Contrarian Music

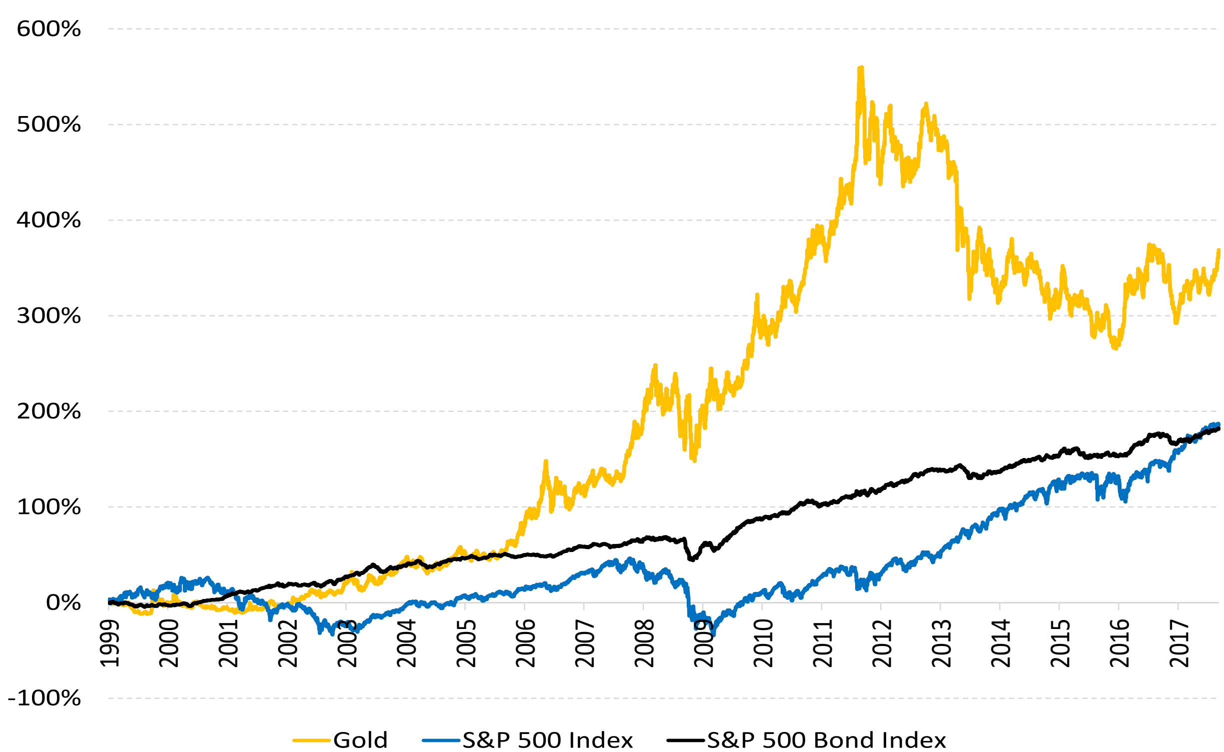
Tocqueville Gold Strategy

Third Quarter 2017 Investor Letter

Gold appears to have formed a solid base since bottoming at year-end 2015 at $1060.00/oz. Through 9/29/17, the metal's price increased 11.10%, even after a sharp pullback from its early September 2017 high of $1355. As of September 30, 2017, the price stood at $1280.15, 20.75% above its low at year-end 2015.

In our view, gold and the precious-metals complex is in the early stages of a dynamic up-cycle that will match or exceed the run from 2000 to 2011. Downside appears limited; the greatest challenge for investors will be to muster the necessary patience to hang on until the up-cycle becomes more assertive and evident.

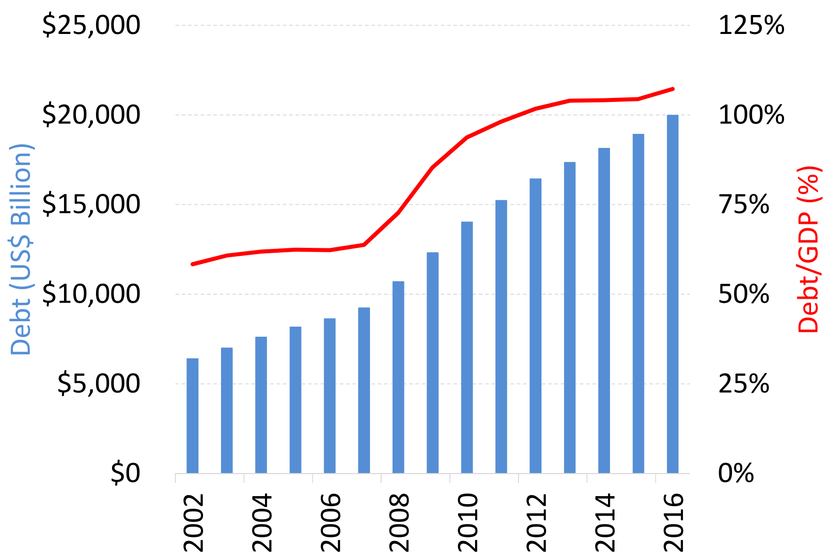
Despite the four-year correction from $1900/oz. to $1060 at year-end 2015, gold has outperformed stocks and bonds since 2000, the dawn of radical monetary practices by the world's central banks. We have shown the chart below in previous letters, and repeat it again here only to emphasize this under-recognized fact.



Despite this record, gold is deeply out of favor and dramatically underrepresented in the portfolios of wealthy families and institutions in the Western world. Gold mining shares have uncharacteristically barely kept pace with the gold price (GDX, the most commonly followed mining-share ETF, has risen only 9.75% year-to-date). This tepid performance relative to the metal is one of many signs of prevailing negative sentiment. Despite modest gains year-to-date, gold mining shares remain sold out and very cheap in light of their upside potential, which will be driven by their own fundamentals as well as those affecting the gold price.

Unsound monetary policy is the most important driver of our gold thesis. The exit from radical monetary policy will be difficult, if not impossible. On this point, we recently had an off-the-record conversation with a former governor of the Fed, who wholeheartedly agreed with this assessment.

Gold is an efficient hedge against the real possibility that the Fed will be unable to exit its super-easy stance without triggering significant disruptions in financial asset valuations, imperiling already weak economic momentum, and destroying any pretense of fiscal sanity. A 1% rise in interest rates increases the federal deficit by 25% to 3.9% of GDP. The fiscal vulnerability is underscored by the fact that 50% of the debt matures in less than three years.



The US debt-to-GDP ratio is now 106%, a level that has historically been economically destabilizing to other countries and that has often led to blatant monetary printing and currency destruction. It is not just a U.S. problem, world-wide global debt burdens are sufficiently high that only small rate increases are required to inflict significant economic and market damage.

Concern over North Korean nukes is commonly credited as the reason for gold's push to new high ground this summer. Of course, we hope that these concerns prove to be transient.

Also credited with gold's recent strength, according to conventional wisdom, is the pronounced dollar weakness according to the U.S. dollar index (DXY), which blossomed during July and August. Keep in mind that gold rose from roughly $300 to $1900 from 2000 to 2011. That 11-year period encompassed intervals of both extended dollar strength and weakness. It is therefore incorrect, in our opinion, to attribute primary influence for gold's direction to short-term fluctuations in the dollar exchange rate.

In 1999 gold began to rally, and few could figure why. Anticipating proximate causes for major price trends is only speculation. Gold was well into a major upswing before the dot-com bust, 9/11, ultra- low interest rates, the housing bubble and mortgage-backed securities debacle, and the 2008 credit crash. These headlines of course fueled a bull trend that was already well underway. At the end of the day, price makes news and the headlines follow. The obvious lesson is that all markets, including gold, discount future events and that the development of prices in the absence of easily articulated causes must be respected.

The prospects for gold and its price behavior today appear similar to those of the early 2000s. The gold price has been advancing for nearly two years for no obviously apparent reason. What we know is that the financial markets are bulging with systemic risk. Financial-asset valuations by many measures (see below) are at all-time highs; to our way of thinking, they constitute prima-facie evidence of significant risk.

Source: John Hussman

What we also know is that gold production is peaking out, and is likely to decline over the intermediate term even if gold prices rise substantially. Should investor demand reawaken, there is very little slack in supply to absorb it. The depletion of gold inventories in London and other Western vaults – a result of demand in Asia – is a finite process with measurable limits. There are many signs that those limits are being reached.

