Degussa Market Report

8 December 2017 Economics · Finance · Precious Metals

USD per ounce of gold

USD per ounce of silver

EURUSD

Source: Thomson Financial.

Precious metals prices

	Actual (spot)	Change against (in percent): 2 W	3 M	12 M
I. In US-dollar				
Gold	1.258.7	-2.5	-1.3	5.6
Silver	15.9	-6.7	-5.2	-4.8
Platinum	897.1	-3.9	-1.7	-7.7
Palladium	992.3	-1.9	7.9	31.6
II. In euro				
Gold	1.066.9	-2.0	-1.8	-5.2
Silver	13.5	-6.3	-5.7	-14.6
Platinum	760.4	-3.4	-2.5	-16.8
Palladium	841.0	-1.4	7.1	18.0
III. Gold price in other currencies				
JPY	141.655.0	-1.3	-1.4	3.0
CNY	8.327.6	-1.9	-1.9	0.8
GBP	941.0	-3.0	-3.6	-3.5
INR	81.249.7	-2.5	-2.6	-0.1
RUB	74.654.1	-1.1	0.7	5.0

Source: Thomson Reuters; own calculations.

OUR TOP ISSUE

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

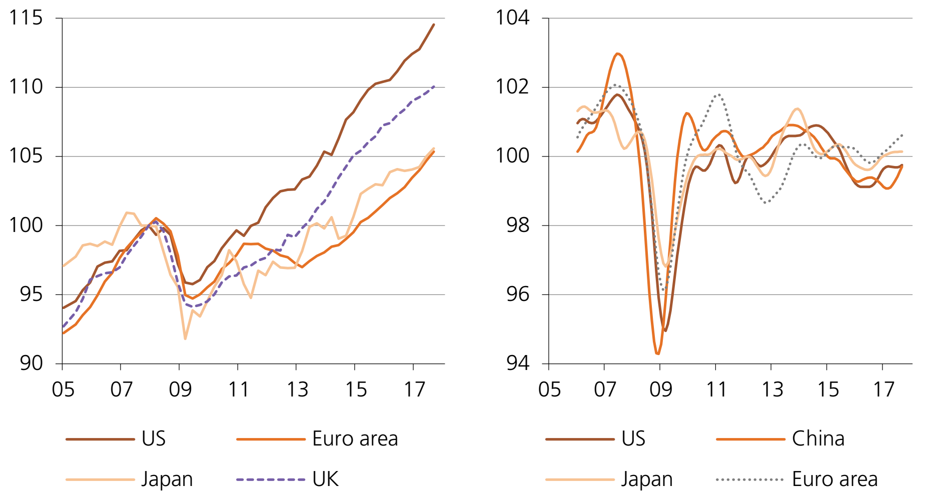
It Is Just Another Inflationary Boom

There are situations in which you could argue whether the glass is half full or half empty. The current state of the world economy is such a situation. Production and employment have been increasing in recent years, accompanied by rising stock and house prices. To most observers, these developments signal an ongoing and broadening recovery from the severe 2008/2009 crisis. However, there is also room for a viewpoint that is rather different.

It suggests that central banks have set into motion yet another 'inflationary boom', which brings output and job gains (boom) now but will have to be followed by a sharp slump (bust) later. Why? Well, central banks have pushed interest rates to very low levels. In fact, real interest rates for shorter maturities have been urged into negative territory. The regime of artificially depressed, exceptionally low interest rates has far-reaching consequences.

1 World economy keeps expanding (moderately)

(a) Real GDP of selected currency areas, levels [(1)] (b) OECD leading business cycle indicators



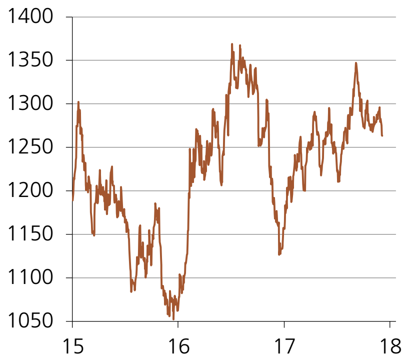
Source: Thomson Financial; own calculation. [(1)] Q3 2007 = 100.

