RCUBE

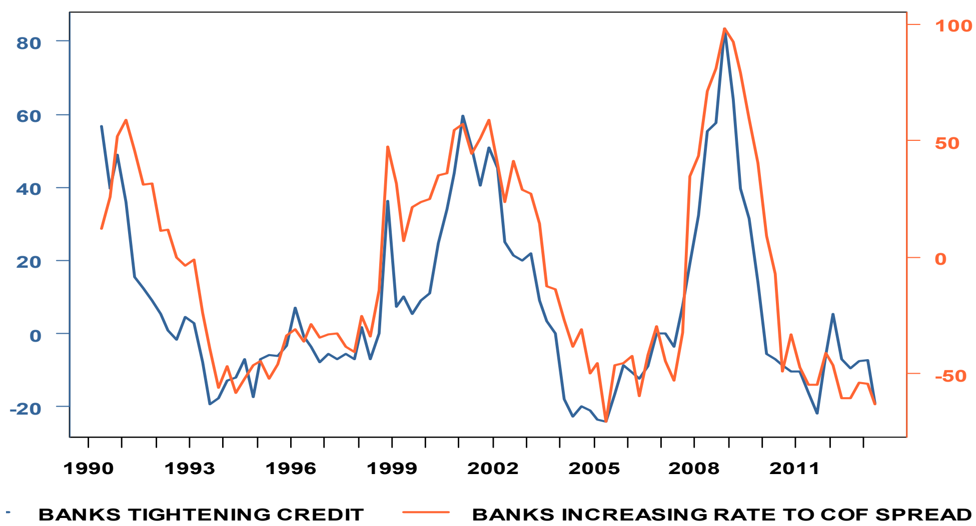
Global Macro Monthly Review

August 2013

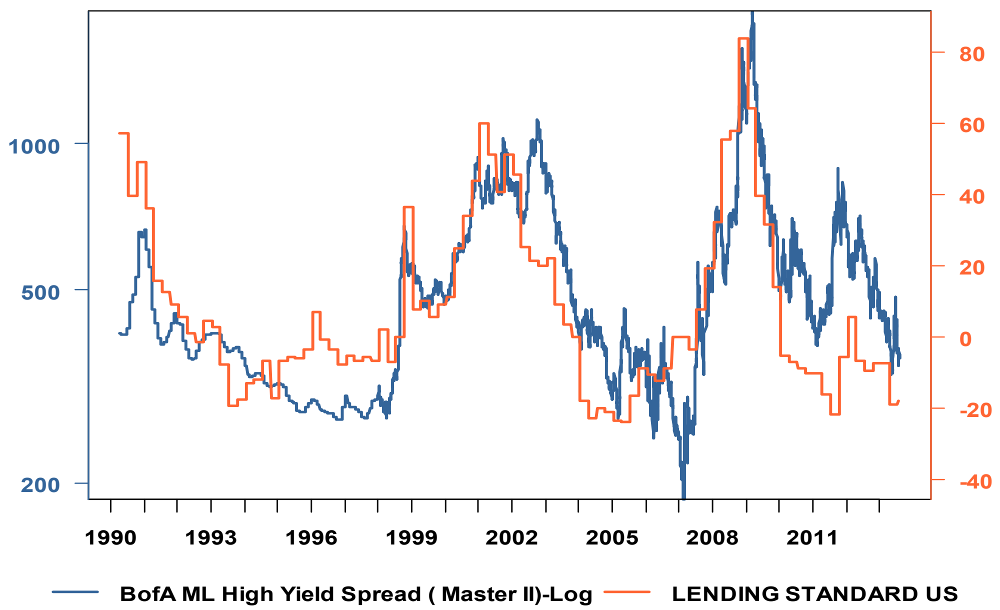
This publication describes our asset allocation views and explains the reasons behind our main portfolio moves for the preceding month.

The FED Senior Loan Officer Survey was released earlier this week, it brings little to what is already known (and priced). Banks are lending, lending standards are being eased and spreads over cost of funds are narrowing further.

US BANK LENDING SURVEY - (LARGE & MEDIUM FIRMS)



