In Gold we Trust 2016 *Compact Version*

Gold is back! With the strongest quarterly performance in 30 years, the precious metal in Q1 2016 emerged from the bear market that had been in force since 2013. A decisive factor in this comeback is growing uncertainty over the recovery of the post-Lehman economy. After years of administering high doses of monetary painkillers, will the Fed succeed in discontinuing the practice? Or is the entire therapy about to be fundamentally questioned?

Authors:

Ronald-Peter Stoeferle, CMT
rps@incrementum.li
Twitter @RonStoeferle

Mark J. Valek, CAIA
mjv@incrementum.li
Twitter @MarkValek

About the Report:

This is the 10th anniversary of our annual "In Gold we Trust"-Report. It provides a holistic assessment of the gold sector and the most important factors influencing it.

The "Compact Version" is a strongly condensed version of the report. The extended version is available at:

www.incrementum.li

Feedback welcome:
ingoldwetrust@incrementum.li

Generating growth and inflation remains the imperative of monetary policy. The systematic credit expansion required for this just doesn't want to get going. Even the ECB, which initially acted with restraint after the financial crisis, is nowadays stuck in a perennial loop of monetary improvisation and stimulus. **General uncertainty has now increased even further after the surprise outcome of the Brexit referendum.**

After years of pursuing low interest rate policies, central banks have maneuvered themselves into a lose-lose situation: Both continuing and ending the low interest rate regime harbors considerable risks. In an attempt to finally achieve the desired boost to growth, a monetary Rubicon has been crossed in several currency areas with the imposition of negative interest rates. **Gold is increasingly attractive in this environment. It used to be said that gold doesn't *pay* interest, now it can be said that it doesn't *cost* interest.**

As a last resort, even the radical measure of helicopter money is considered these days. As the flood of liquidity has hitherto primarily triggered asset price inflation, newly created money is now supposed to be injected into the economy by circumventing the banking system in order to boost aggregate demand. It seems realistic to expect that such a windfall would indeed ignite the much-coveted price inflation. Whether it will be possible to put the genie back into the bottle once it has escaped is a different question.

An exit from the Fed's monetary emergency programs has been announced for years in the US. This, together with the perception that the economy was recovering, led to a strengthening US dollar in recent years. Commodities and gold weakened as a result. So far, the actual extent of the normalization of monetary policy consists of the discontinuation of QE 3 and a single rate hike by 25 bps.

The US economic expansion appears to have run its course already. Should the rate hike cycle that has been initiated fail, a significant loss of confidence in the central bank's policies and with it the USD appears likely. **This would go hand in hand with rising commodity prices and a return of inflation and would represent a "perfect storm" for gold.**

We believe the time for investing in inflation-sensitive assets has come. Apart from gold, silver and mining stocks offer very interesting opportunities. After several years of drastic adjustments, it is likely that mining shares will once again exhibit strong gold price leverage.

According to our perception the events of the past year are validating our views and we are maintaining our gold price target of USD 2,300 by June 2018.

We would like to express our profound gratitude to our premium partners for supporting the "In Gold we Trust" 2016

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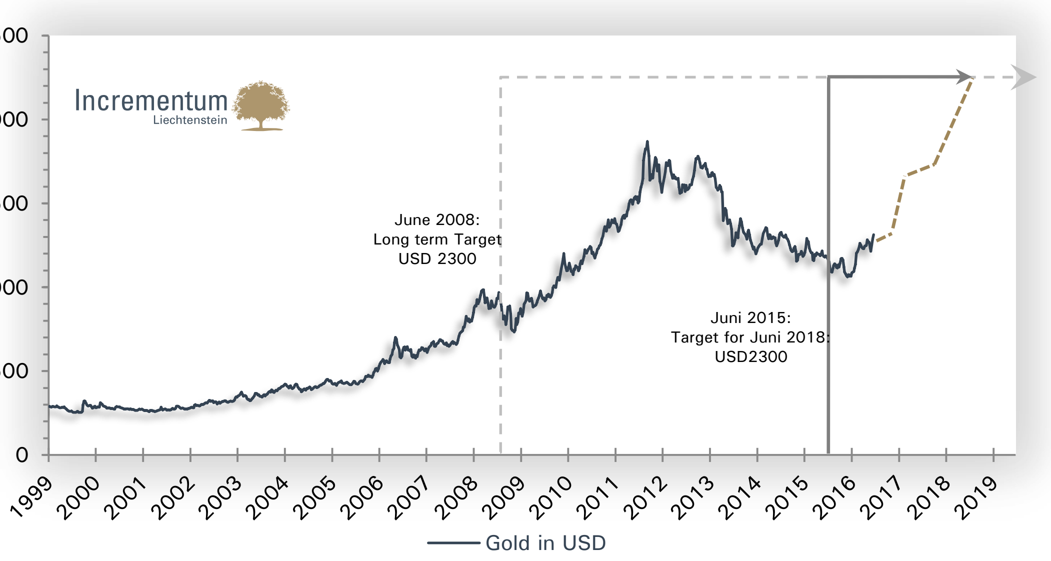
INTRODUCTION

On occasion of the anniversary, we permit ourselves to undertake a brief – and definitely self-critical - review of our most important statements regarding the gold price. When gold traded at USD 800 in 2008, we first called for a long term price target at the inflation-adjusted all time high of USD 2,300, which must have appeared outlandish to many market participants at the time.

Gold price since 1999 (in EUR and USD)



Source: Federal Reserve St. Louis, Incrementum AG

After the gold price had reached a (nominal) all time high of USD 1,920 in September 2011, a correction started, which – contrary to our expectations – evolved into a full-blown bear market in 2013. While most analysts subsequently expected prices to languish for many years, **we continued to stand by our thesis that gold was still in a secular bull market**.

„It would be nice to know when the rest of the world will come around to the gold-friendly view that central bankers have lost their marbles.“
Jim Grant

Our main argument was primarily that it is an impossibility to create a “self-sustaining” economic expansion by means of the printing press. Central bankers succeeded in suppressing symptoms, which restored faith in the monetary system and seemingly made gold *passé*. The underlying structural problems creating the crisis in the first place have only gotten worse. We therefore remained optimistic with regards to the overarching trend in the gold price. Last year we felt confident enough to set an **ambitious price target of USD 2,300 by June of 2018**. In the following, we will explain why we believe that our views from then have been validated by events over the last twelve months and why we are maintaining our price target.

