Degussa
GOLD UND SILBER.

CHANCES AND RISKS FOR INVESTORS IN 2018

Madrid, 18 January 2017

Thorsten Polleit
thorsten.polleit@degussa-goldhandel.de

SUMMARY

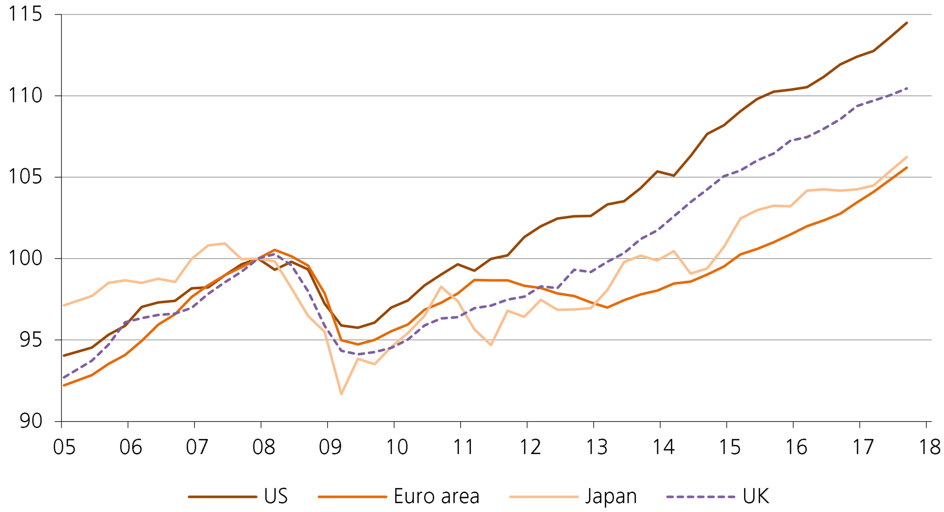
- The world economy can be expected to continue to expand at a fairly rapid clip in 2018.
- However, the current "boom" has been fueled by central banks' ultra-loose monetary policy, which will cause trouble further down the road.
- For instance, exceptionally low interest rates will increase the level of overall indebtedness, …
- … and this will make it increasingly difficult to "normalize" interest rates anytime soon.
- As monetary policies remain expansionary, asset prices such as, say, stock and real estate prices, are likely to go up further …,
- … to be followed by higher consumer price inflation – both developments resulting in the erosion of the purchasing power of money.
- However, the current boom is particularly delicate as central banks have effectively put a "safety net" under financial markets, …
- … which encourages investors to undertake questionable trades and engage in risky investments.
- We consider holding gold as insurance against the vagaries of the unbacked paper money fueled boom, …
- … especially so as the current price of gold seems to be relatively cheap; that said, gold equates to portfolio insurance with upside value potential.

***

"When you combine ignorance and leverage, you get some pretty interesting results."

—Warren E. Buffett

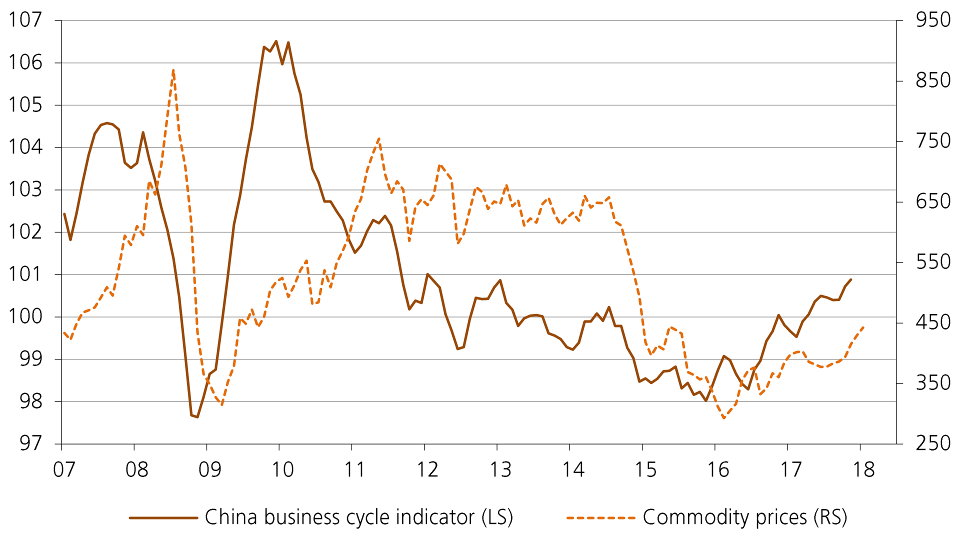
1 Real GDP of selected economies[(1)]



► The major economies of the Western world are on an expansionary course, …

Source: Thomson Financial; own calculation. (1) Q4 2007 = 100.

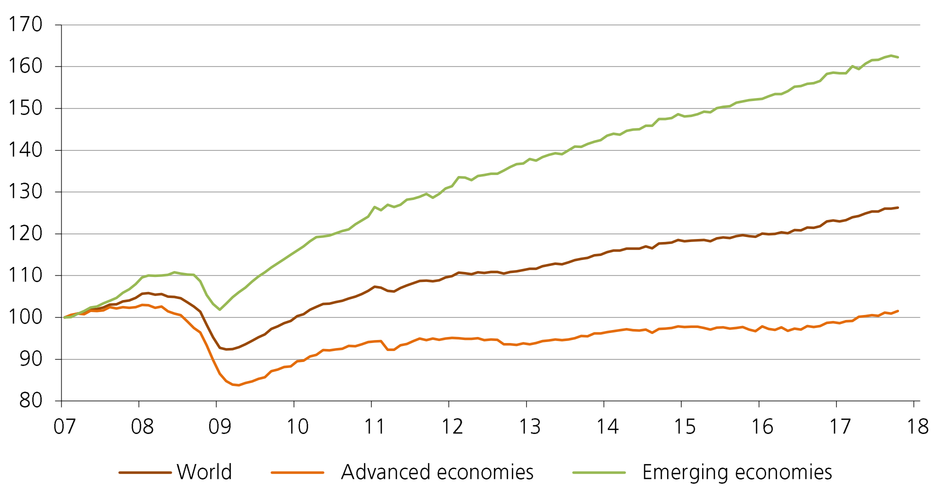
2 China's business cycle and commodity prices (in US-Dollar)



► … and the Chinese business cycle seems to be improving further, dragging commodity prices upwards.

