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	1.287.3	1.6	-4.4	12.5
Silver	17.0	1.5	-5.2	1.0
Platinum	938.2	2.3	-6.6	1.6
Palladium	1.012.4	4.5	8.3	40.7
II. In euro				
Gold	1.105.1	1.6	-1.2	1.9
Silver	14.6	1.5	-2.0	-8.5
Platinum	805.4	2.3	-3.5	-7.9
Palladium	869.0	4.3	12.0	27.0
III. Gold price in other currencies				
JPY	145.680.0	0.9	0.3	8.9
CNY	8.544.6	1.6	-2.0	8.3
GBP	978.5	1.7	-4.1	7.6
INR	83.627.5	1.8	-2.6	8.5
RUB	76.345.5	4.2	-1.1	7.5

Source: Thomson Reuters; own calculations.

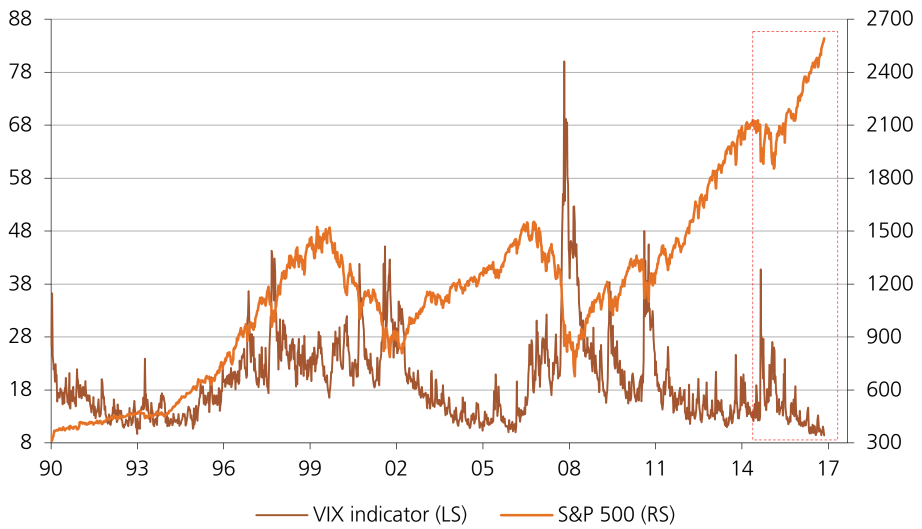
OUR TOP ISSUE

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

Calm Markets: The Great Mystery

Indicators for financial market „stress" have reached their lowest levels in decades. For instance, stock market volatility has never been this low since the early 1990s. Prices for credit default swaps have fallen to pre-crisis levels. In fact, investors are no longer haunted by concerns about the stability of the financial system, potential credit defaults, and unfavourable surprises in the economy or financial assets markets. How come?

1 Stock market volatility at record low, stock prices at record high
VIX indicator and S&P 500



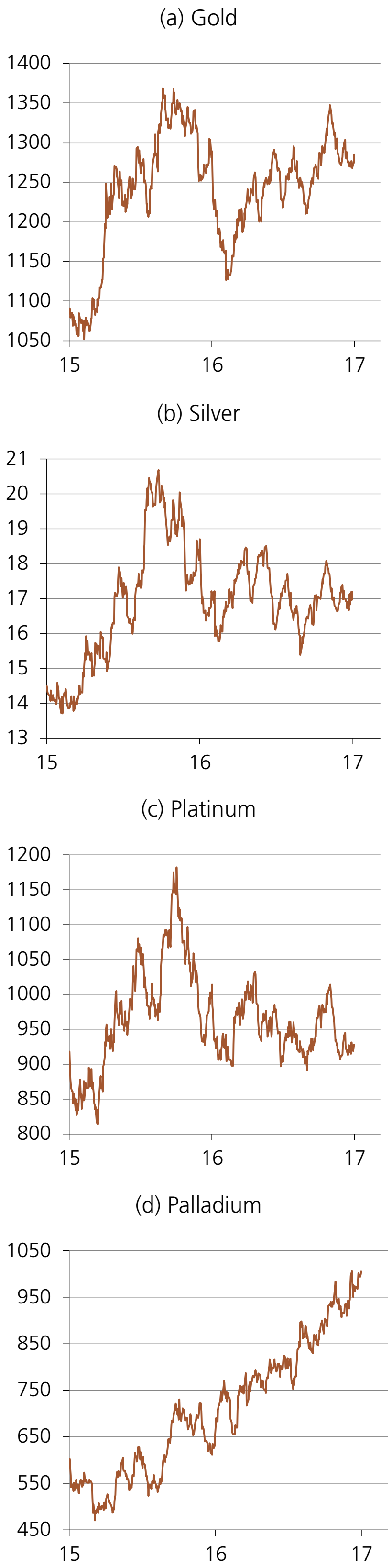
Source: Thomson Financial.

