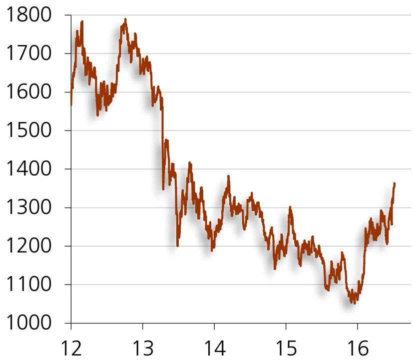
# Degussa Market Report

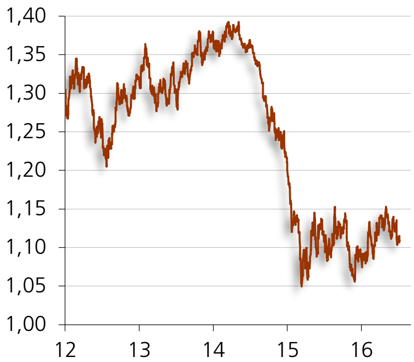
**8 July 2016** — Economics · Finance · Precious metals

**Gold price, USD/oz**




**Silver price, USD/oz**


**EURUSD**




Source: Bloomberg.

| Precious metals prices | Actual (spot) | Change against (in percent): 2 W | 3 M | 12 M |
|---|---|---|---|---|
| **I. In US-dollar** | | | | |
| Gold | 1,355.3 | 4.3 | 4.8 | 23.7 |
| Silver | 19.6 | 12.3 | 10.1 | 32.9 |
| Platinum | 1,080.1 | 11.4 | 0.3 | 9.8 |
| Palladium | 604.4 | 13.1 | -3.0 | -1.2 |
| **II. In euro** | | | | |
| Gold | 1,223.8 | 6.3 | 8.4 | 22.7 |
| Silver | 17.7 | 15.2 | 13.9 | 32.1 |
| Platinum | 975.8 | 13.8 | 3.8 | 9.3 |
| Palladium | 545.7 | 16.1 | -0.6 | -2.1 |
| **III. Gold price in other currencies** | | | | |
| JPY | 136,343.9 | 0.8 | -0.9 | 0.4 |
| CNY | 9,063.0 | 6.9 | 8.1 | 33.2 |
| GBP | 1,047.8 | 15.9 | 18.4 | 49.4 |
| INR | 91,312.0 | 1.9 | 6.5 | 30.4 |
| RUB | 86,954.2 | 3.9 | 4.1 | 29.2 |

Source: Bloomberg; own calculations.

## OUR TOP ISSUES

*This is a short summary of our fortnightly* ***Degussa Marktreport****.*

## Escaping the Euro Trap

The good ship Euro is in dire straits. High time for investors to steer out of troubled waters by reducing clustered risk.

## Putting a Fair Value on Gold: An Estimation

Looking to the distant horizon, the gold price appears to be still hovering at an undervalued altitude. We argue for a cautious reading.

## Gold and Stocks in the Portfolio

Cracks are spreading across the walls of a house built with paper money. Reason enough to keep gold and stocks parked in portfolios.

## The Debt Bubble

Central banks' low interest rate policies are inflating the price of debt. A bigger disaster than the 2008/2009 fiasco looms.

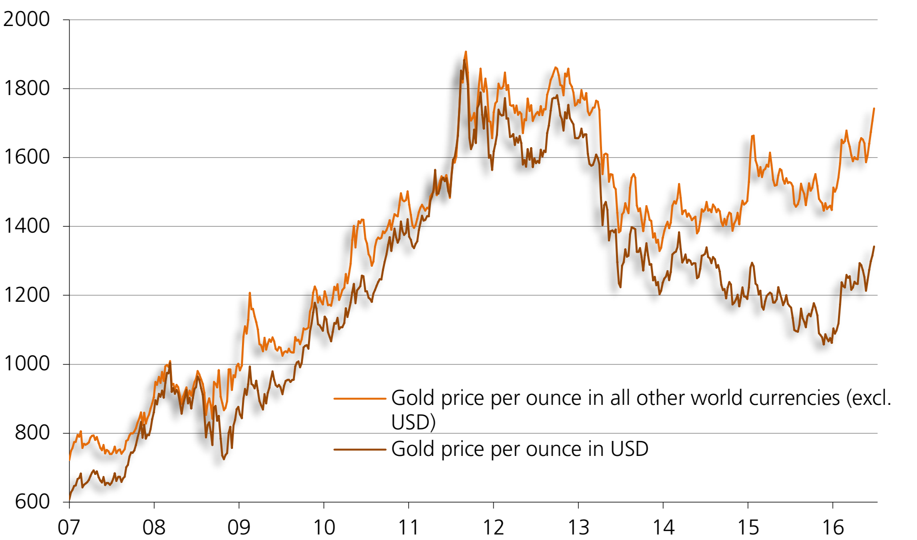
## A Word on the Precious Metals Market

ETF investors remain a driving force behind gold and silver prices' rebound.