Lower interest rates shore up stock and housing prices. As far as stocks are concerned, expected corporate profits are discounted at suppressed interest rates, resulting in higher present values and thus stock prices. What is more, declining cost of capital coaxes firms to pounce on risky ventures. They begin investing in time-consuming production processes.

This, in turn, increases firms' business risk: The longer it takes to recover the invested capital, the higher the risk. This is especially true in an unbacked paper, or fiat money system. Because the boom, which has been set into motion by artificially lowered interest rates and an increase in the quantity of money and

Precious metal prices (USD/oz)

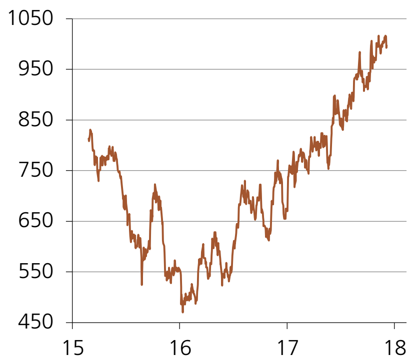
(a) Gold



(b) Silver

(c) Platinum

(d) Palladium



Source: Thomson Financial.

credit, will sooner or later turn into a bust, and not all new investment projects will survive economically.

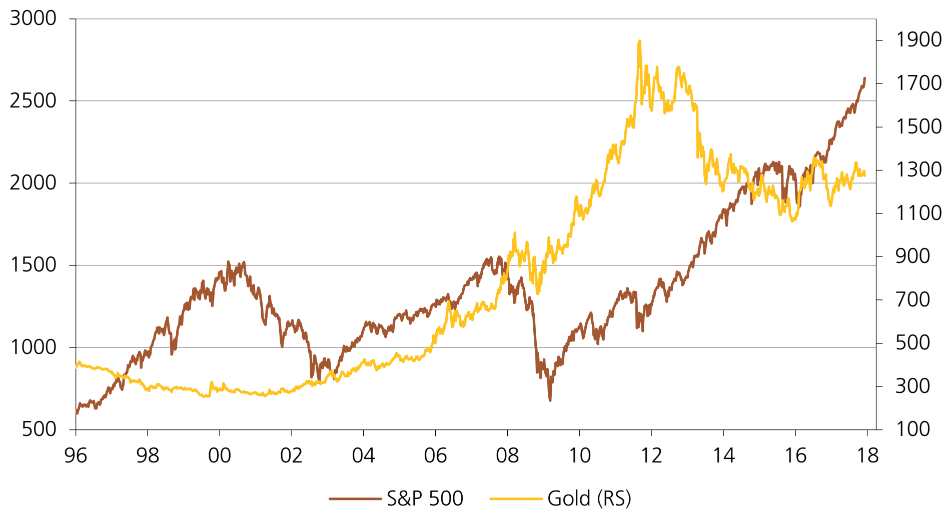
Artificially lowered interest rates also inflate real estate and housing prices. Owners of these assets enjoy a 'windfall profit'. Their net asset values increase, allowing them to go even further into debt. Banks, in turn, become increasingly willing to extend new loans in view of rising real estate prices. That said, asset price inflation feeds a self-strengthening process of more borrowing, higher asset prices and even more borrowing.

By no means less important, central banks have put a 'safety net' under financial markets: Given the central banks' track record, financial market agents have strong reason to expect monetary policymakers to come to their rescue if and when things turn sour. Central banks have caused an enormous 'moral hazard': Investors are willingly engaging in risky trades they wouldn't pursue in the absence of monetary policy makers' safety net.

That said, there is indeed good reason to argue that the current economic expansion is just another inflationary boom. If this is so, investors should remain vigilant, because it is in the boom (which typically everyone welcomes) that scare resources are squandered and malinvestment occurs. The boom sows the seeds for the bust – which, economically speaking, corrects the damages caused by the boom.

One could even say that an inflationary boom is a bust in the making. Unfortunately, however, it is impossible to predict (by scientific means) when a boom will turn into bust. For this depends on the 'specific conditions'. For instance, if and when central banks succeed in keeping interest rates artificially suppressed, the boom might well go on for quite a while.

