



Tocqueville Asset Management L.P.

Tocqueville Gold Third Quarter 2012 Investor Letter

Gold and precious metals stocks rallied sharply in the third quarter. The rally suggests that the lengthy correction which began in August of 2011 has been completed, setting the stage for a powerful new leg in the bull market for precious metals and related mining shares. During the quarter, the metal rose 10.9% to \$1,772/oz. while the XAU index rose 21.7% to 191. Since mid-May, precious metals shares as measured by the XAU have outperformed gold bullion, with the XAU index rising 35.9% against a 14.8% advance for the metal. Outperformance by the shares over the metal has historically coincided with the strongest advances in both absolute and relative terms for the precious metals complex.

The trigger for the strong advance was the overt resumption of quantitative easing by the Fed and ECB in late August. The resumption of aggressive monetary easing, in our opinion, had been foreshadowed by the failure of gold to make new lows after repeated denials by the Fed during the first half of 2012 that such action was “off the table.” As we opined in 1Q12 and 2Q12 quarterly commentaries, as well as our web site article *Gold, Gold Mining Shares, and QE*; gold’s resilience in the face of superficially “bad news” was signaling that repeated Fed disavowals of the need for more monetary stimulus would prove to be misguided and misleading.

Where do we go from here? We expect gold to trade at new highs against the \$US in the next twelve months. It is already trading at record levels against the euro. We believe that precious metals stocks will rally strongly once the metal shows that it can breach the previous high and trade sustainably in new high territory. It has been our conviction over the past year that the main thing ailing precious metals stocks was market uncertainty as to the future direction of the gold price. The headwind of a year-long correction in the metal prices was the principal reason for the dismal performance of mining shares. All of the other reasons advanced to explain the poor performance of the shares was, in our opinion, sell-side research gibberish that extrapolated past transgressions of the mining companies into future expectations. For this reason, we believe that a more favorable perception of the condition of the gold bull market will translate into outsized relative performance for the mining shares.

What are the fundamentals that will drive gold to new highs? We believe it all starts with negative real interest rates. Negative real rates are the universal source of dissatisfaction and potential mayhem in the capital markets. They drive capital to seek alternatives to what would otherwise be regarded as safe havens for liquid assets and in the process misprice both safety and risk. Real interest rates at 4% in 90 day Treasuries would represent a significant headwind for gold. However, it is difficult to imagine a transition to real rates of 4% without inflicting significant damage to the financial markets or the economy.

Some suggest that a Republican victory in November would be a game changer for gold. It could bring about the dismissal of Bernanke, the taming of fiscal deficits, the painless elimination of excess liquidity from bloated central bank balance sheets, and the restoration of robust economic growth. All of this would need occur within the four years allotted to a new administration while voters patiently awaited the magic to take effect. While this rosy scenario is possible, we believe it would be a long shot. Therefore, we regard any possible pre-election weakness in gold and mining stocks based on such a possibility as a buying opportunity.

Another scary scenario for gold would be that the lame duck congress, post the election, embraces something akin to the Simpson Bowles plan. One only has to look at previous attempts to introduce formulas to limit government spending and reform the tax code to see that this is a long shot as well. In our opinion, there is no political consensus to implement the kind of change required for meaningful reform. Political consensus of the sort required for a basic alteration of entitlement programs and the tax code will most likely arise from a financial crisis on the order of 2008. We believe that the fiscal and monetary policies that are currently in place will lead to such an outcome. Until then, we find exposure to gold a strategic imperative.

The appended *Gold Monitor* consists of three sections: Macro, Gold Specific, and Mining Equities. There are 60 separate charts, graphs and tables pertinent to these categories. A few observations:

Macro: Real interest rates remain negative for most key economies and central bank balance sheets are bloated. Reported inflation is muted and economic activity is lackluster. Credit spreads are creeping higher, and are almost at levels preceding the 2008 financial meltdown. This is a space to watch. Minimal interest rates in our opinion represent a time bomb with the interest component of the federal budget at the lowest level since 1988 despite an increase in the federal debt outstanding of 6.2x. China is exhibiting a growing distaste for U.S. securities.

Gold Specific: Sentiment has improved substantially since the historic lows earlier this year, suggesting the possibility of a short term pullback. Central banks have moved decisively to the buy side over the past few years, but are very “underweight” the metal and “overweight” paper with no yield. Mining production is creeping higher at best, but represents no threat to gold prices. Since 2008, gold has outperformed other “hard assets” by a wide margin.

Mining Equities: The shares remain historically cheap. Profit margins are at record highs and returns on capital are approaching respectable levels. Equity capital issuance has dropped sharply in the last few years, a reflection of the industry’s much improved profitability. The sell side consensus assumes forward gold price is \$1,313/oz., a discount of 26% to current spot.

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SECTION I: MACRO

Fig. 1: Gold and U.S. Real Rates

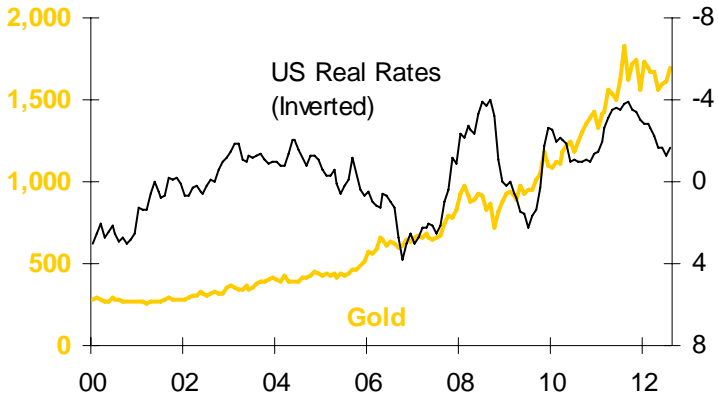


Fig. 2: Fed Balance Sheet (US\$B)

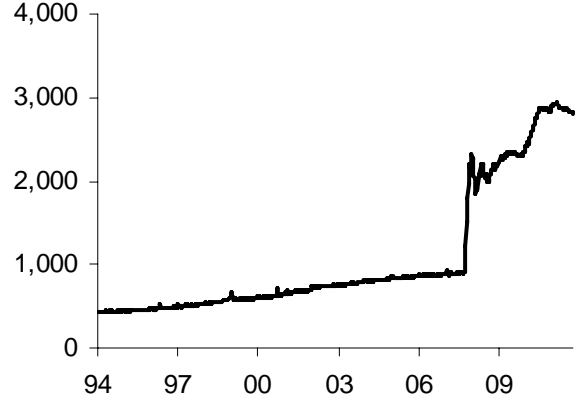


Fig. 3: Gold in EUR and ECB Real Rates

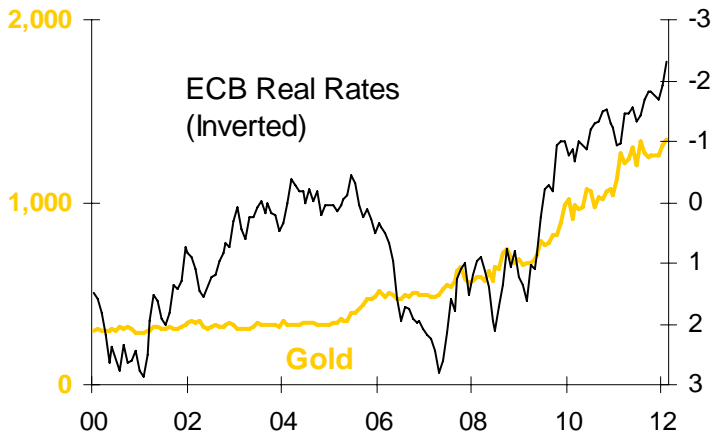


Fig. 4: ECB Balance Sheet (euro B)

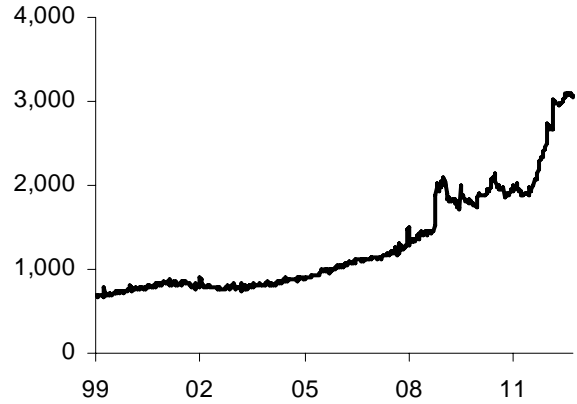


Fig. 5: Gold in RMB and Chinese Real Rates

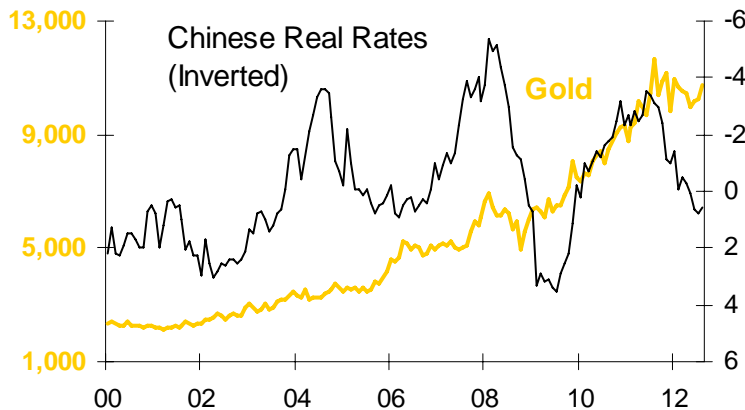


Fig. 6: PBoC Balance Sheet (RMB B)

