PRECIOUS METALS OUTLOOK
DECEMBER 2017

CPM Group
Gold

Gold prices are expected to be well-supported above $1,220 over the course of December, despite the possibility of facing some headwinds during the month as markets try to get clarity on future U.S. monetary and tax policy. Prices are forecast to head higher during the first couple of months during 2018 as seasonal factors contribute to higher prices especially in January ahead of the Chinese Lunar New Year, which will occur in the middle of February. Prices could rise toward $1,320 during these two months.

Heading into 2018 gold prices should be expected to remain at elevated levels but not expected to rise sharply. Healthy global economic growth, low inflation, and the possibility of a corporate America friendly tax code should help to keep investors focused on stock markets, at least in the near term. These factors could weigh on gold prices. That said, there are several risks to present global economic conditions, ranging from heightened political risks, massive increases in global debt (see front section of this report), possible medium and long term negative impact of the reformed U.S. tax code (an increase in the deficit), and the possibility that the Fed tightens monetary policy more than necessary. These risks are expected to prevent gold prices from declining sharply. Gold prices are forecast to average $1,290 on an annual basis, up 2.4% from the projected 2017 annual average price. Gold prices are expected to perform best during the first and last quarters of 2018.

Among the major global economies, the United States seems most vulnerable to an economic downturn in the medium term. It is CPM Group’s expectation that the U.S. could head into a short and shallow recession during the second half of 2018 or in 2019. The U.S. economic recovery is now long in the tooth, and while U.S. monetary policy is very loose it has been tightened the most among the major central banks. The timing and depth of the recession will to a large extent depend on the degree to which monetary policy is further tightened. Policy is expected to be kept relatively loose, however, if policy is tightened more than what U.S. wage growth and inflation can sustain the recession could come sooner rather than later.

There is a higher possibility of an economic slowdown in the United States during 2019 than in 2018, as any negative impact political or economic typically has an effect on the economy with a lag. Based on this expectation, gold prices are forecast to rise more strongly in 2019 than in 2018, averaging $1,379 during the year, up 6.9% from 2018. Timing recessions and financial crisis is more art than science, although there are a number of economic and econometric tools that help time issues visible on the horizon.

CPM Group notes that investment demand for gold already is at historically high levels, although down from the levels that took gold prices to record levels in 2008-2012. CPM does not see current levels of investment demand and prices as peaks, however. Rather, they are viewed as new basis from which both investment demand and prices will rise further the next time the economic and political environment inspires investors to rush even more dramatically back to gold.

CPM Group has been writing for a few years now that it considered the gold and silver markets to have reached cyclical bottoms in prices in late 2015 or early 2016, and that these markets were in the early stages of what should be expected to be multi-year bull markets. Further, CPM
has stated several times that it expected gold and silver prices to rise sharply at some point over the next three to 10 years, with the potential for gold to reach record levels surpassing those seen in 2011 and 2012.

Triggers

CPM Group’s long-term price projections are predicated on a mix of trends in each commodity’s fundamentals with a macro-economic view of the economic, financial, and political environment that affects and determines those trends in supply, demand, investment demand, inventories, and other market segments.

Our present view of the global economy and consequently commodities markets and prices has imbedded in it the view that there could be a short, shallow recession perhaps limited to the United States in 2018 or 2019, followed by an anemic recovery in economic activity for a few years, with a much more significant global financial crisis and economic downturn possibly emerging around 2022 – 2024.

As a result of these economic projections, our expectations are that gold and silver prices could rise sharply at some point in the coming decade, when a number of economic, financial, and political constraints combine to lead investors to move more forcefully into these precious metals.

What Will Happen

Given such strong projections, it behooves CPM to explain what we think may cause the next period of increased, out-sized investor buying of gold and silver. Historians write about the causes and occasions for events to unfold. There can be many causes, but some event or set of events serve as the occasion that triggers the larger event to occur. This paper focuses on the potential catalysts for the next round of sharply increased investment demand and prices.

