Manager Commentary: On the Gold Market

Gold came under pressure in February, ended month at $1,579.58/ounce

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Fund Review

The Fund's Class A shares lost 12.17% for the one-month period ending February 28, 2013 (excluding sales charge), while the NYSE Arca Gold Miners Index (GDM) lost 9.96% for the same period.

Average Annual Total Returns (%) as of February 28, 2013

	1 Mo[1]	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	-12.17	-34.45	-3.28	13.52
Class A: Maximum 5.75% load	-17.23	-38.23	-4.41	12.84
GDM Index	-9.96	-31.27	-5.83	--

Average Annual Total Returns (%) as of December 31, 2012

	1 Mo[1]	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	-3.87	-9.61	4.47	15.31
Class A: Maximum 5.75% load	-9.38	-14.79	3.24	14.63
GDM Index	-1.55	-8.46	1.17	--

[1]Monthly returns are not annualized.

Expenses: Class A: Gross 1.20%; Net 1.20%. Expenses are capped contractually until 05/01/13 at 1.45% for Class A. Caps exclude certain expenses, such as interest.

Please note that precious metals prices may swing sharply in response to cyclical economic conditions, political events or the monetary policies of various countries. Investors should be aware that recent market conditions resulting in high performance for the gold sector may not continue. The tables present past performance which is no guarantee of future results and which may be lower or higher than current performance. Returns reflect applicable fee waivers and/or expense reimbursements. Had the Fund incurred all expenses and fees, investment returns would have been reduced. Investment returns and Fund share values will fluctuate so that investor's shares, when redeemed, may be worth more or less than their original cost. Fund returns assume that dividends and capital gains distributions have been reinvested in the Fund at NAV. Index returns assume that dividends of the Index constituents in the Index have been reinvested.

Market Review

Gold came under pressure in February, falling $84.07 or 5.05% to $1579.58 per ounce. Gold has been consolidating since reaching $1921 per ounce in September 2011. Since 2001, this gold bull market has been characterized by strong advances followed by long consolidations. We define consolidation as the time it takes the gold price to return to a long-term high. The consolidation following the $720 peak in May 2006 took 16 months. The longest was the 19-month consolidation after the March 2008 $1032 high. The current consolidation looks to us that it will set the new record, as it is now 17 months old and $342 below the last peak. It is these long consolidations that test investors' patience and provide fodder for bears, analysts and pundits who call for gold's demise.

This consolidation is exhibiting a couple of unusual characteristics. Gold embarked on a classic seasonal break-out in August/ September 2012 around the Federal Reserve Bank's (the "Fed") QE3 (quantitative easing) announcement and we thought, at that time, that gold would trend to new highs. Instead the break-out failed. Gold has trended sideways and out of the long-term trend that has been in place since the financial crisis. Hence, we believe it is likely that a new trend will begin to develop in 2013. We believe this consolidation has been prolonged by the belief in the markets that the economy and the financial system are beginning to function normally. There no longer seems to be much worry in the markets over sovereign debt, fiscal deficits or extreme monetary policies. In such an environment, there is no perceived need for a safe haven like gold. In February, the U.S. Dollar Index[1] (DXY) broke out to new six month highs and the Dow Jones Industrial Average moved through 14,000—near all-time highs.

We disagree with the market's assessment and believe instead that things are still very far from normal. Positive housing data is seen as a prominent sign of normalization. However, when taken in a longer term context, we believe the housing market is anything but normal. Mortgage rates are currently below 4% and last year was the third worst on record for new home sales. The Case-Shiller "20-city" Home Price Index[2] has recouped just 11% of the recession plunge. Housing starts in 2012 totaled 779,900, far below peak levels of 2.07 million. Distressed sales accounted for 23% of existing home purchases in January. Home prices have firmed due to inventories that fell to 13-year lows in January.

Please note that the information herein represents the opinion of the portfolio manager and these opinions may change at any time and from time to time.

With low prices and many mortgages still underwater, in our opinion, fewer are willing or able to put their homes on the market. Last year, 36% of homes sold were purchased without mortgage financing, compared with 15% in 2007. Private equity funds have taken the place of first time buyers, converting thousands of homes to rentals.

The Congressional Budget Office posits that the fiscal deficit will fall to $845 billion. Perhaps markets believe this is normal after four years of trillion dollar deficits. However, at 5.3% of GDP, this will be the second biggest post-World War II deficit outside of the past four years.

The five biggest U.S. banks have 43.7% of all U.S. deposits, up from 37.1% in 2007 and 28% in 2002. Those banks are sitting on over $1 trillion in idle reserves. The banking system has not returned to normal.

Around 48 million Americans are on food stamps. Since 2007, disability recipients have doubled to approximately 11 million. About 10 million have dropped out of the workforce. At the job creation rate of roughly 150,000 per month seen for many months now, it would take until 2018 to reach the Fed's 6.5% unemployment target. Definitely not normal to us.

