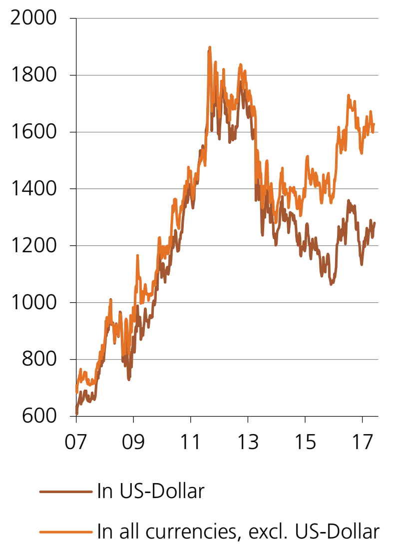
Degussa Market Report

"To be sure, gold may not be a perfect standard, but the mere fact that it has been chosen by the most enlightened commercial nations – by demand from within, not by imposition from without –, is strong proof that it is the fittest single commodity for practical use as a standard."

—J. Laurence Laughlin (1850 - 1933)

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

OUR TOP ISSUE

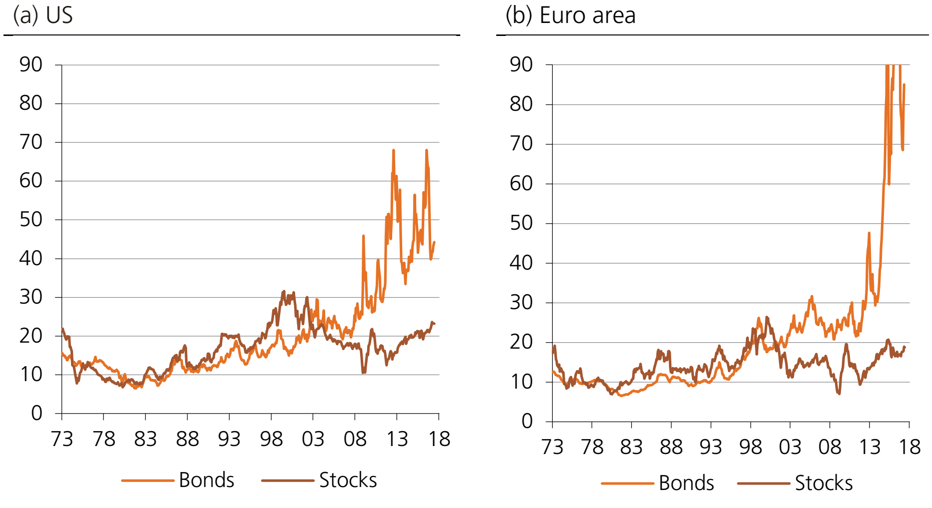
*This is a short summary of our fortnightly **Degussa Marktreport**.*

Trapped in Boom-and-Bust

Economic growth has returned. Production and employment slope upwards in basically all developed countries of the world. However, the recovery has been accompanied and fuelled by an unprecedented expansionary monetary policy. Interest rates have been pushed down to extremely low levels, and central banks have de facto provided financial markets with a safety net: Investors can rest assured that monetary authorities are willing and prepared to fend off another crisis - 'whatever it takes.'

As a result, financial asset prices have been pulled up to elevated valuation levels. In particular bond prices have been inflated to an extraordinary degree. For instance, the price-earnings-ratio for the US 10-year Treasury yield stands around 44, while the equivalent for the Eurozone even trades at 85. In other words, the investor has to wait 44 years (85 years, respectively) to recover the bonds' purchasing price through coupon payments.

Significantly inflated bond prices - as indicated by price-earnings ratios[1)]

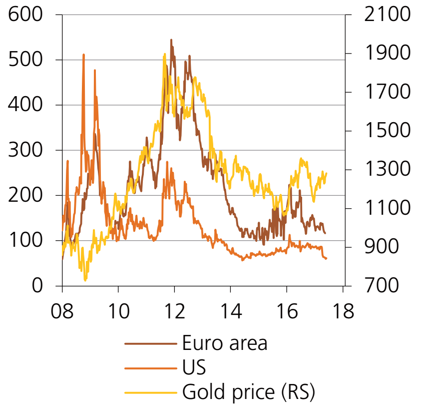


Source: Thomson Financial; own calculations. [1)] For bonds: Calculated as 1 divided by the 10-year government bond yield.