It seems most likely that it will be some combination of financial and economic events. There may be one development that serves as the trigger or occasion of the change, but it is likely to be the culmination of many financial and economic trends that lead up to both that causative event’s occurrence and the subsequent effects across markets: Gold, silver, stocks, bonds, and other financial assets.

We cannot foresee the specific mix of events that leads to a reversal of the present focus on stocks and relatively stable although high levels of investment demand for gold and silver. However, we are pretty sure that much of the bases for the inevitable spike in investment demand and prices for gold and silver will rest in the debt market. The debt markets – public, private, corporate, and personal, nationally and globally – have not improved since the Global Financial Crisis. They have gotten more problematic. Where in the wide world of debt the cracks first appear is a key question, one the answer to which no one knows. As discussed below, most likely the cracks will appear in smaller, less protected financial arenas.

There are nonetheless certain hot spots in financial markets that are likely to participate in the next spasm of financial market credit constraints that consequently would lead to a major round of economic problems and a rush to gold and silver.

These include the following. They may be divided into two subsets. The first are the longer term, structural problems facing the world. The second are the smaller problems, which actually are more likely to join in some combination to serve as the occasion or trigger for the next round of financial panic.

Structural Issues

- Persistent government deficits,
- Ever expanding sovereign debt,
- The squeezing out of debt markets of more productive private sector borrowing by this sovereign debt,
- Probable negative consequences from the Fed’s policies of raising interest rates and shrinking its balance sheet, which will constrain private sector borrowing further,
- Mounting private sector debt,
- Long-term unemployment and labor market surpluses,
- Inability to grow consumer demand sufficient to keep pace with production of consumer goods and services,
- The mismatch between pension fund returns since 2008 and their long-term obligations, which are leading to pension funds taking greater risks in order to try to regain some capital.
- And more...
Possible Occasions

- Issues such as the hidden illiquidity inherent in the growing open interest of exchange traded products relative to the underlying assets’ market sizes,
- The disappearance of market makers, specialists, and other braking mechanisms from global financial markets,
- Program trading,
- And the inevitable unforeseen events....

It may seem odd to write about the next financial crisis at this time. In late 2017 volatility in the stock market, bond market, gold, silver, oil, currencies, and other markets are at or close to historical lows. In the financial markets, all seems unnaturally calm.

It is natural in fact to worry at times like the present especially. The reality is that financial markets are grossly under-pricing risk, just as they did in the periods of 1998 – 2000 and then 2004 – 2006. At some point financial market volatility is likely to increase sharply, dramatically, and suddenly. That would be translated into a very sharp drop in stock prices, a sharp drop in bond prices, and a sharp rise in gold and silver prices. We are not writing about a 15% - 20% decline in stocks. In 2001 and the 2008 – 2009, the S&P 500 was virtually cut in half, while some other market indices such as Nasdaq declined much more.

Other Stress Points

The occasions will occur somewhere else. To figure out what combination of such factors may serve as a collective trigger, one needs to consider carefully the secondary list of trends listed above, as well as to struggle with discerning other trends not so readily apparent.

The Fed’s policies of raising interest rates and reducing its balance sheet in order to prepare for the next recession and financial crisis, will play an important role in the coming drama. CPM has written it feels these policies are misguided for several years now. The very acts of Fed tightening could well precipitate or contribute heavily to the emergence of the next recession and financial crisis.

So, the Fed’s policies are likely to be a factor. They most likely will not be the trigger, however, since they are so obvious and important that almost the entire world’s financial sector is focused mightily on these.
The occasion is more likely to appear in an overlooked corner of financial markets, just as the collateralized debt obligations built on shoddy U.S. mortgage industry practices served as the occasion in 2007 – a part of financial markets that many participants were unaware even existed until it became a problem.

In searching for overlooked corners of financial markets that have unsustainable structures, the departure of market makers, the rise of electronic, mechanical trading, and the mismatch in liquidity between ETFs and the underlying asset markets all pop to the front of consciousness. Indeed, the mismatch between ETF open interest and the volume of underlying assets is very similar to that which existed, and exists again, in the U.S. mortgage and housing market.