**Gold price per ounce**

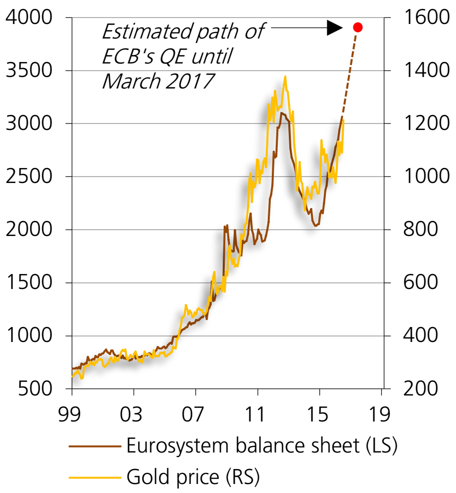
*in US dollars and all world currencies (excl. the US dollar)**

January 2007 to July 2016




Source: Bloomberg; own calculations. *Calculated from the gold price (USD/oz) and the nominal trade weighted exchange rate of the US dollar. The timeline was indexed at 5 September 2011 with a value of 1.900

**On the link between the Eurosystems's balance sheet and the gold price**
Balance sheet of the Eurosystem and the price of gold (Euro/oz)




Source: Bloomberg

The similarly positive trajectories of the Eurosystem's balance sheet volume and the price of gold (in euros per ounce) since the start of 1999 suggest the two are connected. But then again, this relationship may also have been somewhat spurious: The euro system kept extending credit to euro zone banks as commodity prices boomed in the early 21st century.
However, there appears to be more to it than that. When the international financial and economic crisis reared up in 2008, the ECB, other central banks, and the US Fed especially started pumping new funds into the banking system. The price of gold took a sharp upturn, driven by growing demand for a safe haven. With the financial market on the road to recovery from fall of 2011 to early 2014, the euro system's balance sheet shrank and the gold price fell.
Perhaps the marked increase in the Euro system's balance sheet volume (representing all the additionally extended credit) has a positive effect on the price of gold in euros. If so, we have reason to expect the gilded metal's price to edge up further. The reason for this is the Eurosystem is about to ramp up its balance sheet again, potentially bringing it to around 3.9 trillion euros by March 2017. This could devalue the euro exchange rate and/or drive up the price of gold in US dollars.

# Escaping the Euro Trap

**The good ship Euro is in dire straits. High time for investors to steer out of troubled waters by reducing clustered risk.**

The European Union (EU) is reeling under a heavy blow dealt by the prospects of Brexit. Perhaps more fundamentally, the impact has rocked the very foundations on which the single currency was built.

Recall, if you will, the ideas put forth to legitimize the euro's introduction by merging diverse national currencies into a single legal tender in early 1999.

According to the crowding theory, the euro was meant to be introduced once there was sufficient economic harmonization or convergence among participating nation-states.

The alternative was the cornerstone theory, whereby the euro was to compel adopting nation-states towards economic and political integration.

Neither theory panned out. Rather than growing closer, nation-states are drifting apart; the case for a single currency has not been strengthened but weakened.

Many countries simply lack the discipline needed to adapt fiscal and economic policies to the demands of a stable common currency. And several were lured in by a very juicy carrot—far too lax monetary policy.

The European Central Bank's (ECB) policy triggered a colossal credit boom, particularly in countries on the periphery of the euro zone. These countries went broke when the inevitable bust came.

Had banks and states defaulted on their debt, it probably would have spelled instant doom for the euro project. To prevent its demise, the ECB lowered interest rates to practically zero. Listen closely and one can almost hear those electronic presses humming away in the ether, printing up piles of digital cash to keep the credit flowing.

The ECB buys government bonds with newly created euros. This can provide some short-term relief for overstretched debtors, but it wreaks political havoc in the euro zone.

## Dragged down by banks

A partial breakup or outright dissolution of the EU has suddenly become a possibility, and where the EU goes, the euro is sure to follow. This puts tremendous pressure on euro zone banks, which do their business across borders.

This poses some tough questions for investors, foremost: What happens to bank deposits, debentures and bank equity's value if the euro puzzle is in pieces?

If euro banks default on their payment obligations, the euro's demise could be instantaneous. The ECB has already stepped in to prevent this, showering banks with new credit at astonishingly favorable rates.

The euro system is poised to ramp up its balance sheet, potentially bringing it to around 3.9 trillion euros by March 2017. The central bank has since June of 2016 been issuing new credit to banks at minus 0.4 percent interest, provided that lend the money to consumers and corporates in the euro zone. This scheme is called TLTRO II.

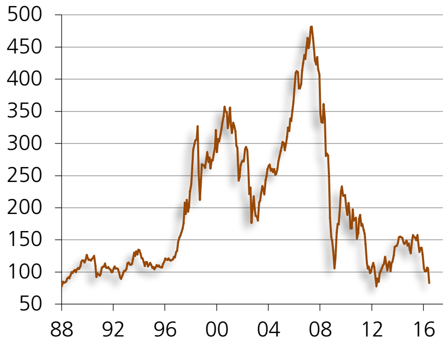
Negative ECB lending rates help bolster banks' equity capital. This is why the notion that the ECB could push its lending rate even further into the cellar no longer seems so far-fetched. This would compound the pressure on market interest rates.

The fact is that the ECB is on an epic monetization spree: It has been buying 80 billion euros worth of bonds a month, which could increase the euro base money supply to around 1.7 trillion by March 2017.

That's not the whole story, though. If the ECB starts monetizing debentures issued by banks, the base money supply could gradually rise by another 3.8 trillion euros.

**Bank stocks dip back to near record lows**

Euro Stoxx Bank index




Source: Bloomberg

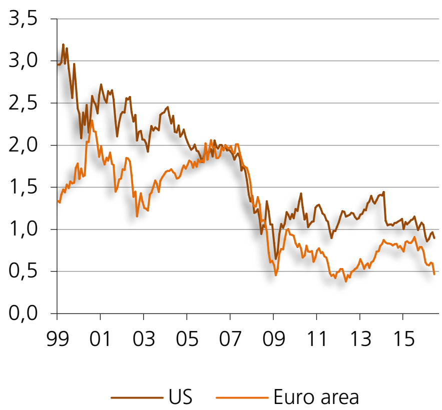
### Inflation genie out of the bottle

Chances are that printing up piles and piles of euros to prevent defaults on a colossal scale will eventually erode confidence in the currency and conjure the spectre of inflation.

