als market participants are pointing to this and taking hope that the trend will reverse, with metals prices rising relative to stocks. That may not be a reason to be optimistic about metals prices, however, based on consideration of the previous two experiences.

In the first instance, in 1987, the ratio hit a low level as stock prices reached high levels. The ratio reversed sharply when the stock market crashed in October 1987. It was not that metals prices rose, but that stocks collapsed.

The second time the ratio hit such a low was around 1999, the height of the wildly intellectually unsupportable "New Economic Paradigm" that fueled the tech stock boom, once more spurring talk that, under this new paradigm, there would never be another recession, inflation was dead, and stocks would rise to 40,000 for the Dow Jones Industrial Average within a year or two. Metals prices were depressed at the time as well. Instead, within a year or two there was a major recession, the Nasdaq fell something close to 90%, the S&P dropped about 50%. Even with these sell offs, the ratio did not initially budge. The movement in the relationship of base metals prices to stock prices was much slower this time, rising modestly for about five years before the next bubble pushed metals prices sharply higher for another five years before they crashed back down.

So, the lesson to be learned is that this ratio may well have a cyclical nature, but the economic realities behind the ratio may not spell good things for industrial precious metals prices. Increases off of past lows have had more to do with stock market distress than metals strength.

The low ratio now largely reflects wild imbalances within both the U.S. and global economies. The real economy, where industrial precious metals are used, is not in such great shape. The stock market has been booming, for a variety of reasons that are not necessarily good for the real economy overall, nor suggestive of longer term real economic strength.

Over the past decade stocks have risen steadily in part due to Fed monetary policy, which has paid banks and institutional investors to take low-risk positions in highly leveraged stock derivatives. Meanwhile corporations have been decapitalizing: They have been using profits to buy back stocks, reducing the float of their shares and pushing stock prices higher. When corporations do this, they are not using their profits to build new factors, research new and better products, buy equipment, or hire people. All of this does not portend well for future growth.

These bad habits have been shot full of steroids in the past year. Stock prices have been pushed higher by corporations taking more than $1 trillion in tax refunds and reductions this year and using them to buy stock back, reducing the stock of their equities outstanding and raising the price of the remaining shares. Companies are not plowing net profits into new factories, new equipment, and new employees. They are plowing the money into the stock market instead. So, too, are wealthy investors who have reaped enormous benefits from recent tax cuts in the United States.

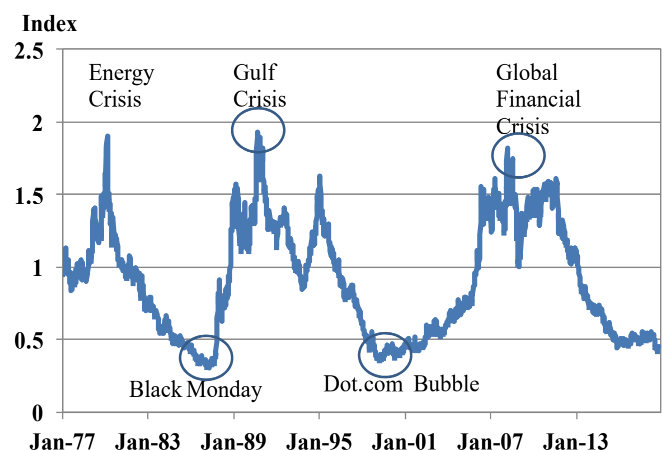
Meanwhile, the tax cuts will take the U.S. federal budget deficit from $438 billion in 2016 to close to $1.1 trillion in 2019, causing the Treasury to need to borrow that much more just as investors around the world. This is happening just as investors globally are deciding to stop buying, and even unloading, U.S. Treasuries, helped in the decision by rude behavior toward their nations by the U.S. government as well as the simple financial reality that a government knowingly doing this to its budget probably should not be lent more money.

In this way, the rise recently in stock prices is not really very healthy. Instead, it is worrisome. The boost or goosing of stock prices from a trillion dollars of tax cuts in 2018 and accelerated corporate depreciation tax provisions will not be repeated next year.