Monetary policy plays the significant role. By slashing interest rates and ramping up the quantity of money in the banking system, central banks around the world have more or less kick-started the economies following the 2008/2009 crash. But this is not the full story. The fact that investors expect central banks to stand at the ready to fend off a slowdown of the economy and price declines in stock and housing markets is by no means less important.

Investors expect central banks to provide a 'safety net'. This expectation encourages them to make risky investments again (which they would otherwise have declined). As a result, central banks have caused an enormous 'moral hazard': Investors feel pretty much assured that the risk-reward profile of their investments has become more favourable - that they can enjoy a considerable upside, while the downside is limited.

Asset prices are driven up. As stock prices rise, firms' cost of capital falls, encouraging additional and risky investments. Consumers, with their real estate assets appreciating, go into debt. Maturing debt is rolled over at low interest rates, and borrowers' spending capacity increases. In other words: The down-

Precious metal prices (USD/oz) in the last two years



Source: Thomson Financial.

ward manipulation of interest rates and investor risk aversion translates into a cyclical strengthening of the economy.

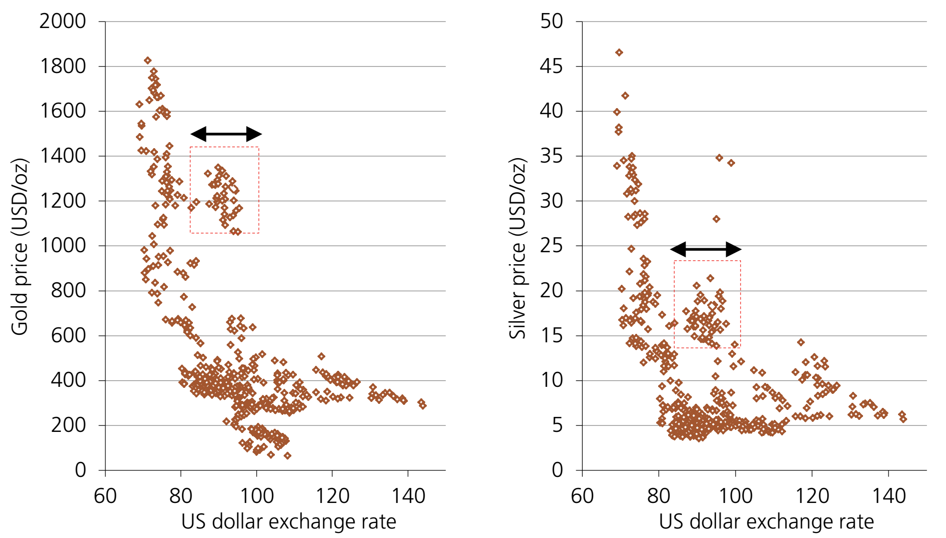
But wait: Will the Fed's hiking of interest rates and the planned shrinking of its balance sheet not undo the very forces that have pushed economic activity back into positive territory? Not necessarily. The crucial point is the Fed's safety net: If investors continue to assume that the Fed stands ready as the 'lender of last resort', a monetary policy tightening is unlikely to do much harm to the current recovery.

