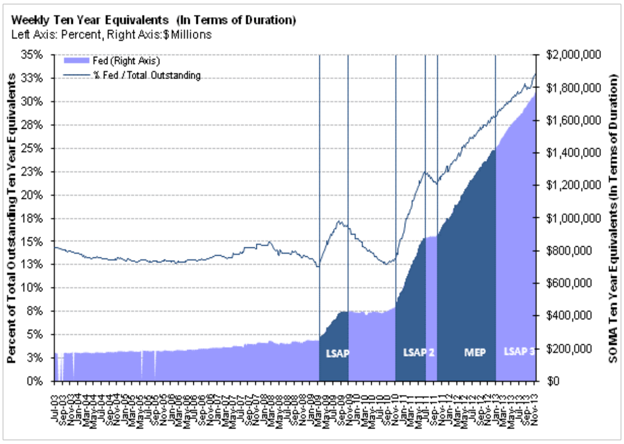
ISIN: LU0344810915/ WKN: A0ND6Y/ BLOOMBERG: SUNARES LX / WWW.SUNARES.COM

Easy Money and Asset Markets

The investment environment in 2013 was dominated by central banks and the monetary support that they have collectively given through historically low interest rates and via quantitative easing or so-called QE. The US has led the way with its QE asset purchase policy of adding US$85bn every month to its programme of buying US treasury bonds as well as buying mortgage-backed security bonds. Japan has also opened the monetary spigots with Abenomics, an attempt to bring the country out of deflation and to engender inflation with a massive increase in the money supply in the hope of kick-starting the economy and firing up the export markets.
The additional money has driven many asset prices to places where they would almost certainly not have arrived on their own and this money creation has other long-term consequences that are yet to be seen but will make their presence felt in the future.

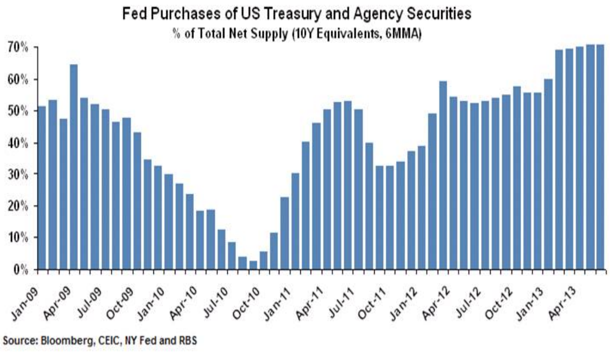
In bond markets both short-term and long-term yields have been driven down to exceptionally low levels. With the US Federal Reserve now starting the process of unwinding the monthly QE programme with an initial cut to US$75bn, bond yields have risen. The 10-year bond closed the year at a yield of 3.0282% from a low of 1.3875% in July 2012 and a low of 1.6290% in May 2013. In the UK the 10-year bond yield has also risen from 1.439% in August 2012 and a low in 2013 of 1.623% in May to end the year at 3.022%. These are significant increases even if the rates are still extremely low and policy-makers will be keeping a watchful eye on them to ensure that they do not keep heading higher. Higher rates act as a drag on the economy and this is not desired at this point in the recovery cycle.

The Federal Reserve has scaled back their buying programme for two reasons. Firstly because the central bank already owns more than one third of the bond market and this level of ownership is distorting the operation and availability of collateral in the money markets. Their purchases have backed them into a position where they have become the proverbial elephant in the room.



Federal Reserve Holdings of US treasury Paper 2003 to 2013

This rate of buying means that the Federal Reserve has been buying (monetising) a record 70% of all net US 10-year equivalent issuance and this is certainly reason enough for the tapering to begin before nothing is left in the free market!



Ben Bernanke as head of the central bank. He hands the reins over to Janet Yellen with the satisfaction that history will show that he has placed the central bank on a sensible path to normalisation of monetary policy. Whether normalisation will be achieved is an open question and one that causes concern. How do you unwind such an enormous buying programme without real-market consequences?

