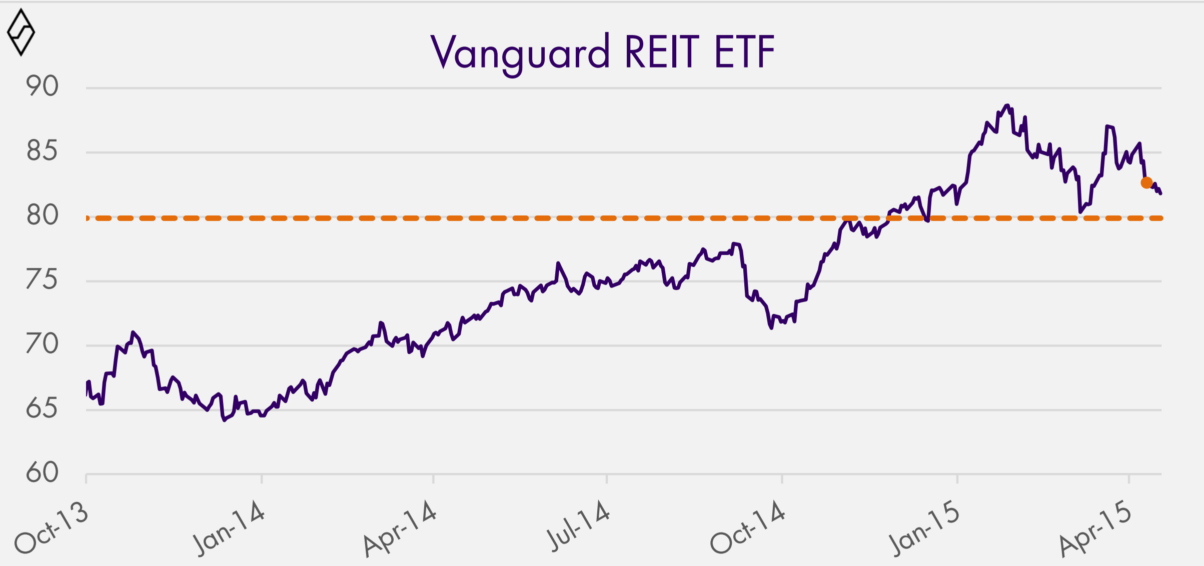
mainstream media, so it should not come as a surprise if there is no rate hike in June. On the contrary, if there is a big surprise (i.e. a rate hike) in June, all the better for our position.
One of the most destructive factors for sentiment is uncertainty (especially political). We've seen it time and time again. For all the negativity surrounding Greece, the country was actually improving before the circus show arrived (you know who I am referring to). The same sentiment indicator (ESI) actually reached pre-2008 levels in the summer of last year with other indicators also improving (for more data and charts look at Greenlight Capital's **presentation**). After all, 'historically, what is important to the market is not whether growth is good or bad, but whether it is getting better or worse' (Colm O'Shea, Hedge Fund Market Wizards).
The UK has been a relatively stable place from the perspective of politics and monetary policy in the last 5 years. Consequently, the country has performed above average. However, uncertainty is increasing on the margin as last year's Scottish referendum pointed out. We looked at the data from pre-voting polls by different agencies and took the 'Yes lead' (people saying they will vote FOR independence minus those saying they would vote AGAINST) as a proxy for uncertainty. The average Yes lead in 2013 was -18 (negative), meaning that a lot more people were determined to vote against independence. Fast forward to summer of 2014 (June – August) and this number had been halved to -9, i.e. increasing uncertainty. Going into the first week of September (vote was on 19 September) the gap was almost inexistent at -3. How did the pound performed at that period? From all major currencies, GBP had the worst performance from beginning of July to 9 September (-5.81%). In the same period the UK economy was actually performing quite well. Not all indicators were perfect but at least from a PMI perspective the country was amongst the best in the world. Meanwhile, Australia and Canada were under pressure due to their exposure to commodities, the EU had already slipped economically back in March and Japan had just printed its lowest GDP number in 5 years (-6.7% QoQ SAAR). My point is that from an economic perspective, GBP should not have been the worst performing currency. Yet, it was, which might be exactly due to the uncertainty factor.
All this brings us to the general election next month. The spread between the first two parties (Tories and Labour) in recent **polls** is roughly 0, which is not great less than a month before the election. I'm not a political person and don't really know much about UK politics so I will cautiously trust Kevin Daly from Goldman Sachs, who thinks it's "not an exaggeration to say that the outcome to this election is more uncertain than any in a hundred years" (**link**).