Source: Thomson Financial; own calculations.

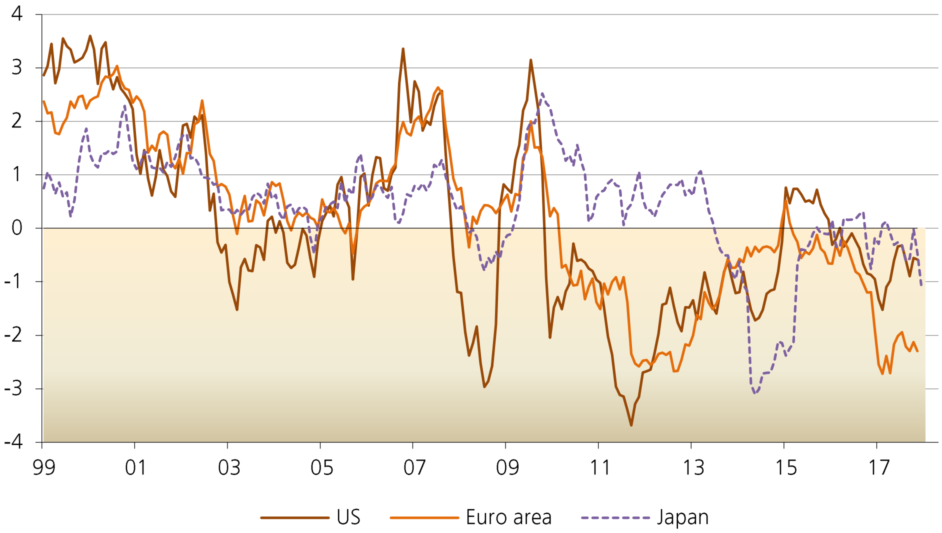
3 World Trade[(2)]



► World trade (export and import) keeps expanding at a healthy clip.

Source: CPB; own calculations. (2) In real terms, excl. construction, indexed (Jan. '07 = 100).

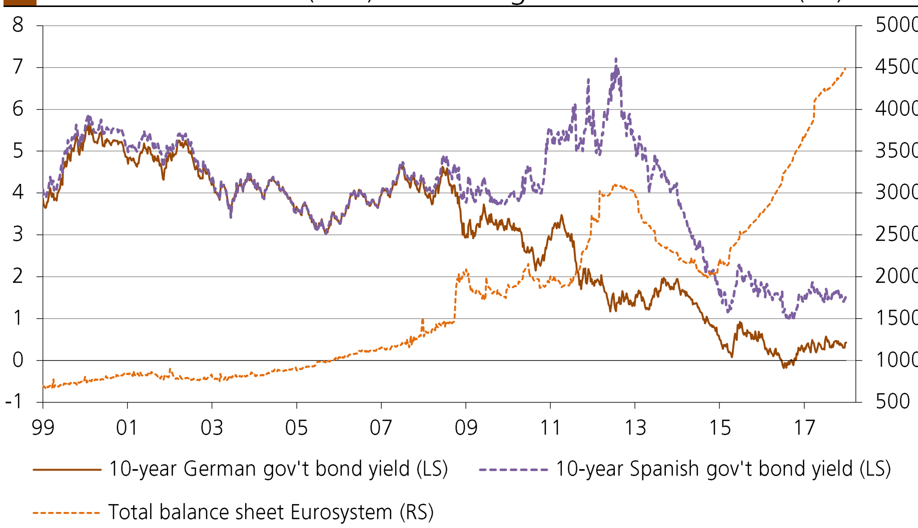
4 Short-term interest rates in percent, in real terms [1]



► Central banks have pushed (short-term) interest rates into negative territory.

Source: Thomson Financial. [1] 2-year gov't bond yields, deflated by consumer goods price inflation.

5 ECB balance sheet (€bn)[2] and long-term interest rates (%)



► ECB's bond purchases have pushed yields to extremely low levels.

Source: Thomson Financial. [2] ECB plus euro area national central banks.

6 The "safety net"

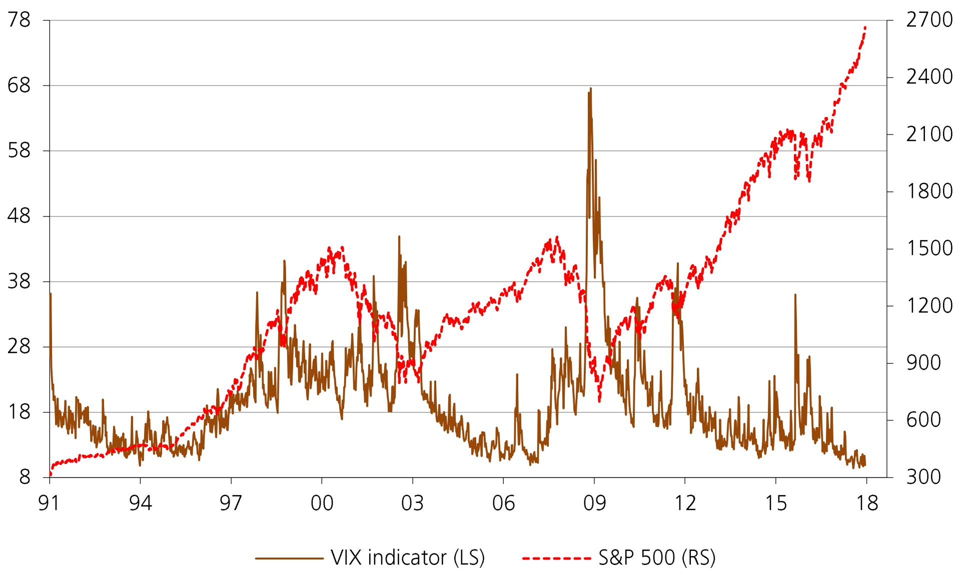
Central banks have spread a safety net under financial markets – causing a great deal of „moral hazard"

