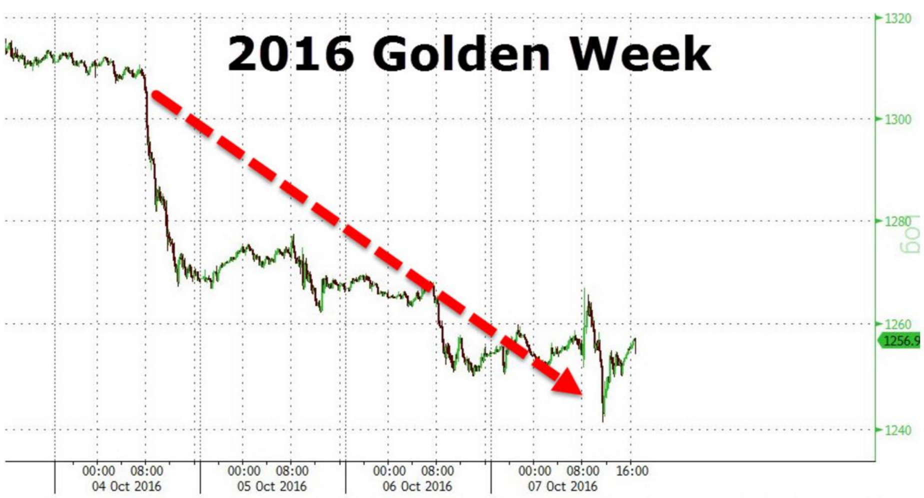
Tocqueville Gold Strategy

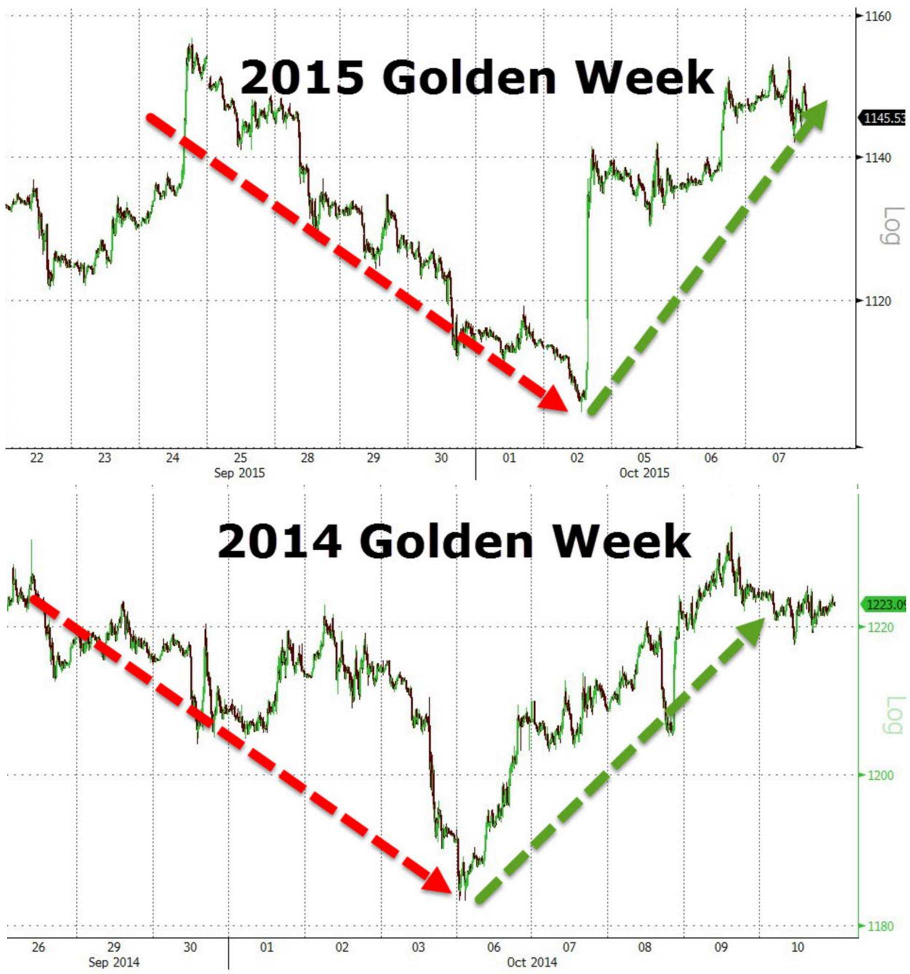
Third Quarter 2016 Investor Letter

During the third quarter of 2016, gold and gold mining shares consolidated in a narrow range following substantial gains in the first half of the year. On a year to date basis (9/30/16) gold bullion rose 24% while most gold mining shares gained 3x-4x the gold price.

During the first few days of October, the gold price broke sharply lower beneath the consolidation range of the third quarter. The decline in gold accelerated after breaking through technical support zones clustered around $1300/oz. in only a few days. High frequency and short term momentum traders piled on as they typically do when technical support is breached. Intense short selling by these players accelerated the market decline. Bearishness has replaced the euphoria and overconfidence that dominated only a few months ago in early July. It must be remembered that these short term gyrations reflect synthetic or paper trading, which we have discussed frequently over the past two years, and is almost completely disconnected from flows of physical metal.

Long term, we don't think this washout signals a structural change in gold's outlook; it may have been a clean-out of weak holders as prices recalibrate lower towards physical support from Asian buyers. The correction of the past few days coincided with an absence of Chinese buyers due to the "Golden Week" holiday there. "With China (by far the largest buyer of physical gold) closed, the markets were open for rampant manipulation, which is exactly what happened as several billion dollars in paper assets were dumped." (Zero Hedge Oct. 9, 2016) As noted in the October 10 Belkin report, "who sells $22 billion of gold for maximum market impact over a very short period of time? The global monetary cabal (central banks, BIS) have a long history of suppressing gold prices because a rising gold price discredits their legitimacy. But never mind, gold is still up 18% year to date …even after last week's intervention." As the charts below show, this intervention was very similar to the previous two years. Paper losses inflicted by synthetic speculators during Golden Week were recouped in the subsequent trading sessions.





Source: ZeroHedge.com

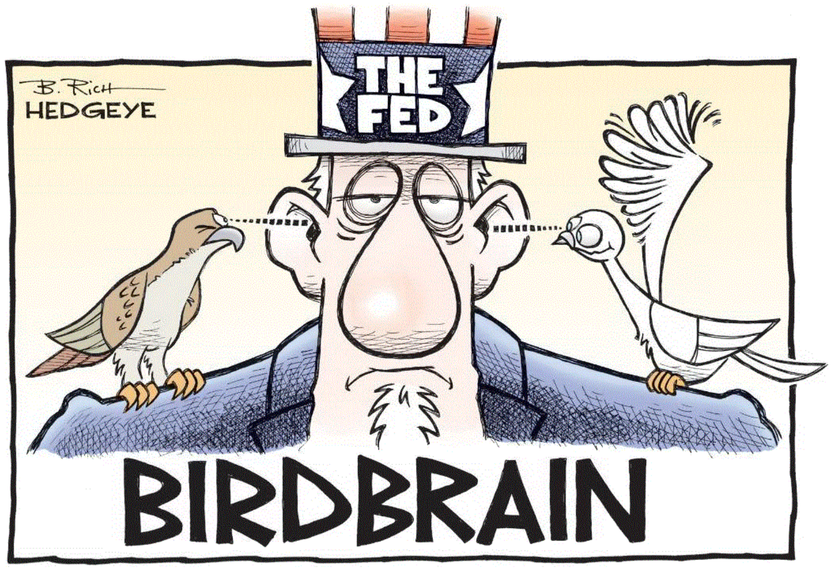
To us, it looks like a bull market shakeout triggered by worries over rising interest rates and perceived lack of action by central bankers, especially in Europe, to expand monetary stimulus in response to a growing banking crisis at Deutsche Bank, Unicredit, etc., all orchestrated with virtually no physical gold being transacted. We would expect to see a sharp reduction in speculative COMEX long positions over the next few weeks as confirmation that the shakeout has run its course.

One must ask whether anything has really changed in terms of the investment rationale for gold. In our opinion, gold began a second leg of a long term bull market at the end of 2015. Bull market shakeouts are a regular feature of longer term price advances and serve to restore the component of doubt necessary to reconstruct the wall of worry characteristic of all bull markets.