US HIGH YIELD SPREAD vs US LENDING STANDARD



GLOBAL MACRO MONTHLY REVIEW

August 2013

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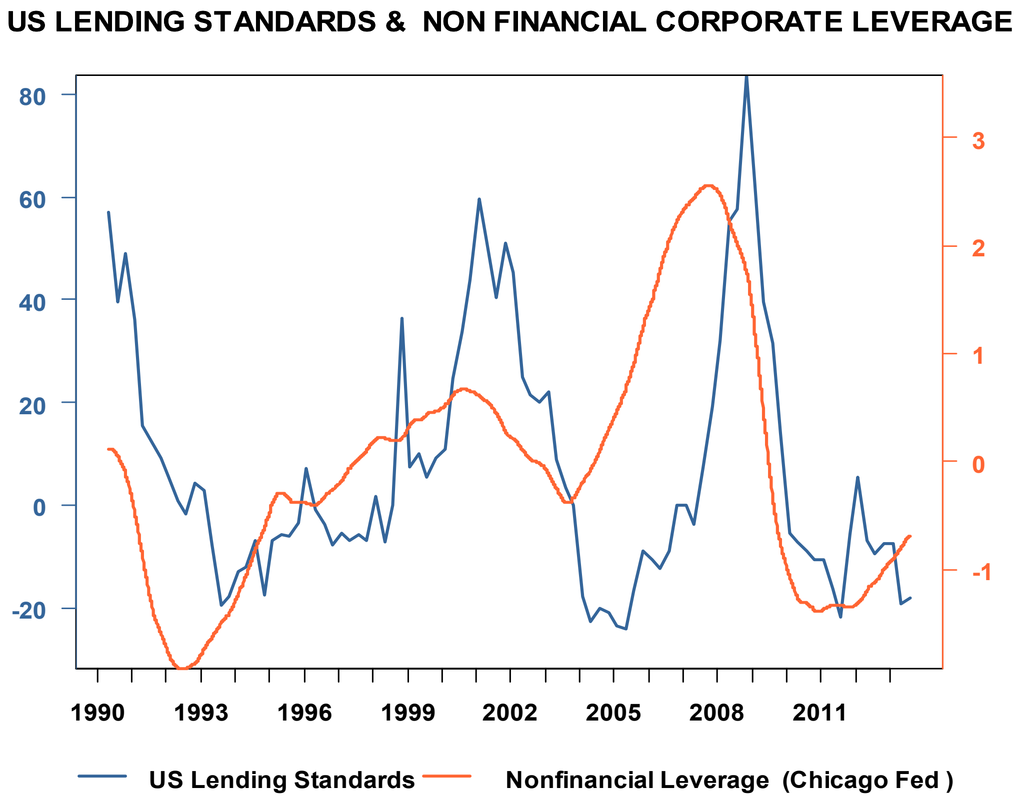
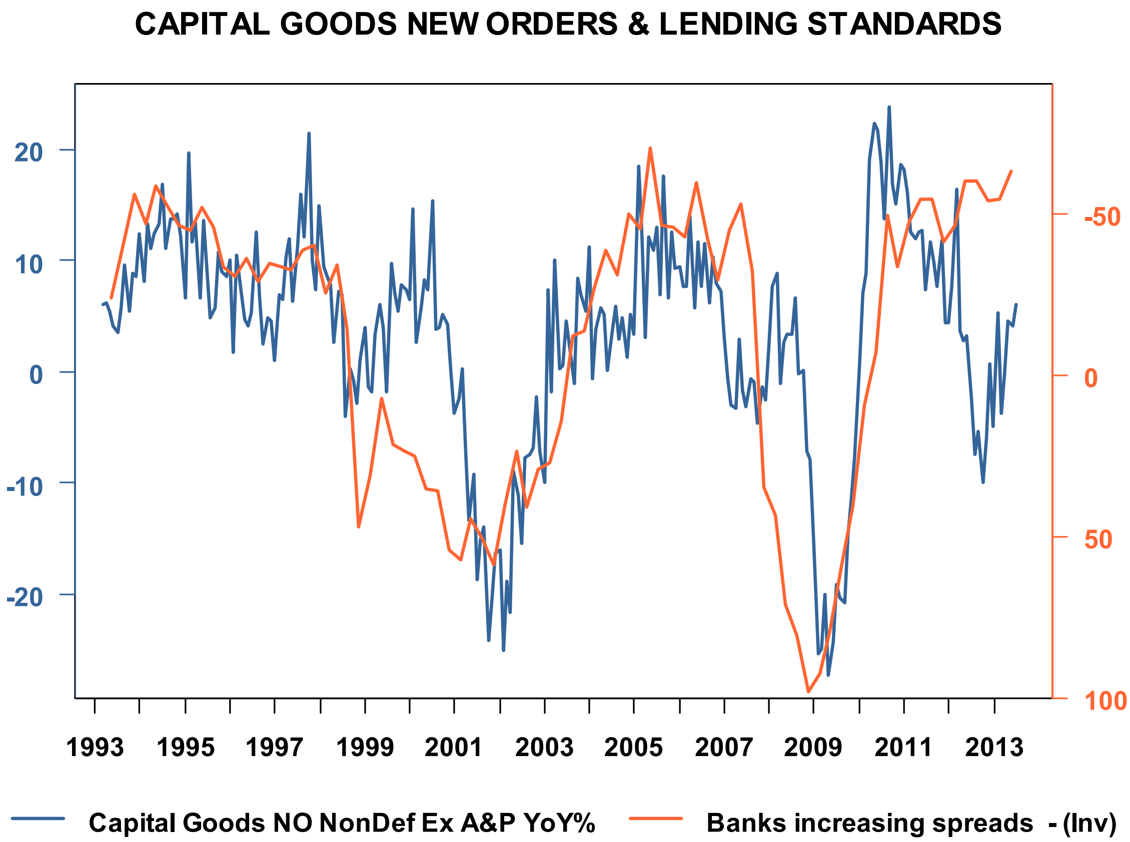
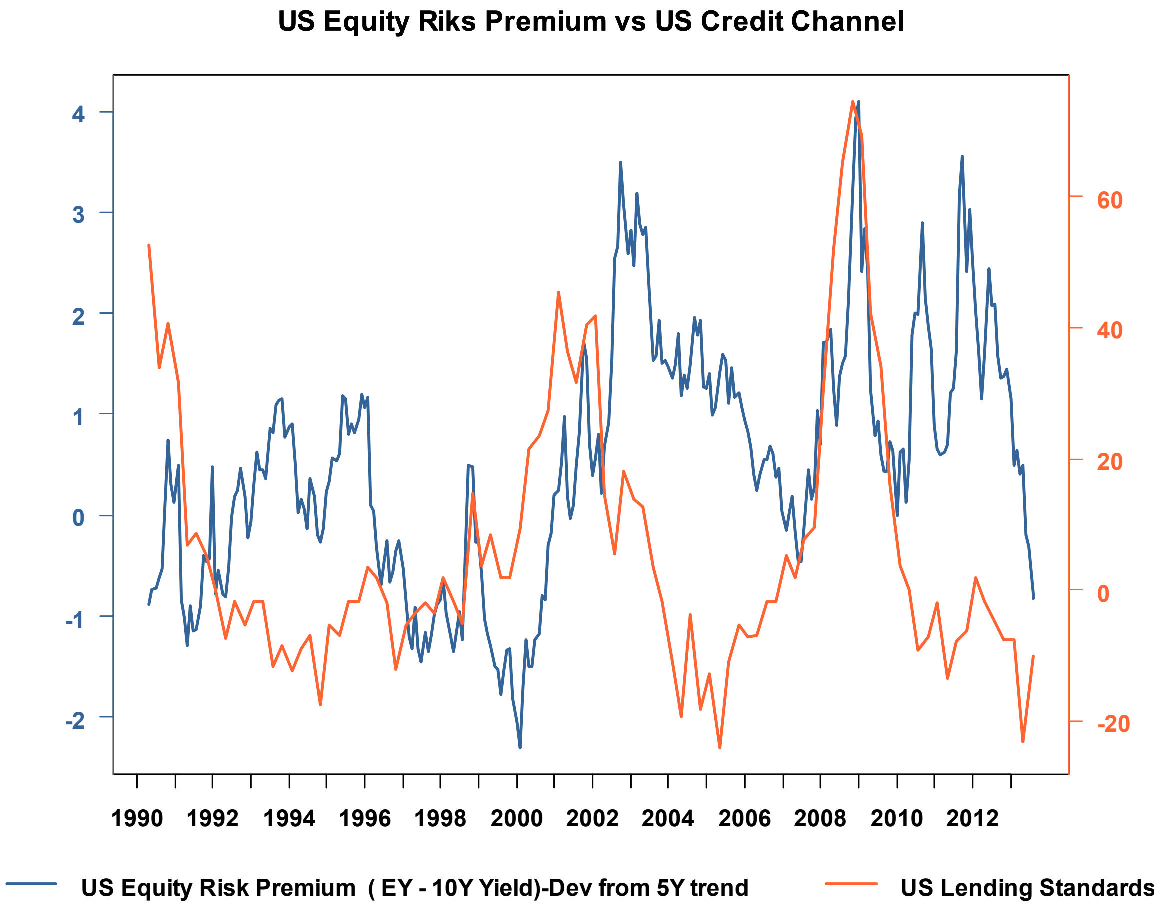
This should remain broadly unchanged in the next few quarters since non-financial corporate balance sheets remain strong.



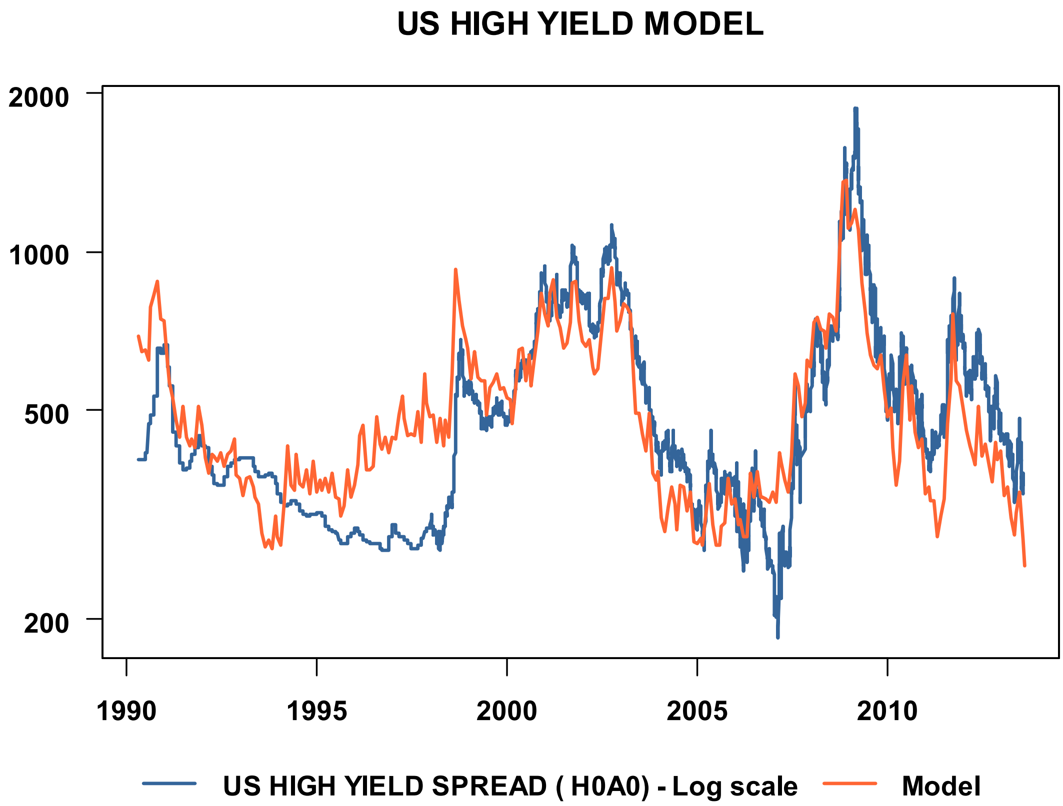
As a result, demand from both households and corporate should remain firm.