Because if things turn sour, the Fed is expected to reverse its restrictive monetary policy. This might explain why financial markets have remained rather relaxed in the light of the Fed's current hiking cycle, which has begun back in December 2015. While many people welcome output and employment gains, coupled with decent investment returns in asset markets, the downside of all this should not be overlooked.

Central banks around the world, under the leadership of the Fed, have orchestrated yet another artificial boom – which, sooner or later, will falter and turn into bust. This is, by no means, a pessimistic prediction. But it is based on sound economics: A policy of artificially lowered interest and politically distorted prices simply cannot bring about greater prosperity and higher employment in the long run. To think so is delusional. The truth is that such a monetary policy will be cause trouble further down the road.

2 The relation between the US dollar exchange rate and gold and silver

(a) US dollar exchange rate and the price of gold (USD/oz) [1] (b) US dollar exchange rate and the price of silver (USD/oz) [2]

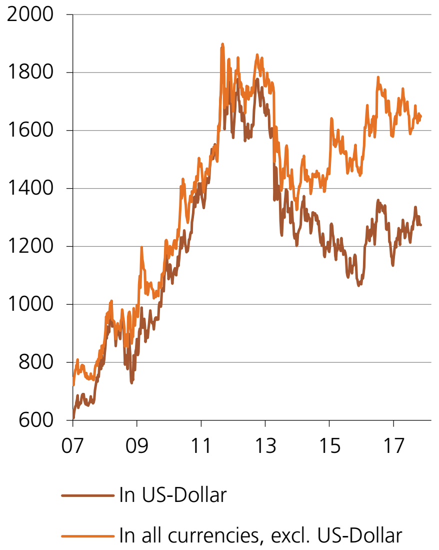


Source: Thomson Financial; own calculation. [1] Period: March 1973 to October 2017. [2] Period: February 1979 to October 2017.

US dollar, gold, and silver

In this context, it is interesting to note that in recent years the *negative relation* between the US dollar exchange rate and the prices of gold and silver has changed. In the past, a stronger Greenback has been accompanied by a lower gold price and vice versa. Since around 2014, however, the US dollar exchange rate has increased, while the prices of gold and silver have moved sideways. Even a stronger US dollar has obviously not discouraged investors from holding precious metals.

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

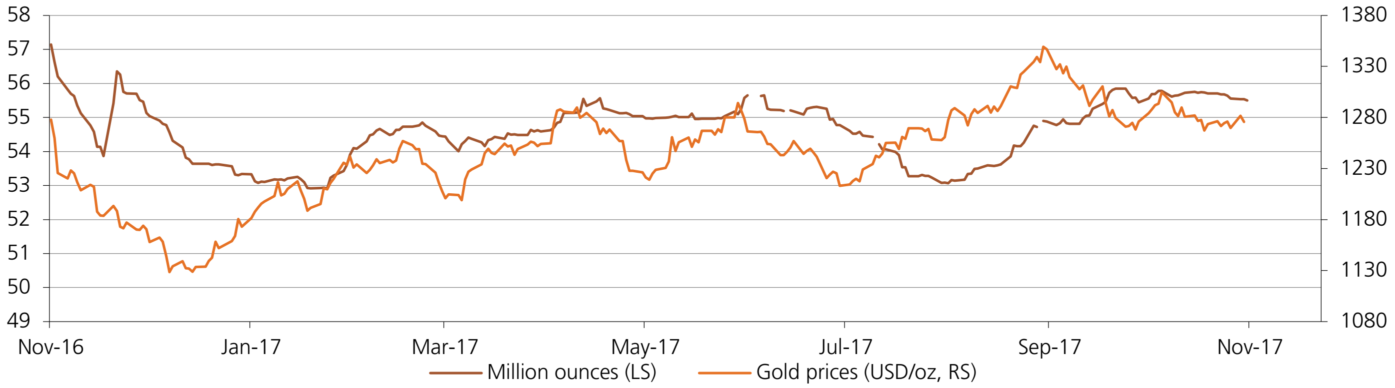
This might suggest that gold, and perhaps to a somewhat lesser extent silver, has increasingly become an effective means for diversifying investors' currency portfolios. If unbacked paper currencies come under pressure, and investors would increasingly want to rely on the US dollar – the world's principal unbacked paper money –, gold and silver would serve as an effective hedge against the downfall of the Greenback.

