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Gold in the Age of Eroding Trust

incrementum

Ronald-Peter Stoeferle
& Mark J. Valek

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Introduction

"Put not your trust in money, but put your money in trust."

Oliver Wendell Holmes

Key Takeaways

- Trust is the basic value of interpersonal cooperation and the cement of our social order. The erosion of our "trust capital" can be observed in many areas of society.
- The breakdown of trust in the international monetary order is manifesting itself in the highest gold purchases by central banks since 1971 and the ongoing trend to repatriate gold reserves.
- Gold reaffirmed its portfolio position as a good diversifier as trust in the "Everything Bubble" was tested in Q4/2018. While equity markets suffered double-digit percentage losses, gold gained 8.1% and gold mining stocks 13.7%.
- The normalization of monetary policy was abruptly halted by the stock market slump in Q4/2018. The "monetary U-turn" that we already forecasted last year has begun.
- Recession risks are significantly higher than discounted by the market. In the event of a downturn, negative interest rates, a new round of QE, and the implementation of even more extreme monetary policy ideas (e.g. MMT) are to be expected.
- When it comes to trust in investments, our vote is clear. Trust looks to the future, forms itself in the present, and feeds itself from the past. Gold can look back on a successful five-thousand-year history as sound money.

"Gold is 'clotted' trust or, if you like, clotted mistrust against all other promises of value. That leads us to the trail of its strange price movements: Its price rises wherever mistrust arises (mistrust of the future, politics, rulers), and it falls or stagnates where trust prevails."

Roland Baader

In front of you, dear reader, lies the 13th edition of our *In Gold We Trust* report.[1] It's a special edition. Never before have we invested so much time, energy, money and passion into this report. Never before has the team for the report been so large. And never before have we analyzed such a broad spectrum of topics. For the first time, we are publishing the *In Gold We Trust* report in China, for a market that is becoming increasingly important for us and for the gold industry.

But it is also a special vintage because we have chosen a theme that is of the utmost importance for both interpersonal cooperation and economic prosperity. The term is so crucial that it is an integral part of the name of our annual publication: ***trust*.**

Let's start with the definition:

trust: firm belief in the reliability, truth, ability, or strength of someone or something.[2,3]

Love all,
trust a few,
do wrong to none.
William Shakespeare

Trust is often underestimated. Many of us take trust for granted, but almost all **human interactions are based on trust**. When visiting a restaurant, we trust that the cook will not use any spoiled ingredients, ensures cleanliness in the whole preparation process, that eventually results in a tasty meal. We trust that the pilot, crew, and technicians will do a good job when we get on a plane and go on holiday. We trust that our friends are there for us when we really need them, and we trust our partner to always remain faithful to us. Without a minimum of trust, a human relationship – even in a rudimentary form – is simply unthinkable. **Trust is the basic value of human interaction and the cement of our social order.**

In a constitutional state, citizens trust state institutions to respect and protect their private property. But equally private and public institutions such as the media and science build on a certain basic trust.

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[1] All previous issues can be downloaded free of charge from our archive.

[2] Oxford Dictionary entry "trust"

[3] Wikipedia entry "Trust": On the etymology of trust: "Trust has been known as a word since the 16th century (Old High German: "fertruen", Middle High German: "vertruwen") and goes back to the Gothic *trauan.* The word "trust" belongs to the group of words around "faithful" = "strong", "firm", "fat". In Greek this means "πίστις" (pistis) ("faith"), in Latin "fiducia" (self-confidence) or "fides" (faithfulness). Thus, in ancient and medieval use, trust stands in the area of tension between good faith and faith (e.g. with Democritus, who demands not to trust everyone, but only the tried and tested). For Thomas Aquinas, "Trust is hope confirmed by experience for the fulfillment of expected conditions under the premise of trust in God.". Our translation.

Gaining trust, erosion of trust, and social polarization

Trust looks to the future, forms itself in the present, and feeds itself from the past.

Trust within a society must grow; it is not simply there. Societies are characterized by different levels of trust. A distinction is made between so-called "high-trust societies" and "low-trust societies".[4] In a high-trust society, individuals are more open to new personal friendships and new business relationships, while in low-trust societies there are major barriers to building trust with people outside the family.[5]

Similar to the capital stock of a society, whose abundance and stability leads to a more productive economy, trust capital can also be consumed and gambled away. As with physical capital, *building* trust capital is much more difficult than *consuming* it; and as with physical capital, consumers of trust capital can consume too much of it in the short term –taking without giving.

When mistrust comes in, love goes out.
Irish proverb

The Western world is to a large extent a high-trust society. Cooperation is no longer based on belonging to a small, tight-knit community such as a clan, but rather to a comparatively anonymous society in which people trust each other without necessarily knowing each other. Without this advance of trust, without this open approach to each other, there can be no mutually beneficial cooperation. **However, there is growing evidence that this trust is increasingly eroding.**

Trust in institutions such as politics, science, and the media is of crucial importance to society. Confucius was of the opinion that three things were necessary for governance: weapons, food, and trust. If a ruler is unable to obtain all three things, he should first give up weapons, then food, and finally trust.[6]

Trust, but verify.
Ronald Reagan

Politics, science, and the media have suffered losses of confidence in recent years, some of which have been significant. Since 1972 the General Social Survey has measured the confidence of Americans in various institutions. Since 2000 confidence in virtually all institutions has eroded, with the exception of the military. Only one in five persons still has confidence in banks, churches, or big business and only one in ten (!) in the government. According to the next graph, trust in politics is eroding all over the globe.

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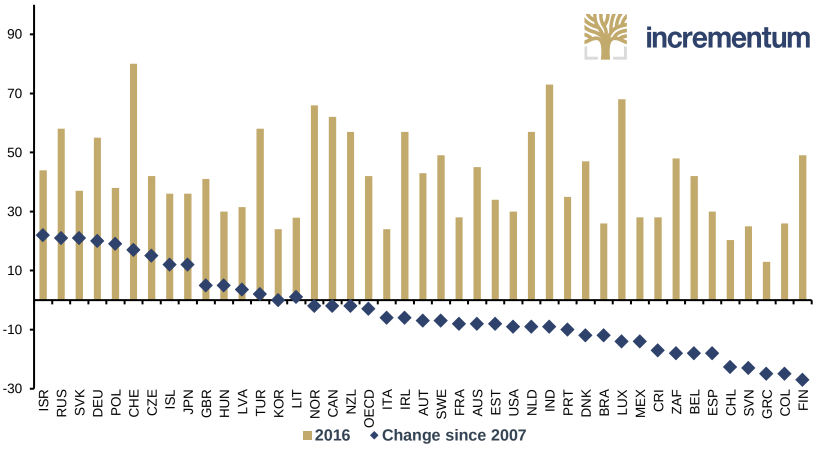
4 *See* Wikipedia entry "High trust and low trust societies", as well as Stoeferle, Ronald, Hochreiter, Gregor and Taghizadegan, Rahim: Die Nullzinsfalle (The Zero-Interest Trap), FinanzBuch Verlag, 2019, chapter 3.

5 *See* Govier, Trudy: Social Trust and Human Communities. 1997, pp. 129 ff.

6 Haumer, Hans: Vertrauen. Angst und Hoffnung in einer unsicheren Welt (Trust. Fear and hope in an uncertain world). 2009, p. 101

Trust in governments, in %, 2016 and change since 2007



Source: OECD, World Gallup Poll., Incrementum AG

We don't want a future. We just don't want the present to stop.
Philipp Blom

Among millennials, confidence in democracy is waning, says Neil Howe: *"Millennials are the least likely to actually think that democracy is important. A lot of millennials look at democracies today and they see these are governments which seem to be perennially dysfunctional. All they do is borrow from our future. They do nothing to invest in our future."* Howe refers to studies by Harvard professor Yascha Mounk showing that not only American but also Western European youth have lost faith in democracy. The later the interviewees were born, the lower their confidence in democratic institutions and the greater their desire for strong leaders.[7]

A by-product of the loss of trust is the spreading polarization of society.[8] This development is so pronounced that the degree of polarization sometimes culminates in personal contempt and even violent acts. Surveys show that Americans, for example, are politically more polarized than they have been since the Civil War. Since the election of Donald Trump as US president, one in six US citizens no longer talks to a close relative or once close friend if they belong to the other political camp.[9]

When the heavens laugh, great problems become small; when the heavens weep, small problems become great.
Chinese Proverb

In Europe, too, different symptoms of loss of trust can be seen, accompanied by increasing social polarization. The emergence of right-wing and left-wing populist parties and movements is not the only sign of a loss of confidence in the established party landscape. Phenomena such as the Yellow Vests protests in France and the Reich citizens' movement in Germany are clear indications that some European citizens are withdrawing confidence from the government. The Friday-for-Future movement, which openly accuses politicians of failing to live up to their responsibilities, has recently joined the ranks of the disaffected.

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[7] *See* "Neil Howe: Super-bullish the U.S.A. in the 2030s. But between now and then…", Macrovoices Interview, April 2019

[8] *See* "Populism and its true root", *In Gold We Trust* report 2017

[9] *See* Gaulhofer, Karl: „So klappt es auch mit Feinden" (This is also how it works with enemies), *Die Presse,* April 10, 2019: "Since 2014 the asymmetry in the attribution of motives (my convictions are based on love, yours on hatred) has been as great as between Palestinians and Israelis. Nine out of ten Americans suffer from the division." (Our translation). In this respect, the book *Love Your Enemies,* by Arthur C. Brooks is recommended.

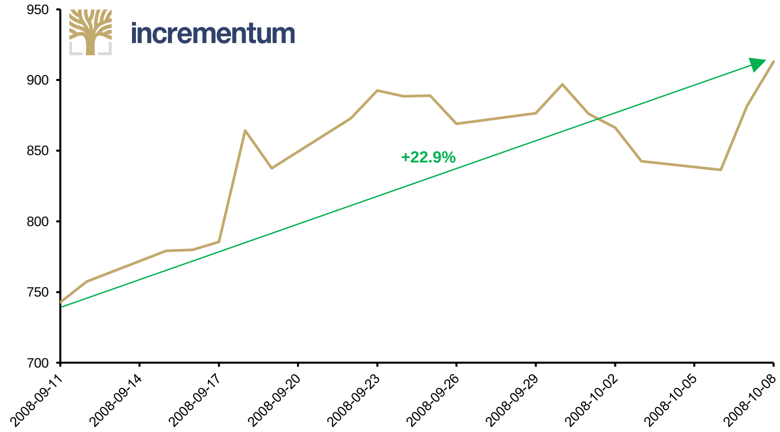
Envy is an enemy of trust. By breeding the envy complex populists undermine social trust.
Hans Haumer

Trust in the mass media has undoubtedly also declined. Donald Trump, who has regularly questioned the integrity of the press in the USA since taking office, has contributed to this. Numerous other media events, such as the scandal surrounding the German journalist Claas Relotius, who made up some of his reporting,[10] have also further damaged confidence in the media. The designation of the mainstream media as a "lying press", spouting "fake news", is an expression of this loss of trust, which further deepens social polarization.

Trust in science is also declining. Skepticism towards scientific findings is widespread. Much attention is paid to topics such as climate change, which are highly emotional, but the various camps are deeply distrustful of the scientific facts presented by the other side. The loss of confidence also manifests itself in doubts about highly conventional scientific findings. Thus, dubious worldviews such as the "Flat Earth Theory" are enjoying increasing popularity.[11]

The phenomena of the increasing erosion of trust are fascinating and worrying, but they should not be the focus of this publication. Nevertheless, we wanted to start by deliberately pointing out such developments in order to put the leitmotif of this year's report into context. **Because if the level of public trust is declining, that may have serious implications for one of the most important institutions of our society: money.**

Gold price during Lehman crash, in USD, 11/09/2008-08/10/2008



Source: Federal Reserve St. Louis, Incrementum AG

Trust in the monetary system

When you devalue money, you devalue trust.
Dylan Grice

High basic trust within a society results in economic prosperity, because only trust enables an efficient division of labor. One prerequisite for this is a medium of exchange that enjoys general trust, because otherwise the exchange of goods and services becomes constrained, highly inefficient and costly. Money is ultimately spiritual energy which man acquires, reasonably consumes, gives away, or gambles away. Money is thus nothing more than an abstract energy store. But in order for fairness of exchange to be maintained over time, money should be a stable

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[10] *See* All posts on the Claas Relotius case, spiegel.de
[11] *See* Stoeferle, Ronald: Keynote Presentation at the European Gold Forum Zurich, April 2019

measure of trust.[12] David Hume described trust as a *performance of promises,* which perfectly captures the perfidy of inflation. **Inflation is a devaluation of the future through broken promises.**

Courtesy of Hedgeye

As our loyal readers know only too well, our current monetary system has been de facto uncovered and dematerialized for almost half a century now. All the more important, therefore, is the aspect of trust. Looking at monetary history from the point of view of confidence, one can see a history of ups and downs of dwindling and regained confidence.

The asymmetry of trust means that the fear of loss triggers greater, faster, and stronger reactions than the expectation of gain.
Hans Haumer

In the first decade after the final dematerialization of the monetary system in August 1971, the international monetary system was seriously shaken. Several US recessions, coupled with international conflicts and high price inflation, put the now uncovered world reserve currency under enormous pressure. International investors increasingly lost confidence in the US dollar. In 1978, US bonds had to be issued in the hard currencies of the Swiss franc and the German mark – the so-called Carter bonds.[13]

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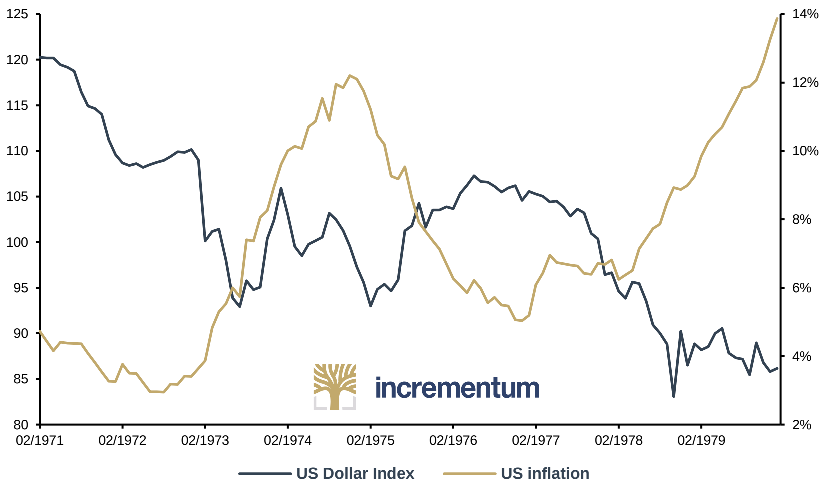
[12] *See* Haumer, Hans: Vertrauen. Angst und Hoffnung in einer unsicheren Welt. (Trust. Fear and hope in an uncertain world). 2009, p. 85.
[13] *See* U.S. Department of Treasury: "Resource Center – International – Exchange Stabilization Fund – History"

US Dollar Index (left scale) vs. US inflation (right scale), in %, 02/1971-12/1979



Source: Federal Reserve St. Louis, Incrementum AG

It takes 20 years to build a reputation and five minutes to ruin it.
Warren Buffett

The Federal Reserve under the chairmanship of Paul Volcker was able to turn the tide, rehabilitate the US dollar, and successively restore confidence only through **a highly restrictive monetary policy that led to sky-high interest rates and is still unparalleled today.**[14] The capital of trust in the US-centric order continued to be restored with the fall of the communist Eastern bloc in the early 1990s. In the struggle of systems, the "neoliberal capitalist system" associated with the USA emerged as the supposed victor. There remained a geopolitical tailwind for the US-centric world order until the mid-2000s. The influential US geostrategist Zbigniew Brzeziński said that the US was "*the only comprehensive global superpower*"[15]. **But the events of the years 2008-2009 represented a serious turnaround. For the first time since the 1980s, confidence in the US-centric system was fundamentally eroded, as the global credit crisis originated from within the USA.**

Source : Wiki Commons

Erosion of trust in international monetary policy

The toughest thing about the power of trust is that it's very difficult to build and very easy to destroy.
Thomas J. Watson

The steady buying of gold and the repatriation of central bank gold clearly indicate growing mutual distrust among central banks. Last year we took up this topic under the heading *"A turning of the tide in the global monetary architecture"*[16], and this year we are again dealing with the topic of de-dollarization, which has lost none of its relevance, in a separate chapter.[17] The

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[14] This year two chapters deal with this era of monetary history: (1) "The Relevance of John Exter", including an interview with Barry Downs, John Exter's son-in-law, and (2) "History Does (Not) Repeat Itself: Plaza Accord 2.0 at the Gates?" The two chapters are part of the "Extended Version" which you can download for free at https://ingoldwetrust.report/igwt-en/?lang=en.

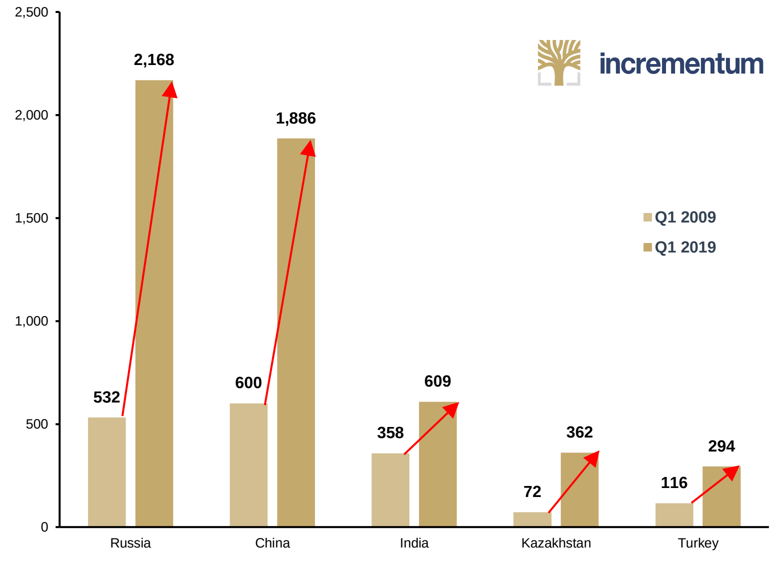
[15] Brzezinski, Zbigniew: *The Grand Chessboard: American Primacy and Its Geostrategic Imperatives*, p. 25

[16] *In Gold We Trust* report 2018

[17] This chapter is part of the "Extended Version" which you can download for free at https://ingoldwetrust.report/igwt-en/?lang=en.

rising gold stocks of the Russian and Chinese central banks are not news to most people interested in gold.

Change in gold reserves of emerging countries, in tonnes, Q1/2009-Q1/2019



Source: World Gold Council, Incrementum AG

In addition to the “usual suspects”, a growing number of other central banks are currently following the example of the *“axis of gold”*.[18] An example is the recent tenfold increase in the Hungarian gold stock. The official announcement of the Hungarian central bank on its first gold purchases since 1986 states:

> *“In normal circumstances, gold has a confidence-building feature, i.e. it may play a stabilising role and act as a major line of defence under extreme market conditions or in times of structural changes in the international financial system or deep geopolitical crises. In addition, gold continues to be one of the safest assets, which can be related to individual properties such as the limited supply of physical precious metal, which is not linked with credit or counterparty risk, given that gold is not a claim on a specific counterparty or country.”*[19]

There’s nothing to add. It seems as if our Hungarian friends are attentive readers of the *In Gold We Trust* report!

We aren’t ditching the dollar, the dollar is ditching us.
Vladimir Putin

Further catalysts for emancipation from the US dollar are, among other things, the monetary and economic reprisals undertaken by the USA, which are occurring more and more obviously under the Trump administration. These include explicit sanctions, as in the cases of Russia and Iran, as well as political influence on the SWIFT payment processing system.[20] Even in Germany, which is otherwise loyal to the US, for the first time voices are growing louder in favor of

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[18] James Rickards includes Iran, Turkey, Russia, and China. *See* Rickards, Jim: “Axis of Gold“, Daily Reckoning, December 20, 2016.
[19] Press release: “Hungary’s Gold Reserve Increase Tenfold, Reaching Historical Levels“, Magyar Nemzeti Bank, October 16, 2018
[20] *See* “Die Dominanz des Dollars weckt Unmut” (“The Dominance of the Dollar Arouses Discontent”), *Neue Zürcher Zeitung,* April 4, 2019

more self-confidence in matters of international currency policy. This is what the German Foreign Minister wrote in a guest article in the German *Handelsblatt* in autumn 2018:

> *"It is therefore essential that we strengthen European autonomy by establishing payment channels independent of the US, creating a European Monetary Fund and building an independent SWIFT system."*[21]

And the criticism of the greenback's currency monopoly is also gradually becoming louder on the part of the EU. In his "Speech on the State of the Union 2018", EU Commission President Jean-Claude Juncker noted:

> *"It is absurd that Europe pays for 80% of its energy import bill – worth 300 billion euro a year – in US dollars when only roughly 2% of our energy imports come from the United States. It is absurd that European companies buy European planes in dollars instead of euro. […] The euro must become the face and the instrument of a new, more sovereign Europe."*[22]

Building trust in new technologies

If the modern world is ancient Rome, suffering the economic consequences of monetary collapse, with the dollar our aureus, then Satoshi Nakamoto is our Constantine, Bitcoin is his solidus, and the Internet is our Constantinople.
Saifedean Ammous

As a consequence of the erosion of confidence in international monetary policy, new technologies are increasingly being examined with the aim of helping circumvent sanctions and achieve greater autonomy in international payments. Iran, for example, is reported to work on various blockchain projects that will make it easier to circumvent US sanctions.[23] Moreover, an increasing number of private crypto projects in the gold sector are also worth mentioning in this context. The "*Turning of the Tide in Technological Progress*", which we described in last year's report, is thus making definite progress.[24] **However, these new technologies need to prove themselves over a longer period of time to earn trust for wider use.**

The Everything Bubble: A bubble of misguided trust

Although there is increasing evidence at the international level that confidence in the US-centric world order is crumbling, the apparent loss of confidence has so far not been reflected in either a weak US dollar or a significant rise in the price of gold (in USD). How do we explain that?

From our point of view, Donald Trump's "all-in" economic policy contributes significantly to this. In the years following the financial crisis, global central banks flooded the economy with exorbitant monetary stimuli. Nearly 20trn USD of central bank money was created ex nihilo. Global stock markets were deliberately driven up in order to accelerate the so-called "wealth effect". However, this did not seem to be having any effect in 2015, and stock markets began to stagger in the wake of fears of low growth.

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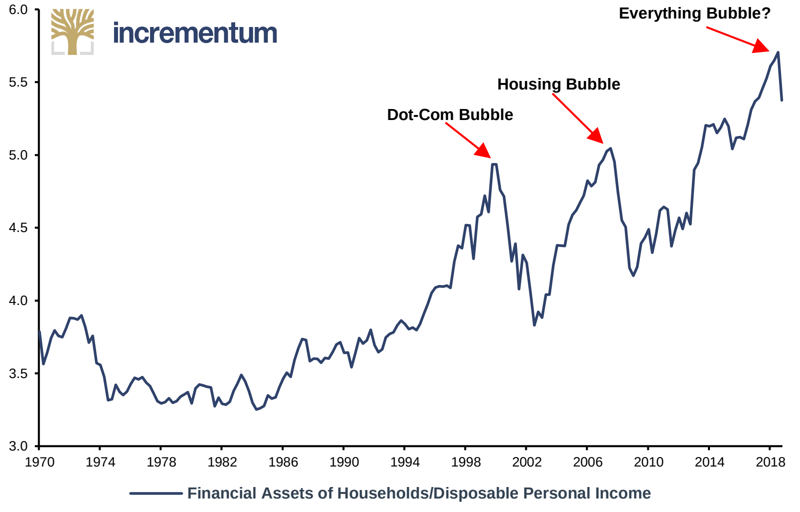
[21] *See* Maas, Heiko: "Wir lassen nicht zu, dass die USA über unsere Köpfe hinweg handeln" ("We will not allow the United States to act over our heads"; guest commentary), *Handelsblatt*, August 21, 2018
[22] Jean-Claude Juncker: "State of the Union 2018 - The hour of European sovereignty", September 12, 2018
[23] *See* "Iran in Talks With 8 Countries for Use of Cryptocurrency in Financial Transactions", news.bitcoin.com, January 29, 2019
[24] *In Gold We Trust* report 2018

Courtesy of Hedgeye

When we recall the 2016 election year, various indicators at the time seemed to point towards an economic slowdown and approaching US recession. The gold price acknowledged the foreseeable end of economic expansion and the renewal of monetary and fiscal stimuli with its first significant rally since the bear market that began in 2011-2012. On the **fateful election night in November 2016,** however, the momentum was temporarily halted. Yields at the long end of the bond yield curve rose, allowing the Federal Reserve to implement long-awaited rate hikes in subsequent quarters without having to invert the yield curve. With the rise in interest rates, the gold rally was halted, at least for the time being.

Through massive tax relief and a change of mood on the part of many disillusioned voters, who often voted for Donald Trump because of economic dissatisfaction, the economic cycle could actually be extended once again. Not only the stock markets but also corporate bonds, luxury real estate, and works of art boomed. To describe this period, we have adopted Jesse Felder's apt term *"The Everything Bubble*".

Everything Bubble: Financial assets of households / disposable personal income, Q1/1970-Q4/2018

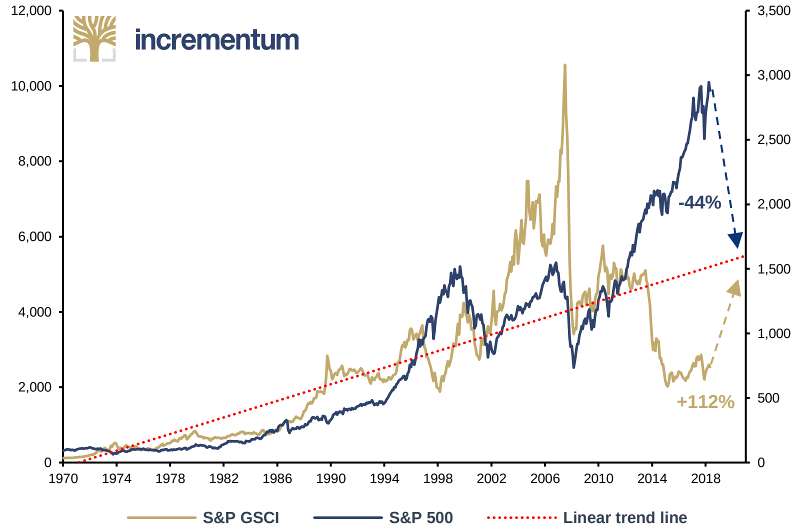


Source: Federal Reserve St. Louis, Incrementum AG

Looking for a good investment is nothing more than looking for a good bargain.
John Templeton

Alas, commodities remain the exception to the rule and still do not participate in the everything bubble. The extreme relative undervaluation of commodities compared to the stock market becomes evident in the next chart. It shows the development of the S&P GSCI and of the S&P 500, as well as their long-term upward trend line. To return to this trend line – which happens on average every 6 to 8 years – the S&P would have to fall by 44% and the GSCI to rise by 112%. This is a scenario that seems highly unlikely, if not impossible, at the moment. However, a glance at the following chart or at the history books puts this alleged impossibility into perspective.

S&P GSCI (left scale), and S&P 500 (right scale), 01/1970-05/2019



Source: Prof. Dr. Torsten Dennin, Lynkeus Capital, Bloomberg, Incrementum AG

Trade and war are opposites, trade war an oxymoron. In the century before last, the French economist Frédéric Bastiat had formulated the idea that either goods cross borders or soldiers do.
Rahim Taghizadegan

In any case, as long as the equity market party continues, trust in the credit-financed growth model seems intact. The President regularly exploits the all-time highs of US stock markets in the media, and investors and commentators praise the resurrection of the USA as a global economic locomotive. In the midst of a global economic slowdown, US consumers are being celebrated as “consumers of last resort”. Not even the permanently boiling trade conflict between China and the USA can spoil the mood of investors. **But how sustainable is such an upswing, really?**

You don’t have to look too far below the surface of economic data to be suspicious of the sustainability of the recovery. The debt increases at the governmental and, in particular, at the corporate level continue to be largely ignored. This topic is dealt with in detail in the next chapter “The Status Quo of Gold”.[25]

Last year we therefore warned under the heading “The tide is turning in monetary policy” that the planned reduction of liquidity would inflict severe damage on the stock markets. This is exactly what happened in the fourth quarter of 2018: The stock markets suffered their biggest selloff in years and the Federal Reserve promptly announced that it would stop raising interest rates.