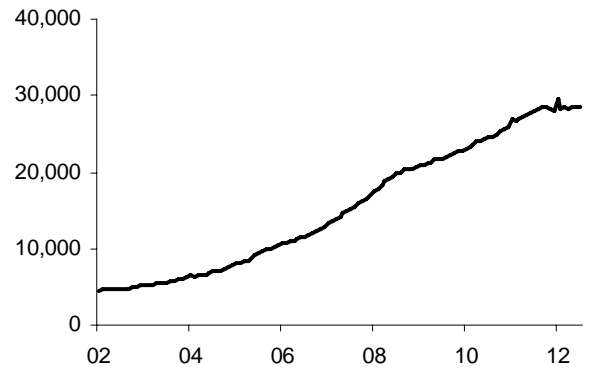
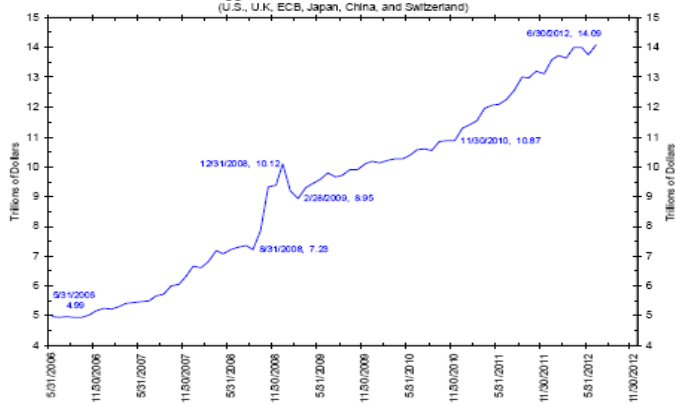




Fig. 7: The Biggest 6 Central Bank Balance Sheets



Source: Bianco Research

Fig. 8: Gold and M2 (US\$T; Fed, ECB, PBoC)

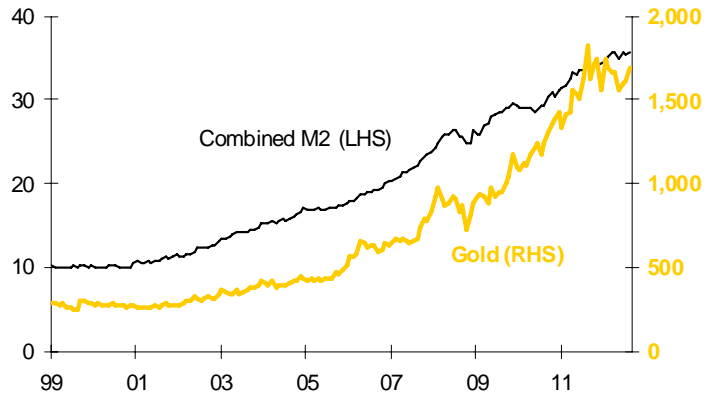


Fig. 9: U.S. M1 (YoY %)

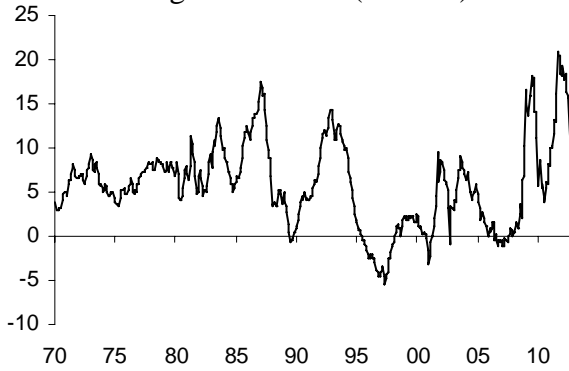


Fig. 10: U.S. M2 (YoY %)

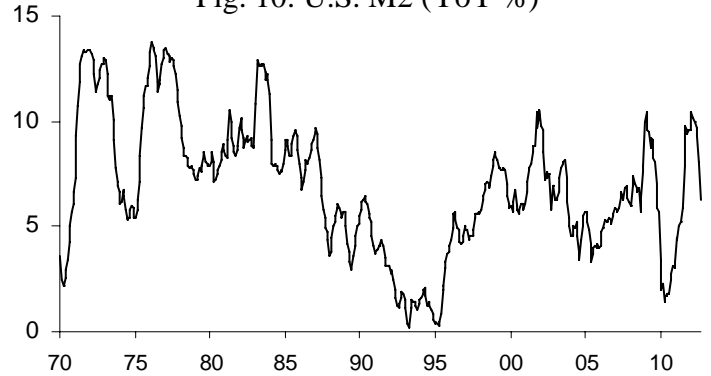


Fig. 11: ECB M1 (YoY %)

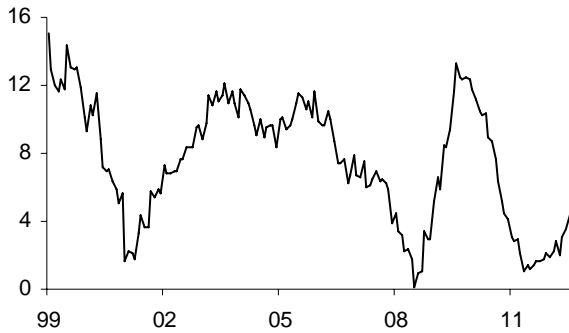


Fig. 12: ECB M2 (YoY %)

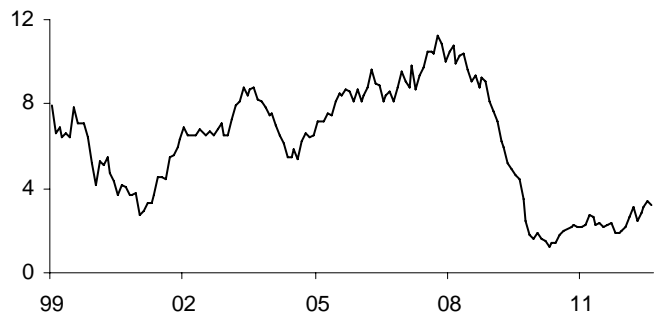


Fig. 13: PBoC M1 (YoY %)

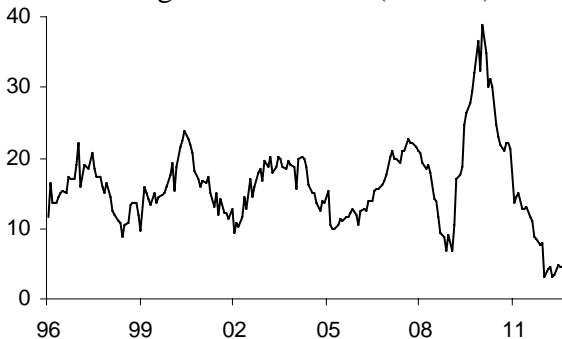


Fig. 14: PBoC M2 (YoY %)

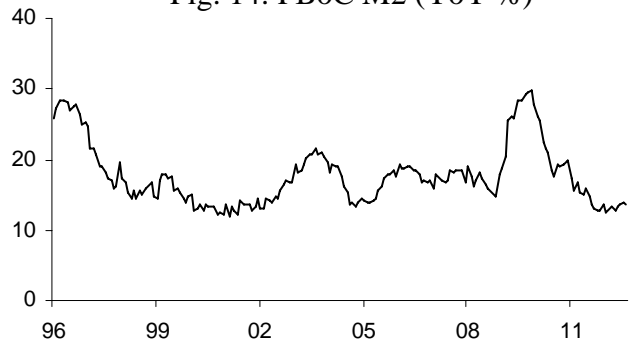
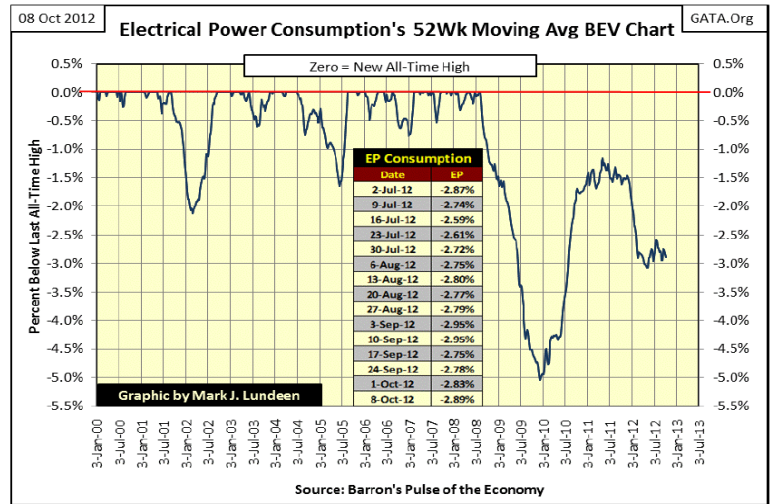