7 Financial market stress indicator (1)

► Central banks' safety net has largely wiped out investor risk concerns.

Source: Thomson Financial, Federal Reserve Bank of St. Louis. (1) A rise (fall) of the line signals a rise (fall) in financial market stress.

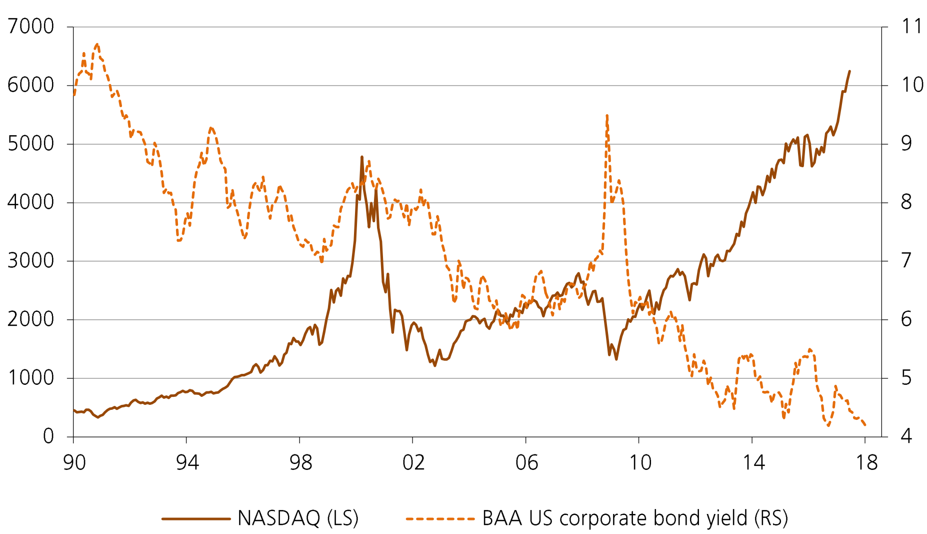
8 Stock market volatility and S&500



► This may also explain why stock market volatility has dropped to record lows, while prices have reached record highs.

Source: Thomson Financial.

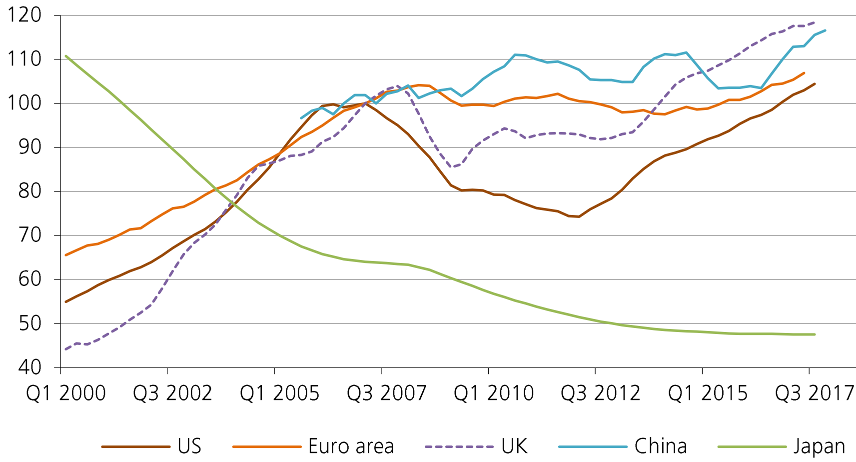
9 NASDAQ and corporate bond yield in percent



► Expansionary monetary policies, coupled with a retreat of investor risk concern, lowers cost of credit, and pushes up asset prices.

Source: Thomson Financial.

10 Housing prices in selected currency areas[1]



► In many currency areas, housing price inflate – in great part due to the expansionary monetary policies.

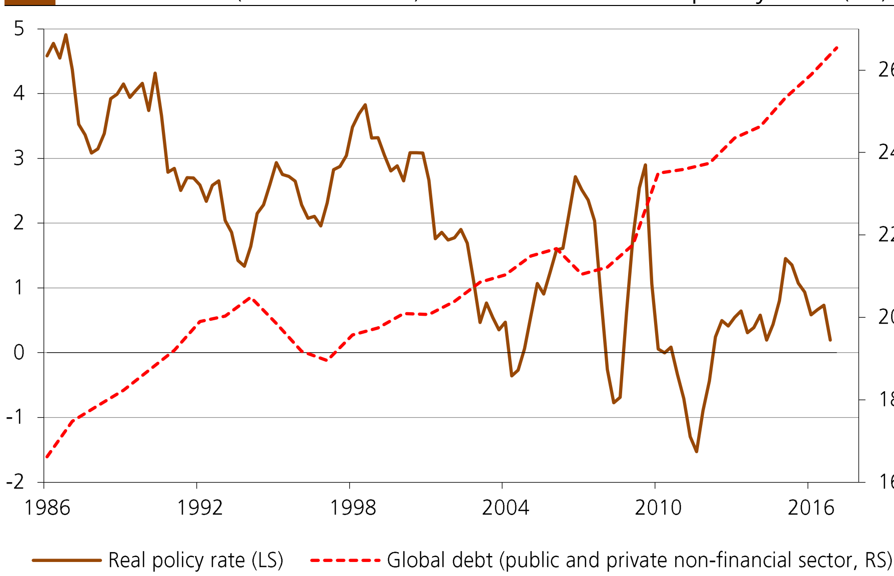
Source: Thomson Financial. [1] Indexed (Q2 2017 = 100).