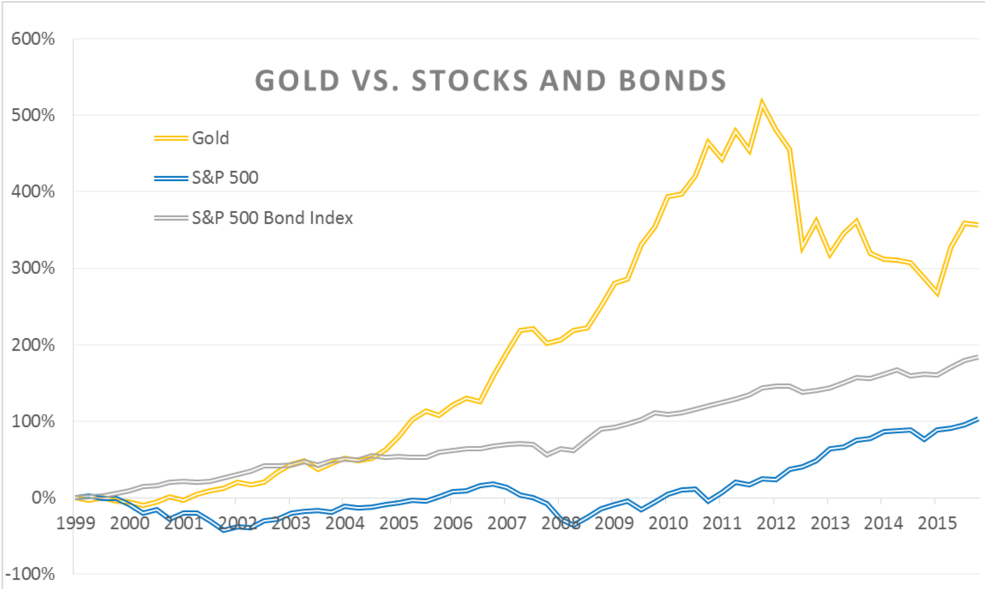
In our opinion, systemic risk continues to grow in a stealthy manner and is only manifested episodically, as in the current European banking crisis and in the fragmentation of the political consensus that was once the foundation for the Eurozone and the euro itself. Investors in gold should find reassurance in the palpable decay of investor confidence in central banking and radical monetary policy. There is scant reason, in our opinion, to expect waning confidence to revive. In fact, there is substantial evidence to suggest that ultralow interest rates, ballooning fiscal deficits in Western democracies, and competitive currency devaluations are jelling into a negative feedback loop for global economic growth. We believe the most likely macroeconomic scenario for years to come is a Japanese like twilight zone that oscillates between feeble growth and periodic downturns.

In our opinion, numerous catalysts are aligning to stoke broader interest and a renewed advance in gold prices:

- Spreading loss of confidence in central banking, both from investors and policy insiders. Trial balloons to eliminate cash, ramp up fiscal deficits, and push nominal interest rates below the zero bound seem to proliferate. Commentary in main stream financial media openly questions the efficacy of ultralow interest rates and QE to stimulate economic growth.



- Interest rates appear set to rise on a schedule not orchestrated by the Fed but by the financial markets. Both political candidates favor fiscal stimulus that will inflate deficits at a time when non US buyers of treasuries, a principal source of demand in recent years, have been in a liquidation mode for the past twelve months. In our opinion, a continuation of rising interest rates will lead to steep capital losses for holders of low to negative yielding sovereign debt, and cause considerable collateral damage to equities.
- Global gold mining production, in our opinion, appears locked into an irreversible decline for the next 5 to 10 years. Because exploration has slowed sharply, there are fewer new deposits to mine. Industry reserve life is dwindling. Barriers to new mine construction seem more formidable than at any time for the past twenty years.
- The US economy is cruising at stall speed on a best case basis and more likely teetering on recession. Should interest rates rise at this precarious juncture, monetary policy, perceived to be in a tightening mode, could be forced into another phase of QE or even more radical measures.
- Gold is extremely under owned in Western investment portfolios. Because supplies of above ground stocks normally available to satisfy Western investment demand have been severely depleted by flows to Asian investors, the price dynamics could be explosive.
- Gold has enjoyed a stealth bull market since the advent of radical monetary policies around 2000. As the chart below shows, gold has been the best performing asset class since then, a fact that is completely unrecognized by main stream media and conventional investors. The painful correction from 2011 to year end 2015 camouflaged gold's strength and explains why most investors remain complacent as to systemic risk, intellectually understanding the unsustainability of radical monetary policy but unmotivated to seek gold's protection.



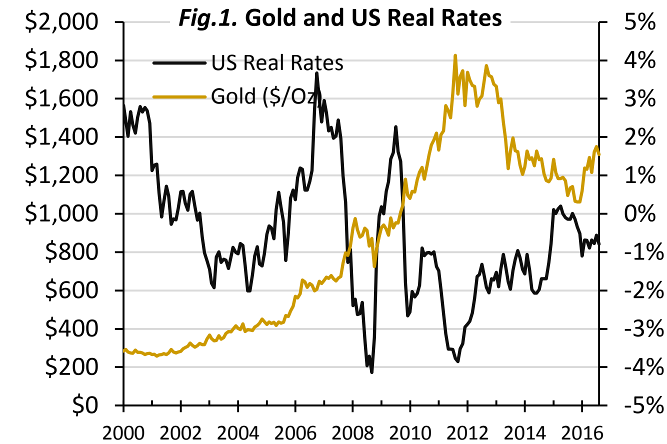
It seems unlikely that the long term erosion of investment confidence, the onset of a secular bear market in financial assets, and further advances in the stealth bull market for gold will take place in a linear fashion. There are bound to be shakeouts and fake outs along the way to camouflage the underlying reality that the global financial system as we know it is in extremis. We also believe that the current sharp correction in the precious metals complex is a setup for another major advance toward new highs in metal and share prices. We therefore recommend taking advantage of current weakness to build or establish new positions.