Finally, we know that the fiscal position of Western democracies is perilous and worsening. History teaches that resolution of fiscal impasses most often results in monetary debasement, which has invariably led to a rise in the nominal value and purchasing power of liquid assets that cannot be debased. Gold and silver constitute a short list of non-financial assets with monetary characteristics.

Fundamental facts that can be ascertained today rarely provide clues to the timing of what they portend. However, they help to gauge the potential for return on capital deployed in anticipation. As in the period from 2000 to 2011, the gold price moved well in advance of the headlines. However, it was quite possible to assess systemic risk by observing the extreme market valuations of the late 1990s. We believe that a reversion to the mean from the giddy financial-asset valuations of 2017 is inevitable, and that it will occur sooner rather than later. In contrast to the mainstream financial assets that the crowds seem to clamor for, gold and gold mining shares enjoy pariah status. That alone is music to our contrarian ears.

John Hathaway
Senior Portfolio Manager

October 9, 2017

GOLD MONITOR

Gold Monitor Chart Comments (3Q 2017)

1. Real interest rates remain negative on global basis (Fig. 1, 3, 5)…a bullish sign for gold.

2. Central bank money printing and balance sheet expansion continues on global basis (Fig. 2, 4, 6)…also bullish for gold.

3. Looming US fiscal train wreck (Fig. 16).

4. Barely any pretense of fiscal discipline (Fig. 18).

5. Ultra-low interest rates mean any increases are potentially destabilizing (Fig. 19, 20).

6. Foreign investors including central banks are divesting USD positions (Fig. 22).

7. Bullish gold supply and demand fundamentals - stagnant mine supply and steady demand growth since 2009 (Fig. 24).

8. Investment sentiment remains negative (Fig 34, 35).

9. Mining shares are cheap relative to the gold price (Fig. 41).

10. Fundamentals improving for miners (Fig. 45, 46, 47).

Section I. Macro

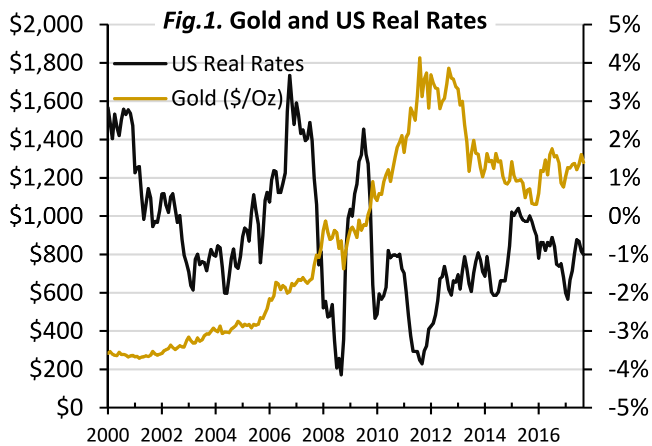


Fig.1. **Gold and US Real Rates**

Source: Bloomberg

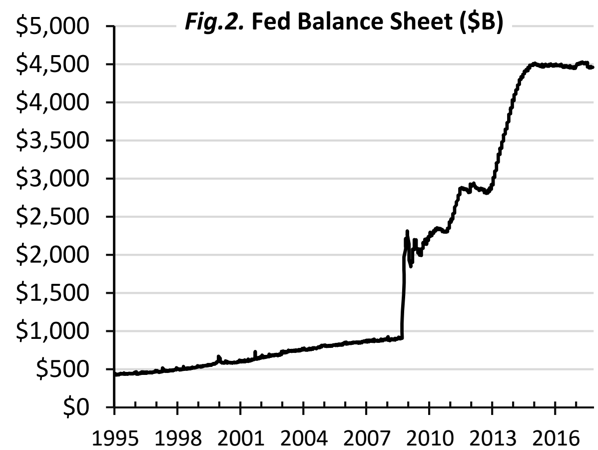


Fig.2. **Fed Balance Sheet ($B)**

Source: Bloomberg

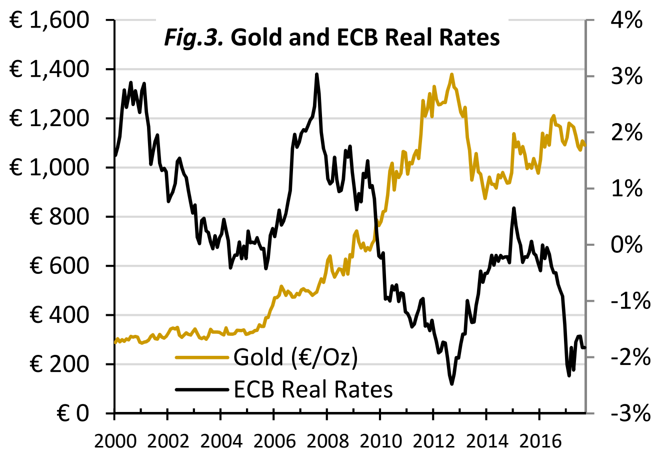


Fig.3. **Gold and ECB Real Rates**

Source: Bloomberg

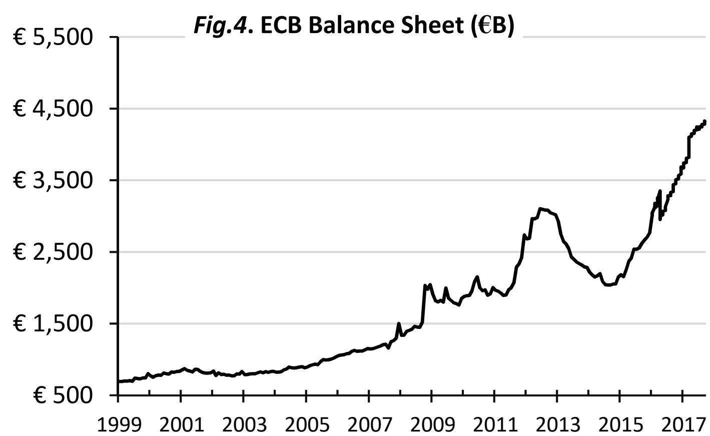


Fig.4. **ECB Balance Sheet (€B)**

Source: Bloomberg

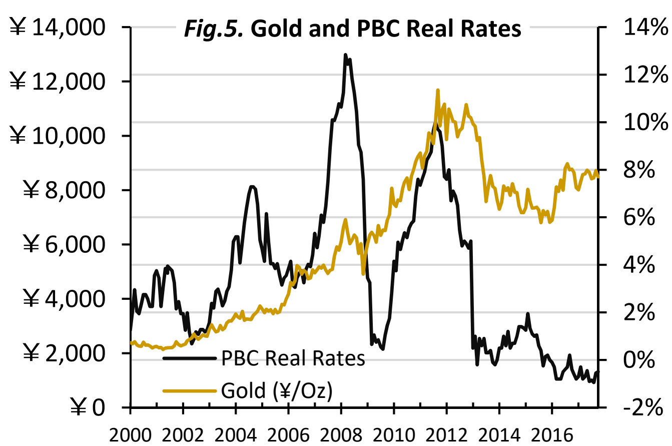


Fig.5. **Gold and PBC Real Rates**

Source: Bloomberg

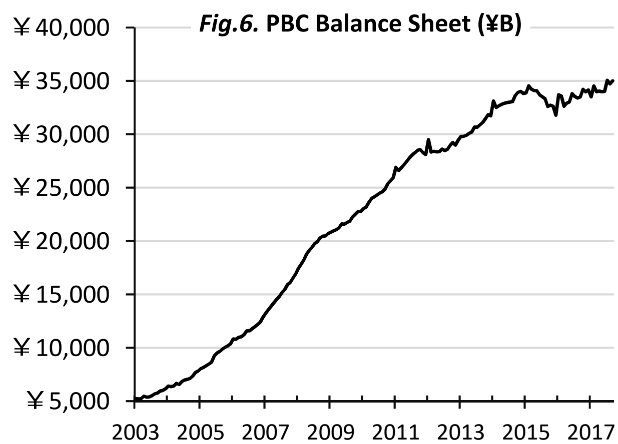
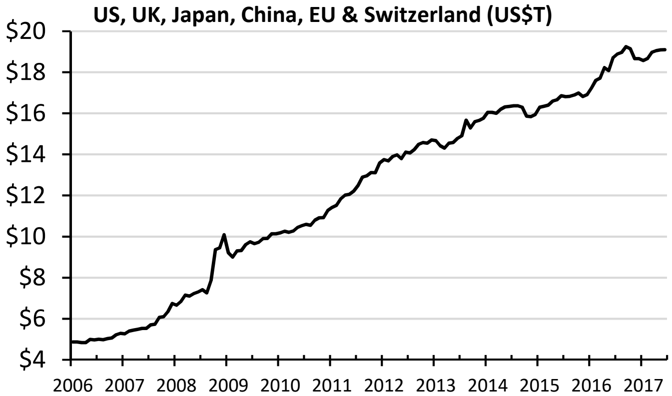


