Manager Commentary: On the Gold Market

Looking ahead to 2012, sovereign debt, other macro forces to support gold prices

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The Gold Market

Gold had another strong year, rising to an all-time high of $1,921 in September 2011. Following this, gold consolidated at lower levels in the fourth quarter to end the year at $1,564 for an annual gain of $143 or 10.1%.

Gold enjoyed two major advances in 2011. In each case, investment demand for a safe haven and currency alternative was strong. The first started from the year's $1308 low in January and rose to a peak of $1,577 on May 2. During that period, civil war in Libya drove crude oil prices to $120 per barrel and sovereign debt levels grew to levels unheard of in the post-war era.

After a brief summer consolidation, in July gold embarked on its second major advance to its September highs as sovereign debt issues created selling contagion across stocks and commodities. Gold received an added boost in August when the Fed announced its intentions to keep the Fed Funds rate at 0% for at least two more years and the Swiss decided to devalue the Franc and peg their currency to the Euro.

In September, gold experienced a sharp sell-off as it became caught in the sovereign debt contagion that was causing forced liquidations, margin calls and flights to cash. Gold continued to consolidate through the fourth quarter and a confluence of factors caused gold to tumble again in December, including U.S. dollar strength and weak demand from India. Gold typically trades as a safe haven, however, late in the year it performed more like a "risk asset" with greater correlation to equities and commodities.

Average Annual Total Returns (%) as of December 31, 2011

	1 Yr	3 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	-21.52	24.73	11.90	24.24
Class A: Maximum 5.75% load	-26.04	22.29	10.58	23.50
GDM Index	-15.48	16.27	6.36	--

Expenses: Class A: Gross 1.25%; Net 1.25%. Expenses are capped contractually until 05/01/12 at 1.45% for Class A. Caps exclude certain expenses, such as interest. 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.

Performance Review

The Fund's A-share class declined 21.52% (excluding sales charge) for the annual period ending December 31, 2011, as few stocks had positive performance across the sector. Over the past ten years, the Fund's A shares have returned 24.24%, annually.

Three main performance takeaways for 2011:

(1) Strong financials did not translate to positive performance across the sector and, as a result, many of the Fund's top ten holdings disappointed. For example, Newmont (5.8% of Fund net assets) declined 0.64%, even though the company had good operating performance and implemented an aggressive dividend policy that increased its yield to 2%, and partially linked future dividends to gold prices.

(2) Companies that disappointed the market may have been too severely punished. Negative news didn't bring higher prices and gold mining equities were abused when they failed to deliver. In some cases, operating difficulties stemming from one mine significantly dragged down an entire stock's performance.

(3) Small cap stocks with market capitalizations under $3 billion fell precipitously, shown by the 33.9% decline for the year in the Market Vectors Junior Gold Miners Index (MVGDXJ). Many juniors have development properties that do not yet generate revenues; hence they depend on debt and equity markets for funding. These stocks tend to underperform when their source of funding comes into question.

Throughout the gold bull market we have maintained roughly 25% to 30% of the portfolio in juniors. A handful of these turned in stellar performance, led by Argonaut Gold (1.9% of Fund net assets), which gained 47.1%. Unfortunately, many juniors created a drag on fund performance. Great Basin (0.4% of Fund net assets) declined 69.2% due mainly to an unexpected fault offset at its South African mine.

Market Outlook: Themes for 2012

(1) Upside in Gold Bullion

The gold bull market began in 2001 in the wake of the tech bust. It has been supported since by increasing levels of financial stress, which rose to extremes in 2008 and returned in the past year. Since 2008, gold has cumulatively gained 77.3%, the NYSE Arca Gold Miners Index (GDM) 57.1%, and the Market Vectors Junior Gold Miners Index (MVGDXJ) 151.0% as of December 31, 2011. We believe the level of financial stress has grown since the credit crisis, and that easy monetary policies that have contributed to high gold prices are poised to continue.

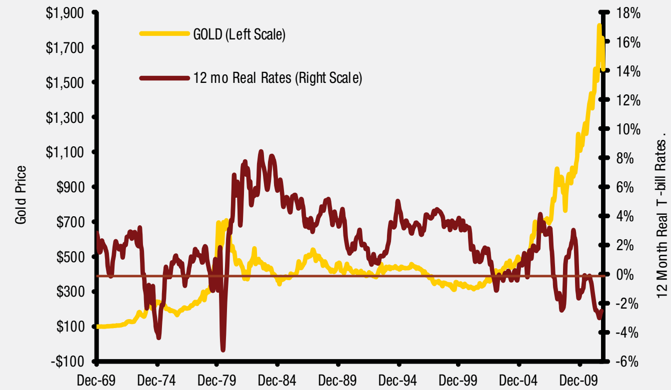
While gold has had a long and spectacular run, we believe the bull market is closer to the middle than to the end. It is difficult to estimate a fair price for gold because it doesn't respond to classic supply and demand fundamentals based on production, inventory, and consumption cycles like other commodities. Gold is also a financial asset and if more investors seek to protect their wealth from currency debasement and financial risks, investment demand might drive the price higher.