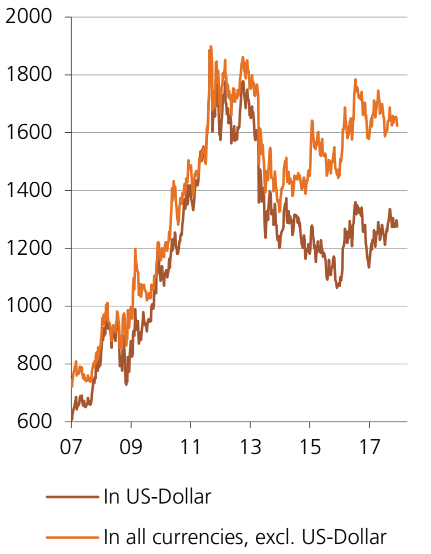
Stocks and gold
S&P 500 and the price of gold (USD/oz)



Source: Thomson Financial.
Note: If you had invested in the S&P 500 from January 1996 until December 2017, your annualized compound return would be 6.8 percent (excluding dividends). Gold would have yielded 5.6 percent, and an investment in 3 months T-Bills 2.2 percent.

Or take the case in which new technologies meaningfully increase the economies' productivity levels. Such a development would improve the growth and income situation, making higher debt levels less of a problem. In other words: There are quite a few factors that might interfere with the boom and bust cycle, and they make it hard to predict when the next crisis will hit.

Gold price per ounce
in US dollars and all world currencies (excl. the US dollar)*
January 2007 to December 2017



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.

Be it as it may, the circumspect investor should by no means turn a blind eye to the undeniable risks inherent in the world's fiat money architecture and their negative consequences for the economy and financial markets – especially not in times when the inflationary boom shows its positive side by making us believe that everything is working just fine in the economic and financial world.

It is quite notable that the price of gold has been climbing since 2014 in basically all major currencies (excluding the US dollar). Also, since the beginning of this year to December, the price of gold has increased by close to 10 percent, compared to 17 percent of the S&P 500. In particular exchange-traded funds (ETFs) have seen increased demand, most likely indicating that their clients – among them many institutional investors – keep seeking exposure in the gold market.

There are indeed sound reasons for the cautious investor to hold gold (if bought at a decent price) as part of one's liquid means and substitute for fiat currency holdings. First and foremost, gold is a currency. It can be seen as the 'ultimate means of payment'. Its purchasing power cannot be debased by political expediency. Gold also serves as portfolio insurance. In times of market stress, the price of gold is likely to go up, which would provide the holder with the opportunity to exchange highly priced gold against attractive assets available at depressed prices (such as, for instance, stock of great companies).

On a final note, we would not argue against investing selectively in stocks, even in times of recurrent boom and bust. Generally speaking, stocks represent ownership in productive capital that yields a positive (inflation adjusted) return on capital invested. This is what the investor wants: An asset that provides a decent return, as it allows to take advantage of compounding interest over time.

However, not all stocks will work. Many firms fail or disappoint the investor in terms of profit and return performance. But there are businesses that have a good chance to keep their promise; companies that may well sail through and survive economically and financially troubled times: Their stock prices might temporally tank, but their business case and ability to deliver positive returns on capital invested are likely to remain intact.

Thus, a selection of such companies is another reasonable portfolio element for the long-term oriented investor in times of boom and bust and, therefore, holding gold and investing in stocks of great companies goes well together. In the current state of the inflationary boom, one of the real challenges for cautious investors might be to reign in their stock market euphoria and, at the same time, keep building their gold position.

Gold In Art

Andy Warhol (1928-1987), Gold Marilyn Monroe, 1962, Synthetic Polymer and Screenprinted Ink on Canvas, 211 x 145 cm: Museum of Modern Art, New York.

Shortly after her death, Andy Warhol made a series of paintings of Marilyn Monroe (1926 - 1962). All portraits are based on a 1953 press photo of the movie Niagara, previously acquired by the artist.

While the serial portraits were produced in large numbers, there is only one copy of the Gold Marilyn. Warhol first painted the canvas gold and then placed the screen-printed photo of Marilyn Monroe in the middle.