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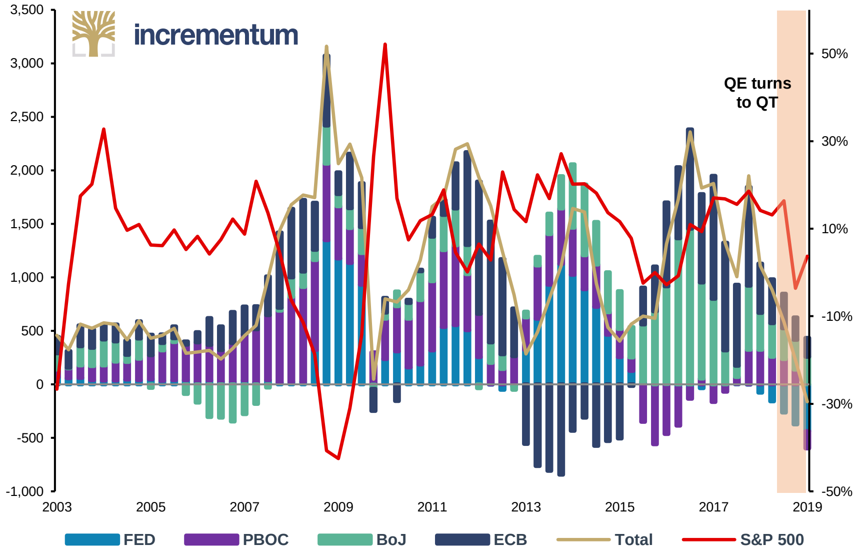
[25] This chapter is part of the “Extended Version” which you can download for free at https://ingoldwetrust.report/igwt-en/?lang=en.

U-turn in monetary policy: Quarterly change in central bank balance sheet (left scale), YoY in USD bn, and S&P 500 (right scale), YoY%, 2000-2019

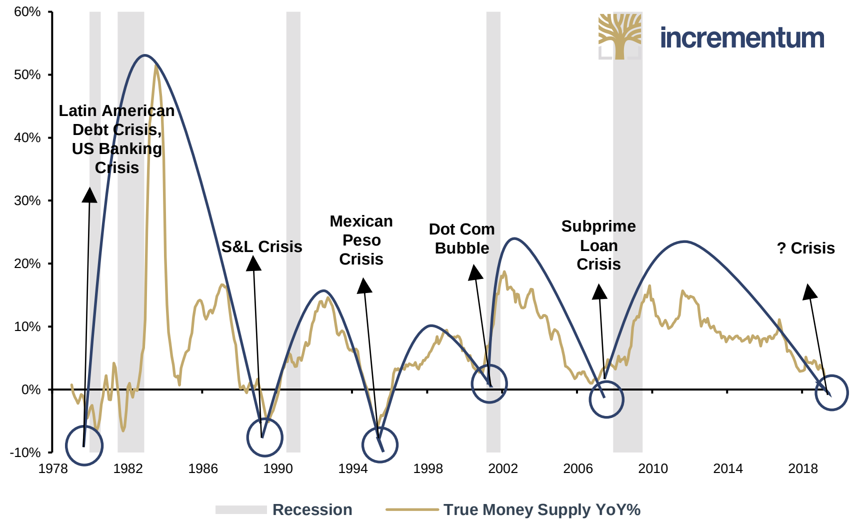


Source: Bloomberg, Incrementum AG

People vastly underestimated the power of QE. And they are in danger of doing the same with QT.
Franz Lischka

In fact, the long-announced normalization of the Federal Reserve's balance sheet via QT (quantitative tightening), which according to Jerome Powell was still running "on autopilot" in December 2018, was cancelled at the next FOMC meeting. **Once again, monetary policy was massively asymmetric: While in previous years the Federal Reserve had expanded its balance sheet by USD 3.7trn, the Federal Reserve is now expected to be able to reduce its balance sheet by only 0.7trn in total.**

True money supply, YoY%, 1979-2019



Source: Michael Pollaro, Incrementum AG

Loss of confidence in monetary policy?

The time is coming (when) global financial markets stop focusing on how much more medicine they will get (QEs) and instead focus on the fact that it does not work.
Russell Napier

How long can the current boom in financial markets be perpetuated? How long will market participants continue to trust the omnipotence of monetary authorities? When will the bubble of misguided trust burst?

For the time being, global central banks have only paused the normalization of monetary policy and not (yet) reversed it. However, it has already been communicated several times that in the event of a renewed economic slowdown, the well-known expansive means of monetary policy will be used. However, there are two major differences compared to the last time:

- Global interest rates are still at an extremely low level and would probably have to be lowered significantly into negative territory.
- A new wave of QE would clearly end any normalization efforts and seriously damage the trustworthiness of central banks.

Things that can't go on forever, won't. Debts that can't be paid, won't be.
Glenn Reynolds

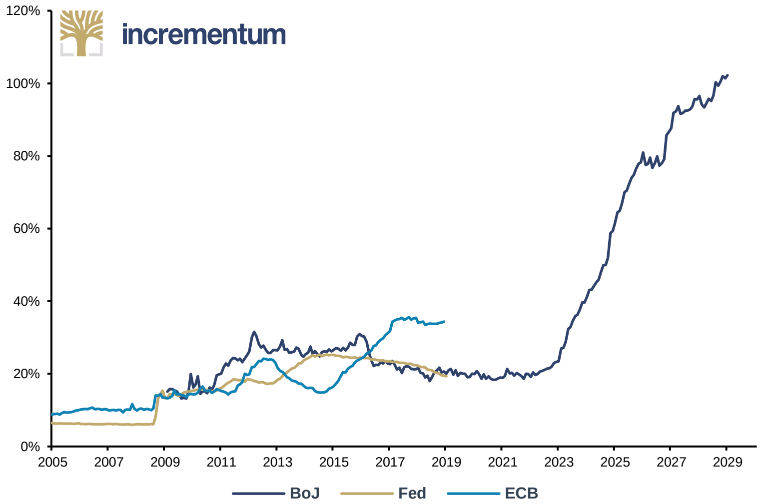
At present, conventional risk investments such as equities are still enjoying the confidence of investors. This could change quickly if the current expansion, which has become the longest economic upswing in the history of the US, comes to an end. The fact that the coming recession could become extremely uncomfortable due to the starting position of economic fundamentals has already been expressed by many grandees of the capital market, such as Jeffrey Gundlach: *"When the next recession comes there is going to be a lot of turmoil."*[26]

The pressure to print will continue to increase

The closer the upcoming presidential elections come, the greater the pressure on the Federal Reserve from the Trump administration not to stall the upswing and to reopen the monetary floodgates. President Trump has cleverly positioned himself in the media by repeatedly criticizing the Federal Reserve for interest rate hikes and quantitative tightening. If there is serious economic slowdown, he will be able to pass the buck to the central bank and adorn himself with a false mantle of economic competence, especially if the Fed does not immediately implement the appropriate measures that he will propose. But as can be seen on the following chart, Federal Reserve and ECB – relative to the BoJ – seem to have plenteous leeway to further increase their balance sheets.

[26] *See* Interview with Jeffrey Gundlach, Yahoo!Finance, February 13, 2019

Federal Reserve balance sheet, ECB balance Sheet, & BoJ balance sheet as % of GDP, BoJ leading 10 years



Source: FFTT, Federal Reserve St. Louis, Incrementum AG

MMT is the post hoc justification of both easy fiscal policy and easy monetary policy. As such, it is the new intellectual darling of every political and market Missionary of the Left AND the Right.
Ben Hunt

But the independence of the Federal Reserve will also be increasingly tested by the opposition Democrats. The left wing of the party is strengthening and increasingly flirting with questionable monetary experiments that usually start with the buzzword MMT ("Modern Monetary Theory").[27] A Democratic victory in next year's presidential election could bring on the perfect storm for the US economic model, which has so far been able to maintain a good mood among investors and the general perception of a humming economy through stock price inflation. All this could change abruptly with a political leftward slide. We will report on this potential in detail in the coming election year.

In any case, our decision to link our four-year price forecast to the US President's term was the right one, because the expanding interventionist measures and indirect and direct influence on monetary policy are obviously increasingly interlinking policy with the financial markets. **Our updated scenarios and forecast can be found in the conclusion of this year's *In Gold We Trust* report, "Quo Vadis, Aurum?"**

In Gold We Trust

Popular trust in the idea that monetary policies can sustain growth and employment and that central banks have inflation under control will be seriously tested in the next recession. The spread of the loss of trust to other pillars of the Western world, such as the media, the financial system, and the judiciary could have devastating consequences.

[27] Evil tongues also speak of the **M**agical **M**oney **T**ree.

The truth is often forced to a long sleep, but when it awakens, its illuminating light reaches into the last dark chambers of error and ignorance.
Roland Baader

When it comes to trust in specific investments, our vote – at least for a portion of the portfolio – is clear. Trust looks to the future, forms itself in the present, and feeds itself from the past. As monetary asset, gold can look back on a successful five-thousand-year history in which it was able to maintain its purchasing power over long periods of time and never became worthless. Gold is the universal reserve asset to which central banks, investors, and private individuals from every corner of the world and of every religion and every class return again and again.

One thing should not go unsaid at this point: If our diagnosis is correct and trust is generally on the decline, this does not necessarily have to be negative. Although many of the developments we have noted should be regarded as worrying, we must not forget that trust levels in a society follow a cyclical pattern. Disappointment with familiar institutions may well allow the laying of the cornerstone for a more solid foundation in the future.

If it not be now, yet it will come. The readiness is all.
Hamlet

Gold looks to a future in which the natural value of this unique precious metal is once again fully appreciated. In our opinion, the currently high trust granted into the skills of central bankers and the supposed strength of the US economy are the main reasons for the somewhat weak development of the yellow metal. If the omnipotence of the central banks or the credit-driven record upswing are called into question by the markets, this will herald a fundamental change in global patterns of thinking and help gold to old honors and new heights.

Now we invite you to our annual tour de force and hope that you enjoy reading our 13th *In Gold We Trust* report as much as we enjoyed writing it.

Yours truly,

Ronald-Peter Stoeferle and Mark J. Valek

P. S. All previous issues of the *In Gold We Trust* report can be found in [our archive](#).

The Status Quo of Gold

“Gold’s Perfect Storm investment thesis argues that gold is at the beginning of a multiyear bull market with ‘a few hundred dollars of downside and a few thousand dollars of upside’.

The framework is based on three phases: testing the limits of monetary policy, testing the limits of credit markets, and testing the limits of fiat currencies.”

Diego Parilla

Key Takeaways

- Last year gold rallied in most currencies with the notable exception of USD, CHF and JPY.
- Since the euro was introduced as book money 20 years ago, the gold price in EUR has risen by 356%, or on average 7.8% per year.
- Despite the interim stock crash in Q4/2018 gold has never been so cheap compared to stocks in more than 50 years.
- How solid the US economic foundation – and thus the US dollar – really is will only become apparent in the next crisis. We are convinced that the boundless trust in the US economic engine and the US dollar might begin to crumble in the coming months.
- Central banks remain net buyers. Investor demand will be the pointer on the scales for the gold price.
- The high share of BBB-rated corporate bonds is a potential risk to the stability of the US financial markets and could endanger future economic growth in the US.

We want to begin this year's *In Gold We Trust* report with our traditional assessment of the gold market. We will take a critical look at the trend of the gold price and analyze whether we really are – as we asserted last year – in the early stages of a new bull market, or whether our fundamental conclusions turned out to be flawed.

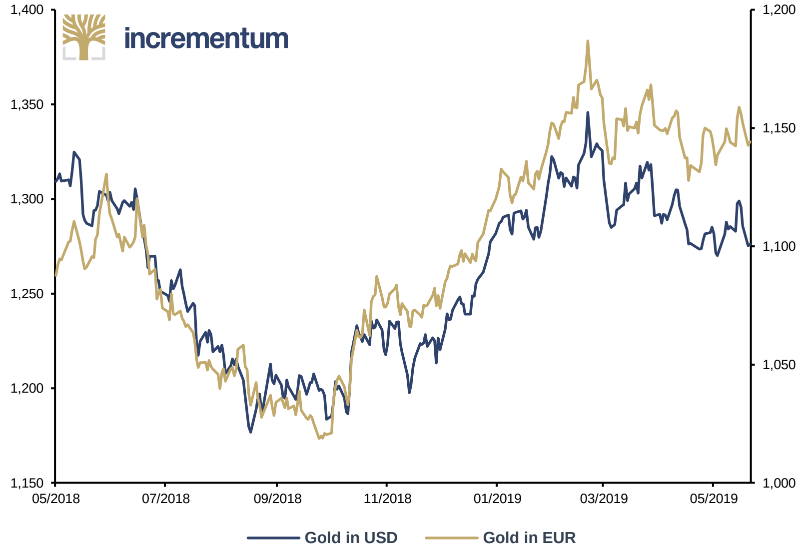
Status Quo of Gold in the Currency Context

> *"Like gold, U.S. dollars have value only to the extent that they are strictly limited in supply. But the U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost."*
>
> Ben Bernanke

The problem is not so much to see what nobody has yet seen, as to think what nobody has yet thought concerning that which everybody sees.
Arthur Schopenhauer

First, let us consider some important performance data. **In USD terms gold generated an unsatisfactory return in 2018, declining by 2.1%, while it gained 2.7% in euro terms.** The development was very different in the two halves of the year. While the gold price briefly (intraday) crossed the USD 1,400 mark in January 2018, the price then slid to USD 1,180 in August. A "panic low" was reached, after which a rally began, which brought significantly higher price levels of up to USD 1,300 at the end of the year. All in all, this was a remarkable development, especially considering the fact that the DXY was up 4.3% in 2018. On a EUR basis, developments were somewhat less volatile, with the gold price oscillating within a range of just under EUR 90.

Gold price since the last In Gold We Trust report, in USD (left scale) and EUR (right scale), 05/2018-05/2019

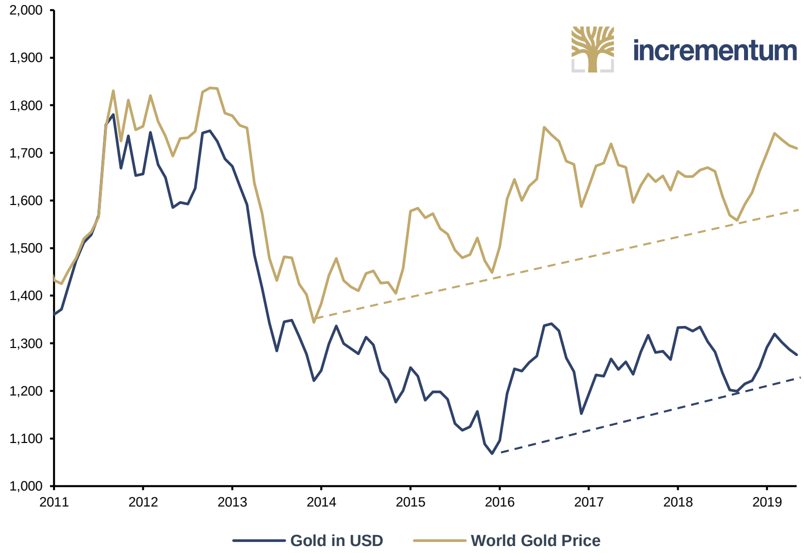


Source: Federal Reserve St. Louis, Incrementum AG

The world gold price is close to its all-time highs!

The next chart is one of the classics of every *In Gold We Trust* report. It shows the so-called world gold price, which represents the gold price not in US dollars or euros but as a trade-weighted US dollar. A glance at the chart shows that the world gold price is now not too far from its October 2012 high of 1,836 USD (monthly average). If one compares the world gold price with the gold price in US dollars, one can see that the spread between them has tightened somewhat since 2017. Since bottoming at the end of 2015, the gold price has begun to establish a series of higher lows, which confirms our essentially positive assessment.

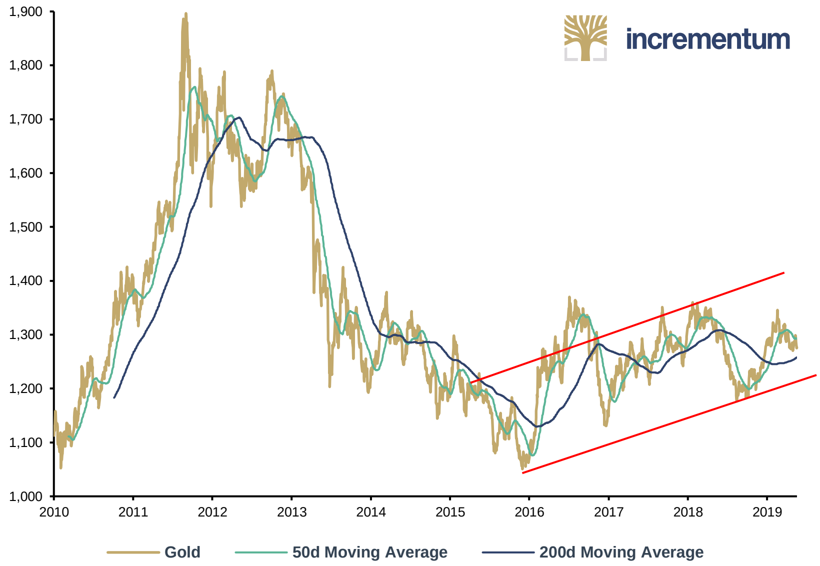
World gold price, and gold price in US dollars, 01/2011-05/2019



Source: Federal Reserve St. Louis, Incrementum AG

Let us look at the gold price trend since 2010. It is evident that the gold price has recently declined below its 50-day moving average. On the other hand, the 200-day moving average is still not breached and looks like a reliable support level, at least for now.

Gold in USD, 50- and 200-day moving averages, 01/2010-05/2019



Source: Federal Reserve St. Louis, Incrementum AG

The role of the U.S. dollar as the world's reserve currency ought to give the Fed a triple mandate: Dollar strength can cause havoc for a world swimming in a pool of dollar-denominated debt.
Yra Harris

Now we want to widen the currency spectrum and look at the gold price in the most important currencies. **2018 as a whole was positive for gold in most world currencies. Only the (supposed) safe-haven currencies (USD, CHF, JPY) recorded (slight) losses.** The average performance in this secular bull market remains impressive. The average annual performance 2001 to now is 9.1%. **Despite significant corrections, gold was able to outperform virtually every other asset class and above all every other currency during this period.** Since the beginning of 2019, the development has been relatively unspectacular. The average plus is 0.8%.

Gold Performance since 2001 in various currencies (%)

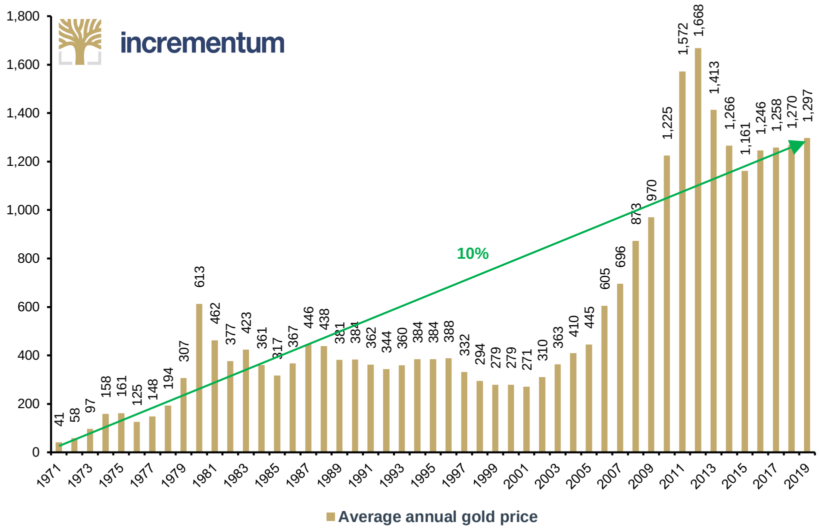
	EUR	USD	GBP	AUD	CAD	CNY	JPY	CHF	INR	Average
2001	8.1%	2.5%	5.4%	11.3%	8.8%	2.5%	17.4%	5.0%	5.8%	**7.4%**
2002	5.9%	24.7%	12.7%	13.5%	23.7%	24.8%	13.0%	3.9%	24.0%	**16.2%**
2003	-0.5%	19.6%	7.9%	-10.5%	-2.2%	19.5%	7.9%	7.0%	13.5%	**6.9%**
2004	-2.7%	5.3%	-2.3%	1.8%	-1.9%	5.3%	0.7%	-3.4%	0.6%	**0.5%**
2005	36.8%	20.0%	33.0%	28.9%	15.4%	17.0%	37.6%	37.8%	24.2%	**26.1%**
2006	10.6%	23.0%	8.1%	13.7%	23.0%	19.1%	24.3%	14.1%	20.9%	**17.2%**
2007	18.4%	30.9%	29.2%	18.3%	12.1%	22.3%	22.9%	21.7%	16.5%	**21.7%**
2008	10.5%	5.6%	43.2%	31.3%	30.1%	-2.4%	-14.4%	-0.1%	28.8%	**15.5%**
2009	20.7%	23.4%	12.7%	-3.0%	5.9%	23.6%	26.8%	20.1%	19.3%	**16.5%**
2010	38.8%	29.5%	34.3%	13.5%	22.3%	24.9%	13.0%	16.7%	23.7%	**25.2%**
2011	14.2%	10.1%	10.5%	10.2%	13.5%	5.9%	4.5%	11.2%	31.1%	**11.2%**
2012	4.9%	7.0%	2.2%	5.4%	4.3%	6.2%	20.7%	4.2%	10.3%	**7.5%**
2013	-31.2%	-28.3%	-29.4%	-16.2%	-23.0%	-30.2%	-12.8%	-30.1%	-18.7%	**-24.1%**
2014	12.1%	-1.5%	5.0%	7.7%	7.9%	1.2%	12.3%	9.9%	0.8%	**6.2%**
2015	-0.3%	-10.4%	-5.2%	0.4%	7.5%	-6.2%	-10.1%	-9.9%	-5.9%	**-3.8%**
2016	12.4%	9.1%	30.2%	10.5%	5.9%	16.8%	5.8%	10.8%	11.9%	**12.3%**
2017	-1.0%	13.6%	3.2%	4.6%	6.0%	6.4%	8.9%	8.1%	6.4%	**6.3%**
2018	2.7%	-2.1%	3.8%	8.5%	6.3%	3.5%	-4.7%	-1.2%	6.6%	**2.6%**
2019 ytd	3.6%	-0.2%	-0.1%	2.3%	-1.9%	0.2%	0.7%	2.8%	-0.2%	**0.8%**
Average	8.6%	9.6%	10.8%	8.0%	8.6%	8.4%	9.2%	6.8%	11.6%	**9.1%**

Source: Federal Reserve St. Louis, Goldprice.org, Incrementum AG, as of May 21st 2019

Diminution in the dollar's value was so slow there seemed no cause for public alarm. It was like watching an ice cube melt. It happens, yet slowly.
Jim Rickards

But let's turn back a little further in the history books. Since August 15, 1971 – the beginning of the new monetary era – the annual rate of increase of the gold price in US dollars has been 10%. The inflation-adjusted appreciation of the currency gold against the US dollar averages 4.5% per year. This long-term context puts the correction of the years 2013-2015 into perspective, as the following chart of average annual prices shows. **The chart also provides impressive evidence that it is advisable to regularly accumulate gold ("gold saving") by harnessing the cost-average effect.**

Average annual gold price, in USD, 1971-2019



Source: Federal Reserve St. Louis, Incrementum AG

Loyal readers know: We believe that commodities are the antidote to the US dollar. There are interactions between movements in commodity prices and the US dollar, with the causality emanating more strongly from the US dollar than is generally assumed. This can also be explained by the crisis in the USD-centric global currency architecture, which we will discuss in detail again in the chapter "De-Dollarization".[28]

Gold, in the end, is not just competition for the dollar; it is competition for bank deposits, stocks and bonds most particularly during times of economic stress.
Paul Volcker

In our opinion, the indications of future weakness of the US dollar are slowly but surely increasing. The deliberate weakening of one's own currency in the context of trade wars in order to support the export economy seems particularly worth mentioning here. It is no surprise to us that President Trump recently increased verbal pressure on the Federal Reserve: "*We have a gentleman that likes raising interest rates in the Fed; we have a gentleman that loves quantitative tightening in the Fed; we have a gentleman that likes a very strong dollar in the Fed.*"[29]

The consensus seems to be that a strong US dollar automatically means lower gold prices. This thesis can also be empirically substantiated. **However, our quantitative analyses show that the correlation is clearly asymmetrical:**

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[28] This chapter is part of the "Extended Version" which you can download for free at https://ingoldwetrust.report/igwt-en/?lang=en.
[29] "Trump Says Dollar Too Strong in Renewed Criticism of Powell", Bloomberg, March 2, 2019

A strong US dollar does much less damage to the gold price than a weak US dollar does to gold.[30]

Courtesy of Hedgeye

Moreover, it seems that historical patterns are currently changing. In our opinion, the "autonomous rate of increase", i.e. the rate of gold price increase that is independent of exchange-rate fluctuations, will continue to rise. One of the reasons for this is that the influence of emerging markets on gold demand has grown significantly in recent years. In this respect, the historically inverse relationship between the US dollar and the gold price could weaken in the future. **What's good for the US dollar doesn't always have to be bad for gold.**

Gold always moves out of countries whose capital stock is declining and flows into countries where capital accumulation is taking place, the economy is prospering, and the volume of savings is increasing.[31] The Romans had already realized this more than 2,000 years ago, when the Chinese and Indians accepted only gold and not Roman goods in exchange for spices and silk.

Gold goes where the money is, and it came to the United States between World Wars I and II, and it was transferred to Europe in the postwar period. It then went to Japan and to the Middle East in the 1970s and 1980s, and currently it is going to China and also to India.
James Steel

In 2020, 50% of world GDP will be generated by emerging economies, compared with only 19% in 2000. As we have described in detail in previous years, the majority of emerging markets have a much greater penchant for gold than the industrial nations.[32] This should translate into a natural, long-term growth of gold demand. The share of emerging markets in total gold demand has risen to 70% over the past five years, as measured by annual gold flows. **China and India accounted for more than half of this figure. The formative historical experience of financial repression, an unstable monetary system, and the associated loss of purchasing power are – apart from cultural and religious aspects – likely to be the decisive factors for the higher basic demand for gold.**

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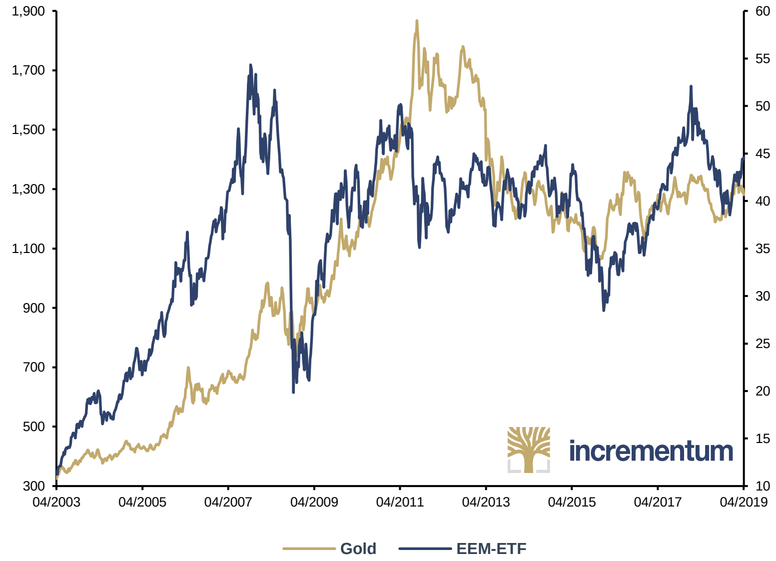
30 *See* "The Link Between Gold and the Dollar", *In Gold We Trust* report 2015
31 *See* "The Long Monetary March", Myrmikan Update, September 17, 2013; updated on September 23, 2013
32 *See* "The Portfolio Characteristics of Gold", *In Gold We Trust* report 2018

The following chart shows impressively how tight the correlation between the economic development of the emerging markets, as measured by the EMM ETF,[33] and the gold price is. Naturally, the US dollar trend plays a central role not only for gold but also for the development of the emerging markets, i.e. a weak dollar usually favors the development of the emerging markets and vice versa.