Vanguard REIT ETF ($VNQ) / NEW

Direction: LONG
Open price: 82.61
Stop loss: 79.90 / -3.28%
Weekly performance: -0.87%

Date taken: 14 Apr 2015
Target 1: 86 / 4.10%
Target 2: 89 / 7.74%
Inception performance: -1.00%

Looking at global yield trends we believe that long term returns on US treasuries are still very attractive even if the Fed raises interest rates. That is why the reach for yield is still the place to go. VNQ is a way to position ourselves in a long term interest yielding instrument. REITs are companies that own and normally manage income-producing real estate or real estate related assets. Home prices have been accelerating, which is good for rents, partially because of an economic aggregate demand increase and partially due to a lot of cheap money looking for a place to be invested in. Also, supply and demand housing data has been trending up and REITs have stronger balance sheets. Even as the US continues to show weaker economic data in general, rents lag at least six months to home prices. Simply put VNQ is the instrument of choice for our macro understanding of the developments in the US economy, which is in for a rough ride now that the easy Q1 is gone. As for inflation, the second factor after employment the Fed focuses on, it is non-existent. CPI fell 0.1% (YoY) in March, while the Core measure (less food and energy) increased 1.8% (YoY). This is supportive of our position, as looking at the breakdown, one of the few things holding the Core measure up is housing.

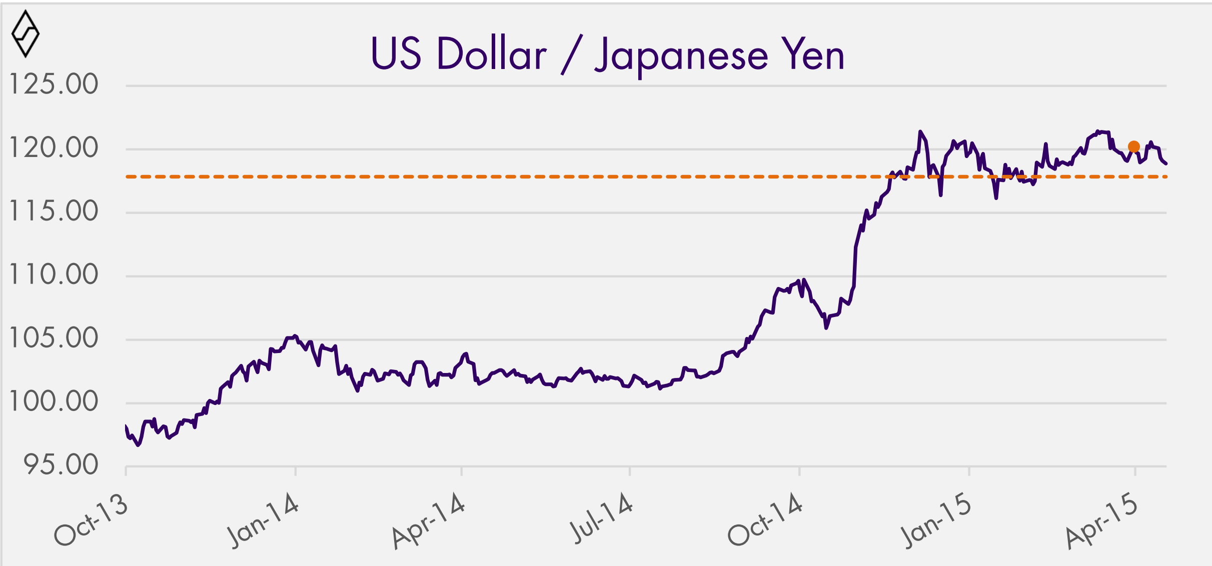


Source: Thomson Reuters data

US Dollar /Japanese Yen (USDJPY)

