Degussa Market Report

13 October 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	1.294.7	0.6	0.5	5.7
Silver	17.2	2.1	0.7	1.2
Platinum	928.5	1.0	-5.2	-1.6
Palladium	962.3	3.6	7.8	34.5
II. In euro				
Gold	1.092.1	0.0	0.2	-4.6
Silver	14.5	1.5	0.4	-8.6
Platinum	783.2	-0.1	-5.5	-11.3
Palladium	812.0	3.0	7.7	20.8
III. Gold price in other currencies				
JPY	145.495.0	0.6	3.4	9.0
CNY	8.526.6	-0.5	-0.7	1.3
GBP	978.2	2.2	-1.2	-0.5
INR	84.257.1	0.0	1.9	1.3
RUB	74.652.7	0.2	-3.2	-5.7

Source: Thomson Reuters; own calculations.

OUR TOP ISSUES

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

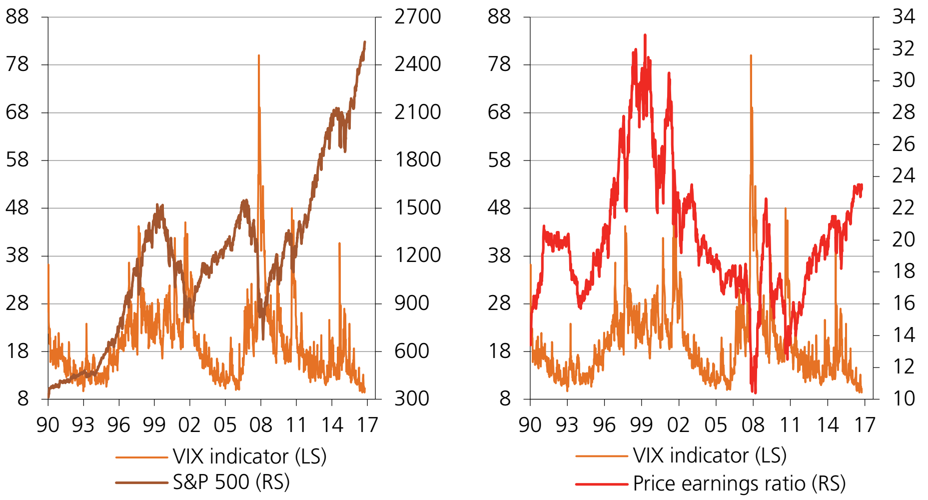
The Great Complacency

One of the perhaps most striking features of current financial market price action is the conspicuous absence of investor risk concern. Stock market price volatility, for instance, has reached the lowest level since the early 1990s. At the same time, stock prices have gone up to all-time highs, and the valuation level has increased substantially (with, say, the PE ratio standing now well above its long-term average). Investors are apparently quite confident that corporate earnings will continue to go up and a stock price correction is nowhere near.

Stock market volatility has declined to record lows

(a) S&P 500 and price volatility

(b) Stock price volatility and price earnings ratio

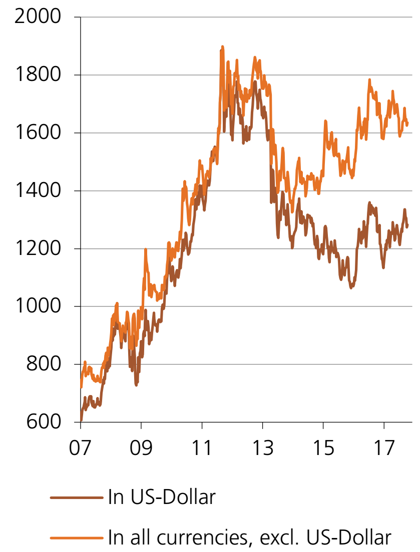


Source: Thomson Financial.

