Degussa Market Report

15 September 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	1.329.5	0.4	7.7	5.0
Silver	17.7	0.3	10.3	1.3
Platinum	978.0	-2.6	6.1	4.7
Palladium	926.9	-5.5	7.2	47.2
II. In euro				
Gold	1.115.2	-0.1	3.7	-3.7
Silver	14.9	-0.3	6.2	-7.2
Platinum	820.3	-3.3	1.6	-3.9
Palladium	777.0	-5.9	3.1	34.7
III. Gold price in other currencies				
JPY	147.122.0	0.7	5.9	11.8
CNY	8.696.9	0.2	4.1	1.9
GBP	989.6	-3.2	4.7	-4.2
INR	85.191.0	0.5	7.3	0.7
RUB	76.335.9	0.3	4.3	-3.4

Source: Thomson Reuters; own calculations.

OUR TOP ISSUES

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

The Case for Gold in the Investment Portfolio

Generally speaking, gold is said that have two characteristics which deserve investors' attention: (1) It protects against losses caused by the debasement of the official currencies, and (2) does not carry a payment, or credit, default risk. In the following, we will explain these two characteristics in more detail and, perhaps most importantly, put our insights into perspective as far as investors' portfolio allocation is concerned.

Today's unbacked paper (or: fiat) currencies lose their purchasing power over time. The reason is that central banks, the monopoly producers of fiat currencies, keep increasing the quantity of money. As money is the generally accepted means of payment, a rise in its supply necessarily leads to a lowering of its purchasing power (compared to a scenario in which the quantity of money has not been increased). Usually, the increase in the supply of fiat currencies manifests in a rise of consumer, producer, and asset prices (such as stock, bond, and real estate prices).

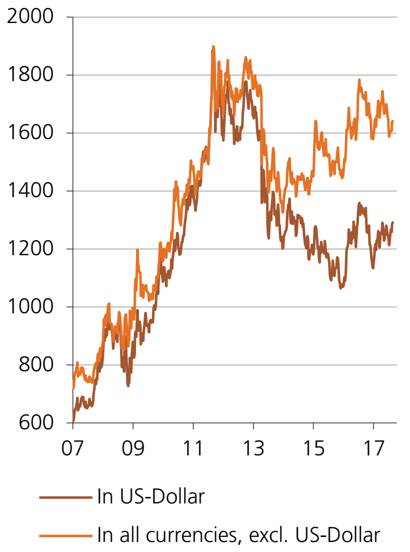
Returns in percent[(1)]

US stocks, market prices	US stock, performance	Gold (USD/oz)	3-mths money (USD)	Consumer prices (USD)
I. February 1973 to July 2017:				
8.98	10.54	6.76	4.87	3.99
II. January 1980 to July 2017:				
10.81	12.12	2.38	4.47	3.10
III. January 1995 to July 2017:				
9.39	10.13	5.46	2.37	2.19
IV. January 2000 to July 2017:				
3.64	5.13	8.75	1.61	2.15
V. June 2007 to July 2017:				
4.29	7.13	6.54	0.48	1.60

Source: Thomson Financial; own calculations.
[(1)] Continously compounded rate, annualized.

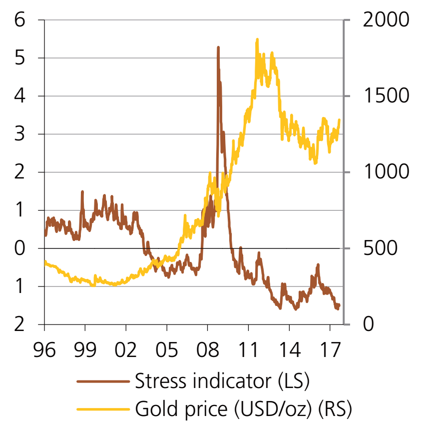
Rising prices erode the exchange value of fiat currencies beyond recall, as central banks will not stop expanding, let alone reduce the quantity of money. This is quite different with gold. The latter's price goes up as the rising quantity of money pushes up all kinds of prices. That said, gold is protected from suffering the same fate of currencies: being devalued by central bank action or political expediency beyond recall.