Gold price, in USD (left scale), and EEM ETF (right scale), 04/2003-04/2019



Source: Investing.com, Incrementum AG

Like Liberty, gold never stays where it is undervalued.
John S. Morrill

The 20th anniversary of the introduction of the euro as book money gives us an opportunity to take a closer look at performance over this period. Since the euro was introduced as book money on January 1, 1999, the price of gold in euros has risen by 367%, or on average 7.8% per year.

Gold price, in EUR, 01/1999-05/2019

Source: World Gold Council, Incrementum AG

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33 EEM – iShares MSCI Emerging Markets ETF

The dramatic loss of purchasing power of the euro against gold is even more impressive if depicted as an inverse. The next chart shows how many milligrams of gold correspond to one euro. **Whereas on January 1, 1999 one euro "contained" 124.8 mg of gold, 20 years later the figure was only 28.3 mg. This corresponds to a loss of 77.5 % in the value of the euro against gold.**

Gold per EUR, in mg, 01/01/1999-01/01/2019

Source: Federal Reserve St. Louis, Incrementum AG

Conclusion

Money is perhaps the most concentrated and acute form and expression of trust in the social-state order.
George Simmel

The whole world seems to be looking exclusively at the gold price in US dollars. The whole world? No, we have looked at the large number of currencies in which the gold price is already close to its all-time high. It is incomprehensible to us that even in the eurozone the price of gold in US dollars enjoys more media attention than the price of gold in euros, and that therefore the considerable gains of gold in euros fall by the wayside, making gold appear much less attractive than it actually is for the euro investor.

We are therefore sticking to our statement from last year that gold is in the early stages of a new bull market – a bull market that could soon pick up momentum on a US dollar basis as well.

Status Quo of the US Dollar and the US Economy

> *"The US dollar now feels like a stock that no longer rises on good news."*
>
> Gavekal

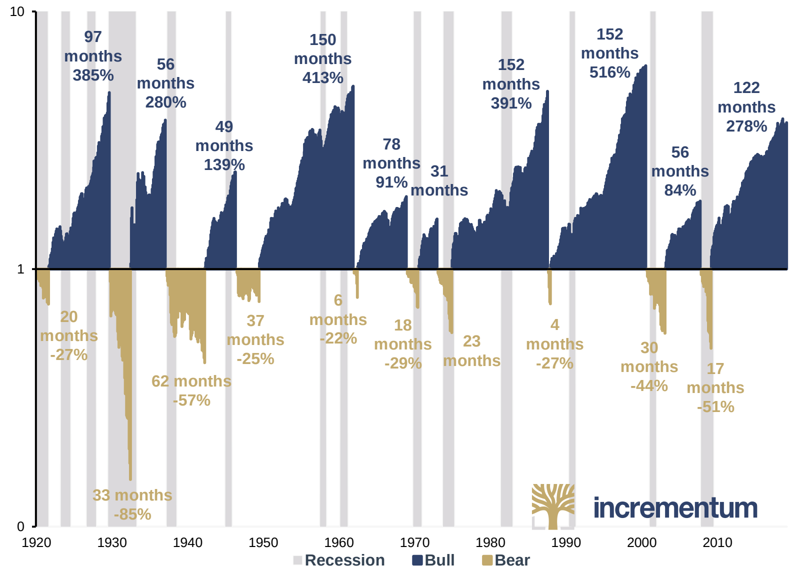
All too often, media coverage conveys the impression that Europe, China, and Japan lie in (economic) ruins, while the US as the only haven of prosperity stands like a lighthouse over the gloomy economic

landscape everywhere else. This shows what high expectations the rest of the world has of the US and that despite all the prophecies of doom and challenges it faces, the US continue to be regarded as the undisputed global economic locomotive.

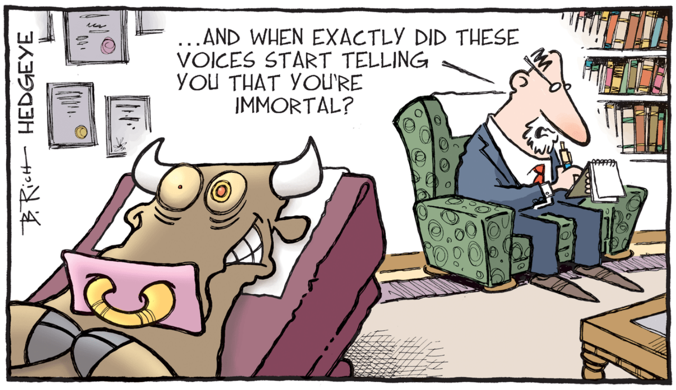
The world is dangerously overweight American assets. The cleanest-shirt-in-the-laundry basket has finally begun to smell like the rest of the dirty pile. If you are going to wear something, at least pick something that has been sitting at the bottom.
Kevin Muir

On the face of it, the starting position in the US appears to be undoubtedly good. Very good, in fact: Unemployment has fallen to its lowest level since 1968, the Federal Reserve has increased its monetary policy leeway by implementing nine rate hikes and QT, the construction sector is booming, commercial banks have been able to increase their profits much more strongly than European banks, and the stock market is rushing from one all-time high to the next. **At 122 months and a total increase of 278%, the current bull stock market is one of the longest and strongest in US history, as the following chart shows. Indeed, confidence and trust in the US economy and the US stock market seem to know no limits at the moment.**

S&P 500 bull and bear markets, 01/1920-05/2019



Source: Bloomberg, Robert Shiller, Incrementum AG



Courtesy of Hedgeye

Let us now turn to the US dollar and its recent trend. At first glance, the dollar seems to be showing its muscle and thus confirming the strength and stability of the US economy. Apart from a pronounced phase of weakness in 2017, the DXY has moved in only one direction since the end of 2011: upwards.

Therefore, there are also numerous proponents of a strong US dollar thesis among the gold bulls. Among them is our esteemed colleague Brent Johnson, who makes the following arguments in favor of a stronger greenback:[34]

- **Capital flows to the US as a consequence of global economic cooling and the high interest rate differential:** The US dollar remains the safe-haven currency of choice in the event of a political or economic crisis.
- **11trn USD in foreign debt:** De facto the whole world has a shortage of US dollars. Since these countries can only repay their debts in US dollars, devaluation of their own currencies leads to an increase in the real value of their USD-denominated debt, which in turn spurs greater demand for US dollars.
- **Elections to the EU Parliament:** If populist candidates continue to gain votes, this anti-establishment movement could undermine confidence in the euro.
- **Raising the US debt ceiling:** Raising the debt ceiling is bad for the dollar in the long run. But in the short run it means that the biggest buyer in the world (the US government) is buying dollars from the market and crowding others out from an increasingly tight supply.

News is not important. It is the way the market reacts to the news that is important.
Joseph E. Granville

However, for reasons that we will describe on the following pages, we tend to be in the dollar-bearish camp. In view of these reasons and given the numerous economic, political, and social trouble spots in the EU – Brexit, Italy's open rebellion against the Stability and Growth Pact (SGP) , the yellow vest protests in France, the economic slowdown in Germany – it is remarkable how little the USD has appreciated. In 2018 the DXY strengthened by just 4.3% and has oscillated between 95 and 98 since the beginning of the year. Looking at the monthly chart of the DXY Index, we can see that a SHS formation might be in the making.

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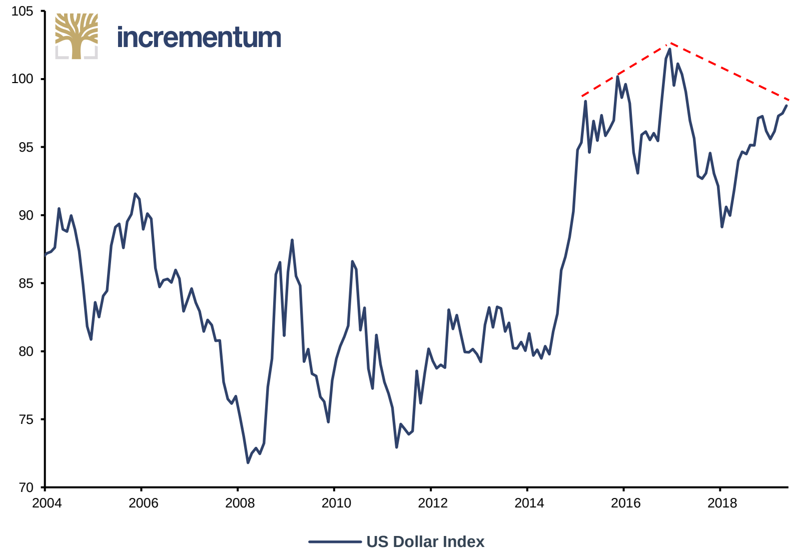
34 We recommend the presentation "The Dollar Milkshake Theory", by Brent Johnson.

US Dollar Index (DXY), in points, 01/2004-05/2019



Source: Federal Reserve St. Louis, Incrementum AG

Time takes everybody out; time's undefeated!
Rocky Balboa

A further indication that the US dollar could slowly but surely lose its status as a classic safe-haven currency is the fact that in the course of the sharp correction of the stock markets in Q4/2018 the greenback strengthened only marginally. **We regard this as a prime indication of a US dollar bear market, whose starting signal has not yet been apprehended by the majority of investors.**

DXY, gold, and S&P 500, price performance in %, 2000-2018

Period of dollar weakness	DXY	Gold	S&P 500
06.02.2002–23.07.2008	-26.85%	221.71%	14.74%
11.03.2009–02.12.2009	-12.56%	27.39%	60.23%
26.05.2010–27.07.2011	-11.06%	36.94%	25.17%
28.12.2016–31.01.2018	-10.14%	17.86%	25.11%

Source: Euro Pacific Capital, Incrementum AG

Last year we asked the crucial question: *What will happen to the US dollar if the current Goldilocks scenario is called into question, recession concerns arise, and the Federal Reserve is forced to reverse its monetary policy?*

I want a dollar that does great for our country, but not a dollar that's so strong that it makes it prohibitive for us to do business with other nations and take their business.
Donald Trump

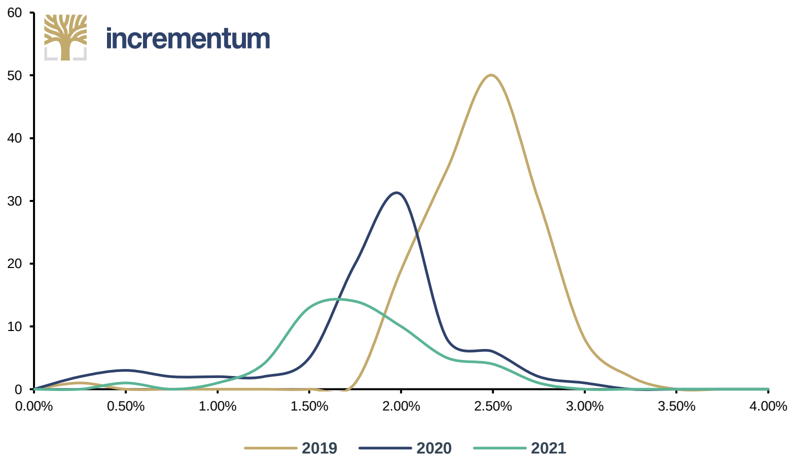
From our point of view, the US dollar is already discounting future economic weakness. The economic situation in the USA still seems to be on the sunny side, but the picture has already clouded over the past few months.

Over the past 100 years, the US economy has fallen into recession on average every six and a half years. More than ten years have now passed since the last recession, and yet the mainstream does not expect an immediate economic downturn in the foreseeable future, but only in the next 2-3 years. In view of the almost limitless hubris, the surprise potential appears to be clearly asymmetrical. Last year we wrote in a sarcastic way: *"At the moment, a decline in US economic output seems as unlikely to most economists and market participants as Vin Diesel coming home with an Oscar, or the national football team of Fiji winning the World Cup."*[36]

Compared to last year, there has been a slight change of perception, but a recession still seems less likely to the market consensus than the San Francisco 49ers bouncing back next year to win the Super Bowl.

Of 87 analysts surveyed by Bloomberg, not a single one currently expects US GDP to contract in 2019, 2020, or 2021.[37] The expected median and average growth in these three years is between 1.8% and 2.4%. Compared to the previous year, however, growth expectations have already declined slightly (from 2.1%-2.8%).

Expected real economic growth 2019/2020/2021 in %, number of analysts



Source: Bloomberg, Incrementum AG

We know that most likely every market participant was forced to take on more risk in recent years, but we don't know how much more because we don't know the price of money.
Vitaliy Katsenelson

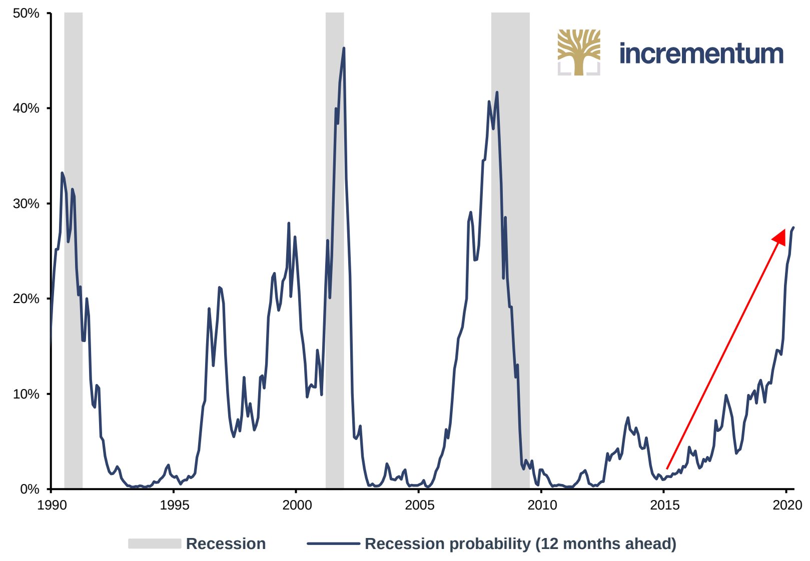
The rather poor forecasting ability with regard to recessions has recently been confirmed by numerous studies: According to a study by Fathom Consulting, the IMF has correctly predicted only 4 (!) of 469 downturns since 1988. Since 1988, the IMF has never predicted a recession in an industrialized country with a time lead of more than a few months.[38] An IMF working paper found that out of 153 recessions in 63 countries, only five were forecast by a consensus of private economists in April of the previous year.[39]

Meanwhile, however, it appears that signals of a US recession are slowly increasing. For example, the Federal Reserve's recession indicator currently indicates a recession probability of 27.5% for April

[36] *See* "White, Grey and Black Swans", *In Gold We Trust* report 2017
[37] By the way, NO analyst expected a recession in 2007 either!
[38] *See* Bridgen, Andrew: "The economist who cried wolf?", *A sideways look at economics*, Fathom Consulting, February 1, 2019
[39] An, Zidong, Jalles, João Tovar and Loungani, Prakash: "How Well Do Economists Forecast Recessions?", *IMF Working Paper*, No. 18/39, March 5, 2018

2020.[40] In the past 30 years, this figure has never been so high if there was no recession in the following two months.

US recession probability, in %, 01/1990-04/2020e



Source: Federal Reserve New York, Incrementum AG

Historically the inversion of the yield curve has been a good sign of economic downturns, but this time it may not.
Ben Bernanke

The best track record for recession forecasts is clearly to be found in the yield curve. A study recently published by the San Francisco Federal Reserve shows that inverse yield curves have announced most recessions since the 1950s.[41]

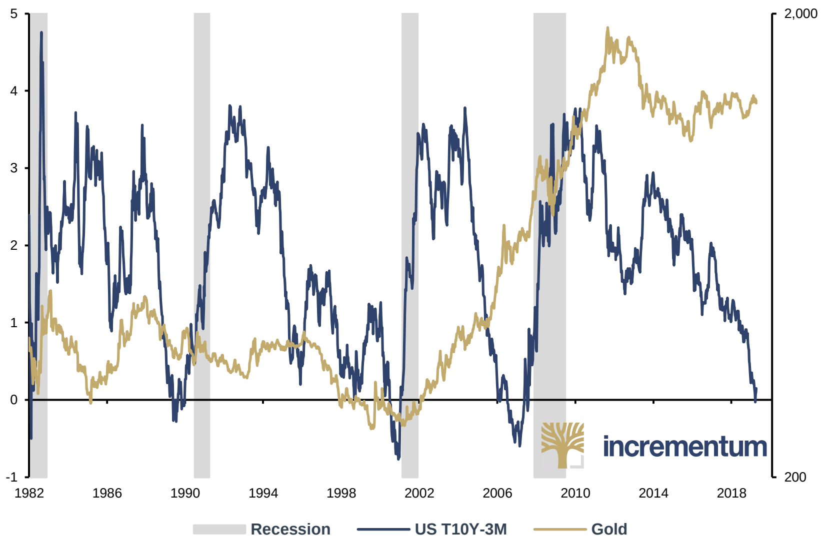
Courtesy of Hedgeye

The logic behind that fact is the following: In anticipation of an economic downturn, investors reduce their demand for short-term bonds and shift their demand to longer-term bonds, whose prices thus rise and whose yields fall even further compared with short-term bonds. For its part, the declining demand for short-term bonds raises interest rates at the short end. **The next chart shows**

[40] The exact methodology of the recession indicator can be found here.
[41] *See* Bauer, Michael D. and Mertens, Thomas M: "Economic Forecasts with the Yield Curve", *FRBSF Economic Letter*, March 5, 2018

this intertemporal allocation shift in an inverse yield curve with a negative slope.

Interest spreads on benchmark US government bonds, in % (left scale), and gold price, in USD (log, right scale), 01/1982-04/2019



Source: Federal Reserve St. Louis, Incrementum AG

It's not a matter of if; it's a matter of when. And I could be early on the call as I was back in 2007, but I am suggesting that, if you don't open the umbrella, just make sure you have one on you.
Dave Rosenberg

From an empirical point of view, the narrowing of interest spreads is typically followed by an economic downturn and then by the appreciation of gold. Especially since the Nixon shock in 1971, this chronological sequence can be regularly observed. **The current structure of the yield curve inevitably raises the question of whether the stability of the banking and credit sector is at risk in the current refinancing carousel and whether systemic risks may not be on the rise.**

Modern Monetary Theory (MMT) – The new darling of the inflationists?!

> *"Modern Monetary Theory is an argument that would be wonderfully familiar to every sovereign since the invention of debt. It is essentially the argument that significant sovereign debt is a good thing, not a bad thing, and that budget balancing efforts on a national scale do much more harm than good."*
>
> Ben Hunt

Another gateway to an even looser monetary policy is the "Modern Monetary Theory" (MMT), which is finding more and more supporters, especially in the US.[42]

According to Wikipedia,

> "MMT is a heterodox macroeconomic theory that describes currency as a public monopoly for a government and unemployment as the evidence that a currency monopolist is restricting the supply of the financial assets needed to pay taxes and satisfy savings desires. MMT is seen as an evolution of chartalism and is sometimes referred to as neo-chartalism.
>
> MMT advocates argue that the government should use fiscal policy to achieve full employment, creating new money to fund government purchases. The primary risk once the economy reaches full employment is inflation, which can be addressed by raising taxes and issuing bonds, to remove excess money from the system.
>
> MMT states that a government that can create its own money, such as the United States:
>
> - Cannot default on debt denominated in its own currency;
> - Can pay for goods, services, and financial assets without a need to collect money in the form of taxes or debt issuance in advance of such purchases;
> - Is limited in its money creation and purchases by inflation, which accelerates once the economic resources (i.e., labor and capital) of the economy are utilized at full employment;
> - Can control demand-pull inflation by taxation and bond issuance, which remove excess money from circulation, although the political will to do so may not always exist;
> - Does not need to compete with the private sector for scarce savings by issuing bonds."

There's nothing to prevent the federal government creating as much money as it wants in payment to somebody.
Alan Greenspan

In short, this means that public debt and budget deficits are not a problem. The central bank or the Treasury could always provide additional liquidity, and a state could therefore never become overindebted or illiquid in its own currency. As issuers of fiat money, states are, in the opinion of MMT advocates, unlimitedly solvent. As long as real resources such as labor remain outside of the economic process, i.e., are "idle", they can be activated by the state, creating additional demand with newly issued money.

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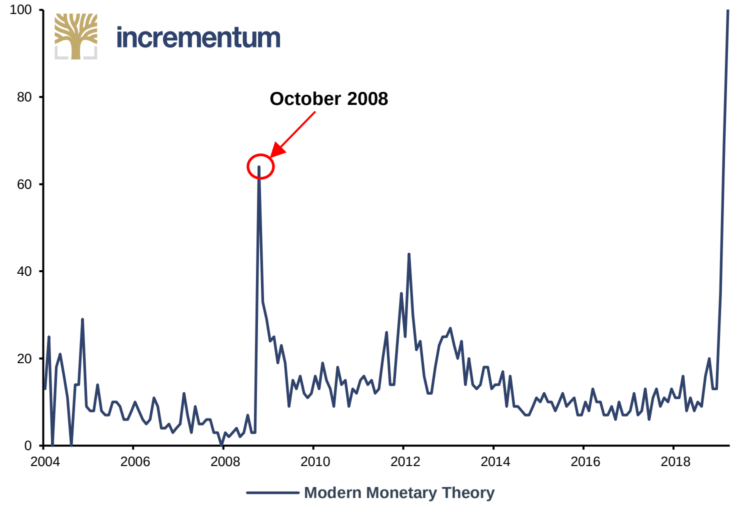
[42] We first discussed MMT in 2016: "Inflation and Investment", *In Gold We Trust* report 2016. For a profound analysis of MMT *see* Pater Tenebrarum: "The Revival of Chartalism", *Acting Man,* May 23, 2011; Reknr hosts: The MMT Podcast, especially episode 13; Randall Wray: *Modern Money Theory;* "Everything you wanted to know about MMT (But were afraid to ask)", *Macro Tourist,* January 30, 2019

Google searches for "Modern Monetary Theory", 01/2004-03/2019



Source: Google, Incrementum AG

MMT is the theoretical justification for the economic policies of every potential Democratic presidential candidate in 2020. Because with MMT, you CAN have it all. You can pay for wars without end. You can pay for universal single-payer healthcare. You can pay for everyone to go to college. You can pay for a universal basic income.
Ben Hunt

MMT postulates that the strict functional distinction between fiscal and monetary policy – the violation of which is reflected, for example, in the actions brought against the ECB's various extraordinary measures – should be abolished. **This approach is a carte blanche for politicians to throw their already modest budget discipline completely overboard. In contrast to helicopter money, MMT enables the state to be permanently financed by the central bank. The theory is not entirely modern, however, because direct financing of the state by means of the printing press was already implemented in the Weimar Republic – and ended catastrophically.**[43]

In the USA, which is already in the early campaigning phase for the elections in 2020, these ideas are enjoying great popularity. One example is the idea of a "Green New Deal", a term deliberately modeled after Franklin D. Roosevelt's "New Deal". Others want to finance an unconditional basic income, massive investments in infrastructure, or significant tax cuts once budget and debt barriers are abolished by the application of MMT. The tax cuts pushed through by the Trump administration in 2017, for example, are also in line with the basic tenets of MMT.[44]

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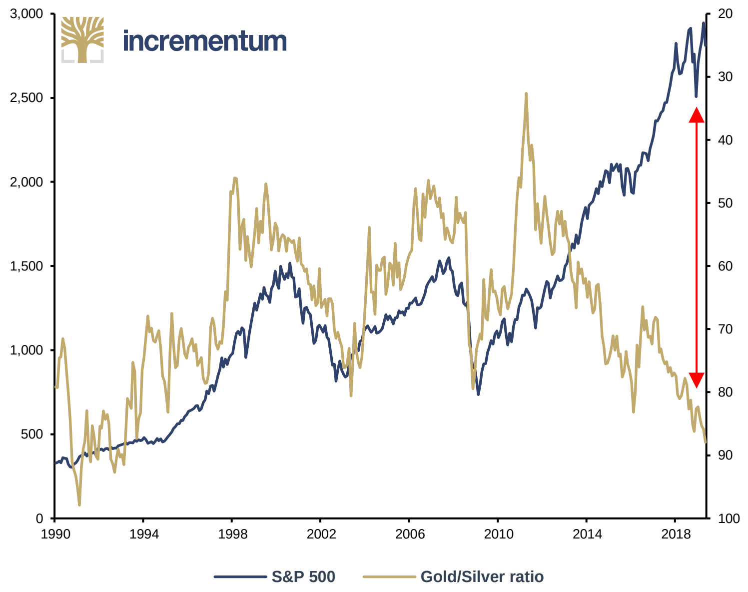
43 *See* Stelter, Daniel: "Wie die machtlose EZB zur Gefahr für die Märkte werden kann" (How the powerless ECB can become a threat to the markets), *WirtschaftsWoche*, 11 April 2019
44 *See* "Practitioner's Guide to MMT: Part 2", The MacroTourist, April 24, 2019

S&P 500, and gold/silver ratio (inverted), 01/1990-05/2019



Source: Investing.com, Incrementum AG

Don't underestimate how pissed off the average American is….! Monetary stimulus with fiscal austerity doesn't do anything except make the rich richer.
Kevin Muir

Since 2011, disinflationary forces have provided a tremendous tailwind to financial assets one more time. The relationship between financial assets and the gold/silver ratio in particular drives this point home, as depicted in the chart above. Since the early 1990s there has been an astonishing synchronization: A rising stock market usually goes hand in hand with a falling gold/silver ratio, i.e. an outperformance of silver compared to gold. **However, in 2012 this correlation broke down.**

Our interpretation for this phenomenon is that in previous economic cycles reflation was conventionally achieved by expanding credit. This has a fast impact on the real economy and leads to rising consumer price inflation. This time, reflation was achieved by buying securities, which made monetary assets in particular more expensive but did not sustainably fuel consumer price inflation.

MMT is the sovereign-friendly justification for deficit spending without end.
Ben Hunt

In contrast to QE, MMT will have a much more direct effect on the inflation rate. QE has a direct impact only on the yields of the purchased bonds. Second-round effects may be inflationary, provided that economic agents use the lower refinancing costs for additional expenditures. **MMT, on the other hand, will increase demand more directly and rapidly through higher budget deficits and will bring inflationary price increases with it. This applies in particular to markets that are at or close to their capacity limits, such as the construction sector.**

Holders of financial assets had a great run riding the 35-year wave of declining rates and rising asset values. The return trip won't be nearly as much fun.
Simon Mikhailovich

If implemented, MMT would bring the decade-long bond rally abruptly to an end, and significantly higher yields seem inevitable. More generally, financial assets would tend to suffer, while real assets as well as gold should benefit from the surge in inflation.[45]

30-year US government bonds, in %, 01/1980-03/2019

Source: Investing.com, Incrementum AG

Increasing political pressure on central banks

> *"I am certainly concerned about the independence of central banks in other countries, especially the most important country in the world."*
>
> Mario Draghi

QE is a stagflation machine for market-world, where we've inflated prices for fin'l assets and crushed productive corporate growth. MMT will be a stagflation machine for real-world, where we will inflate prices for goods/services and crush productive private sector growth.
Ben Hunt

But it is not only monetary theorists and economists who are tending the pendulum in the direction of a further easing of monetary policy. The appointment of leading central bankers is not surprisingly guided by (party) political interests, but the explicit intervention of politicians in monetary policy was previously associated exclusively with banana republics.

This has changed recently. At the International Monetary Fund's spring meeting in Washington, the executive director of the International Monetary Fund, Christine Lagarde, and the outgoing president of the ECB, Mario Draghi, felt compelled to warn urgently against curtailing the independence of central banks.