It appears that the ECB is more concerned about keeping struggling borrowers afloat than buoying the euro's buying power. When this realization dawns, financial market players certainly won't be uncorking the celebratory champagne. Forget the fizzy stuff; it will be the inflation genie that comes out of that bottle.

**Bank stocks' valuation back down to 2008/09 crisis levels**

Price book value of bank stocks




Source: Bloomberg

The consequences would likely be global. Most, if not all, major currencies have one thing in common with the euro: They are unbacked paper money, the quantity of which can be increased any time in any amount deemed politically expedient.

If the euro's internal and external buying power is debased, doubts about the quality of other unbacked paper currencies will surely arise.

Most national currencies are threads in the global monetary tapestry, so the ECB’s patchwork euro rescue policy could eventually unravel the world’s system of unbacked paper currencies.

### Consequences

The first thing investors could do to reduce the 'euro cluster' risk is to diversify their liquid assets into other currencies such as the US dollar and Swiss franc.

**Concerns about credit defaults for subordinated bonds issued by Deutsche Bank rising sharply**

CDS for 5-year bonds (subordinated) of Deutsche Bank in basis points


Source: Bloomberg.

They should also consider keeping gold and silver as part of their cash holdings. These precious metals are particularly well-suited as substitutes for time and savings deposits.

While gold and silver are subject to market price changes, they do not carry any credit or counterpart risk. Gold and silver's buying power is immune to inflationary policy.

It is equally important that investors consider buying into good companies; and our definition of a good company is an enterprise that will be in a position to earn positive real returns on capital invested even in times of inflation.

The investment risk can be contained by picking up a stake in these companies at decent prices—that is, at a cost lower than a company’s fundamental value. In any case, it is high time to take action for the investors seeking to escape the euro trap.

1 Yields on 10-year government bonds in percent


▶ The trend towards falling interest rates has pushed long-term rates to the zero line and below it in the case of Japan and Germany.

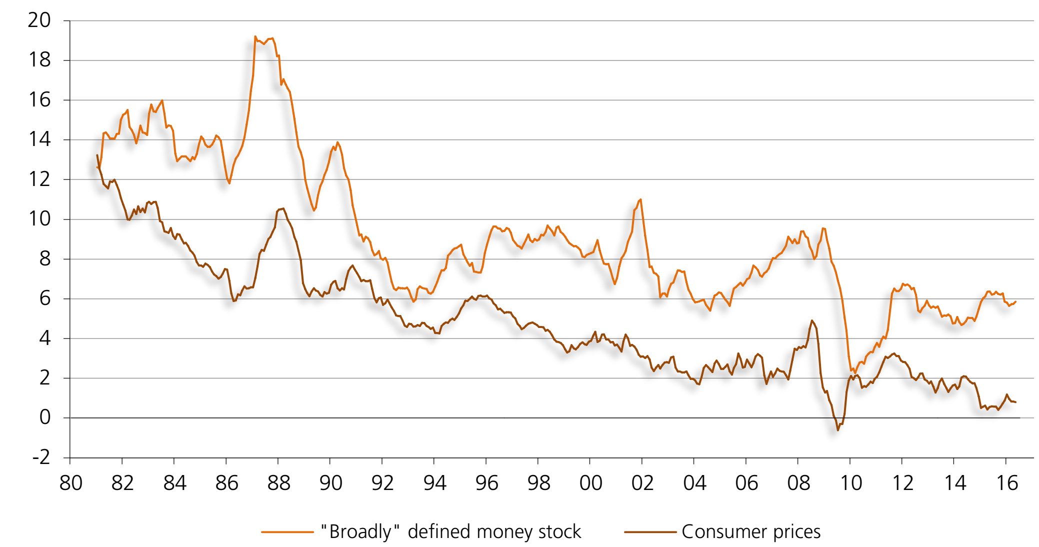
Source: Thomson Financial

2 Exchange rate of the Chinese renminbi vis-a-vis the US dollar


▶ China's renminbi continues to slide vis-a-vis the US dollar, making it even more difficult for the US Fed to raise interest rates.

Source: Thomson Financial

3 Money stock and consumer prices in the OECD, y/y changes in percent




▶ The global money supply continues to grow at a healthy clip, suggesting that deflation is not lurking around the corner.

Source: Bloomberg

# Putting a Fair Value on Gold: An Estimation

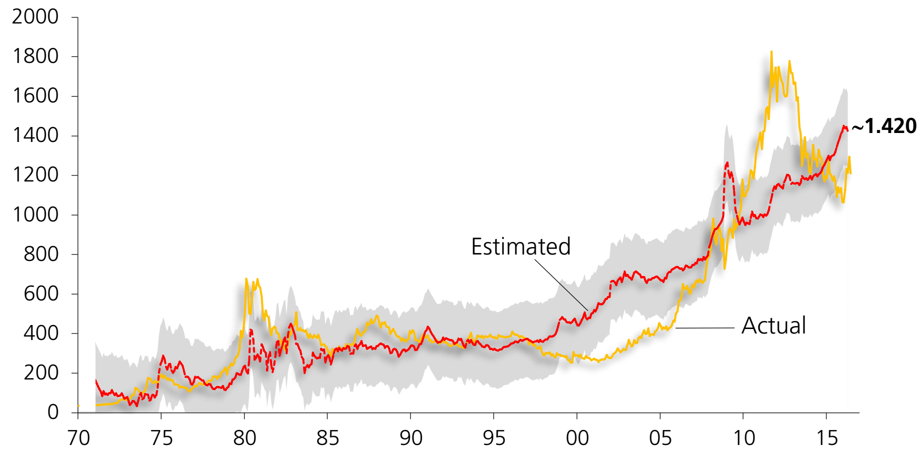
**Looking to the distant horizon, the gold price appears to be still hovering at an undervalued altitude. We argue for a cautious reading.**