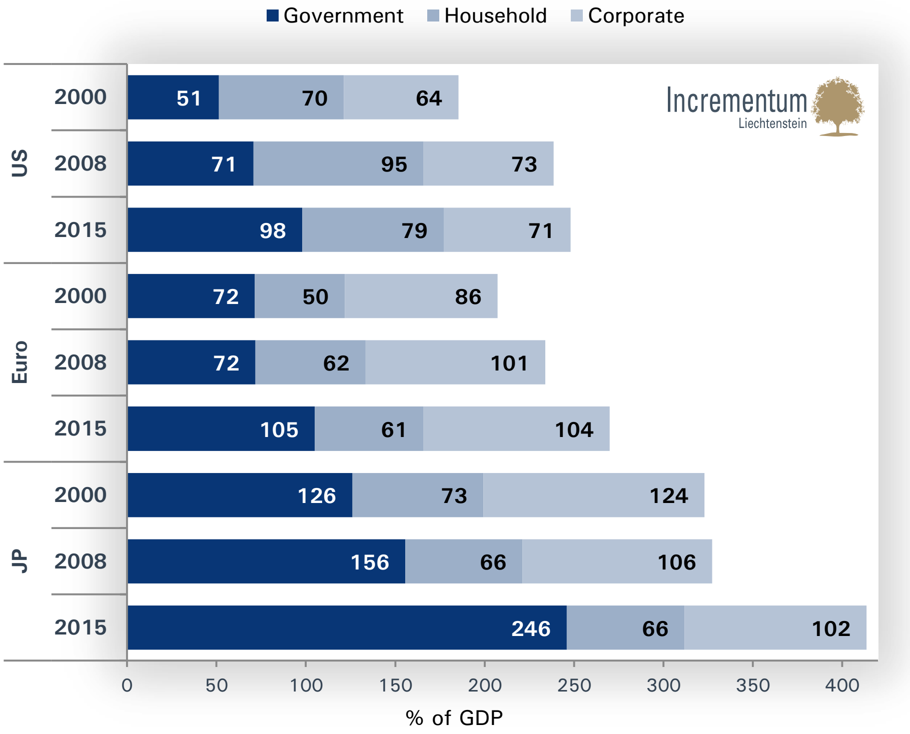
WHERE THINGS STAND

Structural over-indebtedness is obvious in many parts of the world. **Since true reform and spending cuts appear illusory and massive tax increases are counterproductive, more growth has to be generated at**

"Turn and face the strange
Ch-ch-changes
Don't want to be a richer man
Ch-ch-ch-ch-changes."
David Bowie

any cost in order to make it possible to service these debts over the medium term. And so the monetary all-or-nothing gamble of global central bank experiments continues unabated – in the vain hope that it will eventually bring about the long promised self-supporting and sustainable recovery.

Private and public debt as a ratio of GDP (2000/2008/2015)



Source: BIS, Incrementum AG

"Markets say the ECB is done, their box is empty… But we are magic people. Each time we take something and give to the markets - a rabbit out of the hat."
Vitas Vasiliasukas, member of the ECB's Governing Council

Negative interest rates are one of the last hopes to which policymakers cling.[1] This monetary Pandora's box has in the meantime been opened in five currency areas[2]: While just a few years ago, the imposition of negative rates was largely considered a thought experiment of monetary cranks with too much time on their hands, nowadays the debate is solely focused on how deeply into negative territory interest rates can be pushed. The fatal "unintended consequences" of this monetary wrack and ruin are hardly ever discussed. **Central banks are increasingly becoming hostage to developments which they themselves have helped to set into motion.**[3]

"Government bonds are the last bastion of the illusion of value."
Christoph Pfluger

Interest rates have never been as low as today; 5,000 years of data confirm this. In the meantime government bonds valued at more than eight trillion dollars[4] have negative yields to maturity. As an asset class, fixed income securities are more expensive than ever before. By now, central bank interventions have decimated all notions of honest, free market price discovery in bond markets and beyond. The centrally planned bubble in bonds is about to bring about the "euthanasia of the rentier" so craved by Keynes himself and his acolytes. **When this bubble inevitably bursts, it**

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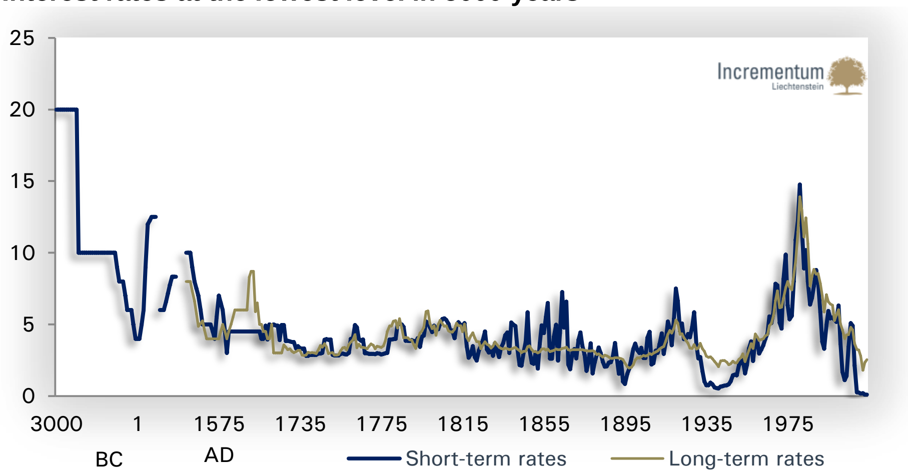
[1] Stocker, Ferry: "Geldpolitisches Extremdoping ohne Ausweg" *("Extreme monetary policy doping without way out"), Die Presse (guest commentary), December 30, 2015*
[2] Japan, Eurozone, Switzerland, Sweden and Denmark
[3] See: "Data dependent", *Market Outlook Fall 2015*, DALE Investment Advisors
[4] This number probably rose sharply since the Brexit vote

will be abundantly clear how valuable an insurance policy in the form of gold truly is.

Interest rates at the lowest level in 5000 years



Source: Bank of England, "Growing, Fast and Slow", Andrew G. Haldane, 2015

From "gold *pays* no interest" to "gold doesn't *cost* interest"

Today's interest rate environment will have grave consequences for investors. A foretaste of what to expect was provided by Muenchner Rueck: As the second-largest reinsurance company in the world, with a balance sheet of EUR 280 billion, it felt extraordinary when they announced they have started to put physical cash and gold into storage.[5]

Peak Monetary Policy?

However, what will happen if it turns out that negative interest rates aren't an effective means for achieving the long wished-for economic expansion either? As a last resort, helicopter money is waiting in the wings. This measure ultimately combines two ingredients that are already problematic on their own: more expansive monetary policy and more expansive fiscal policy. **This instrument could succeed in boosting price inflation and help central banks to achieve one of their goals. It seems however quite possible that they would end up grossly overshooting their objective. Excessive use of helicopter money would change the monetary system fundamentally.**

The whole world is in thrall to central bankers imposing ever more expansive policies...the whole world? No! In one currency area administered by indomitable central bankers, normalization of monetary policy has actually begun quite some time ago. The Fed announced the gradual tapering of its QE 3 program in the first half of 2013, and cautiously reduced its asset purchases over the course of 2014. The subsequent step that has been talked up as a new rate hike cycle, so far amounted merely to a hike in the federal funds rate by 0.25% in December of 2015, coupled with an announcement that four additional hikes were in the offing in 2016. However, the stock market quickly demonstrated to Ms. Yellen that a price would have to be paid for rate hikes, by slumping in January and February. **The turnaround in US interest rates played up by the media has failed miserably in our opinion.**