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

Central banks have credit default concerns to rest
Gold price (USD/oz.) and "Financial Market Stress Index"[(1)]



Source: Thomson Financial, Federal Reserve Bank of St. Louis. [(1)] A rise (fall) of the series denotes a rise (fall) in market stress.

In this context, it should also be mentioned that it cannot be ruled out that in an extreme situation of, for example, political or economic-financial disruption, fiat currencies might no longer be accepted as a means of exchange. Hyperinflation comes to mind or a severe recession-depression in which banks shut down and go under. In situations, we can expect that gold would serve as the 'ultimate means of payment'; it will always be accepted as a means of exchange.

And finally, gold indeed does not carry any default risk as bank deposits or short-term debt denominated in fiat currencies do. For instance, banks can default on their payments. If losses are substantial, and if deposit insurance is insufficient, not only banks' equity, banks' senior and subordinated debt could go under, but also savings deposits could be lost. While investors might consider such a scenario to be less likely, it would be certainly unwise to assign it zero probability.

From the above, we learn that gold can, in fact, serve as portfolio insurance and insurance against the caprices of the fiat currency system that has been established worldwide. To qualify as a truly effective insurance, however, it is important that the investor takes to heart the 'price versus value' principle. *Price* is what you pay, and *value* is what you get. If you buy something at a price that is (considerably) lower than its value, you get to enjoy a 'margin of safety'. With a decent margin of safety, investors increase their return on investment and, at the same time, reduce the risk of incurring a loss on investment (which may happen if they held too rosy a picture of the future).

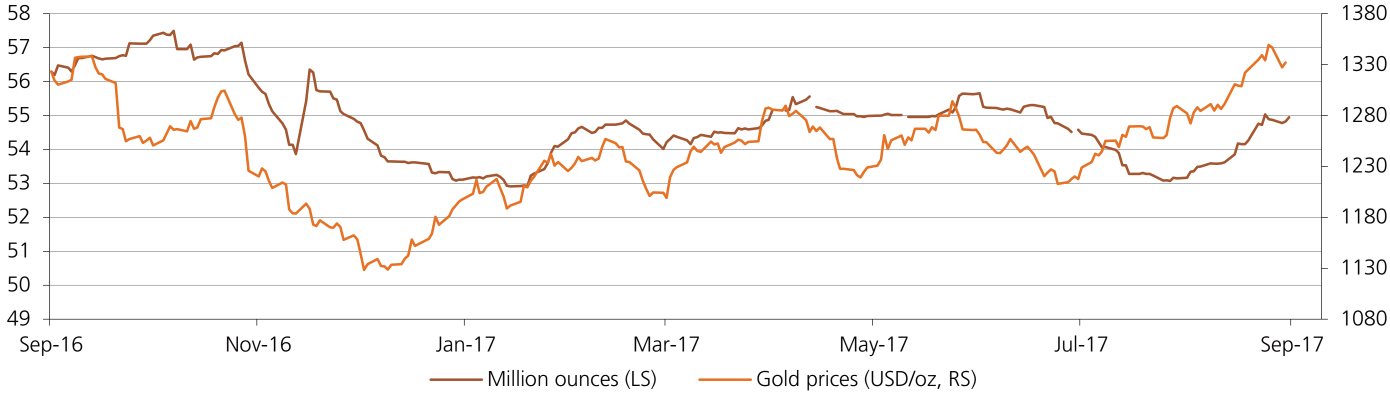
Against this backdrop, it should become clear that the price of gold plays an important role for the yellow metal to serve as portfolio insurance: If you buy at too high a price, gold may not go up in price in a situation in which you hoped it would. But if you succeed in buying gold at a 'cheap' price, you have good reason to expect that gold price gains will either (i) help compensating losses in other assets and/or (ii) provide liquidity that can be used to purchase attractive assets at depressed and thus attractive prices. In other words: The principle 'price versus value' matters for gold as it does for any other investment decision.