Fig. 15: Inflation

	U.S. (Aug)	Euro area (Aug)	China (Aug)
Headline CPI	1.7%	2.6%	2.0%
Core CPI	1.9%	1.0%	N/A
Shadowstats	9.3%	N/A	N/A

Fig. 16: Electrical Consumption



Source: Mark Lundeen, Barron's

Fig. 17: Total U.S. National Debt Outstanding (US\$B)

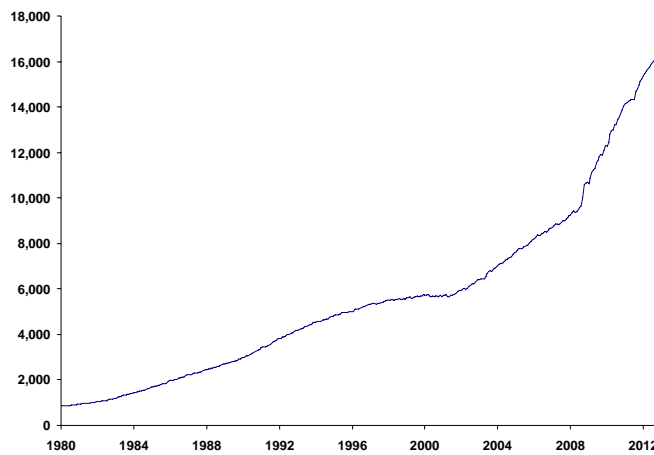


Fig. 18: Average Annual Interest Rate Paid on Debt



Fig. 19: Interest Expense on Debt as a % of Total Government Outlays

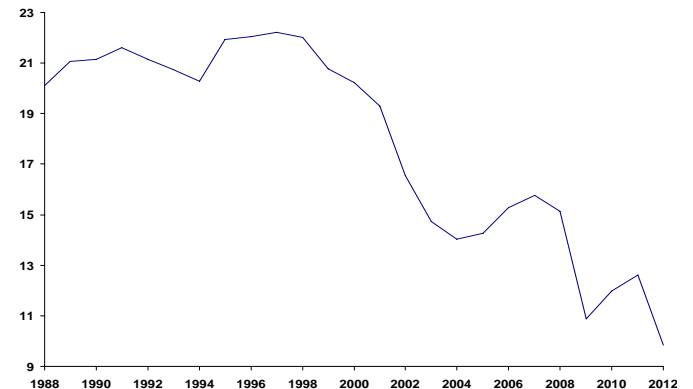
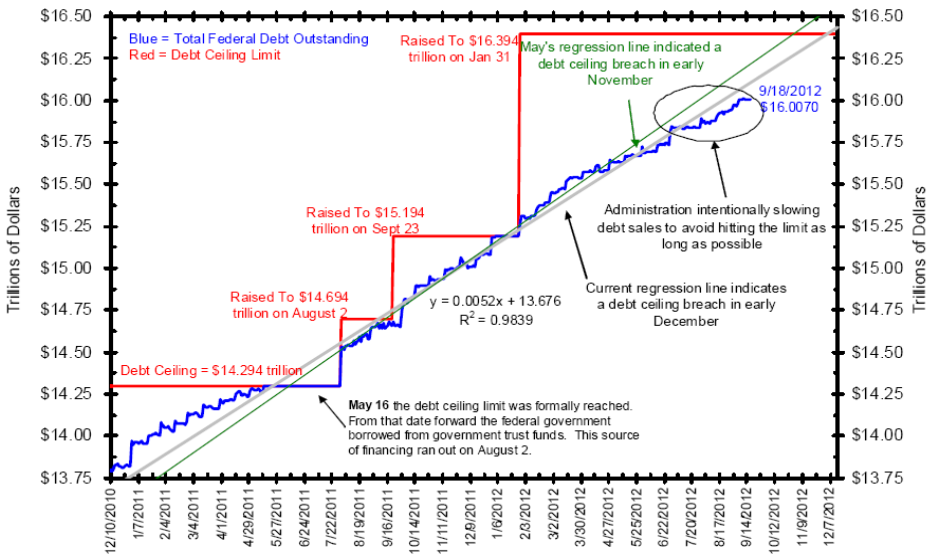


Fig. 20: Total Credit Market Debt as a % of GDP



Source: Ned Davis Research

Fig. 21: The Debt Ceiling



Source: Bianco Research

Fig. 22: Quality Spread and Gold

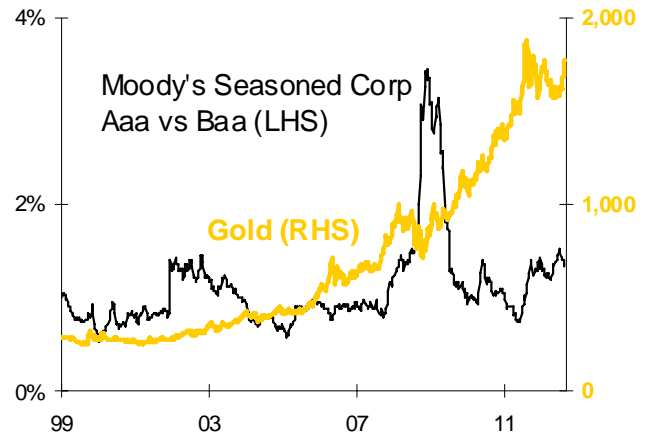
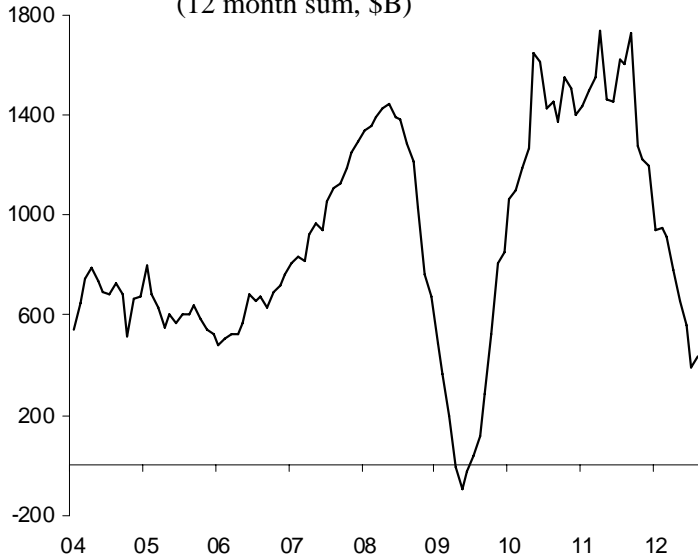




Fig. 23: Global Forex Accumulation (12 month sum, \$B)



Source: MacroMavens, LLC

Fig. 24: Annualized Monthly Growth in Treasury and Agency Holdings under Custody (\$B)

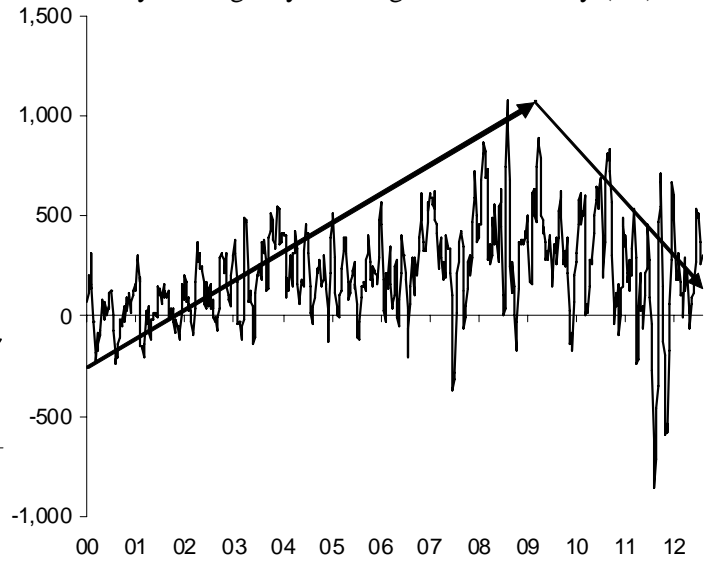
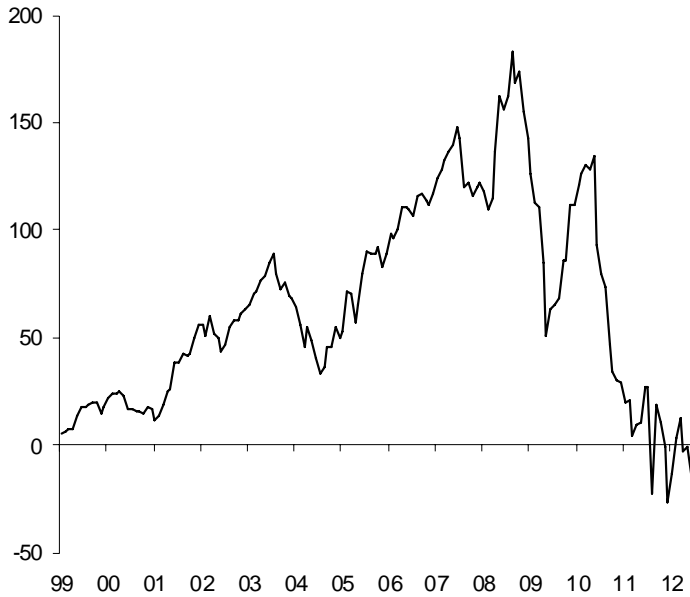
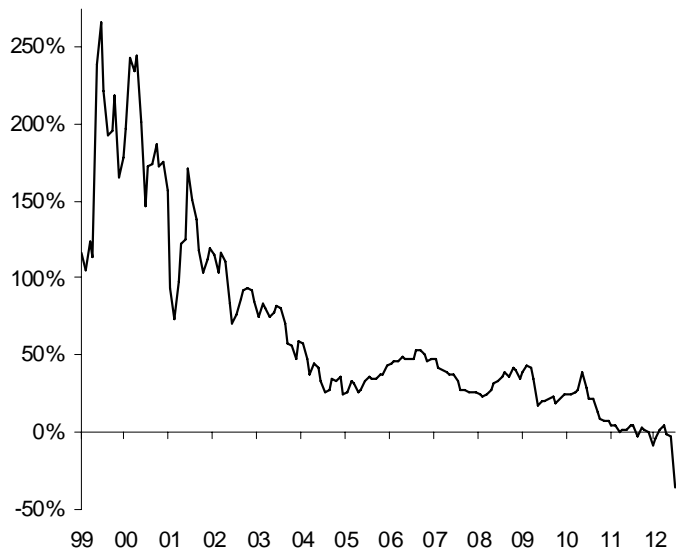