John Hathaway
Senior Portfolio Manager

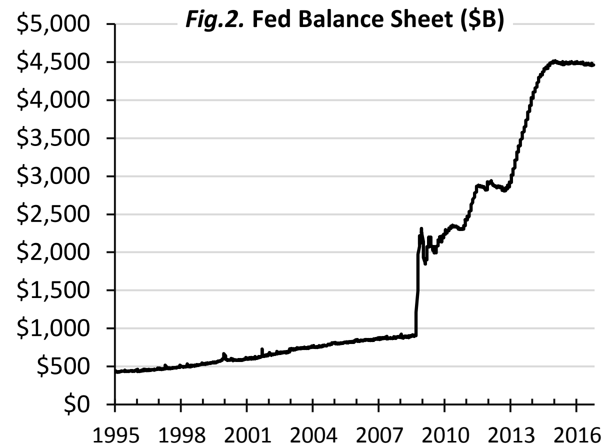
October 12, 2016

GOLD MONITOR

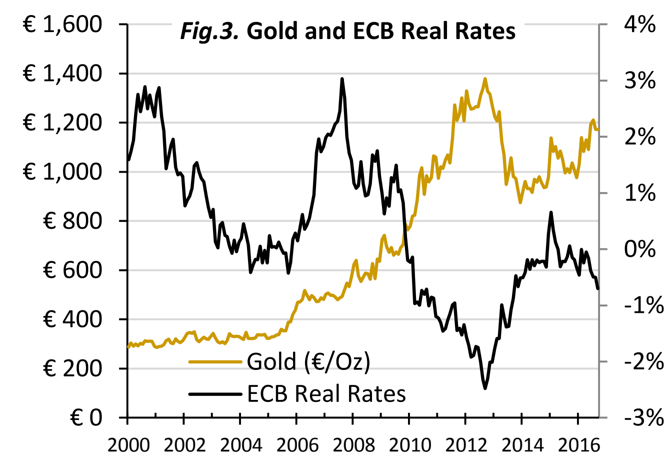
Section I. Macro



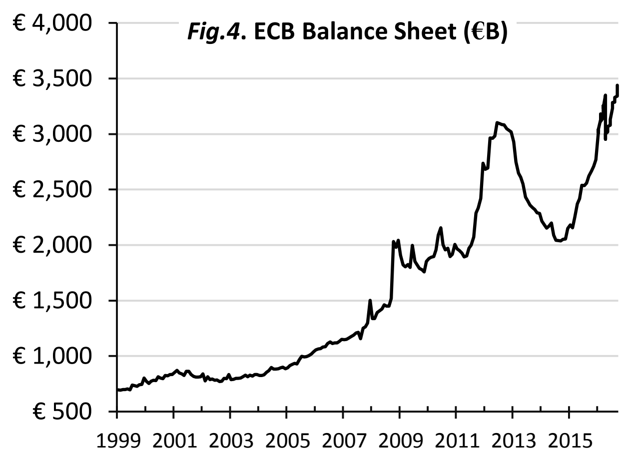
Source: Bloomberg



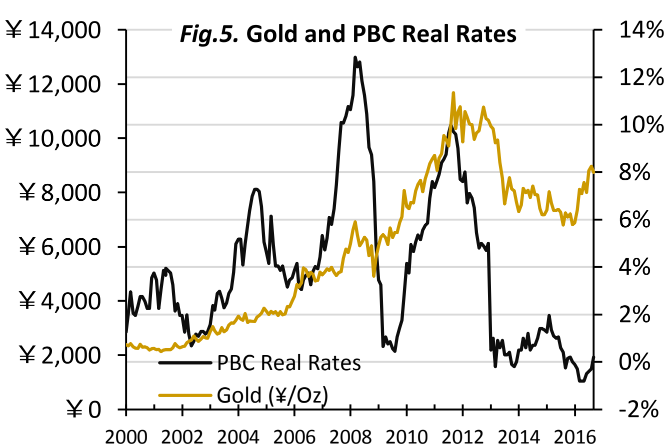
Source: Bloomberg



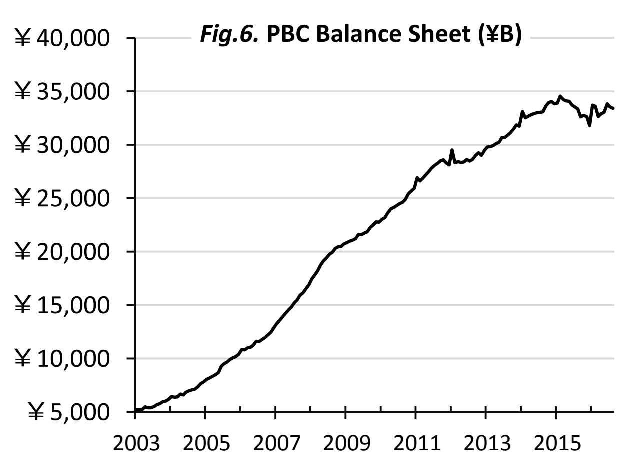
Source: Bloomberg



Source: Bloomberg

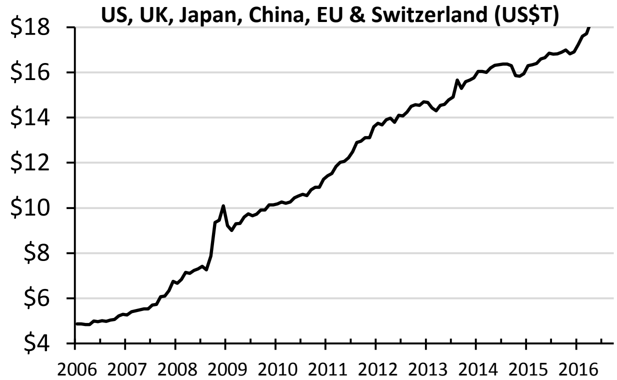


Source: Bloomberg



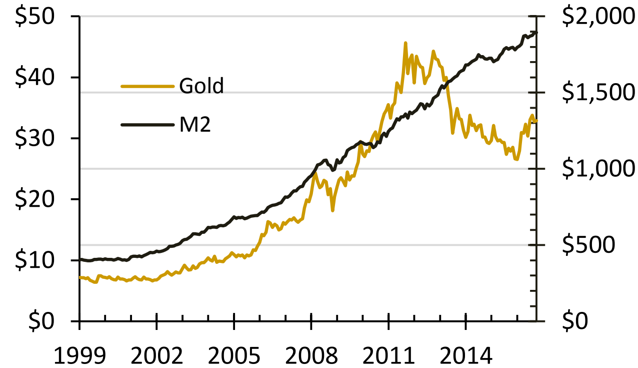
Source: Bloomberg

***Fig.7.* The Biggest 6 Central Bank Balance Sheets US, UK, Japan, China, EU & Switzerland (US$T)**



Source: Bloomberg

***Fig.8.* Gold and M2 (US$B, Fed, ECB & PBC)**



Source: Bloomberg

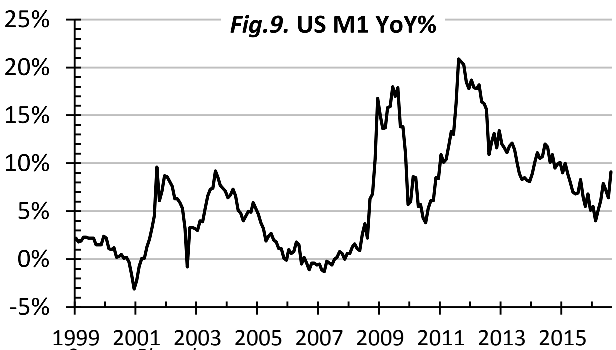


***Fig.9.* US M1 YoY%**

Source: Bloomberg

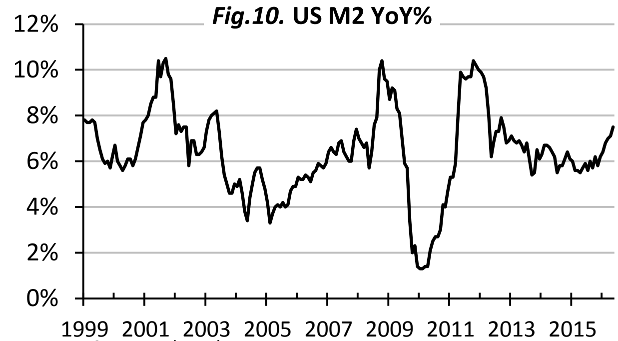


***Fig.10.* US M2 YoY%**

Source: Bloomberg

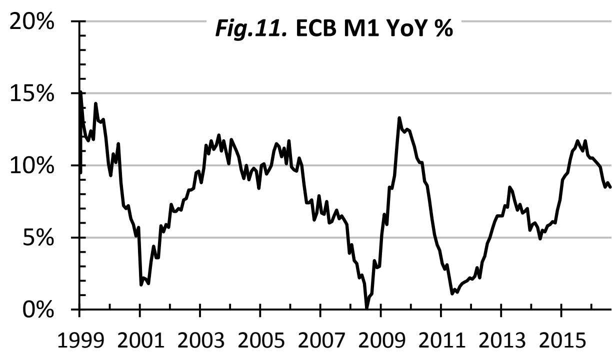


***Fig.11.* ECB M1 YoY %**

Source: Bloomberg

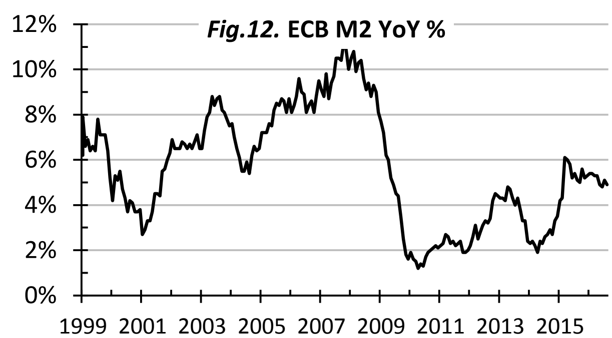


***Fig.12.* ECB M2 YoY %**

Source: Bloomberg

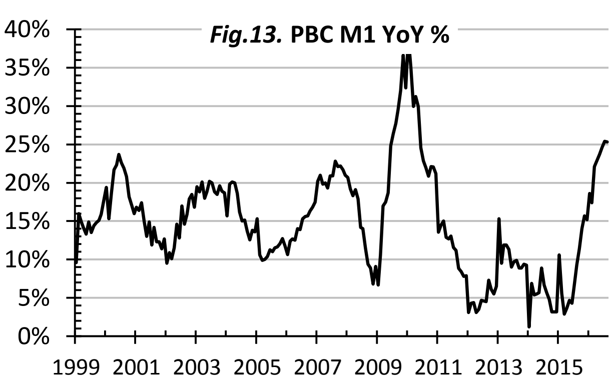


***Fig.13.* PBC M1 YoY %**

Source: Bloomberg

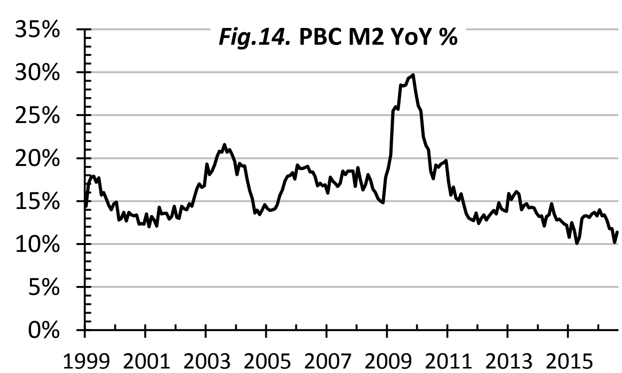


***Fig.14.* PBC M2 YoY %**

Source: Bloomberg

Fig.15. Inflation August 2016			
	US	Euro Area	China
Headline CPI	1.1	0.2	1.3
Core CPI	2.3	0.8	n/a
Shadowstats	8.2	n/a	n/a

Source: Bloomberg, Shadow Government Statistics.

