



Tocqueville Gold Strategy First Quarter 2014 Investor Letter

BY JOHN HATHAWAY ON *APRIL 10, 2014*

Gold and gold mining shares recovered during the first quarter with the metal rising 6.5% and precious metals shares (basis XAU) 8.7% through March 31st. It appears to us that the precious metals complex has bottomed and is attempting to gain footing following the grueling two-plus year correction that started in August of 2011. It is impossible to say whether prices will continue to chop indecisively as part of this process of bottoming, or whether they will spike suddenly higher should some exogenous event spark the pile of tinder representing unresolved systemic risk that has been steadily accumulating since the financial crisis of 2008.

We observe that many investors who understand, and may well have been deeply committed to the investment rationale for gaining exposure to potential currency debasement, have been scarred by two extremely difficult years of negative performance and are therefore on the sidelines looking for a comfortable point to reenter the sector. In the meantime, we have witnessed the entry of contrarian value investors whose rationale can be summed up as viewing gold mining shares as an inexpensive way to protect capital in the event of a broad correction in equity and capital markets. It seems highly certain to us that the positive returns generated by equity markets over the past two years have represented a substantial barrier for capital to reenter precious metals. We therefore believe that a bear market in equities would constitute a catalyst to drive gold and precious metals equities sharply higher.

In terms of supply and demand flows, the stage is set in our opinion for higher gold prices. No mining company management in its right mind would commit to a program of mine construction at current prices. Therefore, we believe that mine supply will shrink in the years ahead, especially after 2015. Given the lead

times involved in new mine construction and even with a moderately rising trend in gold prices, supply could be constrained through the end of the current decade. The demand picture, especially from Asian consumers and possible central banks, looks robust. The flow of gold into China continues to set records and the all-important consumption by the Indian subcontinent remains solid. The Chinese government, acutely aware to the downside risks of its \$4 trillion exposure to the US currency, has almost certainly been surreptitiously accumulating physical gold as a hedge. There has been no update from official sources on central bank holdings since 2009, and if China is still in an accumulation mode, one can be certain that they have taken full advantage of the two year price decline and that their future intentions remain a well-guarded secret.

Should Western investor demand return following its two year withdrawal, the impact could be explosive in the context of an already tight situation for supply. Since the rationale for a turnabout cannot be articulated and is almost inconceivable in terms of consensus investment views, it seems all the more inevitable. The situation seems to have strong parallels to the 1999 bottom in the gold market.

We believe that the architecture of the gold market is set to undergo significant change in the current year and that these changes, which have little to do with macroeconomic considerations, will result in attracting capital flows. These changes begin with inquiries by regulatory authorities in Germany and the UK into possible price manipulation by bullion banks in connection with the London Fix mechanism for gold. These inquiries have been followed by lawsuits seeking damages for plaintiffs possibly injured by price manipulation. We believe many other lawsuits could follow. These in turn would lead to a process of discovery, daylighting the practices of bullion banking. Suspicion of market manipulation and collusive practices has been widespread for many years, and the enlistment of regulatory and legal resources to uncover these possibilities is, in our opinion, constructive.

Gold mining companies, in response to the difficult conditions of the past two years, have cut costs and committed to returning capital to shareholders. There has been wide scale replacement of senior managements in response to shareholder dissatisfaction with poor performance, disrespect for financial discipline, and disregard for shareholder interests. Many of the new class of CEO's have taken an oath to refrain from high risk capital programs that in the past have led to serious dilution of shareholder interests. Even a modest rise in gold prices would result in free cash generation that will in our opinion surprise investors favorably.

Our criteria for selecting equities for our portfolio include a thorough review of the credibility of management's commitment to wealth generation for shareholders on a non-dilutive basis. In addition, we pay close attention to asset quality handicapped for risks faced by those assets in their geographic and political setting. The recent and still ongoing (as of this writing) takeover contest for Osisko Mining is, in our opinion, a validation of our extensive due diligence and highly selective approach to portfolio construction.

As always, we appreciate your support as investors and clients and look forward to responding to any questions or comments that you may have.

With all best wishes,
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