11 Inflation expectations in financial markets in %[2]

► Inflation has remained fairly subdued, despite exceptionally low interest rates and increases in the quantity of money.

Source: Thomson Financial. [2] Inflation swaps: 5-yrs in 5-yrs.

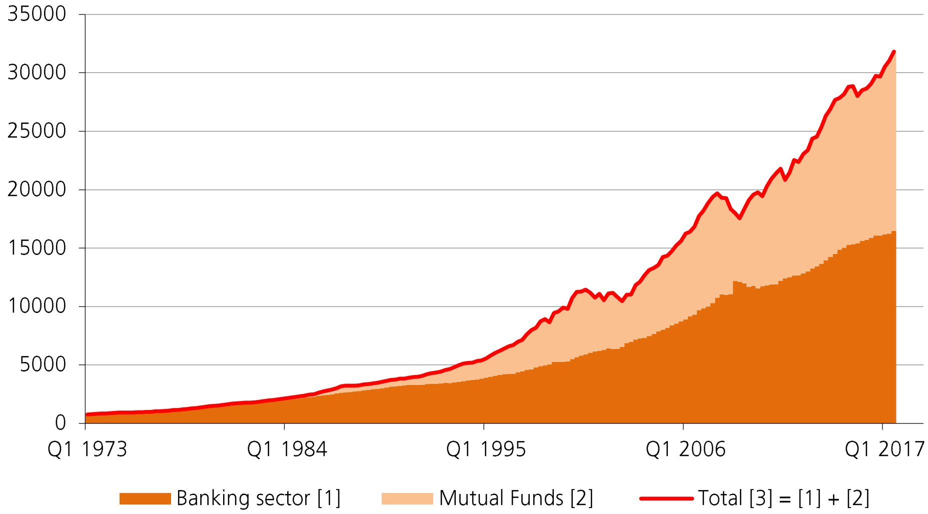
12 Global debt (in % of GDP) and central banks' policy rate (%)



► Central banks push interest rates down, and debt levels go up and up …

Source: BIS.

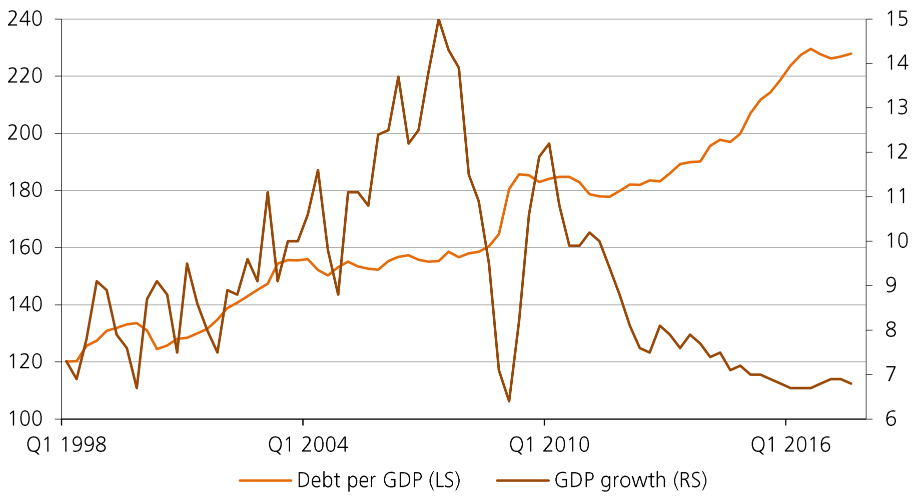
13 US banks and mutual fund industry (US dollar bn)



► Risk #1: Credit risk outside the banking system, where there is little equity capital, is increasingly bloated.

Source Thomson Financial; own calculations.

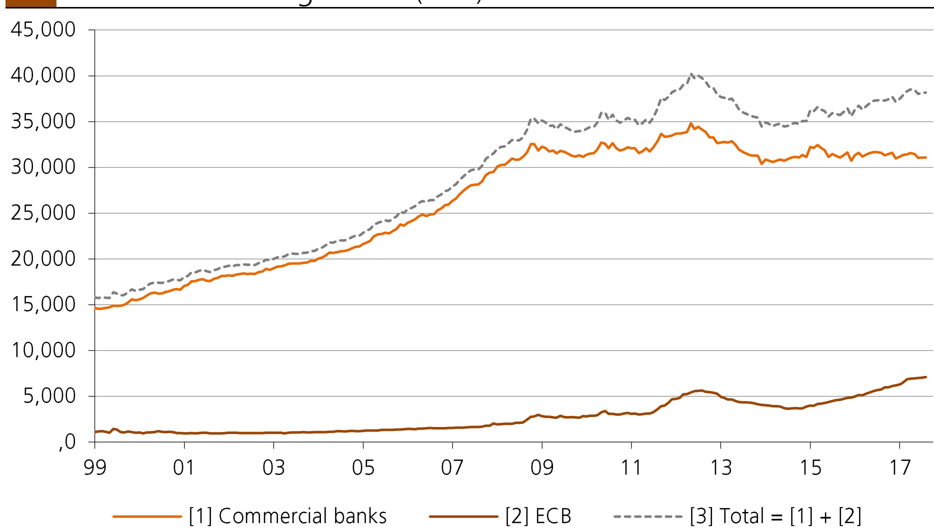
14 China: GDP growth y/y in % and debt in % of GDP



► Risk #2: China's economy has slowed down since 2008/2009, but the rate of debt increase has not …

Source: Thomson Financial; own calculations.