The resulting imbalance plays a big role in macroeconomic trends. It also plays a big role in micro economics

S&P GSCI Industrial Metals Index and S&P 500 Index

Weekly Data, through 5 Oct. 2018



at the household level. Much of the tax cuts went to the top 1% of households and corporations. It pushed stock prices higher. Sure, 47% of U.S. households own stocks, but the top 10% owns 81% of the privately held stock in that country. Meanwhile, 40% of U.S. households forego basic necessities for lack of money and 60% do not have $1,000 to cover even a small personal emergency like an uncovered illness, auto repair, or house repair without borrowing to cover the costs.

The charts at the bottom of this page drive home the growing imbalances. Stock values have doubled since 2000. Industrial production and real medium personal income meanwhile have risen a small fraction of that. Total real GDP has increased less than half as much as the S&P500, pushed higher than industrial production by the rise of the service economy and growing government employment. The number of manufacturing jobs meanwhile has contracted roughly 25%.

These and other imbalances bode ill for continued economic growth, and consequently for industrial precious metals demand and prices.

Meanwhile U.S. Treasury interest rates are rising. The pressure is not just a reflection of Fed policy. It also reflects the aforementioned investors turning away from Treasuries and diversifying into other debt instruments and the upward pressure on interest rates as the U.S. federal budget deficit triples in three years. Of course, a recession would balloon the deficit even more, reducing government tax receipts and raising government outlays in support of industry and unemployed individuals.

While all of the aforementioned developments are bad for the U.S. and global economy and as a result for platinum, palladium, and to some degree silver, they are good for gold. A deflation of the stock market, decline in the value of the U.S. dollar, and a reversal of monetary policy from its current trajectory are all factors that bode well for future gold prices. Silver is a hybrid between an industrial metals and safe haven asset; while the initial impact of weaker economic growth is negative for silver it typically get pulled higher by investor interest in the metal's safe haven attributes.

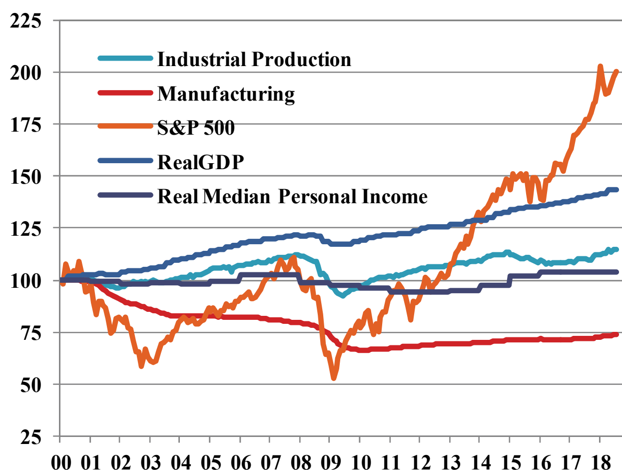
Gold and Silver

The gold and silver markets have seen several false starts in the past few years. Prices rose in anticipation of various risks materializing and then slipped right back to where they started. **It is not that these risks do not exist, but instead that they have been successfully rolled forward, in many cases made much larger than they were, and rarely resolved.** The problems are there, but they are not upsetting global and national economic growth to date so far.

Markets have not dismissed these risks, which range from enlarged government debts to heightened social and political stresses around the world, but have instead chosen to focus on the short term, planning on dealing with these problems when they do materialize later. Still loose monetary policy, a booming stock market, and healthy economic growth make it easy to ignore the risks that could end the party. It could be some time before these risks upend the present economic environment. **That said, with every passing year stock valuations get that much richer, global debt gets that much bigger, and**