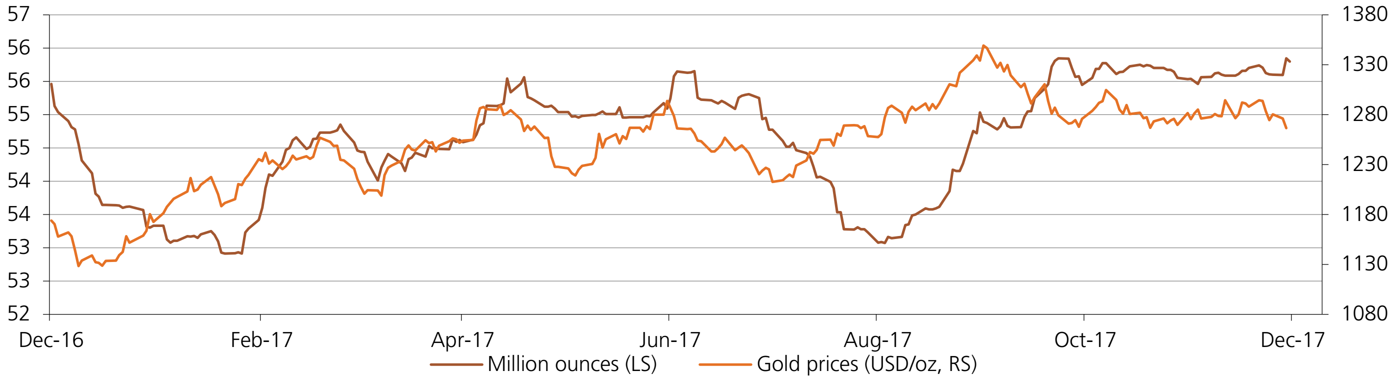
The structure of the picture and its golden background are reminiscent of a Christian Orthodox icon and convey not only uniqueness, but also immortality. In ancient times, because of its indestructibility, gold was used as a symbol of timelessness in the cult of the dead. There are also connections between stars and gold: both stand for economic capital.

Warhol gave Marilyn Monroe not only a supramundane but also a timeless existence.

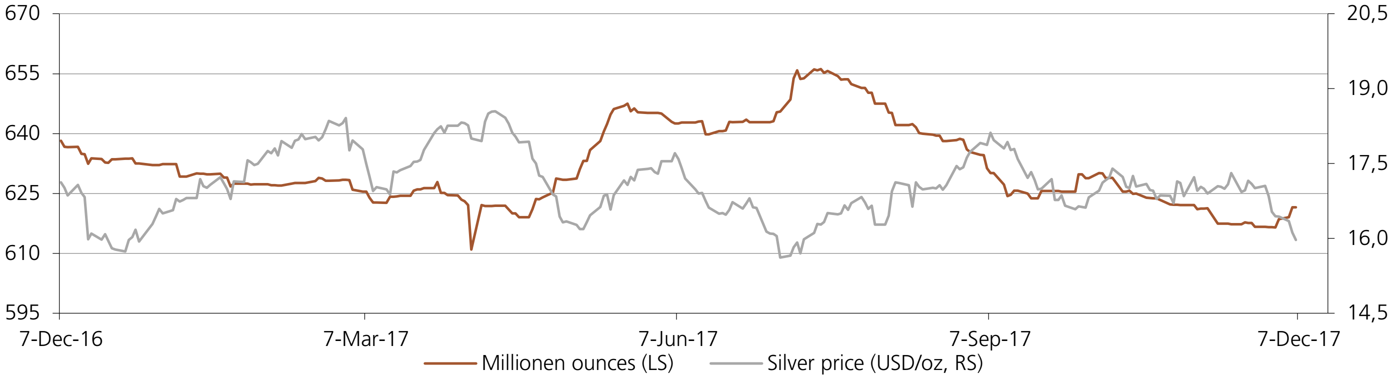
Author: Dr. Ruth Polleit Riechert, Art Historian.