Fig.6. **PBC Balance Sheet (¥B)**

Source: Bloomberg

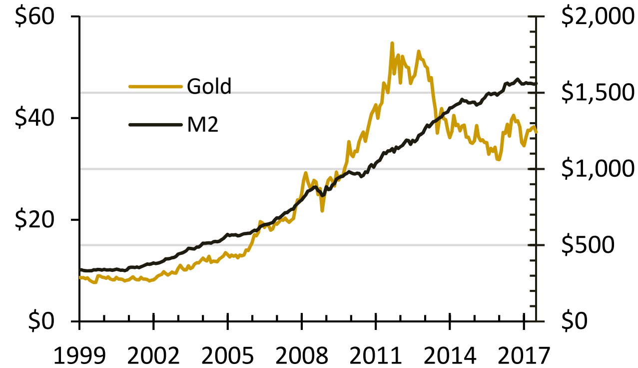
Section I. Macro

***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

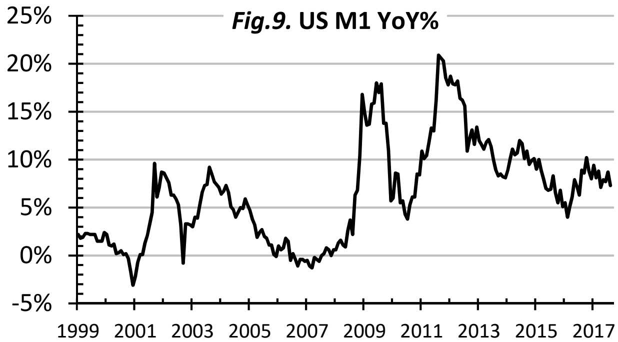


***Fig.9.* US M1 YoY%**

Source: Bloomberg

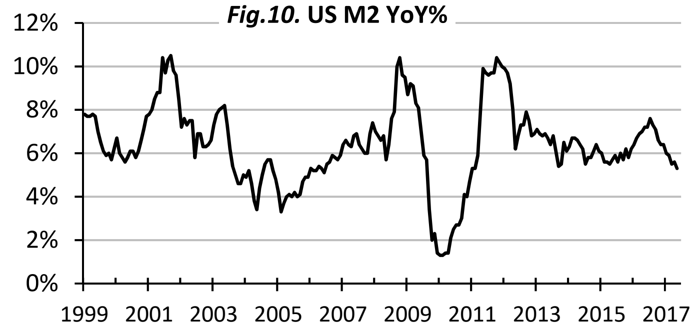


***Fig.10.* US M2 YoY%**

Source: Bloomberg

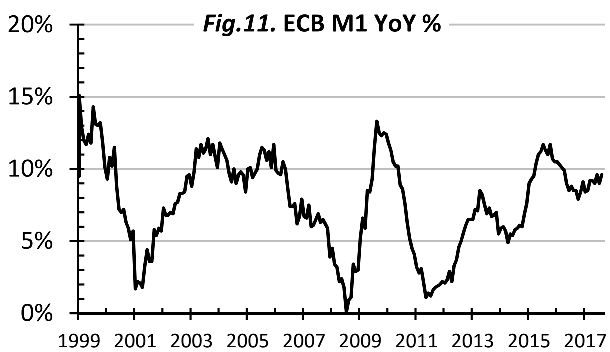


***Fig.11.* ECB M1 YoY %**

Source: Bloomberg

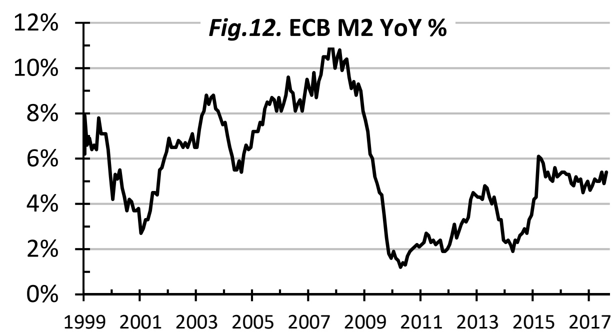


***Fig.12.* ECB M2 YoY %**

Source: Bloomberg

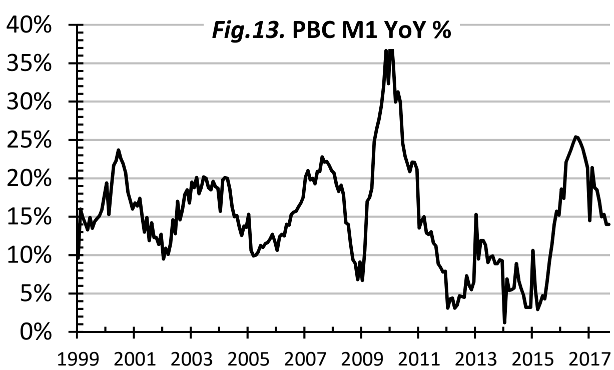


***Fig.13.* PBC M1 YoY %**

Source: Bloomberg

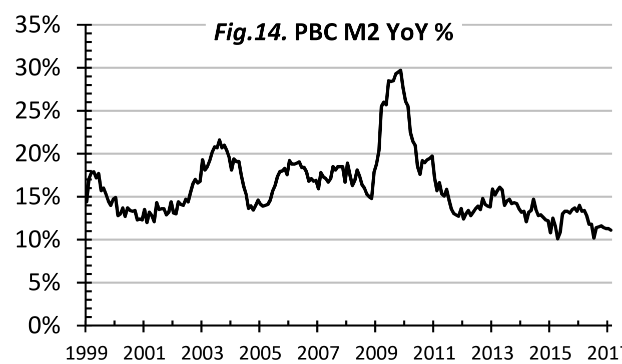


***Fig.14.* PBC M2 YoY %**

Source: Bloomberg

Fig. 15. Inflation as of August 31, 2017

	U.S.	Euro Area	China
Headline CPI	1.9%	1.5%	1.8%
Core CPI	1.7%	1.1%	2.2%
Shadowstats	9.2%	n/a	n/a

Source: Bloomberg, Shadow Government Statistics

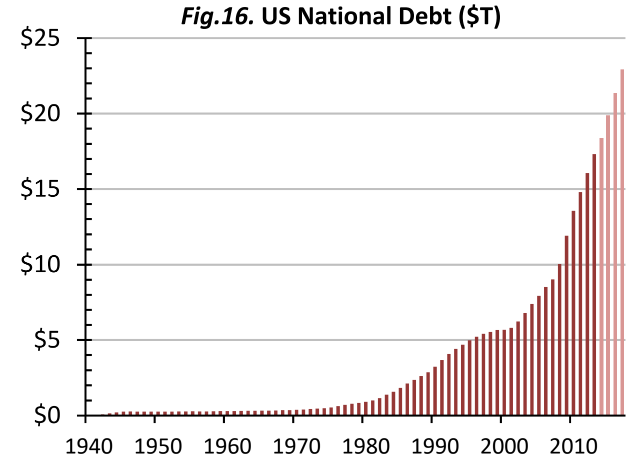


Fig.16. **US National Debt ($T)**

Source: TreasuryDirect.gov, USDebtClock.org
Projections are based on current rates