Back in the period before 2007 there were economists and regulators who expressed concern over the enormous volume of CDO assets relative to the size of the underlying asset markets. Bankers continued deprecated such concerns, saying that such derivative volumes could be ‘netted out,’ reducing the size of the imbalance to manageable ratios. The counter argument that such ‘netting’ only worked if it was simultaneously was written off in the bankers’ testimonies as being an issue that only non-practitioners found worrisome. In the final event, it was exactly the fact that ‘netting’ is not simultaneous that started the GFC. Bad government responses, primarily by the U.S. Treasury, compounded that problem.

All of this points to the idea that the next financial crisis and recession will begin in some esoteric, overlooked corner of the global debt market, or maybe several such corners. ETFs, taking an ever-growing proportion of investor funds, is a good candidate, as is the nature of electronic financial markets. The growing imbalance between the size of the ETF derivatives markets’ open interest or outstanding obligations, on the one hand, and the sharply less liquid markets for many of the underlying assets, poses enormous risks for the overall financial market. Just as the liquidity and credit crunch in the CDO market led to a freezing of global credit that caused a plunge in all asset values, a seemingly minor liquidity event in a series of ETF derivatives could trigger a similar global financial crisis in the future.

- Net long Comex gold positions held by institutional investors rose over the course of November. This increase in net long positions occurred at a time when prices stabilized at lower level from the highs in September. This was another sign that investors see limited downside from present levels and used the softness in gold prices as a buying opportunity. Net long positions reached 23.5 million ounces at the end of November, driven higher by a combination of an increase in gross long positions and a decline in gross short positions. Gross long position were at 29.5 million ounces up from 26.9 million ounces at the end of October, while gross short positions were down to 5.98 million ounces at the end of November from 7.3 million ounces at the end of October. While gross longs rose back to the levels seen in September 2017, when price peaked for the year, gross short positions were at their lowest level since September 2016.

- Total open interest in Comex gold declined over the course of November to 47.4 million ounces at the end of the month, down from 53.2 million ounces at the end of October. The decline in total open interest suggests that market participants closed out of the nearby active December Comex contract and did not roll their positions into the forward active contracts.

- Central banks continued to add gold to their holdings on a net basis during October. Central banks increased their holdings by 1.37 million ounces during the month, with Russia, Turkey, and Jordan making the largest additions. During the first 10 months of the year central banks have added 9.4 million ounces of gold to their holdings on a net basis. Outside of Russia, which has been on a mission to replenish its gold reserves, Turkey has been adding to its holdings in a meaningful way this year, adding around two million ounces or a fifth of the gross additions in 2017, within a span of six months.
Silver

Silver prices are forecast to remain weak through the end of this year. An overall positive sentiment toward the global economy is expected to weigh on silver investment demand. Prices are not expected to slip below $15, however. Prices are forecast to rise during the first two months of 2018, driven higher by seasonal demand. On the upside, silver prices are expected to face initial resistance at $17.40. If this level is broken, prices could rise toward $18.50.

Silver prices moved mostly between $16.67 and $17.39 during November, breaking out on the downside during the last two days of the month. Prices slipped to an intraday low of $16.28 on 30 November and settled at $16.38 on that day. While silver prices moved in a narrow band during November they did so in a choppy fashion, which pushed monthly price volatility to 23.3%, the highest level since July 2017.

Silver prices could soften further or remain at low levels before they rise at the start of next year. Investor sentiment toward the global economy is positive at this time which is expected to weigh on safe haven demand and silver prices in the medium term. Seasonal strength in demand at the start of the calendar year is expected to offset some of the softness in prices resulting from a positive investor sentiment toward risk assets. Prices could fall back during the middle of the year, however, with prices recovering only in the fourth quarter of next year. Silver prices are forecast to average $17.10 on an
annual average basis during 2018, essentially flat from the forecast annual average for 2017.

The global economy is faced with several political as well as economic risks and these risks are expected to be supportive of silver prices in the medium term, however, they are unlikely to push silver prices significantly higher, instead they are expected to prevent prices from declining sharply from present levels. The potential for a U.S. economic recession in 2019 should be supportive of silver prices during that year, with prices forecast to rise to $19.33 on an annual average basis, up 13% from 2018 levels.