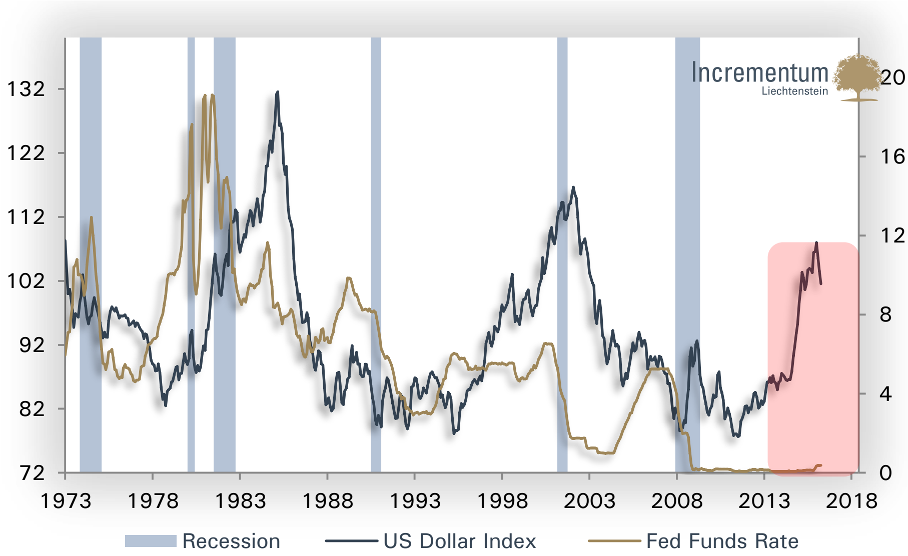
"Study predicts gold could plunge to $350 an ounce!"
Market Watch, July 30, 2015

On the back of relative optimism with respect to the US economy we have seen "peak bearishness" on commodities last year and "peak bullishness" on the US dollar. These sentiments depend however crucially

[5] See: "Versicherer hortet Geld statt es der EZB zu geben" (*"Insurance company hoards money instead of depositing it with the ECB"*), *Die Welt*, March 16, 2016

on the narrative that there will be a return to a normal monetary policy environment in the US.

Trade-weighted US dollar index (lhs) and the effective federal funds rate (rhs)



Source: Federal Reserve St. Louis, Incrementum AG

Why do we believe recent events are validating our views with respect to our gold price target? In our Christmas letter to investors we stated the following:

"It is impossible to overlook that investors are focused on US interest rate policy and the global reserve currency at the turn of the year. *In the middle of a currency war driven by deflationary pressures, after eight years and countless delays, expectations regarding a normalization of US interest rate policy are enormous.* ***We believe the potential for disappointment that could result from a further delay in the normalization process or a return to reflationary measures is extraordinarily high."***

"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

What we have witnessed in the markets so far this year is a foretaste of what is going to happen if the expected monetary policy normalization cannot be implemented. The rally in the gold price in the first quarter of 2016 was the strongest quarterly performance in 30 years and has finalized the metal's bottoming process in our opinion. Once the feasibility of current monetary policy is fundamentally questioned, significant consequences for investors will be in the offing. **Volatility, this is to say uncertainty about the future as reflected in market prices, will increase markedly once market participants fully realize that we have gradually moved toward a monetary and fiscal dead end in recent years.**

Brexit will be a welcomed excuse for the Fed to stop, or reverse their policy

Most market participants still seem to assume that the normalization of US monetary policy has begun. However, they are also aware of the fact that the number of trouble spots in the world is on the rise and that policy-makers continually resort to improvisation. The measures they implement are allegedly without alternative, but ultimately only push problems into the future, while making them even worse in the process. We are absolutely certain, that **the unexpected Brexit may well serve as a welcomed excuse for the Fed to officially communicate a "temporary" halt of the process towards a normalization of monetary policy.**

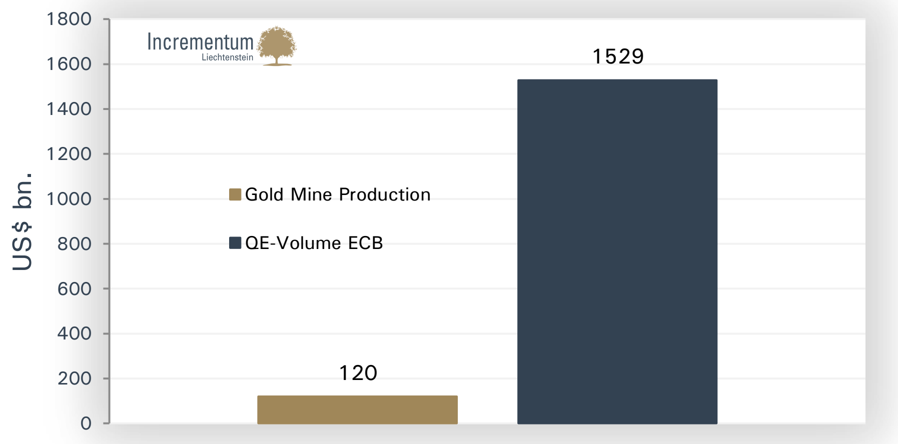
It is obvious that central banks in particular have become hopelessly entangled in an interventionist spiral; that is, it has seemingly become impossible to exit from "unconventional monetary policies" once they have been adopted, and that a normalization of policy is out of reach everywhere. Most market participants have largely suppressed memories of the monetary near-death experience of 2008. **They have also become inured to the fact that they have to take ever greater risks in order to achieve desired returns.**

In order to put the size of QE programs into perspective, we are comparing them to the value of global gold production. At a price of USD 1,200 per ounce, the ECB could have bought 4,698 tons of gold in the first quarter of 2016 alone with the current volume of its QE program. Thus the ECB's asset purchases in the first quarter of 2016 have exceeded the value of globally mined gold by a **factor of more than 6**.

The amount printed by the ECB and the BoJ in a single month is equivalent to the value of global annual gold production.

If the European QE program is continued as planned[6], it would be equivalent (assuming prices don't change) to the value of 21,609 tons of gold, this is to say approximately 12% of the total stock of gold of 183,000 tons mined over the past several thousand years. If one adds the volume of the Bank of Japan's QE asset purchases to this, the total would be equivalent to the value of 39,625 tons of gold over 2016 as a whole. **Incredibly, the ECB and the BoJ are printing an amount equivalent to the value of global annual gold production within just 30 days.**

Gold production vs. volume of ECB and BoJ QE



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

THE DOMINANT NARRATIVE

The following economic worldview continues to predominate in the press; it is derived from statements by central bankers, politicians, representatives of supra-national organizations (IMF, World Bank, G7, G20, OECD, etc.), as well as the majority of financial market pundits:

- **The Keynesian economic policies which have been implemented in the wake of the "global financial crisis" were fundamentally correct and necessary.**