Now that we have understood better the *mystery of calm markets*, we may also be able to understand better why gold and silver prices have not seen a stronger upward drift yet. Central banks have put investor risk concerns to rest, and one consequence is, of course, an artificially lowered demand for insurance against inflation and default, resulting in lower prices for gold and silver. At some point, however, the mystery – effectuated by central banks – will most likely unravel.

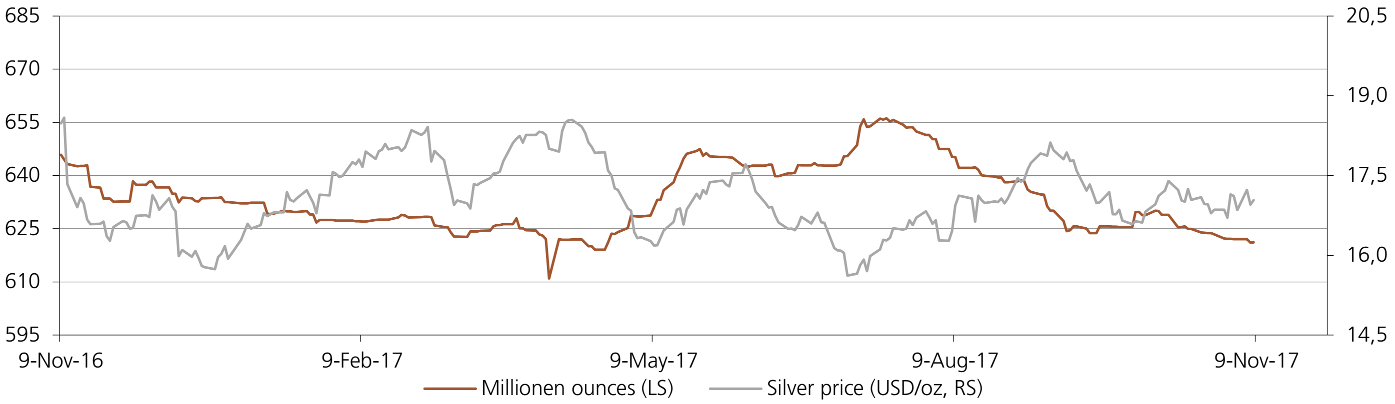
As Abraham Lincoln (1809 – 1865) has allegedly said: "You can fool all the people some of the time, and some of the people all the time, but you cannot fool all the people all the time." From this viewpoint, we continue to consider gold and silver to be an effective portfolio insurance, currently trading at a rather attractive price.