The equity risk premium has already started to normalize through higher equities and more recently higher bond yields.

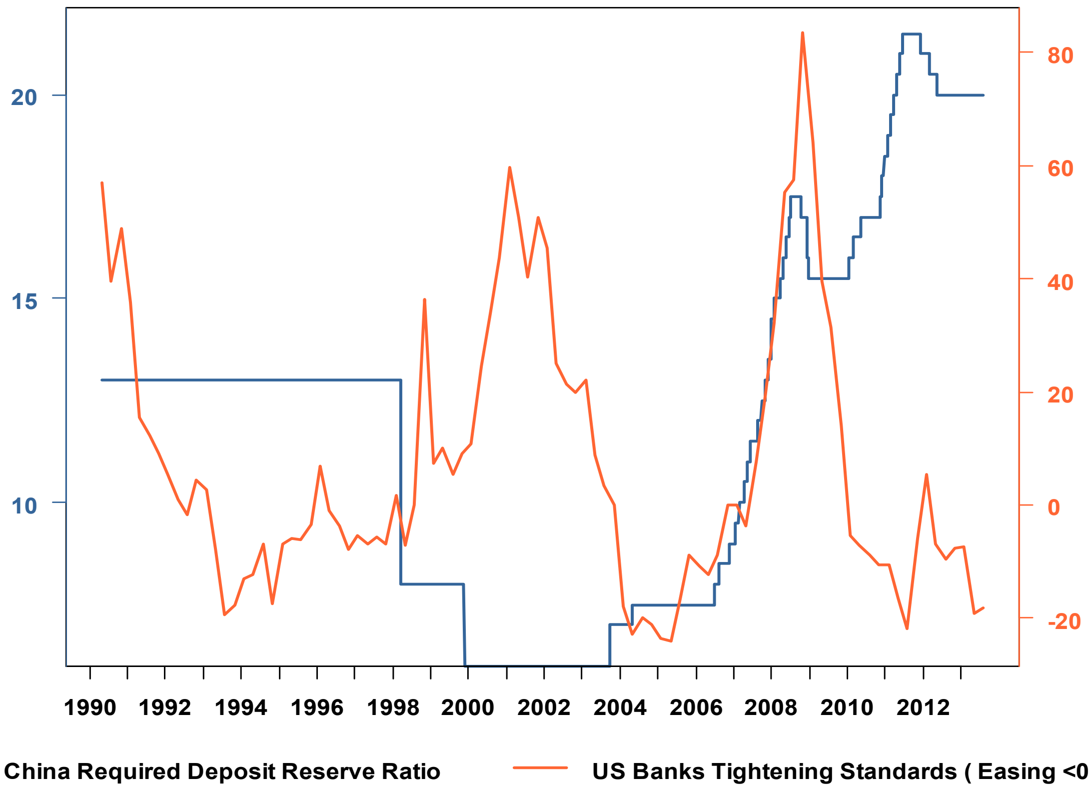


Credit spreads should stay relatively tight as our model is showing. Credit availability is ample and balance sheet leverage is low.



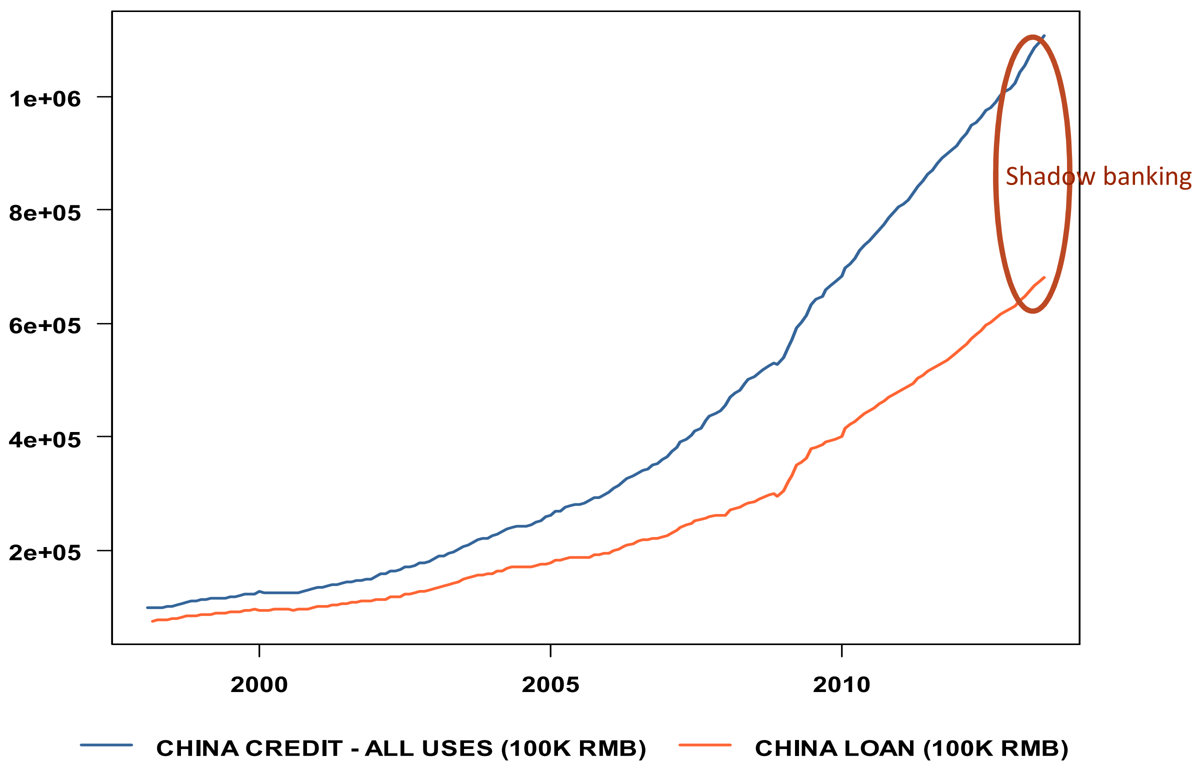
Contrary to what is happening in the US, it is likely that bank lending behavior is now starting to tighten meaningfully in China. Reserve Requirement Ratios are historically high. Authorities are now targeting the distribution of credit through the shadow banking system.