At the same time, credit markets seem to be in a relaxed mood. In general, borrowing costs are very low – both for government as well as for corporate credit. Credit spreads are declining, and by now they have returned to pre-crisis levels. Borrowers experience no difficulties rolling over maturing debt – and can also increase their total debt rather effortlessly. The critical question is, therefore: *How come that investor risk aversion has decreased so substantially?*

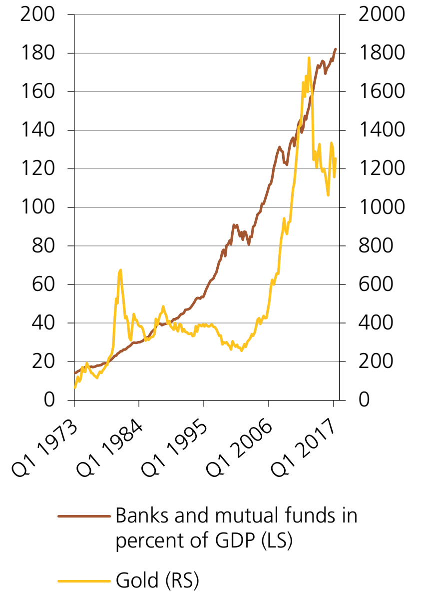
Is it because we have finally left the worldwide economic and financial crisis behind us? Well, there are quite a few reasons to express some doubt. For example, total debt levels have not come down since the 2008/2009 crisis - on the contrary, they have grown further. At the end of 2007, global debt (public and private non-financial sector) stood at 212% of the world GDP, according to data provided by the Bank for International Settlement. By the end of 2016, the global debt-to-GDP ratio stood at 265%. So, what could be the reason that has put investor risk concern to rest?

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

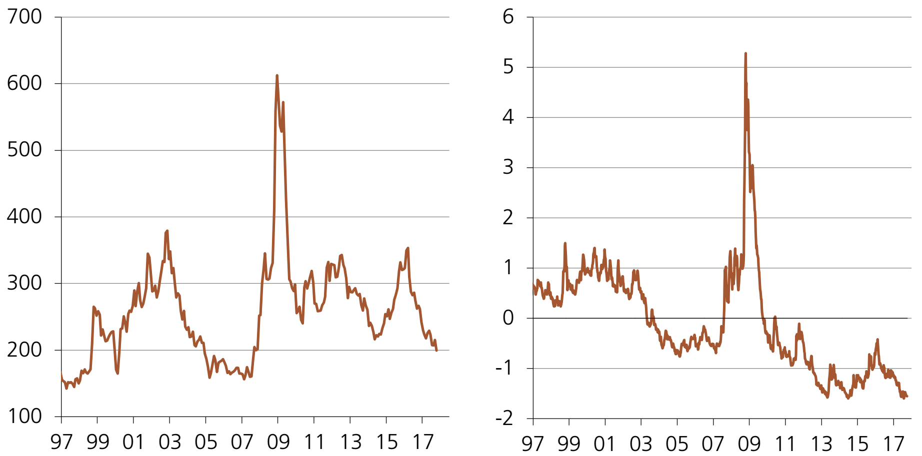
US financial sector keeps expanding quite rapidly
Balance sheets of US banks and mutual funds in percent of GDP[1] and the price of gold (USD/oz)



Source: Thomson Financial; own calculations. [1] Mutual funds: Including fixed income and equity positions.

Central banks come to mind – because not only have they beat interest rates down to hitherto unseen low levels. They have also created a 'safety net' – not officially, but through the very policies they have implemented in the last decade. Investors have noticed – and now expect central banks to stand ready to fend off any adverse developments in the real economy and financial markets again should it become necessary. Having little to fear in terms of systemic risks, investors feel encouraged to engage in risky investments: investments they would not be making if central banks hadn't put out a safety net.

Credit spreads and "financial market stress" have declined
(a) US BAA corporate credit over 10-year US Treasury in basis points
(b) Financial market stress indicator[1]



Source: Thomson Financial; own calculation. [1] A rise (fall) in the series indicates rising (falling) stress in financial markets.