Precious metals prices and ETF holdings

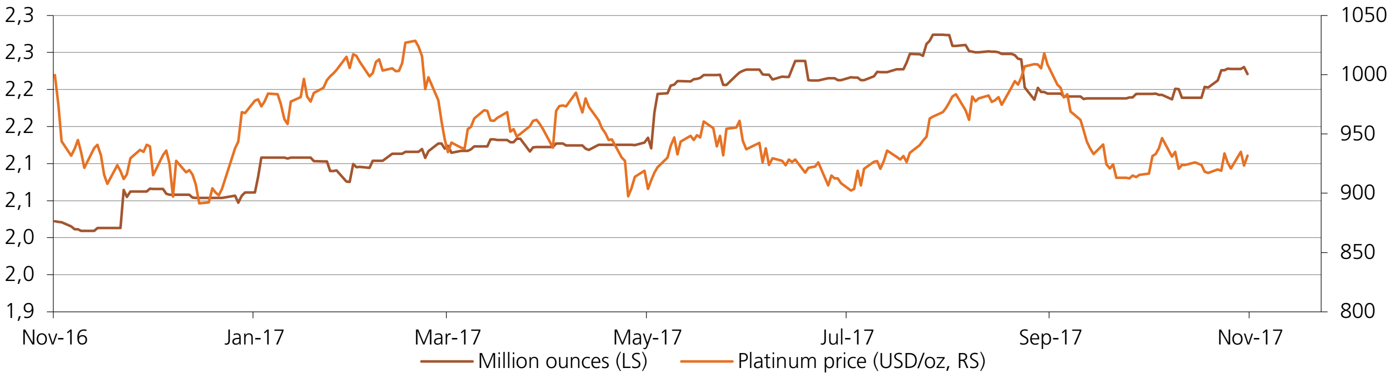
Gold ETFs (million ounces) und gold price (USD/oz)



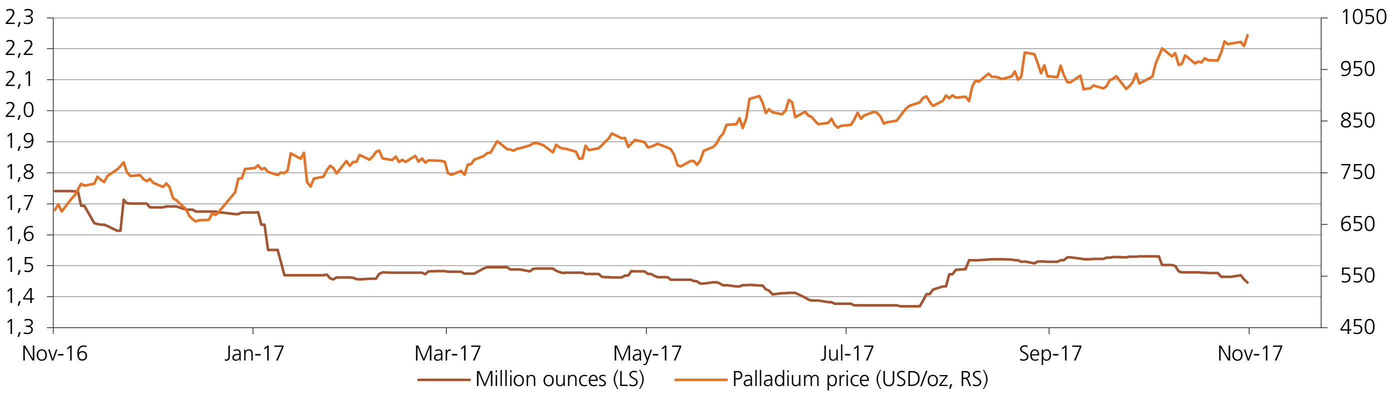
Silver ETFs (million ounces) and silver price (USD/oz)



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	1286.7		17.0		937.9		1012.4	
II. Gliding averages								
5 days	1275.5		17.1		925.2		999.3	
10 days	1274.2		16.9		923.4		988.6	
20 days	1279.9		17.0		924.9		982.7	
50 days	1295.8		17.2		941.9		953.5	
100 days	1277.0		16.9		942.2		917.6	
200 days	1263.1		17.2		950.9		858.0	
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	1104.9		14.6		805.4		869.4	
II. Gliding averages								
5 days	1098.9		14.7		797.1		860.9	
10 days	1096.4		14.6		794.5		850.6	
20 days	1093.1		14.5		789.9		839.4	
50 days	1097.4		14.5		797.6		807.8	
100 days	1090.4		14.4		804.5		783.4	
200 days	1121.1		15.3		844.9		759.6	
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.