US vs. CHINA CREDIT SUPPLY



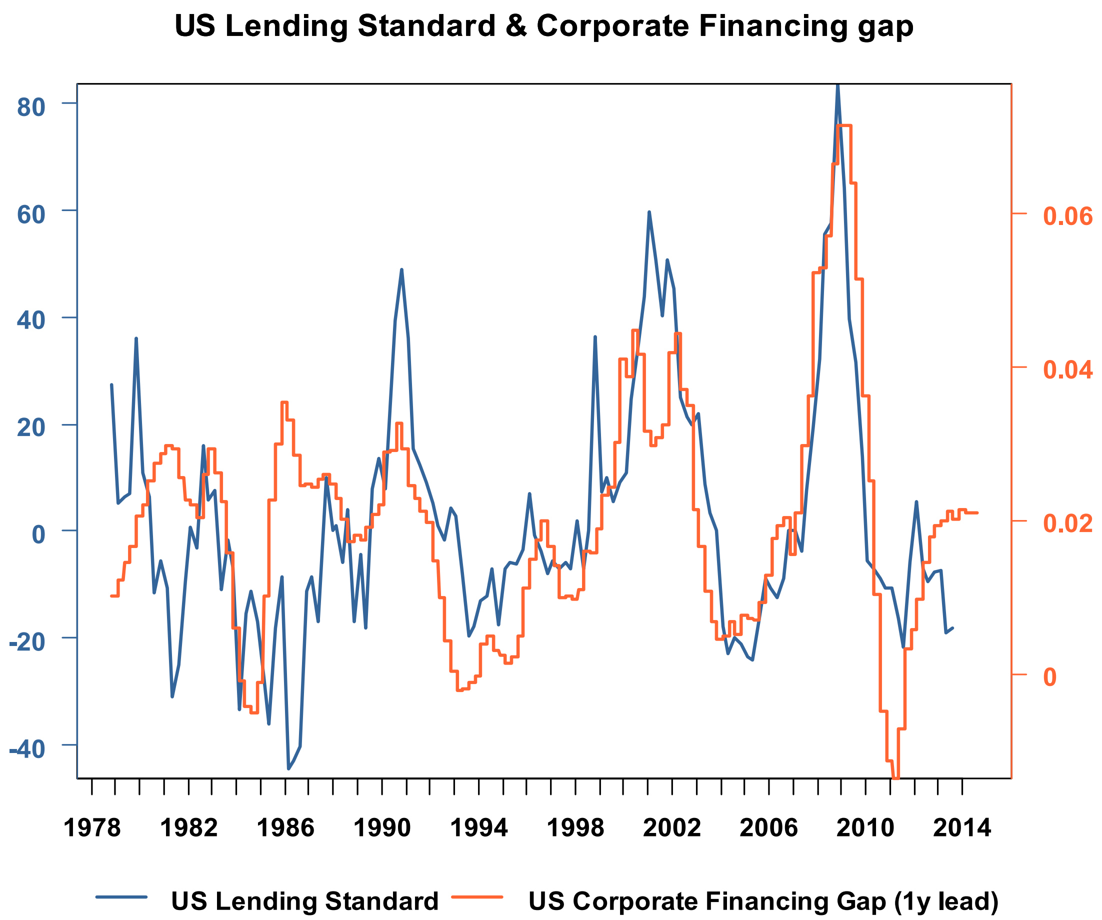
There has been a massive credit growth over the last 5 years combined with an epic real estate boom.

CHINA CREDIT GROWTH



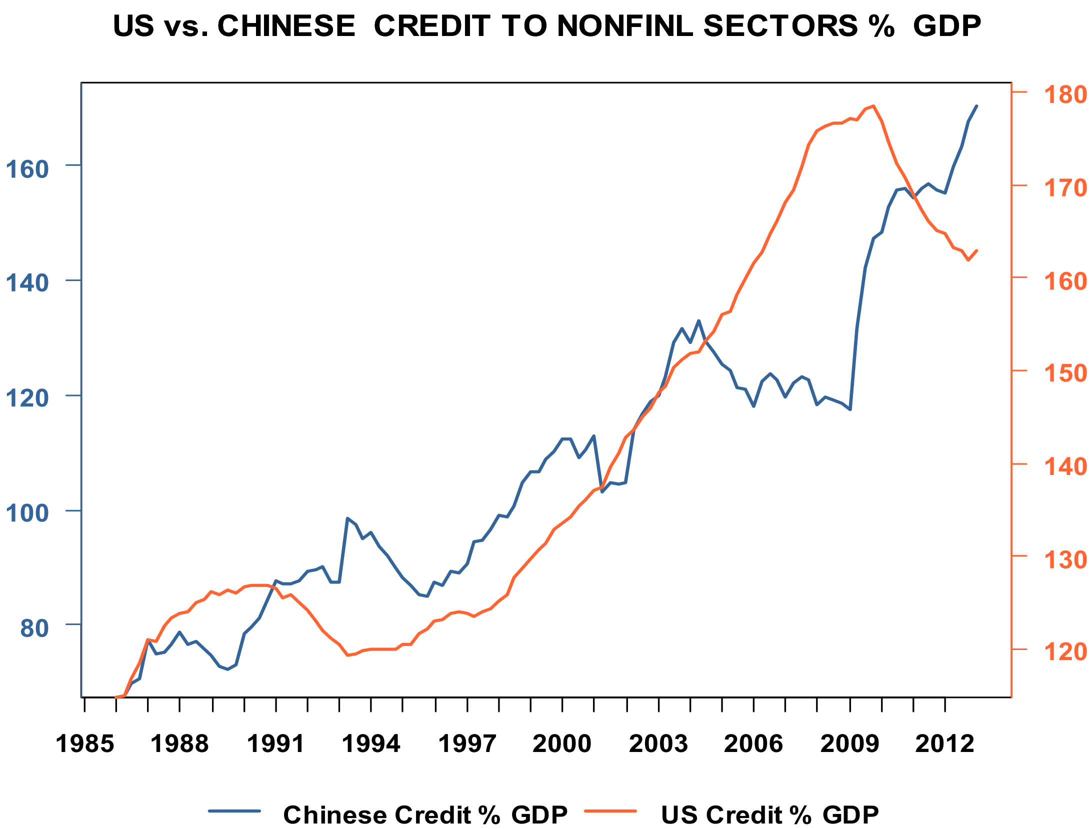
Mr Albert Wojnilower wrote in 1980 in a major piece titled :"The Central Role of Credit Crunches in recent Financial History": The key observation ….is that the propensity to spend (that is the demand for nominal GNP) and therefore the demand for credit are inelastic (or at times even perversely positive) with respect to the general level of interest rates. The growth of credit is therefore essentially supply-determined-if not always, then at least at those times that are cyclically important; and not at every level of rate, then at least at any level that the community on the basis of its experience has regarded as remotely conceivable".

We fully agree with the thesis and have tried to show in the past why bank lending behavior was so crucial in determining expected demand. We also have explained why bank lending behavior was mostly influenced by non-financial corporate leverage.