[6] At its current size of EUR 80 billion per month

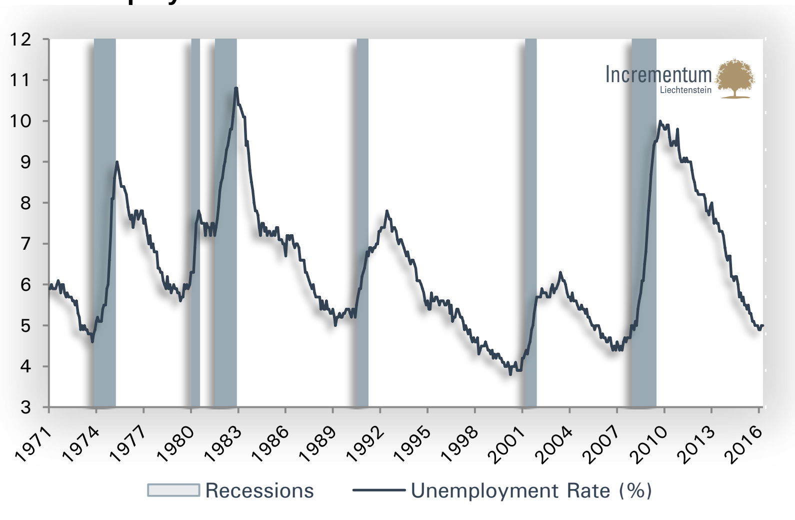
- The US has taken the most forceful economic policy actions in order to counter the crisis and has therefore returned much faster to economic growth than all other developed nations.
- **The US economy is in a process of recovery since the crisis,** the "patient" is on the way to regaining his health.
- **Due to the progressing recovery it is now possible to slowly normalize monetary policy again.**
- **Central banks have things under control and can always provide financial market backstops if necessary – the Greenspan/Bernanke/Yellen/Draghi/Kuroda put is alive and well.**

"If command economies worked we would all be speaking Russian."
Kyle Bass

Not least because the US is seen as a model country and the engine of global growth, the US economy is watched very closely. **Should the normalization of monetary policy, which has been postponed several times already, not succeed, we believe the economic narrative could be shaken to its core. The recent Brexit vote may be exactly the excuse the Federal Reserve need to postpone its rate hikes for the indefinite future.**

Proponents of the dominant narrative cite the decline in the unemployment rate in recent years as the main evidence for the success of US economic policy. However, labor market data are a lagging economic indicator and as such would not necessarily be relevant in a free market. Since the Fed is responsible for keeping the unemployment rate at a low level as part of its dual mandate, market participants are able to anticipate the Fed's likely actions on the basis of employment data. **Due to the growing dependence on easy money, interest in labor market data has increased strongly in recent years.**

U.S. unemployment rate and recessions



Source: Federal Reserve St. Louis, Incrementum AG

Whether the Fed will be able to continue with the rate hike cycle it has initiated and will start to reduce the "temporary increase in the money supply" again, is probably the litmus test that will show whether the US economy has truly recovered. Should monetary policy however become more expansive again due to an economic slump, the effects on the financial markets will probably be grave. **The 18 trillion dollar question is therefore: When will the next recession strike and how will the Fed react?**

THE RECESSION THAT MUST NOT HAPPEN

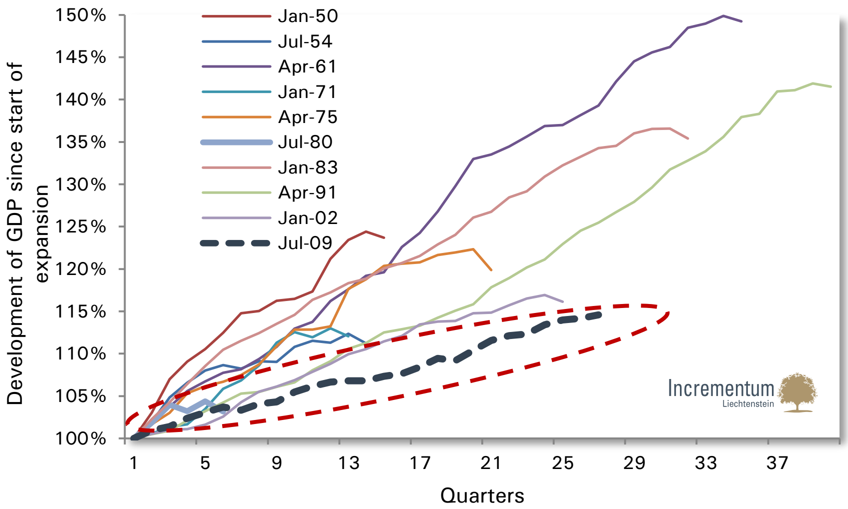
"I find myself in an unpleasant situation. I had preached for forty years that the time to prevent the coming of a depression is the boom. During the boom nobody listened to me. Now people again turn to me and ask how the consequences of a policy of which I had constantly warned can be avoided."
Friedrich August von Hayek

"We are approaching the longest expansion in history and it is fake."
Dave Collum

We have discussed the growing probability of a US recession in detail in our chart book "[Who's Afraid of Recession?](#)".[7] In the following section we want to explore the evidence again, as an imminent beginning of a recession would force a u-turn in monetary policy and lead to a significant loss of face for central banks.

The bubble in the US real estate market that burst almost nine years ago, caused a severe international crisis. The situation only calmed down again by the end of 2009, at least superficially. Although the financial crisis still reverberates in many ways, there haven't been any large setbacks in economic growth yet, at least in the US, which is experiencing one of the longest economic upswings since World War II. The following chart shows that of the last eleven economic expansions, only three have lasted longer. The current expansion could therefore be seen as especially successful, if not for a number of facets that are marring the picture markedly:

US economic expansions after World War II (duration and extent)



Source: Bawerk.net, Incrementum AG

Firstly, the current upswing is borne by a giant cushion of air in the form of zero interest rates and unconventional measures, such as quantitative easing and Operation Twist, provided by the Fed. These measures have inflated asset prices in particular, which benefits mainly the financial industry and the rich, and moreover represents evidence that capital is once again being misallocated.

Secondly, the population at large, which has benefited only marginally from the renewed surge in stock prices, appears to be dissatisfied with the economic situation. Strong evidence for this is provided by the massive support for populist parties in Europe, as well as by the Presidential election campaign in the US. Donald Trump has gotten in the presidential election

[7] "Who's Afraid of Recession?", February 19, 2016

campaign currently ongoing in the US. His platform plays directly into the disgruntled and marginalised white middle class with few prospects for the future. Likewise, we see the same political movement going on in Europe where populist parties are gaining momentum. **Our view of a new political reality building across the Western World was recently substantiated by the recent Brexit vote.**

"Only informed optimists reject that market is forever doomed to rich valuations and dismal future returns. Rain is good."
John P. Hussman

Against this backdrop the economic situation appears anything but rosy: The current expansion is old, weak, artificial and not satisfactory in the eyes of the broad population. In the tradition of the Austrian School, we actually want to be cautious about extrapolating past patterns into the future; nevertheless, we don't believe it likely that the current cycle will break significantly from the frequency with which expansions and recessions have occurred in the past several decades.