Fig. 25: China Net Purchases of LT U.S. Securities (Annual \$B)



Source: MacroMavens, LLC

Fig. 26: China Recycling Purchases of U.S. Securities as % Forex Accumulation



Source: MacroMavens, LLC

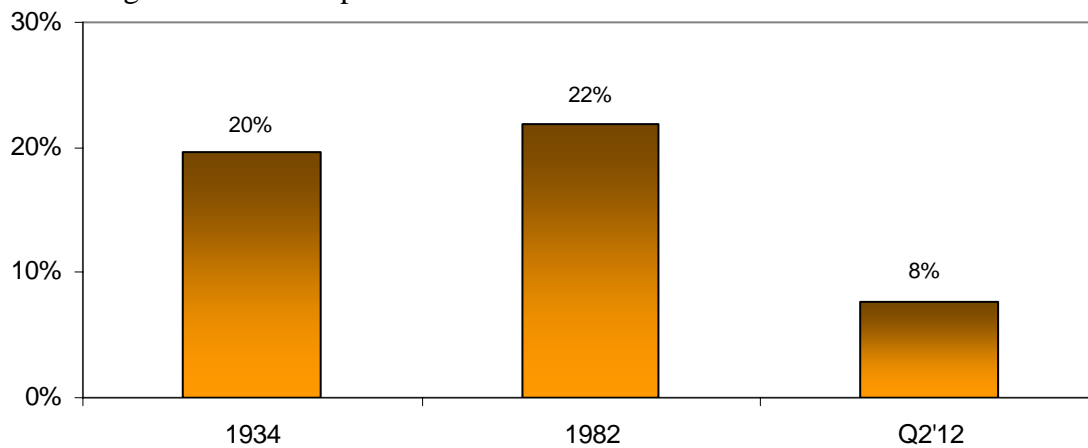
SECTION II: GOLD

Fig. 27: GFMS Gold Supply and Demand (tonnes)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011e
Supply											
Mine production	2 646	2 618	2 623	2 494	2 550	2 485	2 478	2 409	2 572	2 693	2 812
Old gold scrap	749	872	985	878	898	1 129	958	1 217	1 674	1 651	1 689
Subtotal: Traditional supply	3 395	3 490	3 608	3 372	3 448	3 614	3 436	3 626	4 246	4 344	4 501
Net official sector sales	520	547	620	479	663	365	484	236	41	0	0
Net producer hedging	0	0	0	0	0	0	0	0	0	0	32
Implied net disinvestments	0	0	0	15	0	0	0	0	0	0	0
Total supply	3 915	4 037	4 228	3 866	4 111	3 979	3 920	3 862	4 287	4 344	4 533
Demand											
Jewellery	3 009	2 662	2 484	2 616	2 718	2 298	2 417	2 193	1 759	2 017	2 032
Other	474	481	515	555	581	650	672	696	658	767	809
Total fabrication	3 483	3 143	2 999	3 171	3 299	2 948	3 089	2 889	2 417	2 784	2 841
Net official sector purchase	0	0	0	0	0	0	0	0	0	77	336
Bar hoarding	261	264	180	257	264	235	236	386	187	859	1 065
Net producer de-hedging	151	412	289	438	92	434	444	352	254	108	0
Implied net investments	20	220	760	0	459	365	169	330	1 429	516	292
Total Demand	3 915	4 039	4 228	3 866	4 114	3 982	3 938	3 957	4 287	4 344	4 534

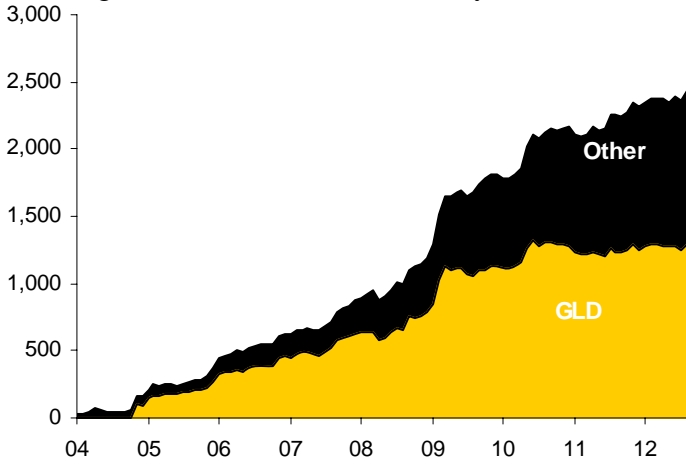
Source: AngloGold Ashanti, GFMS

Fig. 28: Market Cap of Above Ground Gold/ U.S. Financial Assets



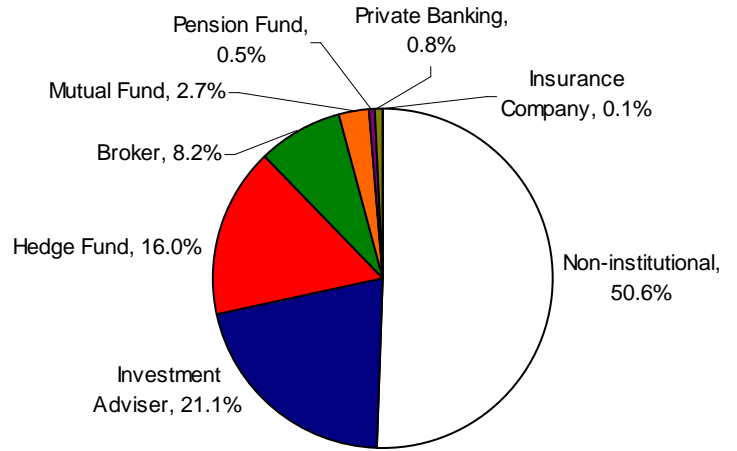
Source: Tocqueville Asset Management

Fig. 29: Tonnes of Gold Held by Gold ETFs



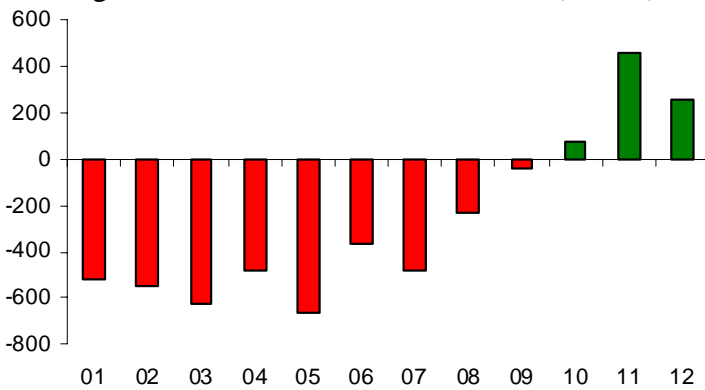
Source: World Gold Council

Fig. 30: Ownership of GLD by Type



Source: FactSet Research Systems

Fig. 31: Central Banks Net Purchases (tonnes)