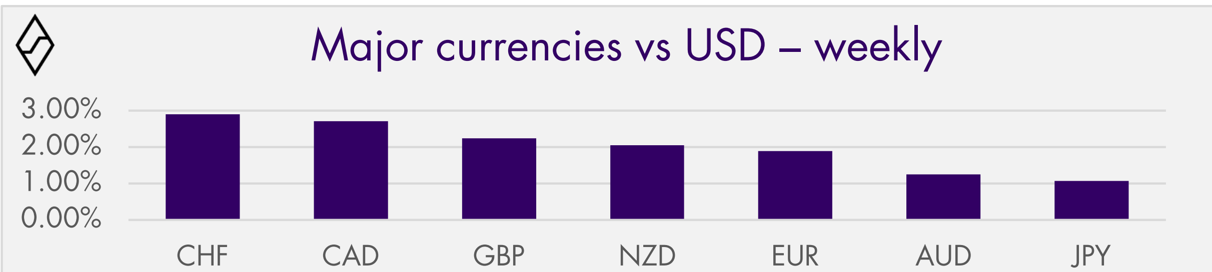
Direction: LONG
Open price: 120.17
Stop loss: 117.86 / -1.92%
Weekly performance: -1.09%

Date taken: 31 Mar 2015
Target 1: 124.00 / 3.19%
Target 2: 135.00 / 12.34%
Inception performance: -1.06%



Source: Thomson Reuters data

The dollar had its timely correction against all major currencies (JPY included). This is in line with the fact that the dollar move has been played quite heavily already, so pullbacks are expected. Fundamentally, our trade is still solid in the intermediate term, although divergences between exposures and FX movements might push the yen sharply up in the immediate term, which will probably get us stopped out of this trade. For more explanation look at the text for EUR/JPY above.



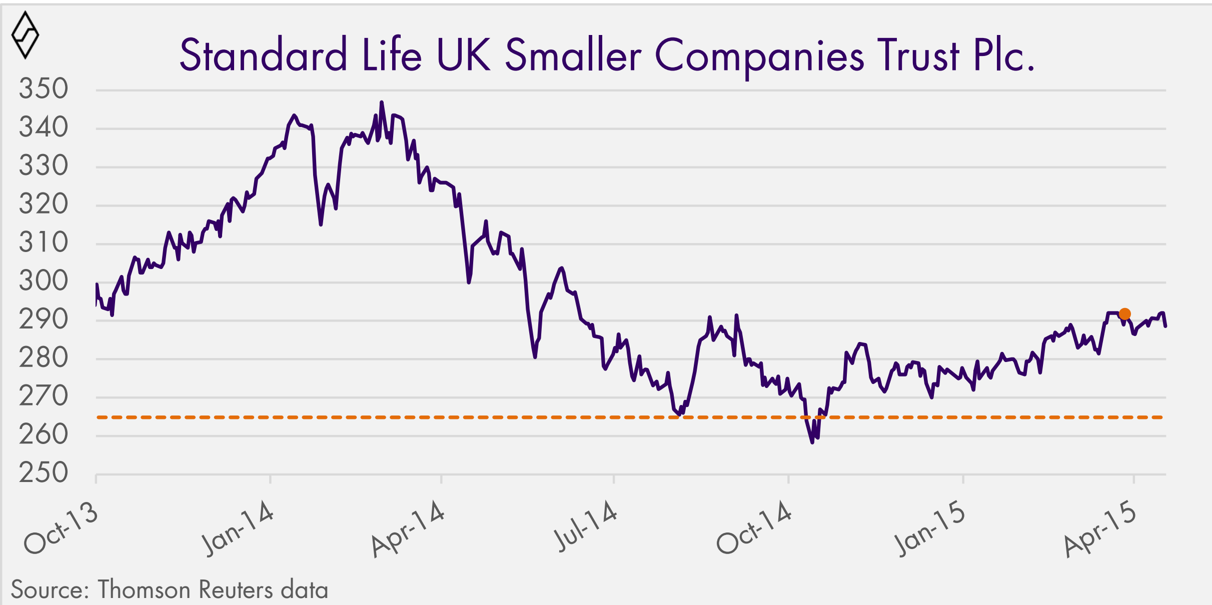
Source: Thomson Reuters, as of 17.Apr close