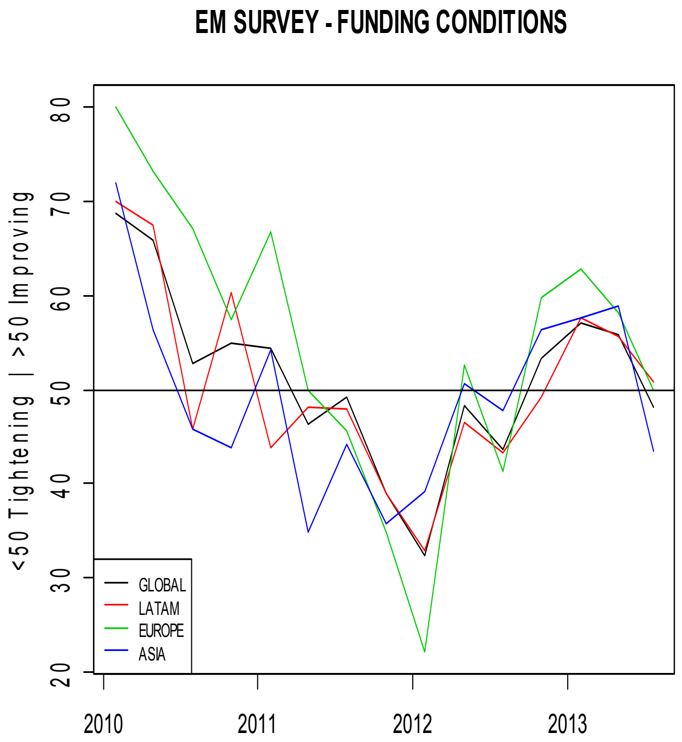


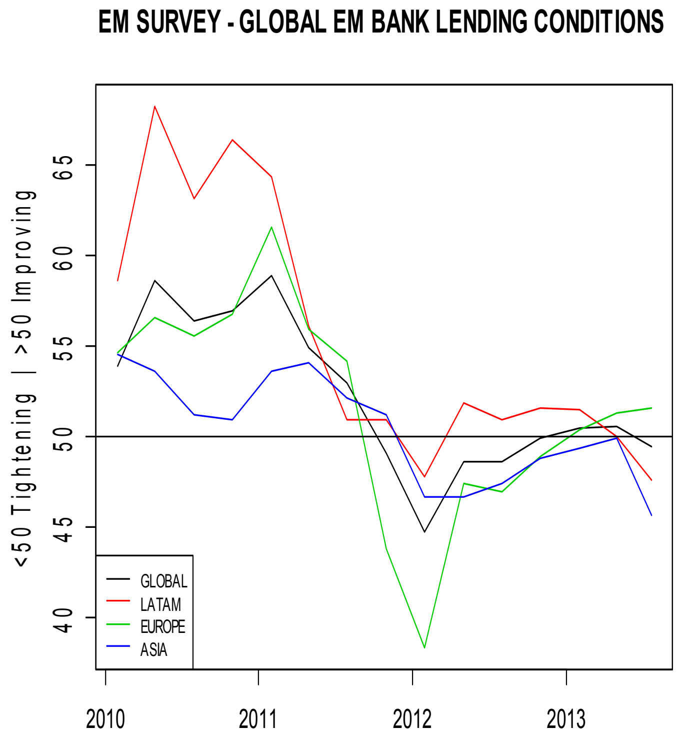
After an aggressive private sector credit growth expansion (like in the US between 2004 and 2007, or in China since 2009), corporate balance sheets health weakens. Consequently banks become less accommodative. A credit crunch usually follows. If the explosive credit growth is associated with a real estate bubble, the shock is all the more violent.

The Chinese non-financial sector debt to GDP ratio has almost doubled over the last 5 years, implying that balance sheet health has substantially deteriorated. Bank lending behavior will most likely become much less accommodative as a result of weak borrowers balance sheets and increased regulation by the authorities.



The IIF Emerging Markets Bank Lending Conditions Survey showed that bank lending conditions in Asia have weakened to the lowest level since at least 2011 when the survey began.

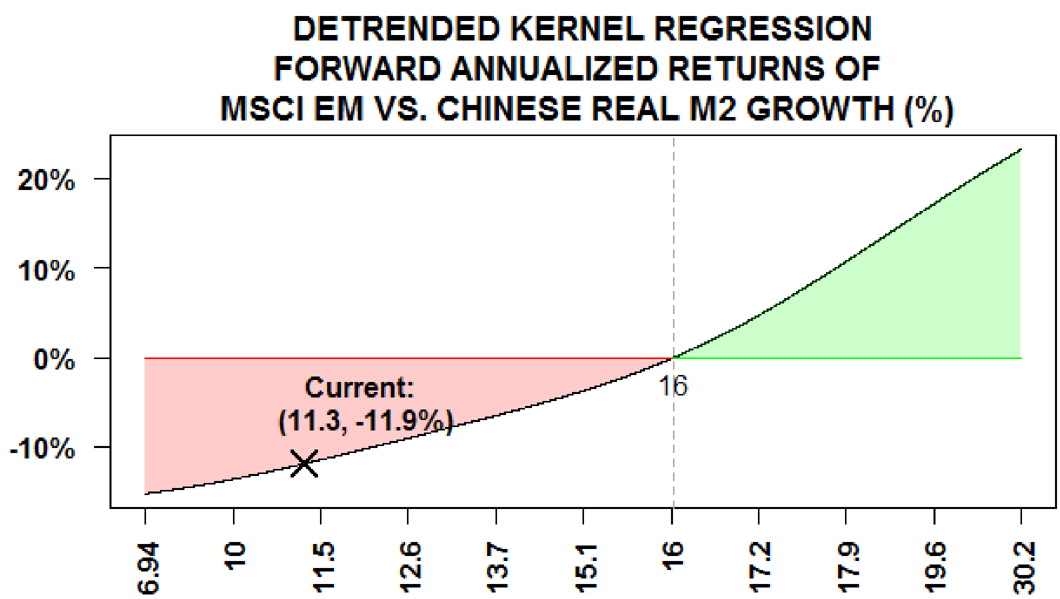




Source: The Institute of International Finance - Emerging Markets Bank Lending Conditions Survey - 2013Q2 -

We failed to apprehend that credit conditions in China would deteriorate so quickly, and paid the price with our emerging market equity exposure.

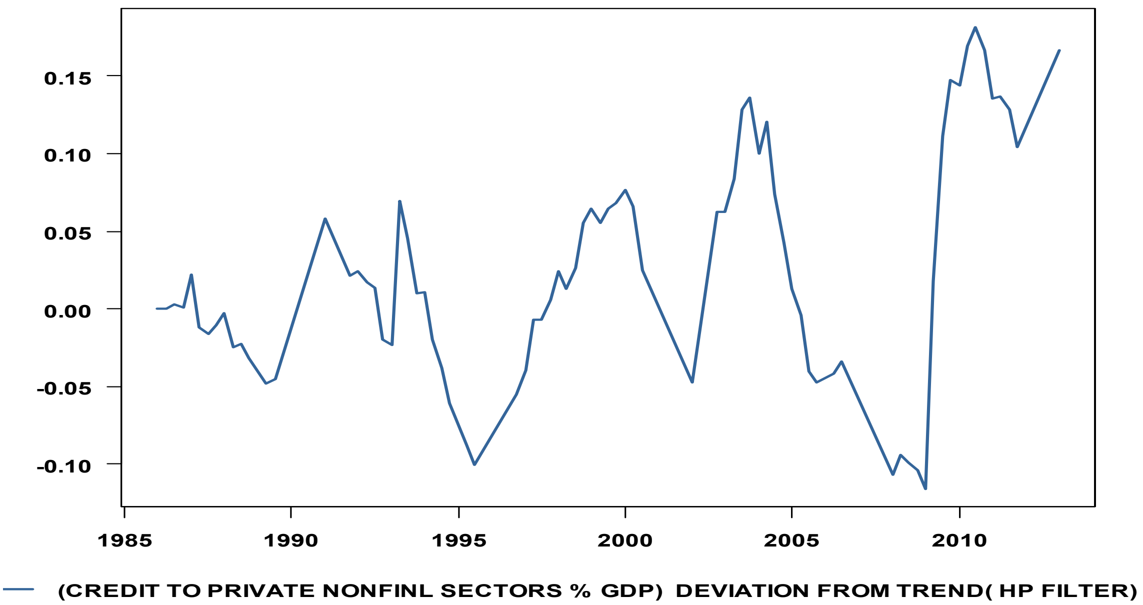
Now the main challenge is to understand if the recent regulatory crackdown by the POBC of the shadow banking system, which has been able to circumvent higher reserve requirements, has set in motion a negative dynamic for animal spirits in China. Certainly all ingredients seem to be in place now for a credit crunch to take place, namely: weak borrowers' balance sheets, regulatory constraints, an housing and credit bubble. Given the well-known impact of credit growth on Chinese equities and EM equities expected returns as the chart below shows, the recent rebound might be nothing else than a brief short squeeze.



The BIS published a piece called "Total credit as an early warning indicator for systemic banking crisis". In it, it shows that relying only on bank credit can be misleading since it does not take into account shadow banking flows. As a result they have built a new set of data that includes credit for both households and the non-financial private sector from all financial sources. Once the total credit to GDP ratio has been calculated, we, just like them look at the ratio's deviation from its one-sided long term trend using a one sided Hodrick-Prescott filter.