Draghi's criticism was hardly covert with regard to the US, where President Donald Trump had criticized Federal Reserve policy for some time. In October 2018, after the Federal Reserve raised interest rates again, he tweeted that in his opinion the Fed had *"gone crazy"*. In the eyes of President

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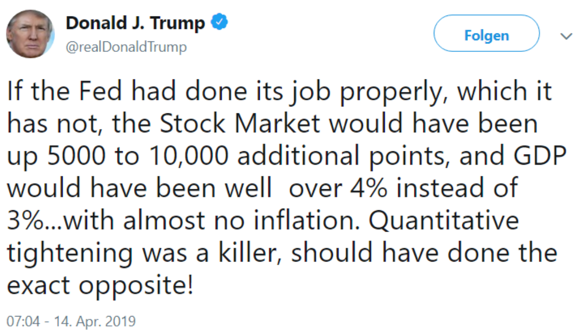
45 *See* "Practitioner's Guide to MMT: Part 2", The MacroTourist, April 24, 2019

Trump, who himself appointed Jerome Powell as chairman of the Federal Reserve, the monetary policy pursued by Powell is disastrously tight.

Independence has served them well and hopefully will in the future.
Christine Lagarde

In December, the Federal Reserve raised interest rates once again, probably to demonstrate that it is not acting at Trump's beck and call. But Trump will not be content with trying to end the interest rate hikes, because the US presidential election in November 2020 is already casting a long shadow. "It's the economy, stupid": A US economy that is clearly losing momentum would significantly reduce Trump's chances of being re-elected. During the spring meeting of the IMF he tweeted:[46]

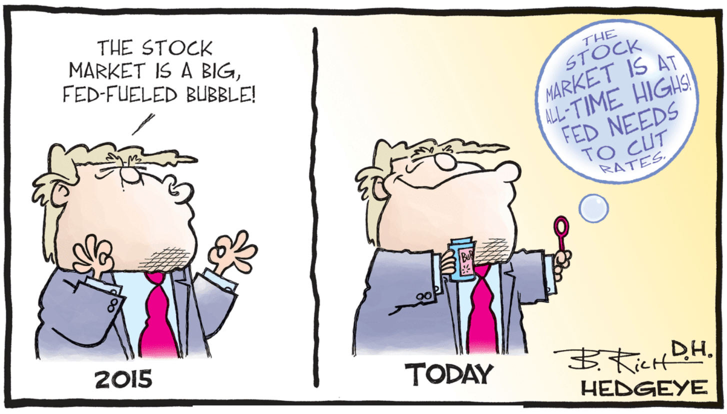

Donald J. Trump
@realDonaldTrump
Folgen

If the Fed had done its job properly, which it has not, the Stock Market would have been up 5000 to 10,000 additional points, and GDP would have been well over 4% instead of 3%...with almost no inflation. Quantitative tightening was a killer, should have done the exact opposite!

07:04 - 14. Apr. 2019

It is probably a central feature of Donald Trump's character that he resists institutional limitations. Lagarde's and Draghi's statements are explicit, however: The incumbent US president should respect these limits. Otherwise, it is feared, a loss of confidence in the independence of the Federal Reserve could undermine confidence in the stability of the dollar, which in turn would fuel inflation. Such a loss of trust would only be repairable – if at all – at great cost and effort.

On the other hand, the withdrawal of Stephen Moore, nominated by President Trump for the Federal Reserve Board, from the appointment process is interpreted as a victory for the independence of the Federal Reserve. Even the Republican-dominated Senate, which has to confirm the nominated candidate, had expressed considerable concern that Moore's too-close proximity to President Trump could seriously jeopardize the institutional independence of the Federal Reserve.



Courtesy of Hedgeye

[46] Donald Trump: Tweet, April 14, 2019, 7:04

On this side of the Atlantic, the left- and right-wing populist government in Italy is once again toying with the idea of nationalizing the Banca d'Italia's large gold reserves in order to finance widening budget deficits through the partial sale of the world's third-largest gold reserves of 2,451.8 tonnes.[47] Such a step would massively jeopardize confidence in the independence of the Italian central bank, which in turn would have a negative impact on the euro. Given Italy's profound structural problems, these populist motivations will not disappear in the foreseeable future.

Conclusion

Despite all the difficulties, the US is still the undisputed global economic locomotive. If the US coughs, the rest of the world gets the flu. How solid the US economic foundation – and thus the US dollar – really is will only become apparent in the next crisis. **However, we are convinced that the boundless confidence in the US economic engine and the US dollar might begin to crumble in the coming months.**

Status Quo of Gold Relative to Stocks and Commodities

> *"Although there is no explicit reason why a commodity bear market bottom should coincide with a speculative stock market top, the fact remains that it happened twice before, and history suggests it's about to happen again—another data point suggesting that today's commodity bear market is rapidly drawing to a close."*
>
> Leigh Goehring & Adam Rozencwajg

Bonds and stocks really are just trading off non-market dynamics that would have made Grigory Potemkin very proud.
Dave Rosenberg

Not only absolute performance but also relative performance – especially in comparison to stocks and commodities – is important for a comprehensive analysis of the status quo of the gold price. Thus on the following pages we examine the relative valuation and trend strength of gold compared to other asset classes in order to better understand the opportunity costs of an investment in gold.

Loyal readers know: We regard the continued positive stock market performance as currently the largest opportunity cost of gold. In this respect, a significant outbreak of the gold price could only be accompanied by a stagnating or weaker equity market. A comparison of the development of the gold price with the development of the most important stock market indices shows that the relative weakness of gold seems to be coming to an end on the quiet.

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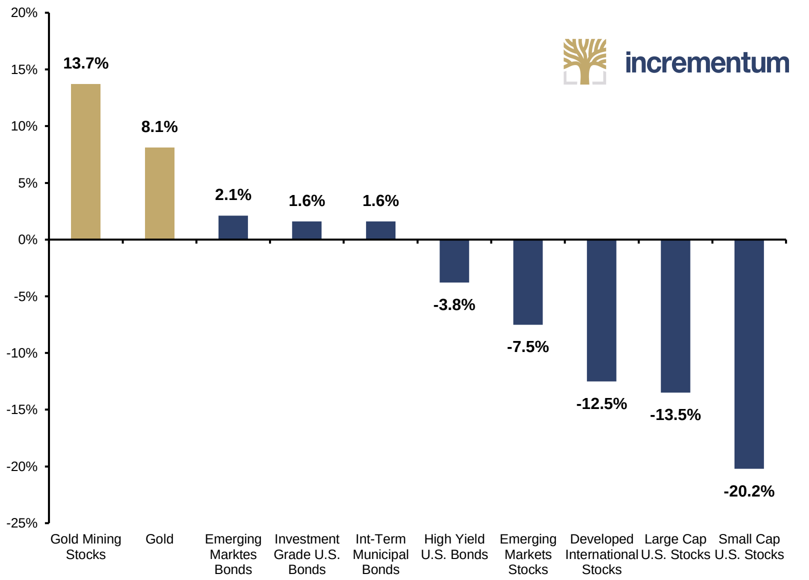
[47] *See* "Salvini schielt auf Goldschatz – Verkauf ‚interessante Idee'," (Salvini has a eye on the gold treasure – sale 'interesting idea'), Reuters staff, February 11, 2019

…relative to financial assets, the GSCI is at one of its lowest points in history. That has historically been resolved by commodities putting on a stunner of a show, stoking inflation. I wouldn't be surprised if that happened again.
Paul Tudor Jones

What happened in Q4/2018, when almost every asset class sold off, seems particularly remarkable to us. The S&P 500 was still up a comfortable 9% in the first three quarters, before a sell-off started in October and culminated in December in the weakest performance since the Great Depression. This seems particularly significant as Q4 usually has the best seasonal performance. On a sector basis, only 7 of the 121 industry groups in the S&P 500 reported positive performance. At the top: **gold mining stocks gained 13.71%.**

Performance by asset class, in %, Q4/2018

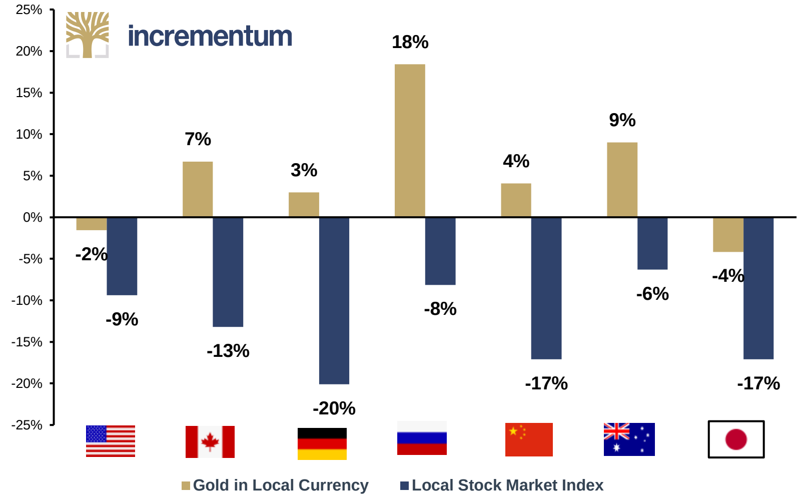


Source: Federal Reserve St. Louis, Investing.com, Incrementum AG

A nation's exchange rate is the single most important price in its economy. It will influence the entire range of individual prices, imports and exports and even the level of economic activity.
Paul Volcker

Due to the sharp stock market slump in Q4, 2018 as a whole was a good year for gold relative to major stock indices. For the first time in many years, the seemingly untouchable competitive advantage of stock markets has been seriously questioned. Gold has outperformed all major domestic equity markets. The gold price also showed relative strength in the USA and Japan, even if the price fell slightly in US dollars and yen. However, the losses suffered by stock market investors were respectively 7% and 13% larger than those of US and Japanese gold investors. In Germany, gold investors achieved a return of plus 3%, while the DAX recorded a remarkable loss of 20%.

Gold in local currency, and domestic stock index, annual performance in %, 2018

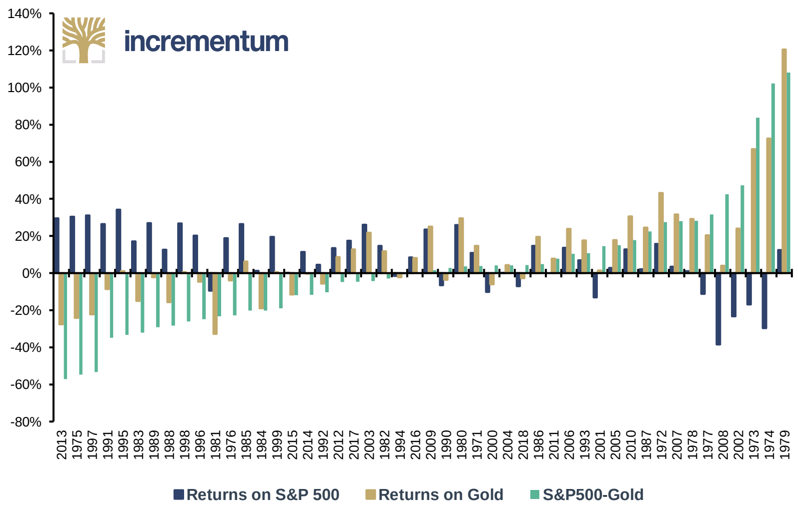


Source: Bloomberg, Incrementum AG

In prosperity prepare for a change; in adversity hope for one.
James Burgh

This comparison clearly confirms our thesis of gold (and mining stocks) as a portfolio stabilizer. This can also be clearly seen from the following chart, which shows the price developments of the S&P 500 and gold. Gold performed poorly compared to the S&P 500 in those years when the S&P posted very high gains. Gold, on the other hand, recorded the highest relative gains compared with the S&P in those years in which the S&P did poorly – with the exception of the special year 1979.

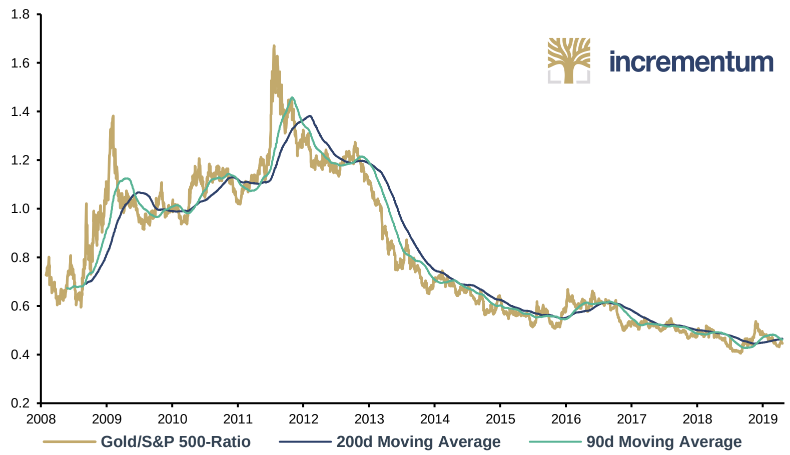
S&P 500 vs. gold, year-on-year change and difference in change, in %, 1971-2018



Source: Federal Reserve St. Louis, Incrementum AG

The sharp correction in the stock markets in Q4/2018 has now been more than offset. Gold therefore continues to exhibit some relative weakness as the following chart of the Gold/S&P 500 ratio clearly shows. The trend of an ounce of gold buying fewer and fewer shares of the S&P 500 has not yet been broken, but the purchasing power of gold measured against the S&P 500 seems to at least be stabilizing.

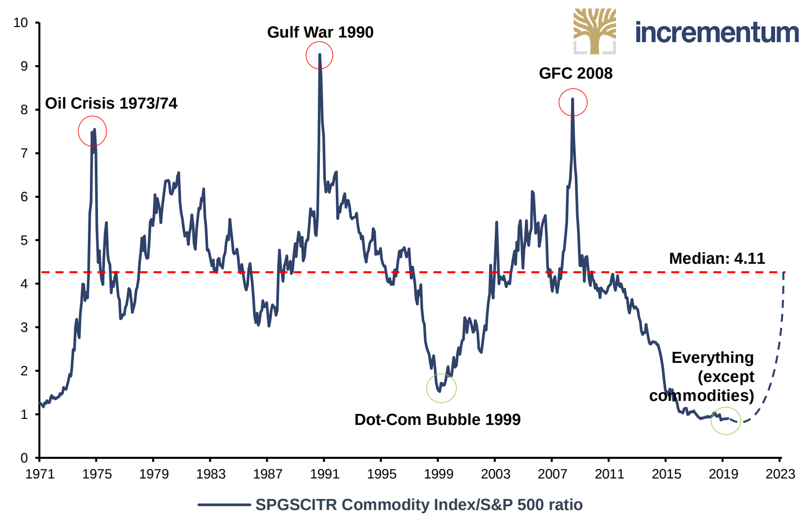
Gold/S&P 500 ratio, 50-day and 200-day moving averages, 01/2008-05/2019



Source: Federal Reserve St. Louis, Incrementum AG

Now let's take a look at the performance of gold relative to commodities. The following chart was by far the most cited one in last year's *In Gold We Trust* report.[48] It is an outstanding illustration of the fact that commodities have traded at an extremely favorable valuation relative to equities, historically. In relation to the S&P 500, the GSCI Commodity Index (TR) stands at 0.9 and thus significantly below the long-term median of 4.11 and light years away from its peaks.

GSCI (TR) / S&P 500 ratio, 1970-2019



Source: Prof. Dr. Torsten Dennin, Lynkeus Capital, Bloomberg, Incrementum AG

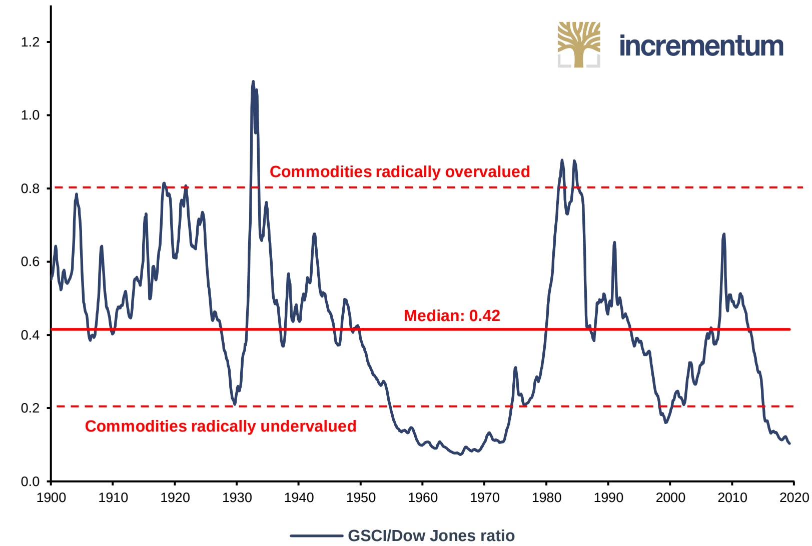
[48] We would again like to thank Prof. Dr. Torsten Dennin (Lynkeus Capital), who had the idea for this magnificent chart.

Commodities with lowest valuation in 100 years?

You can't be serious!
John McEnroe

Now we want to take a view of the commodities sector over an even longer time span.[49] The next chart shows that commodities are currently trading at their lowest level relative to US equities since the 1960s. **Moreover, there were only two other occasions when commodities were similarly undervalued relative to equities: just ahead of Black Thursday on October 24, 1929, and during the excesses of the dotcom bubble.**

GSCI/Dow Jones Industrial Average ratio, 1900-2019



Source: Goldman Sachs Commodity Index since 1970, Goehring & Rozencwajg Commodity Index pre-1970, Bloomberg, Incrementum AG

Now let's take a closer look at the last two phases in which commodities were so cheaply valued compared to equities and then entered a secular bull market:

- **1970s:** The foundation of the gold and commodity bull market (or USD bear market) was already laid in the 1960s. While the US dollar had been defined as the weight and price of gold for 180 years,[50] the pressure to devalue the US dollar increased dramatically in the 1960s due to exploding budget deficits, because of the Vietnam War and other factors. The expansion of the money and credit supply manifested itself at first only in rising share prices, in particular the prices of the infamous "Nifty Fifty"[51], which were at the epicenter of the stock market mania. While the broad stock market had a P/E ratio of 20 in the early 1970s, the Nifty Fifty had a P/E ratio of 50. Subsequently, a long-term bear market set in on the US stock market – particularly on a real basis. Most of the Nifty Fifty stocks collapsed by 90% or more. Adjusted for inflation,

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49 Our thanks to Leigh R. Goehring and Adam A. Rozencwajg: "Commodities at a 100-Year Low Valuation"?
50 Until the Gold Standard Act (1900), the US was on a bimetal standard, which effectively ended with the Coinage Act (1873).
51 Wikipedia entry "Nifty Fifty"

the Dow Jones ended the decade with a minus of 48%. The GSCI, on the other hand, recorded a considerable increase of 700%.[52]

- **2000s:** Due to oversupply and clearly negative sentiment, the oil price collapsed around the turn of the year 1998/1999 to below USD 12/barrel, the lowest level since the Great Depression after adjusting for inflation. Boundless pessimism spread in the commodity sector, but it was overlooked that the rapid and broad industrialization of China and other emerging markets would significantly increase demand for commodities. In addition, investment in technology and exploration was neglected for years, resulting in a rapid rise in oil prices to USD 138 per barrel in the summer of 2008. The markets were further supported infamous "Greenspan put". The rally finally came to an end in the sharp recession of 2008/2009, following the Great Financial Crisis of 2007/2008.

It's important to highlight that both periods of extremely depressed commodities prices (1970 and 2000), were accompanied by overvalued equity markets and related investment bubbles—a situation that exists once again today.
Leigh Goehring & Adam Rozencwajg

The parallels between the 1970s and 2000s on the one hand and today's situation on the other hand are astounding. Each time, an expansionary monetary policy fed a period of booming stock markets. Subsequently, a decade of surging commodity prices set in. If the GSCI had been bought in 1970 and sold in 1980, an annualized return of 20% would have been achieved. The same applies to the phase from 2000 onwards, when commodities were particularly attractive as equities tended to move sideways. **In recent years we have experienced the most expansive and experimental monetary policy in history, but it has only reached commodity markets peripherally.** What were the Nifty Fifty in the 1960s were the DotComs in 2000 and are now the FAANG stocks as well as unlisted unicorns.

In our opinion, we reached the bottom of the commodity price trough in February 2016. However, investors – especially from the institutional sector, but also from the retail sector – still show little to no interest in the commodity sector. Sentiment and numerous negative arguments such as alternative energies on the rise, China on the verge of collapse, and the shale gas revolution seem commonsensical and are thus largely priced in.

Bull markets are more fun than bear markets.
Bob Farrell

It may be an anecdotal proof, but the mood at the most important industry conferences has been as exciting as a North Korean ballot count. However, we assume that the commodity sector will give us more pleasure again in the future. What's more, the real party may already have begun. **We interpret the extreme relative undervaluation of the commodity sector compared to financial assets described above as an anticyclical opportunity for contrarians with strong nerves and a long-term investment horizon.**

What may change the trend and trigger a new bull market? **From our point of view, the 2 main reasons will be:**

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[52] The apocalyptic forecasts of the Club of Rome caused a "peak everything"-panic right at the peak of the commodities mania in 1980. At exactly the same time, oil production in the North Sea, Alaska and Western Siberia started picking up. These deposits were discovered during the 1960s and 1970s. Subsequently, a 20-year-old bear market in commodities began and confirmed the old adage: "The cure for high prices is high prices."

- weakness of the US dollar
- reallocation from financial assets to real assets (MMT)

Conclusion

The upward trend on the global stock markets, which seemed unassailable for a long time, suffered a considerable setback in Q4/2018. As a result, gold – contrary to mainstream media reports – rose (significantly) in 2018 relative to stock indices everywhere, and in absolute terms everywhere except the US and Japan. However, the significant undervaluation of commodities compared to equities has not changed significantly over the past year, which is why the upside potential for commodities in general, and gold and silver in particular, remains intact.

Status Quo of Debt Dynamics

> *"Truth hurts. Maybe not as much as jumping on a bicycle with the seat missing, but it hurts."*
>
> Inspector Frank Drebin

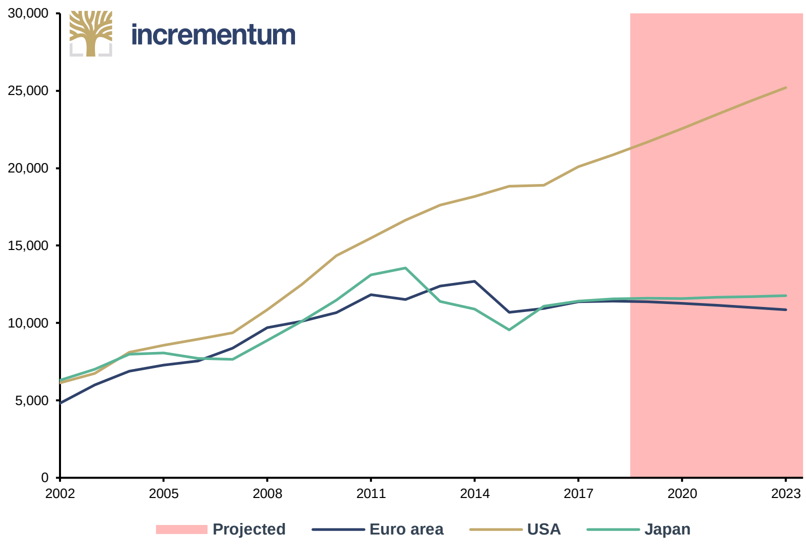
From now on, I will only spend as much as I earn – even if I have to borrow money for it.
Mark Twain

This year, too, we find it important to remember that overindebtedness is progressing briskly in most economies. The US, in particular, appears to be *pursuing* its debt policy entirely in line with the well-known cry of *Marquise de Pompadour: "Après nous le déluge!"*

The U.S. is beginning to sport a debt-to-GDP ratio worthy of any banana republic. Therefore, we believe that exposure to gold is both timely and potentially rewarding.
John Hathaway

From 2020, US government debt will exceed the combined debt of Japan and the eurozone, despite the fact that absolute US and Japanese debt were at similar levels until 2011, rising almost in step. By comparison, euro area debt is developing relatively unspectacularly. This is due primarily to Germany's falling debt level, which with the exception of 2012 has been falling steadily since peaking in 2010, and has been falling even in absolute terms since 2013. In 2018, the 2trn EUR mark was crossed downwards.

Public debt: euro area, USA, Japan, in USD bn, 2002-2023



Source: IMF, OECD, Incrementum AG

High and rising federal debt would reduce national saving and income, boost the government's interest payments, limit lawmakers' ability to respond to unforeseen events, and increase the likelihood of a fiscal crisis.
Congressional Budget Office

The forecasts of the Congressional Budget Office (CBO) for US deficits over the next ten years are worrying, as the deficit is expected to rise significantly by 2029. In every single year, the annual deficit is expected to exceed 1trn USD. **By way of comparison, in 2018 the budget deficit of the entire eurozone was just over EUR 60bn (approx. USD 67bn).** Apart from Italy, France, and Greece, the fiscal soundness of the euro area countries is quite solid. In 2018, Germany recorded a staggering general government surplus of EUR 58 billion, offsetting France's deficit almost exactly 1:1.

As described above, the situation in the US is completely different. In 2019, the debt burden will increase by another USD 1.4trn, which equals Spain's total economic output. In the next 10 years, the debt burden is expected to rise by USD 11.6trn.[53] This corresponds approximately to the combined GDP of Japan, Germany, and France. **The question arises: Who will finance these deficits and, above all, at what price?**

Courtesy of Hedgeye

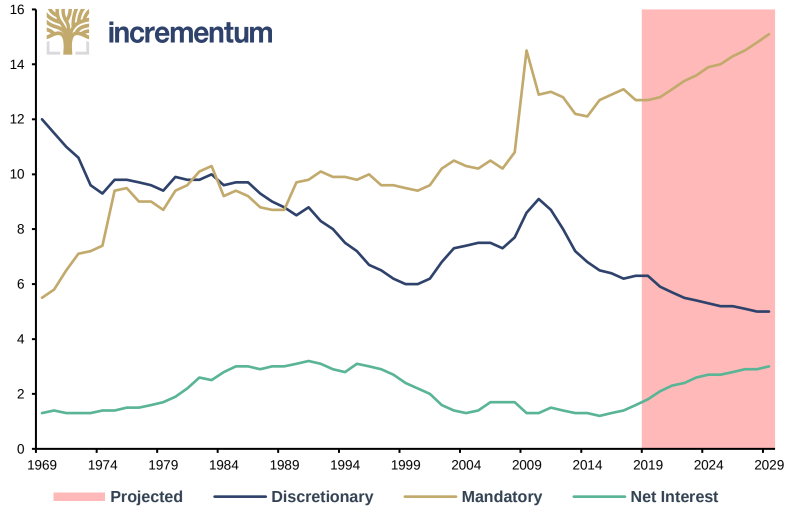
—
53 *See* Congressional Budget Office: "The Budget and Economic Outlook: 2019 to 2029", January 28, 2019

The next chart shows that the US is heading towards a situation in which ever larger parts of the budget are devoted to obligatory expenditures. Because interest payments are also rising steadily despite the low level of interest rates – according to CBO calculations, interest payments will be the third largest expenditure in 2026, the second largest in 2046, and the largest in 2048 – the scope for future-oriented expenditures as well as for infrastructure is constantly narrowing.

When a country has mortgaged all of its future revenues, the state by necessity lapses into tranquility, languor, and impotency.
David Hume

David Hume described well this decreasing room for manoeuvre in his essay "On Public Credit" in 1752: An excess of debt leads to governments pledging virtually their entire future revenues and falling into a state of dullness and inability to act. In the long run, deficits will have a negative impact on US growth potential.