At the same time, valuation levels of the stock markets have been edging up as well. This can in part be attributed to the very low interest rates: Future corporate earnings are discounted by low yields, translating into higher stock prices. Furthermore, the ongoing economic recovery makes investors more confident with regards to the growth of future corporate profits. That said, any investor should consider it important to learn more about the drivers of the current recovery.

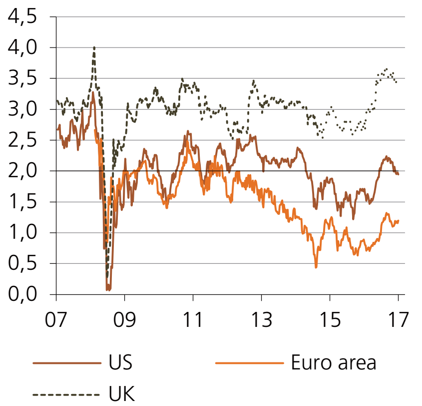
If and when central banks, in cooperation with commercial banks, increase the outstanding quantity of money through credit expansion - namely through credit that is not backed up by "real savings" -, an artificial upswing ("boom") is trig-

Investor credit default concerns on the decline
Gold price (USD/oz) and CDS for bank bonds (5-yrs, bp)



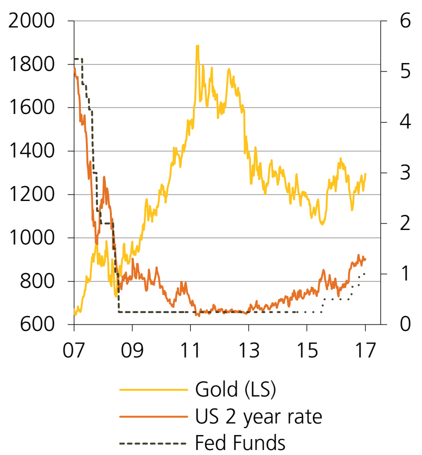
Source: Thomson Financial.

Inflationary expectations have remained fairly subdued
Measured by the 5y/5y inflation swap rates in percent



Source: Thomson Financial.

Gold price up, despite higher US short-term rates
Gold price (USD/oz) and US short-term rates in percent

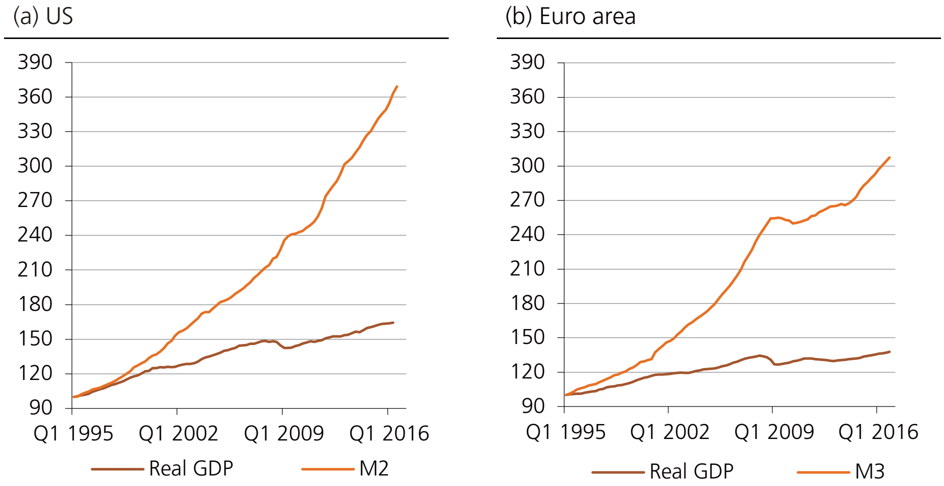


Source: Thomson Financial.

gered. Artificial credit expansion lowers market interest rates (to below the level that would prevail had there been no credit expansion 'out of thin air'). Investment and consumption expenditures go up; jobs are created. But it cannot go on forever.