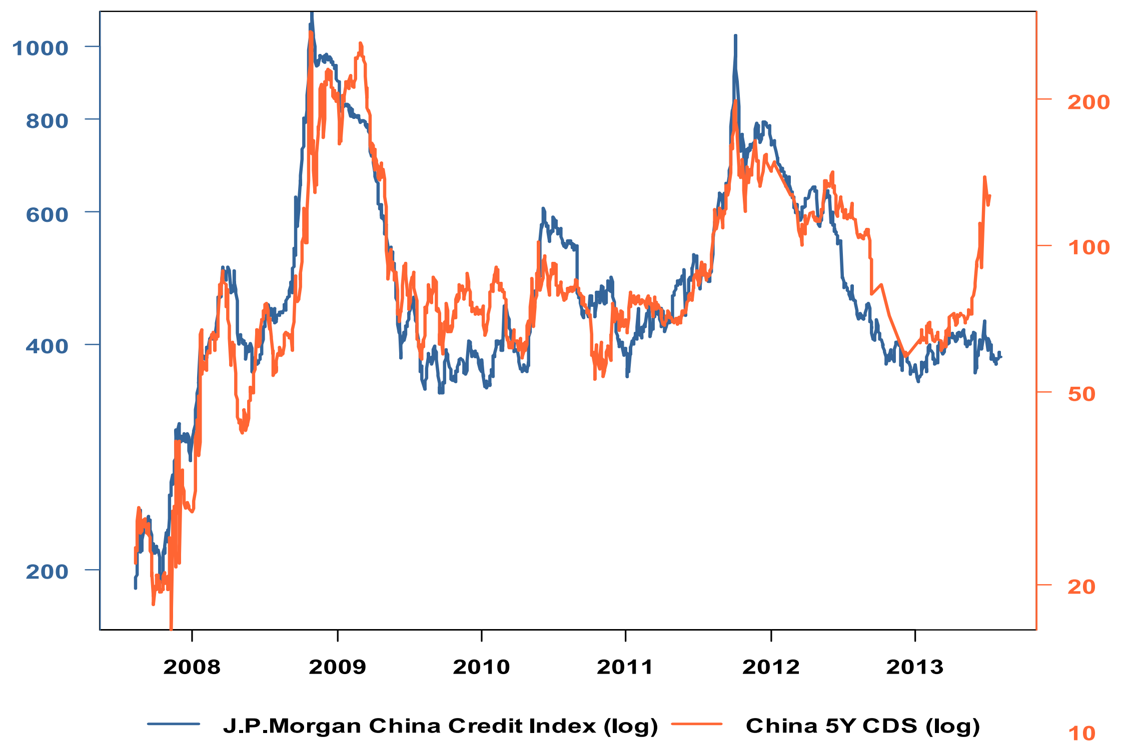
On that basis it is interesting to see that China's total credit to GDP gap is dangerously high

CHINESE CREDIT GAP

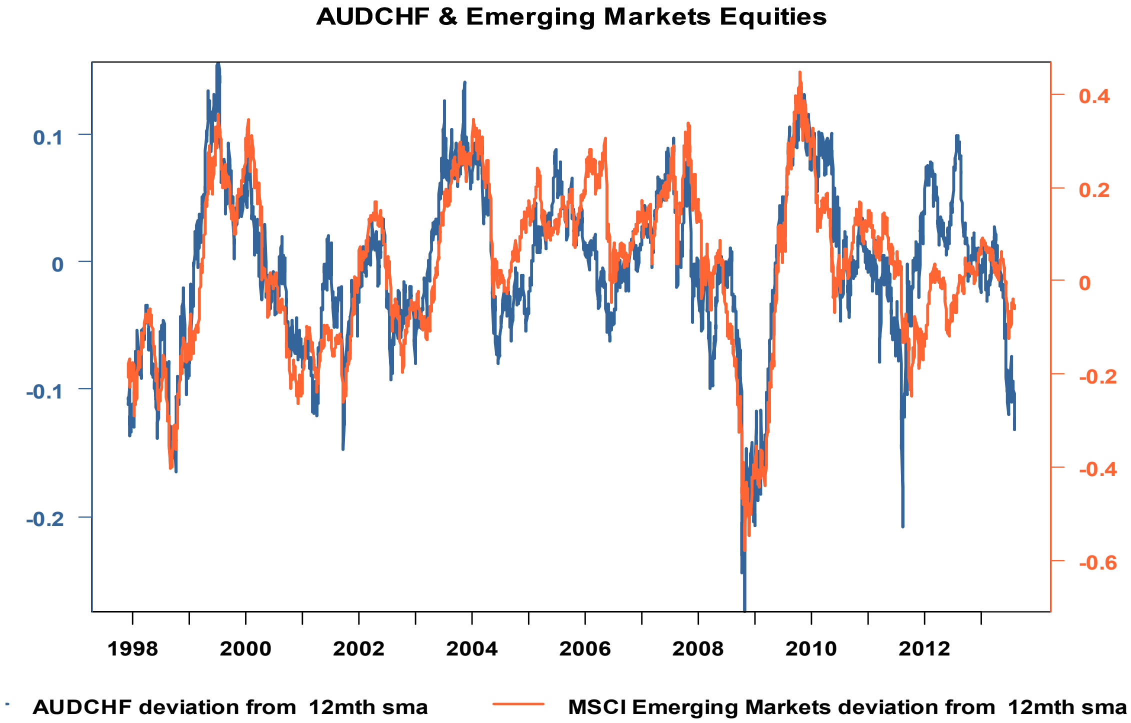


First signs of a credit crunch should be visible on Chinese corporates' credit spreads. So it is extremely important going forward to pay close attention to these. So far there has been little spread widening, but as the chart below shows, China's sovereign risk has risen.

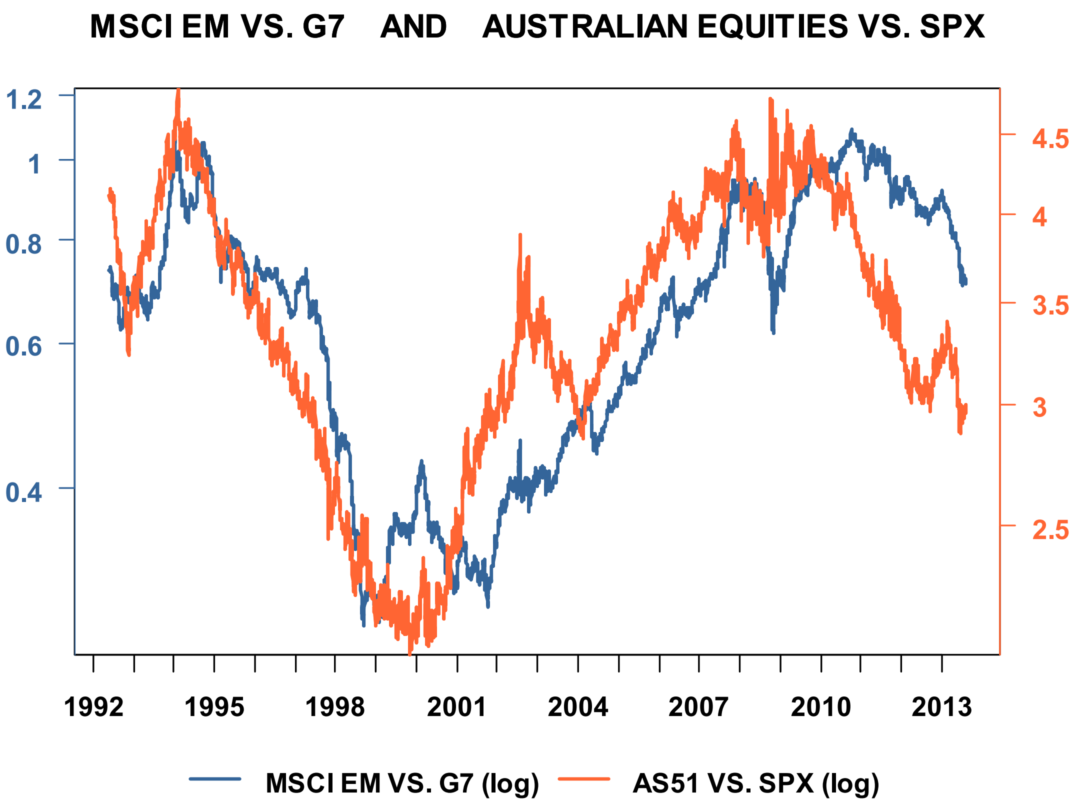
CHINA CREDIT SPREAD VS. SOVEREIGN RISK



Australia as a leading indicator is currently sending worrying signals on Chinese growth and as a result on emerging market equities.