Standard Life UK Smaller Companies Trust Plc (£SLS)

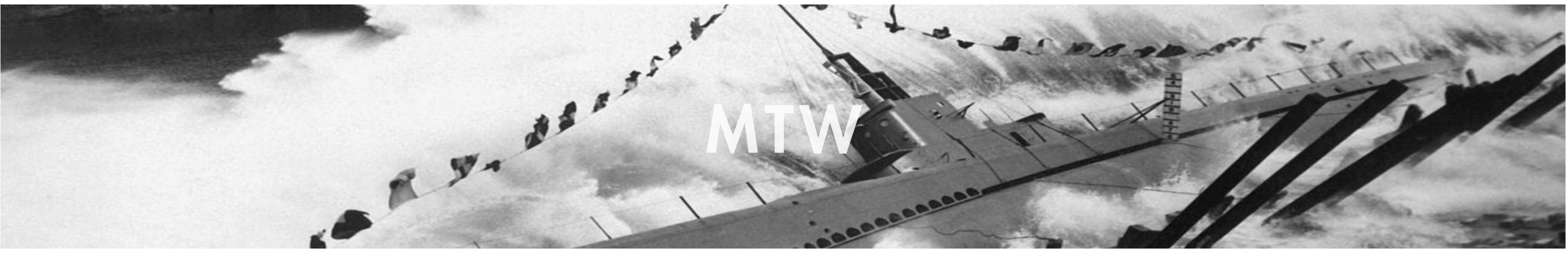
Direction: LONG
Open price: 291.75
Stop loss: 264.75 / -9.25%
Weekly performance: -0.73%

Date taken: 31 Mar 2015
Target 1: 310.00 / 6.26%
Target 2: 330.00 / 13.21%
Inception performance: -0.51%

There is no material update for Manitowoc this week but the long comments about the GBP/USD short position might be relevant here as well. Even though we are bearish on the pound, that does not necessarily make us negative about the stock market. In fact, recent times have shown us that cheap currency means stock market gains, so following that logic, a cheaper pound might be even a more attractive environment for this position than a strong currency. I think so far there has been no indication that the trend will not be our friend and the security is slowly but surely climbing up. If it manages to confidently break the 290 level, we might move our stop loss up to reduce our risk further.



Manitowoc Company Inc. ($MTW)