The gold/silver ratio has risen to 77 in November 2017, which is well above its long-term average of 56. This suggests that silver is underpriced relative to gold and that prices could rise more sharply when prices begin to rise.

Net long positions held by institutional investors rose during the first half of November and declined during the second half. Net long positions reached 341 million ounces on 14 November, which was the highest level of net long positions since the middle of September 2017, when silver prices reached near their highs for this year. Net long positions ended the month at 290 million ounces, down from 295 million ounces at the end of October.

The decline in net long positions during November was entirely the result of a decline in gross long positions. The positions declined to 448.7 million ounces at the end of November, down from 471.6 million ounces at the end of October and were at the lowest level since the middle of July 2017. Gross short positions, meanwhile, also declined resulting in a net positive effect. These positions had slipped to 158.5 million ounces down from 176.5 million ounces at the end of October.
Silver

Monthly U.S. Eagle Silver Coin Sales by the U.S. Mint

<table>
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<tr>
<th>Month</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
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<tbody>
<tr>
<td>January</td>
<td>5,530,000</td>
<td>5,954,500</td>
<td>5,127,500</td>
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<tr>
<td>February</td>
<td>3,022,000</td>
<td>4,782,000</td>
<td>1,215,000</td>
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<td>March</td>
<td>3,519,000</td>
<td>4,106,000</td>
<td>1,615,000</td>
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<tr>
<td>April</td>
<td>2,851,500</td>
<td>4,072,000</td>
<td>835,000</td>
</tr>
<tr>
<td>May</td>
<td>2,023,500</td>
<td>4,498,500</td>
<td>2,455,000</td>
</tr>
<tr>
<td>June</td>
<td>4,840,000</td>
<td>2,837,500</td>
<td>986,000</td>
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<tr>
<td>July</td>
<td>5,529,000</td>
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<tr>
<td>August</td>
<td>4,935,000</td>
<td>1,280,000</td>
<td>1,025,000</td>
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<tr>
<td>September</td>
<td>3,804,500</td>
<td>1,675,000</td>
<td>320,000</td>
</tr>
<tr>
<td>October</td>
<td>3,788,000</td>
<td>3,825,000</td>
<td>1,040,000</td>
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<tr>
<td>November</td>
<td>4,824,000</td>
<td>3,061,000</td>
<td>385,000</td>
</tr>
<tr>
<td>December</td>
<td>2,333,500</td>
<td>240,000</td>
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<tr>
<td>Total YTD</td>
<td>44,666,500</td>
<td>37,461,500</td>
<td>17,323,500</td>
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% Change YOY: 7.5% -16.1% -53.8%

Annual Total: 47,000,000 37,701,500
% Change YOY: 6.8% -19.8%

Note: Red bar is net addition during 2016 for corresponding period in 2017


Chinese Market Activity

- Chinese net imports rose sharply in October to 6.9 million ounces, up 184% over the corresponding period in 2016. This was also the highest level of net imports into the country since February 2014 when it stood at 10.6 million ounces. The sharp increase in net imports into China during October 2017, was the result of a sharp decline in net exports versus an increase in imports. Gross imports reached 11.6 million ounces in October, up 2.3% over the corresponding period in 2016, however, gross exports declined to 4.6 million ounces during the month, down 48% from the same period in 2016.

- Silver inventories held at SHFE-approved warehouses rose in November to 43.9 million ounces, up 2.87% over October. Inventories were down around 25% over the past year and are down around 31% from the beginning of this year.

- Combined open interest for silver futures on SHFE rose in November to 150.3 million ounces, up 5.4% from 142.6 million ounces at the end of November. During November the volume of silver futures transactions on the SHFE rose to 1.84 million ounces, up 50% from October.
Platinum

After a mild rebound during November, Nymex platinum prices fell sharply in the first few trading days of December, with prices slipping to an intraday low of $895.50 on 7 December, the lowest since 11 July when the intraday low hit $891.40. This development effectively erased the gains made by platinum during November.