ISIN: LU0344810915/ WKN: A0ND6Y/ BLOOMBERG: SUNARES LX / WWW.SUNARES.COM

There is no question that dent will continue to be issued as the economy needs money to keep funding all manner of government spending. This is why the debt ceiling squabbles that led to a partial shut-down of the US government is a scenario that will keep on cropping up as spending has to continue to keep the economy on track. This is something that Australia has recognised back in October when they agreed to raise their own debt limit by 2/3rds to A$500bn. Treasurer Joe Hockey said that he wanted to avoid a crisis similar to the recent US fiscal emergency.

"The debt limit needs to be set so as to provide sufficient headroom to ensure there is stability and certainty for the financial markets about the government's capacity to finance its operations for the foreseeable future. We need not look any further than the recent events in the United States to realise how imperative for stability and certainty is for confidence."

Australia's debt to GDP level is relatively conservative at 30% compared to 92% for the UK and nearly 106% for the US.

In spite of tapering the US Federal Reserve has pledged to keep short-term interest rates as close to zero as possible and for an extended period but the rise in long-term rates will be a major concern as the longer term borrowing rates influence and determine decisions for the mortgage market as well as borrowing for business decisions. For now bond market yields are still within the yield channel that has been in place since yields spiked in the early part of the 1980s (see chart below) so we are within the established range for the moment. However, a break upwards from this zone could signal that interest rates are going to head higher quicker than expected. The risk is that the economy may not be able to withstand higher interest rates at this point and central bankers may have to intervene in the bond markets once more to keep longer rates down. Certainly an important point to watch closely as the year unfolds as there may yet be a return to further QE.

US 10-year bond yields from the mid-1970s. Source: Bloomberg

A New Head of the Federal Reserve

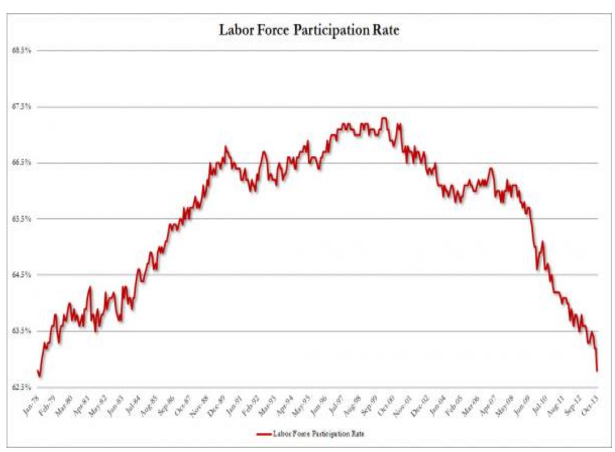
So what can we expect of the new head of the Federal Reserve, Janet Yellen? At the Commonwealth Club of California on 30th June 2009 she said the following:

"I'll put my cards on the table right away. I think the predominant risk is that inflation will be too low, not too high, over the next several years. (…) The vigorous policy actions of the Fed and other central banks, combined with sizable fiscal stimulus here and abroad, have sent a clear message that deflation won't be tolerated."

Mrs Yellen also spoke to the labour unions in February 2013 and said the following:

"Three million Americans have been looking for work for one year or more; that's one-fourth of all unemployed workers, which is down from 2011's peak but far larger than was seen before the Great Recession. These are not just statistics to me. We know that long-term unemployment is devastating to workers and their families… If the current, elevated rate of unemployment is largely cyclical, then the straightforward solution is to take action to raise aggregate demand. If unemployment is instead substantially structural, some worry that attempts to raise aggregate demand will have little effect on unemployment and serve only to stoke inflation. I see the evidence as consistent with the view that the increase in unemployment since the onset of the Great Recession has been largely cyclical and not structural."

It would appear from both statements that Fed policy under Janet Yellen will stay loose to combat deflation and will pay close attention to the labour participation rate. Unemployment will have to fall significantly in order for the Fed to tighten policy substantially. However, it also leaves the door open to a different form of monetary support altogether, especially as QE is now in the process of being reduced. QE has pushed asset prices but it has done little to help ordinary people. Will we see more direct monetary assistance to the wider population? That is something that we should watch out for in 2014 as she marks out her leadership of the Fed.