Gold market pundits and players alike know how difficult, and perhaps even impossible, it is to come up with a reliable forecast for future gold prices. So many variables to juggle…

One approach to gauging the gold price's 'fair' value is to examine the long-term relationship between the price of gold and determining factors such as interest rates and the quantity of money. If we find a discrepancy between actual and estimated gold prices, we may gain insight as to whether gold is currently overvalued, undervalued or fairly priced.

In our estimation, gold should be trading at around 1.420 USD/oz given the current state of its determining factors. This would suggest that the actual gold price is still on the undervalued side of the coin. However, caution is advisable when interpreting this finding.

**Tracking the 'fair' gold price**
Gold price (USD/oz), actual and estimated*

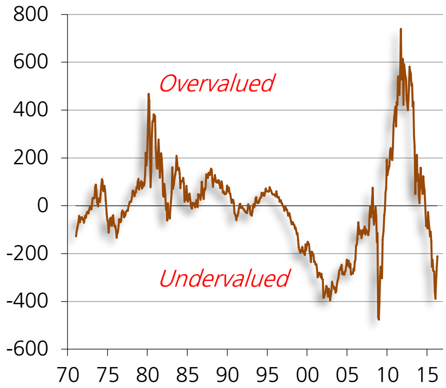



Source: Thomson Financial; own calculation. Estimate for the period of January 1971 to May 2016. Explanatory factors are the real (that is, inflation-adjusted) Federal Funds Rate, the credit spread in the US market, and the US money stock M2. Gray area represents one standard error of the estimate

For one, explanatory factors have proven to be significant in the past, but their influence may wane going forward. Other factors could come into play that impinge on or even overshadow the explanatory factors that have held sway in the past. Equations such as our long-term gold price estimation are thrown off balance when the parameters change.

More importantly, though, we can only factor what we know and can reasonably assume into the equation. No one knows what a potential disruption of today's global unbacked paper money system will mean for tomorrow's 'fair' price of gold. But something tells us that in the event, the estimated 'fair' gold price may be quite conservative.

**Actual gold price still looks undervalued**
Deviation of actual from estimated gold prices in USD/oz*




Source: Thomson Financial. *Graph depicts residuals of the long-term estimation of the gold price

# Precious metals prices, actual and projections (per ounce)

**In US-dollar**

| | Gold | | Silver | | Platinum | | Palladium | |
|---|---|---|---|---|---|---|---|---|
| I. Actual | 1,356.0 | | 19.6 | | 1,080.1 | | 604.6 | |
| II. Gliding averages | | | | | | | | |
| 5 days | 1,357.6 | | 19.9 | | 1,078.7 | | 608.2 | |
| 10 days | 1,340.7 | | 19.2 | | 1,043.6 | | 595.9 | |
| 20 days | 1,313.1 | | 18.3 | | 1,011.2 | | 570.9 | |
| 50 days | 1,277.4 | | 17.4 | | 1,016.9 | | 570.1 | |
| 100 days | 1,259.1 | | 16.6 | | 995.5 | | 566.2 | |
| 200 days | 1,187.2 | | 15.6 | | 947.5 | | 566.8 | |
| III. Projections | | | | | | | | |
| | *Rante* | | *Range* | | *Range* | | *Range* | |
| | *Low* | *High* | *Low* | *High* | *Low* | *High* | *Low* | *High* |
| Q2 2016 | 1,139 | 1,280 | 16.1 | 17.3 | 790 | 1,050 | 560 | 610 |
| Q3 2016 | 1,175 | 1,320 | 16.1 | 17.9 | 820 | 1,090 | 580 | 630 |
| Q4 2016 | 1,251 | 1,360 | 15.6 | 18.4 | 770 | 1,130 | 590 | 650 |
| Q1 2017 | 1,279 | 1,390 | 16.3 | 19.1 | 1,010 | 1,180 | 620 | 670 |
| IV. Annual averages | | | | | | | | |
| 2013 | 1,398 | | 23.4 | | 1,473 | | 725 | |
| 2014 | 1,252 | | 18.6 | | 1,370 | | 805 | |
| 2015 | 1,154 | | 15.5 | | 1,043 | | 684 | |
| 2016 (projected) | 1,209 | | 16.2 | | 905 | | 570 | |