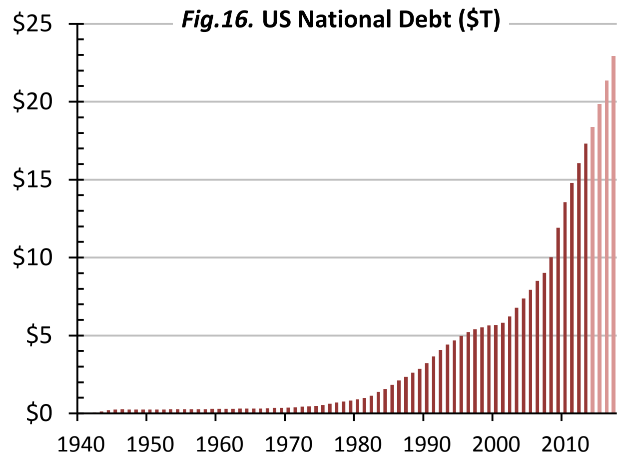


***Fig.16.* US National Debt ($T)**

Source: TreasuryDirect.gov, USDebtClock.org

***Fig.17.* Total Pubic Market Debt as % of GDP**

Source: Stlouisfed.org

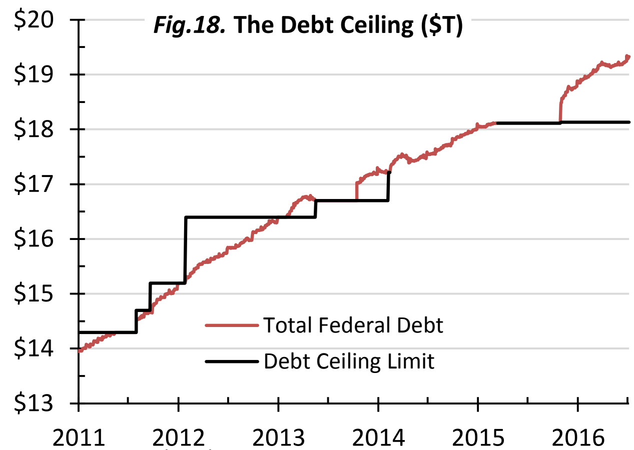


***Fig.18.* The Debt Ceiling ($T)**

Source: Bloomberg

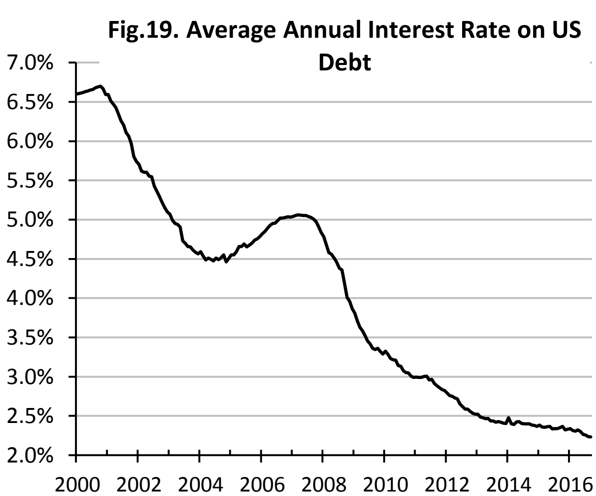


Fig.19. Average Annual Interest Rate on US Debt

Source: US Treasury, Meridian Macro.

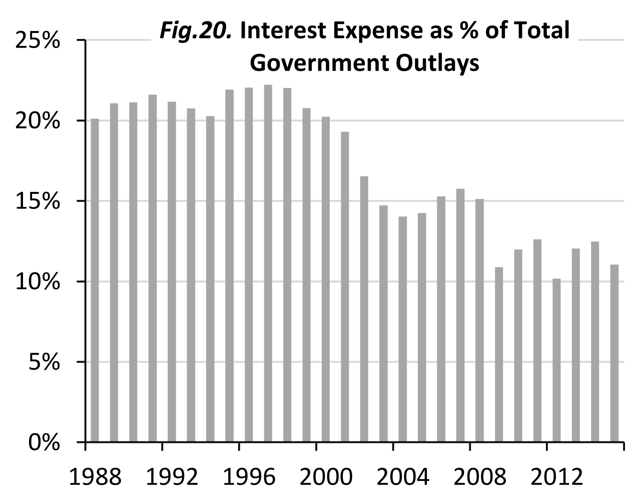
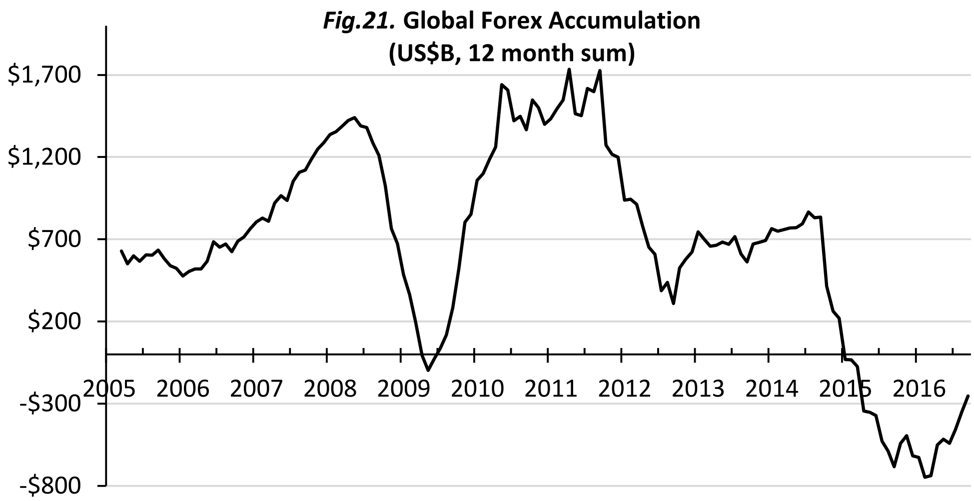
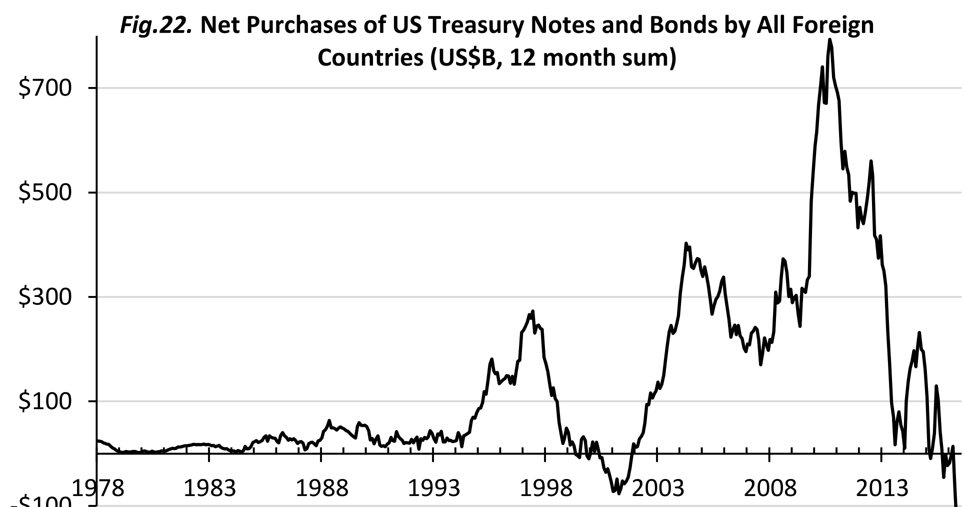