Precious metals prices and ETF holdings

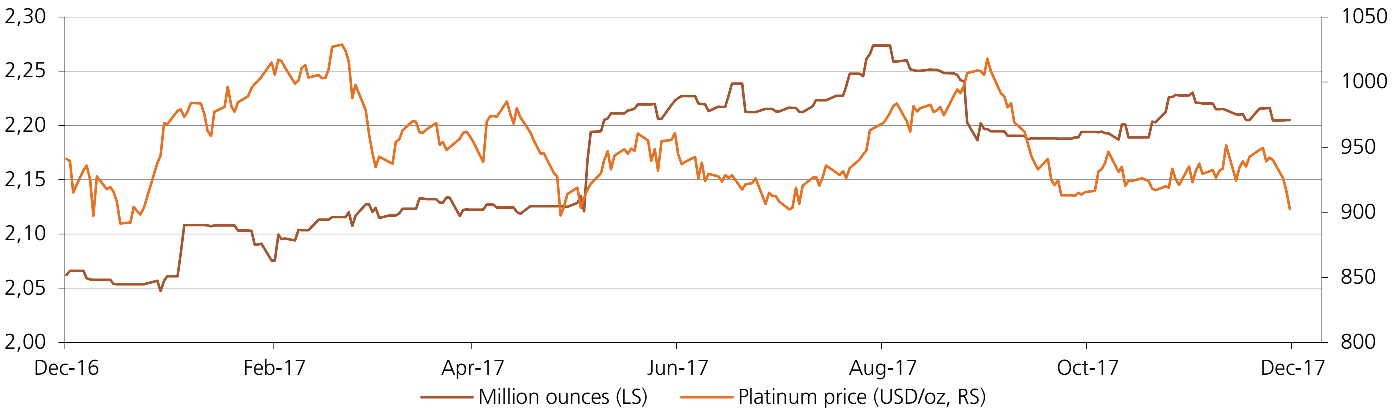
Gold ETFs (million ounces) und gold price (USD/oz)



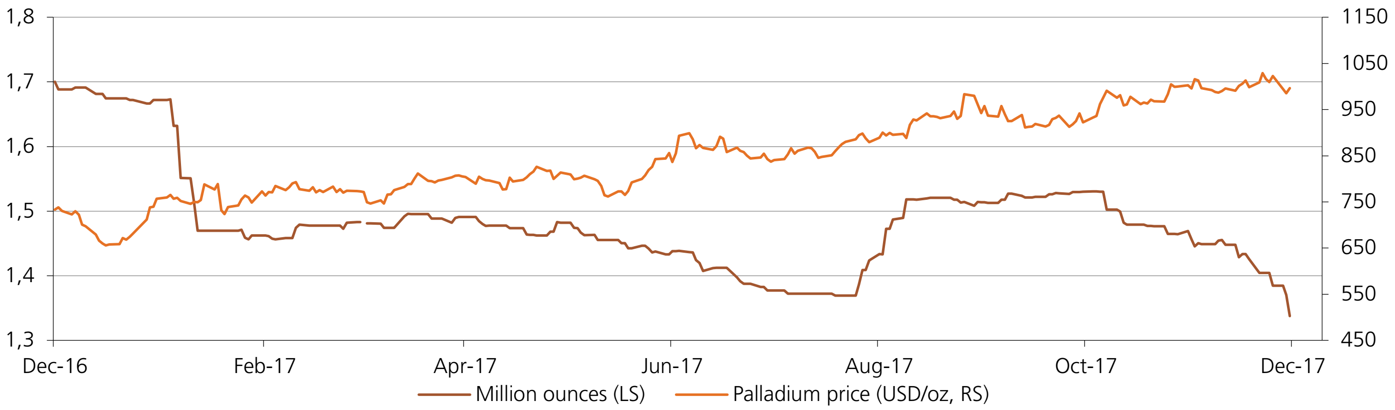
Silver ETFs (million ounces) and silver price (USD/oz)



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



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



Source: Thomson Financial.

Precious metals prices

In US-dollar

	Gold		Silver		Platinum		Palladium	
I. Actual	1259.0		15.9		897.1		993.8	
II. Gliding averages								
5 days	1272.8		16.2		925.4		1006.0	
10 days	1281.9		16.6		934.3		1006.5	
20 days	1282.1		16.8		933.9		1000.9	
50 days	1280.8		16.9		926.7		979.7	
100 days	1287.0		17.0		945.9		946.7	
200 days	1267.6		17.1		943.5		880.4	
III. Projections for 2017	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1148.0	1390.0	15.9	23.0	906.0	1100.0	700.0	900.0
IV. Annual averages								
2013	1429		24		1487		724	
2014	1260		19		1382		800	
2015	1163		16		1065		706	
2016	1242		17		985		617	

