Tocqueville Gold Strategy Investor Letter Fourth Quarter 2012

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The bull market in gold remains intact. The metal rose approximately 7.14% in 2012 in US dollar terms and has increased in each of the last 12 years.

Negative real interest rates incentivize capital to move into gold. It is difficult to imagine a world of positive real interest rates, absent a significant shift in monetary and fiscal policy in the Western democracies.

Gold and gold shares historically have been positively correlated. However, during the past few years, gold mining stocks have underperformed the metal due a host of issues that we have discussed at length, including our website article **A Golden Mulligan**. Although the article was published a few years ago, the issues afflicting gold mining stocks mentioned then still hold true.

Gold mining stock valuations are at the low end of the historical range since the introduction of the gold

ETF (GLD) in 2004, or roughly 10% (basis XAU/spot bullion.) This relationship is depicted on page 10 of the appended data section to this report. Significant rallies in gold mining shares have occurred in the past few years from this compressed valuation base.

We see evidence of fundamental change within the gold mining industry which addresses many of the concerns that have caused negative investor sentiment. For example, cost pressures are leveling off, which should help margins. Investor pushback against major capital spending projects is leading to better capital allocation decisions. There have been a number of departures at the CEO level due to investor dissatisfaction, and this should heighten the sense of accountability to shareholder interests in the ranks of management. On the other hand, resource nationalism remains a strong headwind. Only the better managed companies will be able to deal successfully with these pressures.

Despite the steady rise in the gold price over many years, it has failed to exceed the 2011 high of $1901/oz. achieved during the debt ceiling crisis and US credit downgrade. This lack of direction has hurt gold mining stocks, which do best when the upward trend of the gold price is clear. We believe that gold stocks will respond favorably to a new high in the gold price.

Gold needs to rise only 15% to trade at a new high. We believe that this is in the cards for 2013, and that such a move will be driven by the continuation of negative real interest rates and heightened concerns over the direction of monetary and fiscal affairs in all western democracies. Such concerns will be exacerbated by the continuation of extremely weak economic activity in 2013 and quite possibly the resumption of a recession, anticipated by few.

Most investors seem to expect a gradual acceleration of economic growth in 2013. We disagree and believe that the recent tax hike, one of the largest in history, will dampen economic activity sufficiently to widen the deficit and require the extension of debt monetization by the Fed for years to come.

Polarization of public opinion and the political process over austerity versus growth agendas will also serve to paralyze economic activity. Not only will this require continued monetization of fiscal deficits, but it will affect business and consumer behavior negatively. Intractable fiscal issues such as tax and entitlement reform, in our opinion, will only be achieved through political consensus. In the absence of effective political leadership, such a consensus seems achievable only in the aftermath of a financial and economic meltdown on the order of 2008.

Once gold demonstrates that it can trade sustainably above $2000, or 20% above current levels, we believe that gold mining stocks could trade at 13%-15% of spot bullion (basis XAU). That would translate into appreciation of 60%-90% above the current XAU level of 160. Investor sentiment on gold is extremely negative, comparable to the levels of mid-May 2012, when gold was trading approximately $100/oz. below current levels (see Fig.34- Fig.35 on pp. 8 of the appended data section). Historically, extreme negative sentiment levels such as these have provided excellent entry points for new positions in bullion and the mining shares.
Tocqueville Gold Monitor 4Q12 [PDF]
Tocqueville Gold 4Q12 Letter and Monitor [PDF]

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