MANAGER INSIGHTS

Gold Equities *versus* Gold Bullion: The Case for Gold Shares Amid Rising Costs

Van Eck Global SINCE 1955

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Introduction

The performance of gold shares has been disappointing so far in 2011. Year-to-date as of October 14, 2011, gold has gained 18.3%, while the NYSE Arca Gold Miners Index has declined 5.3% and the Market Vectors Junior Gold Miners Index has lost 21.0%. In contrast, for the ten-year period ending October 14, 2011, gold gained 19.4%, while the NYSE Arca Gold Miners Index gained 19.2%. We believe the key reason for the short-term underperformance of gold shares is rising production and capital costs in the mining industry *(see Chart 1 below)*. Energy can make up as much as 40% of operating costs at a gold mine; therefore, it is not uncommon to see share prices lag when oil prices rise dramatically. For 2011, gold companies have been using $80-$90 crude prices for forecasting. This year Brent Crude has traded as high as $127 per barrel, just $21 from its 2008 all-time high. In addition, prices of other commodities vital to mining, such as copper and steel, have risen. High commodity prices have brought a global mining boom with competition for equipment and labor that drives costs upward. Historically gold stocks have outperformed gold when the price rises. However, it looks as though the market is in the process of discounting the rising costs. Despite these cost pressures, the gold industry continues to exhibit benefits in four major ways: 1) increased company profits, 2) increased M&A activity, 3) current attractive valuations versus bullion, and 4) rising dividend yields.

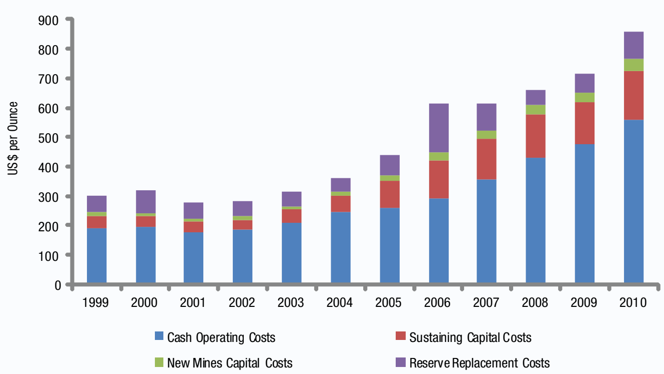
Increase in Profits

RBC Capital Markets is forecasting gold company earnings before interest, taxes, depreciation and amortization (EBITDA) margins of 55% for 2011 versus 51% for 2010, which is still a substantial increase when compared to previous years *(see Chart 2 below)*. Even with recent cost escalations, we believe that the current gold price supports a significant increase in earnings payout ratios of 2-3%, currently averaging 1% for the gold industry. RBC concluded that gold mining companies currently have the earnings potential for higher payouts, but need to catch up with the dividend payout policies of other industries. On April 7, Newmont Mining Corp increased its dividend and linked it to changes in the gold price. Newmont's yield is now 1.8% and carries leverage to gold. We believe gold companies should target yields of at least 2% in order to further differentiate themselves from other gold vehicles such as bullion exchange-traded funds and physical gold (which have no yield). We are now seeing others follow Newmont's lead.

Increase in Mergers and Acquisitions

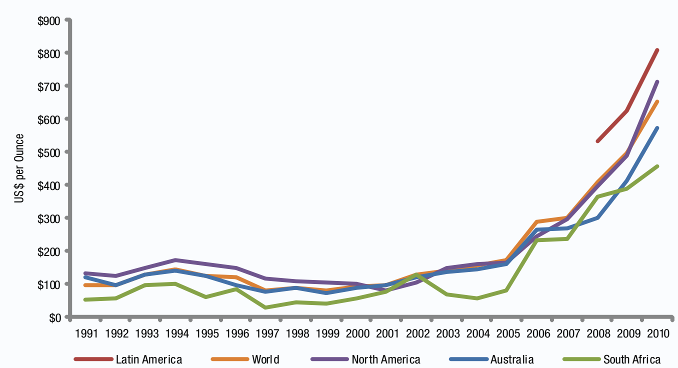
At the end of 2010, the market capitalization of the global gold-mining industry totaled approximately $475 billion. The industry is comprised of hundreds of companies. However, the top 15 producers, at $305 billion, make up the lion's share of the market cap. The rest are mid-tier producers, junior producers, junior developers and exploration companies. These smaller companies play a very important role in the discovery, development, and growth of the industry. This is especially true today as the industry has had difficulty replacing reserves depleted through mining for the last decade. According to the Society of Economic Geologists, in the period since 2000, about two thirds of new gold discoveries have been made by junior explorers. Juniors have found about 40% of the valuable larger or "world class" discoveries. In 2008, the junior sector accounted for 71% of all exploration on gold in the Western world. Larger producers actively monitor junior companies as potential acquisition targets for growth. According to Merrill Lynch, the value of global gold M&A transactions in 2010 reached record highs at $29.5 billion (*see Chart 3 on the next page*).