US government expenditures by category, in % of GDP, 1969-2030

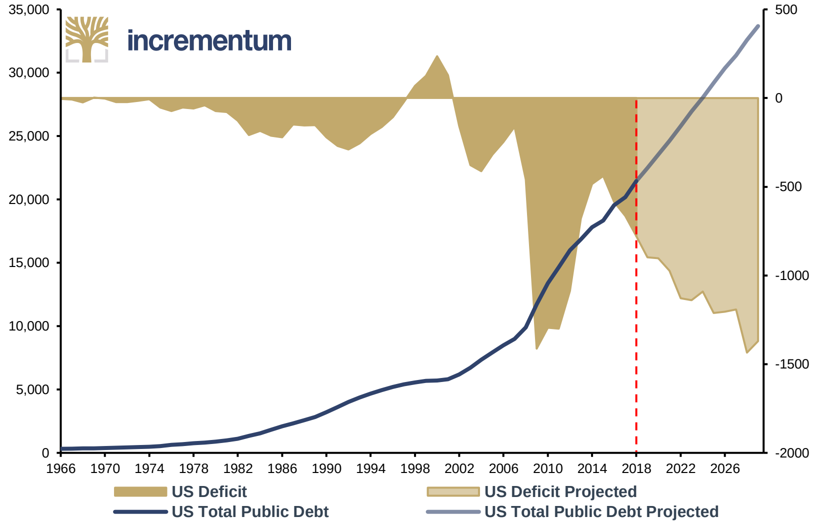


Source: CBO, Incrementum AG

It is a fact that when our national debt gets to the level ours is, that it constitutes an economic threat to society.
John Bolton,
US National Security Advisor

It should also be noted that the CBO forecasts are based on very optimistic, almost naive premises. For example, the CBO assumes that the USA will not slide into recession in the next ten years (!) and that the economy will grow by 3% annually. A very bold assumption, especially as the US economy has never experienced such a long upswing phase. Thus, the US deficit could turn out to be significantly higher within the next decade than currently forecast by the CBO.

USA: Debt, in billions of USD (left scale), and deficit (right scale), in billions of USD, 1966-2029e



Source: CBO, Federal Reserve St. Louis, Incrementum AG

To say Congress is spending like drunken sailors is an insult to drunken sailors.
Ronald Reagan

According to CBO forecasts, the deficit of USD 1,370bn in 2029 will be only slightly lower than in the crisis year 2009 (USD 1,413bn). Budget deficits of comparable size were recorded only in the period 2009-2012. **It should be noted, however, that this was a phase in which the Federal Reserve used QE to absorb almost USD 500bn per year in Treasuries.**

Conclusion

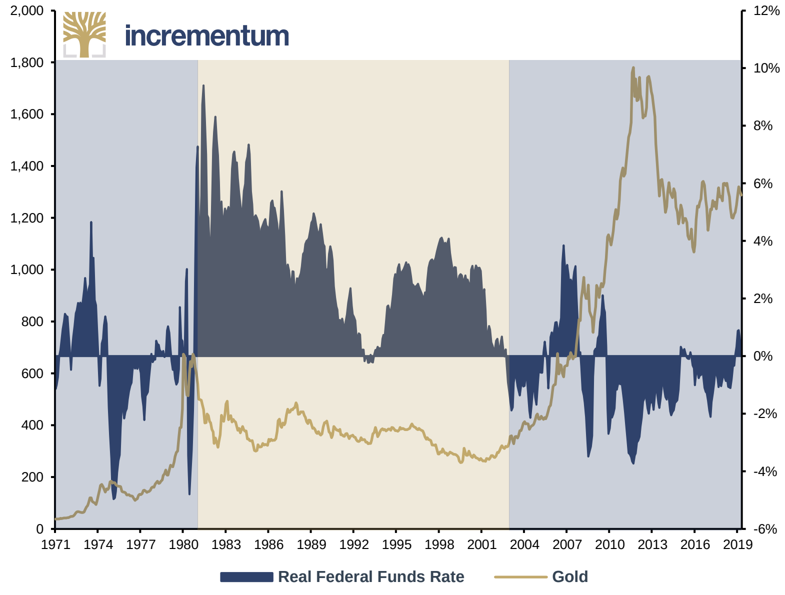
Insanity becomes invisible when it has reached a sufficiently large scale.
Berthold Brecht

Due to the – now global – high indebtedness of all sectors (government, companies, private households), deflation cannot be systemically tolerated. Deflation would further increase the real debt burden, and even higher defaults rates due to bankruptcies would be unavoidable. Because comparatively sound companies would have to adjust their balance sheets in the course of writing off losses due to bankruptcies, a cascading collapse of the debt pyramid would be difficult to prevent.

Therefore, we will wait in vain for significant increases in interest rates or clearly positive real rates in the coming years. **The world seems in large part to be caught in the zero- or at least in the low-interest-rate trap.**[54] For gold, the age of negative real interest rates, the end of which is not in sight, should have a supportive effect for the foreseeable future, since negative real rates are an excellent environment for the yellow metal, as the following chart demonstrates.

54 *See* "Sustainable Wealth Accumulation in an Unsustainable Monetary System", *In Gold We Trust* report 2017, Stoeferle, Ronald, Hochreiter, Gregor and Taghizadegan, Rahim: Die Nullzinsfalle, FinanzBuch Verlag, April 2019 (The English edition will be published in late autumn 2019.)

Gold price, in USD (left scale), and US real interest rate, in % (right scale), 01/1971-04/2019



Source: Federal Reserve St. Louis, Incrementum AG

Status Quo of Inflation Dynamics

> *"Volatility collapsed after the crisis because of central bank manipulation. That game's over. With inflation pressures now building, we will look back on this low-volatility period as a five-standard-deviation event that won't be repeated."*
>
> Paul Tudor Jones

Finally, let us take a look at the development of inflation. To us it often seems that inflation concerns are one of the most contrarian things these days. As can be seen in the picture on the left, the April 2019 *Bloomberg Businessweek* just proclaimed "the death of inflation", which reminds us eerily of the historic "Death of Equities" cover in August 1979. While many market participants will remember that cover, only few will recall the subtitle, "How inflation is destroying the stock market".[55] It appears to us that inflation pressures are slowly building and the inflation monster on the left might resurrect – especially as this is exactly what politicians and central bankers want to achieve with their monetary experiments. **With roughly USD 10.8trn in government bonds trading at negative rates, inflation seems poised to be the pain trade of the decade.** The *Businessweek* cover might be anecdotal evidence, but it shows us that lowflation is now fully priced in in everyone's asset allocation and that inflation is at risk of looming large again. **An inflection point in inflation may be close.**

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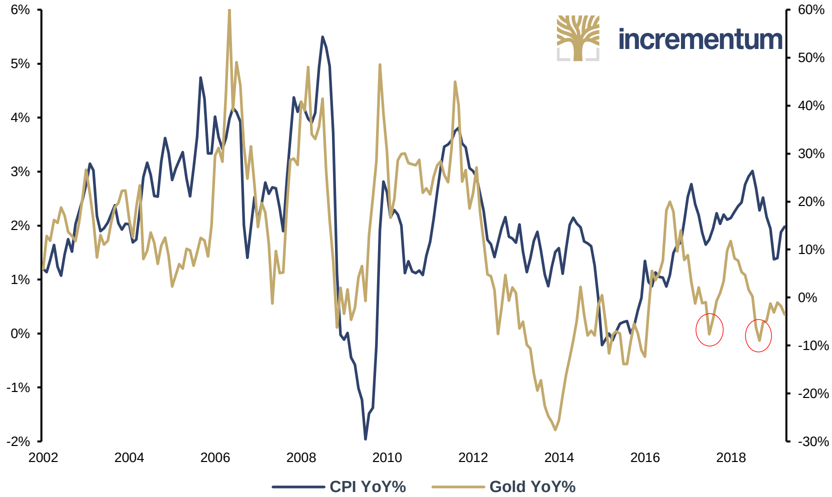
55 *See* "The Bell has been rung", Goehring & Rozencwajg Market Commentary, Q1 2019

We believe the April 22, 2019 Bloomberg Businessweek cover, 'Is Inflation Dead?', will turn out to be as historic as the 1979 cover.
Goehring & Rozencwajg

Loyal readers know that rising inflation rates generally mean a positive environment for the gold price, while falling but positive rates (=disinflation) represent a negative environment. From the end of 2011 to the beginning of 2015, the inflation trend in the US declined, but since then it has been on the rise again. In July 2018, the CPI reached an interim high of just under 3%, due largely to the base effect. Since then, price inflation has fallen again.

Price inflation (CPI), in % (left scale) and gold price in USD, rate of change in % (right scale), 01/2002-05/2019



Source: Federal Reserve St. Louis, Incrementum AG

Inflation consists of subsidizing expenditures that give no returns with money that does not exist.
Jacques Rueff

If we now look at the projection of the US inflation rate, it should bottom out at around 1.3% in the summer of 2019 and then tend to become firmer. In November and December 2018, the inflation rate fell – not least due to the falling oil price – so from the perspective of the base effect there is the prospect of an inflation increase in November and December 2019.[56]

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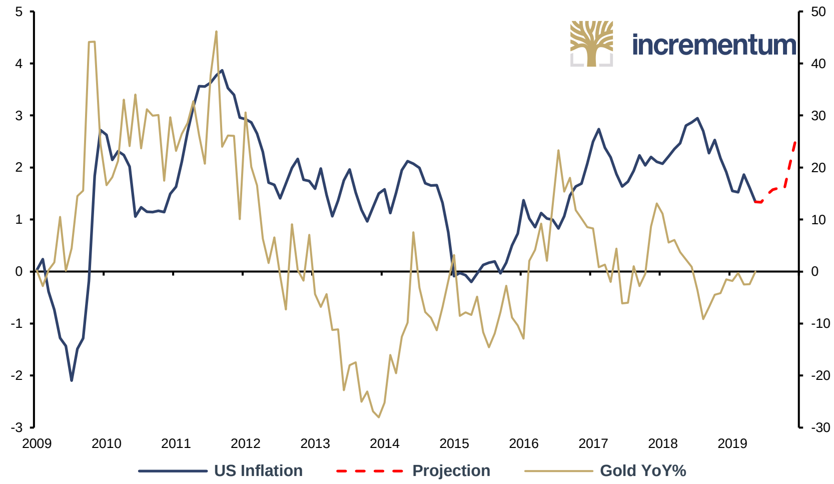
[56] *See* "Wellenreiter-Invest.de", Robert Rethfeld, May 3, 2019

US inflation rate (left scale, projection for 2019), and gold price (right scale, YoY%), 01/2009-12/2019e



Source: Wellenreiter Invest, Federal Reserve St. Louis, Incrementum AG

Incrementum Inflation Signal

Whether initially deflationary or ultimately inflationary, this profound shift ends the long period of disinflation, but it also creates the necessity for much more aggressive financial repression in the developed world.
Russell Napier

If you want to get an idea of global inflation trends, it is helpful to look at the price development of inflation-sensitive asset classes such as gold, silver, other commodities (BCOM) or gold mining stocks. These provide forward-looking information on inflation trends in the short and medium term, while conventional inflation statistics only reflect past inflation developments. These statistics are insignificant for the investor, who always tries to predict the price development in the future. We have therefore created a proprietary inflation signal to analyze the current inflation trend. **The inflation signal thus obtained forms the basis for asset allocation decisions.**

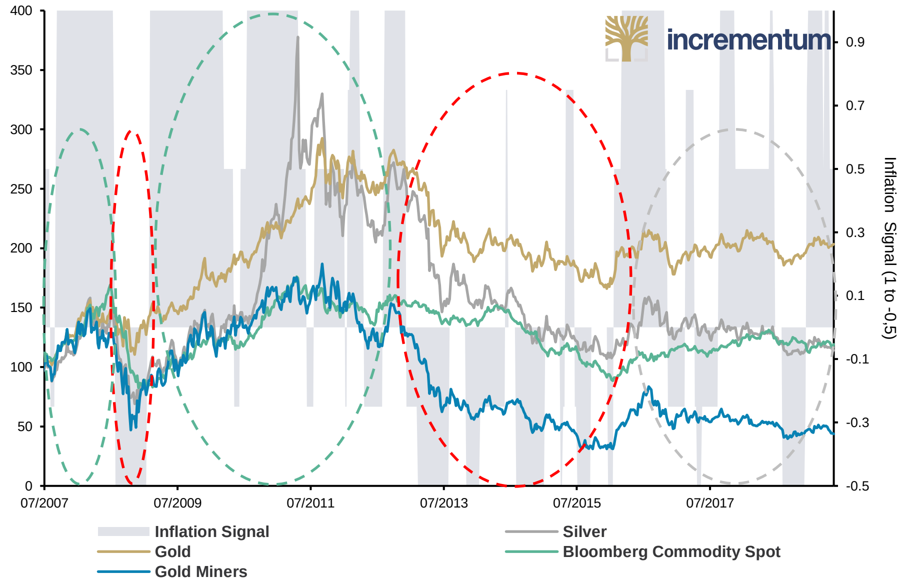
Over the past decade and a half, the following major inflationary trends have been observed:

- Inflationary phase until August 2008
- Disinflationary/deflationary shock in the wake of the Great Financial Crisis 2007/2008 until March 2009
- Reflation until 2011/2012
- Disinflationary trend until the end of 2015
- Sideways phase since the beginning of 2016

The lesson is clear. Inflation devalues us all.
Margaret Thatcher

Inflation trends were unambiguous until the end of 2015, but since then this clarity has been somewhat lost. **The large deflationary pressure should be over, but a sustained inflationary trend has not yet set in.** It is quite conceivable that the coming U-turn in US monetary policy will give the inflation trend the decisive impetus to move inflation-sensitive asset classes back into positive territory.

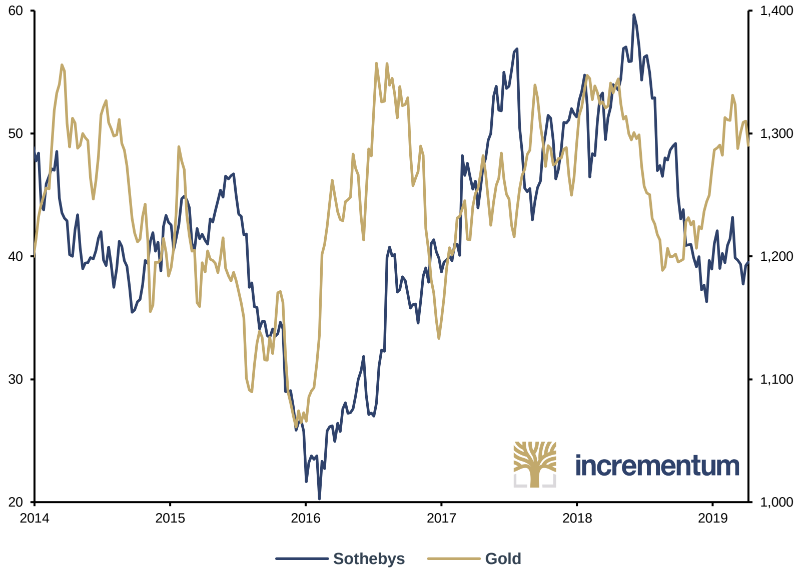
Incrementum Inflation Signal 07/2007-05/2019



Source: Incrementum AG

Let us now turn from *price* inflation *to asset price* inflation. The performance of shares of the auction house Sotheby's seem to be a good proxy for asset prices. In connection with the exit of investors out of "hot money", it appears that for the time being the great boom in the art scene is over.[57]

Share price of Sotheby's, in points (left scale), and gold price, in USD (right scale), 01/2014-04/2019



Source: Investing.com, Incrementum AG

Still, the share prices of the two French luxury goods companies LVMH Moët Hennessy and Kering, which are representative of the trend in **conspicuous consumption** (also called hedonistic demonstrative consumption)**,** show a steep

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57 *See* "Inflation vs. Deflation - The Great Showdown?", *In Gold We Trust* report 2018

upward trend. The last time the share prices of these two luxury goods manufacturers skyrocketed was in the years of the dotcom bubble. After the bursting of this bubble, the price of both shares fell even faster than they had originally risen.

Stock price LVMH (left scale), and stock price Kering, (right scale), 01/1995-04/2019

Source: Investing.com, Incrementum AG

Conclusion

Consumer prices continue to show only a restrained upward trend, a trend that central banks use to justify the continuation of their zero- or low-interest-rate policies. **Rising price inflation coupled with mounting economic risks would probably mean the perfect storm for gold: stagflation. At the moment, however, the consensus view is that this seems an almost impossible scenario.**

Status Quo of Gold Demand

> *"Central banks have three main objectives when they are thinking about reserve assets: to keep their assets safe, to keep their assets liquid, and to generate returns. Gold can help to meet all three policy objectives."*
>
> Natalie Dempster, World Gold Council

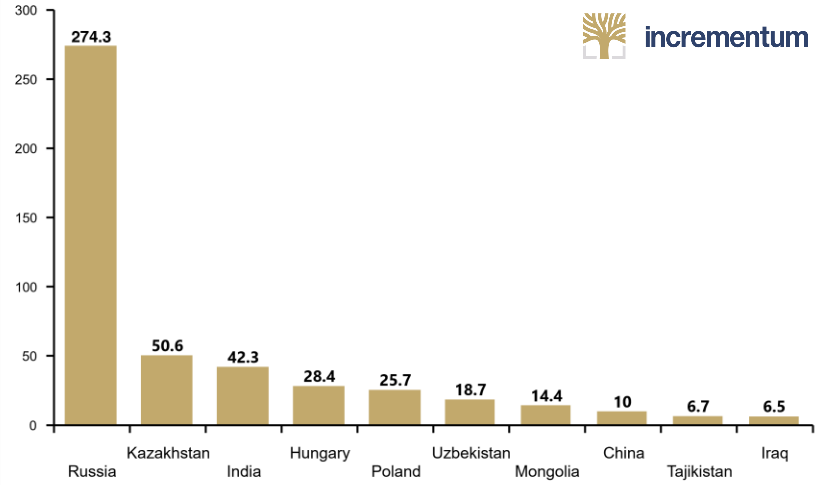
In buying 657 tonnes of gold in 2018, central banks made the largest purchases of gold since the end of Bretton Woods in 1971. Russia (274 tonnes), Kazakhstan (50 tonnes), and India (42 tonnes) were the largest buyers.

76% of central banks view gold's role as a safe haven asset as highly relevant, while 59% cited its effectiveness as a portfolio diversifier. And almost one fifth of central banks signaled their intention to increase gold purchases over the next 12 months.
World Gold Council

The high demand from central banks continued in the first quarter of 2019. According to the World Gold Council, central banks increased their gold reserves by 145 tonnes, the largest increase since 2013.[58] Russia continued its shopping spree, adding a further 56 tonnes to its reserves in the first quarter, and thus gold now accounts for 18.4% of Russia's total reserves.[59]

Central banks of some EU states were also net buyers in 2018. As mentioned in the introduction, Hungary has increased its gold reserves tenfold. Poland, also a non-euro country, is one of the top five buyers and last year made its largest purchase since 1998.

Gold purchases, in tonnes, 2018



Source: World Gold Council, Incrementum AG

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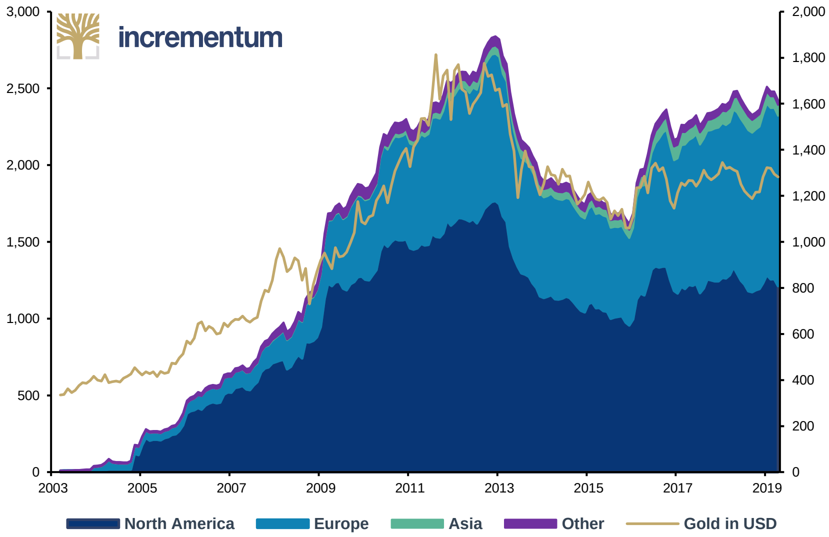
58 *See* "Gold Demand Trends Q1 2019", World Gold Council, May 2, 2019
59 *See* "Russland kauft weiter tonnenweise Gold" ("Russia continues to buy tons of gold"), Goldreporter.de, April 22, 2019

Moreover, the interest of financial investors in gold is slowly rising again. This is confirmed by the inflows into gold ETFs, which have been on the rise since the end of 2015. For us, this indicator is representative of Western financial investors, who choose ETFs as the primary instrument for managing their gold exposure. This is also reflected in the fact that gold ETF inflows follow an extremely procyclical pattern.

Geographical segmentation shows that in recent years European investors have weighted gold ETFs more strongly than their North American peers. Since 2016, European exchange-traded products (ETPs) have increased rapidly and have reached a new record high. Assets under management (AuM) in European gold ETFs rose to 2,440 tonnes at the end of 2018. This is now equivalent to 45% of the total market.[60]

We interpret this increase primarily as a consequence of the devastating zero- or negative-interest-rate environment, aggressive ECB policy, smoldering fears of recession, and political developments, as well as the rather weak stock market performance in Europe, especially relative to US markets.

ETF gold holdings, in tonnes, and gold price, in USD, 01/2003-04/2019



Source: World Gold Council, Bloomberg, Incrementum AG

Gold is forever. It is beautiful, useful, and never wears out. Small wonder that gold has been prized over all else, in all ages, as a store of value that will survive the travails of life and the ravages of time.
James Blakeley

Private investors are showing a strong interest in gold, as the recently published *Edelmetall-Atlas Schweiz* reveals. The renowned University of St. Gallen has produced this report on behalf of and in cooperation with philoro Schweiz AG.[61] After real estate but still ahead of equities and fund investments, gold ranks second among the most popular forms of Swiss investment. Almost every fifth Swiss considers it likely that he or she will buy gold in the next twelve months.

According to the report, the most important reason that investors give for buying gold is to hold it as a long-term investment, followed by

—

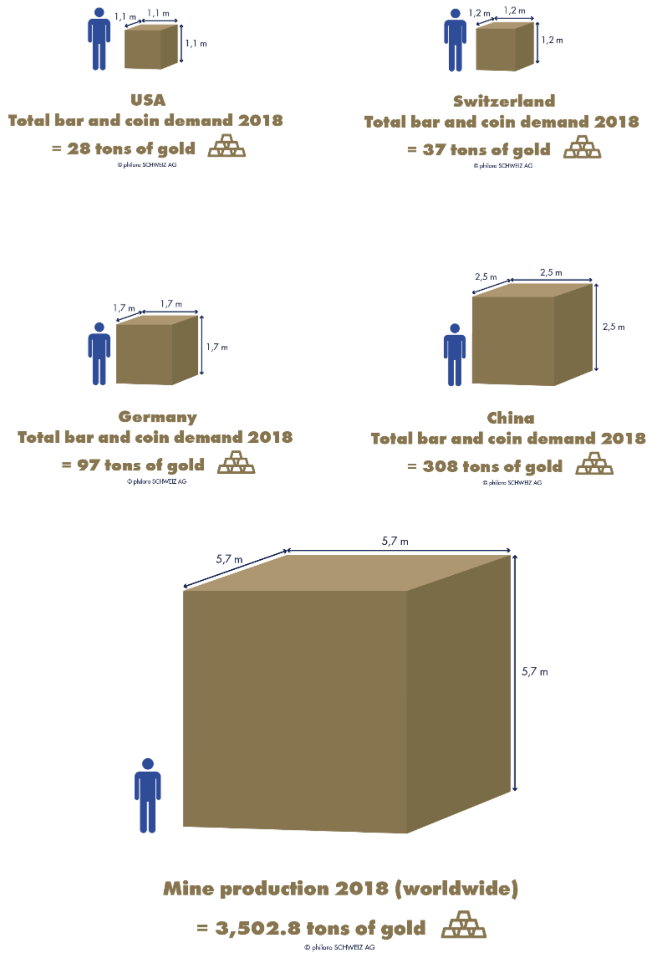
[60] *See* World Gold Council: "Market Update: European ETPs reach record highs", April 17, 2019
[61] www.goldstudie.ch

security, stability, asset accumulation, and finally return. This shows that the typical Swiss gold investor is long-term-oriented and not focused on short-term speculative gains. Interesting are also the results regarding the question as to where people prefer to buy gold. In all age cohorts, the investor's house bank ranks first; nevertheless, there are clear differences in purchasing behavior among the age groups. The older the investor, the more often the house bank is chosen. Second ranked among the youngest investors (18-29 years) is the online purchase of gold, while with the 30–39-year-olds, precious metal dealers with stationary places of business take the second spot.

O Gold! I still prefer thee unto paper, which makes bank credit like a bark of vapour.
Lord Byron

The comparatively high affinity of the Swiss for gold is summarized in the following chart. The demand for gold by private investors in Switzerland exceeds that in the US and on a per capita basis is significantly higher than the demand in Germany or China.

Gold demand USA, Switzerland, Germany, China, in tonnes, and mine production, in tonnes, 2018



Source: University of St. Gallen, philoro SCHWEIZ AG

Changes in Basel III – not a Big Deal!

In the spring of 2019, a change in the risk-weighting rules for gold in the relevant guidelines of the Bank for International Settlements (BIS), as part of the Basel III banking regulations, led to sensational reports on the gold scene. There was even talk that the gold standard would be reintroduced through the back door.

On closer inspection, however, the changes appear far less spectacular, not to say nearly insignificant. The new standards stipulate that for gold held for third parties or for gold held in another bank on an allocated basis, i.e. if the gold is covered by corresponding gold liabilities, the risk weighting has been reduced from 50% to 0%.[62]

I like gold because it is a stabilizer; it is an insurance policy.
Kevin O'Leary

A risk weighting of 50% meant that only 50% of the maximum equity capital deposit of 8%, i.e. only 4%, of the amount to be assessed had to be raised as equity. If the amount to be assessed was EUR 1,000, previously EUR 40 had to be held as equity. Under the new rules it is EUR 0. Equity is in turn a complex composition of Common Equity Tier 1, Additional Tier-1, and Tier-2 capital. These standards cover only the credit risk of a bank, i.e. the risk that a liability has to be written off in part or in full. The regulations do not deal with market risk, i.e. the risk to a bank's balance sheet from changing market prices for assets. This market risk is particularly significant when banks hold gold without a corresponding hedge.

Anecdotal evidence of three worldviews – investment demand will tip the balance on the gold scales

Like any price, the price of gold depends on the assessments of market participants. As we have seen, gold, in its capacity as a hedge against crises of trust, is thus directly dependent on the level of public trust. In an earlier *In Gold We Trust* report, we described three groups of people whose worldviews differ fundamentally in their assessment of the overall economic situation, in order to be able to better assess the expectations of market participants and thus the development of gold prices.[63] We developed these summary worldviews through countless discussions with professional market participants, including asset managers, fund managers, and private bankers.

Roughly, these three groups can be characterized as follows:

1) ***"Believers": persons with high trust in the status quo***

Well, it's too late tonight to drag the past out into the light.
"One", U2

This group of people has no fundamental doubts about the status quo. They consider the measures implemented in the wake of the Great Financial Crisis to be fundamentally correct and expedient. Following this view, the economy is in a healing process, even if it is healing slower than expected. All in all, however, "the patient" is on the road to recovery. **This view is currently the most**

—
[62] Basel Committee on Banking Supervision (BCBS): "Basel III: Finalising post-crisis reforms", December 2017. There it says under number 96: "A 0% risk weight will apply to (i) cash owned and held at the bank or in transit; and (ii) gold bullion held at the bank or held in another bank on an allocated basis, to the extent the gold bullion assets are backed by gold bullion liabilities."
[63] *See* "Where Things Stand", *In Gold We Trust* report 2016

widespread. **The proportion of gold in the portfolios structured by these individuals has been low or zero in recent years.**

> ***2) "Skeptics": people who had initial doubts about the recovery but who regained trust in the status quo***

In this camp are people who had an initial, timid distrust of the sustainability of the extreme economic policy measures taken in the last decade. In the portfolios they manage they allocate gold on a pragmatic basis. **In the years following the Great Financial Crisis, a lot of gold was accumulated, but in the meantime these positions have been reduced and often completely eliminated.** Due to earnings pressure, in recent years these investors have increasingly relied on the classic "risk-on" investment classes such as equities, high-yield bonds, etc.