Sooner or later the monetary illusion must evaporate. Entrepreneurs will all of a sudden realize that their investment returns fall short of expectations. Sales will disappoint, and input costs turn out to be higher than originally anticipated. Firms liquidate their flop investments, shedding jobs. The boom turns into a bust. In an attempt to fend off the approaching collapse, the central banks will rush in, lowering interest rates and pumping in new money to keep struggling borrowers afloat.

Money growth well in excess of real output gains



Source: Thomson Financial; own calculations. Series are indexed (Q1 1995 = 100).

Indeed, to keep the boom going, central banks have to keep pushing down the interest rates and make sure that new credit and money keeps flowing into the system. That said, the latest attempts by the US Federal Reserve (Fed) to bring short-term rates back up makes boom turning to bust increasingly likely. The same goes for the European Central Bank (ECB), which also signals that it might sooner or later end its overly expansionary interest rate policy.

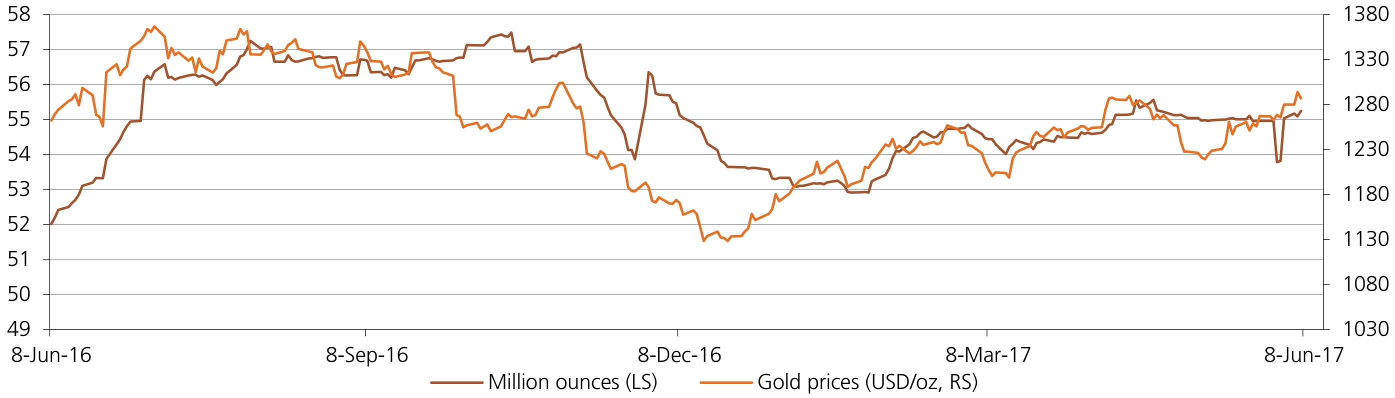
Another bust would presumably be rather painful for the highly leveraged economies. However, financial markets seem to be more or less ignorant of the scenario in which things turn sour. On the one hand, investor credit default concerns have declined to relatively low levels. On the other hand, inflation expectations have remained subdued. Looking ahead, it is difficult to understand that we can have both at the same time.

And this is where gold comes into play. Gold is, as we have written in earlier publications, a hard currency that cannot be debased by central bank policies. In that sense, gold is an excellent substitute for liquid assets such as time and savings deposits, especially so as short-term interest rates are basically zero or even negative in real (that is: inflation-adjusted) terms. What is more, gold also serves as insurance: It does not carry a default risk, unlike bank deposits and bonds.