Labour Force participation rate 1978-2003

ISIN: LU0344810915/ WKN: A0ND6Y/ BLOOMBERG: SUNARES LX / WWW.SUNARES.COM

Labour participation rate is now at a lowly 62.8%, the lowest level since 1978 and the drop in October was a massive 932,000 people. For the economy to be in recovery, jobs need to be created to give people money to spend.
The labour participation rate is an indication that not all is well despite reports of *"green shoots"* appearing in global growth data. Disinflation lingers with the threat of outright deflation still present in many countries – after all, the scale of debt has never been truly addressed in the aftermath of the 2007 banking crisis. Central bank policies have not brought us back to targeted rates of inflation despite all of the intervention so they will be fighting deflation for some time yet.

Deflation

The media and the markets have become fixated with the tapering debate but the ongoing deflation battle means that the Fed continues to operate monetary policy aggressively and as we have said, Mrs Yellen is likely to step into the fray with new policies.
Japan is printing an enormous amount of money in a bid to end its 20-year affair with deflation and explicitly wants inflation at all costs with the yen being sacrificed for this over-riding policy aim. The lower yen is intended to boost the country's exports and it means that Japan is exporting deflation, and resultant lower prices in these goods, to the rest of the world.
Europe is also struggling with the deflation demon and a strong euro, which hampers export efforts. China and Korea are also hurting from Japan's actions. How long will it be before governments around the world take action to lower their own currencies and we hear the phrase *"currency wars"* again? If we see such a move then this could push asset prices higher from already elevated levels as assets respond to a further expansion of the money supply.
Europe is in a difficult spot because the central bank is not able to engage in direct QE where they buy sovereign debt to keep yields down. This explains the aggressive rate cut that the central bank took recently, as a reduction in the lending rate for commercial banks encourages banks to buy government bonds and this feeds through into lower corporate borrowing rates. A look at the inflation picture shows how real the threat of a stalling economy is for Europe.

Eurostat Eurozone Harmonised Inflation Year-On-Year. Source: Bloomberg

Agriculture in 2013 and outlook

2013 was a tumultuous year for agricultural prices and in particular for the fertiliser sector where a disagreement amongst the big producers saw prices tumble.

The catalyst for the pricing disorder came from Russia's Uralkali who decide to withdraw from one of the world's largest potash partnerships and then by raising production rapidly attempting to gain market share by selling at a lower price. They aimed to increase sales to 13m tonnes in 2014 and 14m tonnes in 2015 from 10.5m tonnes in 2013 by expanding its market share in China, India and Brazil. This break-up of the Belarus Potash Company partnership (BPC) left North America's Canpotex as the ruling potash export venture. BPC and Canpotex had accounted for 70% of global trade in potash, which is an important ingredient for fertilizer, and the duopoly had agreed to set identical prices in key markets such as China and India.

However, things are rarely straight-forward when it comes to dealings in Russia and the plot twisted when the head of Uralkali was imprisoned in Belarus and charged with "abuse of power". This led to a change in shareholders at Uralkali which in turn led to the release of the imprisoned CEO back to Russia. In a plot worthy of a Bond movie there is now a likelihood of a reconciliation between Uralkali and the Russian side and Belaruskali on the Belarussian side and a renewed partnership could see prices recover substantially from where they are now. They probably woke up to the fact that they had shot themselves in the foot by abandoning the cartel.

The Russian ambassador to Belarus, Alexander Surikov said on 27th December:

"After the change of owners - shareholders were replaced by Uralchem [the world's second largest ammonium nitrate producer] and interests of Prokhorov [Russian tycoon-turned-politician in the form of ONEXIM] - Uralkali is ready to restore cooperation with Belaruskali."

He blamed the original breakup partly on the Russian side as they had:

"acted thoughtlessly and did not calculate all the consequences" but he added that *"both sides were to blame"*. He also said that the joint marketing system should be restored as it would be advantageous for both sides – an obvious statement but it seems that someone needed to say it!

Dmitry Razumov, CEO of ONEXIM said:
"We are certain that the potash industry has strong fundamentals and that Uralkali, as the world's leading producer and the key player in the industry, has considerable potential for growth in value."