As investors expect interest rates to remain suppressed (or even be lowered further, if and when the economy or financial markets get hit by an adverse shock), asset prices keep going up, and lenders continue extending new loans. Consumption and investment are expanding, indeed suggesting that the recovery is growing stronger. However, the safety net provided by central banks is distorting interest rates, financial asset prices, and the cost of capital significantly.

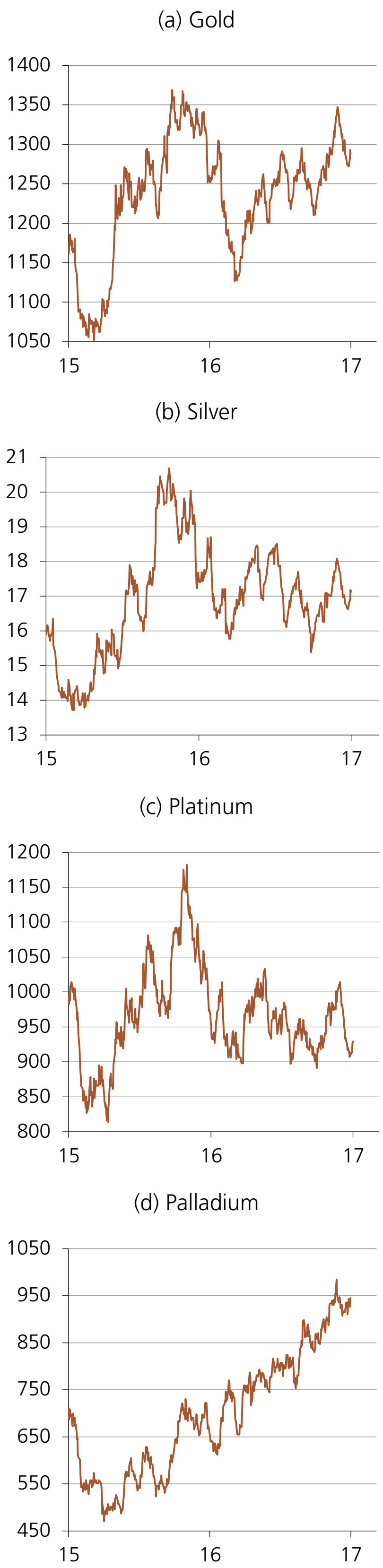
That said, as long as the safety net remains in place, we can assume that the effectiveness of central bank actions (such as, e.g. increasing short-term interest rates and unwinding bond purchases) is greatly diminished, because market agents have little reason to expect a final exit from the excessively loose monetary policy if such an attempted exit jeopardized the strengthening recovery and asset price inflation.

With the ignorance and under-pricing of risk – in the credit as well as the equity markets – central banks have orchestrated something that might best be referred to as 'the great complacency". They have created the illusion of stability and returning prosperity. To prevent the painful awakening, they have to keep interest rates and the cost of capital low and to fight any new trouble in the economic and financial system with an even looser monetary policy.

Gold as insurance

How long will central banks get away with their policy of distorting financial asset prices (credit premia in particular) and misguiding the allocation of scarce resources this time? The truth is: Nobody knows. It may go on for quite a while. It may also come to a shrieking hold due to unforeseeable events. In any case, the prudent investor is well advised to keep an eye on the non-negligible downside

Precious metal prices (USD/oz)