This group of marginal buyers will play a particularly important role in the future development of the gold price. They will enter the gold market without hesitation if it seems interesting again, especially if the psychologically and medially important resistance zone at USD 1,360-1,380 is taken out.

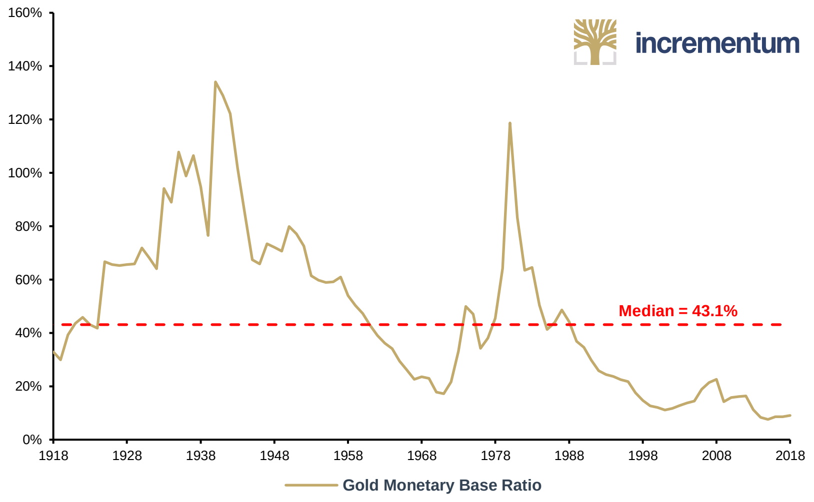
> ***3) "Critics": people who question the viability of the status quo***

What's past is prologue.
William Shakespeare

This group is convinced of a *systemic* error in the structure of the monetary system; from their point of view, most of the rescue measures of recent years only addressed the symptoms, not the root cause of the problem.

This group is characterized by a high affinity for investing in gold and sees gold as the ultimate investment hedge against the erosion of economic, political, and social trust. The value of the US Treasury's gold holdings has historically traded in a band between 20 and 140 percent of the monetary base. Currently, the percentage stands at 9%, which clearly indicates an extreme undervaluation of gold.

US gold reserves at market prices/M0, 1918-2018



Source: Federal Reserve St. Louis, World Gold Council, Incrementum AG

USD strength is the key pillar of the deflationary mindset. A crumbling of that pillar would lead to a very different investment environment.
Louis Gave

The relative size of these three groups is relevant for the development of the gold price. The gold price will be boosted as soon as there is a shift from the groups with comparatively high confidence in the status quo (1+2) to the groups with relatively low confidence in the status quo (2+3). This shift between the groups may occur suddenly – albeit not unexpectedly from the point of view of the third group. **This shift would strongly increase investment demand for gold, but also for silver and mining stocks. In our opinion, investment demand will tip the balance for the further development of the gold price.**

Conclusion

The roaring bull markets in equity, bond, and real estate markets are still showing no signs of fatigue, which also blocks spillover into consumer prices – and into gold. **Gold purchases by central banks, mainly in the East – some buying significant amounts – show, however, that at least these agents do not really trust the seemingly perpetual low-inflation environment.** The accelerating trend towards the repatriation of central bank gold (e.g. by Romania, Poland, Germany, and the Netherlands) also speaks to the declining trust in financial centers in Anglo-Saxon countries.

Gold is therefore anything but a barbaric relic, neither for central banks nor for private investors nor for institutional investors, even if the latter in particular are still hesitant.

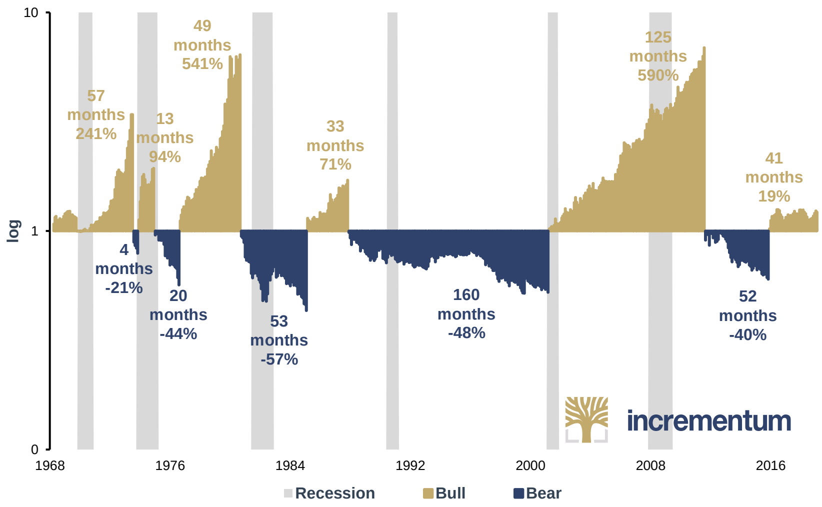
The Status Quo: Conclusion

> *"Whoever wishes to read the future has to leaf through the past."*
>
> André Malraux

Gold is not a drug that cures the disease but merely a symbol of the flight from dishonesty – a symbol of independence, honest money and permanence.
Anthony Deden

We remain convinced that we are in the early stages of a new gold bull market. As we have explained, we see considerable price potential in the commodity markets generally. These are significantly undervalued both in absolute and relative terms, especially in comparison to stock markets. **If you look at the gold bull markets of the last 50 years, you can see that even in its weakest upward period, gold was able to gain 71%. This makes us optimistic about the future.**

Gold in bull and bear markets, in % (log), 04/1968-05/2019



Source: Bloomberg, Incrementum AG

Last year we quoted our esteemed colleague Adrian Day, who said, "People expect too much from gold! Whatever scenario you're in, everyone expects gold to react more than it does. But when you think about what gold has done, I think it has done very well this year."[64]

In other words, gold investors should not fall into the trap of having too-high price expectations. A look at the current situation in the financial markets shows that gold is still facing considerable headwinds, even if the wind strength has weakened since last year's *In Gold We Trust* report:

- (US)Equities are still the most popular asset class and close to all-time highs.
- Volatility remains at a relatively low level.
- In almost every country real estate is trading at or close to all-time highs and is considered to be "without alternative" (aka "concrete gold").
- Trust in the financial system and in banks remains relatively high.

[64] "People expect too much from Gold – Adrian Day", Kitco News, September 18, 2017

- Relatively low (price) inflation.
- Central banks tend to be more hawkish than in previous years.

The good news is that we know what is coming next. The bad news is that we know what is coming next.
Russell Napier

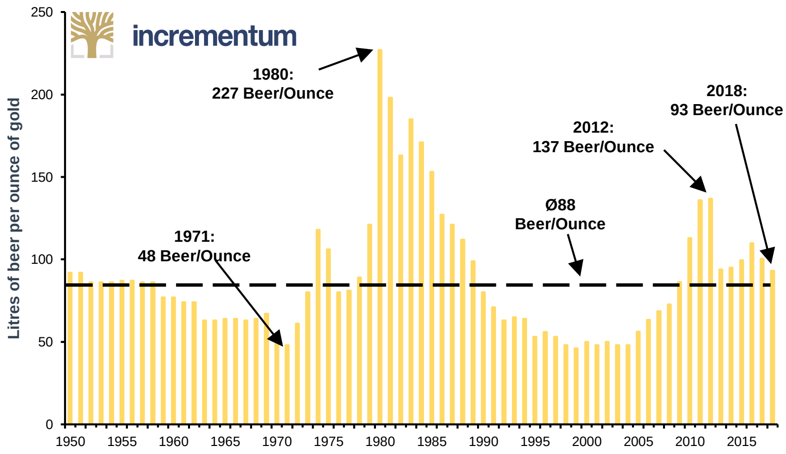
What makes us think that the headwinds have slackened? The most important reasons are deteriorating economic figures, the discontinuation in the US of interest rate hikes, and the probable end of quantitative tightening by autumn, as well as a strengthening stance in favor of a more lax fiscal policy. **The developments in Q4/2018 in particular confirm our assessment.** Longer-term macroeconomic and geopolitical factors should also translate into a positive "atmosphere" for gold.

As we do every year, we end our golden tour d'horizon with a visit to the Munich Oktoberfest. An *In Gold We Trust* report without the Gold/Wiesnbier Ratio is like a beer without foam. Where does the fabled ratio currently stand?

You can't be a real country unless you have a beer and an airline – it helps if you have some kind of football team, or some nuclear weapons, but at the very least you need a beer.
Frank Zappa

At the last Oktoberfest a one-Maß (1-litre) beer cost up to 11.50 EUR. In 1950 the beer-loving visitor had to put only 0.82 EUR on the counter. Since 1950, the annual average inflation rate of the Oktoberfestbier has therefore been 4.0%. How many Maß of Oktoberfestbier do you get this year for an ounce of gold? Currently an ounce buys you 93 Maß of Oktoberfestbier. Measured by the historical average of 88 Maß, the "beer purchasing power" of gold is above the long-term average.

Gold/Wiesnbier Ratio, 1960-2018



Source: Historical archive Spaten-Löwenbräu, statista.de, Incrementum AG

Beer makes you feel the way you ought to feel without beer.
Henry Lawson

However, we are still a long way from the historic high of 227 Maß per ounce of gold in 1980. We do not consider it unlikely that this high can be achieved again. Whether the consumption of an ounce of gold in the form of Oktoberfestbier is desirable, each reader must decide for himself. The fact that the increasing purchasing power of gold may cause (alcohol-induced) headaches is not in the spirit of the inventor of this exercise.

Gold Mining Stocks – After the Creative Destruction, a Bull Market?

"For the first time in my lifetime the gold mining industry has actually decided to become an industry rather than a floating abstraction. This focus on productivity, this ability to deliver economic results in 2018 combined with the expectation of performance in the mining industry, which is nil, is going to yield surprise after surprise after surprise in 2018, with damn near all of those surprises being good."

Rick Rule

Key Takeaways

- Mining stocks tended to be weaker last year, with the usual high volatility. Relative to their own history and the price of gold, mining stocks continue to appear attractively valued.

- After several years of creative destruction in the sector, most companies are now on a much healthier footing. The recent M&A wave reinforces our positive basic assessment.

- In our investment process we are currently concentrating on high-quality producers as well as some junior explorers. If the gold/silver ratio falls, silver miners should again appear more in the focus of investors.

Where We Stand

> *"… companies have undergone a rapid transition from debt-fueled, acquisition-driven expansion and a 'production-at-all-costs' mindset, to a period of aggressive downsizing to reduce bloated cost structures and – for some – to avoid potential insolvency. After five years of restructuring, impairments, and write-downs, the industry is recovering and cash flows and profit margins are improving."*
>
> McKinsey

Strength does not come from winning. Your struggles develop your strengths.
Arnold Schwarzenegger

This year we have devoted considerably more attention to the mining sector than in previous years. We are delighted to present a guest contribution from our friend Mark Burridge, Fund Manager at Baker Steel, a London fund boutique with which we have recently entered into a fund cooperation agreement. We then look at two major long-term trends in the mining sector: **(1)** the growing importance of ESG and (**2)** how disruptive innovations are putting gold mining on a new footing.[65]

Before doing so, however, we would like to take a brief look back at the most important developments of the past 12 months and assess the position of the relative valuation level of gold mining stocks. From 2011 to 2015, gold mining stocks experienced a disastrous bear market, with a total drawdown of 83%. The first strong sign of a possible sustainable trend reversal occurred in the first half of 2016, when the HUI exploded from 110 to 270 points within a few months. When our last *In Gold We Trust* report appeared, the Gold Bugs Index was at 178 points, 15% above its current level.

[65] These three chapters are part of the "Extended Version" which you can download for free at https://ingoldwetrust.report/igwt-en/?lang=en.

Gold Bug Index (HUI) and 50-day and 200-day MA, 01/2004-05/2019

Source: Investing.com, Incrementum AG

I've been through a lot and I realise the future can't be controlled. I'm not worried. You can always learn to overcome difficulties.
Niki Lauda

If we look at mining stocks in relation to the broad equity market, we clearly see that the gold sector has been met with enormous scepticism since 2011. The XAU/S&P 500 ratio is currently at a lower level than it was in 2000, when the last big boom began, and at the same level as in 2016, when a 170% rally began.

Philadelphia Gold and Silver Index (XAU) / S&P 500 ratio (log), 01/1984-05/2019

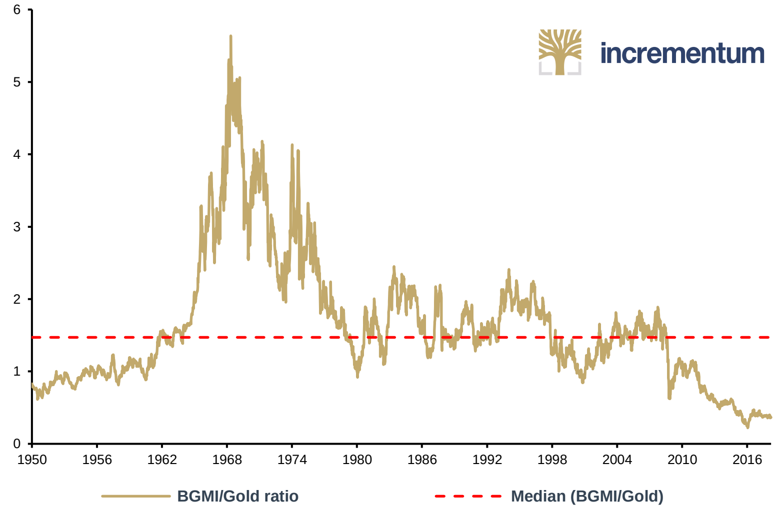
Source: Bloomberg, Incrementum AG

The extent of the underperformance becomes particularly clear when we make a longer-term comparison. The oldest available gold mining index, the Barron's Gold Mining Index (BGMI),[66] is currently at its lowest level relative to

[66] The BGMI index can be found at http://www.goldchartsrus.com.

gold in 78 years. In addition, the current value is miles below the long-term median at 1.5x.

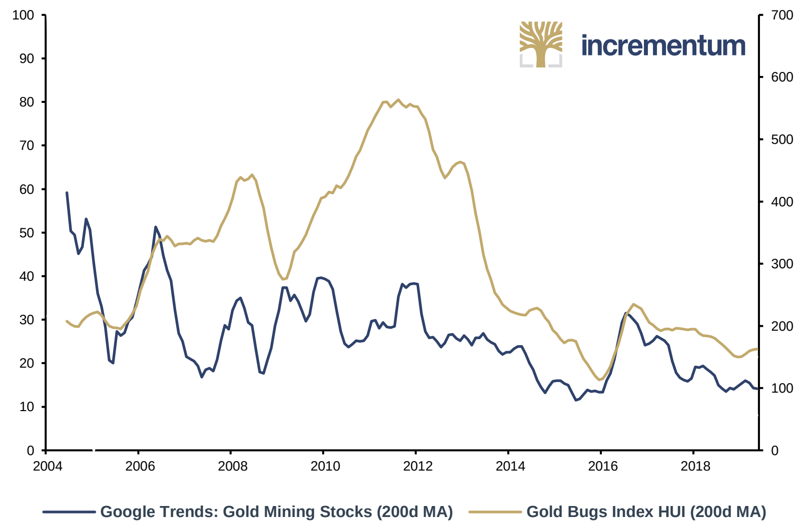
BGMI/gold ratio, 01/1950-05/2019



Source: Nowandfutures, Bloomberg, Incrementum AG

Interest in the mining sector seems to still be lackluster at the moment. Google searches reveal an interest level similar to the lows in 2009 or late 2015, so the mining sector can continue to be confidently described as an exceptional contrarian investment.

Google searches for "gold mining stocks" and "HUI Index", 01/2004-05/2019

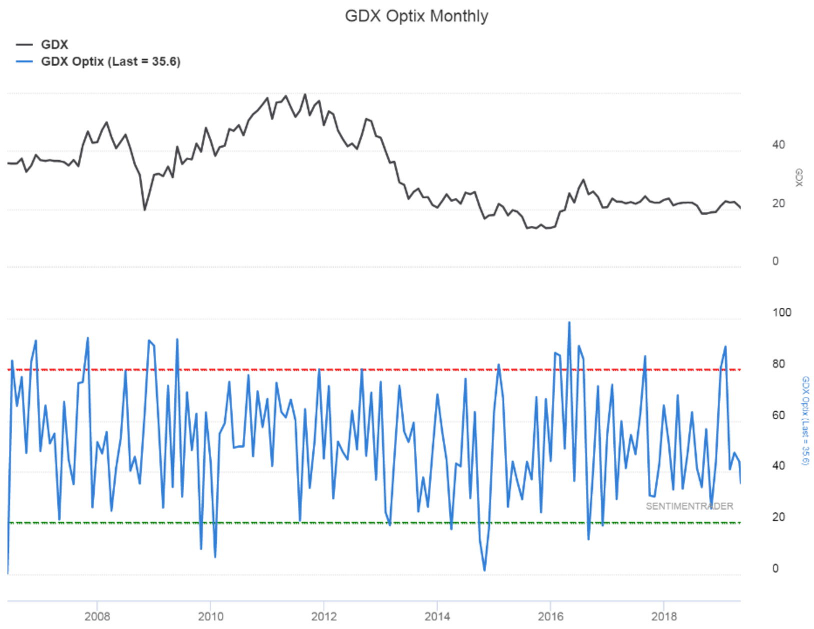


Source: Google Trends, Incrementum AG

To us, redeployment of a portion of general U.S. equity exposure to gold shares at this juncture represents a non-consensus portfolio allocation with extremely high probabilities for success.
Trey Reik

The atmosphere at mining conferences continues to resemble a birthday party at an old people's home. This anecdotal evidence is of course also confirmed by sentiment indicators. One of our favourite indicators is Sentimentrader's Optix Index.[67] The chart below shows that the mood is currently comparatively negative and that a panic low was marked in the summer of 2018. With a current level of 35.6, the indicator is in the low neutral territory.

GDX Optix, 2007-2019



Source: Sentimentrader

If we become increasingly humble about how little we know, we may be more eager to search.
John Templeton

The hypothesis we have put forward in previous years is that gold bull markets must always be confirmed by mining stocks. If we now analyse the dynamics within the mining sector, it seems that risk appetite is slowly returning. The GDXJ Index has shown slight strength relative to the GDX since mid-2017.[68] If we compare silver mining stocks[69] with the GDX, we see that there is still less momentum. **We consider a strong outperformance of the silver miners against the broad gold mining index to be a reliable trend confirmation indicator.**

—
[67] www.sentimentrader.com
[68] The GDX primarily represents large-cap gold producers, while the GDXJ includes the riskier junior and small-cap stocks and has a significantly higher beta. A rise in the ratio indicates that the smaller junior stocks are showing relative strength, which in turn signals an increasing risk appetite on the part of investors.
[69] Global X Silver Miners ETF (SIL)

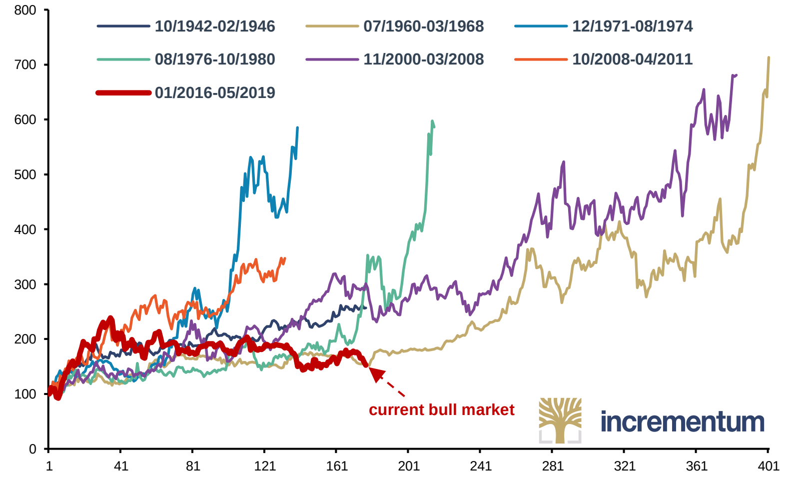
SIL/GDX ratio and GDXJ/GDX ratio (left scale), and gold price (right scale), in USD, 05/2010-05/2019

Source: Bloomberg, Federal Reserve St. Louis, Incrementum AG

The great financial success stories are people who had cash to buy at the bottom.
Russell Napier

Now let's take a look at one of last year's *In Gold We Trust* report's most popular charts. The chart shows all bull markets of the Barron's Gold Mining Index (BGMI) since 1942. The current upward trend is still relatively short and weak compared to the previous bull market. If we are really at the beginning of a pronounced trend phase at the mines – as we assume – there should still be sufficient upside potential. In addition, one can see that every bull market always ended with a parabolic upward trend that lasted 9 months on average and at least doubled the price.

BGMI bull markets in comparison, length in weeks, 100 = beginning of bull market, 1942-2019



Source: Nowandfutures, TheDailyGold.com, Barrons, Incrementum AG

A first interim résumé is therefore that mining stocks continue to be valued extremely favourably relative to equities, gold, and their own

history and that investor interest is low. It seems that the sector is about as popular as root canal treatment without anaesthesia, freedom of the press in North Korea, or a Viennese ball without waltz music.

Fiat hedges against fiat currencies

Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down.
Warren Buffett

The relative and absolute valuation of the gold miners thus appears interesting. Now signs are also increasing that the "accumulation phase" described in the "Technical Analysis" chapter is in full swing. An example of this was the recent investment by the holding company of the renowned Agnelli family, which built up investments worth USD 500mn in the mining sector over the past year. These included share packages in Harmony Gold, New Gold, and Nova Gold. The Agnellis clearly regard gold as a safe-haven investment. On the other hand, the company also wants to secure supplies of platinum and palladium, which are essential for automobile production, by acquiring a stake in Sibanye.[70] **We interpret this announcement as symbolic of the actions of many other countercyclical and long-term (value) investors who are currently building up positions.**

But it is not only investors from outside the industry who are showing increasing interest; the propensity to buy has also risen again within the industry. Last year, we wrote at this point: "*We expect mergers and acquisitions to accelerate noticeably in coming years.* *Producers will be forced to replenish their shrinking reserves by takeovers and mergers, particularly targeting exploration and development companies active in politically stable regions.*"[71]

The Barrick-Randgold merger represents an important strategic turning point for the sector. The rationale behind the deal is to create a merged company which will deliver shareholder returns, growing via exploration while divesting non-core assets and reducing overheads.
Metals Focus

This assessment has proved to be spot on. According to the always readable *Gold Focus* of our esteemed colleagues at Metals Focus, the M&A volume last year rose to USD 12.6bn. This represents a strong recovery compared to the previous year's USD 5.7bn. The (zero premium) merger between Barrick and Randgold of approximately USD 5.3bn was the first deal between majors since Barrick's acquisition of Placer Dome in 2005, triggering a wave of M&A activity[72] that included an all-share deal of almost USD 10bn between Newmont Mining and Goldcorp. The acquisition of Tahoe Resources by Pan American Silver and of Klondex Mines by Hecla Mining, as well as the strategic partnership between Newcrest Mining and Lundin Gold regarding Fruta del Norte should also be mentioned.

The storms come and go, the waves crash overhead, the big fish eat the little fish, and I keep on paddling.
Varys, Game of Thrones

It appears that the market is largely supportive of these acquisitions, as they differ significantly in valuations from those of the previous boom. **In the boom years from 2000 to 2010, more than 1,000 acquisitions worth USD 121bn were made, and at the peak of the bull market in 2011 the figure was USD 38bn. Takeover premiums of 40-50% were quite common.**

—

70 "Exor e lo shopping di miniere d'oro, platino e palladio tra Sud Africa e Canada", Il Sole 24 Ore, March 22, 2019

71 "Precious Metals Shares – More Than a Silver Lining?", *In Gold We Trust* report 2018

72 The failed takeover of Newmont Mining by Barrick Gold led to an innovative joint venture between the two companies in Nevada, which we will discuss further in our chapter on technology in mining. This chapter is part of the "Extended Version" which you can download for free at https://ingoldwetrust.report/igwt-en/?lang=en.

I've failed over and over and over again in my life. And that is why I succeed.
Michael Jordan

Merger mania usually culminates at the end of a bull market or at the low point of a bear market. In view of the current mood and valuation situation, there is much to suggest that we are at the end of the latter. In the course of a bear market, the wheat is separated from the chaff. Now, stronger market participants are setting the course for the future bull market. **Our esteemed colleague Frank Holmes compares the wave of takeovers in the mining sector to the creative destruction that has taken place in the airline industry:**

> *"Look at domestic airlines. It's easy to forget now that between 2005 and 2008, more than two-thirds of U.S. airlines were operating under Chapter 11 bankruptcy protection. A huge wave of consolidation followed, giving us the 'big four' carriers—Delta, American, United and Southwest. Profits surged to new highs. This year, according to the International Air Transport Association (IATA), global airlines should see their 10th straight year of profitability and fifth straight year where 'airlines deliver a return on capital that exceeds the industry's cost of capital, creating value for its investors.'"*[73]

I guess what I'm trying to say is that if I can change and you can change, everybody can change!
Rocky Balboa

The gold mining industry is currently experiencing a tidal change, which Mark Burridge of Baker Steel will discuss in detail in a separate chapter.[74] In our opinion, such an extent of creative destruction within an industry is healthy in the long term. It seems that the industry is in the process of setting new priorities. Profitability, capital discipline, and stable cash flow per ounce are now preferred over maximum gold production. **Some positive developments are mentioned below:**

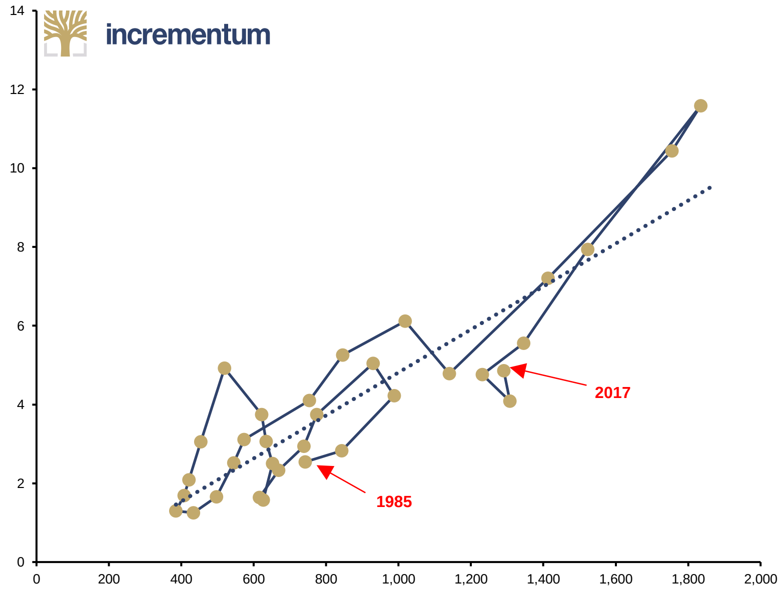
- **Cost transparency:** "All-in sustaining cash costs" (AISC) have become a benchmark in the past few years and increase the comparability and transparency of the sector.
- **Write-off or sale of high-priced projects:** Numerous exploration and development projects were sold or put on hold. Balance sheets were strengthened, and USD 30bn in write-downs were made. Operating leverage[75] in the sector fell from 1.6x to currently 1.1x.
- **Takeovers are no longer paid in cash or debt, but mostly in own shares.**
- **Refocusing on investments in exploration:** In the previous year, there was a slight trend reversal towards increased exploration activity. In 2018, 49,312 drill holes (+14% vs. 2017) were reported from 1,261 projects (+11% vs. 2017).[76]

—
[73] *See* Holmes, Frank: "The Newmont-Goldcorp Deal Is Positive News For Gold", *Frank Talk – Insight for Investors*, U.S. Global Investors, January 15, 2019
[74] This chapter is part of the "Extended Version" which you can download for free at https://ingoldwetrust.report/igwt-en/?lang=en.
[75] Net debt/EBITDA
[76] *See* "World Exploration Trends 2018", S&P Global Market Intelligence, March 15, 2019

The best time to get in is when exploration spend bottoms out and starts rising…Which is NOW!
Richard Schodde

"Real value is created through the drill bit" **is an old saying in mining. Between 2011 and 2017, the 20 largest gold producers invested a total of USD 12.7bn in exploration.**[77] However, brownfield exploration and the expansion of existing deposits accounted for a large proportion of this. **In the coming years, the neglect of greenfield exploration will take its toll.** The gradual deterioration in the production profiles of many major producers is likely to continue. As can be seen from the next chart, exploration spending is primarily a function of the gold price, with a tight correlation of 0.81.