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

Source: Stlouisfed.org

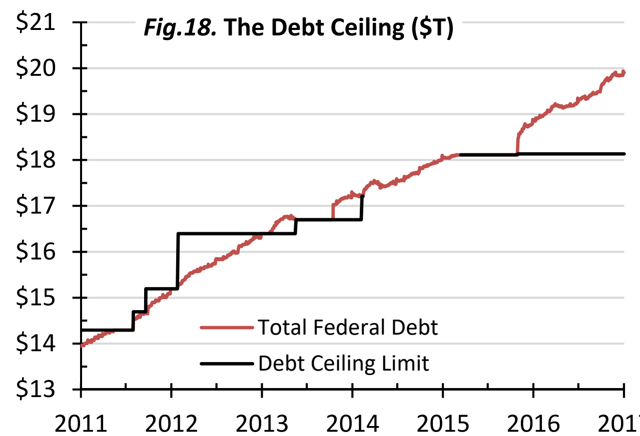


Fig.18. **The Debt Ceiling ($T)**

Source: Bloomberg

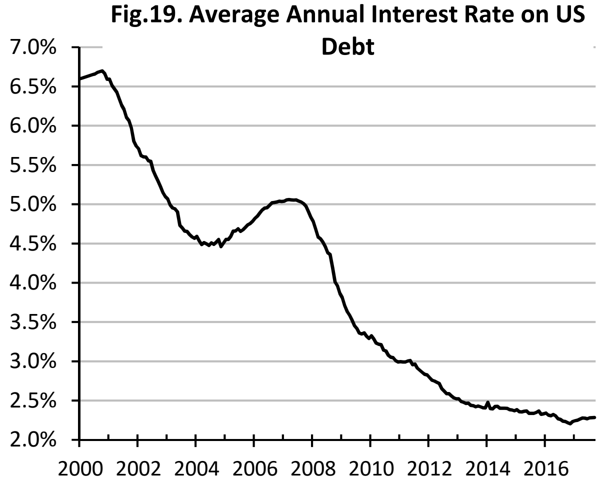


Fig.19. Average Annual Interest Rate on US Debt

Source: US Treasury, Meridian Macro

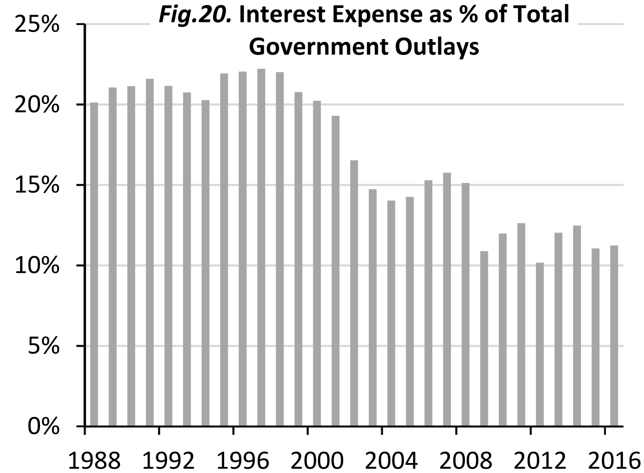


Fig.20. **Interest Expense as % of Total Government Outlays**

Source: Bloomberg; US Treasury

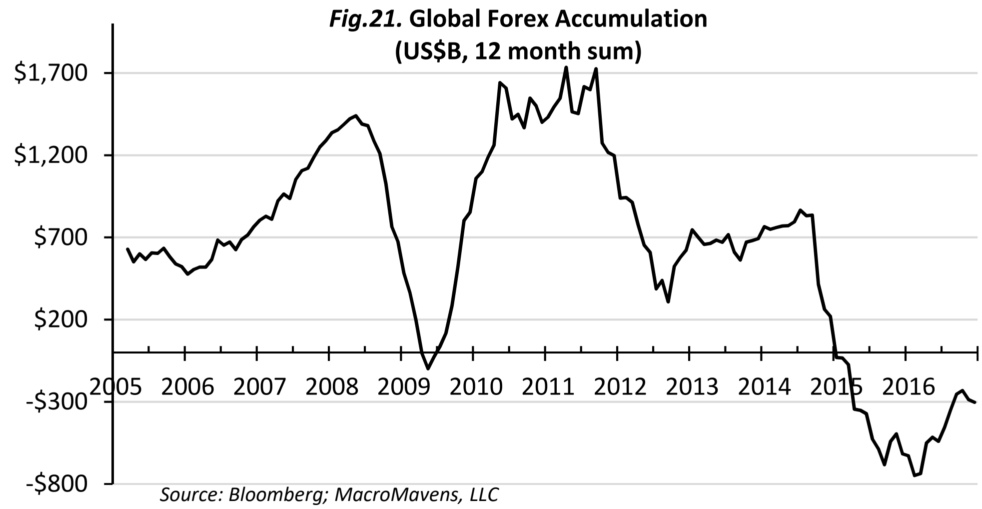


Fig.21. Global Forex Accumulation
(US$B, 12 month sum)
$1,700
$1,200
$700
$200
-$300
-$800
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
Source: Bloomberg; MacroMavens, LLC

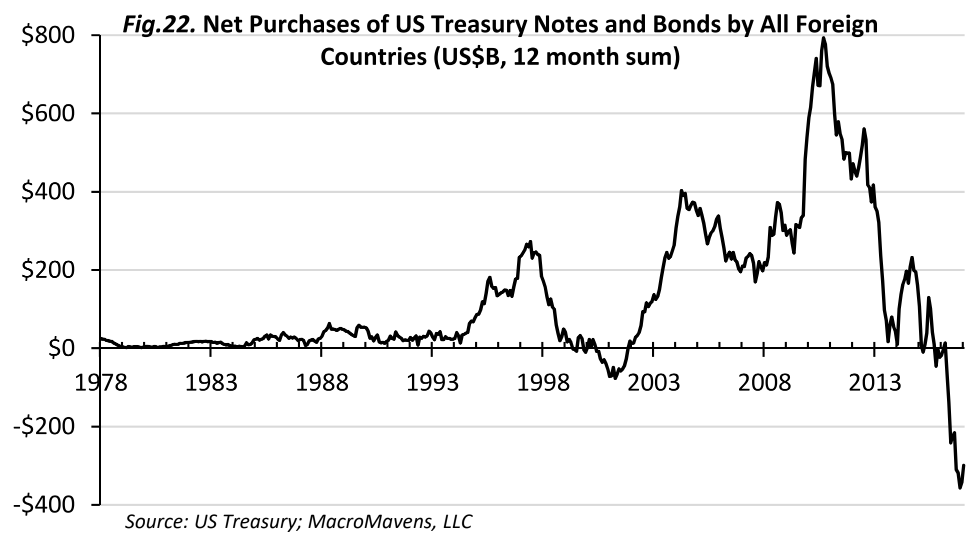


Fig.22. Net Purchases of US Treasury Notes and Bonds by All Foreign Countries (US$B, 12 month sum)
$800
$600
$400
$200
$0
-$200
-$400
1978
1983
1988
1993
1998
2003
2008
2013
Source: US Treasury; MacroMavens, LLC

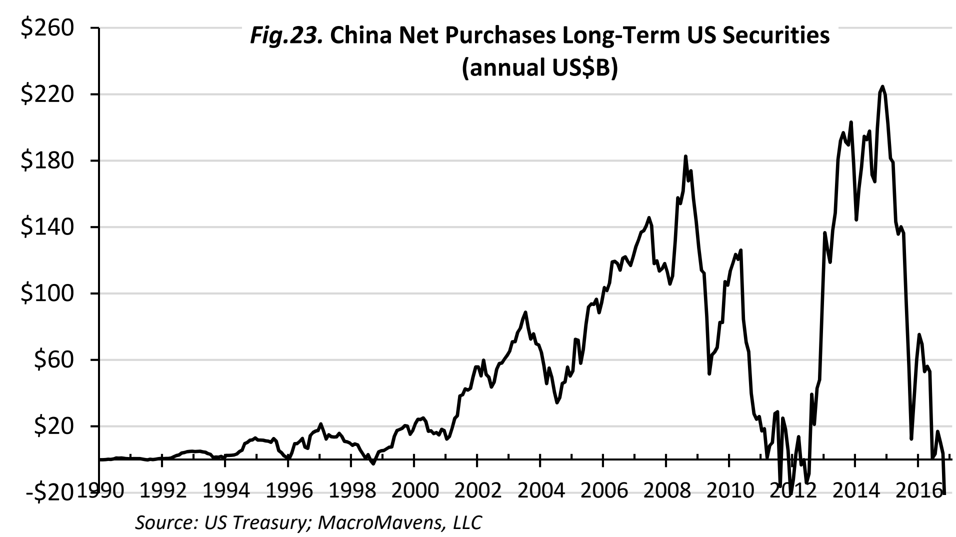


Fig.23. China Net Purchases Long-Term US Securities
(annual US$B)
$260
$220
$180
$140
$100
$60
$20
-$20
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012
2014
2016
Source: US Treasury; MacroMavens, LLC