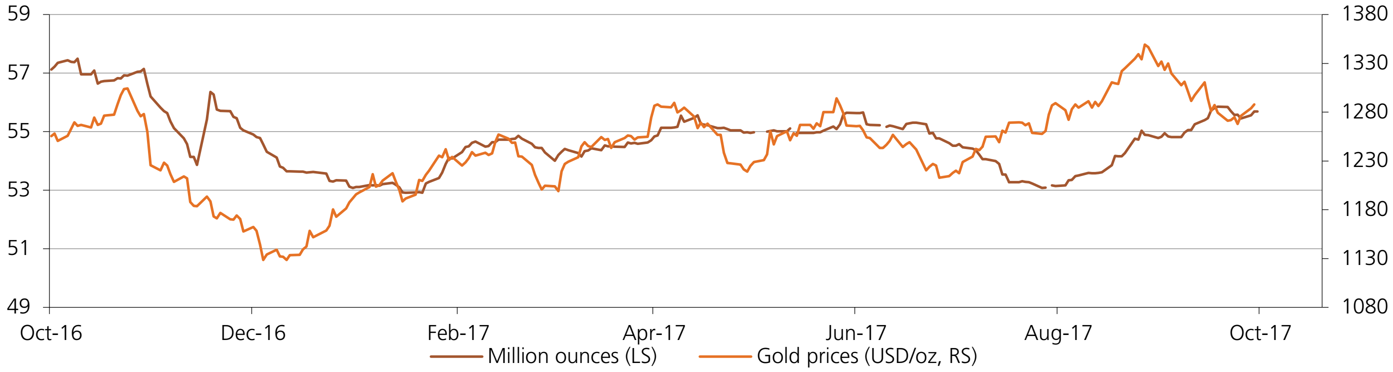
Source: Thomson Financial.

potential for economic and financial developments.

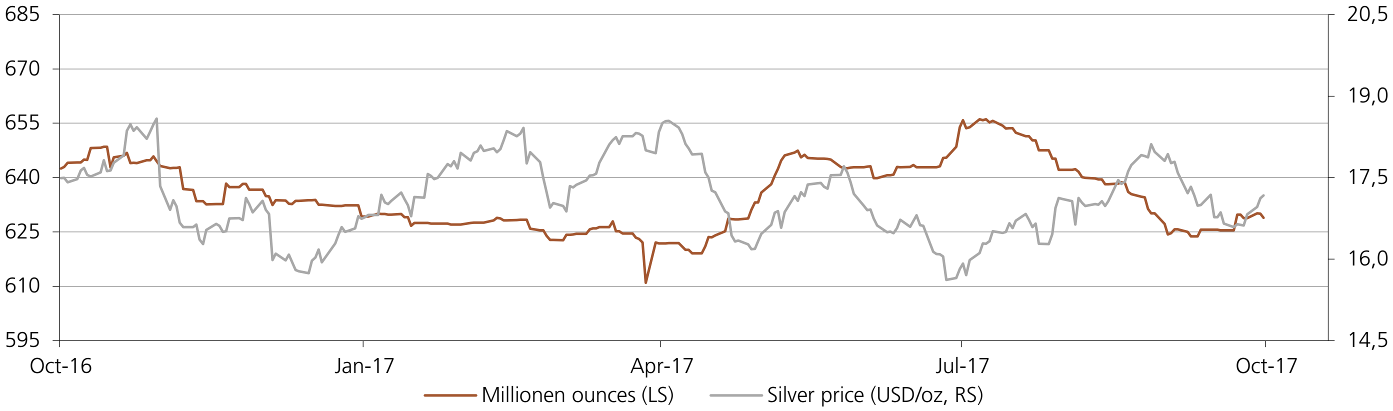
Given the "The Great Complacency", gold comes to mind as an option to provide portfolio protection. The purchasing power of gold cannot be debased by central banks running the printing press. What is more, gold does not carry a default risk – unlike bank deposits and short-term debt instruments. By no means less important, the current price of gold does not appear to be too high. In fact, gold may be considered an effective insurance against the vagaries of central bank policies, and this insurance value has substantial upside potential. (See in this context see our **Degussa Market Report, On the Intrinsic Value of Gold, 1 September 2017**).