A key question is, therefore: What is the "fair" price of gold? As the reader may well know, there is not an easy answer to this question. However, you simply have to form a view about the "fair" price of gold, because without having such an (hopefully well informed) opinion, a wise decision regarding sound portfolio allocation is impossible. According to our (quite cautious/conservative) estimate, the current price of gold (in US-dollar terms) is on the 'cheap side'. If it was to adequately respond to the long-term factors that have been driving the price of gold over the last four decades, it should stand at around 1.415 USD/oz. (with the 'upper price band' being at 1.600 USD/oz. and the 'lower price band' being at 1.220 USD/oz.).

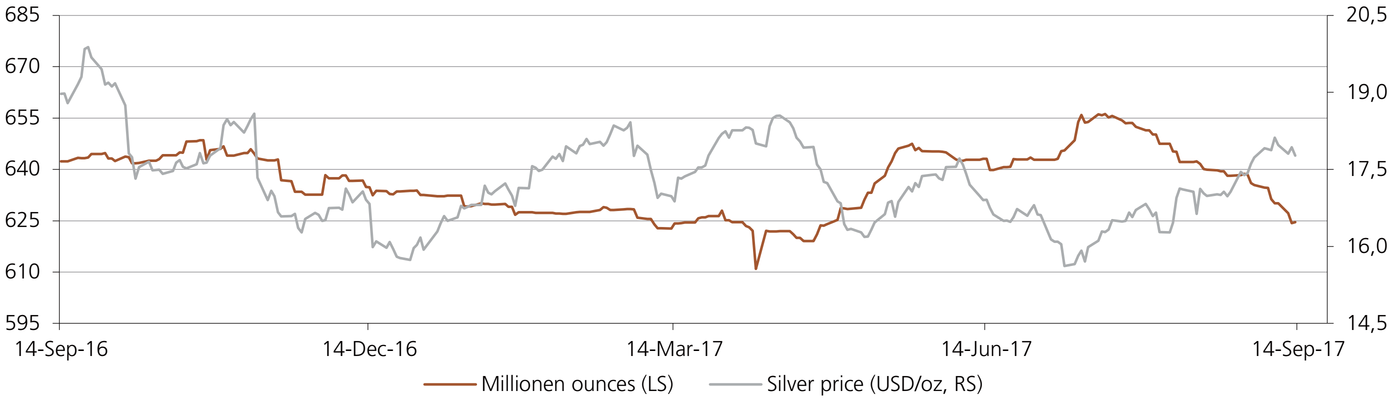
In other words: Gold, at current prices, seems to be an attractively priced portfolio insurance – especially for long-term investors who seek to take advantage of gold's most important characteristic: protecting against (i) losses resulting from a debasement of fiat currencies and (ii) payment/credit defaults. Finally, it should be noted that our (cautious/conservative) estimate of the "fair" price of gold does not take into account the scenario of the international financial and economic system taking a turn for the worse. That said, in a re-emerging crisis, the "fair" price of gold should be higher than suggested by our (admittedly broadband) estimate. We, therefore, think that there currently is indeed a strong case for holding gold as far as portfolio insurance is concerned.