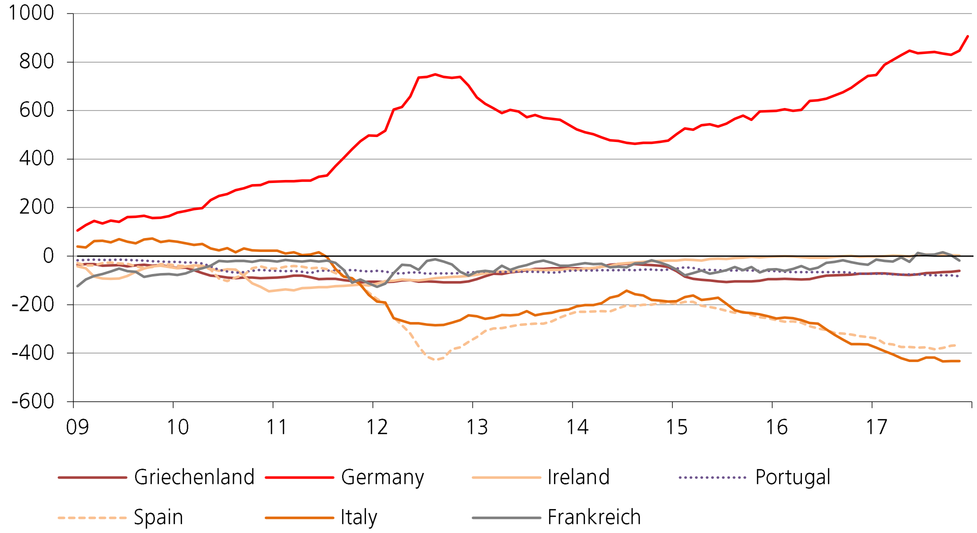
15 Euro area banking sector (€bn)



► Risk #3: The Euro area suffers from an oversized banking system, and the ECB prevents it from shrinking.

Source Thomson Financial; own calculations.

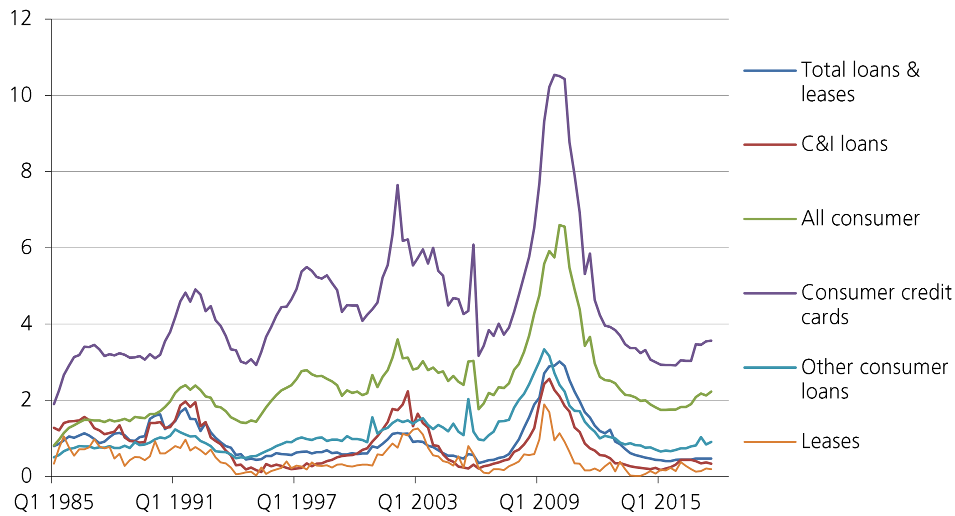
16 Selected "Target-2" balances, €bn



► Risk #4: Stress in the euro area continues, Germany's "Target-2" balance reached 906,9 € bn in Dec. '17 …

Source Deutsche Bundesbank, Universität Osnabrück.

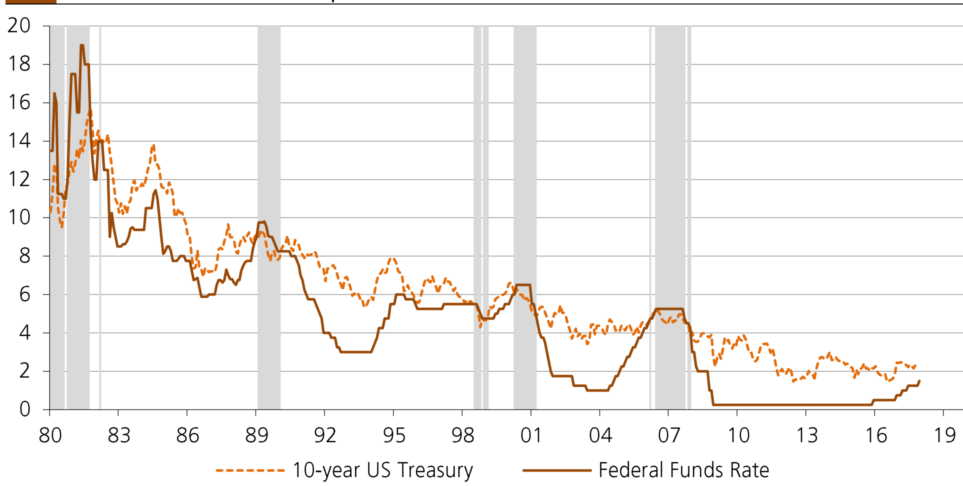
17 US bank credit default rates in %(1)



► US bank credit default rates have remained fairly subdued so far …

Source Thomson Financial.
(1) Creditors to write off installment loans after 120 days of delinquency, while revolving credit accounts must be written off after 180 days.