Bill Doyle the CEO of Canadian company Potash Corp was hugely critical of Uralkali throughout and said that the decision to collapse the cartel-like marketing company and max out production was *"probably the single dumbest thing"* he has ever seen in the fertilizer business. *"Certainly they've upset customers around the world, with many of those customers forced to take write-downs on their inventory. Customers don't forget that type of leadership, or lack thereof in this case. And many of them regard Uralkali as being irresponsible."*
He said that the need for crop nutrients worldwide has not changed, and that demand has recently emerged in the United States and Latin America as farmers entered their planting windows. *"History has shown that buyer deferrals are generally followed by growth in demand."*
The fine details of how the Russian/ Belarussian partnership is going to work in practice have yet to be seen, so it will be another interesting year in the fertiliser industry as the problems work themselves out. Certainly, it could be a year of recovery as customers come back into a more stable market and the big players become reconciled with each other once more.

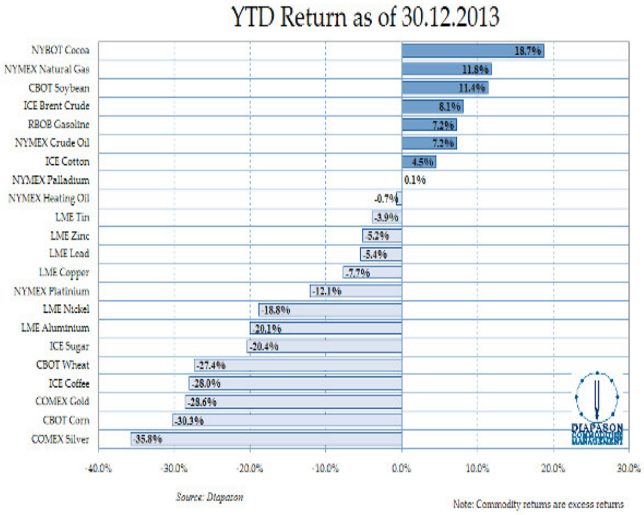
Grains

Wheat and other agricultural commodities like corn have seen lower prices because of high production over the past two years in particular, although lower prices have brought buyers back into the market in the early part of 2014, with the possibility of price stability on the back of this.

Egypt, the world's largest importer of wheat, gave its biggest order since 2010, on 3rd January. The state grain buying agency, the General Authority for Supply Commodities (GASC), revealed orders totalling 535,000 tonnes. It was GASC's 16th international tender since the removal of former president Mohamed Mursi by the army on 3rd July 2013 last year in response to nationwide protests against his rule. This purchase topped a 475,000 tonnes order in September 2012, and a 420,000 tonnes purchase of Russian wheat a year before.

Whilst corn and wheat prices suffered in 2013 cocoa experienced a perfect storm with a combination of raised demand because of the improving economic situation and poor growing yields on the Ivory Coast. As ever it is difficult to speak of agricultural commodities in a general sense as each has its own specific growth and price dynamics.

The best performers on NYBOT (New York Board of Trade) in 2013 were Cocoa (+18.7%), followed by NYMEX Natural Gas (+11.8%) and CBOT Soybeans (+11.4%).



Source: Diapason

Changing Weather Patterns – the Wild Card

The outlook for agriculture is always weather dependent and there is a heightened risk of shortfalls because of the increase in extreme weather outcomes over the past few years.
As Peter Kendall the head of the Nation Union of Farmers in the UK said:

"Farmers can adapt to gradual temperature increases, but extreme weather events have the potential to completely undermine production. It could be drought, it could be too much rain, it could be extreme heat at the wrong time. It's the extreme that does the damage."

The drought in the US in 2012 is one such event but it is worth noting several other recent extremes. Indeed, Robert Hartwig at the insurance institute commented on the general situation:

ISIN: LU0344810915/ WKN: A0ND6Y/ BLOOMBERG: SUNARES LX / WWW.SUNARES.COM

"There's no question, while there's variability and volatility from year to year, the number and the cost of catastrophic weather events is on the rise, not just in the US, but on a global scale. It's all but certain that the size and the magnitude and the frequency of disaster losses in the future is going to be larger than what we see today."