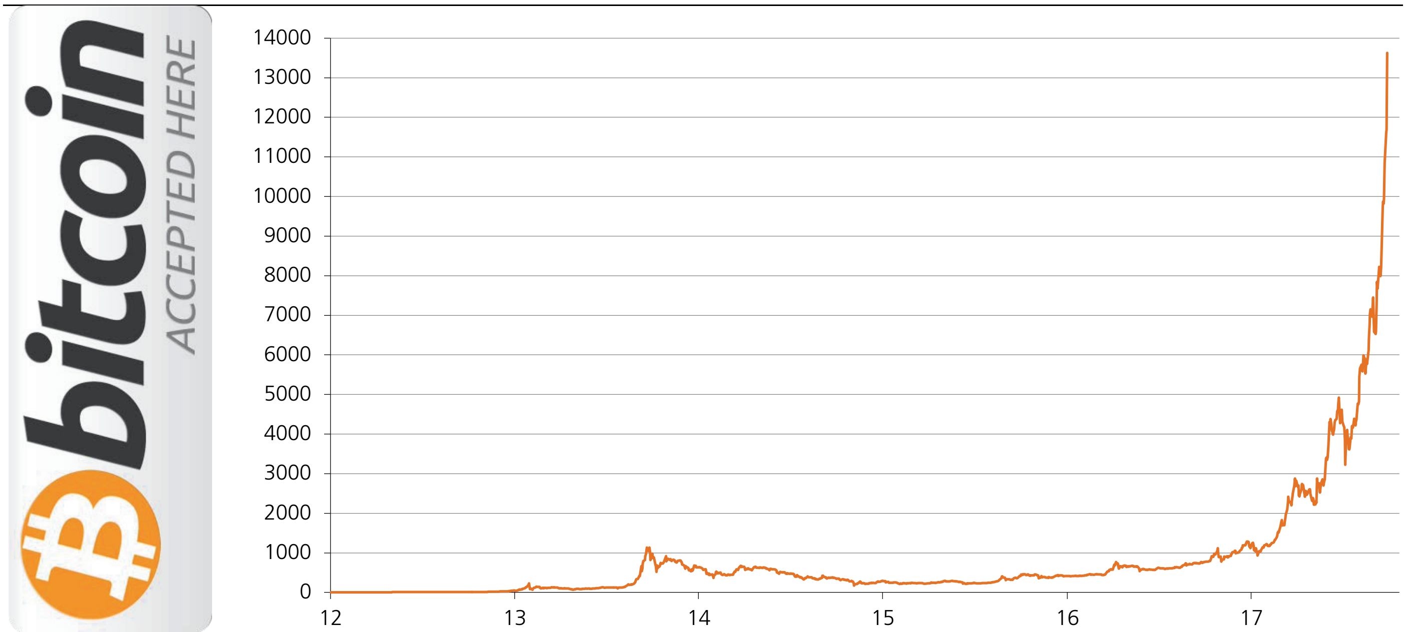
In euro

	Gold		Silver		Platinum		Palladium	
I. Actual	1067.4		13.5		760.6		842.5	
II. Gliding averages								
5 days	1073.9		13.7		780.8		848.8	
10 days	1080.1		14.0		787.3		848.1	
20 days	1086.6		14.2		791.5		848.2	
50 days	1089.4		14.4		788.2		833.3	
100 days	1091.0		14.4		801.8		802.7	
200 days	1113.4		15.0		829.3		771.5	
III. Projections for 2017	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1000.4	1211.3	13.8	20.0	789.5	958.6	610.0	784.3
IV. Annual averages								
2013	1079		18		1123		547	
2014	945		14		1035		601	
2015	1044		14		955		633	
2016	1120		15		888		557	

Source: Thomson Financial; own calculations and estimates.