***Fig.20.* Interest Expense as % of Total Government Outlays**

Source: Bloomberg; US Treasury



Source: Bloomberg; MacroMavens, LLC



Source: US Treasury; MacroMavens, LLC

Source: US Treasury; MacroMavens, LLC

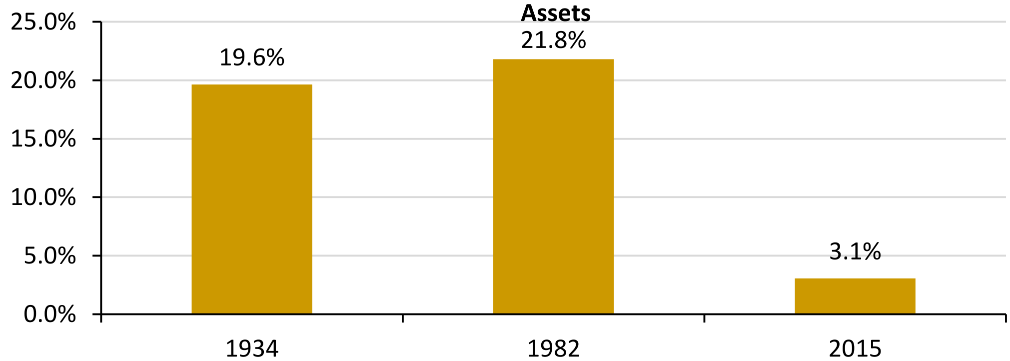
Section II. Gold

***Fig.24.* Gold Supply and Demand (tonnes)**

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2Q16 YTD
Supply															
Mine production	2,591	2,592	2,478	2,550	2,481	2,476	2,409	2,584	2,739	2,827	2,848	3,019	3,114	3,186	1,537
Old gold scrap	835	944	829	886	1,107	956	1,217	1,672	1,723	1,669	1,626	1,371	1,122	1,093	687
Traditional supply	**3,426**	**3,536**	**3,307**	**3,436**	**3,588**	**3,432**	**3,626**	**4,257**	**4,463**	**4,495**	**4,473**	**4,390**	**4,236**	**4,279**	**2,224**
Net producer hedging	-412	-279	-445	-86	-373	-444	-349	-252	-108	10	-20	-50	42	-21	-83
Official sector sales	545	617	497	662	367	484	236	30	-	-	-	-	-		
Total supply	**3,559**	**3,874**	**3,359**	**4,012**	**3,582**	**3,472**	**3,513**	**4,034**	**4,355**	**4,505**	**4,453**	**4,340**	**4,278**	**4,258**	**2,307**
Demand															
Jewellery	2,680	2,522	2,673	2,707	2,283	2,405	2,187	1,760	2,017	1,972	1,908	2,198	2,153	2,455	924
Other	360	385	416	431	458	462	436	373	466	453	428	409	389	331	161
Total fabrication	**3,040**	**2,907**	**3,089**	**3,138**	**2,741**	**2,867**	**2,623**	**2,134**	**2,483**	**2,425**	**2,336**	**2,603**	**2,542**	**2,786**	**1,085**
Bar & coin retail investment	373	314	396	412	421	446	649	743	1,205	1,519	1,256	1,654	1,064	1,012	485
Official sector purchases	-	-	-	-	-	-	-	-	77	457	535	369	477	588	185
ETFs & similar	3	39	133	208	260	253	321	617	382	185	279	-881	-159	-133	579
Implied net investment	143	614	-259	254	160	-94	-80	541	207	-81	47	595	354	5	-27
Total demand	**3,559**	**3,874**	**3,359**	**4,012**	**3,582**	**3,472**	**3,513**	**4,034**	**4,355**	**4,505**	**4,453**	**4,340**	**4,278**	**4,258**	**2,307**

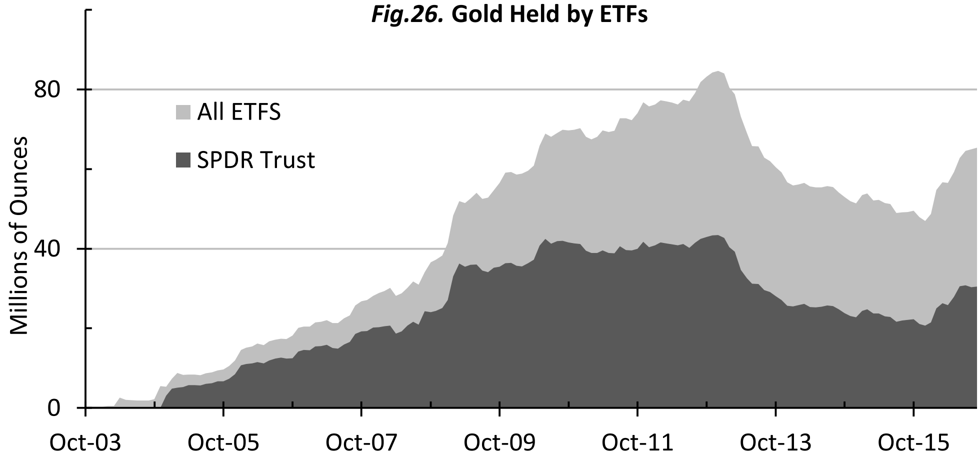
Source: World Gold Council

***Fig.25.* Market Value of Above Ground Gold as % of Total US Financial Assets**



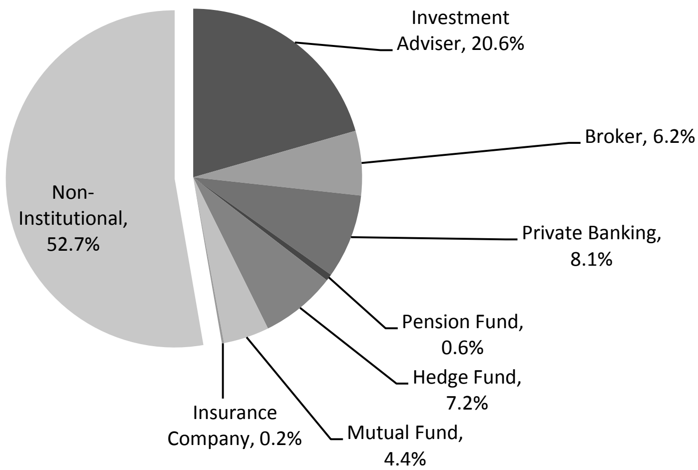
Source: Federal Reserve, World Gold Council

***Fig.26.* Gold Held by ETFs**



Source: Bloomberg, Company Filings.

Fig.27. SPDR Gold Trust Ownership by Type



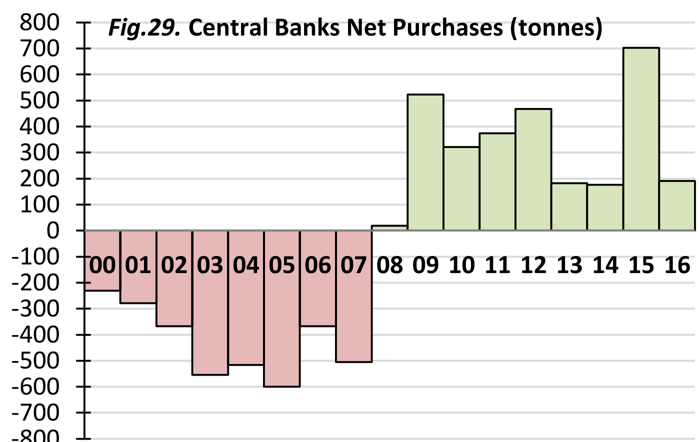
Source: FactSet

***Fig.28.* Notable Transaction in Aug 2016 (YTD)**

Country	Tonnes	Transaction
Russia	112	Purchase
Turkey	60	Decrease
China	71	Purchase