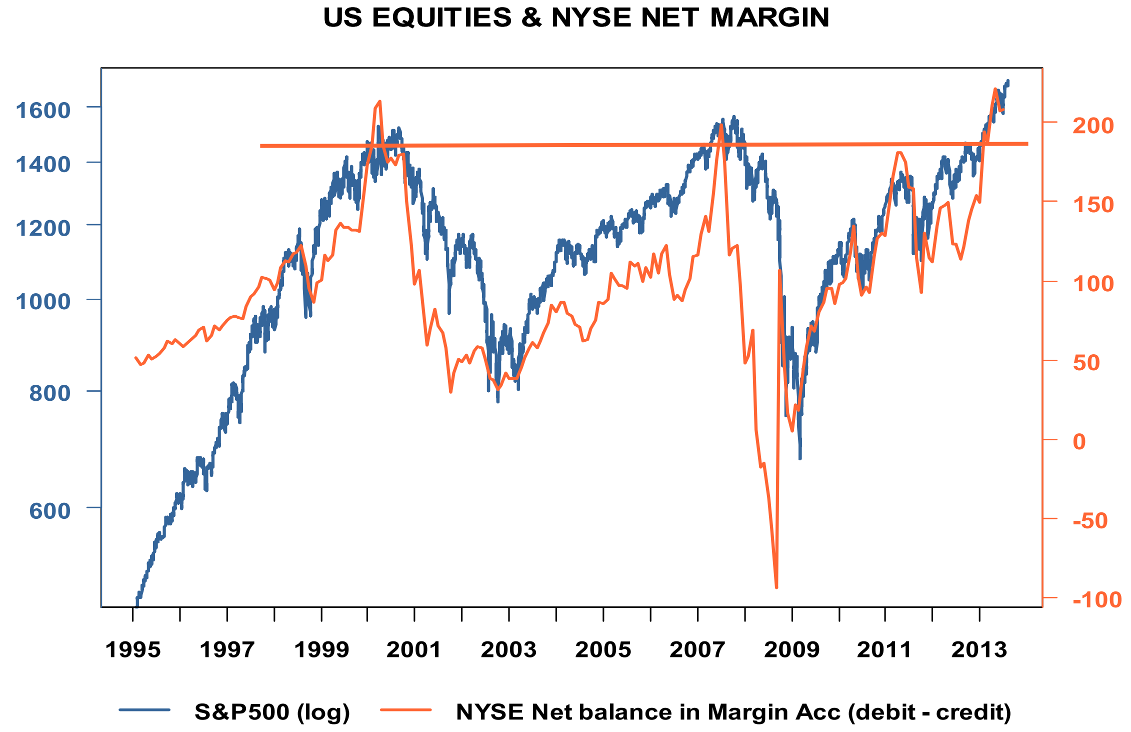


Australian shares relative weakness is another.

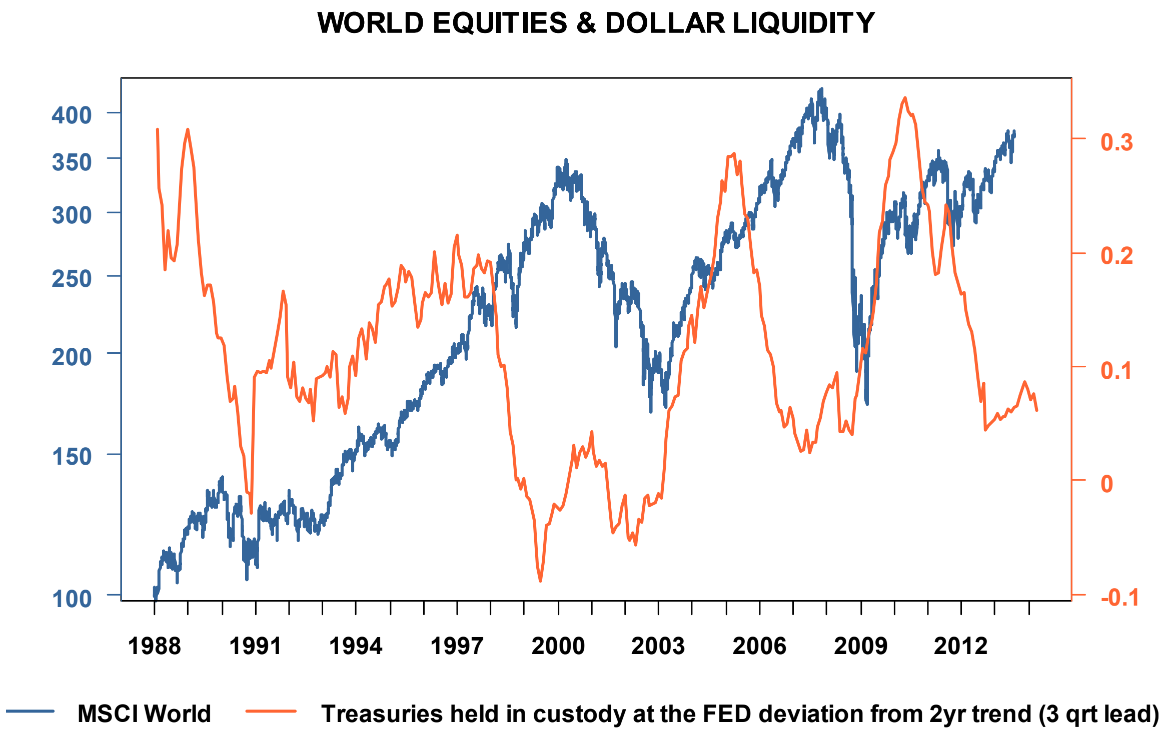


It looks to us that clouds are starting to accumulate on the horizon for equities. The sharp increase in yields globally and in energy prices, combined with the risks of a credit crunch in China and its deflationary consequences are warning signals at a time when signs of investors' complacency are appearing.

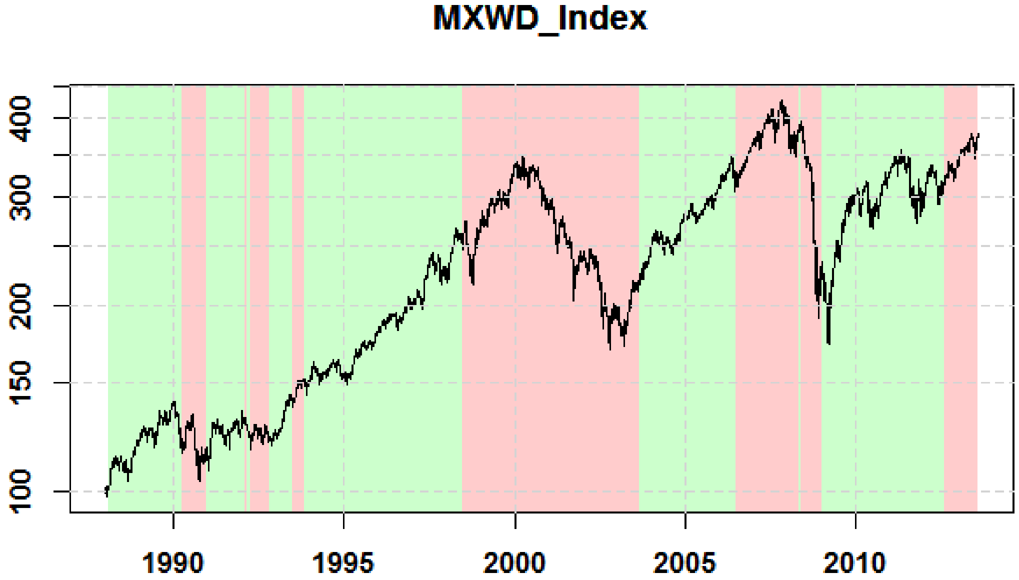
NYSE net margin balances have spiked to historical highs (above 2000,2007 and 2011 levels). In itself this is not a timing indicator, but it warns that in case things don't unfold as expected, the market reaction could be surprisingly violent.