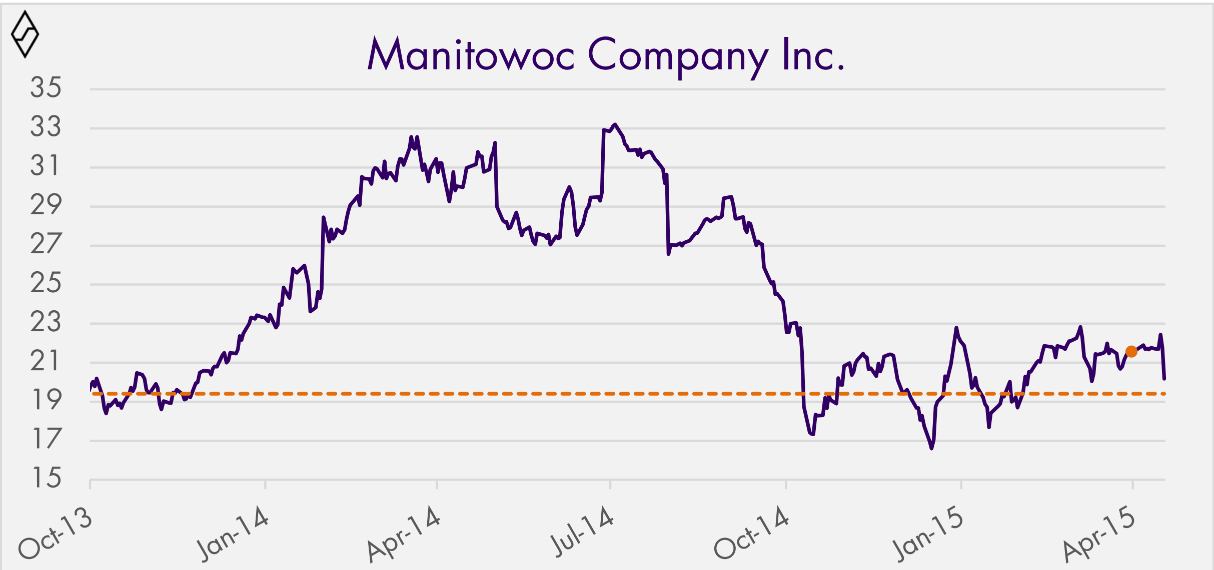
Direction: LONG
Open price: 21.55
Stop loss: 19.40 / -9.98%
Weekly performance: -7.31%

Date taken: 31 Mar 2015
Target 1: 25.75 / 19.49%
Target 2: 33.78 / 56.75%
Inception performance: 6.40%

Manitowoc fell 7% after the company revised down its 2015 guidance for the food-service Equipment segment and pronounced a weaker than expected 1Q 2015. This was followed by a downgrade made by several analysts before the official earnings' announcement next week.

Lower than expected capital expenditure by food-service clients resulted in a weak traffic for most of the quarter. On the positive side, comments made about the cranes segment were quite positive, mentioning some improvement in the business. This might come as a surprise to everyone that expected the decline in oil prices to hurt the business of selling cranes.

The fundamental long-term case for the company is still in place and the value of the two separate businesses is worth significantly more than what the current company is trading at. Yet, in risk management that does not necessarily matter and we might be stopped out due to a temporary sell off. Only time will tell.



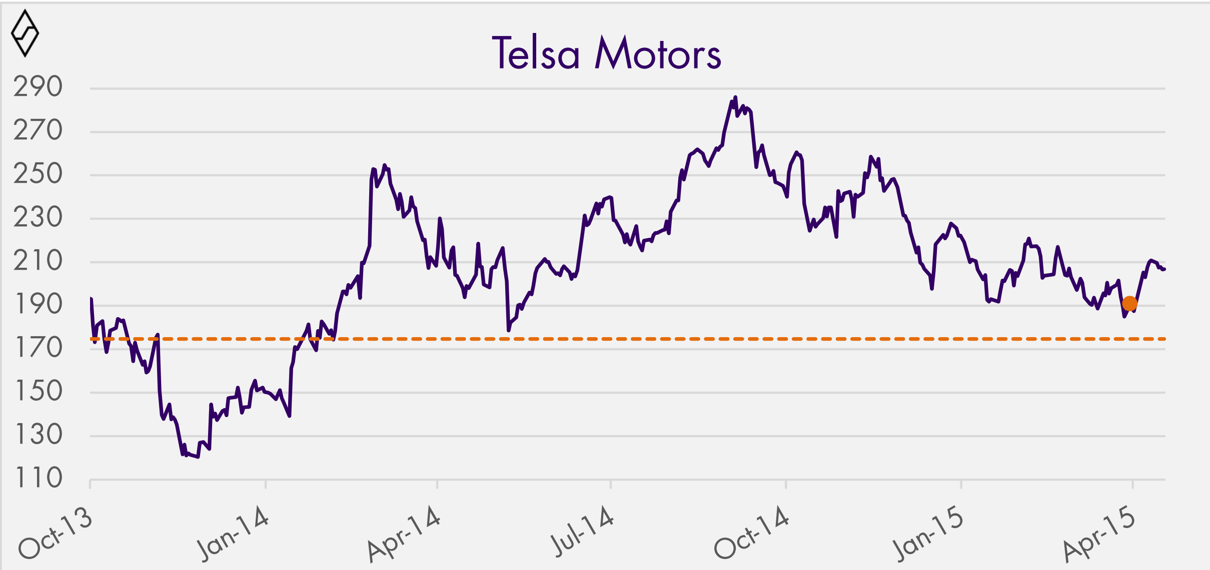
Source: Thomson Reuters data

Tesla Motors ($TSLA)

