

Manager Commentary: On the Gold Market

Gold gains for second straight month, ended September at \$1,772.10/ounce

By: Joe Foster, Portfolio Manager

Fund Review

The Fund's Class A shares gained 12.84% for the one-month period ending September 30, 2012 (excluding sales charge), while the NYSE Arca Gold Miners Index (GDM) rose 12.03% for the same period.

Average Annual Total Returns (%) as of September 30, 2012

	1 Mo ¹	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	12.84	-1.50	9.17	18.87
Class A: Maximum 5.75% load	6.34	-7.18	7.88	18.17
GDM Index	12.03	-1.67	4.67	--

Average Annual Total Returns (%) as of June 30, 2012

	1 Mo ¹	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	2.19	-27.46	7.44	15.59
Class A: Maximum 5.75% load	-3.69	-31.63	6.17	14.91
GDM Index	2.40	-17.27	4.51	--

¹Monthly 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 enjoyed its second consecutive month of gains, climbing \$80.09 (4.7%) to \$1772.10 per ounce. The Federal Reserve Bank ("the Fed") surprised markets on September 13 by announcing it would conduct open-ended purchases of mortgage-backed securities (QE3) until the labor market improves. If improvement is not forthcoming, the Fed has pledged to undertake additional asset purchases. The Fed will begin by printing \$40 billion per month to buy the securities. Brazil's finance minister said this program would "only have a marginal benefit as there is already no lack of liquidity ... and that liquidity is not going into production". Indeed, the Fed already has \$843 billion in agency mortgage-backed securities and \$1.64 trillion in government debt on its balance sheet. In addition, banks are holding \$1.5 trillion in reserves and businesses have \$2 trillion of cash on their balance sheets.

The Fed is not alone. The European Central Bank (the "ECB") announced a program of unlimited bond purchases if asked by governments in need of help. These purchases would be "sterilized" by selling high quality assets to buy low quality debt, so it's not quite the same as the Fed's outright purchases of mortgage backed securities. However, it is aimed at supplying liquidity where the markets dare not to, which degrades the ECB's balance sheet and raises financial risks. Not to be outdone, the Bank of Japan expanded its asset purchase fund by ¥10 trillion (\$126 billion), while Standard and Poor's estimates that this year the Swiss National Bank has bought sovereign bonds equal to nearly half of the annual financing needs of Germany, France, Netherlands, Finland, and Austria. The Peoples Bank of China injected a record weekly amount of cash into its financial system in the last week of September. In a Financial Times column the President of the Bundesbank said "the core problem of today's paper money-based monetary policy is the potentially dangerous correlation of paper money creation, state financing, and inflation". Gold usually reacts strongly to policies that debase the dollar as the world's primary reserve currency. The U.S. Dollar Index (DXY) fell 1.7% in September. Similar actions by many other countries added support to gold as an alternative to paper.

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The Fed also extended its zero interest rate policy to at least mid-2015. Negative real rates are a cornerstone of a gold bull market because they erode wealth and cause investors to seek safe haven and/or riskier investments. We believe that, unless deflation sets in, real rates should remain negative for several more years.

The S&P 500 soared to new post-crisis highs on news of QE3, which is amazing given the anemic growth in the US and emerging markets and recession in Europe. Reports released in September showed durable goods orders and industrial production declined, while payrolls fell far short of expectations and Americans continue to drop out of the labor force. It seems QE3 amounted to a shot of adrenaline to the stock market that may not last given the weak economic fundamentals. Meanwhile, for gold, QE3 and zero rate policies are more like a protein diet that builds strength and endurance.

Market Outlook

Gold is moving higher again and while we expect to see some pullbacks after strong gains, the refocus of attention to the risks facing the U.S. economy could be supportive of gold through year-end. Front and center are the presidential election and what, if anything, will be done about the “fiscal cliff”, whereby automatic year-end tax increases and spending cuts threaten to throw the economy into recession. Moody’s Investors Service warns of a downgrade in its U.S. credit rating without an improvement in the debt/GDP ratio next year. The budget deficit this year is around \$1.2 trillion, while federal debt outstanding recently topped \$16 trillion. Anything that addresses the problem, whether tax increases or cuts in spending, probably creates further financial stress. We just returned from Greece, another heavily indebted country which is farther down the austerity road than the US. Cutting entitlements and jobs upsets people immensely and it creates divisions amongst citizens that make progress all the more difficult. Masking the problem in the U.S. is the fact that during the last fiscal year, the Fed financed about three quarters of the deficit with printed money. It then returned most of the interest it received from treasuries and mortgage backed securities back to the treasury - a sum of \$75 billion in 2011. The Central Bank of Greece doesn’t have the luxury of a printing press – it cannot create Euros. They are getting on with the painful task of shrinking government spending to reduce debt. We wonder how much longer can the Fed continue to use monetary policy to overcome fiscal policies that depend on trillion-dollar deficits?