Much of the decline in prices in early December came from a relatively stronger U.S. dollar. The dollar index climbed to 93.69 on 7 December, up 0.9% from 92.89 on 1 December. Investors appeared to have built some fresh short positions in platinum in early December as total open interest in Nymex platinum rose while prices declined.

In the near term prices may trade in a range of $880 and $955. An absence of fresh catalysts may see many market participants stay on the sidelines. Trading activity typically slows down around Christmas and the New Year, keeping prices relatively stable.

In the first quarter of next year, investor repositioning, a combination of low prices and much of the negativity in the metal’s fundamentals already factored into current prices, could provide some upward momentum to prices. A positive macro background as industrial and manufacturing activities continue to gather momentum in Europe and the United States, short covering and/or fresh long building may send prices higher to $1,000-$1,030 early next year. On the downside, prices could slip to $880 if concerns over declining platinum usage in automobiles re-emerge or if there is a broad-based shift in market sentiment away from precious metals in general.
• With the exception of Brazil, most key auto markets recorded strong growth in commercial vehicle sales. The European market continued to report robust growth in the first ten months of the year, with commercial vehicle sales up 4.3% year-on-year to 2.0 million units. During that period, Spain continued to drive growth (+15.1%), followed by France (+7.7%), Germany (+3.3%), and Italy (+1.8%). However, commercial vehicle registrations in the United Kingdom declined 3.9% year-on-year over the same period.

Notes: Countries/regions included in this data series are China, US, Europe, Japan, India, and Brazil. These countries/regions account for 75% of global annual sales.
Sources: national auto associations, OICA, Bloomberg
Platinum

- Institutional investors turned positive on Nymex platinum during November, with their net longs in the metal surging 68.3% to 1.6 million ounces on 28 November from the end of October. This was a sharp contrast to a lot of fresh short building in the previous month. Over the course of November, institutional investors built fresh long positions in platinum while covering their previously-built short positions. Their gross longs rose 9.4% to 2.7 million ounces on 28 November while their gross shorts were down 29.0% to 1.1 million ounces.

- Total open interest in Nymex platinum rose 0.9% to nearly 3.9 million ounces on 30 November from the end of October. This was accompanied by a 2.5% month-on-month increase in platinum prices at the end of November.
Platinum

**Shanghai Gold Exchange Monthly Platinum Trading Volume**
*Data Through November 2017*

**Chinese Net Imports of Platinum**
*Annual, Through October 2017*

**Platinum Priced in South African Rand and in U.S. Dollar**
*Daily Data Through 7 December 2017*

**Chinese Net Imports of Platinum**
*Monthly Volume, Through October 2017*
Nymex palladium experienced some brief investor profit-taking during the first half of November, before rebounding in the second half of the month to hit a fresh eleven-year high of $1,023.95 on 29 November.

A sharp increase in institutional investors’ gross long positions in palladium was largely responsible for the strong rebound in prices in late November. Gross longs held by institutional investors rose 215,000 ounces between 21 November and 28 November, or an increase of 8.0% week-on-week, although gross shorts also rose, but at a much slower pace of 14,800 ounces, or an increase of 3.4%.

Investors seemed to be impressed with the resilience of palladium prices which held firmly above $980 during the entire month of November in spite of profit-taking during the first half of the month. This boosted investor confidence in the future prospects of palladium’s price appreciation and prompted them to add a large amount of gross longs positions in late November. This helped to push palladium prices to a fresh eleven-year high on 29 November.

The December roll is now behind the market. On 30 November there were around 14,000 ounces of December open interest, against 17,053 ounces of registered inventories and 54,083 ounces of total Nymex reported inventories. This suggested that the spike up in prices on 28 November and 29 November may have been the final spike up for the December delivery roll. Most of the December contract already has rolled into the now nearby active March contract, which had nearly 3.3 million ounces in open interest on 5 December.

The physical market meanwhile seems better supplied. Much of the forward demand seems to be coming from speculators, rather than automobile and other companies looking for metal to meet fabricating needs.