Exploration spending goes hand in hand with gold price development: gold price (x-Axis), in USD, and exploration spending (y-Axis), in USD bn, 1975-2017



Source: MinEx Consulting, Richard Schodde, Incrementum AG

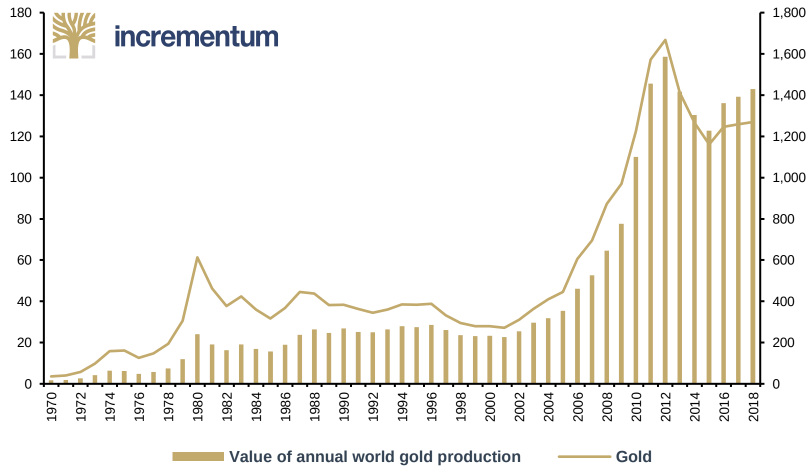
These are the early innings of what we believe will be a new, prolonged M&A cycle. We see tremendous potential especially in the junior mining space, given that smaller gold mining companies are trading at a material discount to larger mining companies.
Whitney George

The structural change of the gold mining industry is fascinating. Even if the panic-mongering before Peak Gold seems (in our opinion) to be strongly exaggerated, structural changes within the industry are occurring.[78] The top 10 producers were responsible for only 25% of gold production in the previous year. In 2010, the figure was still 38%. Moreover, **the** duration from first discovery to production has further increased in recent years. **The average lead time from first targeted exploration to production was 20 years for the 40 major new primary gold mines.** On average, 13 years were spent on exploration work, while 7 years were required to establish the feasibility of commercial production.[79] **For us as investors, this results in the realization that "discovery investing" in junior explorers will become increasingly important.**

—

[77] *See* Callaway, Greg and Ramsbottom, Oliver: "Can the gold industry return to the golden age?"; McKinsey, April 2019
[78] *See* "Precious Metals Shares – More Than a Silver Lining?", *In Gold We Trust* report 2018,
[79] *See* Callaway, Greg and Ramsbottom, Oliver: "Can the gold industry return to the golden age?"; McKinsey, April 2019

Value of annual gold production, USD bn (left scale), and gold price in USD (right scale), 1970-2018



Source: USGS, Federal Reserve St. Louis, Incrementum AG

Conclusion

"If life has any meaning at all, then suffering must also have meaning."

Viktor Frankl

Gold is a current asset, with no future cash flows – it is the financial opposite of biotech. This is why gold is the ultimate loser during the growth of a credit bubble, but a sure winner when it collapses. It is why gold mining companies will go from being worth next to nothing to something, a nearly infinite percentage increase.
Daniel Oliver

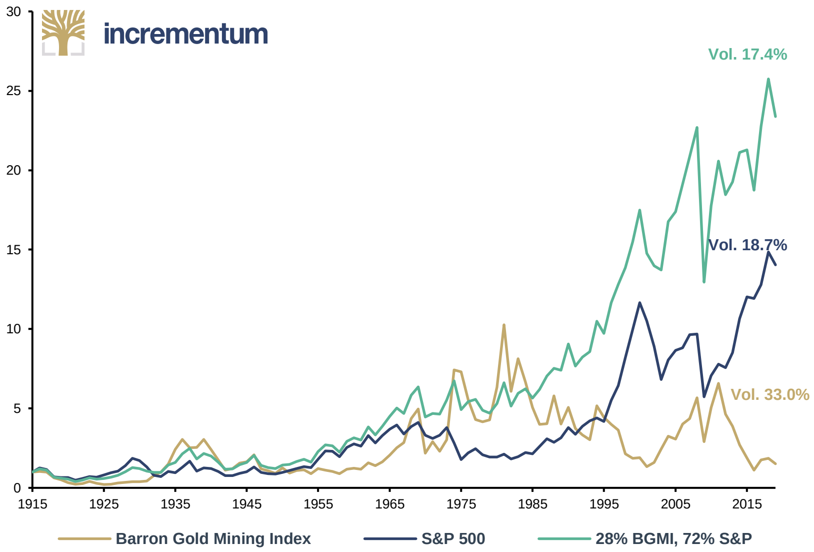
We remain firmly convinced that the four-year bear market has resulted in the majority of mining companies now being on a more solid foundation. Producers are now leaner; they have reduced their immense indebtedness and will benefit more from rising gold prices in the future.

Let's look at the long-term portfolio properties of gold miners. Our colleague and friend Daniel Oliver (Myrmikan Research) notes that the Barron's Gold Mining Index (BGMI) has underperformed the S&P 500 by 88% since 1915.[80] But the sudden revaluations that usually accompany the end of credit cycles often result in rapid multiplications in mine stocks. **For example, a rebalancing strategy[81] with 28% BGMI and 72% S&P 500 significantly outperformed the S&P 500, with lower volatility.**

—

80 *See* "Heads or Tails You Lose", Daniel Oliver, Myrmikan Research, October 11, 2018
81 Annual rebalancing

BGMI, S&P 500, rebalancing strategy, 1915-2018



Source: Myrmikan Research, Daniel Oliver, Incrementum AG

The balance sheets and cost structures of the gold industry are much stronger than five years ago, enabling companies to pay off debt and return cash to shareholders. Growth has reappeared on management agendas and in investor presentations.
McKinsey

There are currently few sectors that are more underweighted by the investment community than the mining sector. This is demonstrated by the almost dwarfish market capitalisation of mining stocks. In this respect, we expect that the mining companies – and their suffering shareholders – will reap a rich harvest in the next few years after a gruelling dry spell. **But now it is up to the industry to deliver on the promises it has made in recent years and to build new investor confidence. Currently, it appears that many companies are slowly adopting a more aggressive strategy and switching from bear market to bull market mode.** M&A but also investments in exploration and technology are particularly worth mentioning here.

Amateurs bet the farm. Pros milk the cows.
Anonymous

Anticyclical investors will find an attractive niche in the precious metals sector over the next few years, with an excellent risk-return ratio. In our investment process, we continue to focus on high-quality producers, as well as developers and emerging producers with takeover fantasies. But even riskier junior explorers with ambitious drilling programs should be put back on the watchlist. Based on our premise that gold is now back at the beginning of a bull market, we expect a falling gold-silver ratio in the medium term. **In this scenario, silver miners could also offer outstanding investment opportunities.**

Technical Analysis

“The two most powerful warriors are patience and time.”

Leo Tolstoy

Key Takeaways

- Gold sentiment continues to oscillate between disinterest, agony, pessimism, and slight confidence.
- From the point of view of current technicals, seasonality and the CoT report, we would not be surprised to see a continuation of the chill-out phase for several weeks. However, we do not expect a deep correction after apparently high buying interest is waiting on the sidelines.
- Midas Touch Model: Gold has is in "bearish mode" since May 20th. A patient stance until the summer low seems advisable. If the resistance at 1,360 is finally taken out, the next price target is 1,500 dollars by spring 2020.
- In our opinion, the gold price is at the transition from the accumulation phase to the participation phase. Investor demand is the key driver. The crossing of the technical rubicon level at 1,360 will trigger increased interest on the part of institutional investors.

Technical Analysis

> *"Jim Grant: "I remember this from my work about Bernard Baruch, the great speculator of the turn of the 20th century. And the phrase was, to quote, 'to break the continuity of bearish thought'. And price action does that, right?"*
>
> *Bill Fleckenstein: "Right. Exactly. So I think that the market breaks very much – you're* ***going to break the discontinuity of bearish thought about gold****… And the miners, as well – they're so depressed. The one who follows the crowd will usually get no further than the crowd. The one who walks alone is likely to find himself in places no one has ever been."*
>
> Jim Grant and Bill Fleckenstein[82]

Again this year, we complement our comprehensive macroeconomic, (geo-)political, and fundamental analysis with a short view on the technical status quo of the gold market.

Successful investing is having everyone agree with you… later!
Jim Grant

Last year we wrote at this point: "*The analysis of market structure, sentiment, and price pattern allows us to come to a positive technical assessment. A speculative adjustment has already taken place in the futures market, which should provide a healthy foundation for further price rises, although a final 'wash-out' under the support at USD 1,280 does not seem entirely unlikely.*"

This assessment has proved to be largely correct. The final "wash-out" went further than expected and culminated in a panic low on August 16. Since then, the gold price has rallied from USD 1,160 to up to USD 1,340.

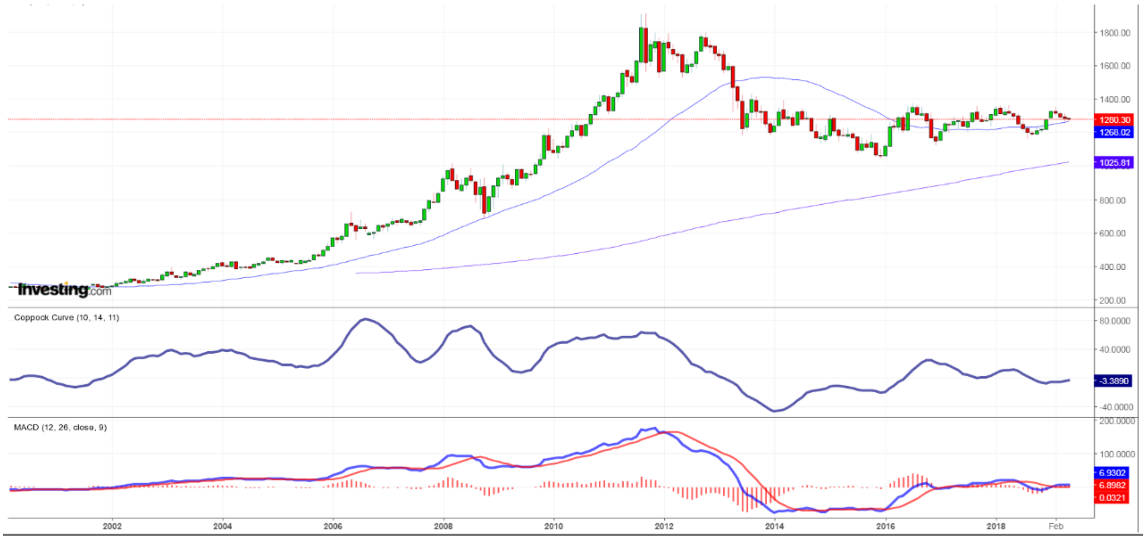
The bigger the base, the higher the space!

What is our current technical assessment of the gold price? We are again using the Coppock curve, a reliable momentum indicator, to determine our long-term view.[83] A buy signal is given when the indicator turns up below the zero line, i.e. assumes a positive slope. The advantage of this indicator is that large trend changes can be reliably identified. The indicator has been on a buy signal since the end of 2015 and has been gradually moving upwards since then. The MACD has also been on a buy since early 2016 and is slowly creeping up.

—

82 "Diagnosing Monetary Disorder", Real Vision interview featuring Bill Fleckenstein & Jim Grant, October 29, 2018
83 Specifically, these are two time-weighted momentum curves that are added together and whose long-term moving average represents the Coppock line. We use a slightly modified Coppock with slightly longer periodicities.

Gold, Coppock indicator, and MACD (monthly) since 2001



Source: Investing.com, Incrementum AG

Patience is power. Patience is not an absence of action; rather it is timing; it waits on the right time to act, for the right principles and in the right way.
Fulton J. Sheen

The following chart clearly shows that the impulsive rise from USD 280 to USD 1,920 has been corrected since 2011. **As part of this corrective movement, an impressive inverse shoulder-head-shoulder formation has been forming since 2013, which could explosively resolve upwards.** Currently, however, the price has already failed several times on the neck line in the resistance range of USD 1,360-1,400. **If the gold price were to break through this resistance zone, the next target would be almost USD 1,800, as calculated on the basis of the distance from the head to the shoulder line, projected upwards.**

Gold (200-day moving average): Shoulder-head-shoulder formation

Source: Investing.com, Incrementum AG

If it's obvious, it's obviously wrong.
Joseph Granville

As far as sentiment is concerned, we can only repeat what we said last year. The mood regarding gold continues to fluctuate between disinterest, agony, pessimism, and slight confidence. According to Bloomberg, the analyst consensus is still without a strong opinion. A slight increase to USD 1,381 is expected for 2022. Such a long-term sideways movement, however, is a development that seems extremely unlikely – if one has studied market behaviour. However, it should also be mentioned that none of the 30 analysts surveyed expects prices *below* USD 1,000 in the long term. From an anti-cyclical point of view, this is quite worrying. **On the other hand, there is only one analyst who expects long-term prices to exceed USD 2,000. The mentioned analyst is the author of these lines, by the way.**

Bloomberg: Analyst consensus for gold and silver: Q2 2019-2022

	Sent.	Spot	Q2 19	Q3 19	Q4 19	Q1 20	2019	2020	2021	2022
1) Gold $/t oz		1281	1284	1291	1299	1310	1297	1322	1353	1381
Forecast (Median)			1300	1325	1345	1350	1315	1367	1324	1328
Diff (Median - Curr)			+16	+34	+46	+40	+18	+45	-29	-53
2) Silver $/t oz		14.84	14.91	14.99	15.13	15.24	15.15	15.42	15.88	16.31
Forecast (Median)			15.66	16.00	16.73	16.76	15.95	17.10	16.75	18.60
Diff (Median - Curr)			+0.74	+1.01	+1.60	+1.52	+0.80	+1.68	+0.87	+2.29

Source: Bloomberg

We forget that Mr. Market is an ingenious sadist, and that he delights in torturing us in different ways.
Barton Biggs

As you know, one of our favourite sentiment indicators is the Optix Index from Sentimentrader.[84] It amalgamates the most prominent sentiment surveys with positioning data from the futures and options markets. The logic behind this sentiment indicator is a very simple one. If public opinion forms a strong consensus, this broad consensus is a good counter-indicator. The market is usually too bullish when prices have already (strongly) risen and too bearish when they have already fallen. If the Optix rises above the red dotted line at 75 points, you have to be more careful. If it is 30 points or below, however, pessimism is pronounced and the downside risk is limited. **The Optix is currently trading at 46 and thus at a neutral level.**

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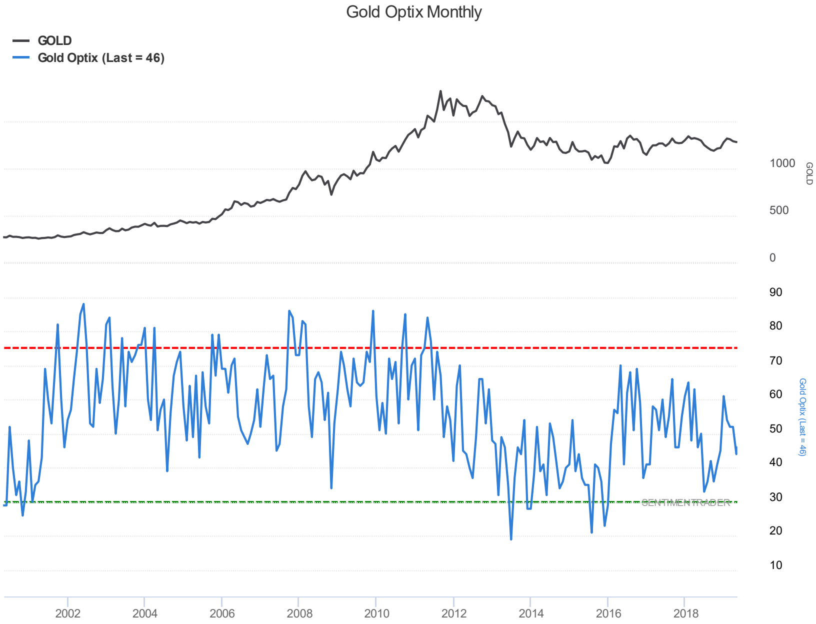
84 www.sentimentrader.com

Optix indicator and gold price since 2000

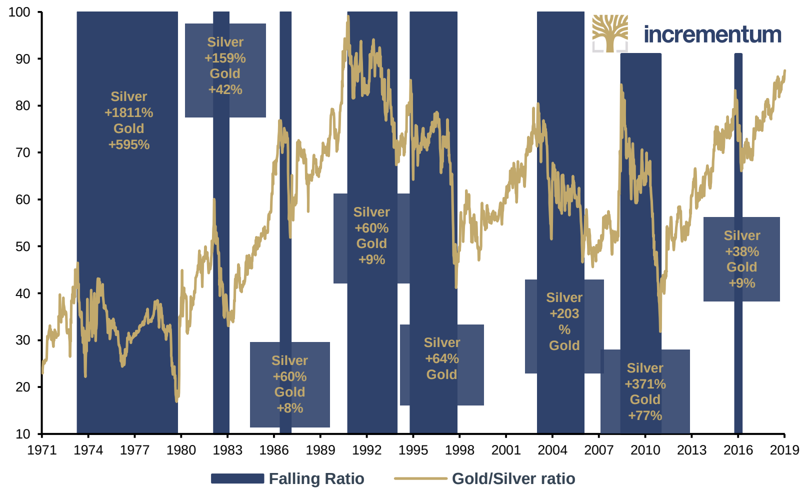


Source: Sentimentrader.com

Better three hours too soon than a minute too late.
William Shakespeare

The silver price could also be interpreted as a sentiment indicator for gold. Strong bull markets for silver usually only happen in the course of rising gold prices, because investors seek higher leverage and end up with mining stocks or silver. With the gold movement still meandering, silver is likely to wait for the next breakout attempt of the gold price before gaining trend strength and relative strength to gold. **The ratio of 88 clearly shows that sentiment in the precious metals space is currently at rock bottom.**

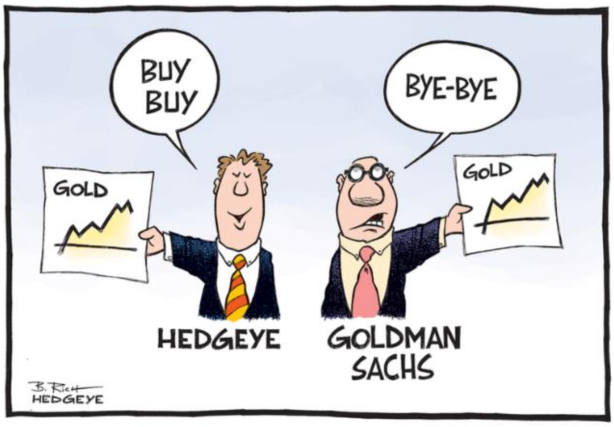
Gold/silver ratio, 01/1971-05/2019



Source: GoldSilver.com, Mike Maloney, Bloomberg, Incrementum AG

To buy when others are despondently selling and sell when others are greedily buying requires the greatest fortitude and pays the greatest reward.
John Templeton

The above chart shows that the G/S ratio is subject to large fluctuations over time. Around 1980 we can see a low point at a ratio of 16, while in 1991 it almost reached the 100 mark. At the moment, it seems that the ratio wants to test the highs from 2008 at around 87. **The risk of price declines appears to be limited at this historically extreme relative valuation.** However, silver remains dependent on the price movements of gold, and bullish momentum seems unlikely in the medium term. **Should our basic assumption of a changing inflation trend prove to be correct, silver is probably one of the best investment opportunities to profit from rising inflation in the coming years**.



Courtesy of Hedgeye

Last year we have thoroughly analyzed the seasonal patterns of gold, silver and mining stocks with the help of our dear colleagues from Seasonax. This year we want to take just a brief look at the seasonal patterns.[85] The following chart shows the annual development of gold in pre-election years. It can be seen that the seasonal tailwind is particularly positive in the second half of the year, but beforehand a low price is reached in summer.

Seasonality of gold in pre-election years

Source: Seasonax.com

85 "Technical Analysis", *In Gold We Trust* report 2018

The Midas Touch Gold Model™[86]

"The beginning of wisdom lies in the definition of terms."

Socrates

A rational and holistic approach to analyzing the gold market.

As in previous years, we would like to give you a comprehensive update on the current status of the Midas Touch Gold Model™ this year.[87] In summary, its strengths lie in versatility and quantitative measurability, as it carefully examines as many perspectives on the gold market as possible.

Since the nasty sell-off in summer 2018, gold prices had recovered in a slow but convincing fashion towards the **well-known multi-year resistance zone around USD 1,350-1,375**. But since the February 20 peak of USD 1,346, the gold market has been in a clear correction, and the final low of this down wave is not yet visible.

The Midas Touch Gold Model: In sell mode since May 20

The Midas Touch Gold Model™ May 20th 2019

Version 1.2

Gold USD - Monthly Chart	US$1,277.91	Buy Signal 02/18/19, reversal @ $1,171.67	Bullish		
Gold USD - Weekly Chart	US$1,277.91	Buy Signal 05/14/19, reversal @ $1,267.51	Bullish		
Gold USD - Daily Chart	US$1,277.91	Sell Signal 05/17/19, reversal @ $1,309.90			Bearish
Gold Volatility CBOE Index	9.16	Lowest volatility since more than 10 years		Neutral	
Gold CoT-Report	-137,183	Commercial Shortposition neutral		Neutral	
Gold Sentiment	49	Sentiment neutral		Neutral	
Gold Seasonality	May	Until end of June negative seasonal cycle			Bearish
Ratio DowJones/Gold	20.10	Buy Signal 11/01/18, reversal @ 21.33	Bullish		
Ratio Gold/Silver	88.43	Sell Signal 02/27/19, reversal @ 84.10			Bearish
Ratio Gold/Oil	20.27	Sell Signal 01/14/19, reversal @ 21.21			Bearish
Ratio Gold/Commodities (GNX)	2.88	Sell Signal 02/13/19, reversal @ 2.96			Bearish
SPDR Gold Trust Holdings (GLD)	736.17t	Minus 4.65t during the last two weeks			Bearish
Gold in $, €, £, ¥	3 out of 4	Gold up against $, € & £, down against ¥ over 1 month		Neutral	
Gold in Indian Rupee	89,204 INR	Sell Signal 05/20/19, reversal @ 92,225 INR			Bearish
Gold in Chinese Yuan	8,833 CNY	Sell Signal 05/20/19, eversal @ 9,018.9 CNY			Bearish
GDX Goldminers - Daily Chart	US$20.29	Buy Signal 05/07/19, reversal @ US$20.39	Bullish		
GDX Goldminers Sentiment	48	Sentiment neutral		Neutral	
US-Dollar - Daily Chart	97.76	Buy Signal 05/16/19, reversal @ 96.83, negative for gold			Bearish
US-Dollar CoT-Report	-30,089	Commercials hold only a medium sized shortposition on US-Dollar		Neutral	
US Real Interest Rate	0.968%	3-month T-bill yield (2.39%) - change in the CPI (1.423%)			Bearish

Gold Model is in Sell/Bearish Mode since 20th of May 2019

in gold we trust .report

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MIDAS TOUCH CONSULTING

Source: Midas Touch Consulting, Florian Grummes

The first principle is that you must not fool yourself – and you are the easiest person to fool.
Richard Feynman

After flashing a sell signal end of February and a neutral reading over the last three weeks, the Midas Touch Gold Model has now moved back to a bearish conclusion. And even though the two higher timeframes (monthly and weekly) for gold in US-Dollar do look rather good, it still takes a gold price above USD 1,310, to turn

—

86 We sincerely thank Florian Grummes for this contribution. Florian is founder and managing director of Midas Touch Consulting (http://www.midastouch-consulting.com). Our readers can subscribe for free updates and the Midas Touch newsletter at the following link: http://bit.ly/1EUdt2K

87 A detailed description of the model and its philosophy can be found in "Technical Analysis", *In Gold We Trust* report 2016.

around the daily chart. **Here we need to consider, that in such an extremely low volatile environment as gold finds itself right now, a fast and unlikely USD 30 plus move to the upside would already be a game changer.**

Looking at the current Commitment of Traders report (CoT), the immediate outlook for gold is rather unfavorable. The smart money, which of course are the commercial hedgers, did increase the cumulated short position into gold´s recent recovery. This short position might now be still large enough to trigger the typical pre-summer panic sell-off towards June or July. Yet at the same time a massive USD 100 plus down wave is rather unlikely.

Source: TradingView, Midas Touch Consulting, Florian Grummes

After spending many years on Wall Street and making and losing millions, I would like to stress the following: I don't deserve the big winnings with my thinking. It was my perseverance. I just didn't let you fool me.
Jesse Livermore

Combining the CoT report with gold's seasonality, the most likely scenario sees a continuation of the ongoing mild correction towards at least the 200-day moving average (USD 1,257). Probably between June and the middle of August, gold should therefore find a bottom between USD 1,200 and USD 1,250. In the bigger picture, this would not violate the series of higher lows but rather strengthen the promising ascending bullish triangle formation that gold has seemed to tinker with since its low at USD 1,045.

If you consider the four ratio components of the Midas Touch Gold Model, none of them is screamingly bullish at the moment. In fact, the Dow Jones/gold ratio is rather close to losing its bullish signal! **But should the "sell in May" cycle, plus the US-China trade dispute, force stock markets lower, the important Dow Jones/gold ratio would remain in favour of gold.** The other three ratios will likely catch up once gold has seen its trend reversal in the next few months.

When gold-mining managers have to justify the weak performance of their stocks, they often complain about ETFs as a passive investment competitor. Certainly, the current holdings of the GLD gold ETF of 736 tonnes are rather shallow, but you can be sure that once gold can break above USD 1,360, mainstream investors will rush into these products as they did from 2004 to 2011. Back then, the ETFs were one of the main drivers behind gold's bull market. But for the time being, the Midas Touch Gold Model considers GLD´s recent outflows as bearish. And talking about the miners & ETFs, the GDX has a buy signal since May 7th but was not able to make any meaningful progress to the upside. This sideways consolidation more likely confirms, that the correction is still not over.

Finally, the US-Dollar might be the missing puzzle for gold´s return. So far, gold has held up surprisingly well as the US-Dollar has been strengthening over the last 14 months. Currently, the model detects a buy signal for the US-Dollar and therefore a bearish signal for gold, while US real interest rates around 1% remain an argument against gold. But the consumer price index (CPI) has been moving up for the first time in six months. **Should this uptrend continue, lower real interest rates could become an important driver for rising gold and silver prices.**

Source: TradingView, Midas Touch Consulting, Florian Grummes

Conclusion

Overall, the model is bearish and advises a neutral and patient stance until the typical summer low (normally to be found between end of June and mid of August). Should gold not dive too deep until this low of the year, the sleeping more than 5,000-year-old golden dinosaur might indeed have enough power to break through the resistance around USD 1,360 and catapult himself towards USD 1,500 by spring 2020.

We are convinced that investors and traders can benefit from the Midas Touch Gold Model and its rational approach. Although the model is of course not always right, it saves a lot of time and provides the user with a professional overview of the situation in the gold market. The model is updated every week and can be followed on the website of Midas Touch Consulting.