Bitcoin, performance of various asset classes

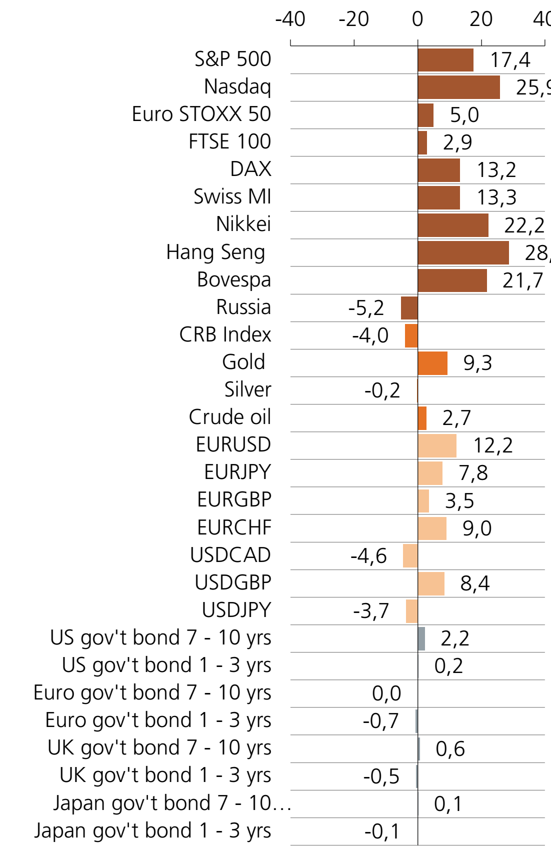
Bitcoin in US dollars



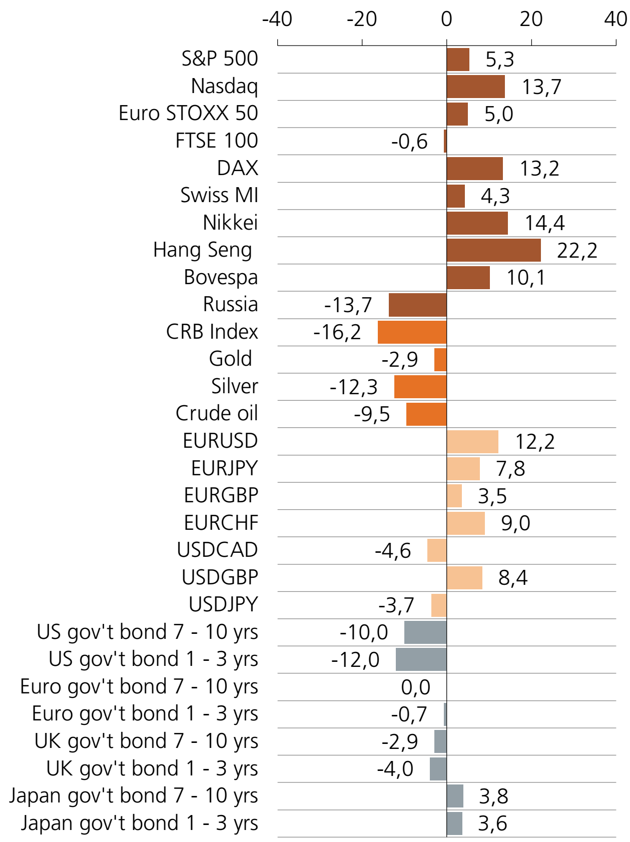
Source: Thomson Financial.

