Degussa

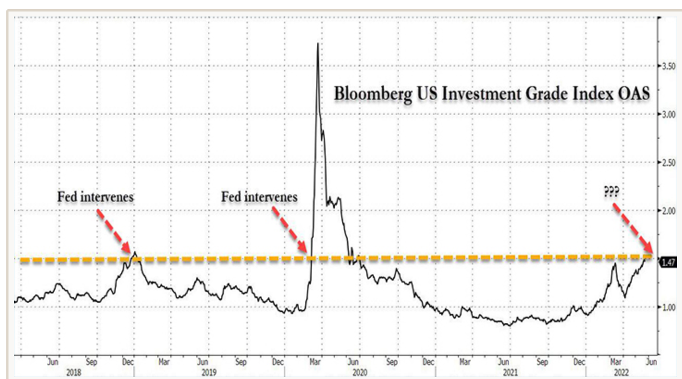
GOLD AND SILVER.

Market Report

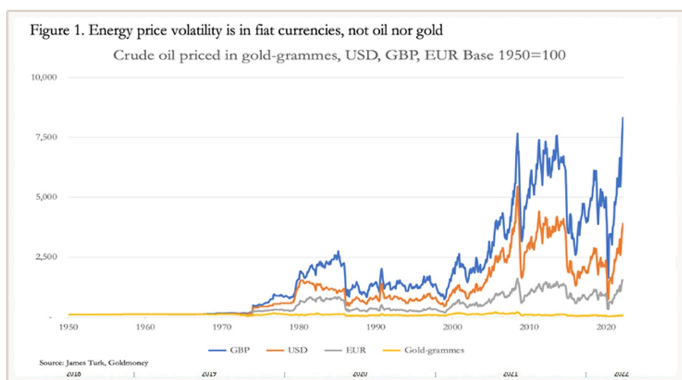
June, 2022

Markets continue to experience volatility as bears and bulls engage in a tug of war. Looming economic decline may drive central banks to lower interest rates in debt-laden nations. Wealth is being repatriated by both NATO based and Shanghai Cooperation Organization (SCO) based investors as geopolitical instability grows. Inflation is driving prices steadily upward, while rumblings of an upcoming food shortage are beginning to affect policy decisions.

Highlights



While the Fed's point of view may be that markets are still trading 15% above their pre-Covid levels, the recent announcement of a possible "pause" in rate hikes indicates they may be starting to get uncomfortable with the ongoing "correction" (20% down from its January peak). Historically, the Fed has seen fit to intervene once turmoil hits the bond market, which is currently approaching the stress-inducing 150 basis point level, making a case that further QE may be on the horizon.



The drastic contrast in price stability between oil priced in gold-grams vs oil priced in fiat currencies tells an interesting tale of where the volatility truly lies. So long as currencies were tied to gold, they retained their credibility as a gold substitute, yet quite rapidly began devaluing as central banks expanded circulation. This clearly supports the classic monetarist theory that money printing drives inflation.

Precious Metals & Commodities

Increasing distortions such as fertilizer shortages and food protectionism in the agricultural supply chain will maintain pressure on further price increases. The long-term potential of all commodities including gold and silver remains upside.

Indicator	Gold	Silver	Copper	Oil	Agriculture
Current	↗	↗	→	→	→
Outlook	↗	↗	→	↗	→
Trend	↗	↗	↗	↗	↗