Direction: LONG
Open price: 191.75
Stop loss: 174.80 / -8.84%
Weekly performance: -1.95%

Date taken: 31 Mar 2015
Target 1: 220.00 / 14.73%
Target 2: 260.00 / 35.59%
Inception performance: 8.22%

There is no material update for Tesla Motors this week. After a strong performance in the previous 5 days, the stock sold off slightly, which is something perfectly normal.



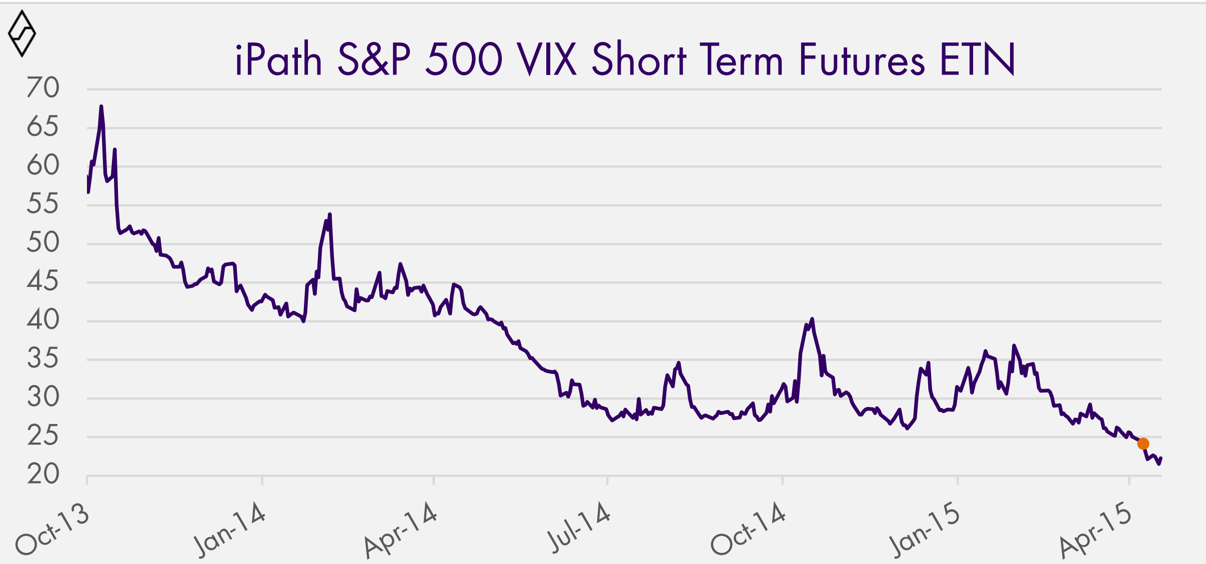
Source: Thomson Reuters data

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

Direction: LONG
Open price: 24.09
Stop loss: N/A
Weekly performance: 0.86%

Date taken: 8 Apr 2015
Target 1: 29.00 / 20.38%
Target 2: 34.00 / 41.14%
Inception performance: -7.50%

On a weekly basis volatility had a modest positive performance, however, Friday was one of those interesting days when the VIX just pops up 10% just like that. Was it the Bloomberg terminal's half day outage, or rumors about a Greek default, or a bit of both plus something else? We don't know but it was a fun day and we expect more of those given the narrowing shape of equity volatility since its multi-year low of 10.28 on 3 July last summer. Given that we are approaching the seasonally weak month of May, this position might perform well in the next month or so. 'Sell in May and go away' sounds rather silly, but the seasonal patterns do not lie. We will present our research about seasonalities this weekend in our monthly issue of Sierra. Having said that, we are also looking at other possibilities to trading the volatility index (VIX). While this ETF ($VXX) has a very close correlation to the actual VIX index, it also has a downward sloping drift, meaning that unlike the VIX itself, it is not restricted to go under certain levels. That makes managing the position a rather unpleasant process, which we are looking to avoid.