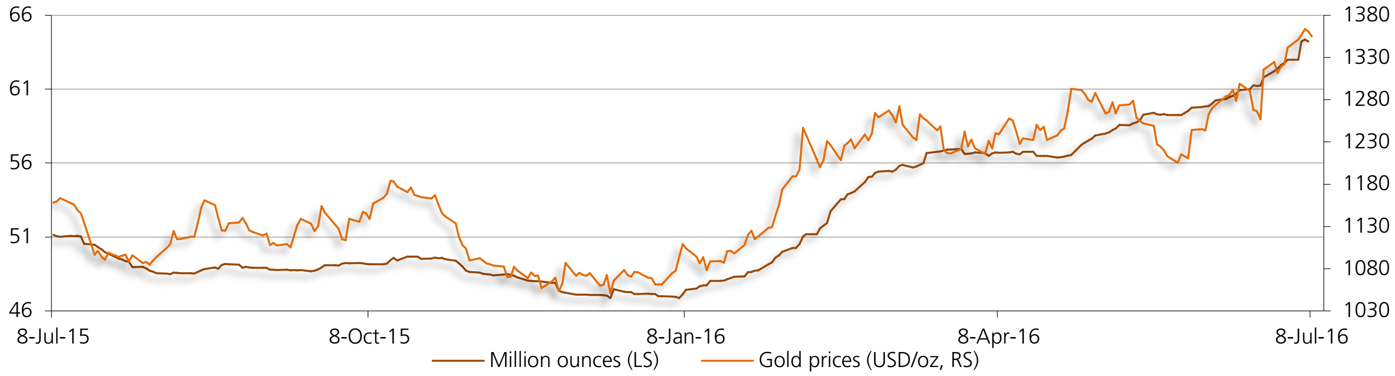
**In Euro**

| | Gold | | Silver | | Platinum | | Palladium | |
|---|---|---|---|---|---|---|---|---|
| I. Actual | 1,225.6 | | 17.8 | | 976.2 | | 546.4 | |
| II. Gliding averages | | | | | | | | |
| 5 days | 1,222.5 | | 17.9 | | 971.3 | | 547.7 | |
| 10 days | 1,208.9 | | 17.3 | | 940.9 | | 537.3 | |
| 20 days | 1,174.8 | | 16.4 | | 904.7 | | 510.9 | |
| 50 days | 1,134.9 | | 15.5 | | 903.2 | | 506.4 | |
| 100 days | 1,121.5 | | 14.8 | | 886.6 | | 504.2 | |
| 200 days | 1,069.5 | | 14.1 | | 853.5 | | 510.8 | |
| III. Projections | | | | | | | | |
| | *Range* | | *Range* | | *Range* | | *Range* | |
| | *Low* | *High* | *Low* | *High* | *Low* | *High* | *Low* | *High* |
| Q2 2016 | 1,036 | 1,164 | 14.7 | 15.8 | 718 | 955 | 509 | 555 |
| Q3 2016 | 1,058 | 1,189 | 14.5 | 16.1 | 739 | 982 | 523 | 568 |
| Q4 2016 | 1,180 | 1,283 | 14.8 | 17.4 | 726 | 1,066 | 557 | 613 |
| Q1 2017 | 1,279 | 1,390 | 16.3 | 19.1 | 1,010 | 1,180 | 620 | 670 |
| IV. Annual averages | | | | | | | | |
| 2013 | 1,052 | | 18 | | 1,108 | | 545 | |
| 2014 | 949 | | 14 | | 1,036 | | 611 | |
| 2015 | 1,045 | | 14 | | 945 | | 619 | |
| 2016 (projected) | 1,098 | | 15 | | 822 | | 517 | |

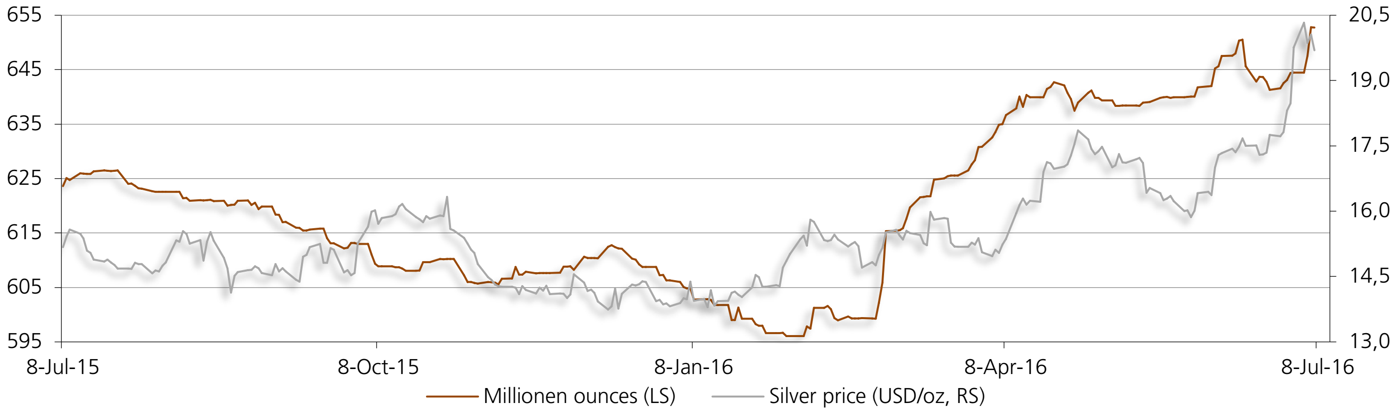
Source: Bloomberg; own calculations. Projections of Degussa Goldhandel GmbH (end of quarter); numbers are rounded.