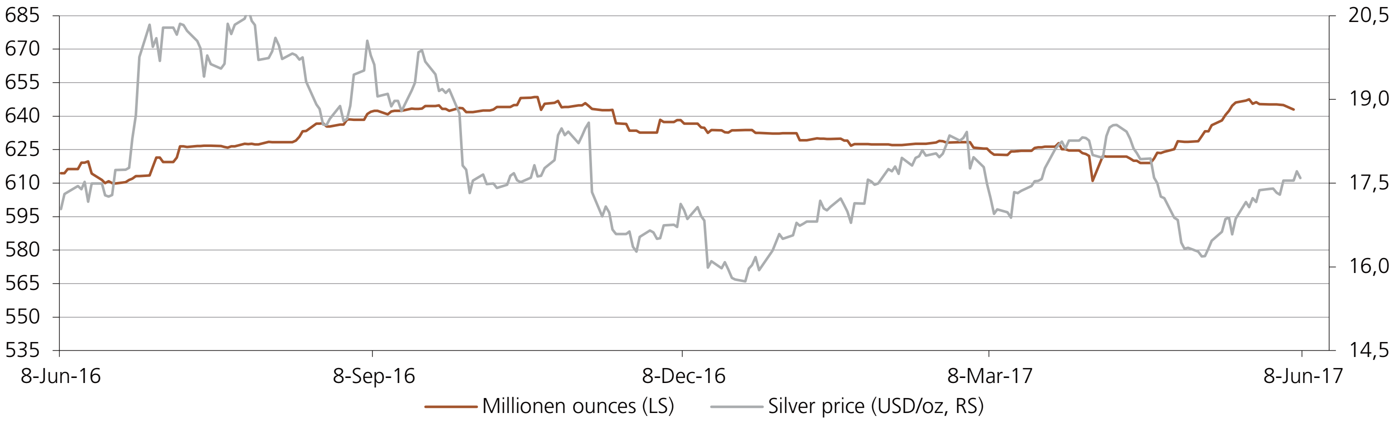
That said, gold may be viewed as a portfolio protection with an upside price potential: According to various measures, we think that the current gold price is relatively attractive, especially so for investors with a medium- to long-term view of, say, a couple of years. And portfolio protection is wise to have: In a fiat money system as ours, which keeps us trapped in a boom-and-bust cycle, booms inevitably turn into bust. This is not a question of if but of when.

Precious metals prices and ETF holdings

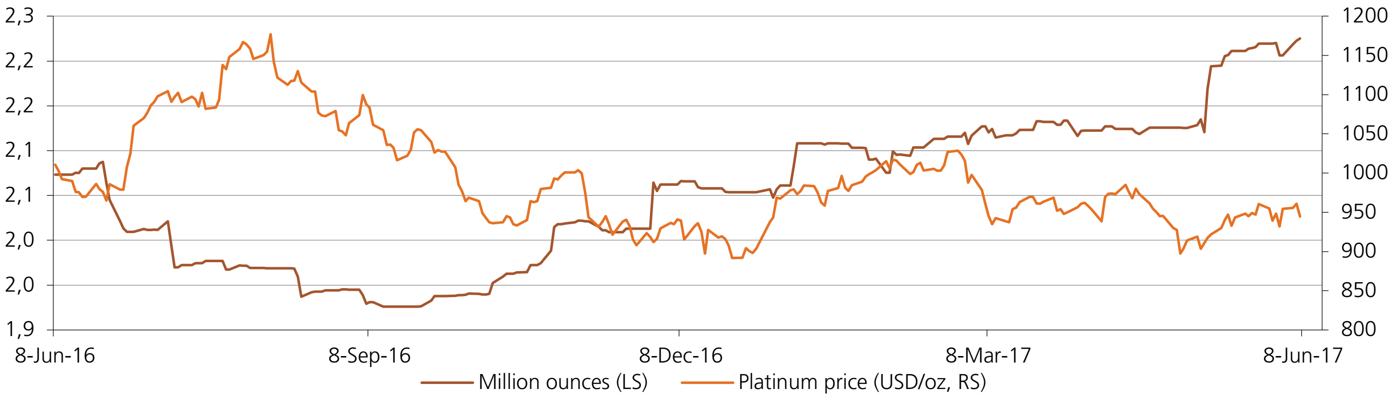
Gold ETFs (million ounces) und gold price (USD/oz)