We think the abnormal "elephant in the room" is the Fed purchase of U.S. Treasuries and mortgage backed securities at the rate of $1 trillion per year, which Fed Chairman Ben Bernanke defended recently as prudent and necessary.

Across the Atlantic, Moody's downgraded the U.K.'s sovereign bond rating. France announced it will miss its deficit reduction target for the year. Italy's Prime Minister election produced an inconclusive result, making it difficult to form a stable government. European banks are taking much longer than expected to repay money borrowed through the Long Term Refinancing Operation (LTRO). Cypriot banks are in need of a bailout. Europe has yet to normalize as well.

We believe these remain risks to the financial system, many of which are the same that drove the gold market to $1921 per ounce. While markets have recently chosen to ignore such risks, it is not hard to imagine them returning to the forefront, especially since, we believe, the full impact of recent tax increases and spending cuts in the US have yet to be felt.

Market Outlook

Gold bullion exchange traded products saw heavy redemptions in February and the net speculative long positions on Comex fell to levels last seen in 2008. The NYSE Arca Gold Miners Index[3] fell 10.0% and the Market Vectors Junior Gold Miners Index[4] fell 15.5% in February to levels not seen since 2009 when the gold price was $950 per ounce. Indiscriminant selling of gold equities suggests that heavy redemptions have occurred and there is a lot of despair in the sector.

It feels tortuous and looking back, we remember such feelings in the 2008 downturn, as well as when gold fell to $250 per ounce in 1999 and 2001. As was the case then, perhaps current sentiment is telling us that we are near the low-point of this consolidation. Gold is not far from substantial technical support at $1525 per ounce, and we do not expect it to trade below this level. Central banks have been heavy buyers for the past two years and may be finding current levels attractive.

The German Bundesbank has decided to increase the portion of its gold held in German vaults to 50%. To do this, it plans to move gold stored in France and the U.S. to Germany. While this has no impact on the price of gold, it comes at a time when emerging market central banks are accumulating gold and suggests that these banks are not comfortable with the current monetary arrangement or policies. We believe they see gold as a form of insurance against currency turmoil.

We visited the mountains of the Dominican Republic recently to see the Pueblo Viejo mine, a joint venture between Barrick and Goldcorp. The mine has reserves of 25 million ounces or 777 tonnes that will be mined over a 25-year life. For comparison, Japan has the ninth largest gold reserve in the world with 765 tonnes. The mine is in start-up and is expected to reach full production in the second half of this year. So far, the start-up is going very well and gold recoveries are already at design rates of 94%. The ore is refractory, which means the gold is locked in the chemistry of the rock. It takes a very complex metallurgical operation to extract refractory gold. Unlike conventional mines, this one needed a limestone quarry, a lime plant, an oxygen plant and a power plant to support the gold operation. The two companies spent $3.7 billion to build it with state of the art technology and processing equipment.

Buying a gold stock is analogous to buying gold in a vault. The gold is safely buried in the earth. The gold company is the only entity with the equipment and expertise to bring the ores to surface and extract the gold from the rock. The Pueblo Viejo joint venture has a stability agreement ratified by the Dominican President and Congress that insures that the companies retain title to the gold. The government benefits from taxes, royalties, a carried net profits interest and needed jobs.

We also visited a couple of significant gold discoveries by Canadian juniors in the Dominican Republic that are forming a new mineralized trend in the western portion of the country. While in its early days, these could potentially form the next gold developments in the country.

People we met in the Dominican Republic were excited for their projects, the discovery of new resources and their plans to build and expand. This is in sharp contrast to the negative mood in New York, Toronto and London. There are two parallel worlds out there: one that is thriving on current high gold prices and the other that is tortured by selling pressure and negative sentiment. It does not seem such a dichotomy can last—it simply does not make sense. We acknowledge that cost inflation and failure to meet guidance in the past are reasonable cause for a derating of gold stocks. However, with gold equity indices now at levels last seen when gold was $629 lower, we believe the New York world of torture is based on fantasy, while the Dominican world that is thriving is based on reality. We do not invest in fantasy.

[1] U.S. Dollar Index (DXY) indicates the general international value of the U.S. dollar. The DXY does this by averaging the exchange rates between the U.S. dollar and six major world currencies.

[2] Standard & Poor's Case–Shiller Home Price Indices are constant-quality house price indices for the United States. The index reflects prices in real terms, which means they are corrected for inflation. There are multiple Case–Shiller home price indices: a national home price index, a 20-city composite index, a 10-city composite index, and twenty individual metro area indices.

[3] NYSE Arca Gold Miners Index (GDM) is a modified market capitalization-weighted index comprised of publicly traded companies involved primarily in the mining for gold.

[4] Market Vectors Junior Gold Miners Index (MVGDXJTR) 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, hold real property that has the potential to produce at least 50% of the company's revenue from gold or silver mining when developed, or primarily invest in gold or silver.

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