# Precious metals prices and ETF holdings

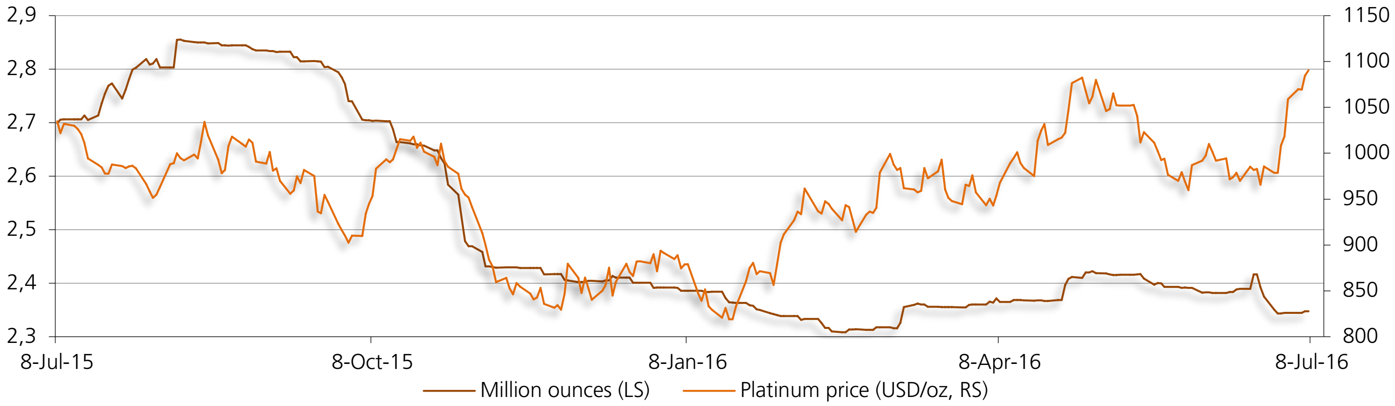
**Gold ETFs (million ounces) und gold price (USD/oz)**



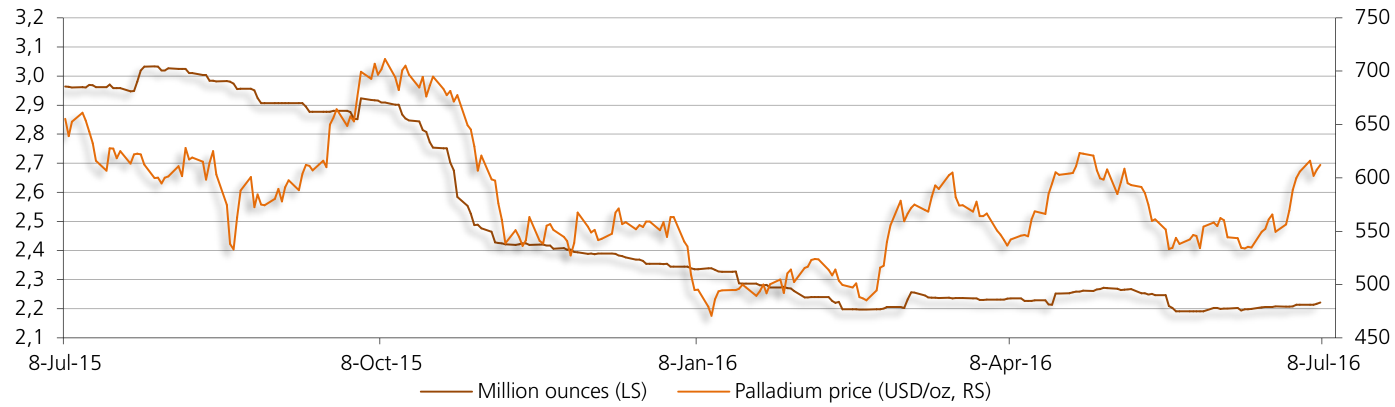

**Silver ETFs (million ounces) and silver price (USD/oz)**




**Platinum ETFs (million ounces) and platinum price (USD/oz)**




**Palladium ETFs (million ounces) and palladium price (USD/oz)**




Source: Bloomberg.