Precious metals prices and ETF holdings

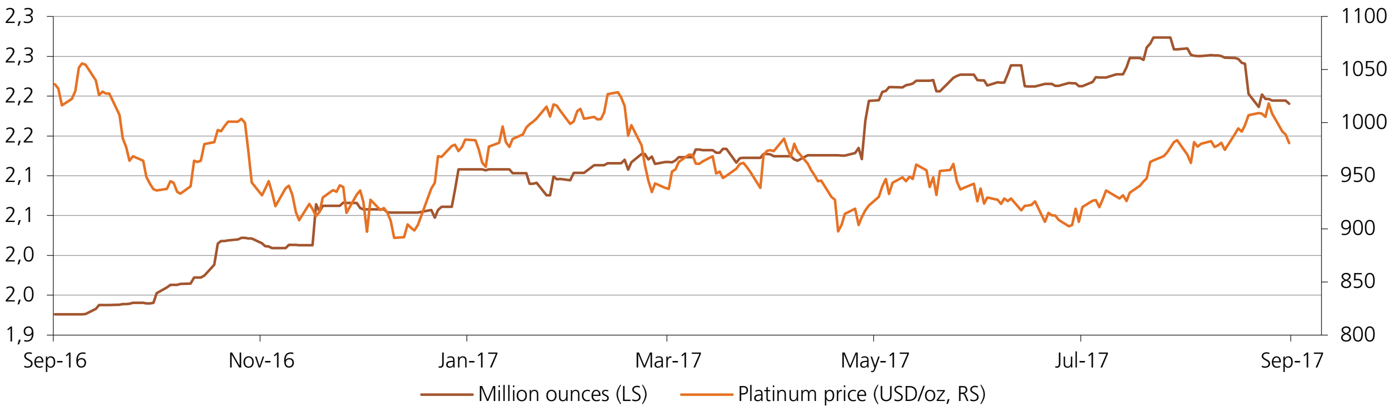
Gold ETFs (million ounces) und gold price (USD/oz)



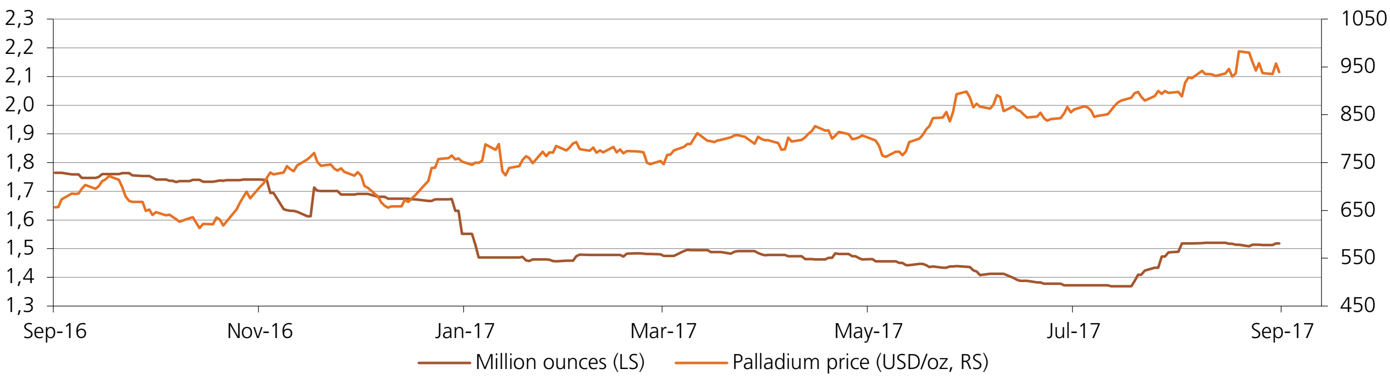
Silver ETFs (million ounces) and silver price (USD/oz)



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	1329.3		17.7		979.7		926.9	
II. Gliding averages								
5 days	1331.2		17.8		990.2		940.8	
10 days	1333.8		17.9		998.1		951.2	
20 days	1316.6		17.5		990.2		943.0	
50 days	1278.8		16.9		960.2		902.4	
100 days	1265.3		16.8		944.9		865.8	
200 days	1241.0		17.1		954.8		812.6	
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	1114.7		14.9		821.6		777.2	
II. Gliding averages								
5 days	1114.0		14.9		828.6		787.3	
10 days	1117.1		15.0		835.9		796.6	
20 days	1106.3		14.7		832.0		792.4	
50 days	1088.1		14.4		816.9		767.7	
100 days	1105.0		14.7		825.1		755.4	
200 days	1124.2		15.5		865.9		734.5	
III. Projections for 2017								
	Low	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1008.5	1221.1	14.0	20.2	795.9	966.3	614.9	790.6
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.