Gross longs held by institutional investors in Nymex palladium stood at 2.91 million ounces on 28 November, a historically high level, or 92.2% of the all-time high of 3.2 million ounces reached on 12 November 2013. This high level of gross longs could make prices vulnerable to
massive liquidation. At the same time, gross shorts in the metal held by institutional investors stood at 449,100 ounces on 28 November, a relatively low level by historical standards.

With the congestion in the palladium market starting to ease, palladium prices may subside and the market may move back to contango in the next couple of months. Investor long liquidation and/or short building could send prices lower to $890. If this level is breached, prices could slip further to $820. On the upside, prices could retest their recent peak of $1,020-$1,024 if the tightness on Nymex palladium contracts re-emerge or fabrication demand from auto makers is stronger than expected.
Palladium

- U.S. auto sales rebounded in November, up 1.3% year-on-year to nearly 1.4 million units, although this did not translate into a year-on-year increase in auto sales during the January-November period. Auto sales in the United States fell 1.6% year-on-year to 15.5 million units in the first eleven months of the year.

- In October Chinese auto sales were up 2.0% year-on-year to 2.7 million units. During the January-October period, auto sales in China rose 4.5% year-on-year to 22.9 million units.

- The other BRIC countries also recorded strong growth in their auto sales in the first ten months of the year. Brazil and Russia posted strongest growth in auto sales during this period, up 13.3% year-on-year and up 11.3% year-on-year, respectively.

- During November institutional investors continued to build fresh long positions in Nymex palladium, and they also covered their previously-built short positions, resulting in a 14.5% increase in their net longs. Their gross longs stood at 2.91 million ounces on 28 November, only a tad lower than the nearly 3.1 million ounces reached on 9 September 2014. This high level of gross longs held by institutional investors suggested that if there is a turnaround in investor sentiment, palladium prices will be vulnerable to massive liquidation.

- Institutional investors’ gross shorts stood at 449,100 ounces on 28 November, down 6.4% from the end of October, and only accounting for 15.4% of their gross longs in palladium, which were at historically high levels.

- Total open interest reached nearly 3.5 million ounces at the end of November, up 1.9% from the end of the previous month.
CPM Group LLC

CPM Group is a fundamentally based commodities research shop. We develop our own proprietary estimates of gold, silver, platinum, and palladium supply and demand on a global basis, drawing on every resource we can find, including our own extensive list of contacts involved in precious metals around the world. We have been doing this sort of research and analysis since the 1970s, far longer than anyone else in the business. We also undertake research in specialty metals, base metals, energy and agricultural commodities. We are known for our basic fundamental research, a wide range of financially oriented consulting services, and our expertise in using financial derivatives to structure financing for producers, refiners, industrial users, and investors interested in either hedging or investing in commodities.

Our investment philosophy is simple: We are value investors who base our decisions on what to buy, sell, hold, or avoid on the fundamentals of each asset, and the macro-economic, financial and political environmental factors that we expect will affect that asset’s value. We have concerns, expressed in this report and elsewhere, about long-term imbalances in government deficit spending, public and private debt, and a wide range of other economic and political factors. We don’t expect the world’s financial system to collapse, however. That is not the way the world tends to work. More likely economic outcomes in the real world lie between the extremes of cataclysmic collapses and nirvana. We advise our clients – and practice what we preach – to have some of their wealth in gold and silver as an insurance policy against a catastrophic failure, but we also advise them to invest other portions of their money in precious metals and other assets based on the assumption that that sort of failure does not occur. We focus on investing based on likely scenarios, but with an eye always open to outlying events that take the world’s markets by surprise. We have watched investors who were so worried about a collapse that they missed some of the largest stock and bond market rallies of all times over the past 30 years, while watching their safe haven assets fluctuate eight-fold in value up and down, and then up and down again. We prefer our clients to buy and sell precious metals and other assets based on cyclical and other developments, while also maintaining that long-term insurance policy in case the levee breaks.
For more information on precious metals and how specific gold, silver, palladium and platinum investments may be used to protect yourself or profit from the events we foresee, please contact:

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