FROM REFLATION TO STAGFLATION

"*One may say that, apart from wars and revolutions, there is nothing in our modern civilizations which compares in importance to inflation."*
Elias Canetti

A new recession is inevitable. As already mentioned above, precise predictions regarding the when or how are not possible. At this juncture we nevertheless want to warn about an economic scenario that we believe to be a realistic possibility, namely ***stagflation***.

The term "stagflation" is derived from the terms stagnation and inflation. It describes an economic situation in which economic stagnation (i.e., stagnating or even contracting economic output) occurs in combination with price inflation. According to the mainstream – i.e., Keynesian – doctrine, stagflation is practically an impossibility, as it is inter alia contradicting the Phillips curve. However, this is no reason for us to dismiss this scenario – quite the contrary.

Today's framework conditions are of course different from those of the 1970s, when the Western world last faced a pronounced period of stagflation.[8] **However, from our perspective it is time to once again warn of considerable currency debasement and stagflationary tendencies arising in its wake.** Last year we described our outlook as follows:

"We are strongly convinced that we are now close to a fork in the road. Over the coming three years, a paradigm change is likely to become evident in the markets, quite possibly including rising inflationary trends. *We believe the following scenarios to have the highest probability:*

Scenario I*: The current economic cycle nears its end and the fairy tale of a self-sustaining recovery is increasingly questioned by market participants.* ***This leads to a significant devaluation of the US dollar relative to commodities, since the Fed – as it has stressed time and again – will once again employ quantitative easing or similar interventions if occasion demands it.*** *In this case gold would benefit significantly from wide-ranging repricing in financial markets. A stagflation-type environment*

[8] See: Browne, Harry: "The coming Devaluation", September 3, 1970

would become a realistic alternative in this scenario, something that is currently on almost no-one's radar screen."[9]

A year later it seems to us as though this scenario has moved a decisive step closer. Economic growth rates are weakening,[10] and the trend of price inflation has turned up. We believe it is easily possible that the economy will slide directly into a pronounced stagflation phase. After many years of credit expansion, boosted by ever lower interest rates and finally the introduction of QE programs, we are now, so to speak, approaching the end of the monetary line.

If reflation through higher credit expansion becomes more difficult, central bankers can do nothing but improvise (e.g. by testing the "academic thought experiment" of helicopter money in practice), which could lead to a loss of confidence in the paper currencies. This could – similarly as in the 1970s – manifest itself in a devaluation of paper currencies towards commodities.

HELICOPTER MONEY: THE REFLATION POLICY'S ACE IN THE HOLE?

„We understand that in the past you have described the concept as 'very interesting', but that it is not something that the ECB is currently investigating. As members of the European Parliament, we call on you to investigate these different and alternative policies."[11]

18 members of the European Parliament writing an open letter to Mario Draghi

"...a very interesting concept…"
Mario Draghi

For several years price inflation has come in way below plan, as a result of which the list of measures central bankers might need to implement next in order to finally boost inflation is getting longer and longer. One concept that is currently a topic of debate nearly everywhere, and which although it hasn't been discussed by the ECB council yet, is "very interesting" according to Mario Draghi, is so-called helicopter money. Peter Praet, chief economist of the ECB, told the Italian newspaper La Repubblica that this "extreme instrument" would in principle be available as a last resort.[12] This seems a good enough reason to take a closer look at it.

"The fact that no responsible government would ever literally drop money from the sky should not prevent us from exploring the logic of Friedman's thought experiment"
Ben Bernanke

What is helicopter money?
The metaphorical term "helicopter money" was coined by Milton Friedman, who used it as an illustration in the context of his monetary theory, describing money supply inflation as akin to a helicopter flying over a model community and dropping money that people would then pick up from the ground.[13] Nowadays it describes a targeted interest- and debt-free expansion of the money supply consisting of direct transfer payments to governments or households. **The goal is to boost demand, and with it inflation.** Thus money created by the central bank will no longer be injected into the economy by buying bonds from banks as has been the case hitherto, but possibly by one or more of the following four methods:

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[9] *In Gold we Trust Report 2015*, p. 119
[10] The World Bank cut its forecast for the world economy from 2.9% to 2.4%. The IMF also recently revised its forecasts downwards. **And of course, as a result of the Brexit we should expect numerous further downward revisions.**
[11] See: "MEPS Want the ECB to look at Helicopter Money", qe4people.eu
[12] See: Giugliano, Ferdinando and Tonia Mastrobuoni: "Peter Praet, capo economista all'Eurotower: La Bce potrà abbassare ancora I tassi", *La Repubblica*, March 18, 2016
[13] See: Friedman, Milton: *The Optimum Quantity of Money: And other Essays*, AldineTransaction, 1969

1. **QE combined with fiscal expansion:** central banks purchase government bonds, temporarily increasing the money supply. This lowers the cost of government financing and creates leeway for fiscal stimulus or tax cuts.
2. **Cash transfer payments to governments:** Very similar to point 1, but without governments having to redeem the debt – the central bank expands the money supply permanently. Rolling over outstanding debt in perpetuity would be one way to circumvent various legal aspects with this strategy. An implicit guarantee that central banks will do this for newly bought bonds also seems possible.
3. **Cancellation of outstanding debt securities, which central banks hold as assets on their balance sheets:** this can be a one-off measure, but regular haircuts of a specific percentage size would also be thinkable. The purchase of negative yielding bonds de facto already represents such a measure.
4. **Cash transfer payments to private households:** Central banks issue checks to individuals or simply credit a certain amount to their bank accounts. [14]

The mere continuation of monetary policy by other means?

Hans-Werner Sinn points out that the QE programs of recent years – even though government bonds were only purchased in the secondary markets – essentially already represent helicopter money as described in point 1. Newly printed central bank money has reached government budgets indirectly through the debt channel, and has served to fund expenditures which otherwise would have required tax increases. Since the interest payments on these bonds are flowing back to governments via distribution of the central bank's profits, this form of financing is ultimately interest-free as well.

"While democratic governments are nowadays determining the extent of their indebtedness, as well as who the recipients of transfer payments or the beneficiaries of tax cuts will be, in the case of helicopter money it is the ECB itself that will make these decisions."[15]

"This would be monetary state financing pure, and in many regions illegal. However, those who therefore dismiss the idea as a pipe dream, underestimate the flexibility of the law and forget that ten years ago, the notion of negative interest rates was at best thought suitable as a little joke around the water cooler. Many a central banker probably regards helicopter money [….] no longer merely as a surreal thought experiment."
NZZ

Helicopter money is legally possible

The suspicion that central banks would exceed their mandates by issuing helicopter money has been frequently voiced. For instance, Bundesbank president Jens Weidmann remarked: "*Central banks do not have a mandate for this policy, not least because massive wealth redistribution would be associated with it*". The legal mandate of ensuring price stability could no longer be safeguarded in the long term in the event of state financing through the printing press, as the momentum of price inflation could easily get out control. However, upon taking a closer look at the issue, many economists have come to the conclusion that the legal hurdles are much lower than is generally assumed.[16]

A study by Deutsche Bank shows that helicopter money – taken to mean monetary state financing – isn't really a new concept, but has already been practiced several times in the past. The institutional framework conditions of central banks are very vague and leave a lot of scope for interpretation;