Precious metals prices and ETF holdings

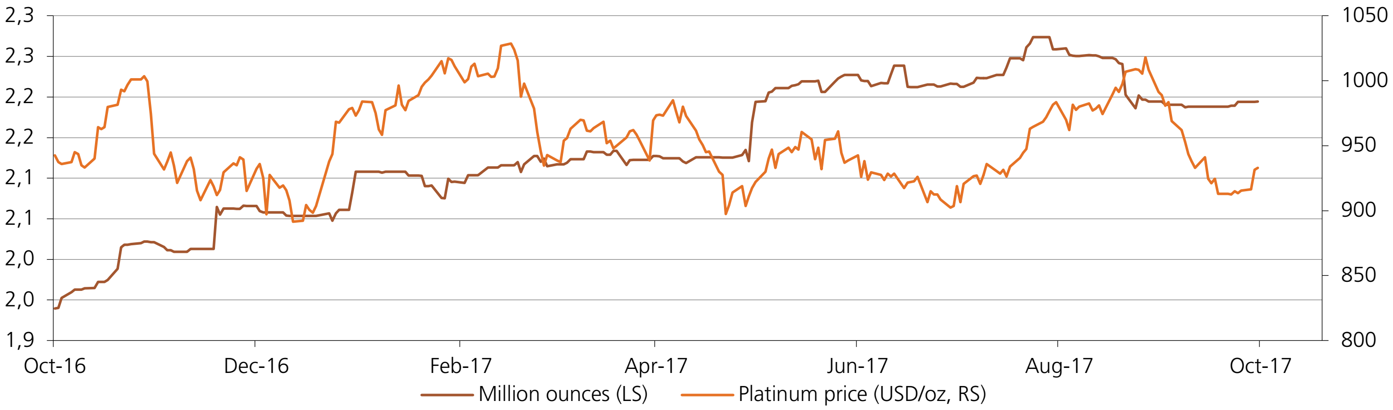
Gold ETFs (million ounces) und gold price (USD/oz)



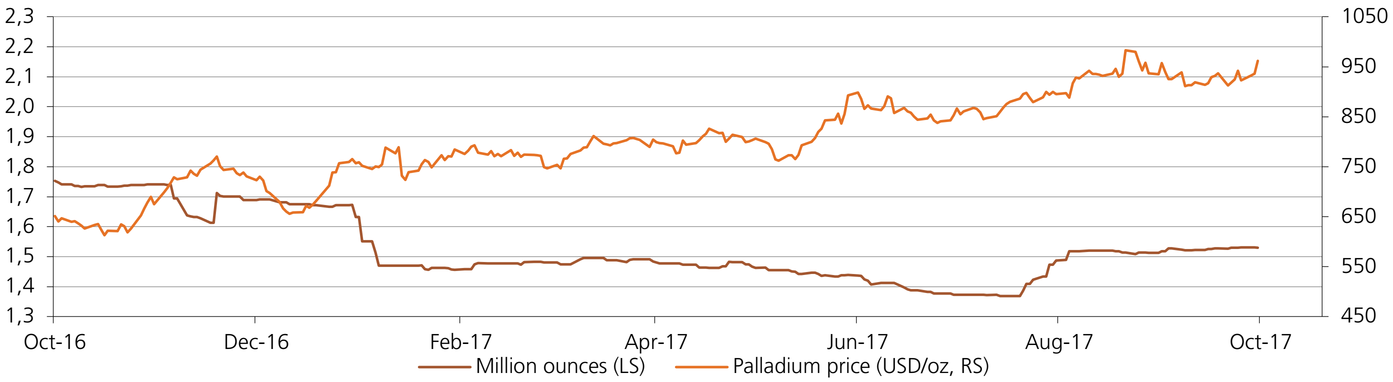
Silver ETFs (million ounces) and silver price (USD/oz)



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	1294.8		17.2		933.1		961.8	
II. Gliding averages								
5 days	1281.7		16.9		918.2		937.2	
10 days	1280.0		16.8		916.0		931.3	
20 days	1293.0		17.0		930.5		925.2	
50 days	1297.3		17.1		961.9		925.8	
100 days	1274.4		16.9		945.0		890.2	
200 days	1254.8		17.2		956.0		834.9	
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	1092.0		14.5		787.0		811.1	
II. Gliding averages								
5 days	1089.0		14.4		780.2		796.3	
10 days	1087.5		14.3		778.2		791.2	
20 days	1092.4		14.4		786.1		781.7	
50 days	1095.2		14.5		812.0		781.5	
100 days	1097.8		14.5		814.1		766.4	
200 days	1124.1		15.4		857.5		746.2	
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.