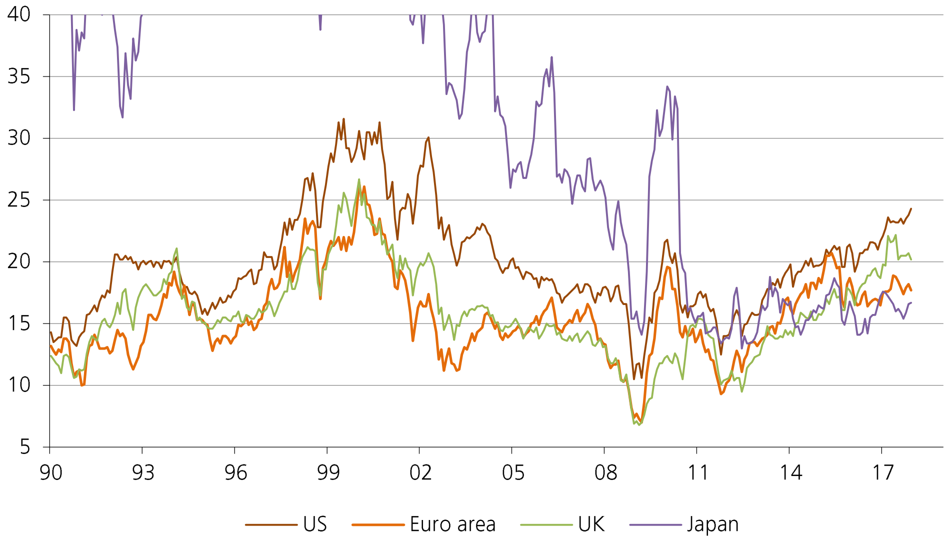
18 US interest rates in percent



► Long-term interest rates have been on the decline – as the Fed keeps easing its monetary policy over time. An end to this policy is unlikely.

Source: Thomson Financial. Grey area: Long-term rates equal or below short-term rates.

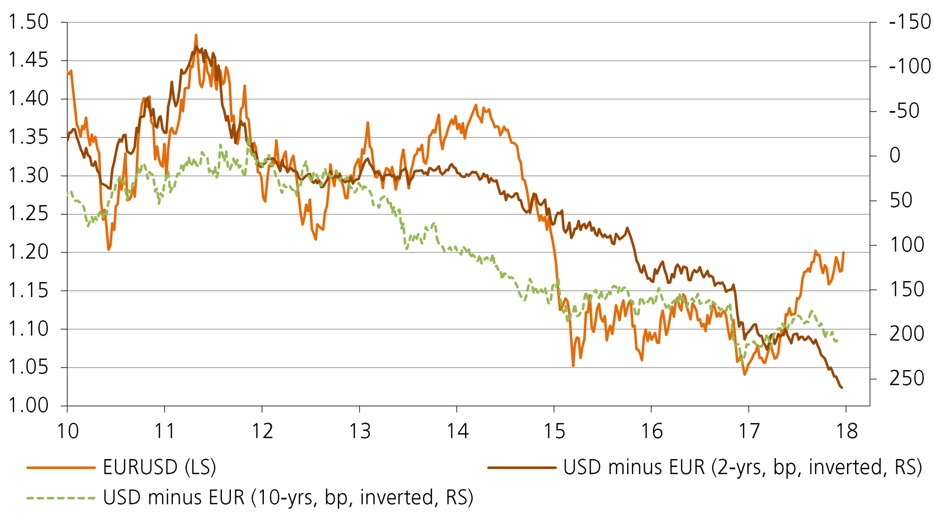
19 Price-earnings ratio of selected stock markets



► With interest rates remaining low, equity valuation could well go up further.

Source: Thomson Financial.

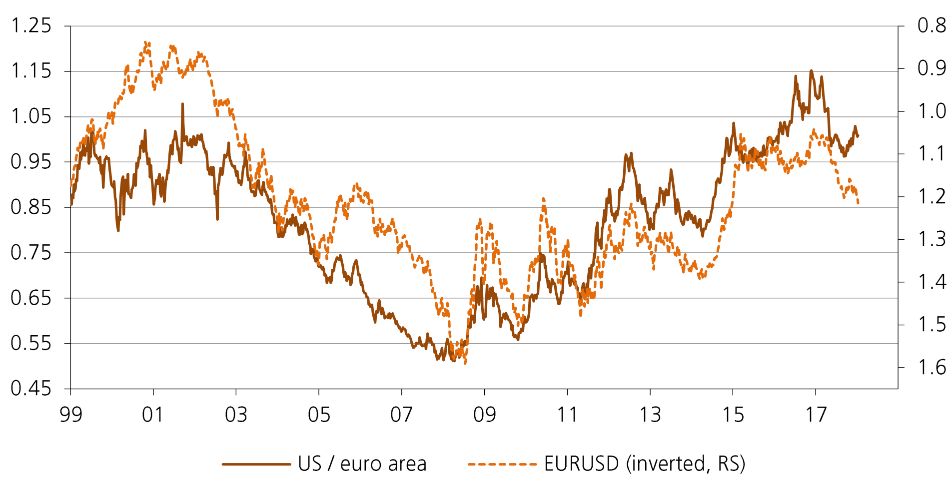
20 EUR-USD und USD-EUR interest rate differential (bp)



► Interest rate differential argues for a much lower EUR-USD.

Source: Thomson Financial; own calculations.