Performance of stocks, commodities, FX and bonds

(a) In national currencies



(b) In euro



Source: Thomson Financial; own calculations

Articles in earlier issues of the *Degussa Market Report*

Issue	Content
8 December 2017	It Is Just Another Inflationary Boom
24 November 2017	There Is, And Will Be More, Inflation
10 November 2017	Calm Markets: The Great Mystery
27 October 2017	The Interest Rate Becomes A “Crash Factor”
13 October 2017	The Great Complacency
29 September 2017	The German Election Outcome Might Turn Up The Heat On The Euro
15 September 2017	A Case for Gold in the Investment Portfolio
1 September 2017	On the Intrinsic Price of Gold
18 August 2017	Gold in Times of Boom and Bust
4 August 2017	The Underpriced Risk
21 July 2017	The Fed Remains on Course – to Trouble
7 July 2017	Gold And The Blockchain
23 June 2017	The Super-Bubble in Danger
9 June 2017	Trapped in Boom-and-Bust
26 May 2017	The Make-Believe World of Fiat Money
12 May 2017	The Fed Will Likely Chicken Out on Planned Rate Hikes
28 April 2017	Central Banks Will not Dare to Take Away the Punch Bowl
13 April 2017	The Gold Price Rise Tells Us: The Crisis Isn’t Over Yet
31 March 2017	ECB Negative Interest Rate Policy Will Come to an End
17 March 2017	The Fed’s Half-Hearted Attempt of Monetary Tightening
3 March 2017	ECB Flirts With Higher Inflation. The Case For Gold
17 February 2017	Gold Gains Ground vis-a-vis the US-Dollar
3 February 2017	Gold Insures Against Risks Lurking in the Financial System
20 January 2017	The Year of Change
20 December 2016	Gold Rather Than Euro
25 November 2016	Mr Trump Loves Gold. Does Gold Love Him Back?
11 November 2016	Trump Election Puts Euro Under Pressure
28. October 2016	US Presidential Elections and the Price of Gold
14 October 2016	Amid Uncertainty, Opportunity Knocks
30 September 2016	On the Debt Ratio and the Price of Gold
16 September 2016	Central Banks May Choose Helicopter Money Over Negative Rates
2 September 2016	No return to “normal” interest rates
19 August 2016	Debt Monetized En Masse to Fend Off the Euro Crash?
5 August 2016	*No English issue due to summer break*
22 July 2016	The Demise of the Interest Rate – the Comeback of Gold Money
8 July 2016	Escaping the Euro Trap
24 June 2014	The Credit Cycle and the Price of Gold
10 June 2016	Savvy Investors Say Yes to Gold and Stocks Despite Prospective Fed Rate Hike
27 May 2016	Central Banks' Illusory Independence and the Price of Gold

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E-Mail: info@degussa-goldhandel.de, Internet: www.degussa-goldhandel.de
Editor in chief: Dr. Thorsten Polleit
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Degussa
GOLD UND SILBER.

Frankfurt Headquarters
Kettenhofweg 29 · 60325 Frankfurt
Phone: 069-860 068 – 0 · info@degussa-goldhandel.de

Retail buying and selling outlets in Germany:

Augsburg (shop & showroom)**:** Maximiliansstraße 53 · 86150 Augsburg
Phone: 0821-508667 – 0 · augsburg@degussa-goldhandel.de

Berlin (shop & showroom)**:** Fasanenstraße 70 · 10719 Berlin
Phone: 030-8872838 – 0 · berlin@degussa-goldhandel.de

Frankfurt (shop & showroom)**:** Kettenhofweg 29 · 60325 Frankfurt
Phone: 069-860 068 – 100 · frankfurt@degussa-goldhandel.de

Hamburg (shop & showroom)**:** Ballindamm 5 · 20095 Hamburg
Phone: 040-329 0872 – 0 · hamburg@degussa-goldhandel.de

Hanover (shop & showroom)**:** Theaterstraße 7 · 30159 Hanover
Phone: 0511-897338 – 0 · hannover@degussa-goldhandel.de

Cologne (shop & showroom)**:** Gereonstraße 18-32 · 50670 Cologne
Phone: 0221-120 620 – 0 · koeln@degussa-goldhandel.de

Munich (shop & showroom)**:** Promenadeplatz 12 · 80333 Munich
Phone: 089-13 92613 – 18 · muenchen@degussa-goldhandel.de

Munich (Old Gold Centre): Promenadeplatz 10 · 80333 Munich
Phone: 089-1392613 – 10 · muenchen-altgold@degussa-goldhandel.de

Nuremberg (shop & showroom)**:** Prinzregentenufer 7 · 90489 Nuremberg
Phone: 0911-669 488 – 0 · nuernberg@degussa-goldhandel.de

Pforzheim (refinery)**:** Freiburger Straße 12 · 75179 Pforzheim
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Stuttgart (shop & showroom)**:** Kronprinzstraße 6 · 70173 Stuttgart
Phone: 0711-305893 – 6 · stuttgart@degussa-goldhandel.de

Retail buying and selling outlets around the world:

Zurich (shop & showroom)**:** Bleicherweg 41 · 8002 Zurich
Phone: 0041-44-40341 10 · zuerich@degussa-goldhandel.ch

Geneva (shop & showroom)**:** Quai du Mont-Blanc 5 · 1201 Genève
Phone: 0041-22 908 14 00 · geneve@degussa-goldhandel.ch

Madrid (shop & showroom)**:** Calle de Velázquez 2 · 28001 Madrid
Phone: 0034-911 982 900 · info@degussa-mp.es

London Sharps Pixley Ltd. (member of the Degussa Group)
Phone: 0044-207 871 0532 · info@sharpspixley.com