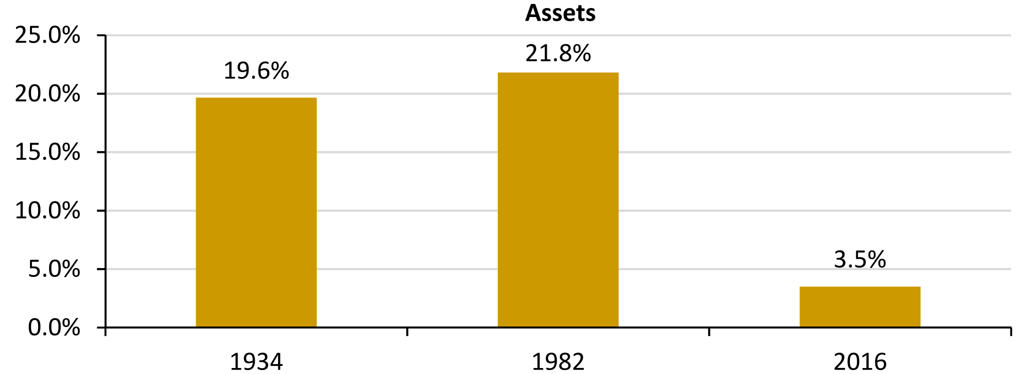
Section II. Gold

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

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
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	3,236
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	1,309
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**	**4,545**
Net producer hedging	-412	-279	-445	-86	-373	-444	-349	-252	-108	10	-20	-50	42	-21	26
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**	**4,571**
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	2,042
Other	360	385	416	431	458	462	436	373	466	453	428	409	389	331	645
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**	**2,687**
Bar & coin retail investment	373	314	396	412	421	446	649	743	1,205	1,519	1,256	1,654	1,064	1,012	1,029
Official sector purchases	-	-	-	-	-	-	-	-	77	457	535	369	477	588	383
ETFs & similar	3	39	133	208	260	253	321	617	382	185	279	-881	-159	-133	532
Implied net investment	143	614	-259	254	160	-94	-80	541	207	-81	47	595	354	5	-60
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**	**4,571**

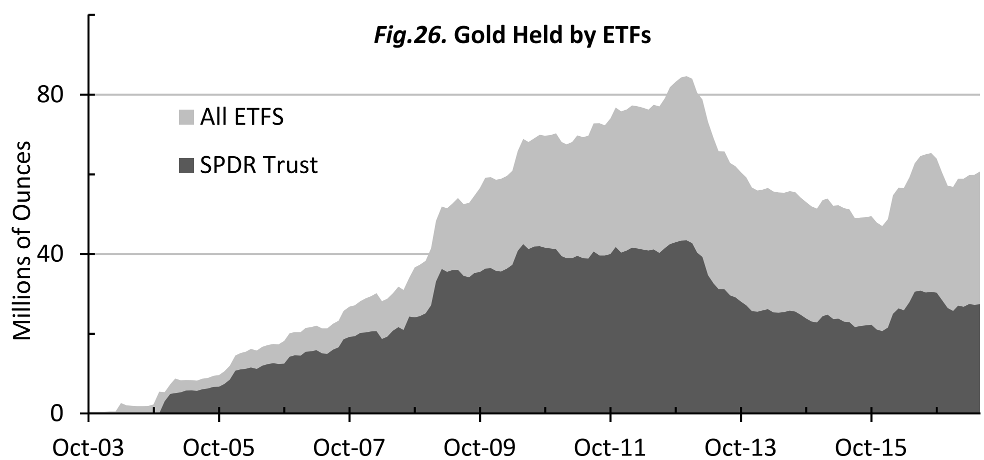
Source: World Gold Council

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



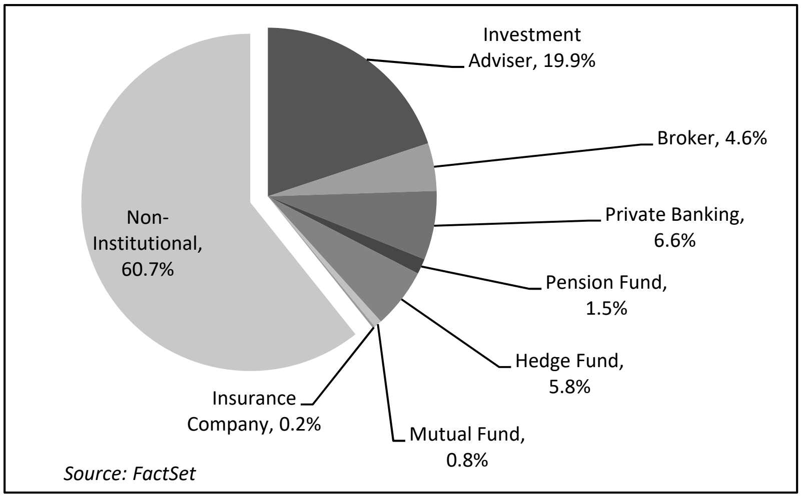
Source: Federal Reserve, World Gold Council

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



Source: Bloomberg, Company Filings

Fig.27. SPDR Gold Trust Ownership by Type



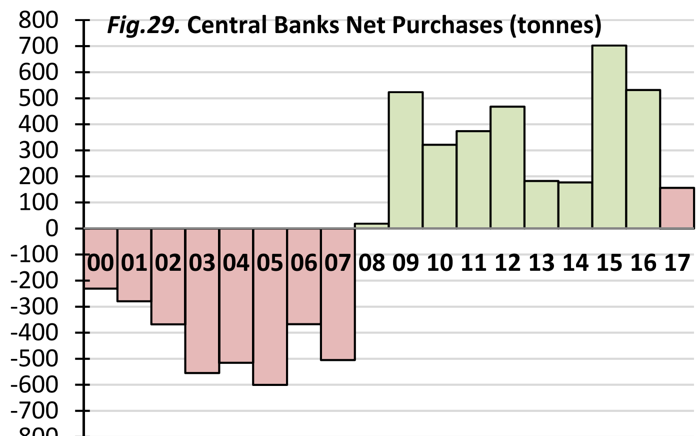
Source: FactSet

Fig. 28. Notable Transaction in 2017

Country	Tonnes	Transaction
Kazakhstan	27.6	Purchase
Russia	129.1	Purchase
Turkey	111.9	Purchase

