



Tocqueville Gold Strategy Investor Letter Third Quarter 2013

BY JOHN HATHAWAY ON *OCTOBER 2, 2013*

Gold and gold mining shares spent most of the third quarter backing and filling without establishing any clear direction. Gold increased 7.6% during the quarter, closing at \$1328.6/oz, but down 20.7% year-to-date. The XAU Index of gold and silver stocks rose 4.1% during the quarter, and was down 42.5% on a year-to-date basis.

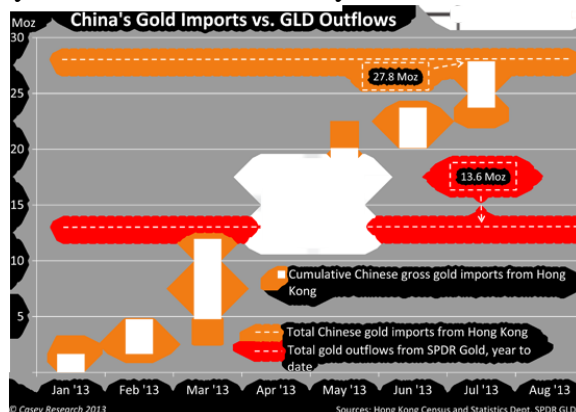
The rationale for investing in the precious metals sector remains compelling, in our opinion. That rationale rests on two fundamental pillars. Firstly, world-wide fiscal and monetary policies have been directly and indirectly subsidizing asset values, which make financial assets especially vulnerable to permanent impairment when supports inevitably end. Secondly, continuous and unconstrained monetary emissions are fraught with unintended consequences, which have historically included debasement of paper currencies via inflation or devaluation and sovereign debt crises. These risks can imperil all financial assets both in terms of their market prices and solvency.

It is astonishing to us that the Federal Reserve and its radical monetary policy retain even a sliver of credibility and trust within the financial markets. Third quarter commentary by various prominent Fed officials conveyed no consensus for attaining their prime objective of slowing the rate of asset purchases and thereafter reducing the size of the Fed balance sheet. The Fed decision not to taper following the FOMC

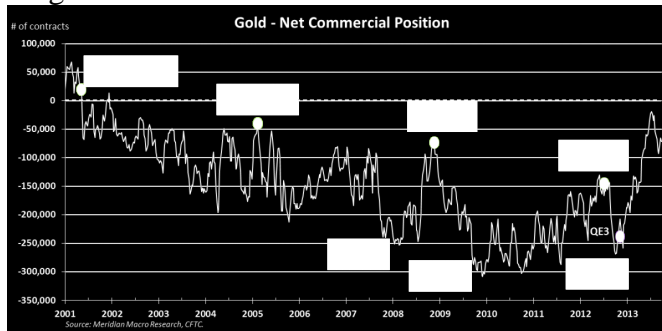
meeting in September momentarily surprised the markets, leading to a brief but sharp rally in gold and related equities. It is our view that the Fed will be unable to taper because economic activity will remain lethargic indefinitely. We also believe that the robust level of activity required to execute the Fed's fabled "exit strategy" will remain elusive because the Fed's strategy of asset purchases suppresses interest rates. Artificial interest rates impede productive economic activity by distorting price signals and misdirecting capital flows. The longer current Fed policies remain in force, the greater the potential disruption to financial markets when it changes, most likely due to events yet unforeseen. Still, conventional economic commentary remains confident of Fed competence to unwind its balance sheet. When this confidence dissipates, as we expect, investment demand for gold will resurface in the most forceful manner.

Other constructive factors we find supportive of future gold demand include:

- The mining industry is in the midst of a major retrenchment. Current gold prices are insufficient to justify new mine construction. Future mine supply seems likely to decline, perhaps significantly.
- The spread of onerous banking and securities industry regulation will, in our opinion, drive investment demand for gold, which, if owned in the correct manner, has little or no counterparty risk and is not subject to financial market and banking industry control.
- A gathering loss of investor credibility in traditional intermediaries between financial markets and bullion, such as Comex and LBMA. These intermediaries in reality offer only a very indirect connection to physical metal and depend on a highly levered structure of collateral re-hypothecation, and in our opinion, market ignorance, in order to operate. Because the paper market in gold is deep and liquid in comparison to other futures markets such as, for example, pork bellies, it attracts speculative capital. However, unlike other deep and liquid commodity markets such as oil, copper, or wheat, the commercial interests, i.e., gold mining companies, jewelry trade etc. have a comparatively small impact on day to day and year to year flows. Therefore, the paper market for gold is ideal for speculative capital inclined to manipulate for purposes of maximizing year-end bonuses.
- Robust Asian demand for physical gold continues in complete contrast to liquidation by Western investors over the past two years. Shanghai premiums vs. London spot were up to 7% this year. Below is a chart of year to date Chinese imports vs. liquidation of ETFs:



- Despite a modest rally over the summer months, market sentiment remains at very low levels (see attached data appendix). In addition, the chart below shows a muted level of interest by speculative longs on the Comex.



In summary, we believe the gold market is set up for a major advance, but recognize that the timing of a turn has been elusive and frustrating. Identifying the catalyst for a new advance is a speculative exercise at best. The current government shutdown is on the one hand an unfortunate headline grabbing side show, which drives aimless short term speculative trading activity. On the other hand, regardless of how it plays out, we regard this very divisive process as a fissure in US credit. We also believe persistent questions about economic recovery in the US and Europe could provide a catalyst in the form of a draw-down of equity market valuations or as a further undermining of Fed credibility. What is certain to us is that market reversals of the kind we anticipate require a tolerance for the pain that it takes to be invested at the low, and that money on the sideline will be paralyzed and unable to act until metals and share prices have advanced strongly.

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Best regards,

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