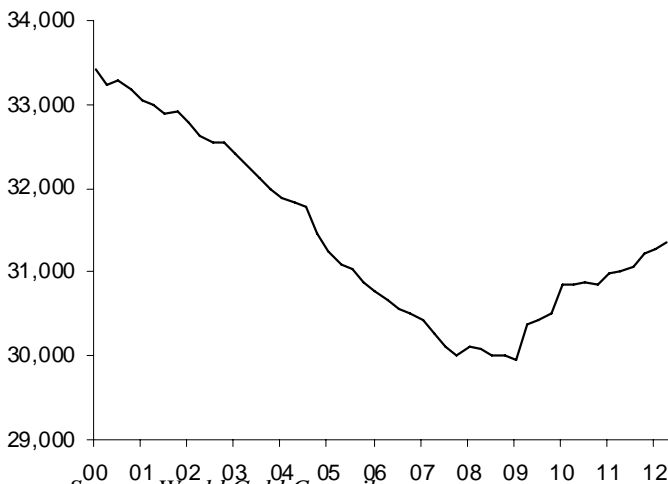
Source: World Gold Council

Fig. 32: Notable Transactions in Q2

Country	Tonnes	Transaction
Turkey	34.6	Addition
Russia	22.3	Purchased
Kazakhstan	5.4	Purchased
Mexico	2.7	Purchased

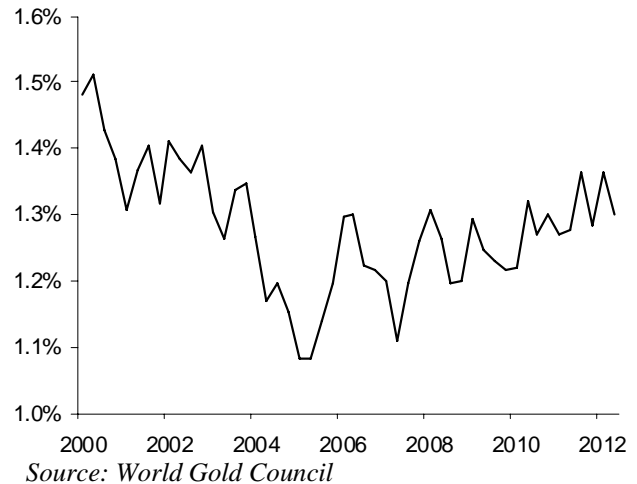
Source: World Gold Council

Fig. 33: Central Banks Holdings of Gold (tonnes)



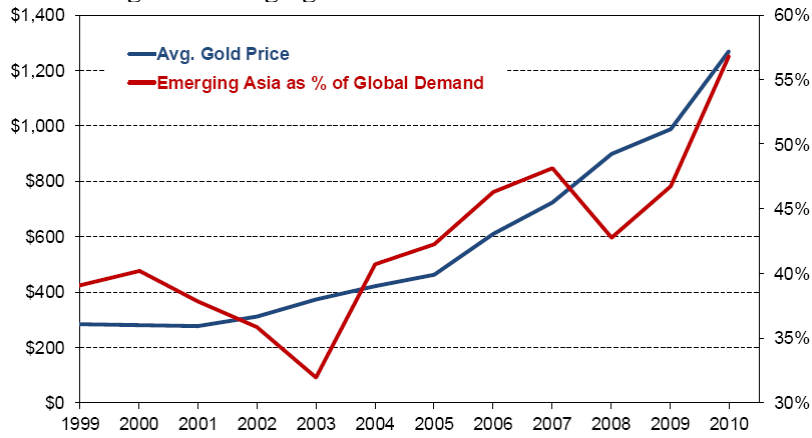
Source: World Gold Council

Fig. 34: Gold as a Percent of Total Reserves



Source: World Gold Council

Fig. 35: Emerging Asia's Share of Gold Demand



Source: GMO, GFMS, World Gold Council, Bloomberg

Fig. 36: Google Searches for: "Gold Bubble"

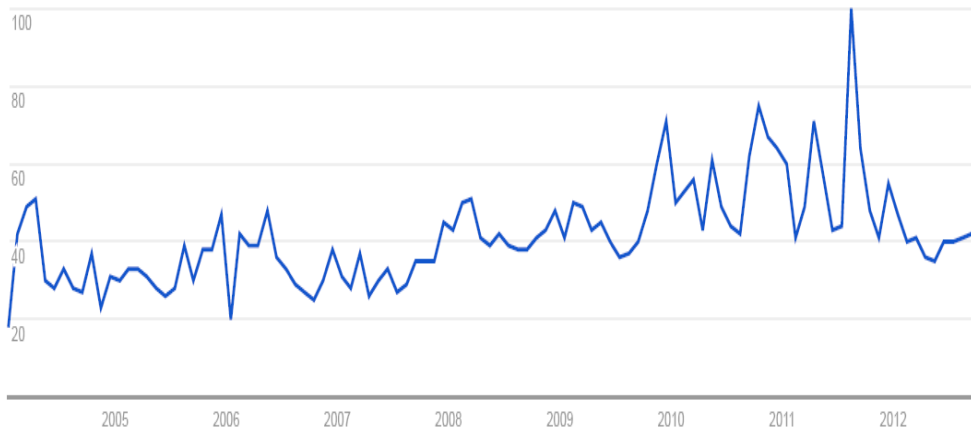


Fig. 37: "Gold Investment"