CHART 1: PRODUCTION AND REPLACEMENT COSTS PER OUNCE OF GOLD



Source: GS Global ECS Research

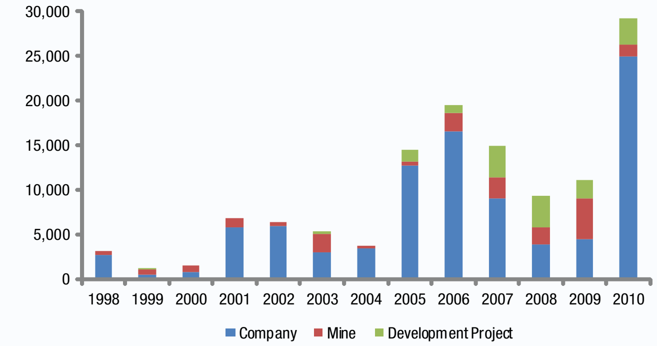
CHART 2: CASH MARGINS (OPERATING PROFITS) GOLD PRICE MINUS OPERATING COSTS



Source: GFMS, Van Eck Research

CHART 3: GLOBAL GOLD SECTOR M&A ACTIVITY

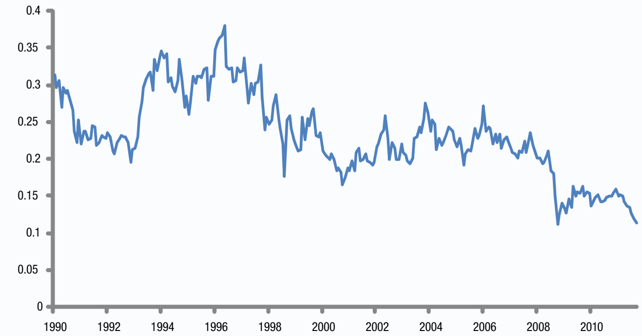
VALUE OF GOLD TRANSACTIONS



Source: Merrill Lynch Research

CHART 4: XAU INDEX/GOLD PRICE RATIO

JANUARY 1, 1990 - SEPTEMBER 30, 2011



Source: FactSet

Good Relative Value

Several metrics indicate that gold shares are trading at historically low valuations. Ratios of gold equity indices to gold have moved to levels last seen during the 2008 financial crisis and the depth of the gold bear market around 2000 *(see Chart 4 above)*. Financial valuations, such as price to net asset value (NAV), cash flow, or earnings show a similar pattern of low valuations. These were periods of acute financial stress for the gold mining industry. The industry is now very healthy financially, which makes the current low valuations anomalous and which we believe may represent a buying opportunity for gold shares.

Conclusion

We believe the market is showing what we think is an unwarranted obsession with mining costs and ignoring the positive attributes of high cash flow and the potential for rising dividend yields, increasing M&A activity and the current relative value of gold equities versus gold. In September, markets became unsettled over concerns about the sovereign debt crisis in Europe and the potential for recession. Gold and gold shares fell sharply as many investors were required or were compelled to raise cash. Gold became a source of liquidity and profit. We continue to believe in the longevity of the bull market in gold. As markets begin to function normally, gold may again emerge as a safe haven and sound currency alternative. The earnings power of the gold industry should become apparent with quarterly reporting. Moving into 2012, we believe the shares are likely to regain the value lost earlier this year.

Indices listed are unmanaged and include the reinvestment of dividends, but don't reflect the payment of transaction costs, advisory fees or expenses that are associated with an investment in a fund. An index's performance is not illustrative of a fund's performance. One can not invest in an index. Philadelphia Stock Exchange Gold and Silver (XAU) Index is capitalization-weighted and includes companies involved in gold and silver mining. The NYSE Arca Gold Miners Index (GDM) is a modified market capitalization-weighted index composed of gold-mining companies. Market Vectors Junior Gold Miners Index (MVGDXJ) is a rules-based, modified market capitalization-weighted, float-adjusted index comprised of a global universe of publicly traded small- and medium-capitalization companies that generate at least 50% of their revenues from gold and/or silver mining.