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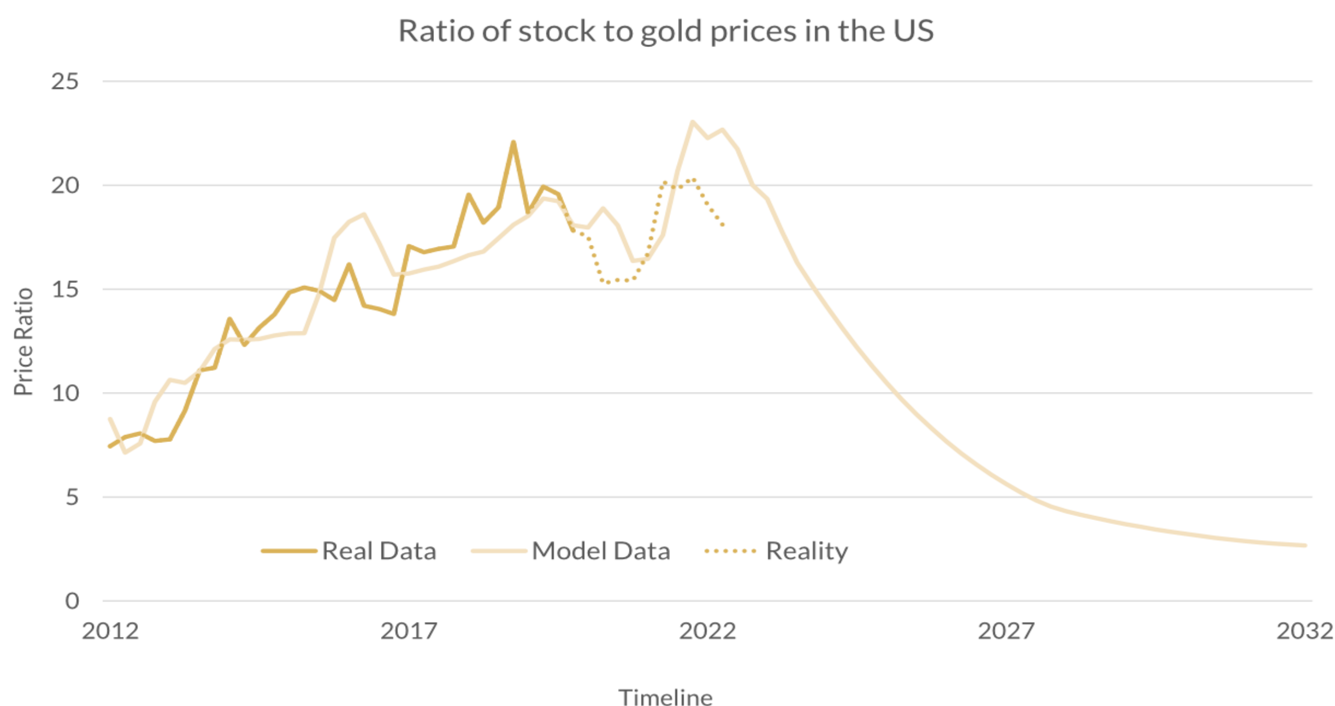
Prediction Model Gold or Stocks?

The current level of debt compared to production of the real economy is similar to the situation in England or Germany before the world wars, and the situation in France before the French Revolution. The chances of a deleveraging process are increasing, and this process can be observed through a Stock-Gold Model created by SIM Research, which predicts, based on a cause-effect model, the turning point at which gold begins to perform better than stocks.

Based on the latest numbers fed into the model, the peak at which economic activity assets will outperform gold is around Q3 2022. From then on, the model predicts a outperformance of gold towards stocks (light line). When looking at the real data of stock to gold price (dotted line), we see the trend of gold outperforming stocks already began early in 2022. Whether we will experience another countermove or not is currently difficult to predict, but the long term trend for higher gold performance remains clear.



Conclusion

Over the last decade markets have become increasingly dependent on QE with central banks intervening at every risk of tremor, resulting in a system that is incapable of self-correcting. A system disproportionately dependent on only a few, yet highly influential, participants (in this case central banks) comes with higher risk.

The European Central Bank has become increasingly hawkish as inflation in the Eurozone continues to pick up pace. ECB President Lagarde announced plans for a rate hike in July, with a goal to exit negative rates by the third quarter.

Conventional thinking is that rate hikes should be followed by weakness in gold prices. The reasoning being that higher rates make fixed-income investments more attractive. However, historical data such as gold's bull market in the '70s, where, by 1980 gold prices had risen by 1600%, while rates were flying as high as 16% , demonstrates that gold can rise even in a higher interest level environment. Further, increased rates means higher cost for refinancing and therefore more price pressure on stock markets. Given current market volatility and overall weakness in equities, being invested into real assets, such as gold, remains well-advised.

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