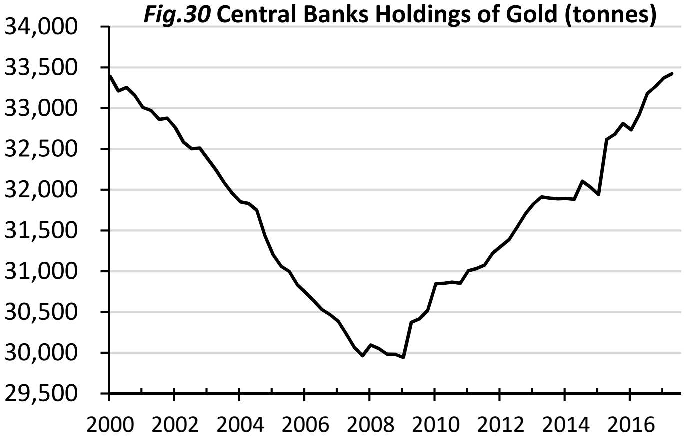
Source: World Gold Council

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



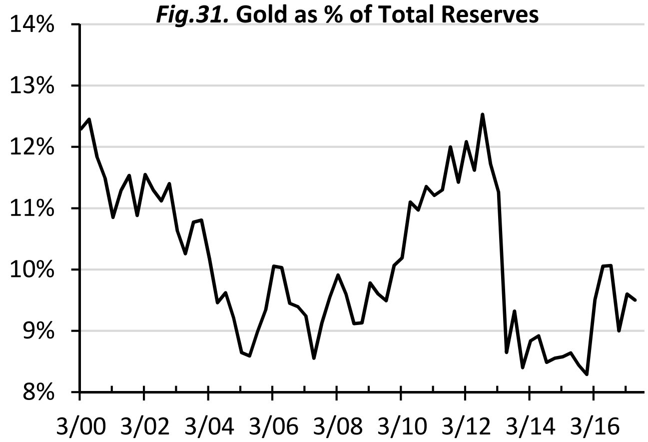
Source: World Gold Council

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



Source: World Gold Council

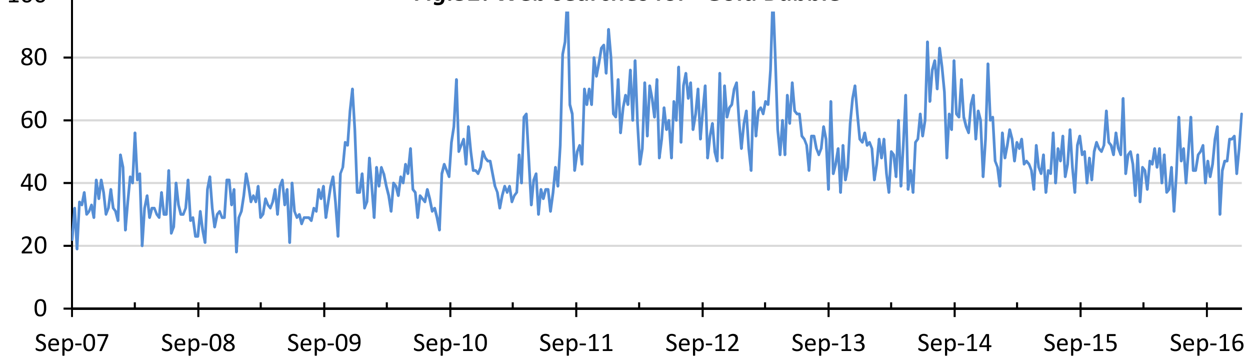
Fig.31. **Gold as % of Total Reserves**



Source: World Gold Council

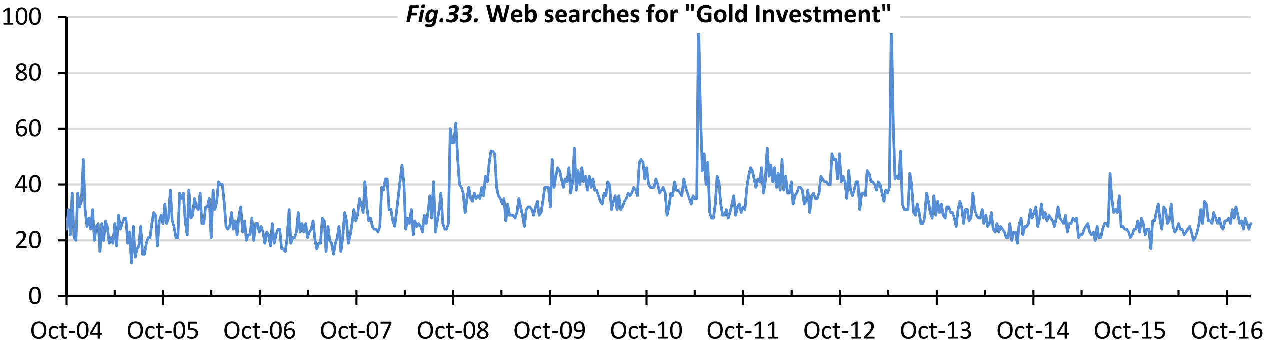
Section II. Gold

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



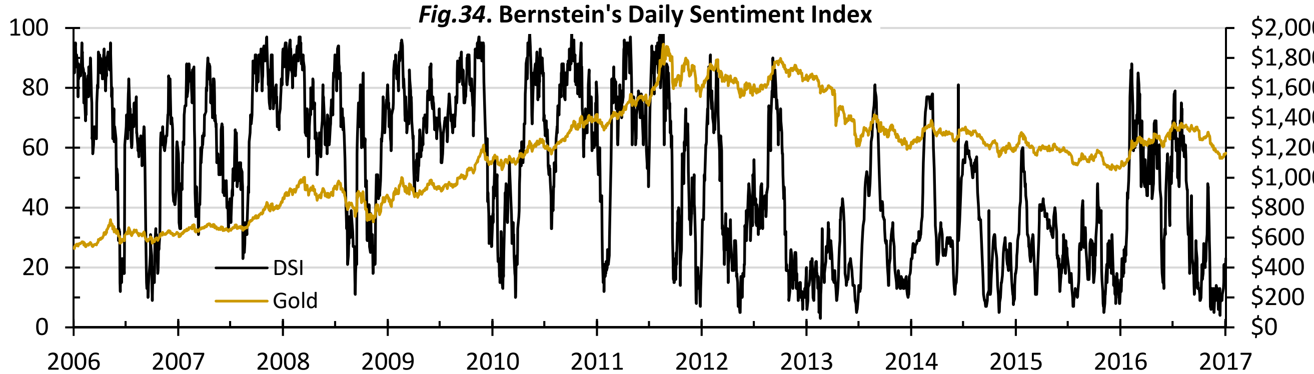
Source: GoogleTrends

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



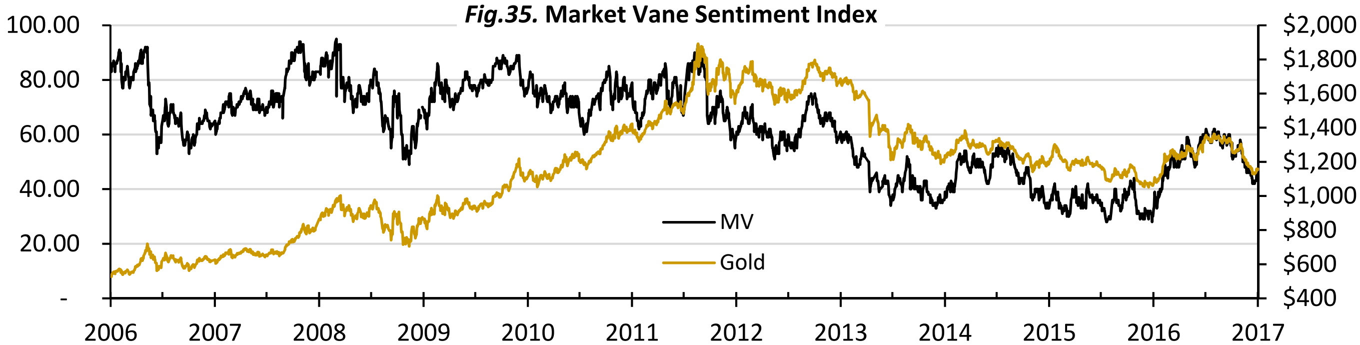
Source: GoogleTrends

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



Source Bloomberg, Bernstein's DSI

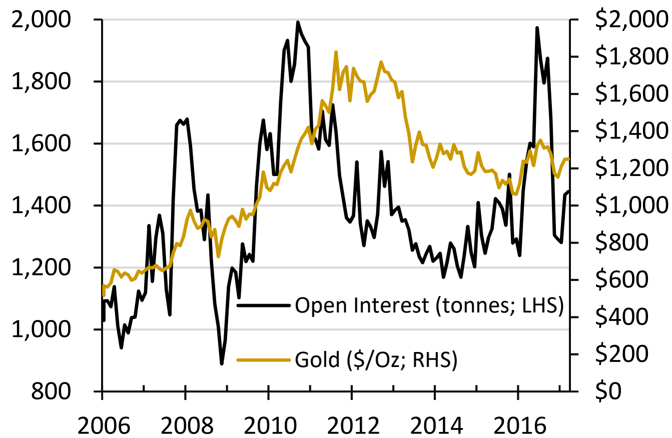
***Fig.35.* Market Vane Sentiment Index**