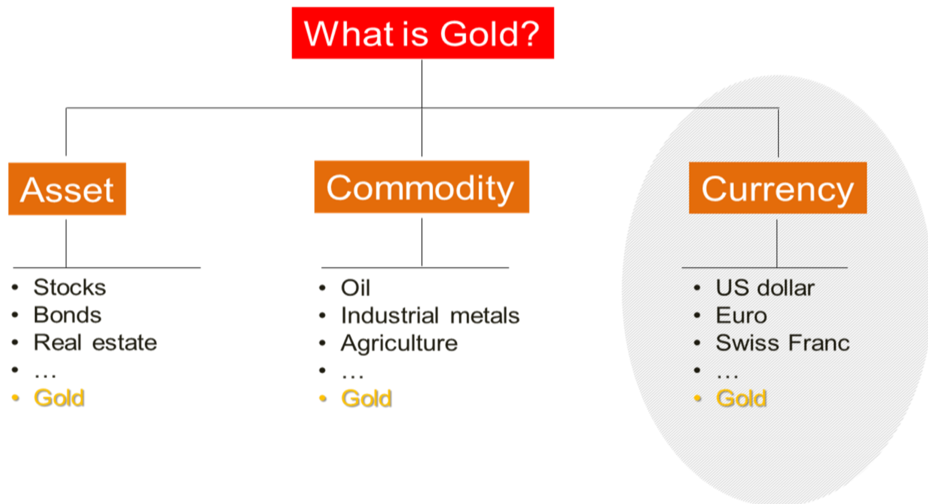
21 Stock markets performance and EUR-USD[1]



► An out-performing US stock market should put the euro under pressure against the US dollar.

Source: Thomson Financial; own calculation.
[1] US stock market index divided by euro area stock market index.

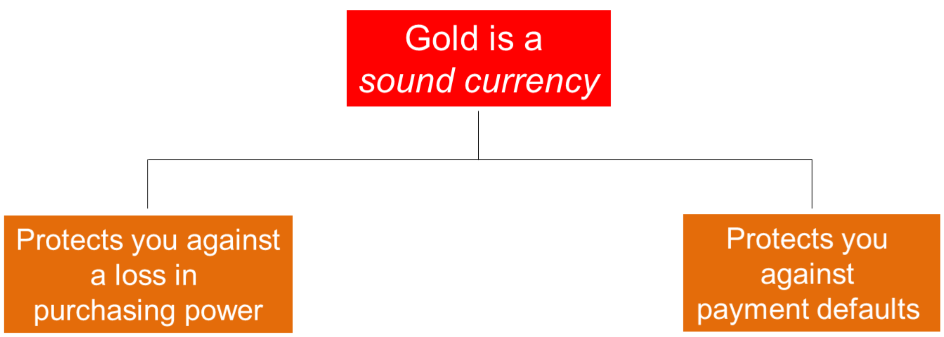
22 How we think about gold



► We consider gold a currency – competing with unbacked paper currencies.

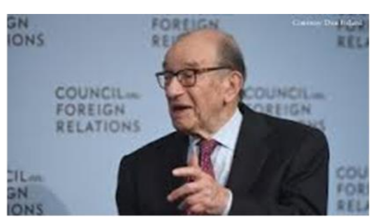
Source: Degussa.

23 What makes gold special?



► Gold has two major advantages over unbacked paper money …

Source: Degussa.

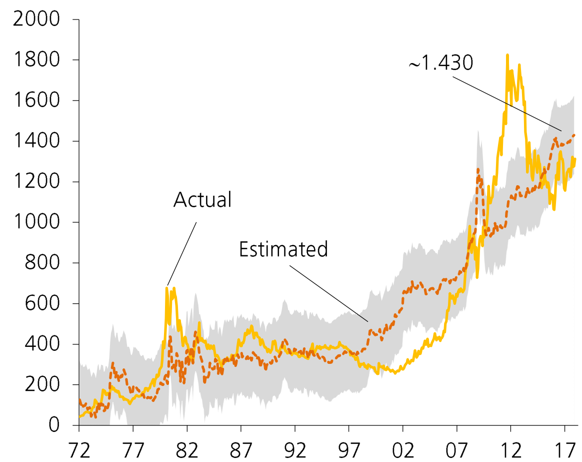


"Gold is a currency. It is still, by all evidence, a premier currency. No fiat currency, including the dollar, can match it."

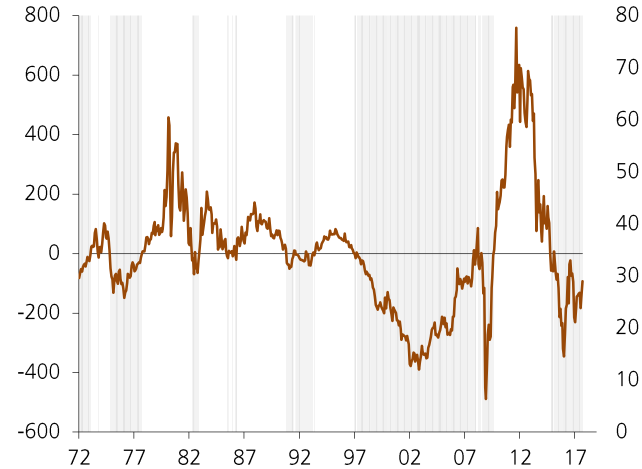
Alan Greenspan,
Council of Foreign Affairs, 29 October 2014.