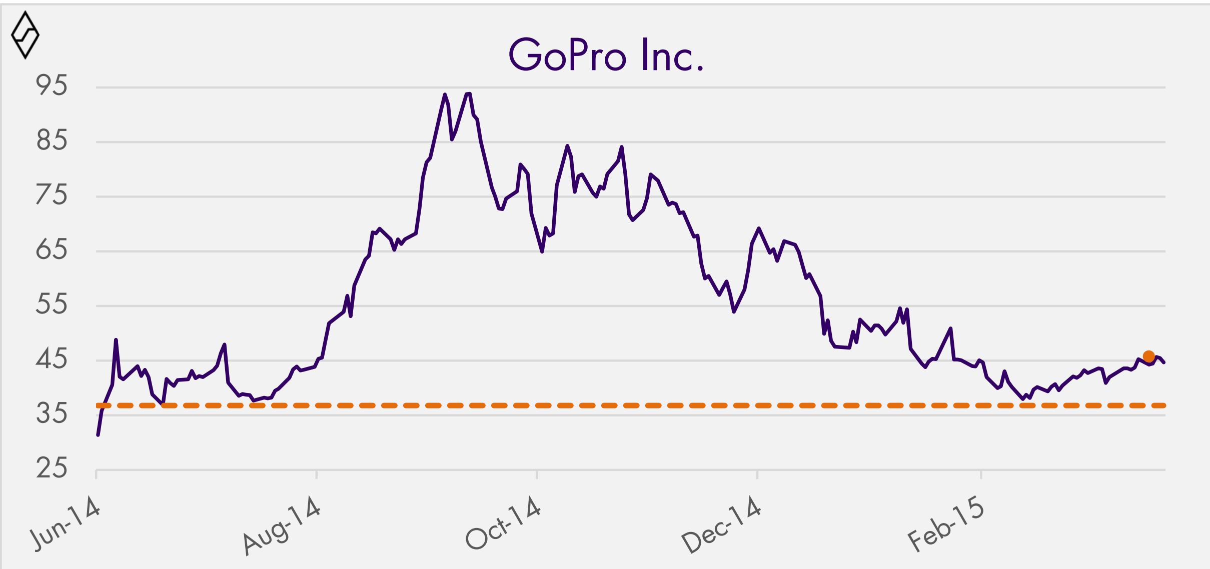
Source: Thomson Reuters data

GoPro Inc. ($GPRO) / NEW

Direction: LONG
Open price: 45.67
Stop loss: 36.75 / -17.58%
Weekly performance: -1.39%

Date taken: 13 Apr 2015
Target 1: 55 / 20.43%
Target 2: 70 / 53.27%
Inception performance: -2.41%

For GoPro, let's firstly get one thing out of the way, we entered the position mainly for its amazing risk/reward timing. That's it!
On another note, we entered this specific company, compared to others that have the same risk/reward timing, because we view this device, as the Apple for cameras. The thing just works well and people don't only pay good money for it. However as we said, we entered it mainly because of the timing, so on that note, here's what we see. The company has a relatively high short interest as percentage of float – 37.8%. Also, the days to cover ratio has reached 4, this along with a huge decline of -54.69% from the top to its current price (as of 17.Apr), the stock is one of the likely ones to be short squeezed, should there be a positive reaction on the upcoming Q1 Financial results on April 28th. This puts us in a favorable position from a risk-reward perspective.
On another note, the company released this week another cool product: HEROCast™, which is the smallest, and lightest professional live-broadcast transmitter... Not that we took this into account when taking the decision, however it's worth mentioning now.