Source: World Gold Council

***Fig.29.* Central Banks Net Purchases (tonnes)**

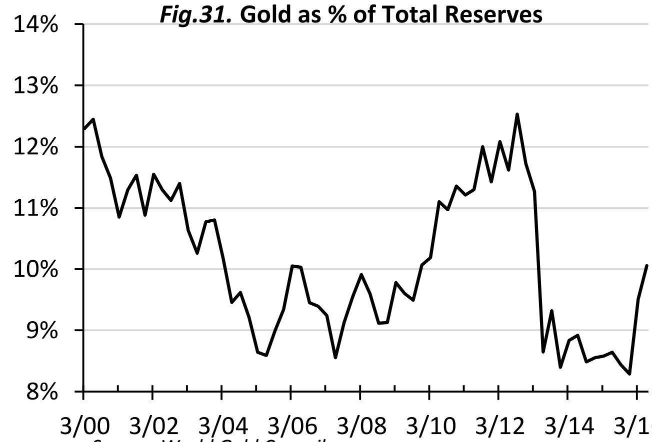


Source: World Gold Council

***Fig.30* Central Banks Holdings of Gold (tonnes)**

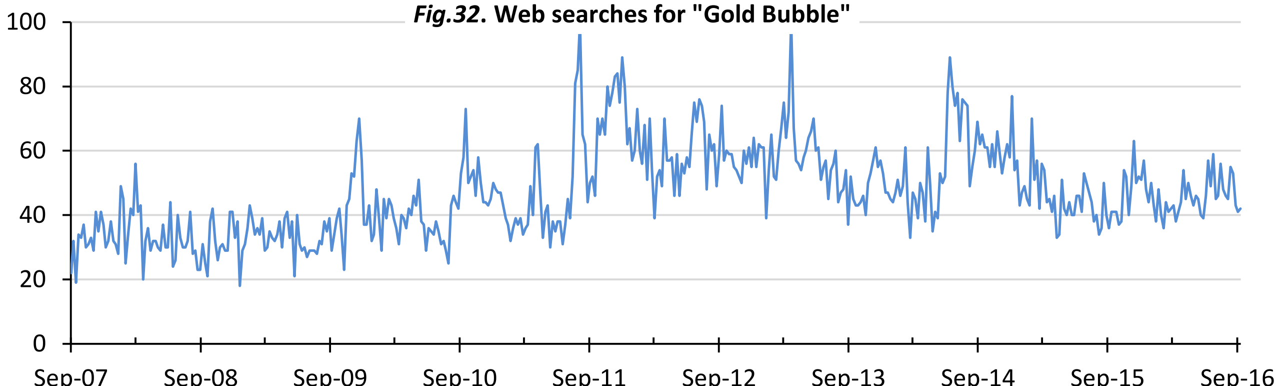
Source: World Gold Council

***Fig.31.* Gold as % of Total Reserves**



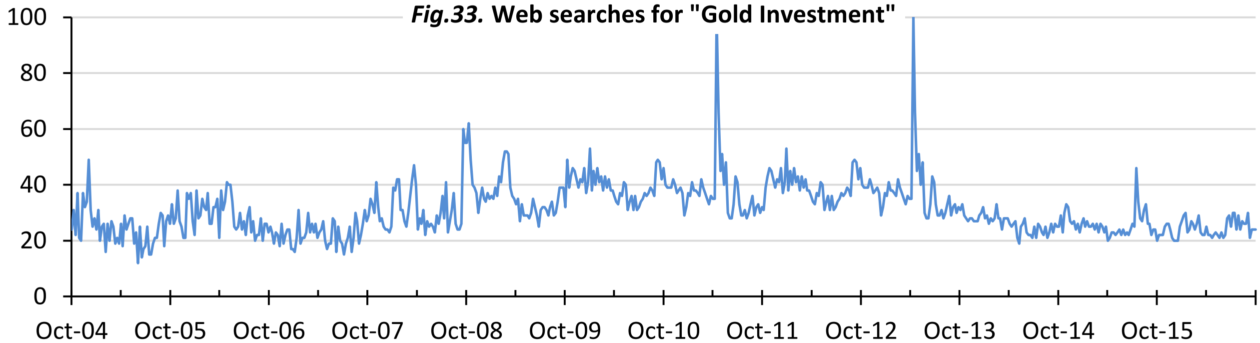
Source: World Gold Council

***Fig.32.* Web searches for "Gold Bubble"**



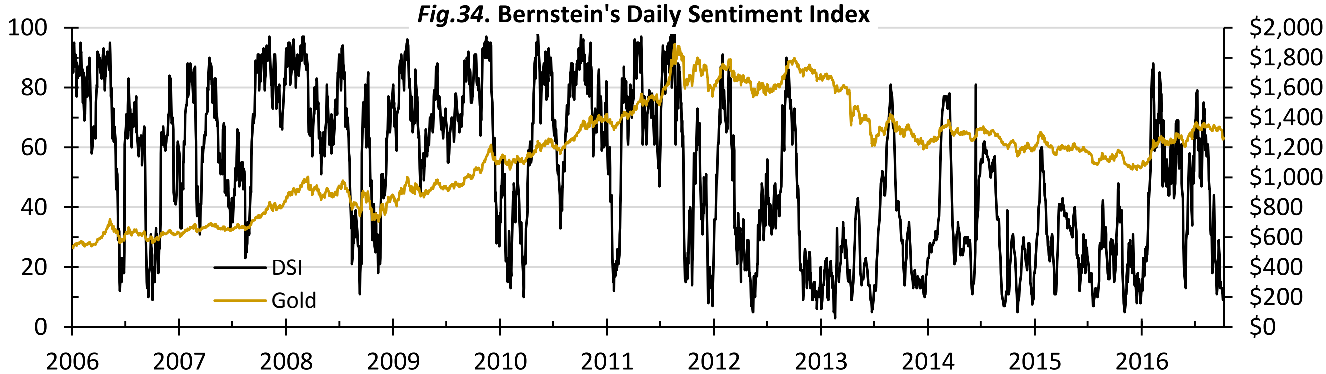
Source: GoogleTrends

***Fig.33.* Web searches for "Gold Investment"**



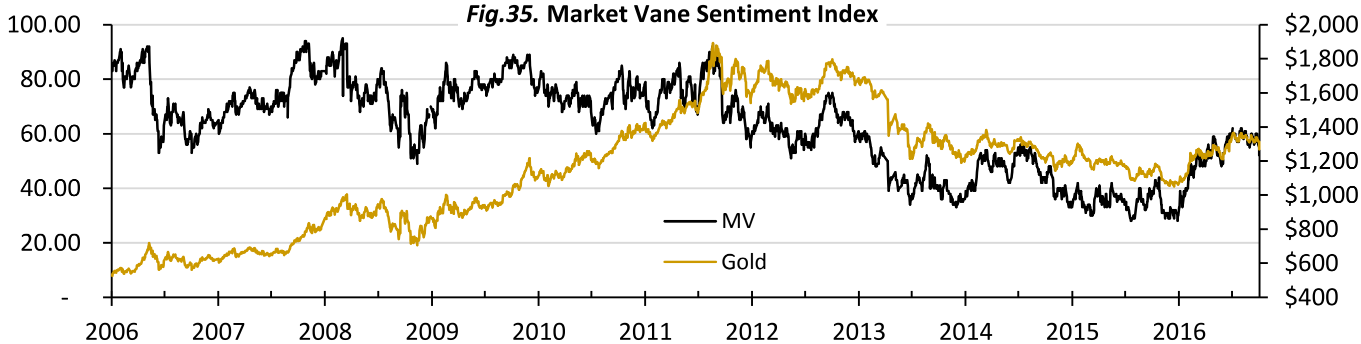
Source: GoogleTrends

***Fig.34.* Bernstein's Daily Sentiment Index**



Source Bloomberg, Bernstein's DSI

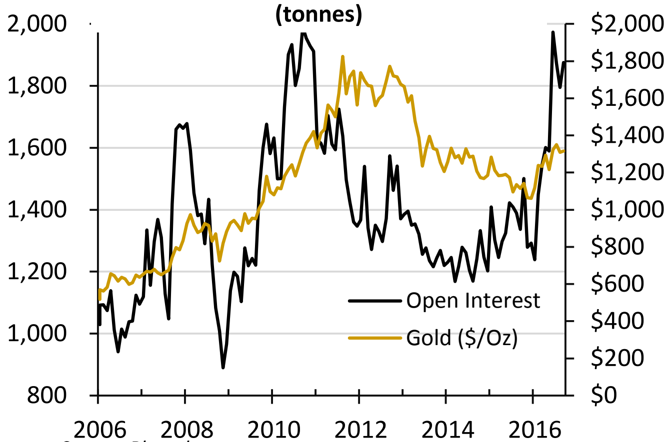
***Fig.35.* Market Vane Sentiment Index**