Source Bloomberg, Market Vane

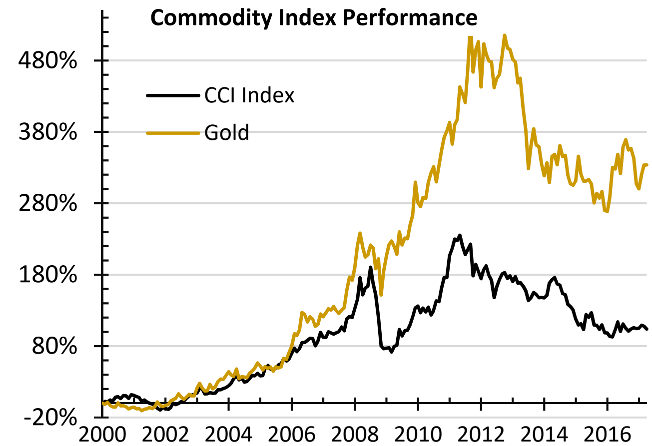
Section II. Gold

Fig.36. **Comex Gold Futures Open Interest**



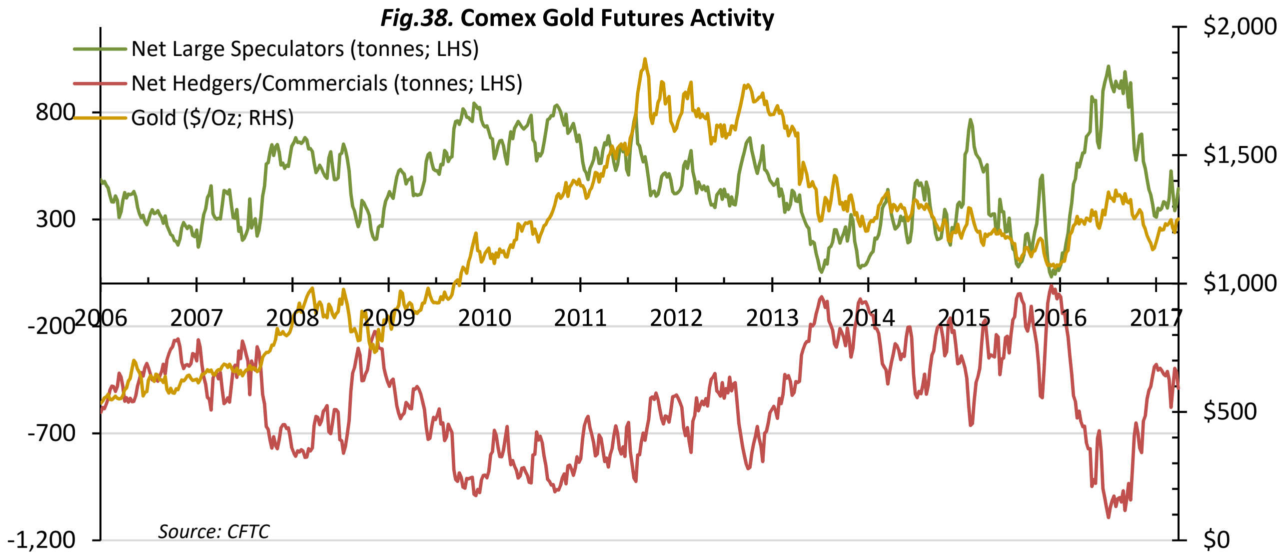
Source: Bloomberg

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



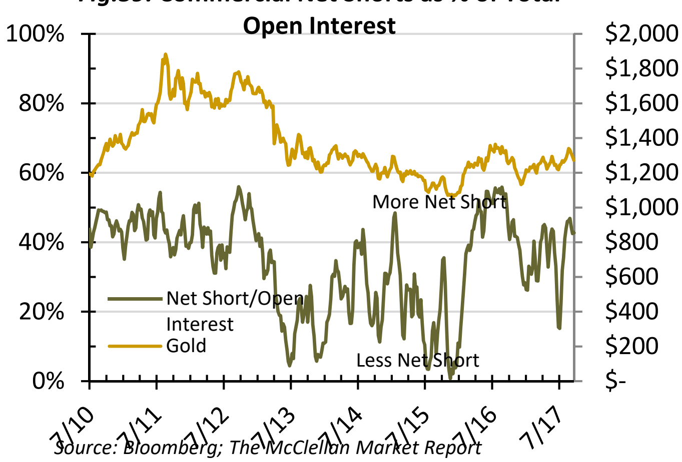
Source: Bloomberg

Fig.38. **Comex Gold Futures Activity**



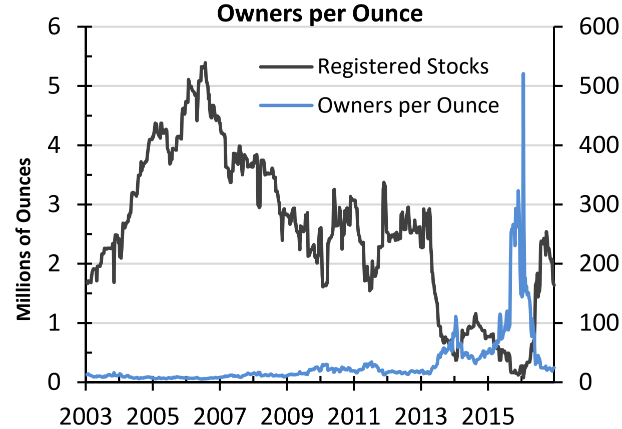
Source: CFTC

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



Source: Bloomberg; The McClellan Market Report

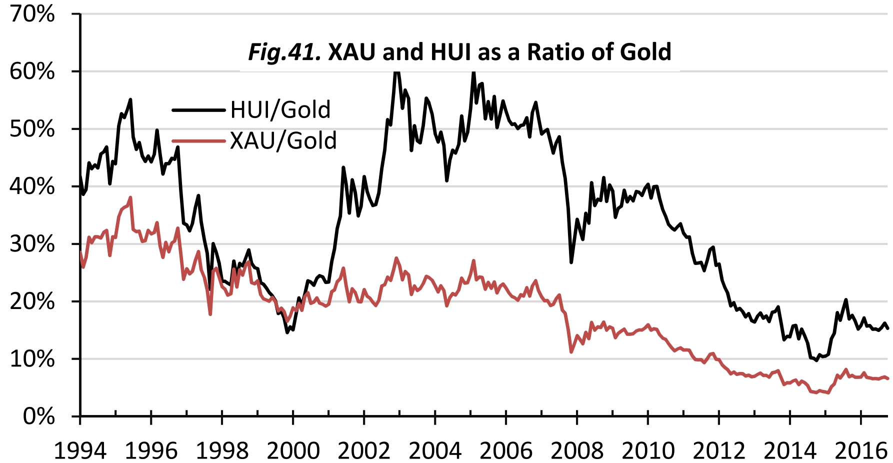
Fig. 40. **Registered COMEX Gold Stocks vs. Owners per Ounce**