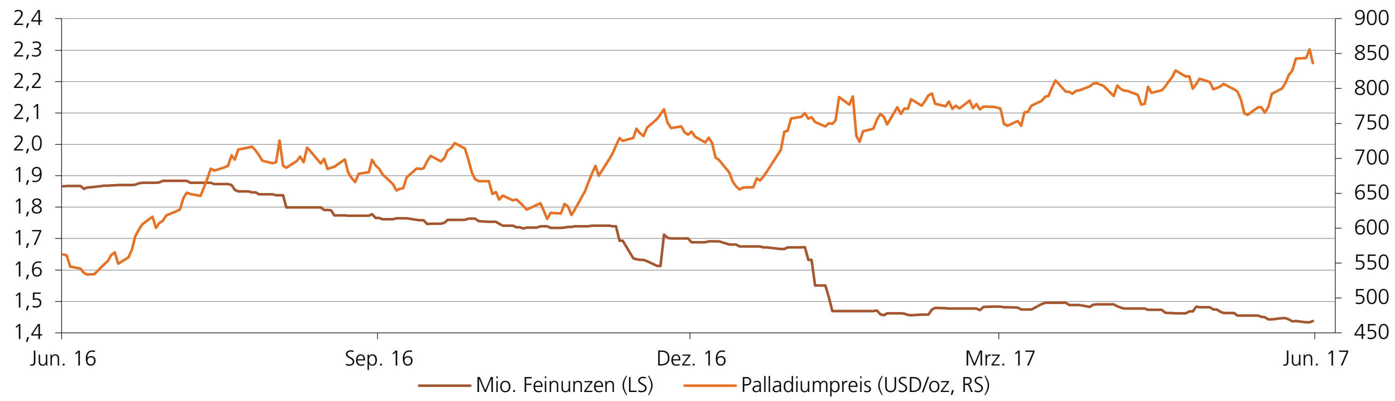
Silver ETFs (million ounces) and silver price (USD/oz)



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



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



Source: Bloomberg.

Precious metals prices

In US-dollar

	Gold		Silver		Platinum		Palladium	
I. Actual	1,278.6		17.4		936.5		855.3	
II. Gliding averages								
5 days	1,282.3		17.5		944.4		839.6	
10 days	1,273.4		17.4		948.2		813.6	
20 days	1,259.9		17.1		942.3		798.8	
50 days	1,260.0		17.4		945.5		801.0	
100 days	1,243.3		17.5		964.5		785.9	
200 days	1,240.0		17.5		966.4		738.2	
III. Projections for 2017								
	Low	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1,148	1,390	15.9	23.00	906	1,100	700	900
IV. Annual averages								
2013	1,429		24.1		1,487		724	
2014	1,260		19.1		1,382		800	
2015	1,163		15.7		1,065		706	
2016	1,242		17.0		985		617	