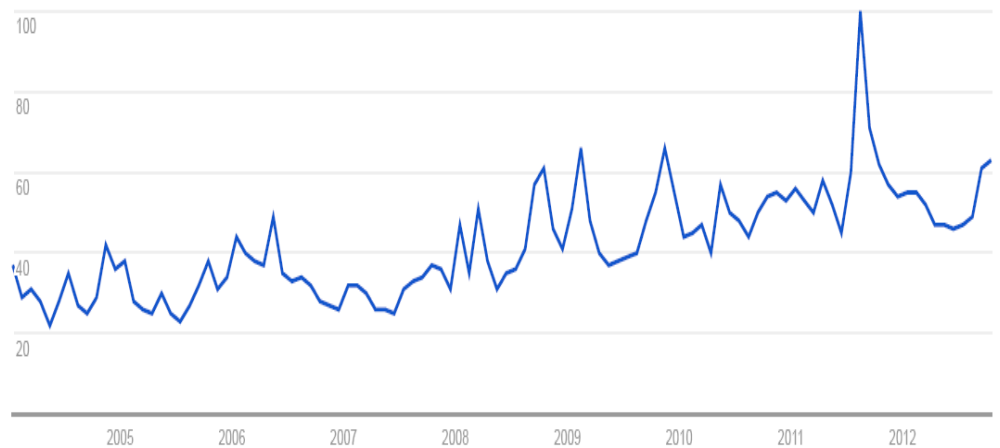


Fig. 38: Ned Davis Research Gold Sentiment Composite

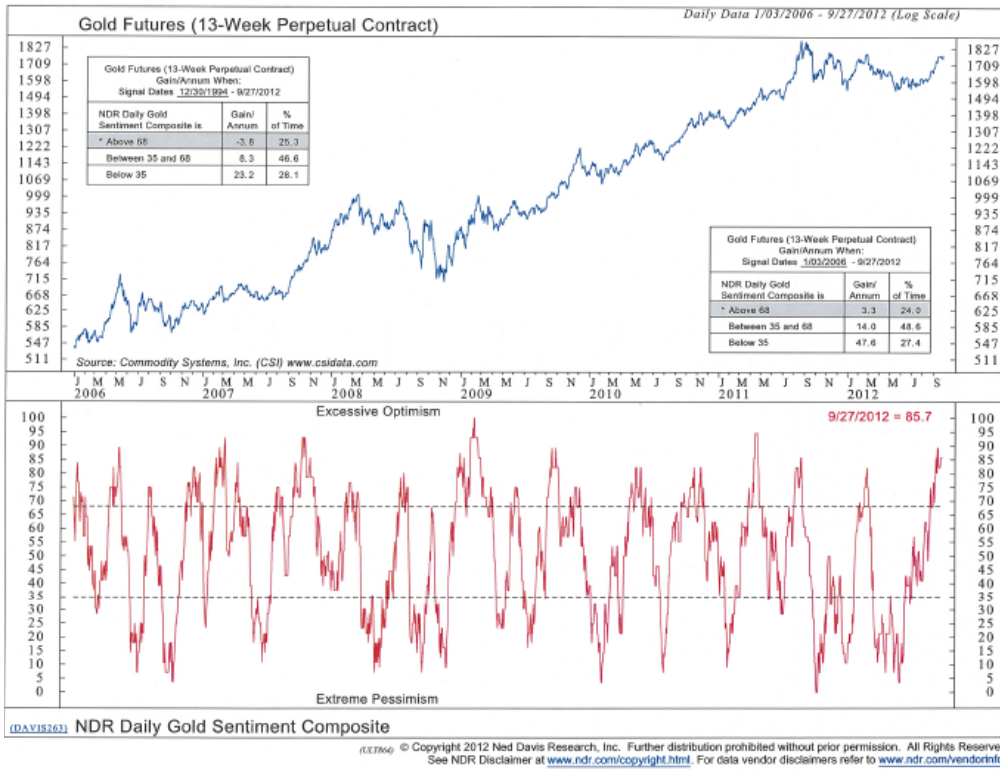


Fig. 39: Hulbert Newsletter Gold Sentiment Index

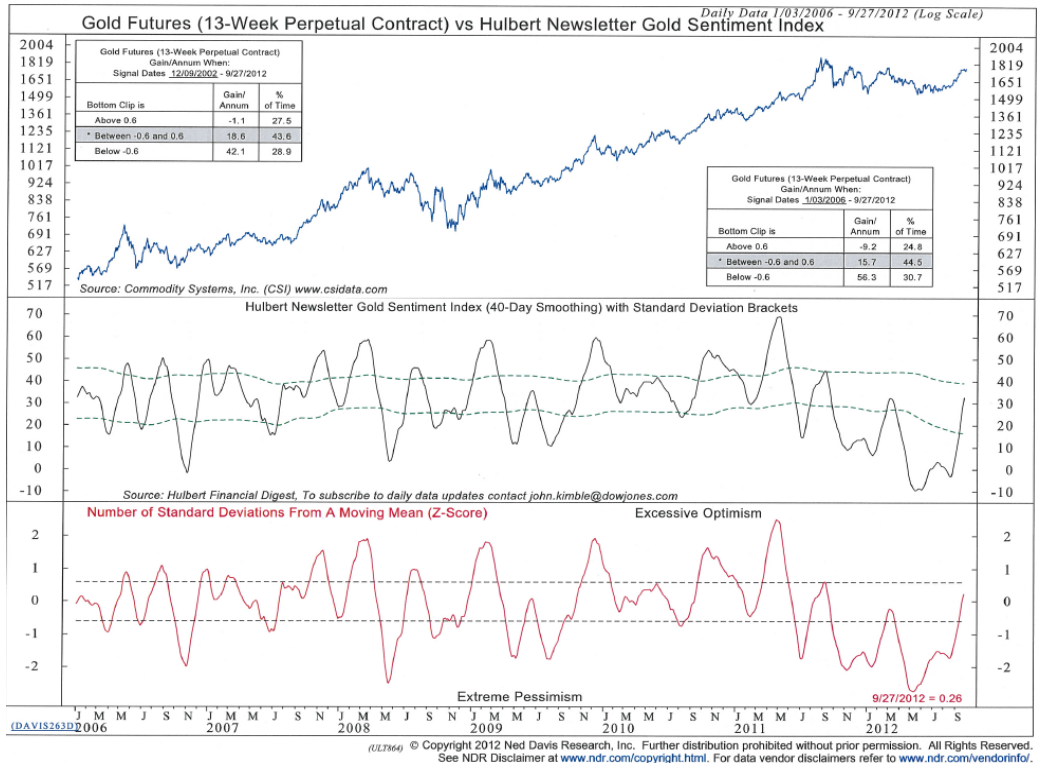


Fig. 40: Market Vane Bullish Consensus

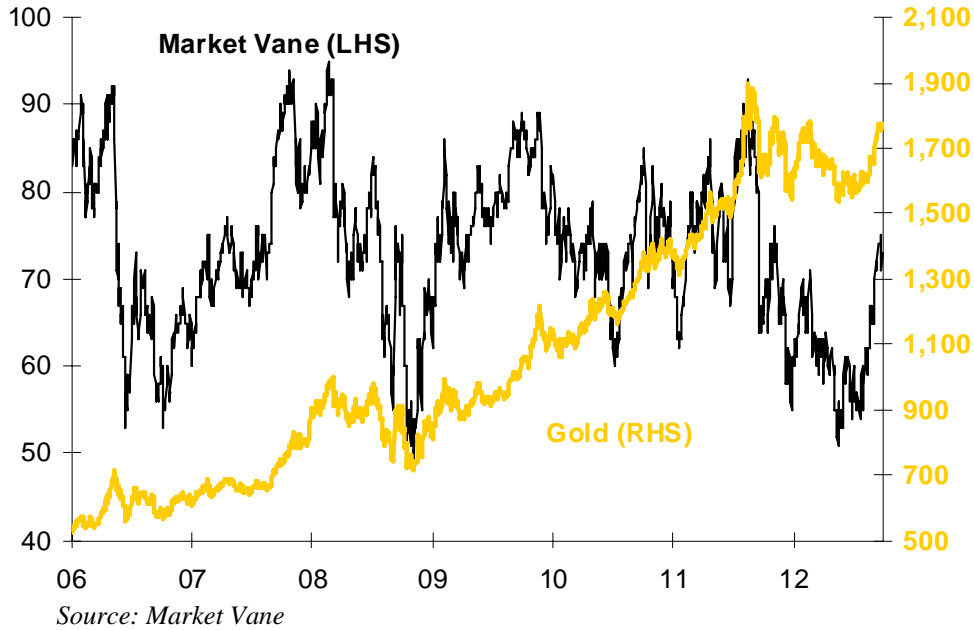


Fig. 41: Bernstein's Daily Sentiment Index

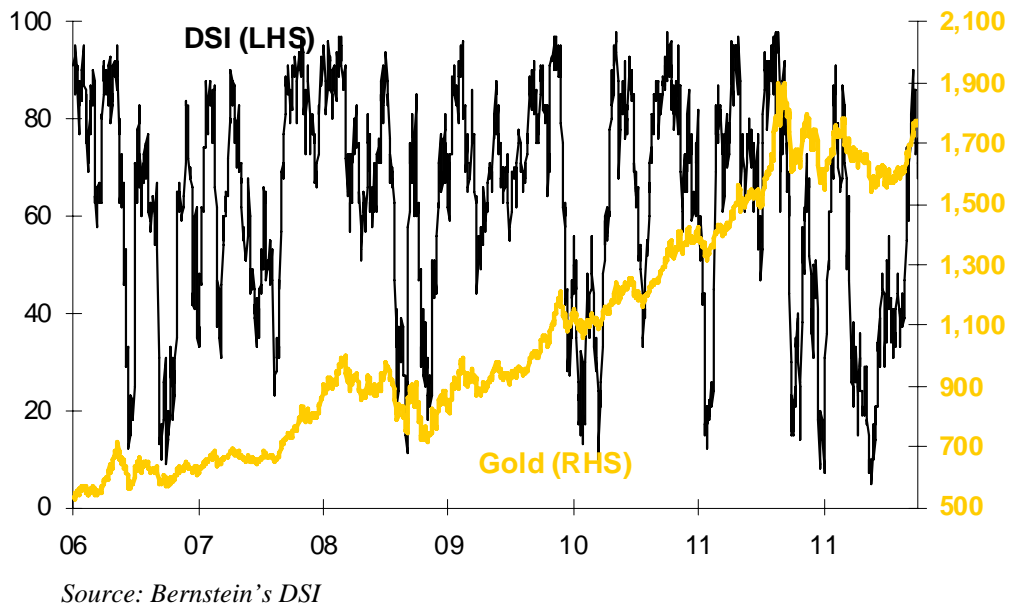


Fig. 42: COMEX Gold Futures Open Interest (tonnes)

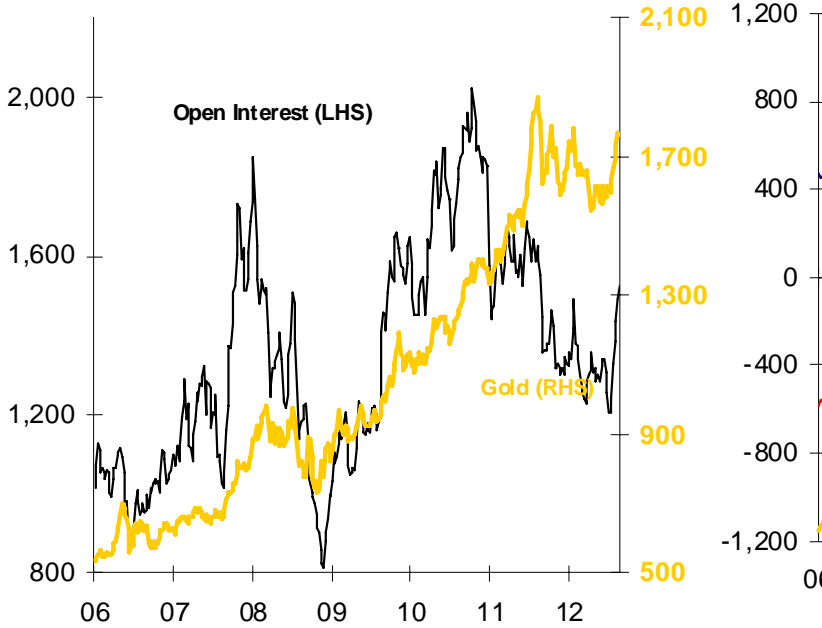


Fig. 43: COMEX Gold Futures Activity (tonnes)