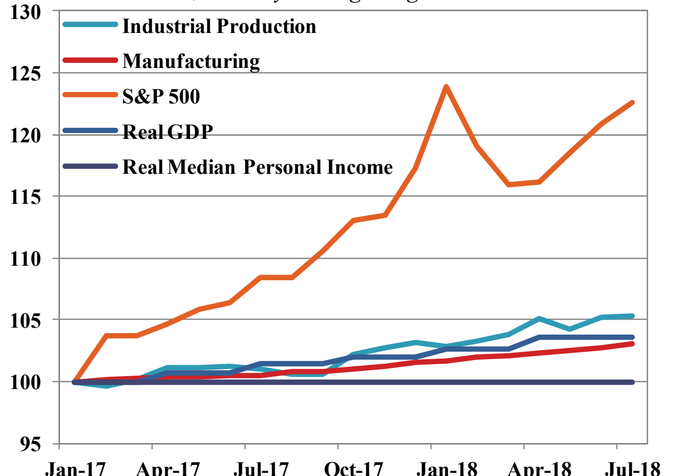
U.S. Economic Indicators

Indexed 2000=100, Monthly Through Aug. 2018



U.S. Economic Indicators

Indexed 2017=100, Monthly Through Aug 2018



unresolved political problems get that much more complex. The S&P 500 Price/Earning ratio presently is around 25:1, high by pre-1999 levels and heading back toward the over-bought peaks of the tech stock bubble around 2000 and the start of the Global Financial Crisis in 2007 – 2008.

The U.S. is likely to lead the world into its next recession. Tightening U.S. monetary policy is likely to expose many of the global economic vulnerabilities that have built up over the past several years or problems that have been swept under the carpet. The intensification of trade wars with China, the second largest economy in the world, is also likely to negatively affect the country's economic performance. While trade today accounts for a smaller share of Chinese gross domestic product (~20%) than it did a decade ago (~35%), it is still a large share.

In addition to the negative impact that the United States could have on the global economy it also is facing several challenges on the home front. While investigations against Russian election meddling are ongoing, the belief that the United States cannot rule out presidential impeachment proceedings, whether right or wrong, will undoubtedly be a major disruption for global world order and its economies. The importance of the midterm elections on 5 November in the course of such matters means that many capital investment and other decisions will be put on hold until November, pending some clarification as to the likely course of U.S. politics and governance. The media is donning punching bags, while the public is subject to gusts of hot air about 'America First,' a strong economy, low employment numbers, and the record breaking stock market. For now U.S. animal spirits are strong, as seen in personal consumption, which makes up over 70% of GDP. But appetites look to dissipate in the coming year. The pace of hourly wage growth is rising but lags company profits post-2008, coupled with an S&P Supercomposite Homebuilding Index down 21% year-to-date as of 24 September, on track for the biggest annual drop since 2008, when it fell 32%.

The U.S. economy may be feeling the positive short-term effects now of a tax cut, as reflected in a stock market that continues to break record highs. While the Tax Cuts and Jobs Act increased first-year capital investment depreciation rates to 100%, in each year following the percentage decreases, eventually disappearing by 2027. Businesses were encouraged to take advantage of the tax cuts this year, meaning fewer purchases going forward. Tax cuts are expected to take the U.S. Federal Budget deficit to $1.1 trillion next year, as mentioned above, making U.S. growth rates above its 2% non-inflationary potential unsustainable. The frothy stock market may see valuations deteriorate as stock buybacks start to wane and business expenses increase.

Strategic buyers, which include long term investors and central banks, have been building their gold and silver positions over the past several years, taking advantage of the lower gold prices and remaining cognizant of the growing risks. Meanwhile, shorter term investors that have been using these metals more for tactical purposes have been behind the swings in prices that we have witnessed since the sharp decline in prices in 2012 - 2013. The strategic buyers have helped gold prices hover around $1,200 for the most part since 2013. Meanwhile tactical buyers have been responsible for the swings in prices down to $1,045 and up to $1,380 during this period. For prices to make a sustainable move higher it will take both shorter term and longer term investors buying metal more consistently than they have been during the past several years. This will occur only when there is a true realization of one or more of the underlying risks.

Near-Term Outlook

Gold

Gold prices are forecast to rise over the last quarter of this year. That said, prices are not expected to rise significantly. Prices are expected to average around $1,217 during the quarter, up from $1,213 during the third quarter.