Conclusion

> *"Great opportunities do not come every year."*
>
> Charles Dow

The public, as a whole, buys at the wrong time and sells at the wrong time.
Charles Dow

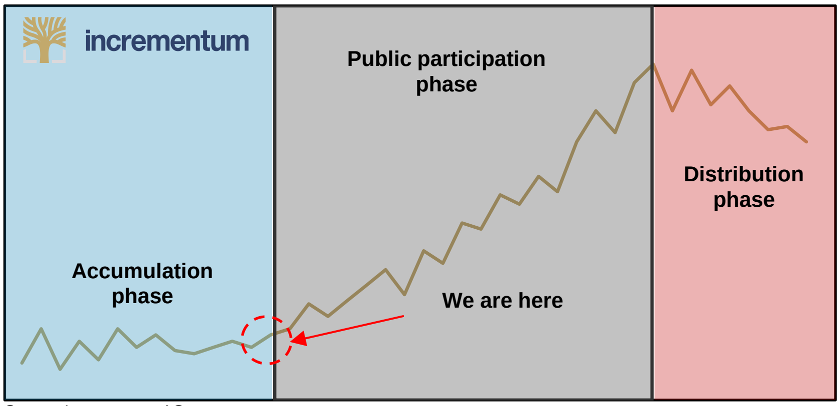
Technical analysis is certainly not an exact science, but rather a useful tool for determining the location and timing of investments. It is important to us not only to understand the "big picture" fundamentally and from a macro point of view, but also from a technical point of view. An extremely useful theory, which also forms the basis of technical analysis, is the subdivision of 3 trend phases. This is based on Charles Dow, the "Godfather of Technical Analysis". **Dow divided each trend into 3 different phases:**

1) Accumulation phase: In this first phase, the most informed, astute, and contrarian investors buy. If the previous trend was downwards, then the clever investors can see at this point that the market has already discounted the "bad news".

2) Public participation phase: Prices are starting to rise slowly. Trend followers are showing interest; news is improving; and commentators, the media, etc. are writing increasingly optimistic articles. Speculative interest and volumes are rising, new products are being launched, and analysts' price targets are being raised.

3) Distribution phase: During this final mania phase, the group of informed investors who have accumulated from near the low point begins to reduce their positions. Media and analysts outperform each other in raising their price targets, and the environment is characterized by "this time is different" sentiment (see Bitcoin at the end of 2017, oil in 2008 and FAANG stocks or unicorns at the moment).

Three phases according to the Dow theory



Source: Incrementum AG

The combination of continued relatively low investor interest and analysts' lack of price fantasizing is a good foundation for a continuation of the uptrend after the final capitulation of the last bulls last summer, and confirms our assumption that the gold price is still in the accumulation phase.

Sometimes the gold market seems like an MMA fight. The metal is down on the canvas, seemingly helpless, yet it keeps getting pummeled unnecessarily.
Brien Lundin

From the point of view of current market sentiment, seasonality, and the CoT report, we would not be surprised to see a continuation of the "chill-out" phase for several weeks. However, we do not expect any significant selling pressure on the downside, as seemingly high buying interest waits on the sidelines, which leads to a "buy the dips". In addition, positive seasonality, which is particularly strong in pre-election years, should provide a tailwind in the second half of the year. **In this respect, conditions for the establishment of the new bull market seem excellent from a technical point of view.** In our opinion, the gold price is at the transition from the accumulation phase to the public participation phase. **Passing the resistance level at USD 1,360-1,380 could trigger increased interest on the part of institutional investors.**

Quo Vadis, Aurum?

"The record of fiat currencies through history, 100%, is eventual failure. The record of gold for 5,000 years, 100%, is lack of failure."

Simon Mikhailovich

Key Takeaways

- **The erosion of trust in many areas plays into gold's hands. An end to these multiple crises of trust is not in sight.**
- **Gold has only recently reconfirmed its status as an excellent hedge against stock market slumps (Q4/2018).**
- **The expected reversal of monetary policy back towards interest rate cuts, QE, negative interest rates, and a loose fiscal policy (MMT) as soon as a recession is in sight will boost the gold price.**
- **The political and economic tensions between the USA and China are increasing. These and other uncertainties, such as the worsening situation in Iran, should support the gold price.**
- **As soon as the gold price breaks through the resistance zone at USD 1,360–1,380, a gold price of USD 1,800 seems within reach in the medium term.**

“Trust is central to an economy that works.”

Stephen Covey

The leitmotif of this year’s *In Gold We Trust* report is the present-day erosion of trust. Because trust is a fundamental requirement of human existence, a shift in the level of trust in a society usually affects most, if not all, aspects of social, political, and economic life. Those who can no longer trust their neighbor or their nation struggle to contribute positively to human society. **Where do we see a particular erosion of trust?**

Erosion of trust in self-evident social and political realities

The battle for what we might call the “prerogative of interpretation” has been going on in the media for some time now: Who is reliably truthful, and who gets to define what is “fake news”? Thus, trust in the established media is declining rapidly in many Western countries.

When the norm is decency, other virtues can thrive: integrity, honesty, compassion, kindness, and trust.
Raja Krishnamoorthi

On the other hand, because the technological revolution makes it possible for everyone to run their own news channel on YouTube, Twitter, Telegram, or as a blog, media institutions that have been unquestioned for decades suddenly face unexpected and sometimes fiercely disruptive competition. And as with every revolutionary innovation, it takes some time for the wheat to be separated from the chaff among the new players and for a new socially accepted structure to come into being.

An essential element – and indeed one of the sources – of this erosion of trust is the increasing polarization of society. Populist movements radically question the self-evident status of the post-war political system. New parties and political movements are emerging, and parties and policies that for decades were taken for granted as key parts of the political process seem to be at risk of disappearing.

In such experience as I have had with taxation… there is only one tax that is popular, and that is the tax that is on the other fellow.
Sir Thomas White

At the heart of many current social and political debates is the increasing inequality of income and wealth. The public discourse completely ignores the fact that this inequality is massively fueled by the current monetary system through the so-called Cantillon effect.[88] From our point of view, this effect will increasingly put social cohesion to the test.

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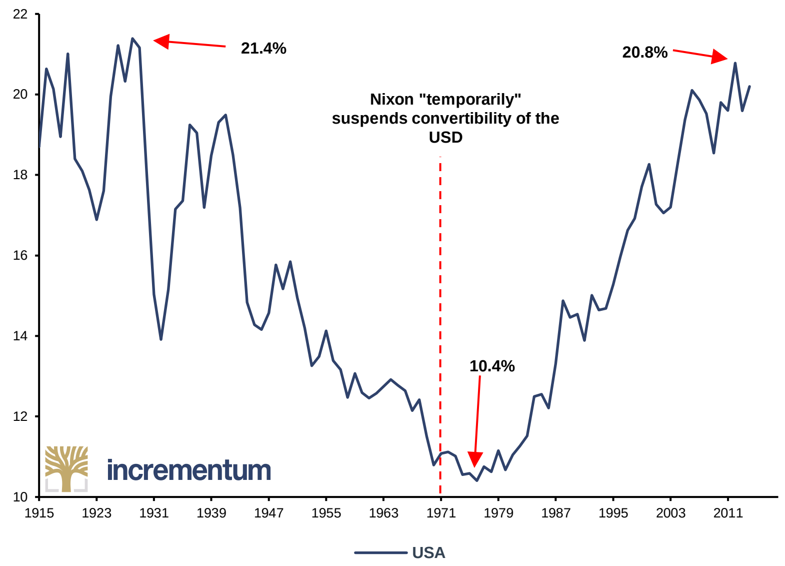
[88] *See* “Gold in the Context of the Current Macroeconomic Backdrop”, *In Gold We Trust* report 2013

Income share of the top 1%, in %, 1915–2016



Source: Ourworldindata.com, Incrementum AG

Erosion of trust in established geopolitical realities

The Trump administration is increasingly using the dollar – and access to dollar clearing and funding – as a geopolitical weapon, risking retaliation and perhaps even jeopardizing the future of the dollar-based global monetary system.
William White

We have not reached "the end of history" that Francis Fukuyama proclaimed in the early 1990s; but certainly, a fundamental rearrangement of the world is taking place right before our eyes. With the resurgence of China, an economically and militarily self-confident player has appeared on the international stage, preparing to promote itself from a minor role into a leading role. The current US administration has identified China as a direct challenger and is increasingly bent on a course of confrontation. At an April 25, 2019, conference organized by the Committee on the Present Danger: China, Stephen Bannon, former chief strategist to President Trump, openly denounced China: "*They have been engaged in economic warfare with the West for 20 years.*"[89] The currently escalating trade war between the planet's largest and second largest economic powers shows how hardened the fronts really are. The best example, in our opinion, of the escalation of bellicosity was an October 4, 2018, speech by US Vice President Mike Pence at the Hudson Institute, in which Pence described the US government's new China strategy. **It was a speech that sounded like the proclamation of another Cold War.**[90]

Look back over the past, with its changing empires that rose and fell, and you can foresee the future, too.
Marcus Aurelius

China is also an increasingly strong presence in the global gold market. We are convinced that China's engagement is not a flash in the pan but will continue to have a significant impact on both the supply and demand sides of the Chinese economy simply because of the size of China's involvement with gold.

—

[89] *See* Stephen K. Bannon's speech at the CPDC conference, April 25, 2019
[90] *See* "The Administration's Policy Towards China", remarks by Vice President Mike Pence at the Hudson Institute, October 4, 2018

Free trade is God's diplomacy. There is no other certain way of uniting people in the bonds of peace.
Richard Cobden

In its confrontation with Iran, another long-term adversary, the US is increasing the pressure again. Following the US withdrawal from the multilateral nuclear agreement in 2018, the US is now growing its military presence in the Middle East. In the event of an escalation, the price of oil would presumably soon be above the USD 100 mark; and it is impossible to imagine what the outbreak of an open conflict in the region would mean for the oil price. The region remains a potent source for international crises. Even in the 1970s, geopolitical uncertainties in the Middle East were ultimately the catalyst that caused the monetary inflation of the 1960s to escalate into price inflation. A déjà vu of this sequence is quite possible.

But elsewhere, too, long-accepted political realities are coming to an end. With Brexit, the EU is shrinking for the first time in its history. The UK is not only the second largest EU economy and a net contributor to the EU, it is also an economically liberal country compared to the southern countries in the EU (including France). As a consequence, the face of the EU will change dramatically. For the time being, the EU seems to be occupied with itself and, despite all its efforts, still has no weight in geopolitical events.

Erosion of trust in traditional monetary arrangements

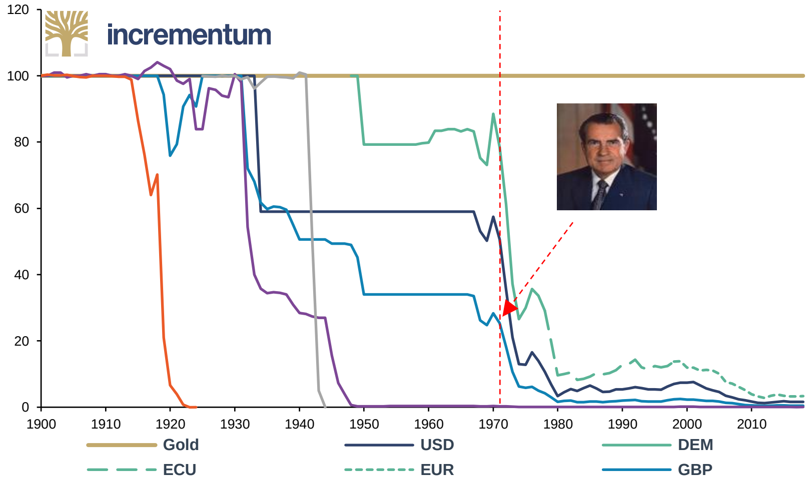
It seems to me that our American partners are making a colossal strategic mistake [as they] undermine the credibility of the dollar as a universal and the only reserve currency today. They are undermining faith in it.... They really are taking a saw to the branch they are sitting on.
Vladimir Putin

Another consequence of the geopolitical changes is the creeping erosion of trust in monetary arrangements. The global process of declaring independence from the US dollar as the global reserve currency continues. The biggest plus for the present currency hegemony is that there is still no serious competition from other government fiat currencies. However, the more the global reserve currency loses its trust capital, the more likely it is that fundamental values, only temporarily set aside, will again be considered as the foundation of a monetary system. Gold purchase increases and repatriations by various central banks demonstrate gold's resurgence in the global monetary order as central banks seek a dependable store of value.

The next chart shows where the erosion of trust in paper money leads in extreme cases. When paper currencies were not trustworthy in the eyes of the population anymore, they reverted to their intrinsic value, and that is zero, as has been detailed out in the guest chapter "Hyperinflation".[91]

[91] This chapter is part of the "Extended Version" which you can download for free at https://ingoldwetrust.report/igwt-en/?lang=en.

Currency values relative to gold, 1900=100, 1900-2018



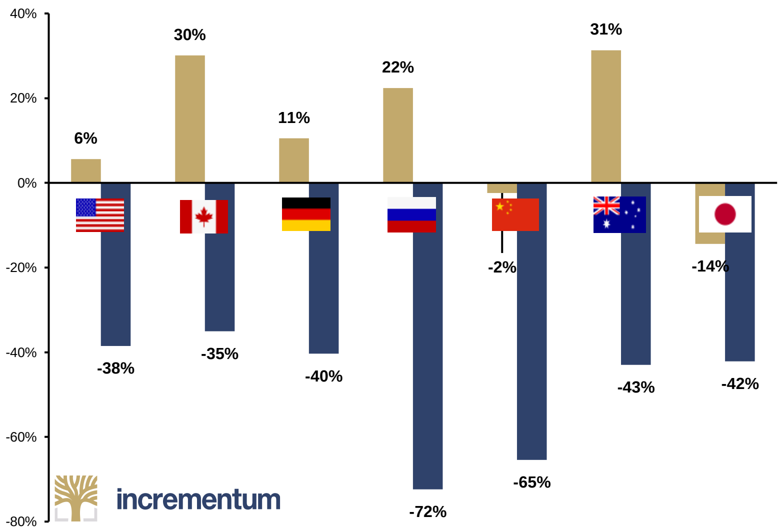
Source: World Gold Council, Harold Marcuse, UC Santa Barbara, Incrementum AG

Gold as a hedge against the erosion of trust

We no longer have business cycles. We have credit cycles.
Peter Boockvar

Throughout history and to this day, gold has shown that it is an excellent portfolio hedge against deep crises of trust. As we have analyzed extensively, this characteristic as portfolio hedge was again demonstrated in Q4/2018, when global stock prices fell sharply but gold gained 8% and mining stocks an impressive 17%. The hedging function of gold was even more apparent in the crisis year of 2008.

Annual performance of gold in local currencies vs. domestic equity markets, in %, 2008



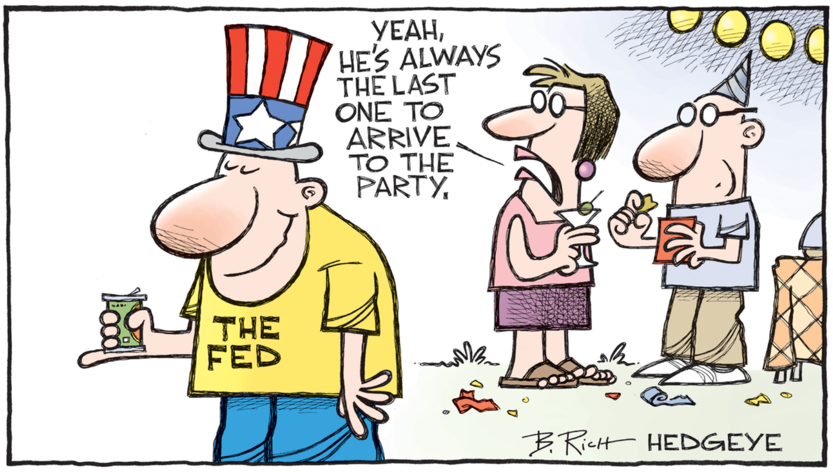
Source: goldprice.org, Yahoo.finance, BGMI Bullion, Incrementum AG

There is hardly anything more insidious in the markets than the illusion of lasting calm.
Claudio Borio,
BIS Chief Economist

The fact that gold is still not trusted by the mainstream, however, is shown by the fact that the following positive performance figures of gold are hardly reported in the media:

- The clear outperformance of gold against most stock indices over the course of 2018, left the impression that gold continued to be on the crutch, even if gold appreciated in absolute terms in EUR and most other currencies. In USD and yen, gold significantly outperformed the respective stock indices.

- Gold in CAD and AUD as well as the world gold price are at or close to their highs.
- Since the introduction of the euro as book money, the gold price has risen by 356%, a performance of 7.8% per annum.



Courtesy of Hedgeye

Like the weather, markets are turbulent.
Benoit Mandelbrot

Economic and monetary conditions offer sufficient arguments for a return of the upward movement of gold in USD and the continuation of upward movement as measured in other currencies:

- Economic worries are becoming greater, which could significantly reduce the opportunity cost of gold investments in the midst of a bull stock market. **Our analysis of the various phases of a recession in the chapter "Portfolio Characteristics"[92] shows that gold was able to compensate very well for share price losses in phases 1-3 of previous recessions.**
- **High indebtedness, the zombification of the economy, and the historically still very loose monetary policy reduce the potential of bonds as diversifier.** Gold therefore appears to remain an indispensable part of the portfolio going forward.
- **The debt levels reached prevent the central banks from (further) significantly raising interest rates.** The Federal Reserve can at least respond to the deteriorating economic situation by cutting interest rates from the current target range of 2.25%-2.50%, while the ECB does not have this main monetary policy instrument at its disposal. Further rounds of QE are therefore to be expected. This is a positive environment for gold. The implementation of negative interest rates, especially if cash holdings and

[92] This chapter is part of the "Extended Version" which you can download for free at https://ingoldwetrust.report/igwt-en/?lang=en.

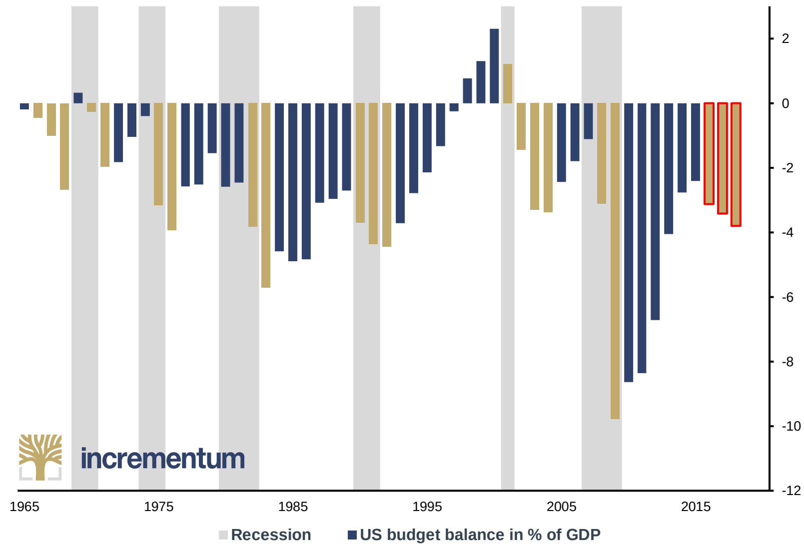
accounts of the general public with commercial banks are included as well, would also be a support for the gold price.

You ain't seen nothin' yet, b-b-b-baby, you just ain't seen n-n-nothin' yet, here's something that you never gonna forget, b-b-b-baby, you just ain't seen n-n-nothin' yet.
Bachman-Turner Overdrive

- **Political pressure on the Federal Reserve, but also on other central banks, will continue to increase.** Not least due to political polarization, ideas such as MMT (Modern Monetary Theory) will continue to find their way into central banking circles. Fiscal discipline, which is already limited in most countries, could thus be further weakened. The more irresponsibly the money monopoly is used to finance debt, the more trust will be withdrawn from conventional currencies.

Despite record-high tax receipts, the US budget deficit once again expanded in Fiscal 2018. This is unprecedented. **We have never seen three consecutive annual deficit increases outside of a recession**.

US budget deficits, in % of GDP, 1965-2018, US recessions (grey areas)



Source: Gavekal, Federal Reserve St. Louis, Incrementum AG

Our tour de force has also brought the following findings to light:

- **Gold and blockchain technology:** This liaison is not a brief summer flirt, but an ever closer relationship. As in any relationship, there will still be some problems to solve until the partnership is consolidated. However, we are convinced of the viability of this relationship.

Outsiders are making the next Renaissance. Those who saddle up and fight for personal, financial, political, and economic authenticity in a world running away from its battles; running to hedonism, nihilism, fatalism, victimology, dependency, economic free-lunchism, and political shortcuts.
Russell Lamberti

- **Gold mining stocks:** After several years of creative destruction in the sector, most companies are now on a much healthier footing. The recent M&A wave reinforces our positive basic assessment. From an anticyclical point of view, there are probably few sectors that are more exciting. In our investment process we are currently concentrating on high-quality producers and mid-tiers. If the gold/silver ratio falls, silver miners should be put back on the watchlist.

- **Technical analysis**: The technical structure of the market looks predominantly positive. It will be decisive whether gold is able to break through the resistance zone at USD 1,360-1,380, the technical Rubicon of the present.

- **Technological innovations:** Innovations such as AI, drones, and digitalization have not bypassed the gold sector; they are revolutionizing it. This process is far from complete and represents a major challenge for both existing and new projects. However, the gold industry has already shown that it can meet and profit from these challenges.

- **Gold is green:** Gold is a green product due to its extremely high degree of recycling. Of course, way too often working conditions could be improved and pollution reduced (problems that are not specific to the gold sector). To improve the situation, the ESG guidelines have gained a foothold in the gold sector and are no longer merely given lip service.

Quo vadis, aurum?

My favorite thing to remember is the future.
Salvador Dali

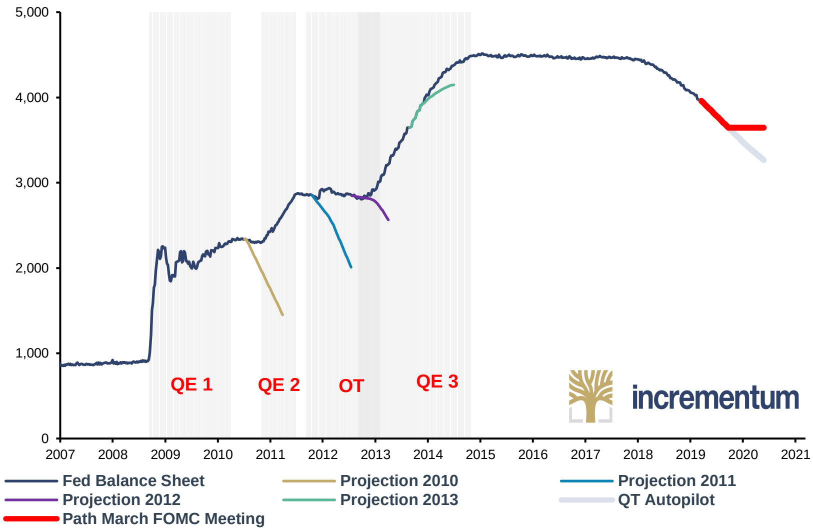
Two years ago, we developed several scenarios for gold price developments that were aligned with the dynamics of GDP growth and the further course of US monetary policy. The time horizon we applied was the term of office of the current US administration (2017-2020). The implementation of monetary normalization was also envisaged for this period.

Term period dominated by	Growth	Monetary normalization	Gold price in USD
Scenario A: Genuine boom	Real growth > 3% p.a.	Success; Real interest rates >1.5%	**700–1,000**
Scenario B: Muddling through	Growth & inflation 1.5-3% p.a.	Still not fully successful	**1,000–1,400**
Scenario C: Inflationary boom	Growth & inflation > 3% p.a.	Still not fully successful	**1,400–2,300**
Scenario D: Adverse scenario	Stagnation / contraction <1.5%	Stoppage & reversal of monetary policy	**1,800–5,000**

Source: Incrementum AG

Scenario B is still the one in which we find ourselves. Trust in the US as a global economic locomotive is currently *still* there, even though it was clearly tested in Q4/2018. This slump reminded us once again how quickly the mood of the markets can change. **But the crucial question is: Has monetary normalization failed?**

Fed balance sheet path, in USD bn, 01/2007-2021e



Source: Federal Reserve St. Louis, Incrementum AG

You're gonna need a bigger boat!
Jaws

We stand by our assessment that the social climate, the economic dynamics, and the course of the public debate suggest that the Federal Reserve will initiate a turnaround in monetary policy before the next presidential election in November 2020. This turnaround, and probably just its announcement, has a good chance of being the trigger that lifts the gold price above the psychologically important resistance zone of USD 1,360-1,380. If this mark is breached, a gold price of over USD 1,800 seems within reach.

Courtesy of Hedgeye

Conclusion

Work hard, use your common sense and don't be afraid to trust your instincts.
Fred L. Turner

The past 12 months have shown that the seemingly invulnerable economic upswing has begun to crack deeply. The worldwide boom, driven by low interest rates and a ceaseless expansion of credit and money, now stands on feet of clay. The probability that the boom will turn to a bust is high, or at least significantly higher than the mainstream assumes.

There were always ample warnings, there were always subtle signs and you would have seen it coming, but we gave you too much time.
"Coma", Guns N' Roses

The developing political, social, economic, and technological upheavals are enormous. On many fronts confidence in the existing order is crumbling, while the new order has not yet gained enough trust to have a stabilizing effect. This trend will intensify in the coming years. **In addition, the bubbles in the equity, bond, and real estate markets – the Everything Bubble – and the corrosive dynamic of overindebtedness further exacerbate the fragility of markets – month after month, week after week, day after day.**

We expect significant upheavals in the coming years, with a substantial impact on the gold price. As you know from reading us for many years, we will follow these events closely, analyze them in detail, and comment on them regularly.

And that is why, in this age of the erosion of trust, we still say:

IN GOLD WE TRUST

About us

Ronald-Peter Stoeferle, CMT

Ronnie is managing partner of Incrementum AG and responsible for Research and Portfolio Management.

He studied business administration and finance in the USA and at the Vienna University of Economics and Business Administration, and also gained work experience at the trading desk of a bank during his studies. Upon graduation he joined the research department of Erste Group, where in 2007 he published his first *In Gold We Trust* report. Over the years, the *In Gold We Trust* report has proceeded to become one of the benchmark publications on gold, money, and inflation.

Since 2013 he has held the position as reader at scholarium in Vienna, and he also speaks at Wiener Börse Akademie (i.e. the Vienna Stock Exchange Academy). In 2014, he co-authored the international bestseller "*Austrian School for Investors*", and in 2019 "*Die Nullzinsfalle" (The Zero Interest Rate Trap)*. Moreover, he is an advisor for Tudor Gold Corp. (TUD), a significant explorer in British Columbia's Golden Triangle.

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Mark is a partner of Incrementum AG and responsible for Portfolio Management and Research.

While working full-time, Mark studied business administration at the Vienna University of Business Administration and has continuously worked in financial markets and asset management since 1999. Prior to the establishment of Incrementum AG, he was with Raiffeisen Capital Management for ten years, most recently as fund manager in the area of inflation protection and alternative investments. He gained entrepreneurial experience as co-founder of philoro Edelmetalle GmbH.

Since 2013 he has held the position as reader at scholarium in Vienna, and he also speaks at Wiener Börse Akademie (i.e. the Vienna Stock Exchange Academy). In 2014, he co-authored the book "*Austrian School for Investors*".

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Incrementum AG is an independent investment and asset management company based in Liechtenstein. Independence and self-reliance are the cornerstones of our philosophy, which is why the four managing partners own 100% of the company. Prior to setting up Incrementum, we all worked in the investment and finance industry for years in places like Frankfurt, Madrid, Toronto, Geneva, Zurich, and Vienna.

We are very concerned about the economic developments in recent years, especially with respect to the global rise in debt and extreme monetary measures taken by central banks. We are reluctant to believe that the basis of today's economy, i.e. the uncovered credit money system, is sustainable. This means that particularly when it comes to investments, acting parties should look beyond the horizon of the current monetary system. Our clients appreciate the unbiased illustration and communication of our publications. **Our goal is to offer solid and innovative investment solutions that do justice to the opportunities and risks of today's prevalent complex and fragile environment.**

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We would like to thank the following people for their outstanding support in creating the In Gold we Trust report 2019:

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