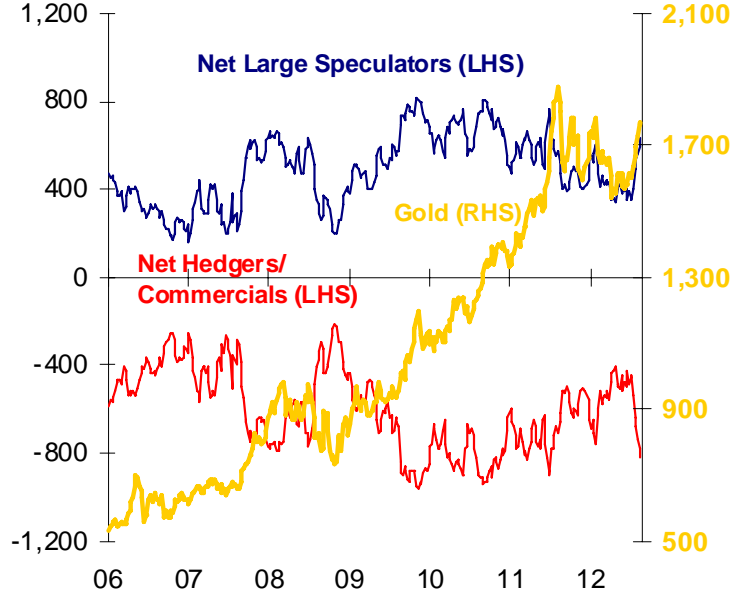


Fig. 44: Commercial Net Shorts as a % of Open Interest

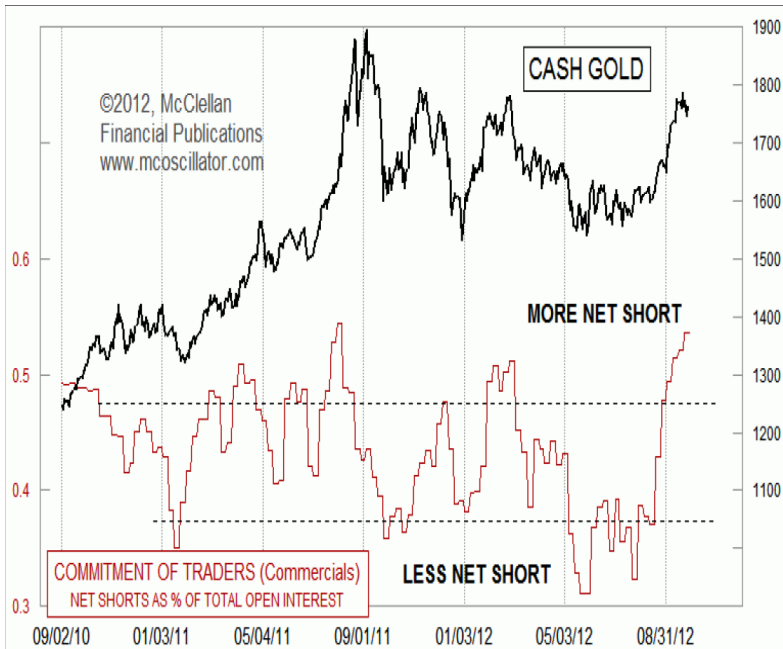


Fig. 45: Gold vs. Continuous Commodity Index



Source: The McClellan Market Report

SECTION III: MINING EQUITIES

Fig. 46: XAU and HUI as a Ratio of Gold

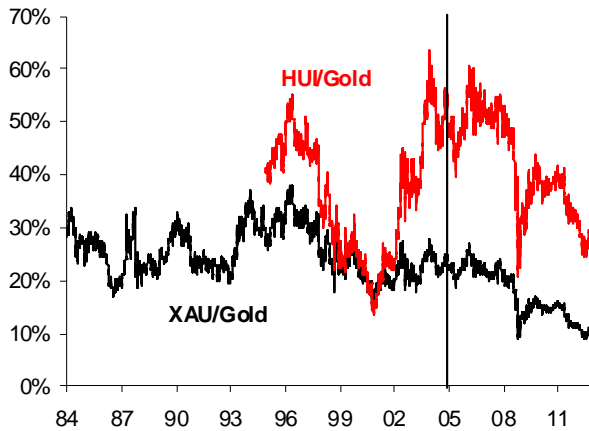
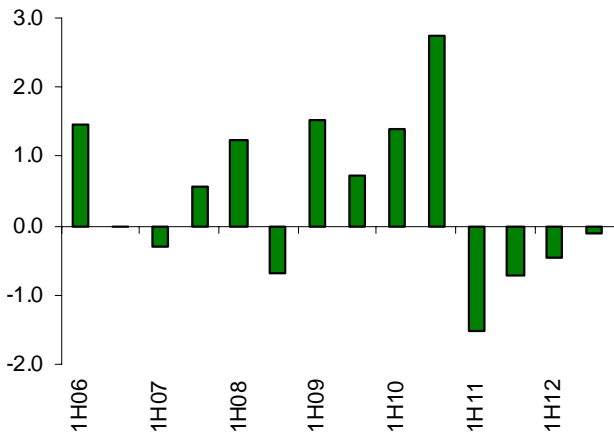
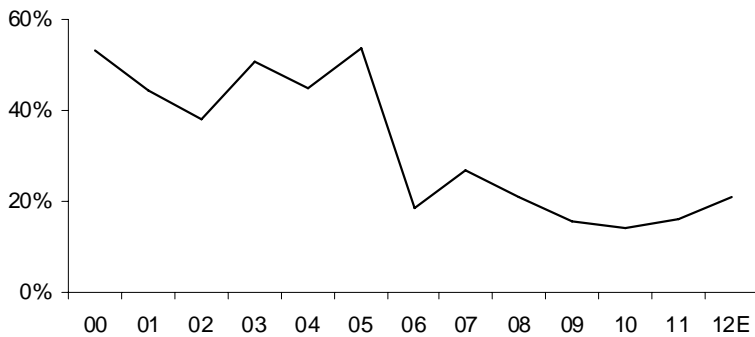


Fig. 48: Net Fund Flows for Lipper's Equity Precious Metals Fund Universe (\$B)*



*Note: 2H12 figure is through August.

Fig. 50: Gold Miners Dividend Payout Ratio*



*Universe includes: ABX, NEM, GG, AU, GFI, KGC, NCM, BVN, HMY, AUY, AEM, IAG, CG, EGO, and GOLD

Fig. 47: GSA's Gold Stocks' Valuation

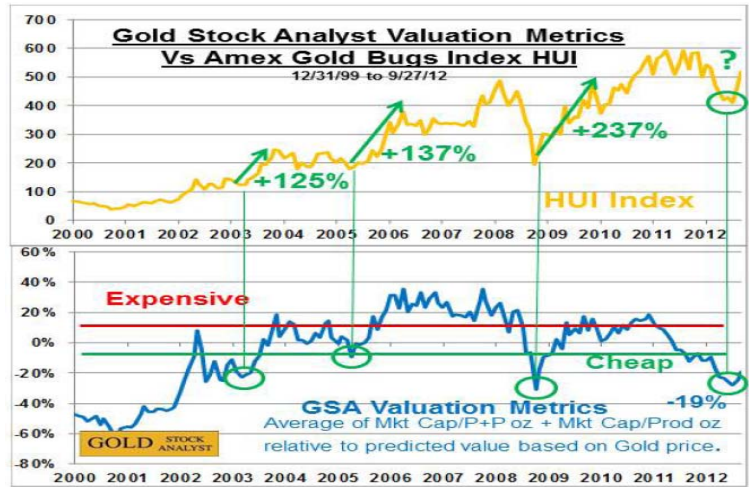


Fig. 49: Market Cap of Van Eck Gold Equity ETFs (\$B)

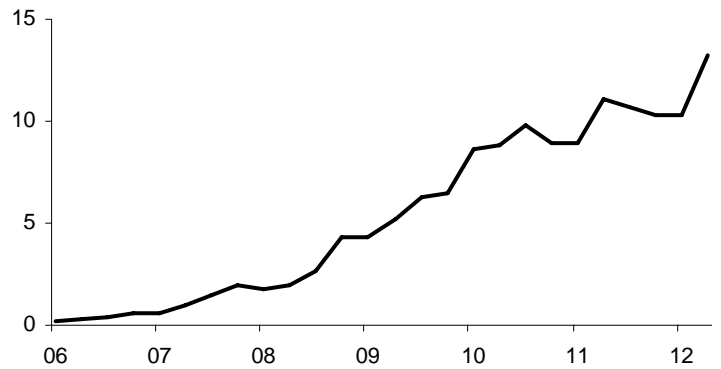
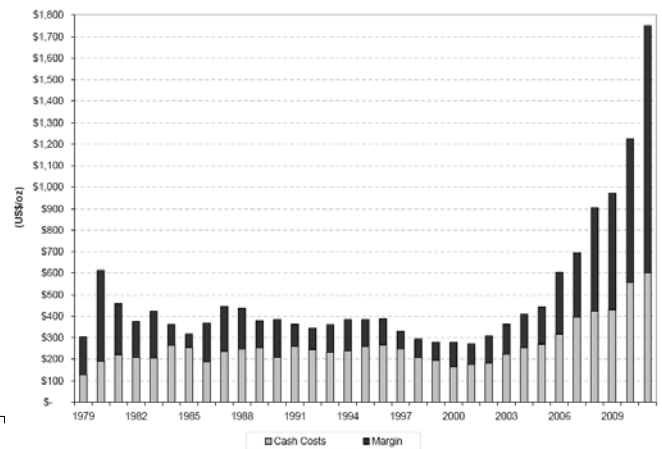