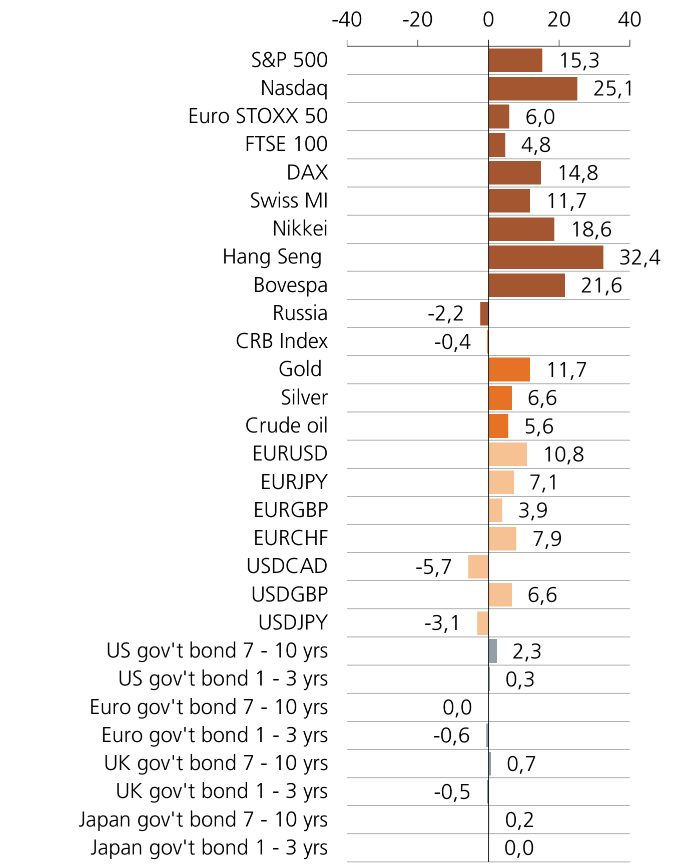
Bitcoin, performance of various asset classes

Bitcoin in US dollars

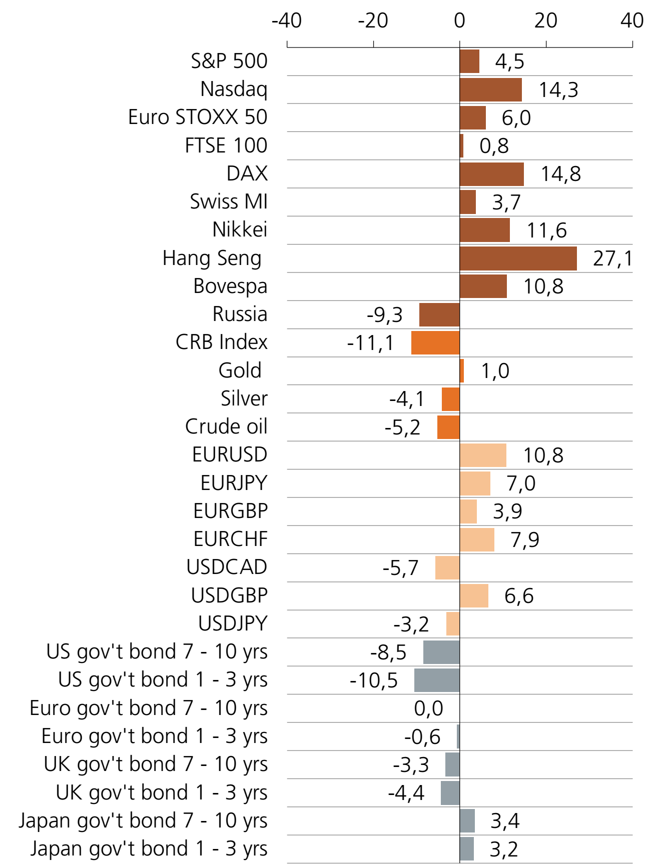
Source: Thomson Financial.

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*

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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
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14 October 2016	Amid Uncertainty, Opportunity Knocks
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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
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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

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