Source Bloomberg, Market Vane

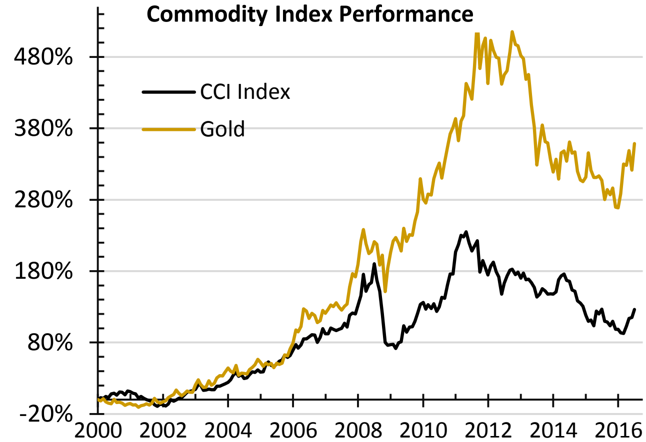
Section II. Gold

***Fig.36.* Comex Gold Futures Open Interest (tonnes)**



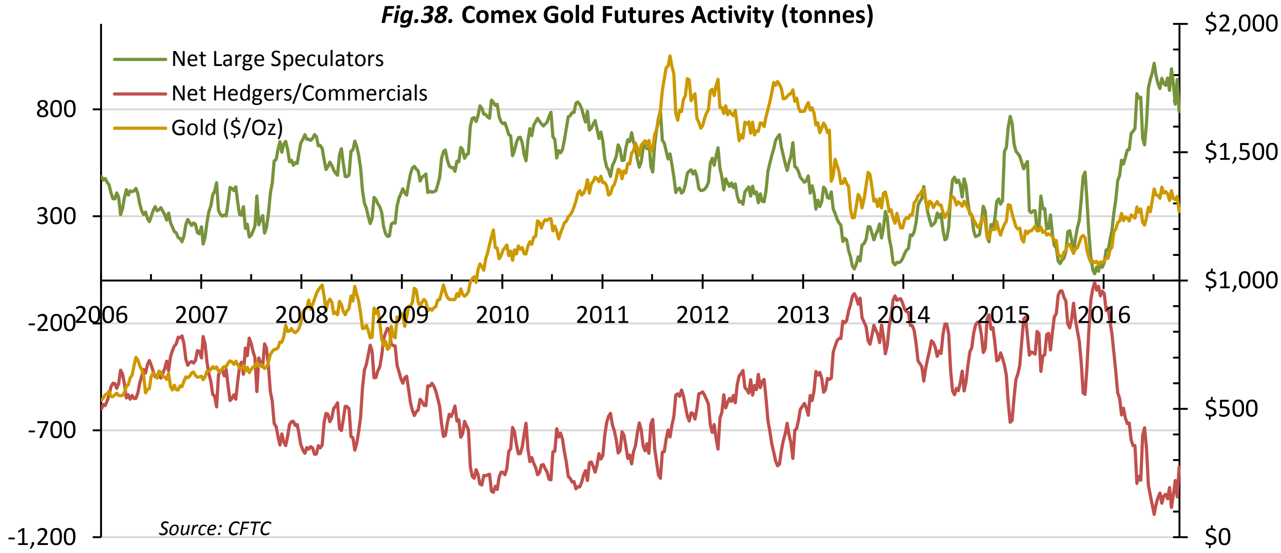
Source: Bloomberg

***Fig.37.* Gold vs Continuous Commodity Index Performance**



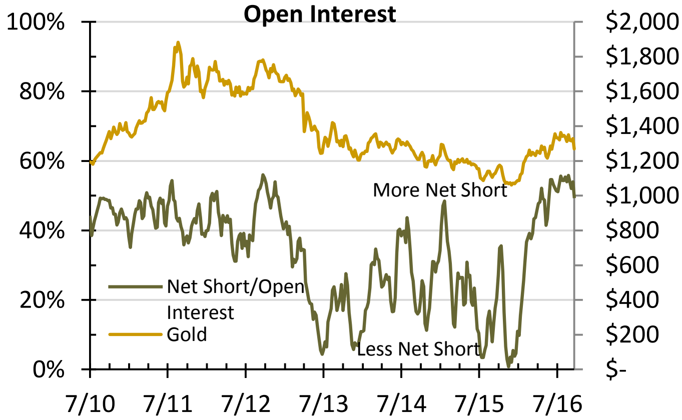
Source: Bloomberg

***Fig.38.* Comex Gold Futures Activity (tonnes)**



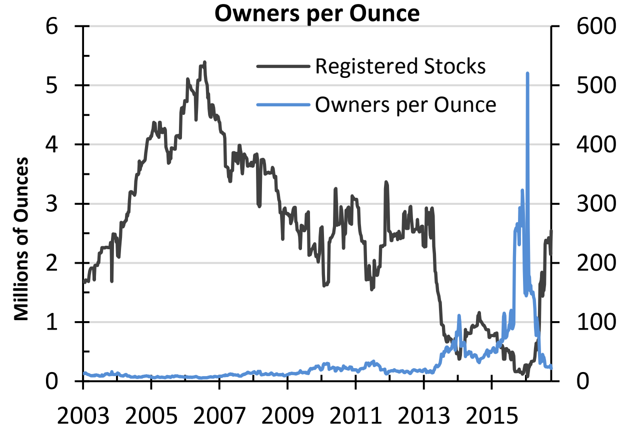
Source: CFTC

***Fig.39.* Commercial Net Shorts as % of Total Open Interest**



Source: Bloomberg; The McClellan Market Report

***Fig. 40.* Registered COMEX Gold Stocks vs. Owners per Ounce**



Source: Bloomberg

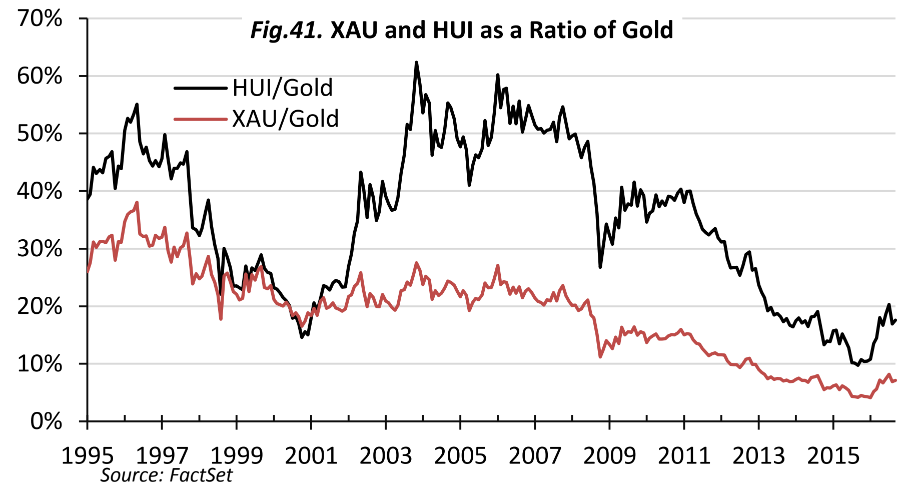


Fig.41. XAU and HUI as a Ratio of Gold
HUI/Gold
XAU/Gold
70%
60%
50%
40%
30%
20%
10%
0%
1995 1997 1999 2001 2003 2005 2007 2009 2011 2013 2015
Source: FactSet

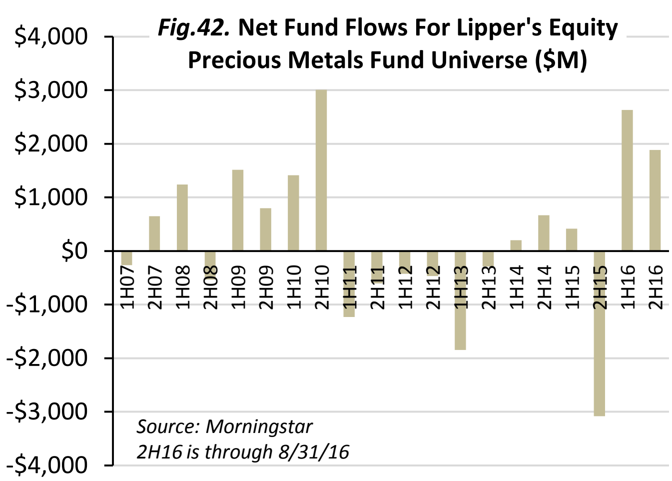


Fig.42. Net Fund Flows For Lipper's Equity Precious Metals Fund Universe ($M)
$4,000
$3,000
$2,000
$1,000
$0
-$1,000
-$2,000
-$3,000
-$4,000
1H07 2H07 1H08 2H08 1H09 2H09 1H10 2H10 1H11 2H11 1H12 2H12 1H13 2H13 1H14 2H14 1H15 2H15 1H16 2H16
Source: Morningstar
2H16 is through 8/31/16

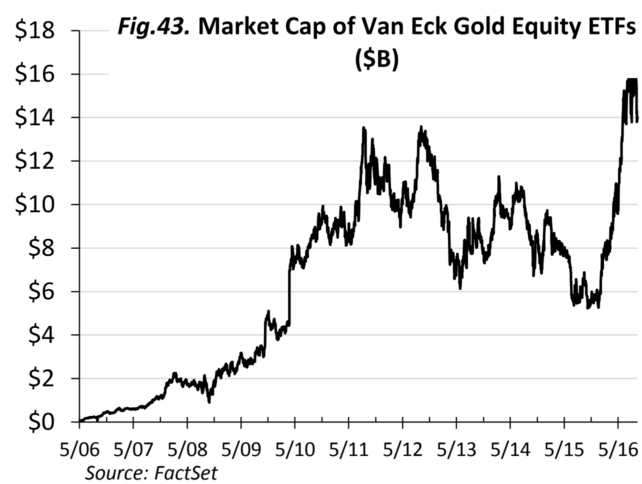


Fig.43. Market Cap of Van Eck Gold Equity ETFs ($B)
$18
$16
$14
$12
$10
$8
$6
$4
$2
$0
5/06 5/07 5/08 5/09 5/10 5/11 5/12 5/13 5/14 5/15 5/16
Source: FactSet

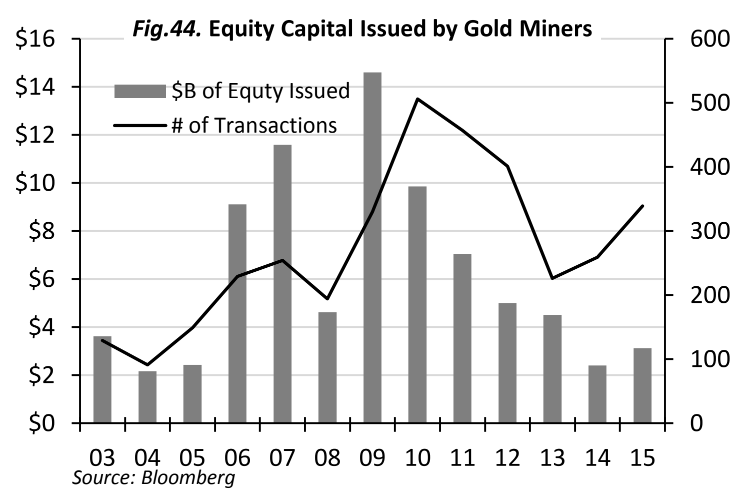
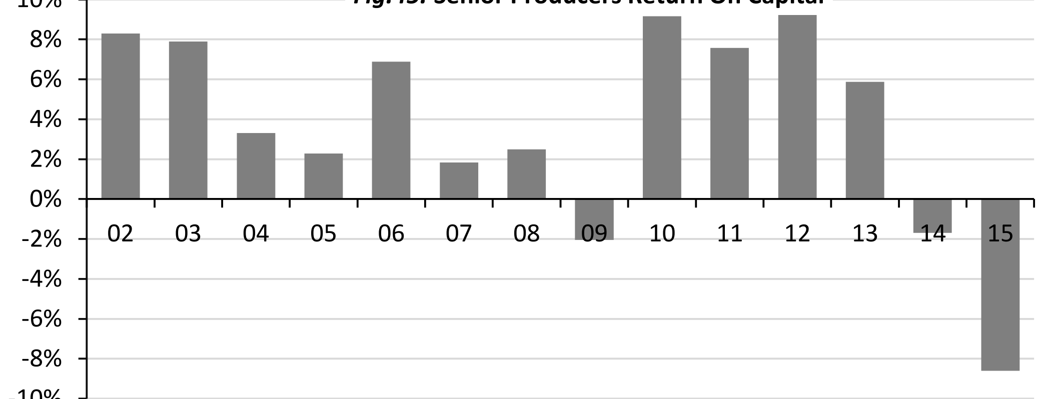