Gold stocks outperformed gold again in September. The NYSE Arca Gold Miners Index advanced 12.0%, while the Market Vectors Junior Gold Miners Index gained 15.1%. A recent trip to Colorado suggests share price gains could be lasting.

The Precious Metals Summit and Denver Gold Forum bring gold companies of all sizes and their top managements together with institutional investors. This year there were several emerging trends that lead us to believe that the fortunes of the gold miners are about to turn after nearly two years of share price underperformance.

First, several high level executives have lost their jobs with major companies recently due to poor share price performance. Like shareholders, the boards of these majors are fed up with the poor operating results, rising costs, and missed expectations that have become too frequent in this sector. Large gold companies have always touted their project pipelines and growth profiles. The problem is that few have been able to actually deliver growth, as discoveries have become harder to find, grades have been declining, and permitting and construction timelines lengthen. In reality, simply replacing the gold that is depleted every year through mining is about all one can expect from most senior gold producers. All-in costs (operating plus capital) have ballooned to \$1400 per ounce for the large producers in 2012. In Denver we heard many of these companies say for the first time that growth is no longer a priority. Instead there is a new focus on generating attractive returns, controlling costs, and meeting expectations. The aim is to rationalize mines and projects to maximize returns to shareholders, rather than spending billions to generate growth that generates little more than the cost of capital. The talk is refreshing, the strategy makes sense, and the conviction is high.

The second reason for optimism is that we believe the industry is in the incipient stage of a decline in costs on several fronts. The global economic slowdown, particularly in China, has caused a fall in base metals, iron ore, and coal prices. Mining companies around the world have begun scaling back or canceling projects. In a September 22 report, JP Morgan Chase & Co. estimates global mining capital expenditures will drop 14% in 2013. From Denver, we are hearing stories of shorter lead times for equipment and materials. Engineering and construction contractors are becoming more available and lower vacancy rates, greater labor availability, and less turnover are becoming more common. And surprisingly, there have been layoffs in Australia, where labor has risen to nearly 50% of the cost base. Cost pressures have become a fact of life in mining and they will likely continue. After labor, energy is the second highest cost driver and we don’t expect the Middle East to settle down anytime soon. Taxes and royalties are also on the rise. However, new trends for labor, equipment, contractors, and materials, suggest that miners now have a shot at holding the line on costs for the first time in years.

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Finally, there are some positive changes happening with the junior developers. Gold stocks have been out of favor, and it has been the juniors whose valuations have suffered the most. Many of them have attractive projects with robust returns at current gold prices, but financing in the capital markets has been nearly impossible. We met with companies in Denver, who are now re-engineering their high capital expenditure (capex) projects. By focusing on higher grades and slimming down operations, some companies are able to generate plans for mines with less output, but higher rates of return and, importantly, lower capex. With a little help from a rising gold price, we expect many such companies to gain the financing they need.

Investors expect gold shares to perform at least as well as gold. A portfolio approach with careful stock selection should outperform in a rising market. However, many investors have moved to gold bullion exchange traded products after a frustrating experience with the miners. It is now up to the miners to bring those shareholders back. The feedback we've had from over 30 one-on-one meetings in Colorado indicates the companies are now prepared to deliver improving results that could be a catalyst to outperform gold.

All company weightings as of September 30, 2012.

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The S&P® 500 Index consists of 500 widely held common stocks covering industrial, utility, financial and transportation sectors. U.S. Dollar Index (DXY) indicates the general international value of the U.S. dollar. It does this by averaging the exchange rates between the U.S. dollar and six major world currencies. 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. Market Vectors Junior Gold Miners Index is (MVGDXJTR) is a rules-based, modified 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. Philadelphia Stock Exchange Gold and Silver (XAU) Index is capitalization-weighted and includes the leading companies involved in the mining of gold and silver.

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