[14] See: Saravelos, George, Daniel Brehon and Robin Winkler: "Helicopter 101: your guide to monetary financing", Deutsche Bank Research, April 15, 2016
[15] See: Sinn, Hans-Werner: "Gefährliches Helikopter-Geld", *Frankfurter Allgemeine Zeitung (guest commentary)*, March 31, 2016
[16] For instance, Klaus Adam, who formerly worked in the research department of the ECB and now is professor at the University of Mannheim, notes it would not violate the central bank's mandates if they acted on their own initiative and with respect to their inflation targets.

specifically the quite unconventional variant of transfer payments to citizens seems legally unproblematic.[17] Political will is ultimately more important than technical and statutory framework conditions. **On occasion of the next recession at the latest, helicopter money will likely appear on the agenda.**

"In theory at least, helicopter money could prove a valuable tool. In particular, it has the attractive feature that it should work even when more conventional monetary policies are ineffective and the initial level of government debt is high."
Ben Bernanke

The limits of the debt money system
As mentioned above, the measures taken to date in the form of zero, respectively negative interest rates and QE have been quite unsuccessful. This was inter alia due to the fact that the efforts of central banks to persuade commercial banks to expand credit have been partially countered by government efforts to make banks safer by means of directives such as Basel III and also because there has been limited demand for new credit in the private sector. In addition, negative interest rates actually seem to hamper credit expansion: Banks are reluctant to pass them on to their depositors, who would likely flee into cash. As a result of this the net interest margins of banks are shrinking, which dampens rather than boosts credit expansion. Helicopter money would therefore represent a suitable means of circumventing the banking sector with respect to the money supply expansion process, as a result of which it is occasionally referred to by the moniker "***QE for the people"***.

ARE INFLATION DYNAMICS CHANGING?

"We may well at present be seeing the first stirrings of an increase in the inflation rate — something that we would like to happen."
Stanley Fischer, Fed Vice-Chair

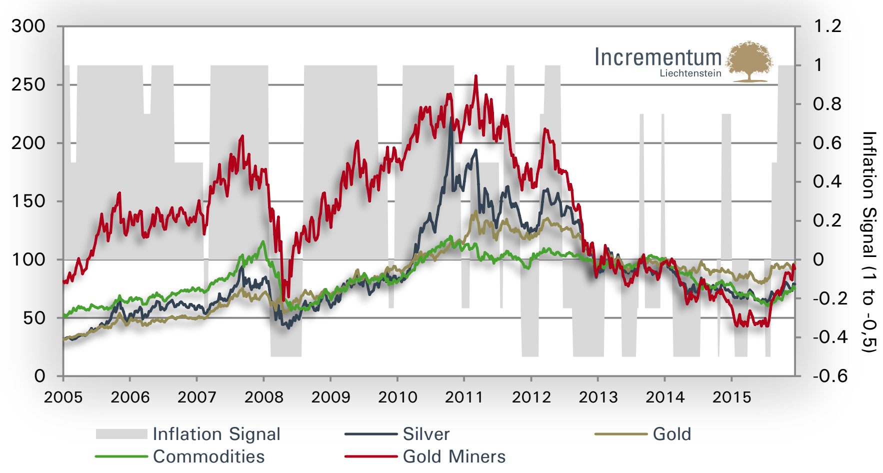
Price inflation dynamics are in our opinion the element that can tip the scales toward a sustained upturn in the gold price. The trend in US price inflation is particularly important for the global environment. **In last year's report we wrote the following on the title page:**

"We are convinced that we are now close to a decisive fork in the road: the disinflationary trend will (have to) be broken. Rising price inflation rates are possible both in conjunction with a revival in economic activity and in a stagflationary environment. In both cases, inflation-sensitive investments including gold and gold mining stocks will benefit."

Has the momentum of inflation, which has been in a pronounced disinflationary trend since 2011, finally turned?
Due to the importance of inflation momentum, we have developed a proprietary inflation signal which we use as a guide for investment allocations in our funds. The signal is exclusively based on market-derived data and has a shorter reaction time than the usual inflation statistics. Depending on the signal's message we shift allocations into or out of inflation-sensitive assets – primarily mining stocks, commodities and energy stocks. **For the first time in 24 months the Incrementum Inflation Signal indicates that a full-fledged inflation trend is underway.**

[17] See: Saravelos, George, Daniel Brehon and Robin Winkler: "Helicopter 101: your guide to monetary financing", Deutsche Bank Research, April 15, 2016

Incrementum Inflation Signal



Source: Yahoo Finance, Incrementum AG

TECHNICAL ANALYSIS

"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

"It is impossible to produce a superior performance unless you do something different from the majority."
Sir John Templeton

A comprehensive analysis of the gold market definitely has to include an analysis of the technical picture as well. It is important in this context to focus exclusively on technical conditions in terms of price and market structure, and to make an objective assessment of those factors independent of one's view of the fundamentals. Sometimes technical analysis can lead an analyst to completely different conclusions than those suggested by his analysis of the fundamental data.

This is in fact what happened in last year's "In Gold We Trust" report, which included the following comment regarding technical conditions on the title page:

"From a technical perspective, the picture is not unequivocal. The downtrend hasn't been broken yet. However, pronounced negative sentiment indicates resignation among gold bulls. ***We believe a final sell-off is possible. During such a sell-off, the support at USD 1,140 could be tested.*** *A reversal following such a test would be a reliable indication of a primary trend change in the gold market."*

"Buy low and sell high. It's pretty simple. The problem is knowing what's low and what's high."
Jim Rogers

From a technical perspective, things looked at best mixed for gold at the time, while based on fundamental analysis, we thought that a resumption of gold's bull market was highly likely in the not-too distant future (even if not right away). As we have already indicated in the preceding chapters, we believe that the bear market ended in text-book fashion at the end of last year and that a new secular uptrend has begun.

We begin with a review of market sentiment. The consensus estimates of analysts always provide interesting insights – particularly for contrarians. As a bull market progresses, analysts will naturally tend to become more optimistic and vice versa. **If one looks at last year's gold price forecasts**

for the end of 2016[18], it appears as though analysts had lost their interest and faith in gold completely. The average price target stood at USD 1,050. The lowest price target was set by Sal. Oppenheim at USD 950, while NordLB called for the highest target of USD 1,175. As a result of the bearish trend that prevailed over the past several years and a price decline of more than 40% from the peak, only very few positive analyst estimates were still in evidence. **Historically very good entry points often coincided with times when pessimism was at its most pronounced.**

Scepticism expressed by the financial media reached a crescendo last year as well. As is fairly typical, bearish commentaries were coming thick and fast right at price lows. Here is a brief overview of the headlines of articles published at these junctures:

- *"How Low Can Gold And Silver Go?", Forbes, July 20th, 2015*
- *"An open letter to investors who are bullish on gold", Howard Gold, Market Watch, July 23rd, 2015*
- *"The gold price has been crushed, and that's the way it will remain", Business Insider Australia, July 25th, 2015*
- *"Gold's Outlook Isn't Shiny", Wall Street Journal, November 17th, 2015*
- *"Hedge Funds Boost Bearish Gold Bets to Record as Rate Rise Nears", Bloomberg, December 1st, 2015*
- *"Goldman Sachs Says It's Time to Short Gold", Fortune.com, February 16th, 2016*
- *"Gold overvalued, time to sell: SocGen", CNBC, February 29th, 2016*

"Where everybody thinks the same, not much thinking is going on."
Karl Valentin

As a result of the advance since the beginning of the year, analysts are now raising their price targets in the usual pro-cyclical fashion. According to Bloomberg the consensus target for year-end 2016 currently stands at USD 1,304. Thereafter gold is expected to move sideways until 2019. Such a development would appear extremely unlikely to anyone who actually studies market cycles. **In our opinion the combination of continued disinterest in gold and silver on the part of many investors and the unimaginative price targets picked by analysts continue to provide a strong basis for a continuation of the rally.**

Bloomberg – analyst consensus for gold and silver: Q2 2016 – 2019

	Sent.	Spot	Q2 16	Q3 16	Q4 16	Q1 17	2016	2017	2018	2019
1) Gold $/t oz		1289	1260	1300	1304	1309	1263	1314	1325	1334
Forecast (Median)			1225	1225	1200	1198	1219	1200	1200	1201
Diff (Median - Curr)			-35.00	-75.00	-104.00	-111.00	-44.00	-114.00	-125.00	-133.00
2) Silver $/t oz		17.44	16.82	17.65	17.73	17.80	16.80	17.89	18.12	18.34
Forecast (Median)			15.80	16.00	16.00	15.25	15.65	16.15	16.50	18.00
Diff (Median - Curr)			-1.02	-1.65	-1.73	-2.55	-1.15	-1.74	-1.62	-0.34

Source: Bloomberg

The analysis of market structure, sentiment and price patterns leads us – contrary to last year – to a clearly positive assessment of the technical picture. In December a double-bottom formed at USD 1,046, a level which we believe represents the low of the bear market. If one examines the following price chart, it can be seen that relatively little technical resistance is lying in wait up to the former major support level around USD 1,530. A rally would therefore encounter little opposition and could be relatively rapid. More specifically, a sustained move above USD 1,300 could trigger a further advance toward the USD 1,530 level.

[18] Forecasts as of early 2016 according to http://www.boerse.de/boersen-prognosen-2016/

Gold Price and MACD

Source: Investing.com

From a sentiment and futures positioning perspective we wouldn't be surprised if a short term correction were in store. However, we don't expect a very deep correction, since it appears as though many potential buyers are waiting on the sidelines, eager to buy dips. Relative strength in silver and mining stocks gives us confidence as well. Positive seasonality in the second half of the year should also provide a tailwind. **All in all, conditions for the new bull market to become firmly established appear to be quite favorable from a technical perspective**.

GOLD STOCKS

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

Rocky Balboa, Rocky IV

"We are starting to see real distress. The sector is mining at a loss in order to keep its debt payments up. The industry is struggling with survival."
Mark Bristow, CEO Randgold Resources, August 2015

At the time our last gold report was published, the Gold Bugs Index stood at 152 points. The final low was put in on 19th January 2016, after the level of 104 had already been successfully tested on several occasions. The brief intraday-dip below the level of 100 in mid-January could well turn out to have been one of the greatest bear traps in history. Right thereafter a stunning uptrend began to take shape, in the course of which the gold mining stocks more than doubled within a few months. **In the following pages we will explain why we believe that this breakout has marked the end of the cyclical bear market and why the boom in mining stocks has only just begun.**

Gold Bugs Index (HUI) since January 2015

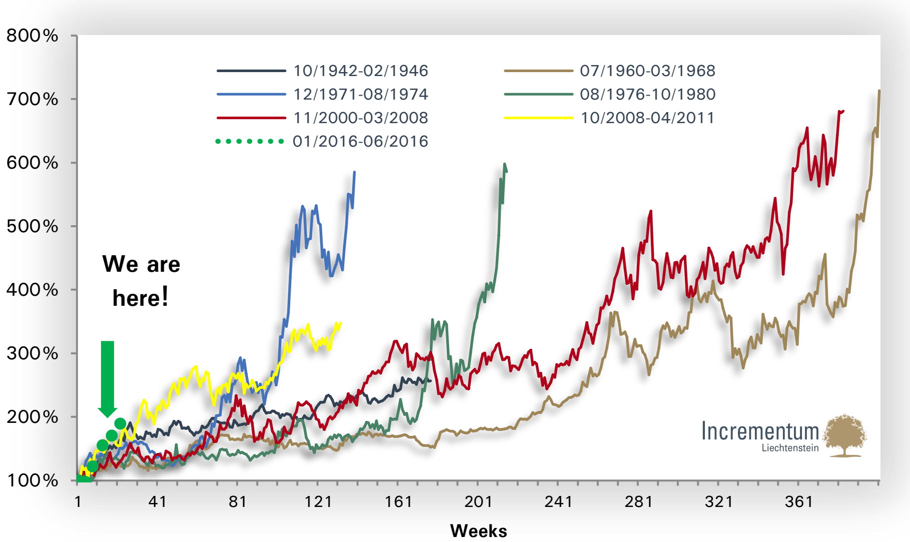
Source: Incrementum AG, Yahoo Finance

Even though gold mining shares have celebrated an impressive comeback since the beginning of the year, market participants remain quite sceptical. The view that mining stocks are already trading at (too) high valuations and that the impulsive move was merely a "dead cat bounce" [19] is still widespread.

"Where one thing falls, another grows. Maybe not what was there before, but something new and wonderful all the same."
Bambi's mother

If one looks at all bull markets in the Barron's Gold Mining Index (BGMI) [20], one can see that the recent uptrend is still relatively small and short in duration compared to previous bull markets. Thus, if this is indeed the beginning of a significant uptrend in gold mining stocks – which we assume to be the case – there should still be a great deal of upside potential.