(2) Leverage in Return to Gold Shares?

Gold stocks struggled throughout the year and turned in a very disappointing performance. GDM lost 15.48% for the year as stock valuations fell to historically low levels. We doubt many would have expected gold stock indices to underperform gold by roughly 25% in a year when gold soared to such heights. This disconnect between gold and gold shares is unprecedented in a bull market. Stock valuations are at levels last seen in the 2008 credit crisis and the bear market lows from 1999 to 2001. Gold companies have had trouble controlling capital and operating costs as prices for energy, materials, and labor have been rising materially for the past several years. Taxes and royalties are also on the rise and regulatory burdens seem to always increase.

While these are certainly reasons to discount stocks, we believe that there are also ample reasons to invest in a thriving industry. EBITDA margins amongst the major producers averaged 50% in 2011. Average dividend yields have increased from well under 1% to 1.5% in just the past year. Producers are able to fund exploration and development out of cash flow for the first time in memory. Juniors control projects that have tremendous value in the ground. While we don't believe it is justified, the gold industry has nonetheless suffered a de-rating. If the de-rating is permanent, then the stocks may outperform gold only to a limited extent and may not return to historic highs in terms of valuation against gold seen in earlier cycles. However, if the de-rating is part of a macro-economic mood that has created an aversion to risk, then perhaps the stocks will regain lost value in a more positive environment, if and when worries around sovereign default, banking failure, and global contagion have abated.

FIGURE 2: GOLD VS. U.S. REAL INTEREST RATES



Source: Bloomberg, Data as of 12/31/11

(3) Negative Real Rates

Emerging market demand was an equally important driver of gold prices in 2011. While sluggish growth and negative real interest rates were impacting advanced economies, emerging markets were struggling with inflation that also created negative real rates. Investment demand for gold as a financial hedge increased, while growing emerging market wealth created stable jewelry demand. Chinese imports are expected to have doubled in 2011. Emerging market central banks looking for a sound reserve asset were also heavy buyers.

According to the Financial Times, since September some European commercial banks have been exchanging gold for USD funding. Banks are so desperate, they are willing to pay a negative interest rate to swap the gold they hold for dollars. Here, gold is serving its essential function as a source of emergency funding, even though it has the near-term effect of damping the price.

FIGURE 1: GOLD SHARES AT LOW VALUATIONS

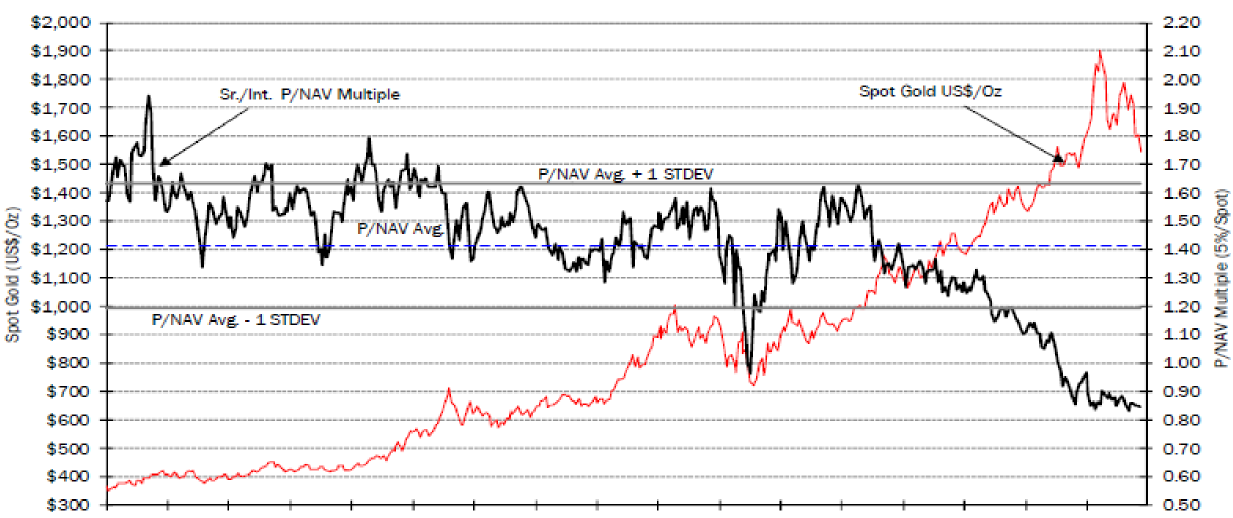


Chart Notes

P/NAV is a discounted cash flow valuation method that divides stock price by net asset value

Future cash flows are calculated using spot gold prices

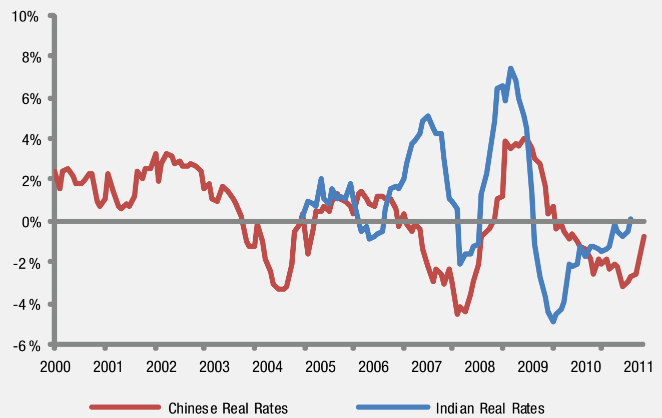
Future cash flows are discounted at 5% to calculate present NAV

Source: Capital IQ, Canaccord Genuity Estimates, Data as of 12/31/11

Standard deviation is a measure of portfolio risk.