Fig. 51: Cash Costs and Margin



Source: Scotia Capital, GFMS



Fig. 52: Total Cash Outflow (\$/oz)

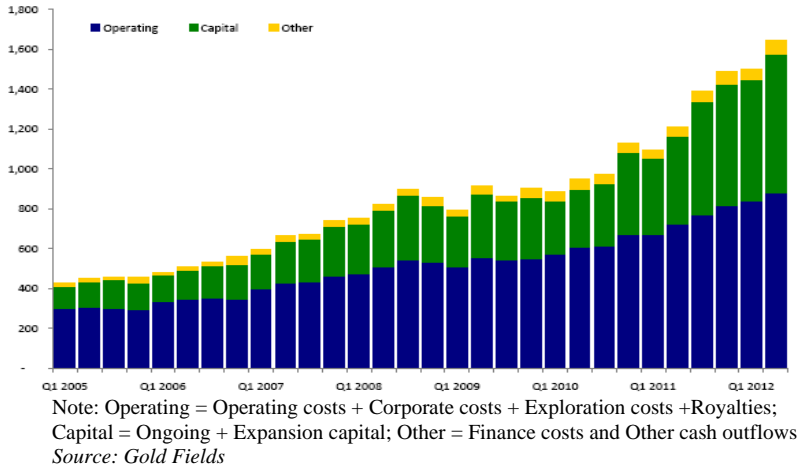


Fig. 53: Returns on Capital*

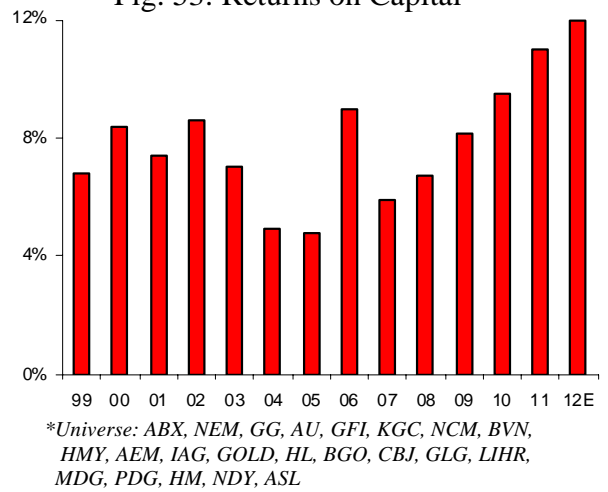


Fig. 54: Average Discovery Cost (\$/oz)



Fig. 55: Equity Capital Issued by Gold Miners

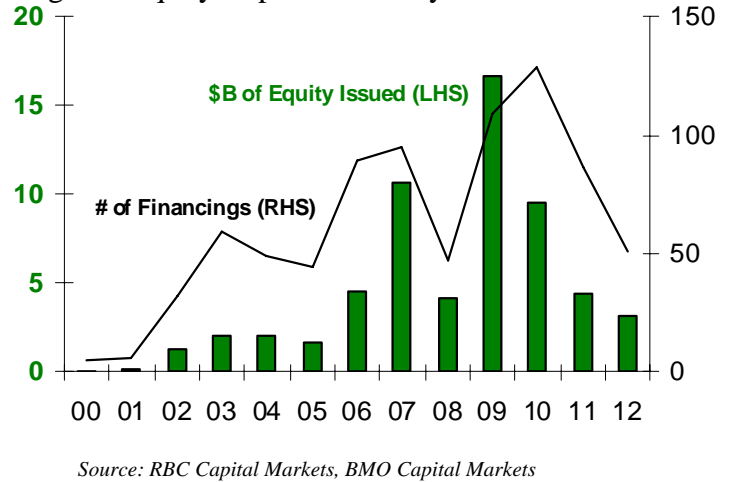


Fig. 56: Cost of Acquisitions in the Gold Sector

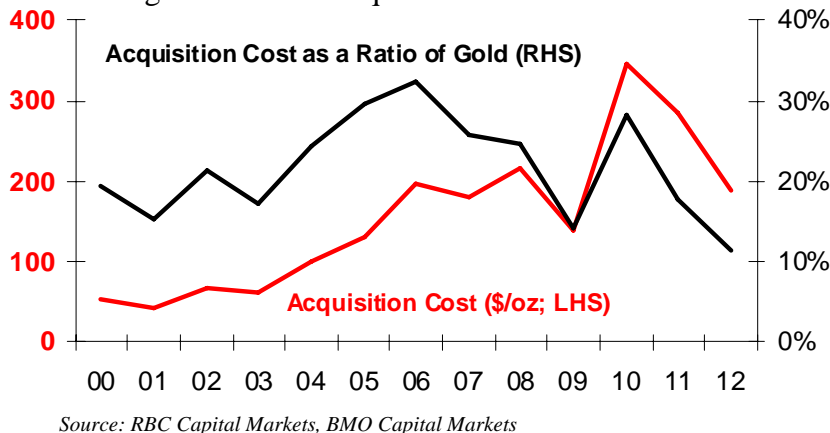
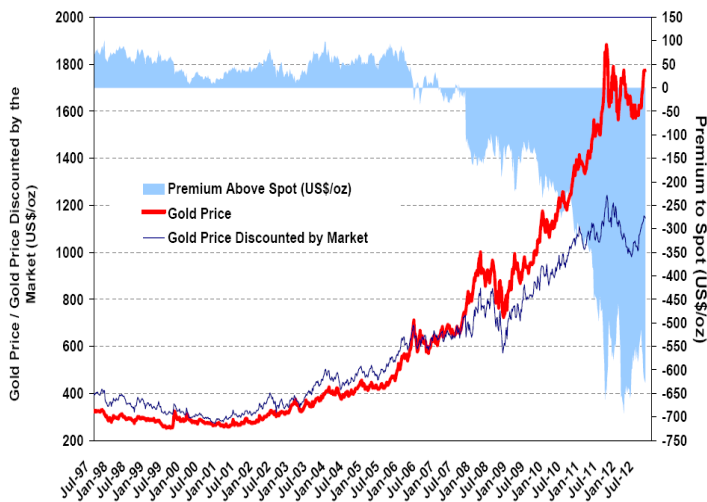


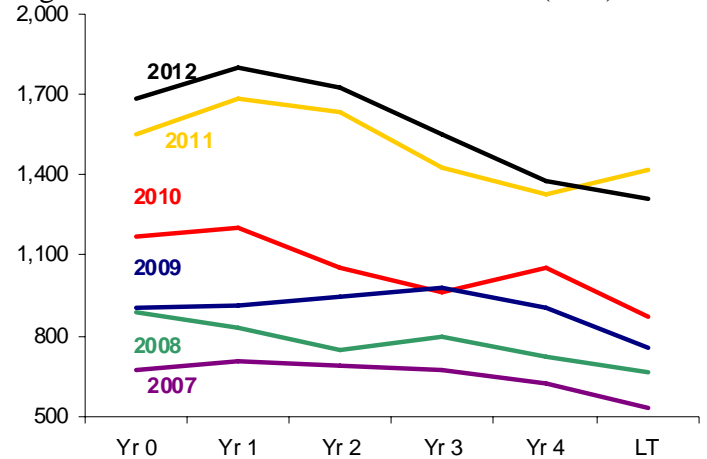


Fig. 57: Gold Price Discounted by the Market



Source: BMO Capital Markets

Fig. 58: Consensus Forecast Gold Prices (\$/oz)



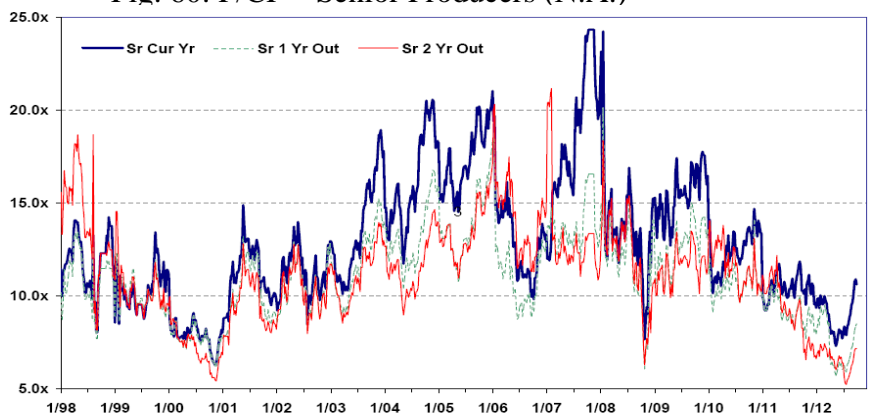
Source: Assorted N.A. Brokerage Research

Fig. 59: NAV Premiums- Senior & Intermediate Producers (N.A.)



Source: BMO Capital Markets

Fig. 60: P/CF – Senior Producers (N.A.)



Source: BMO Capital Markets

John Hathaway
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October 9, 2012

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