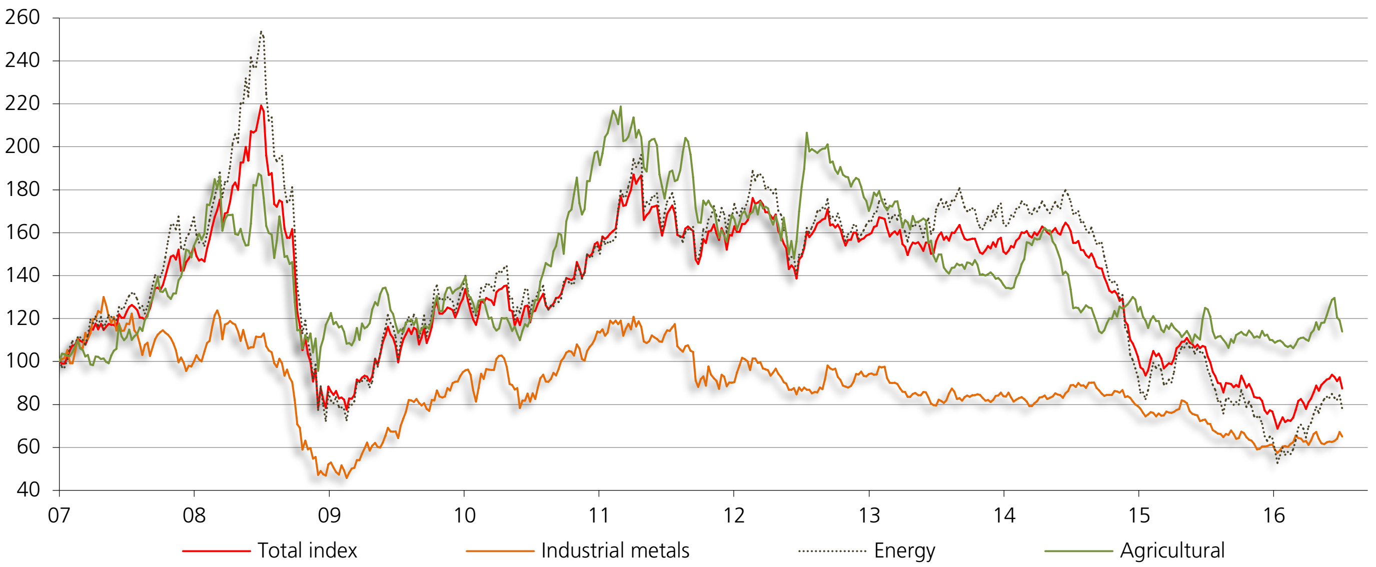
# Commodity prices

**Selected commodity prices**

| | Actual price in US-dollar | Change against (in percent): 1 week | 1 mth | 3 mths | 6 mths | 12 mths | Volatility (in percent): 30 days | 90 days |
|---|---|---|---|---|---|---|---|---|
| **I. Energy** | | | | | | | | |
| WTI crude oil | 45.56 | -4.4 | -3.4 | 10.2 | 14.6 | -26.6 | 42.0 | 39.8 |
| Brent crude oil | 46.82 | -4.5 | -2.6 | 12.2 | 17.6 | -31.4 | 41.7 | 39.4 |
| Gasoline | 137.02 | -10.7 | -14.2 | -4.9 | 2.5 | -28.3 | 38.7 | 35.0 |
| Heating oil | 141.76 | -3.5 | 0.8 | 14.2 | 20.2 | -28.5 | 39.2 | 37.8 |
| Gas oil | 416.50 | -4.9 | -0.9 | 11.2 | 20.9 | ... | 34.9 | 37.0 |
| Natural gas | 2.76 | 2.5 | 14.5 | 24.8 | 11.8 | -12.2 | 42.8 | 36.5 |
| **II. Agriculture** | | | | | | | | |
| Corn | 347.75 | -10.6 | -11.2 | -3.5 | -9.9 | -19.5 | 32.7 | 27.0 |
| Wheat | 429.50 | -7.6 | -13.8 | -12.4 | -14.0 | -32.0 | 28.6 | 27.1 |
| Soy beans | 1034.50 | -4.1 | 2.7 | 11.9 | 15.8 | 6.8 | 32.8 | 23.5 |
| Coffee | 141.80 | 3.4 | 15.0 | 8.0 | 16.3 | -2.4 | 34.2 | 29.7 |
| Sugar | 19.63 | 2.5 | 18.3 | 25.8 | 48.3 | 40.3 | 32.3 | 29.9 |
| Cotton | 64.81 | 0.6 | 3.3 | 12.2 | 5.6 | -2.1 | 20.7 | 17.1 |
| **III. Industrial metals** | | | | | | | | |
| Aluminum | 1638.00 | 1.3 | -2.4 | 7.8 | 7.8 | -3.1 | 17.4 | 17.0 |
| Copper | 4687.00 | -0.2 | -7.2 | -3.3 | 2.8 | -18.7 | 22.5 | 21.6 |
| Zinc | 2098.00 | 4.0 | 8.2 | 15.5 | 29.3 | 4.9 | 24.8 | 27.3 |
| Lead | 1815.50 | 6.1 | 0.6 | 6.5 | 5.7 | 3.2 | 20.2 | 23.4 |
| Iron ore | 54.70 | 0.2 | -16.9 | 2.8 | 32.1 | -11.1 | ... | ... |
| **IV. Precious metals** | | | | | | | | |
| Gold | 1355.21 | 3.0 | 4.8 | 10.0 | 21.2 | 15.5 | 18.1 | 16.8 |
| Silver | 19.64 | 10.7 | 10.1 | 27.7 | 37.7 | 25.1 | 29.3 | 26.3 |
| Platinum | 1080.55 | 9.7 | 0.4 | 10.7 | 24.0 | 0.0 | 22.9 | 23.6 |
| Palladium | 605.02 | 10.6 | -2.9 | 7.4 | 21.1 | -10.3 | 28.1 | 27.4 |
| **V. Ratios** | | | | | | | | |
| Gold-silver | 69.01 | -7.1 | -4.8 | -13.9 | -11.7 | -7.7 | 22.0 | 17.5 |
| Gold-platinum | 1.25 | -6.1 | 4.5 | -0.7 | -1.8 | 15.5 | 19.0 | 15.5 |
| Gold-palladium | 2.24 | -7.1 | 8.8 | 2.4 | -0.1 | 28.7 | 35.3 | 27.7 |
| Palladium-platinum | 0.56 | 1.1 | -3.9 | -3.0 | -1.7 | -10.3 | 26.4 | 22.5 |

Source: Bloomberg; own calculations.