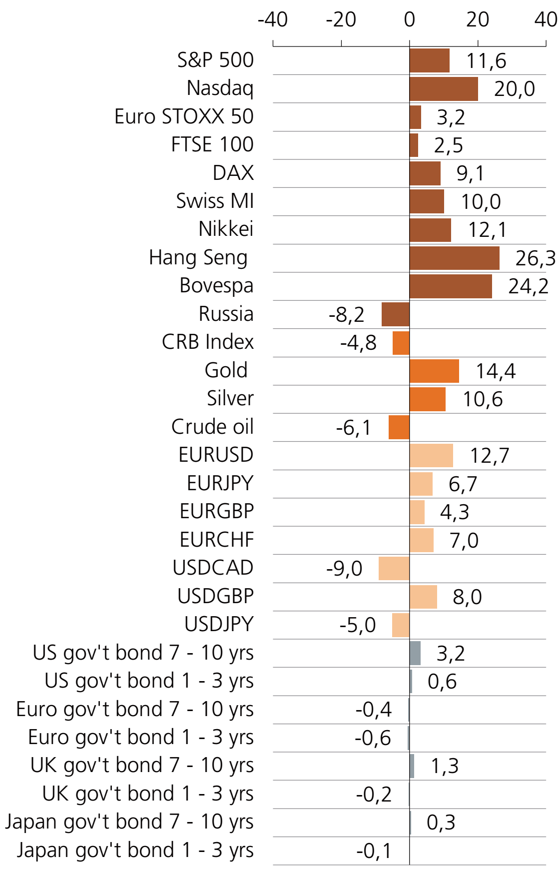
Bitcoin, performance of various asset classes

Bitcoin in US dollars

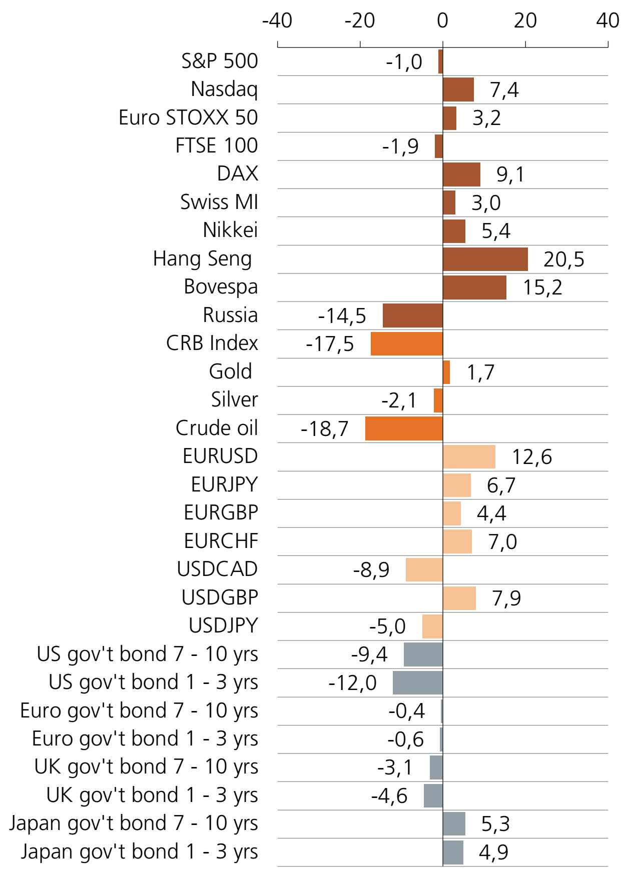
Source: Thomson Financial.

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
15 September 2017	A Case for Gold in the Investment Portfolio
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9 June 2017	Trapped in Boom-and-Bust
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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'

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