Source: Thomson Reuters data

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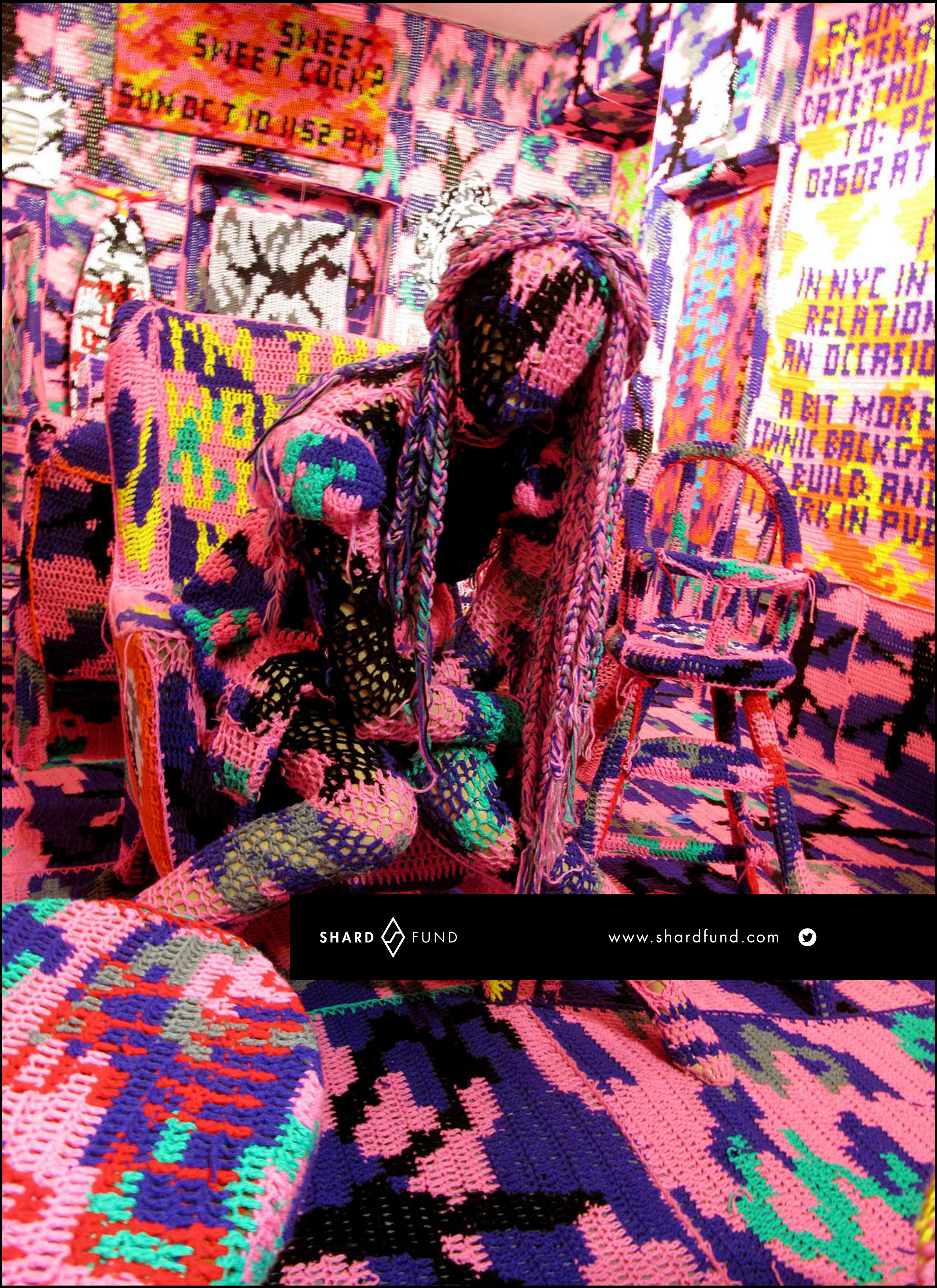
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