This was confirmed by Munich Re, the world's largest reinsurer who said that the number of weather events and earthquakes in 2013 that resulted in insured losses climbed last year to 880 or 40% more than the average of the last 30 years. Readers in the UK will be aware that the majority of serious problems stem from the amount of rainfall and it is clear that heavy rainfall is on the rise.
For example, flood waters in Passau, Germany, in May and June reached the highest level since 1501 and flood waters cost US$15.2bn in damages in parts of Central and Eastern Europe. In the United States there was raised rainfall although regional variations also saw extreme drought in other parts of the country. Too much rain in northern China damaged crops in May, three years after too little rain turned the world's second-biggest corn producer into a net importer of the grain. Dry weather in the United States will cut beef output from the world's biggest producer to the lowest level since 1994, following 2013's bumper corn crop, which pushed America's inventory up 30% percent. In the UK farmers were not able to plant in muddy fields after the second-wettest year on record in 2012 and this hit the country's wheat production.

As a further example of weather extremes at both ends of the scale, China experienced its coldest winter in at least half a century in 2010 and three years after this, Shanghai suffered its hottest summer in 140 years. Similarly, in America record flooding hit the Mississippi River in 2011 and yet a year later record-low water levels made the river impassable and prevented barges from transporting coal, chemicals and wheat.

Naturally these fluctuations are being reflected in food prices. In the past three years, orange juice, corn, wheat, soybean meal and sugar were five of the top eight most volatile commodities (natural gas was the most volatile). The flip side of lower production is demonstrated by the record harvests from India to Brazil and the expanded supply of corn, soybeans, wheat, sugar and coffee leading to lower prices in these foodstuffs. The Standard & Poor's GSCI Agriculture Index of eight crops dropped 22% last year, the biggest annual drop since 1981.

In spite of the fall in price higher food costs pushed 44 million people into poverty from June 2010 to February 2011 according to the World Bank. The three years in the past two decades when global food costs were highest all occurred after 2007, according to the UN. Historic drought on four continents over the last five years is partly to blame.

The US experienced the most severe drought in the US Midwest since the Dust Bowl of the 1930s, which led to lower cattle herds in Texas which in turn pushed the price of beef to a record in America, the world's biggest producer. As of the beginning of last year, ranchers in Texas had reduced their herds to the smallest since 1967, according to the Agriculture Department having shrunk for the past six years to the lowest size since 1952.
Russia has also suffered with its worst dry period in at least 50 years occurring in 2010 and two years later the country lost about 25% percent of its grain harvest in another dry spell.

As food consumers we have generally been used to seeing food in abundance and at cheap prices. However, the enormous amount of food waste that happens in the developed world might reduce with higher prices. It will be interesting to see how weather impacts prices and if this leads to more careful consumption – it could be one positive side effect of changes in food production.

Precious Metals

Gold broke its 12-year winning streak in 2013 with a 28% loss in the year and silver dropped by 35%.
Surprisingly, the main price action took place on just a few trading days when the prices of both metals dropped in waterfall fashion - two days in April (when gold fell $200 and silver by $5) and a few days in June (when gold fell another $150 and silver another $3).

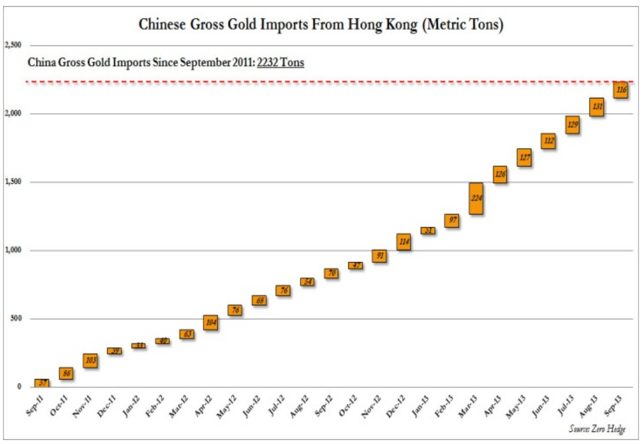
These large price declines came as a surprise to us and to the market especially because physical demand has run so strongly throughout the year as central banks and individuals have rushed to accumulate both metals on price weakness. One of the first Bloomberg stories of 2014 reported that the Perth Mint in Australia increased sales of physical gold in 2013 by 41% to record levels. The US Mint also reported an increase in sales of American Eagle gold coins of 14% in 2013.