In the U.S., anticipation of the Fed's bond operation have caused rates on 30-year bonds to fall below 3%, 10 year bonds below 2%, while yearly headline inflation stood at 3.41% in November. One of the key drivers of a secular gold bull market going forward is negative real interest rates. Real rates on one-year Treasuries have been negative for much of the past decade. The real yield across the duration curve has now turned negative, destroying wealth for many savers, institutions, and sovereigns who invest in such interest-bearing vehicles.

FIGURE 3: CHINESE AND INDIAN REAL RATES



Source: Bloomberg, Data as of 12/31/11

(4) Debt, Debt and More Debt

Another reason we believe in the longer-term continuation of the gold bull market is that once the European financial system is set on a sounder course, attention will probably move to no-less dire conditions in Japan and the U.S. Unlike the U.S. and Europe, 95% of Japanese sovereign debt is held by domestic investors. However, Japan's debt/GDP ratio is the highest in the world at roughly 200%. In November the IMF warned that Japanese debt could quickly become unsustainable at higher rates. Meanwhile, Italy is now teetering on insolvency with a debt/GDP ratio of 120%.

On September 30, the U.S. posted its third consecutive annual budget deficit in excess of $1 trillion. In 2012, U.S. sovereign debt is forecast to surpass 100% of GDP. The inability of Congress' special deficit-cutting committee to agree to anything caused Fitch to revise its U.S. debt outlook to negative in November.

We believe policy makers in the U.S. and Japan will eventually face the same hard choices now being faced by Europeans. Historically, many governments have resorted to monetization to reduce onerous debt burdens. If history repeats itself, then quantitative easing may become accepted as a more frequent policy tool. We believe that in such a scenario, gold should benefit as a sound currency alternative.

Gold may also benefit as an inflation hedge. For example, during the 1970s the U.S. inflation rate averaged over 7%, while the price of gold increased from $35 to $512 per ounce. While this environment created an increase in costs for gold mining companies, it also translated into significant increase in profits, especially during a period of high inflation.

Conversely, during deflationary scenarios such as the 1930s, gold mining stocks tend to outperform other commodities. The great depression led to a deflationary phenomenon caused by decreases in demand, output and various other factors. As a result, falling prices reduced mining costs and increased profits for gold producers. One particular bellwether, Homestake Mining Company, outperformed all other listed companies after the economic collapse of 1929. Essentially, gold and gold mining stocks may outperform in both inflationary and deflationary scenarios.

Summary

Gold performed strongly in 2011, until infected by the sovereign debt contagion that could eventually engulf Japan and the United States. This has made the 2012 picture quite cloudy as the knowledge and leadership needed to snuff it out and make needed reforms may not exist. It seems a Japanese-style economic malaise of low growth and high unemployment is settling over the advanced economies for the long term, while another 2008-style blow-up becomes an enduring possibility. Elevated financial risks may remain in the foreseeable future, which is why we believe the gold bull market could continue for years to come. While precipitous falls in the gold price or the underperformance of gold shares tests the resolve of many gold advocates, we view these as short-term set-backs within a positive long-term trend. Going forward, we expect gold stocks to move higher if the price of gold increases. However, it seems we will have to wait for the European debt crises to subside and for markets to start functioning normally before we see if lost value returns to the gold sector.

All Fund net asset figures are as of December 31, 2011. Please note that precious metals prices can swing sharply in response to cyclical economic conditions, political events or the monetary policies of various countries.

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You can lose money by investing in the Fund. Any investment in the Fund should be part of an overall investment program, not a complete program. The Fund is subject to the risks associated with concentrating its assets in the gold industry, which can be significantly affected by international economic, monetary and political developments. The Fund's overall portfolio may decline in value due to developments specific to the gold industry. The Fund's investments in foreign securities involve risks related to adverse political and economic developments unique to a country or a region, currency fluctuations or controls, and the possibility of arbitrary action by foreign governments, including the takeover of property without adequate compensation or imposition of prohibitive taxation. The Fund is subject to risks associated with investments in debt securities, derivatives, commodity-linked instruments, illiquid securities, asset-backed securities, CMOs and small- or mid-cap companies. The Fund is also subject to inflation risk, short-sales risk, market risk, non-diversification risk, leverage risk, credit risk and counterparty risk. Please see the prospectus and summary prospectus for information on these as well as other risk considerations.

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