While the gold price is not expected to rise sharply over the remainder of this year, neither should a sharp decline in prices be expected. Weakness in prices has been met by demand from the more price sensitive sectors of the market such as central banks, for example, which purchased large volumes of the metal when prices softened during the summer. Fabricators would also rush into buy metal if prices softened sharply during the festival and wedding season, which should provide support to prices during this period.

Silver

Silver prices are forecast to rise during the last quarter of this year, but only slightly and not to higher levels such as had been since prior to August or earlier in the year.

Prices are expected to average $14.70 during the quarter, higher than they were during most of September but still far below early 2018 levels. Even though the forecast is for silver prices to rise, the average silver price for the fourth quarter is lower than the third quarter's $14.99 average price. This is because of the sharp decline in silver prices over the course of the third quarter, which lowered the base from which silver prices are forecast to rise in the fourth quarter.

Platinum

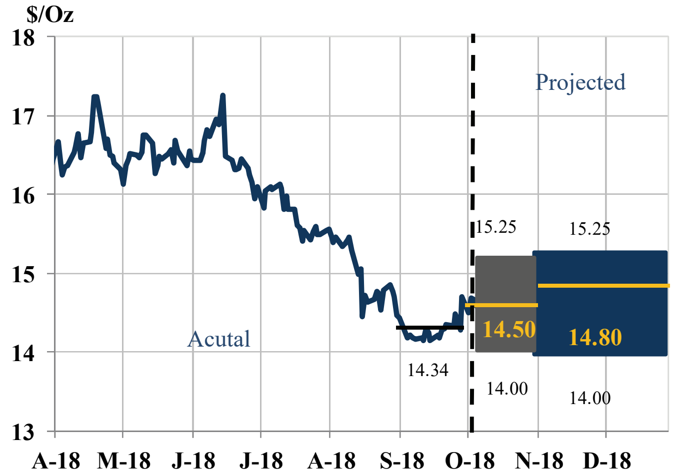
Platinum prices should be expected to move sideways to higher over the remainder of this year. Prices are forecast to average $825 over the course of this quarter. On the upside prices are expected to be limited by some of the broader market factors such as a strong U.S. dollar, concerns regarding the eventual outcome of various trade negotiations, and uncertainty about the Fed's actions at its December meeting. On the upside platinum prices are likely to face resistance at $840 with the next resistance level at $850.

Palladium

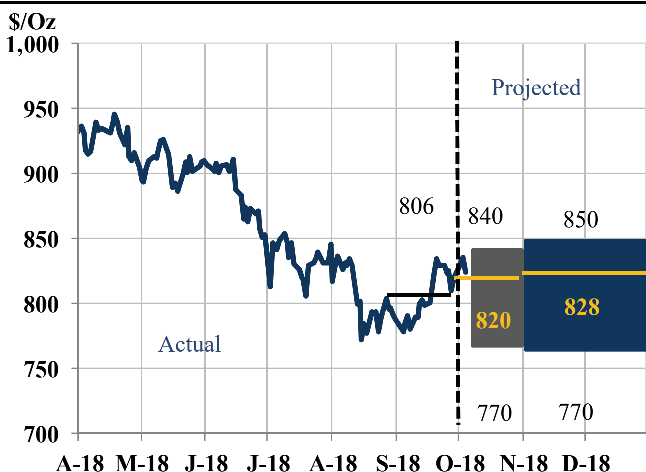
The palladium market is expected to remain in backwardation over the course of the fourth quarter of this year. That said, the backwardation could potentially narrow in coming months relative to levels seen in the second half of September. This would occur in part because of slowing passenger vehicle demand from major auto markets like China and the United States and in part because some investors may see this slowing demand as a sign to get out of the market. Both of these factors could weigh on palladium prices at current levels. That said, prices are expected to remain at elevated levels, averaging around $988 during the quarter. Palladium prices could move between $950 and $1,100 over the remainder of this year.

Three-Month Gold Price Projections

Three-Month Silver Price Projections



Three-Month Platinum Price Projections



Three-month Palladium Price Projection