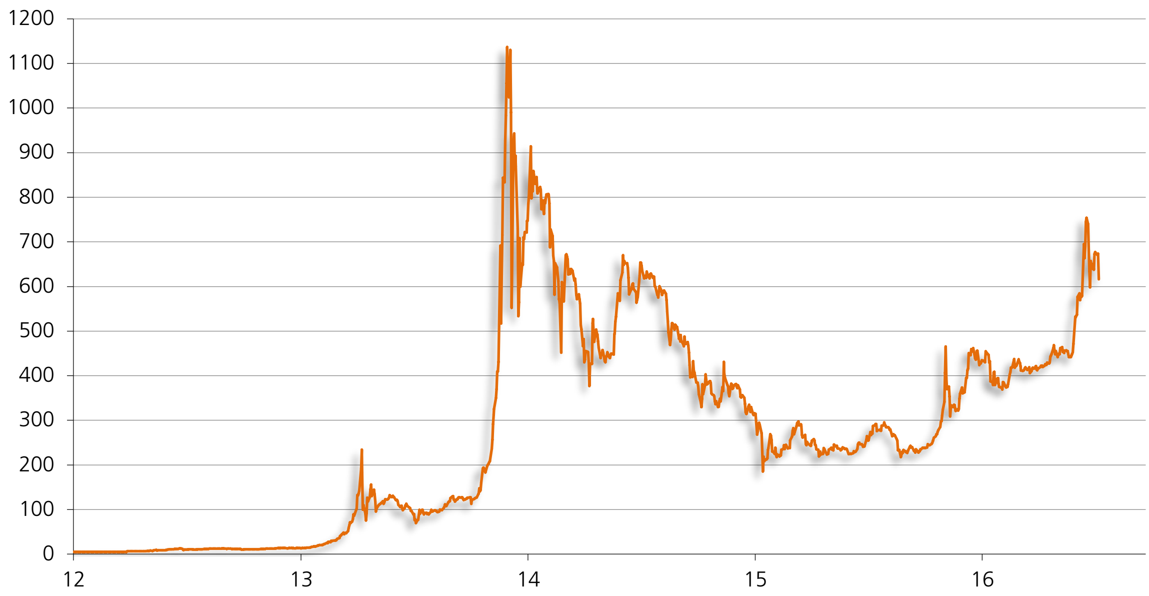
**S&P commodity prices (in US dollar terms)**




Source: Bloomberg. Series are indexed (January 2007 = 100).

## Bitcoin, performance of various asset classes

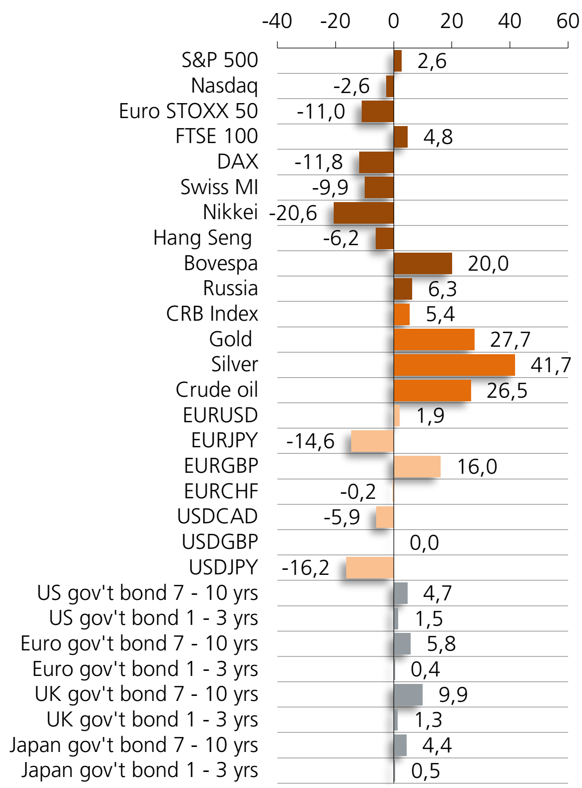
Bitcoin in US-Dollar



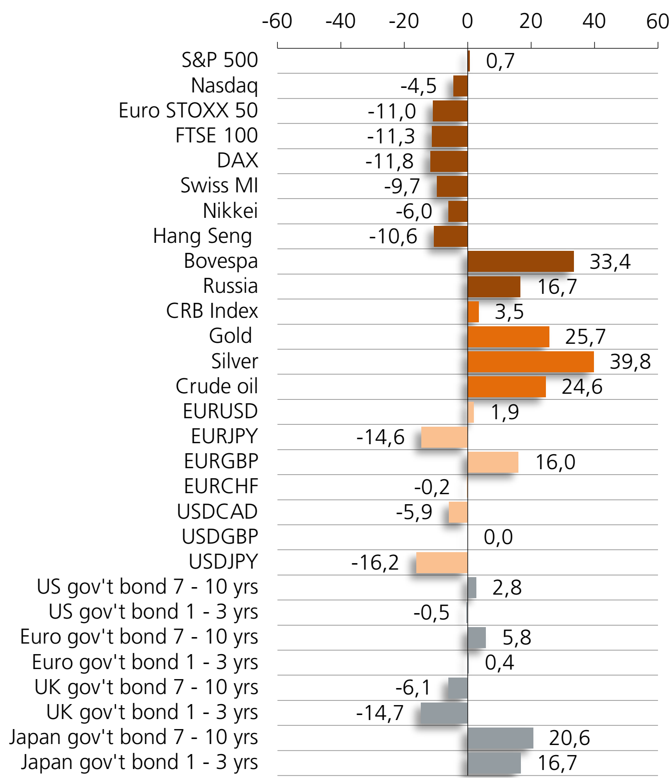

Source: Bloomberg.

**Performance of stocks, commodities, FX and bonds**

(a) In national currencies




(b) In euro




Soure: Bloomberg; own calculations.

**Articles in earlier issues of the *Degussa Market Report***

| Issue | Content |
|---|---|
| 8 July 2016 | Escaping the Euro Trap |
| 24 June 2016 | The Credit Cycle and the Price of Gold |
| 10 June 2016 | US Fed wants to raise rates further - investors should cling to gold and stocks |
| 27 May 2016 | The Illusion of Central Bank Independence and the Consequence for the Gold Price |
| 13 May 2016 | The Fight Against "Secular Stagnation" and What It Means for Gold and Silver Prices |
| 29 April 2016 | US dollar dominance - challenged by gold |
| 15 April 2016 | A World without Returns |
| 1 April 2016 | Helicopter Euros Hovering on the Horizon |
| 18 March 2016 | Gold and stocks protect against 'helicopter-euros' |

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