Bull markets compared: BGMI bull markets since 1942



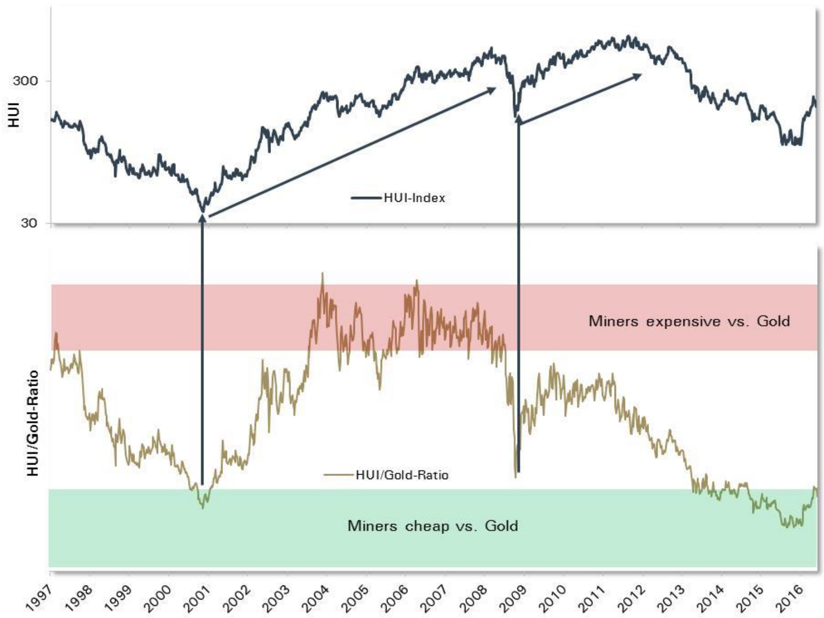
Source: Sharelynx, Nowandfutures, Barrons, Incrementum AG

Relative to the gold price, the gold stocks in the Gold Bugs Index are at the same level as in 2001, when the gold bull market began. This is by

[19] Wikipedia: "In finance, a **dead cat bounce** is a small, brief recovery in the price of a declining stock. Derived from the idea that 'even a dead cat will bounce if it falls from a great height', the phrase, which originated on Wall Street, is also popularly applied to any case where a subject experiences a brief resurgence during or following a severe decline."
[20] The BGMI is the oldest available gold mining index. The index can be obtained at www.bgmi.us

itself strong evidence that gold mining stocks are cheap relative to gold. However, the following chart also shows that mining stocks were only able to outperform gold between 2001 and 2004. We have discussed the reasons for the disappointing performance of the sector in the period after 2004 and its fundamental problems in detail in last year's report under the heading *"Why have gold mining stocks performed so badly?"* However, we also mentioned on that occasion that the gold mining industry had gone through a process of creative destruction and fundamental restructuring. **As a result of this, we expect that in coming years, mining stocks will once again become the kind of leveraged bet on gold that investors crave.**

HUI/Gold-Ratio



Source: WiWo, Bloomberg, Incrementum AG

CONCLUSION

"The Fed has borrowed more from future consumption than ever before."
Stanley Druckenmiller

We went far out on a limb last year by projecting a price target of USD 2,300/ oz. for June 2018 amidst a pronounced bear market. **The first step in this direction appears to have been taken.** The commodity sector, as well as gold, seems to have formed a bottom. Early this year gold celebrated an impressive comeback, exhibiting strong vital signs.

We are nevertheless still a long way from our USD 2,300 price target. In order to reach it, currently prevailing perceptions of the global economic situation will have to change. **Moreover, the feasibility of interventionist monetary and fiscal policy will have to be fundamentally questioned.**

There are more and more signs that scepticism is rising. Something quite telling happened at Ms. Yellen's press conference after the March FOMC meeting. The first question that CBNC journalist Steve Liesman asked her was:

> *"Does the Fed have a credibility problem […]?"*[21]

[21] https://youtu.be/aodavML_cB8?t=15m

With respect to future rate hikes, the verbal dance on eggshells commonly known as the Fed's communication policy doesn't exactly inspire confidence, as no clear monetary policy strategy is discernible. **A significant downturn in economic growth, followed by a renewed stimulus program including even more extreme measures would increase uncertainty further. In this case it would have to be expected that the gold price, commodity prices and also price inflation, would rise.**

In our opinion, this or similar scenarios have a high probability of eventuating within the coming 24 months, and we are therefore sticking with our price target of USD 2,300 by June 2018. **The current combination of obvious over-indebtedness, expansive fiscal and monetary policy and the unrelenting determination of central banks to generate price inflation, continue to represent a stable foundation for further advances in the gold price.**

EXECUTIVE SUMMARY

- **Gold is back, a new bull market is emerging**
- **Increasing uncertainty about economic and political developments boosts the gold price**
- **Monetary stimulus ongoing: the BoJ and the ECB are creating the equivalent amount of the world's entire annual gold production via their QE programs each month**
- **BREXIT: Uncertainty will negatively affect growth. Further monetary and fiscal stimulus to be expected to counter further disintegration of the Union**
- **Dollar strength upon US-recovery and normalization was major contributor to gold/commodity weakness of the last years**
- **The narrative of economic recovery is crumbling; US recession cannot be ruled out; faith in monetary policy measures declines**
- **Continued depreciation of the US dollar and strength in commodities may lead to higher inflation, or maybe stagflation**
- **The persisting low interest rate environment is leading to a revival in interest in gold investments on the part of institutional investors**
- **In addition to gold, this generally means a positive environment for inflation-sensitive assets like silver and mining stocks**
- **Incrementum confirms its long-term price target of USD 2,300 for June 2018**

APPENDIX – ABOUT US

Ronald-Peter Stoeferle, CMT

Ronald is a managing partner and investment manager of Incrementum AG. Together with Mark Valek, he manages a global macro fund which is based on the principles of the Austrian School of Economics.

Previously he worked seven years for Vienna-based Erste Group Bank where he began writing extensive reports on gold and oil. His benchmark reports called 'In GOLD we TRUST' drew international coverage on CNBC, Bloomberg, the Wall Street Journal and the Financial Times.

During his studies in business administration, economics and finance at the Vienna University of Economics and the University of Illinois at Urbana-Champaign, he worked for Raiffeisen Zentralbank (RZB) in the field of Fixed Income/Credit Investments. After graduation, he participated in various courses in Austrian Economics and obtained a Chartered Market Technician (CMT) and a Certified Financial Technician (CFTe) designation. Next to his work at Incrementum he is a lecturing member of the Institute of Value based Economics and lecturer at the Academy of the Vienna Stock Exchange.

Mark J. Valek, CAIA

Mark is founding partner and investment manager of Incrementum AG. Together with Ronald Stoeferle he manages a global macro fund, which is based on the principles of the Austrian School of Economics. In 2014 he co-authored a book on Austrian Investing.

Before founding Incrementum he worked at Raiffeisen Capital Management for more than ten years. There he was fund manager and responsible for inflation protection strategies and alternative investments. During his studies Mark worked in equity trading at Raiffeisen Zentralbank and at Merrill Lynch Private Banking in Vienna and Frankfurt.

Mark's education includes a degree in business administration from the Vienna University of Economics and Business Administration. He is CAIA charterholder and Certified Portfolio Manager. Next to his work at Incrementum he is a lecturing member of the Institute of Value based Economics and lecturer at the Academy of the Vienna Stock Exchange.

About Incrementum AG

Incrementum AG is an owner-managed and fully licensed asset manager & wealth manager based in the Principality of Liechtenstein. Our business focus is the management of investment funds that we believe to be unique.

What makes us exceptional in the traditional asset management space? We evaluate all our investments not only from a global economy perspective but taking the current state of the global monetary regime into account. This analysis produces what we consider a truly holistic view of the state of financial markets. We believe our profound understanding of monetary history, out-of-the-box reasoning and prudent research allows our clients to prosper in this challenging market environment.

Contact

Incrementum AG
Landstrasse 1
9490 – Vaduz/Liechtenstein
ingoldwetrust@incrementum.li

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