Fig.44. Equity Capital Issued by Gold Miners
$B of Equty Issued
# of Transactions
$16
$14
$12
$10
$8
$6
$4
$2
$0
600
500
400
300
200
100
0
03 04 05 06 07 08 09 10 11 12 13 14 15
Source: Bloomberg

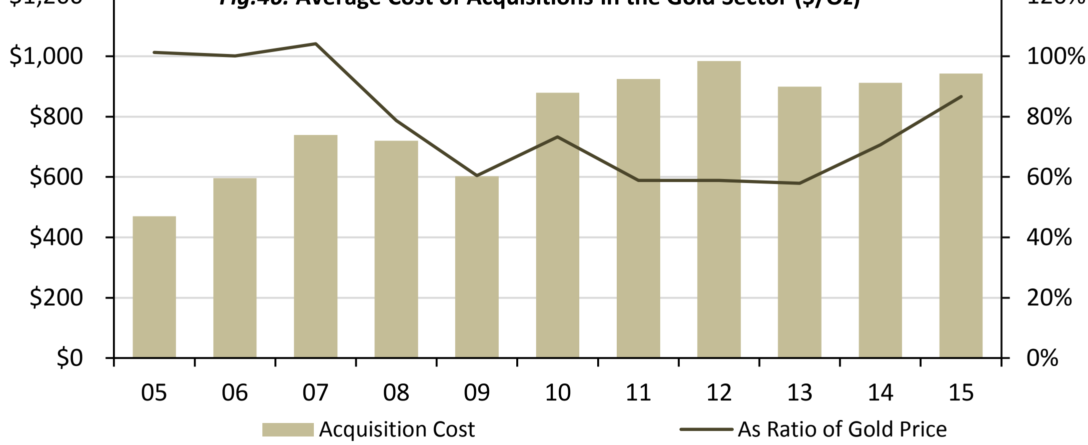
Section III. Gold Mining Equities

***Fig.45.* Senior Producers Return On Capital**



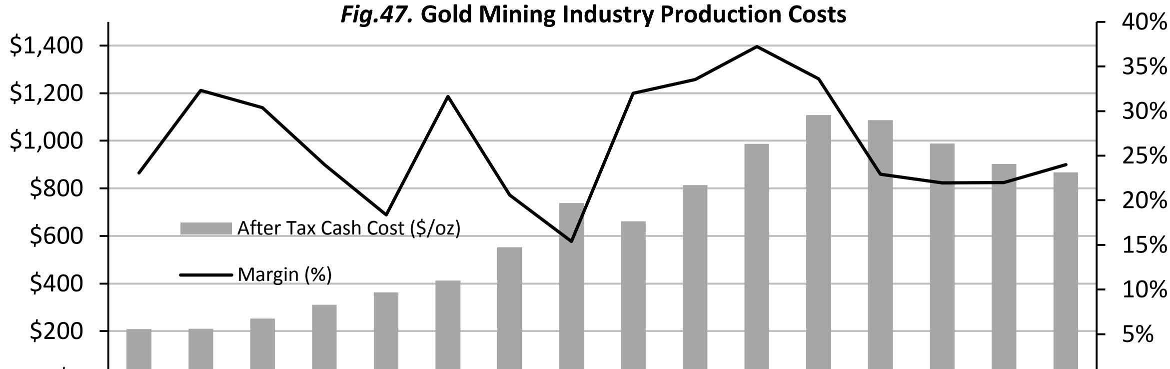
Source: FactSet.
Universe: NEM, ABX, GG, KGC, AUY, NCM, AU, GFI, HMY

***Fig.46.* Average Cost of Acquisitions in the Gold Sector ($/Oz)**



Source: RBC Capital Markets, Bloomberg.

***Fig.47.* Gold Mining Industry Production Costs**

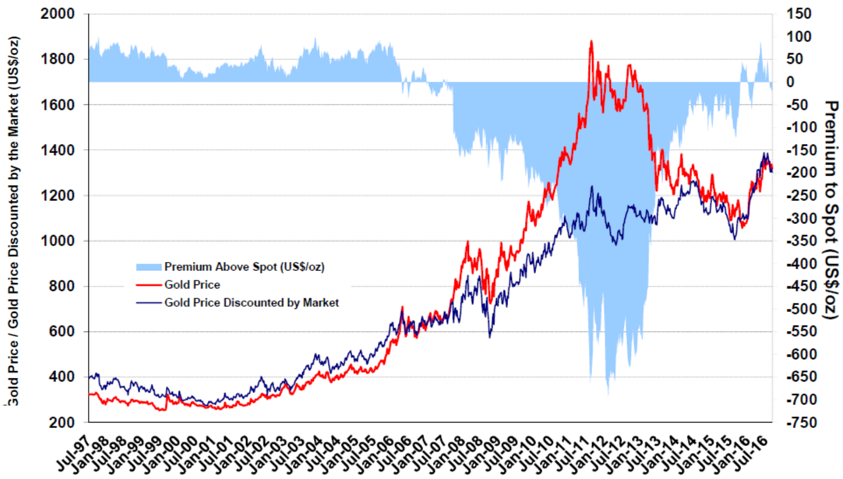


	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 E
After Tax Cash Cost ($/oz)	209	210	253	311	363	413	552	738	661	814	987	1,108	1,087	988	903	868
Margin (%)	23%	32%	30%	24%	18%	32%	21%	15%	32%	34%	37%	34%	23%	22%	22%	24%

Source: Tocqueville Asset Management, FactSet.

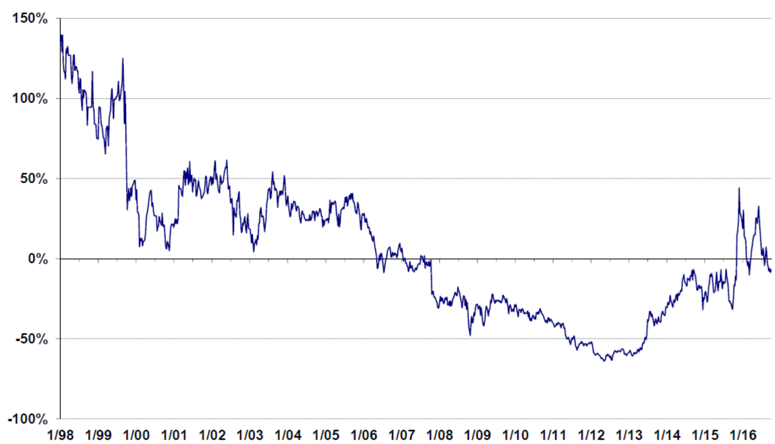
TOCQUEVILLE

Fig.48. **Gold Price Discounted by Market ($/Oz)**



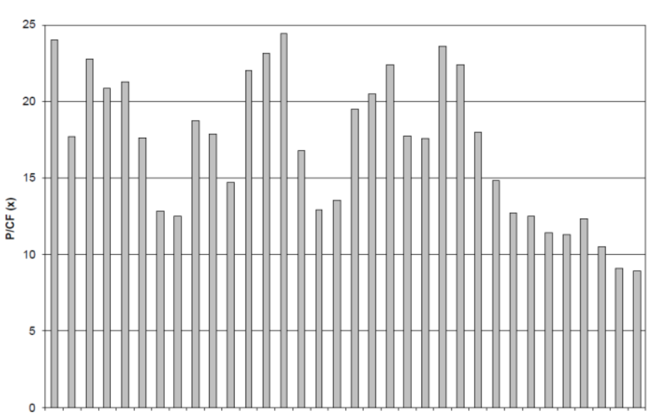
Source: BMO Capital Markets

Fig.49. **NAV Premiums – Senior & Intermediate Producers (N.A.)**



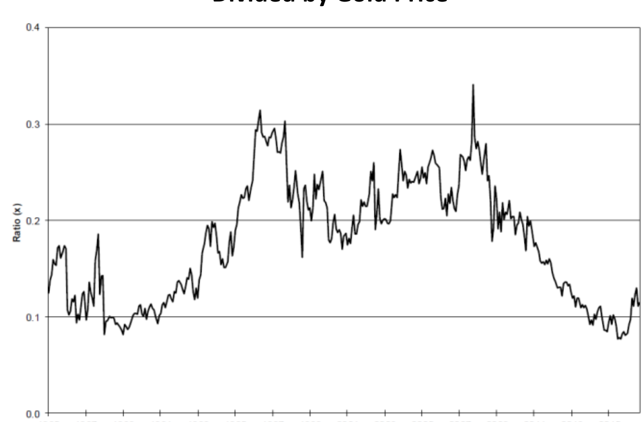
Source: BMO Capital Markets

Fig.50. **P/CF – Universe of Coverage Average**



Source: Scotiabank

Fig.51. **Adjusted Market Cap per Oz of Resource Divided by Gold Price**



Source: Scotiabank