SUNARES
SUSTAINABLE NATURAL RESOURCES FUND

ISIN: LU0344810915/ WKN: A0ND6Y/ BLOOMBERG: SUNARES LX / WWW.SUNARES.COM

We should also point out that Germany's Bundesbank asked the New York Federal Reserve to repatriate a portion (20%) of its gold held with them in a public request made in November 2012. Up until this point the German's have received back 37 tons of physical, which represents just over 5% of the total they want to take delivery of. What is the hold-up and what is going on?

At the same time China, Russia, Saudi Arabia, Turkey (backdoor to Iran) and other governments are all big buyers of physical metal and this is documented for China below.



We looked at the MACD* charts for the S&P500 in the equity section to show how the market is reaching levels that have seen prices pull back in the past and it is helpful to see these charts for gold, silver and precious metal equities too.

*(A brief explanation of MACD: the Moving Average Convergence-Divergence (MACD) indicator is one of the simplest and most effective momentum indicators available. The MACD turns two trend-following indicators, moving averages, into a momentum oscillator by subtracting the longer moving average from the shorter moving average. As a result, the MACD offers the best of both worlds: trend following and momentum.)

Gold 20-year MACD. Source: Bloomberg

Gold has never been this oversold even if we go back to the 1970s.

Silver 20-year MACD. Source: Bloomberg

Silver is also at its most oversold level in history even below the level seen in the 1982 period. It is worth noting that from June 1982 to February 1983 silver rallied a staggering 320%.

XAU Philadelphia Gold & Silver stock index 1994-2013 (longer trading history than HUI index). Source: Bloomberg.

The precious metal shares are also at the most oversold level in their history and at the same time there are a large number of companies that currently trade below their book value. The stocks at these prices offer extreme value and a rebound is to be expected.

JP Natural Resources vs. MSCI World 1999-2003

We have used the price movement of the JPMorgan Natural Resources fund in the following study because it has a long trading history with a focus on basic materials.

A return to the Asia crisis of 1998 is instructive because it was a time of markets no longer believing in the growth of the emerging markets and yet the chart shows just how big the outperformance of resources were in the 5-year period beyond the crisis when compared to the MSCI World index. At the beginning the performance was closely correlated until the divergence accelerated from the year 2000 onwards.

JP Natural Resources vs. MSCI World 1990-2013

A longer time study shows the same resource fund and its swing in price measured against the MSCI World Index. The bull market has been an extremely painful experience and not many investors remain on board as volatility has shaken many off the back of the bull. We too are severely chastened by the experience as we had not expected to see a sell-off of this magnitude. As difficult as the year has been, the bull market remains in place and after the large correction we think that a recovery lies ahead.
We look forward to being in touch with you and take this opportunity to send you our best wishes for a healthy and successful 2014.

With kind regards,

Colin Moor & the SUNARES team

Risk Warning

This document is directed at persons of a kind to whom the Fund may lawfully be promoted. This information does not constitute a solicitation or offer, or recommendation, to buy or sell any investment instruments, to effect any transactions, or to conclude any legal act of any kind whatsoever. This brochure may not be distributed in the United States nor may it be forwarded to US investors. An investment in SUNARES should be regarded as a longer term investment and is of a medium to high risk. This product is not suitable for all investors. The value of all investments and the income from them can decrease as well as increase and investors may not receive back the full amount invested. Investments denominated in currencies other than the base currency are subject to fluctuations in exchange rates, which can be favourable or unfavourable. In addition, investments in smaller companies may involve a higher element of risk as shares in such companies tend to be more volatile than their larger capitalisation counterparts. Potential investors should also be aware that past performance is not necessarily a guide to future performance. The full and the simplified sales brochures, as well as the annual and semi-annual reports, are available free of charge from the following: in Germany, HSBC Trinkaus & Burkhardt AG, Königsallee 21/23, 40212 Düsseldorf; in Austria, Erste Bank der Österreichischen Sparkassen AG, Graben 21, A-1010 Wien; in Luxembourg, VP Bank (Luxembourg) S.A., 26, Avenue de la Liberté, L-1930 Luxembourg, in Liechtenstein, VP Bank AG, Aeulestrasse 6, FL-9490 Vaduz;