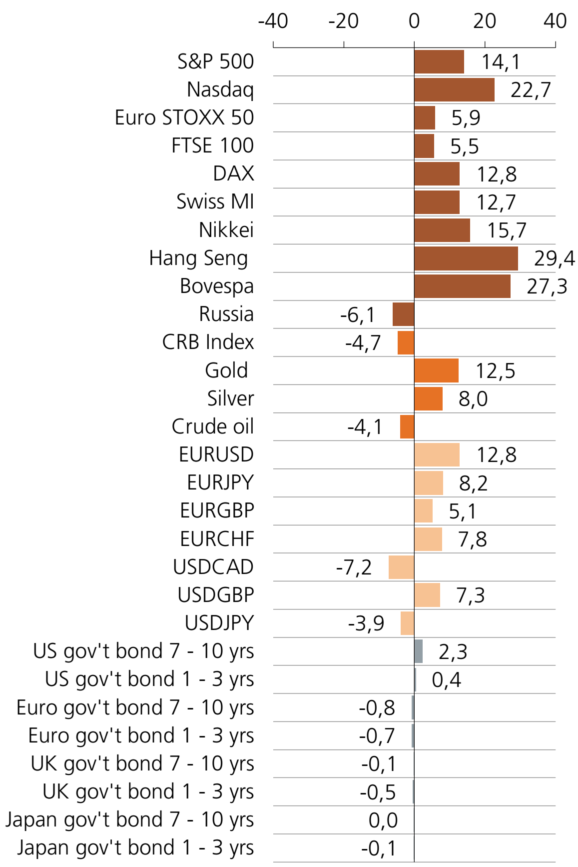
Bitcoin, performance of various asset classes

Bitcoin in US dollars

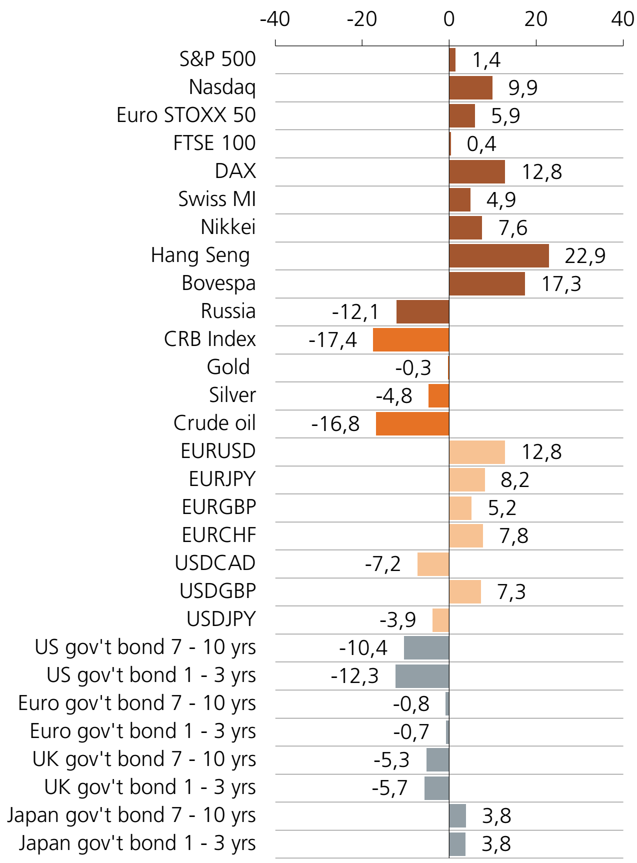
Source: Thomson Financial.

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
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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
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29 April 2016	US Dollar's Dominance Challenged By Gold

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