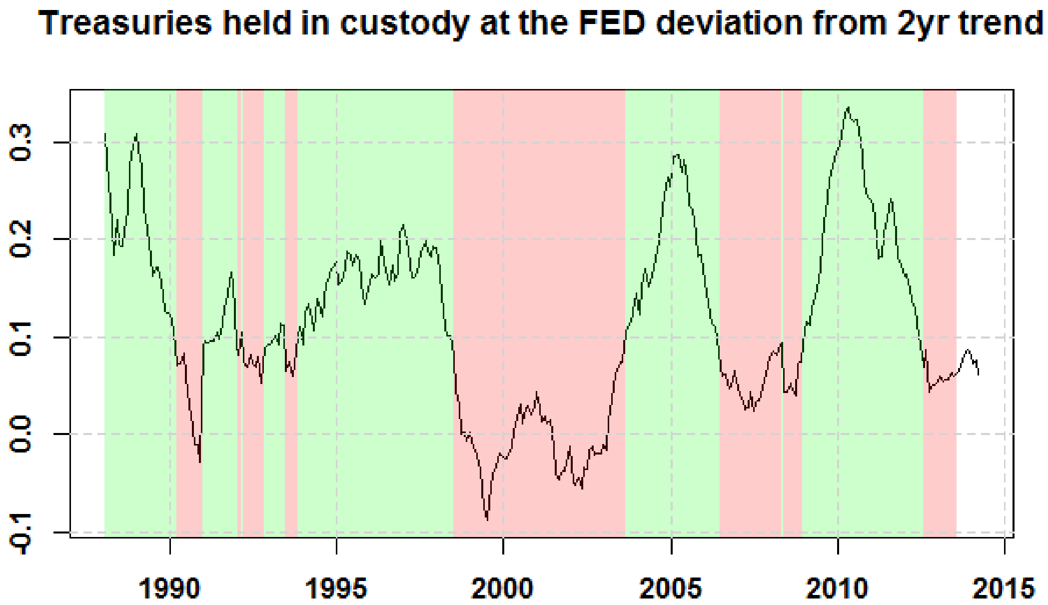


Also a worry is the fact that Treasuries held in custody at the Fed for foreign central banks are declining. Its momentum has been a reliable indicator of medium term forward returns for global equities.



The chart above shows that when foreign central banks buy Treasuries at an increasing pace (adding liquidity to the system) equity forward returns increase and vice versa. The pace of Treasuries buying has slowed since 2011 and more so since the beginning of the year. Like in 1990, 2000 and 2007 the signal was early, but nevertheless proved correct in the longer picture.





Rcube Macro Portfolio synthetic exposure

ASSET CLASS		RISK ANALYSIS August 2013	RISK ANALYSIS July 2013
EQUITY - CREDIT - VOLATILITY		**BETA vs MSCI WORLD**	**BETA vs MSCI WORLD**
Equity		18.0%	13.5%
Credit		0.0%	0.0%
Volatility		0%	0%
Combined Asset class		**18.0%**	**13.5%**
FIXED INCOME	**DV01**		
Long Treasuries		-1.8%	0.0%
Total Duration		**-1.8%**	**0.0%**
COMMODITY	**$MM (Notional)**		
FX DIRECTIONAL	**$MM (Notional)**		
		0.0%	0.0%
TOTAL EXPOSURE vs. MSCI WORLD		**16.3%**	**13.5%**

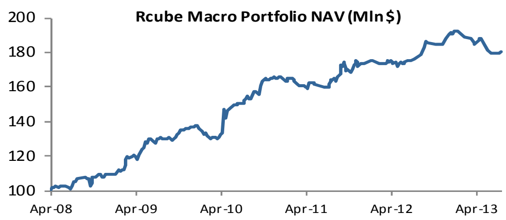
RCUBE MACRO PORTFOLIO (1)

Rcube Macro Portfolio	Start 31/12/2012	open trade (4)
P&L Reporting	Start NAV 190.80 $mln	closed trade (10)
08/08/2013		

ASSET / STRATEGY	Date opened	Date closed	P&L $	Var 95% 5 days ($)	Publication
G10 Equities					
Short XLY vs. Long SPY	23-Sep-11	20-Jun-13	1,944,521		RMP - 23 09 11
Short Personal & HHGoods (DWM2) vs Eurostoxx (VGM2) (€ 5Mln)	04-Oct-11	11-Jan-13	349,817		RMP - 04 10 11
Long SPY ($ 5Mln)	23-Oct-12	25-Jan-13	263,691		RMP - 23 10 12
LONG EUROPEAN EQUITIES SX5E SEP13 2850/3050 CS	09-May-13	open	210,452	970,821	RMP - 09 05 13
EM					
Long EEM Sept 2013 46 Call	06-May-13	open	-1,084,600	71,403	RMP - 07 09 12
Long EEM	07-Sep-12	20-Jun-13	-5,302,543		RMP - 07 09 12
Long Russian Equities ($5Mln) - RSX ETF	14-Nov-12	20-Jun-13	-984,133		RMP - 14 11 12
Long Chinese Equities ($10Mln) - FXI ETF	08-Feb-13	20-Jun-13	-1,676,341		RMP - 14 11 12
TOTAL P&L EQUITIES			**-6,279,136**		
RATES					
OAT/Bund yield spread widener @ 61bp (€50k/bp)	07-Sep-12	20-Jun-13	-813,838		RMP - 07 09 12
Short Bobl (325 x OEH3) & Short US 5Y (469 FVH3)	25-Jan-13	04-Apr-13	-1,800,589		RMP - 01 13 13
5/10 Yield Curve Flattener vs. Euro$ Curve Steepener (EDH6/ EDH5)	08-Mar-13	20-Jun-13	1,498,695		RMP - 08 03 13
Long Treasuries : TYZ3 C129 C x1100	30-Jul-13	open	-85,938		RMP- 07 30 13
TOTAL RATES			**-1,201,670**		
CREDIT					
Long US 2yr swap spreads	16-Mar-11	20-Jun-13	103,250		RMP- 16 03 11
Long US 30yr swap spreads	16-Dec-11	20-Jun-13	1,038,000		RMP- 16 03 11
Long EM Local Currency Debt ($ 15MM EMLC US Equity)	29-Jun-12	20-Jun-13	-1,615,183		RMP - 29 06 12
Long US High Yield (250K HYG US Equity)	19-Jul-12	open	75,000		RMP - 19 07 12
TOTAL CREDIT			**-398,933**		
FOREX					
Long USDJPY @ 79.84 $25mln	01-May-12	25-Jan-13	1,123,744		RMP - 01 05 12
LONG EURBGN 2Y Forward (1.9847) (€ 50MM Notional)	21-May-12	20-Jun-13	-71,372		RMP - 21 05 12
Hedge - Short AUDCAD - AUD 50M - 0.9550 Put 04/08/13	08-Oct-12	08-Apr-13	-40,611		RMP - 10 08 12
Long EM FX (TRY, BRL, RUB) vs USD ($30MM Delta)	29-Apr-13	20-Jun-13	-2,263,477		RMP - 04 29 13
TOTAL FOREX			**-1,251,716**		
COMMODITIES					
GDX ($10MM)	09-Aug-12	04-Apr-13	-2,655,405		RMP 09 - 08 12
TOTAL COMMODITIES			**-2,655,405**		
VOLATILITY					
Short VIX (300 x UXH3)	06-Sep-12	22-Jan-13	1,080,000		RMP - 06 09 12
TOTAL VOLATILITY			**1,080,000**		
CROSS ASSET STRATEGY					
TOTAL CROSS ASSET STRATEGY			0		

TOTAL P&L	**-10,706,859**
As % of NAV Ytd	-5.61%
As % of NAV (Since inception Annualised)	12.56%
NAV	180,094,903

Analysis (since inception)	
Var 95% 5 days ($)	1,022,301
Var 95% 5 d (% NAV)	0.57%
Sharpe	1.40
Monthly Volatility (annualized)	8.80%
Max draw down	6.22%
Hit Miss Ratio	64.00%



Research disclaimer

****The portfolios mentioned within this research material are hypothetical, no actual investments have occurred****

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