

Tocqueville Gold Strategy Update

April 15, 2013



Uncommon Perception

Gold bullion prices have been subjected to a cleverly orchestrated bear raid in our opinion. Selling of paper Comex contracts on Friday, April 12th, and Monday, April 15th, totaled 1 million contracts, exceeding global annual gold production by 12%. The attack succeeded when the technical support in the low \$1500's/oz. easily gave way and led to waves of forced selling. The volume is without precedent and has all the characteristics of a panic liquidation driven by naked short selling. There is no way to know where or when the liquidation will end, but it will inevitably do so, probably sooner rather than later.

According to our source at the World Gold Council, physical buying from India and China, which represents half of global gold consumption, remains robust. Central bank buying activity shows no signs of abating. The notion that weak peripheral European states will be forced to sell their gold holdings is fanciful. A more likely scenario is that these holdings would be used as collateral to support additional credit to the sovereign.

All in all, it appears to us that this gold sell off was made in America, based on an assessment of technical weakness by a large number of opportunistic players, and supported by dubious macroeconomic speculations. At the very least, a sharp rebound based on short covering and physical buying should be expected once the panic has run its course. The bigger consideration is whether the validity of the rationale for gold has changed.

It is quite possible that all of the known bullish arguments had been expressed when gold peaked above \$1900/oz. in 2011. Negative real interest rates, financial repression, intractable fiscal issues, and central bank money printing were on the tip of a thousand tongues. Today, these concerns are widely dismissed or down played. The financial crisis of 2008 is a thing of the past. We are beyond it. The economy is on the mend, real interest rates will rise to levels competitive with gold, central bankers have the tools to exit money printing and will act with resolve to do so when the time comes, and government inefficiencies will someday be fixed.

We have our doubts about the sanguine sentiment that seems to prevail. We believe that crisis of 2008 was never resolved, only papered over with sovereign credit. It is our belief that another, perhaps more dire crisis, lies ahead, centering first on the credit of weaker sovereigns but ultimately drawing fire on the very strongest. Consensus belief in global economic growth seems misplaced. Europe is stagnant, momentum in the US is slackening at best, and possibly illusory, and China seems to be slowing. Japan's aggressive monetary policy is potentially deflationary and certainly destabilizing to what little global growth there may be. Without economic growth, debt burdens whether sovereign or private, will become extremely problematic. It seems quite likely that extreme monetary policies are not a passing phase but a thing of permanence. The idea that the Fed and other central banks will exit on a timely and forceful basis has no historical basis.

Should our views turn out to be accurate, there are a few potential flies in the ointment for those with more complacent views of financial assets than my own. In my view, economic stagnation will lead to inflation, sharply higher than consensus interest rates, and concerted attacks by the political class on holders and generators of private wealth in order to balance the public books.

On the other hand, if the events in Cyprus and Japan, combined with a return to stall speed in the global economy, represent a newly discovered lurch towards deflation, one only need remember how that all turned out. It was the birth of quantitative easing and massive public deficits. We believe that a deflationary turn of events will rekindle the sentiment that public policy is impotent, that paper money is toast, and that private wealth must be conscripted in bail ins yet to come. A deflationary scare was good for gold (with a lag) in 2008, and it should be even better in the current environment, in our opinion.

We recognize that our views are contrarian and at odds with conventional wisdom. Frankly, that has never bothered me, however painful. Market panics often present great opportunity. We believe that the current sell off in gold and gold mining shares provide a very inexpensive call option on the possibility that the next few years may not turn out to be as rosy as widely anticipated.

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