Tocqueville Gold Strategy Investor Letter First Quarter 2013

April 11, 2013

The bottoming process in gold and gold mining shares continues to be an extended and frustrating affair. Nevertheless, the fundamental rationale for positioning physical bullion and gold mining shares seems more compelling than ever. The metal dropped approximately 4.5% during the quarter, but the mining shares (basis XAU) dropped almost 19%. From the September 2011 peak of 227, the XAU had declined -26% to year end 2012 where it stood at 167. Until the end of 2012, the decline was orderly. The decline accelerated sharply in the first quarter of 2013, almost equaling the percentage decline during the previous 16 months.

The accelerated decline in the first quarter of 2013, in our opinion, suggests a capitulative phase in which investors are giving up on the notion of exposure to gold, and especially gold mining shares. The mining shares, which were already historically cheap at the beginning of the quarter, became even cheaper. Intense liquidation of GLD and other gold ETFs during the quarter (see Chart 28 on p.5 of the appendix) also seemed characteristic of a broad capitulation. Gold, a favorite investment theme two years ago, has become toxic to many.

To recap the factors we believe led to the decline:

- Gold became overbought during the threatened government shutdown in August of 2011. As one of our favorite technicians stated, when the price of anything attempts to go parabolic, it must suffer from a hangover.
- The stock market has provided superior returns over the past four years.
- The numerous and cumulative sins of gold mining managements wore investor patience thin.
- As conviction in the upward trend of the gold price dissipated, the rationale for owning gold mining stocks disappeared.
- Several high profile investment firms (Goldman Sachs, SocGen and others) turned negative on gold fundamentals, and the weight of media commentary followed suit.

Deserving special mention in the category of being useful inverse barometers of contrary opinion is the New York Times, which featured on the front page of the 4/11/13 Business Day section: "A Sure Bet Loses Its Luster: Gold, Long a Secure Investment Has Lost 17% of Its Value Since 2011." A brief quote from the article is a paean of shallow conventional wisdom:

"Now, the worst of the Great Recession has passed. Things are looking up for the economy, and, as a result, down for gold. On top of that, concern that the loose monetary policy at the Federal Reserve might set off inflation – a prospect that drove investors to gold – has so far proved to be unfounded."

For a contrarian, commentary such as this provides great cheer.

As a hard boiled value investing convict, I am well aware of the perils of bottom picking. Given this caveat, I believe that the precious metals sector has arrived at a significant bottom and that the next leg in the gold bull market is ready to commence. My evidence:

- Gold bullion has withstood intense liquidation by holders of GLD and Comex traders in paper gold as well as withering and intensely adverse commentary by media, brokerage, technicians and assorted soothsayers, especially during the past 90 days.
- The fundamental case for owning gold has improved since year end 2011. Real interest rates remain negative, worldwide quantitative easing has proliferated, and the events in Cyprus demonstrate that uninsured deposits in the commercial banking system are at risk in any resolution scenario.
- Many of the shortcomings of the gold mining sector, both real and imagined, are on the mend. Shareholder dissatisfaction has prompted significant turnover in executive suites. Managements that were clueless, especially with respect to legitimate shareholder concerns, have been replaced. Where there was arrogance and overconfidence, there is now contrition and introspection. Many of the problems that can be fixed, will be, in our opinion. Of course, there will always be exceptions.
- The gold price itself seems poised to begin the next leg of its multi-year bull market. (Please refer to our recent website article for the possible rationale, "The Investment Case for Gold: Part 2"). When the gold price re-establishes an upward trend, we expect the gold mining stocks to revive and produce very satisfactory returns.

The appended data package shows:

- strong macro fundamentals for gold
- investor sentiment at a negative extreme
- compelling valuations in the mining shares

It seems like a contrarian’s dream scenario to us.

Tocqueville Gold Monitor 1Q13 [PDF]
Tocqueville Gold 1Q13 Letter and Monitor [PDF]

Best regards,
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Portfolio Manager and Senior Managing Director
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