In euro

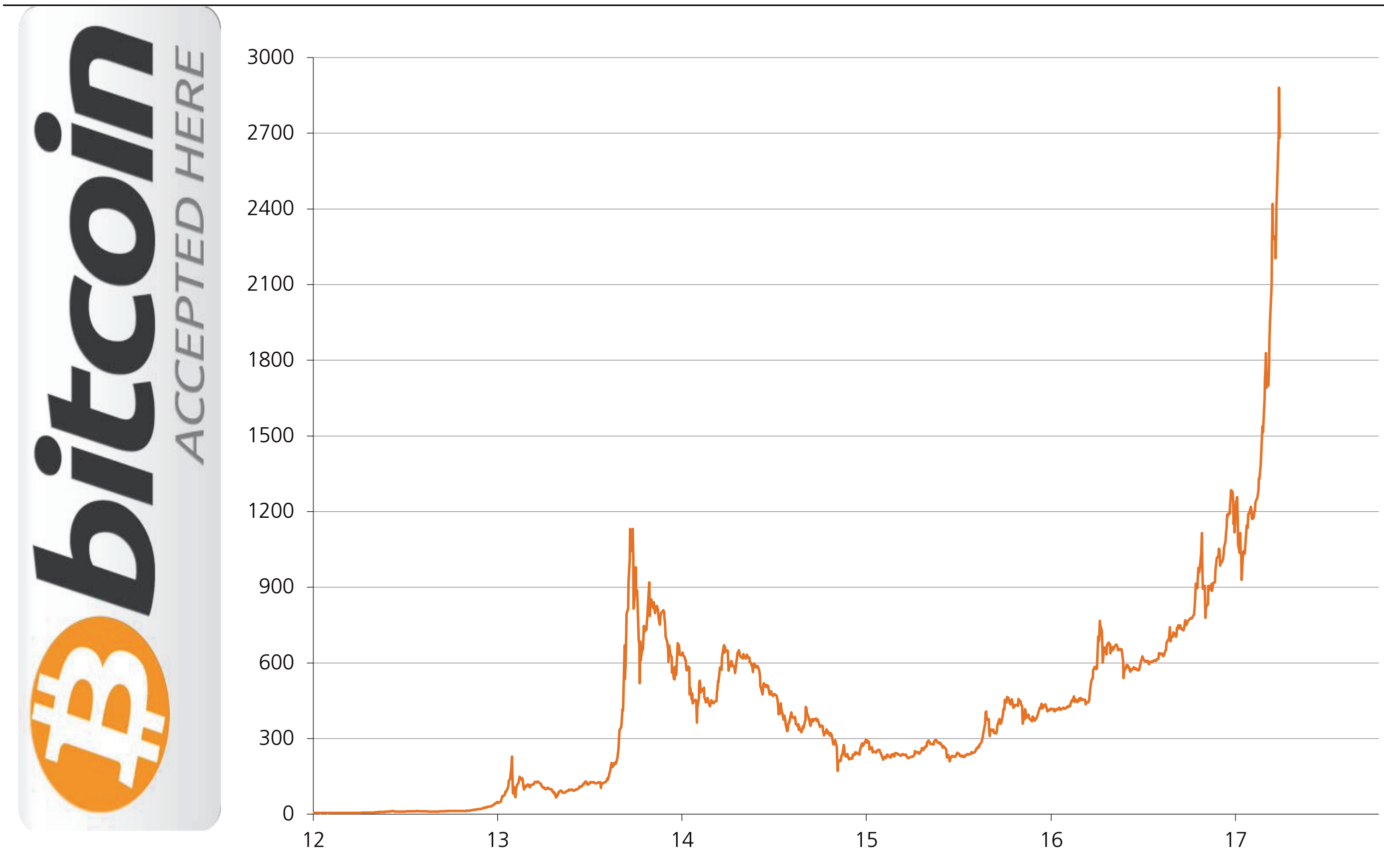
	Gold		Silver		Platinum		Palladium	
I. Actual	1,140.4		15.5		835.3		762.8	
II. Gliding averages								
5 days	1,139.2		15.6		839.0		745.9	
10 days	1,134.1		15.5		844.5		724.6	
20 days	1,128.6		15.3		844.1		715.6	
50 days	1,153.6		16.0		865.8		733.3	
100 days	1,151.3		16.2		893.5		727.7	
200 days	1,145.4		16.2		892.9		682.6	
III. Projections for 2017								
	Low	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1,118	1,353	15.5	22.40	882	1,071	682	876
IV. Annual averages								
2013	1,079		18.2		1,123		547	
2014	945		14.3		1,035		601	
2015	1,044		14.1		955		633	
2016	1,120		15.4		888		557	

Source: Thomson Financial; own calculations and estimates.

S&P commodity prices (in US dollar terms)

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

Bitcoin in US dollars



Source: Bloomberg

Articles in earlier issues of the *Degussa Market Report*

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9 June 2017	Trapped in Boom-and-Bust
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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
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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
13 May 2016	The Fight Against "Secular Stagnation" and Its Consequences for Gold and Silver Prices
29 April 2016	US Dollar's 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'

The Degussa Marktreport (German) and the Degussa Market Report (English) are available at:
www.degussa-goldhandel.de/infothek/marktreport/

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