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Tocqueville Gold Strategy Investor Letter Second Quarter 2015 Investor Letter

BY JOHN HATHAWAY ON *JULY 8, 2015*

It is counterintuitive that gold has weakened following the events in Greece. The potential withdrawal of Greece from the euro at the very least emboldens left wing/nationalist factions in Spain, Italy, and France who see the results of the Greek referendum as legitimizing rebellion against the diet of austerity proposed by Brussels. Should voter unrest spread, it could undermine confidence in the sovereign credit of core nations within the Eurozone.

Are the events in Greece a prelude to greater instability in the entire Eurozone? The Greek economy and banking system are small in relation to Europe and the global economy and therefore it is easy for market bulls to pass it off as an isolated event. Only time will tell if these tensions are symptomatic of a much bigger problem, but as of now, Greece does not by itself engender the sort of fear that would generate massive capital flows into gold.

If Greece is a sideshow for the time being, there are other potential catalysts worth noting that could trigger capital market adversity or cause a rise in the gold price based on factors unique to the gold market itself. These are:

- Overvaluation of financial assets. We commented on this in our first quarter strategy letter. Significant overvaluation could trigger losses in financial assets that would rekindle investor interest in gold. It is worth noting that the leading market averages have made little progress year to date. According to Stan Weinstein, highly respected technician, and publisher of Global Trend Alert, “roughly 60% of stocks are already in their own private bear markets.”

- Extreme Chinese stock market instability. The implications could be significant well beyond China. Weakness in Chinese equities could be in anticipation of or even cause a global economic slowdown.
- Market rout of all commodities. Gold has been caught up in an across the board liquidation of commodity positions ranging from oil to copper and agricultural. The intensity of the rout seems to reflect emotional pressure that is often characteristic of mindless, visceral capitulation.
- Rising signs of economic weakness. To mention just a few, S&P earnings have declined for three consecutive quarters (including the current quarter). Container shipping indexes, which are the sort of data that cannot easily be massaged or beautified for political purposes, have in most cases declined year to date and some are hovering at multiyear lows. We believe that instability in financial markets, particularly in China and other emerging markets could have a negative spillover effect on US and European economies.
- Gold drain. Gold is migrating to Asia in vast quantities. What this means is that that the power of synthetic gold trading on Comex and OTC transactions in NY and London to influence metal prices could be ebbing. Synthetic gold is traded by algorithmic and HFT strategies in which no gold actually changes hands, only paper derivatives connected notionally to physical bullion. The well documented disappearance of bullion from Western vaults means that credit required for transactions in synthetic may become increasingly difficult to obtain. China has built a market infrastructure in the form of the Shanghai gold exchange and will soon initiate gold fixes in renminbi that will be backed by physical gold, unlike Comex. We believe that the Chinese intend to use physical gold in partial settlement of cross border trade transactions to bypass the US dollar. These developments will eventually in our opinion make Western synthetic gold trade less influential in determining bullion prices.
- Supply crunch of newly mined gold. The gold mining industry cannot justify expansion at current low gold prices. We believe that gold production may have peaked out for several years and will quite likely decline starting this year.

In our view, evidence continues to mount that the secular bull market in gold is far from finished and that the next leg higher is about to commence. The current down draft in the precious metals sector seems like a capitulative event that could mark a turning point. Gold is uncorrelated with financial assets and we believe that the trigger for renewed interest among Western investors will be financial market adversity. The potential triggers for such adversity is a matter of speculation and we identified just a few. A position in gold or gold mining equities at this moment seems to offer excellent protection against the bear market downside potential for equities and bonds, a possibility that seems to have little credibility in the current market environment. On contrarian grounds alone, the low valuation of precious metals exposure by the investment consensus in our opinion suggests extraordinary opportunity.

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July 8, 2015

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Source: Tocqueville
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