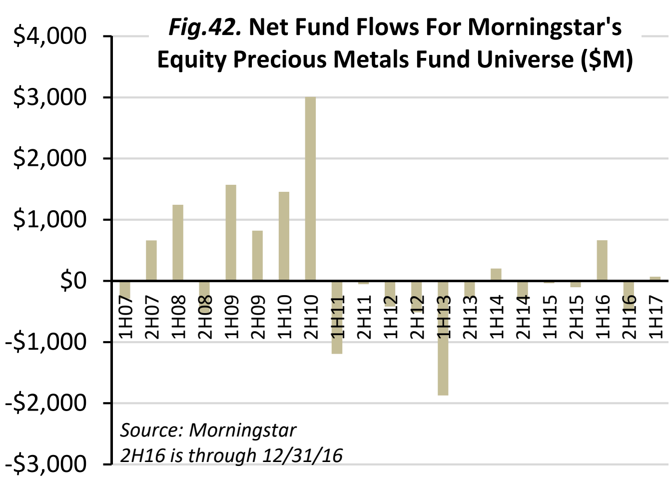
Source: Bloomberg

TOCQUEVILLE

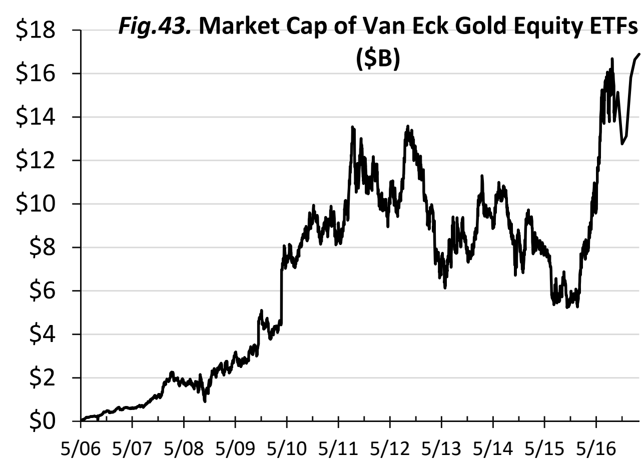
Section III. Gold Mining Equities



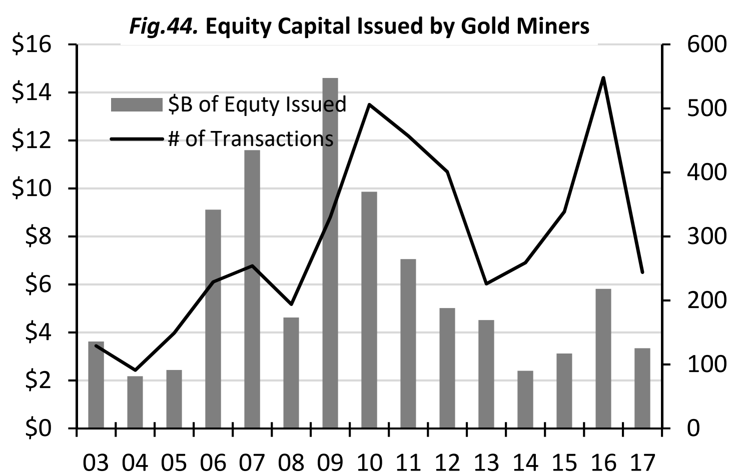
Source: FactSet



Source: Morningstar
2H16 is through 12/31/16



Source: FactSet

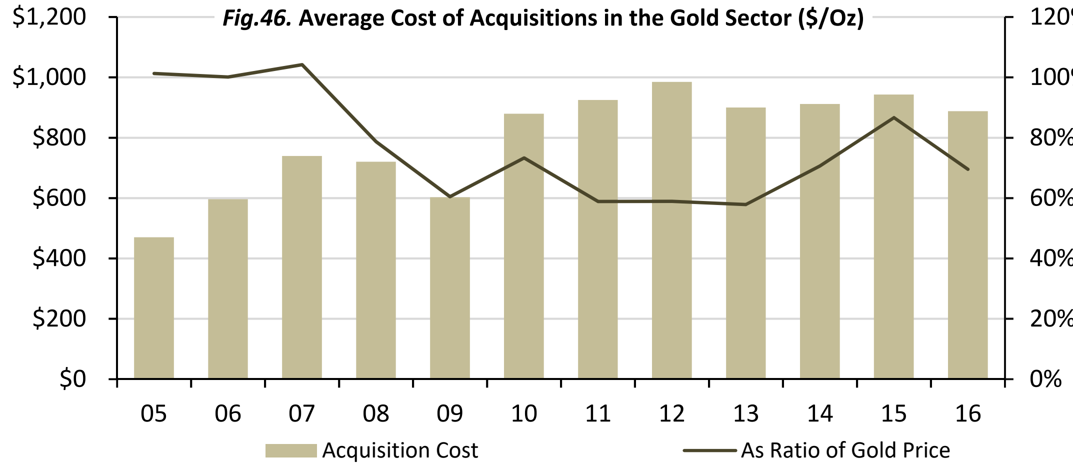


Source: Bloomberg

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

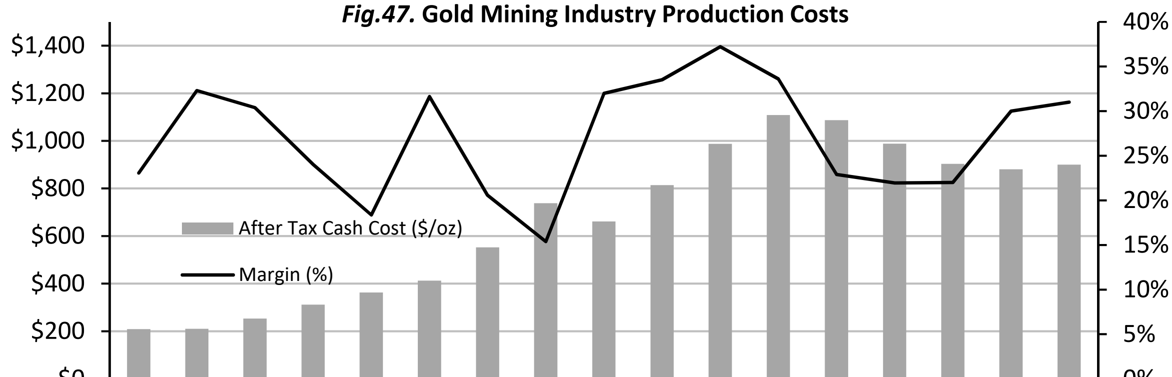
Source: FactSet
Universe: NEM, ABX, GG, KGC, AUY, NCM, AU, GFI, HMY

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



Source: RBC Capital Markets, Bloomberg.

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

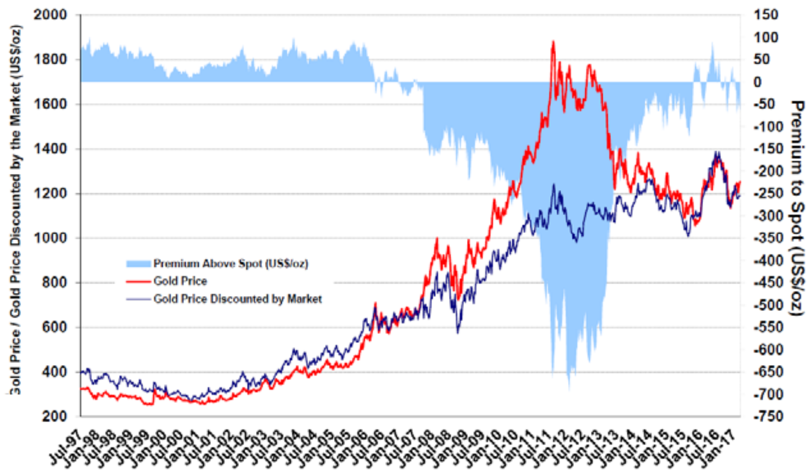


	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 E
After Tax Cash Cost ($/oz)	209	210	253	311	363	413	552	738	661	814	987	1,10	1,08	988	903	880	900
Margin (%)	23%	32%	30%	24%	18%	32%	21%	15%	32%	34%	37%	34%	23%	22%	22%	30%	31%

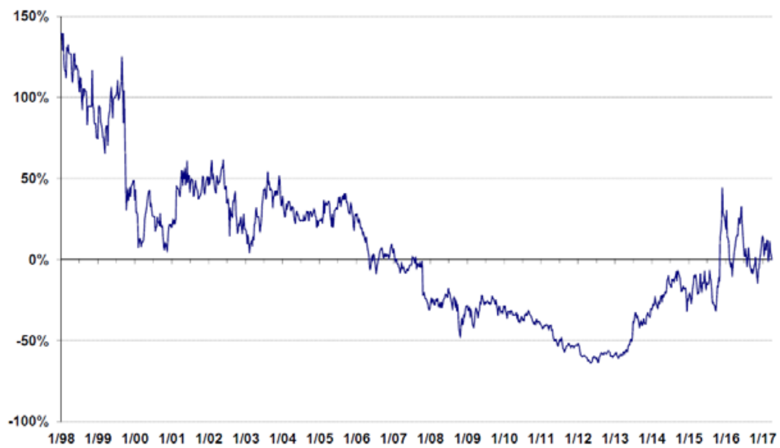
Source: Tocqueville Asset Management, FactSet

Section III. Gold Mining Equities

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



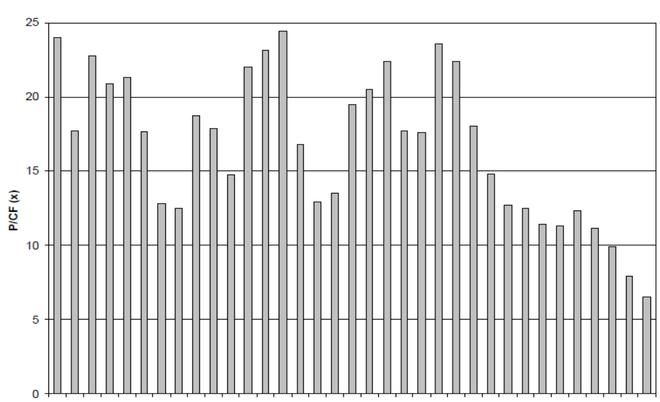
Source: BMO Capital Markets



)

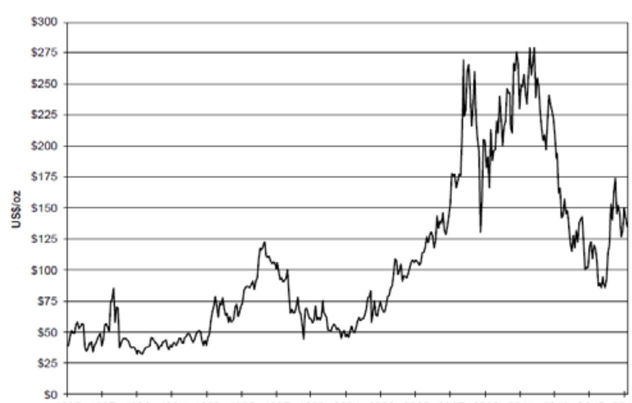
Source: BMO Capital Markets

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