24 Attempt to estimate an 'equilibrium' price of gold

(a) Gold price (USD/oz), actual and estimated(1)

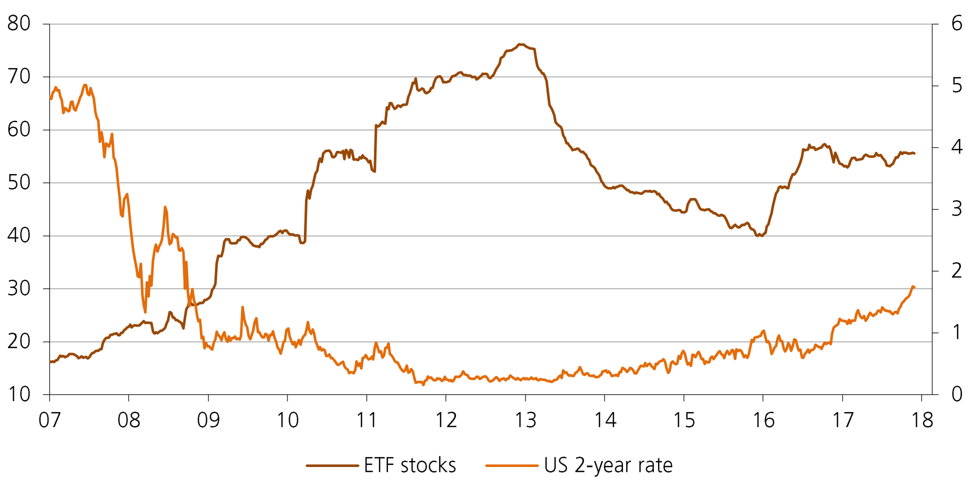


(b) Deviation of the actual price from estimated price(2)



Source: Thomson Financial; own calculations. (1) Shaded area: Standard error. (2) Shaded area: actual price below estimated price (undervaluation).

25 ETF gold demand (mm ounces) and US short-term rate in %



► ETF gold demand has held up, despite short-term rates edging upwards.

Source: Thomson Financial.

26 ETF gold demand and gold price (USD/oz.)

► ETF gold stocks and the price of gold tend to trade on the same bandwidth.

Source: Thomson Financial.

In US-dollar

	Gold		Silver		Platinum		Palladium	
I. Actual	1340.6		17.4		998.0		1127.0	
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. Bandwidths for 2018	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1248	1472	16.0	21.0	936	1048	1033	1261
(1)	*-7*	*10*	*-8*	*21*	*-6*	*5*	*-8*	*12*
IV. Annual averages								
2014	1260		19.1		1382		800	
2015	1163		15.7		1065		706	
2016	1242		17.0		985		617	
2017	1253		17.1		947		857	

In Euro

	Gold		Silver		Platinum		Palladium	
I. Actual	1092.8		14.1		813.5		918.6	
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. Bandwidths for 2018	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1069.2	1260.5	13.7	18.0	801.7	897.9	884.5	1080.0
(1)	*-2.2*	*15.4*	*-3.2*	*27.0*	*-1.4*	*10.4*	*-3.7*	*17.6*
IV. Annual averages								
2014	945		14		1035		601	
2015	1044		14		955		633	
2016	1120		15		888		557	
2017	1116		15		844		760	

Source: Thomson Financial; own calculations and estiamtes.

(1) Estimated return against actual price in percent.

Thank you very much for your attention!

Disclaimer

Imprint
Marktreport is published every 14 days on Fridays and is a free service provided by Degussa Goldhandel GmbH.
Deadline for this edition: 20 December 2017
Publisher: Degussa Goldhandel GmbH, Kettenhofweg 29, 60325 Frankfurt, Tel.: (069) 860068-0, Fax: (069) 860068-222
E-Mail: info@degussa-goldhandel.de, Internet: www.degussa-goldhandel.de
Editor in chief: Dr. Thorsten Polleit
Degussa Market Report is available on the Internet at: http://www.degussa-goldhandel.de/de/marktreport.aspx

Degussa
GOLD UND SILBER.

Frankfurt Headquarters
Kettenhofweg 29 · 60325 Frankfurt
Phone: +49-69-860 068 – 0 · info@degussa-goldhandel.de

Retail buying and selling outlets in Germany:

Frankfurt (shop & showroom): Kettenhofweg 29 · 60325 Frankfurt
Phone: +49-69-860 068 – 100 · frankfurt@degussa-goldhandel.de

Berlin (shop & showroom): Fasanenstraße 70 · 10719 Berlin
Phone: +49-30-8872838 – 0 · berlin@degussa-goldhandel.de

Hamburg (shop & showroom): Ballindamm 5 · 20095 Hamburg
Phone: +49-40-329 0872 – 0 · hamburg@degussa-goldhandel.de

Hanover (shop & showroom): Theaterstraße 7 · 30159 Hanover
Phone: +49-511-897338 – 0 · hannover@degussa-goldhandel.de

Cologne (shop & showroom): Gereonstraße 18-32 · 50670 Cologne
Phone: +49-221-120 620 – 0 · koeln@degussa-goldhandel.de

Munich (shop & showroom): Promenadeplatz 12 · 80333 Munich
Phone: +49-89-13 shop & showroom 92613 – 18 · muenchen@degussa-goldhandel.de

Munich (Old Gold Centre): Promenadeplatz 10 · 80333 Munich
Phone +49-89-1392613 – 10 · muenchen-altgold@degussa-goldhandel.de

Nuremberg (shop & showroom): Prinzregentenufer 7 · 90489 Nuremberg
Phone: +49-911-669 488 – 0 · nuernberg@degussa-goldhandel.de

Pforzheim (refinery): Freiburger Straße 12 · 75179 Pforzheim
Phone: +49-7231-58795 – 0 · pforzheim@degussa-goldhandel.de

Stuttgart (shop & showroom): Kronprinzstraße 6 · 70173 Stuttgart
Phone:: +49-711-305893 – 6 · stuttgart@degussa-goldhandel.de

Retail buying and selling outlets around the world:

Zurich (shop & showroom): Bleicherweg 41 · 8002 Zurich
Phone: +41-44-40341 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

London Sharps Pixley Ltd (member of the Degussa Group)
Phone +44-207 871 0532 · www.sharpspixley.com

Madrid (shop & showroom): Calle de Velázquez 2 · 28001 Madrid
Phone: +34-911 982 900 · info@degussa-mp.es