Manager Commentary: On the Gold Market

Gold posted modest gain in June, ended month at $1,597.40/ounce

By: Joe Foster, Portfolio Manager

Fund Review

The Fund's Class A shares gained 2.19% for the one-month period ending June 30, 2012 (excluding sales charge), while the NYSE Arca Gold Miners Index (GDM) gained 2.40% for the same period.

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	--

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

	1 Mo[1]	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	-12.16	-22.65	11.06	19.38
Class A: Maximum 5.75% load	-17.22	-27.11	9.75	18.68
GDM Index	-10.47	-16.92	5.78	--

[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 advanced $36.97 (2.4%) in June to end the month at $1597.40. Gold has been consolidating for the past nine months since reaching the $1921 high in September. This is becoming one of the longer consolidations of the 11-year bull market. For comparison, consolidations beginning in May 2006 and March 2008 each lasted over a year.

During June, gold gyrated with the market's changing sentiment toward further central bank easing. A weak US jobs report sent gold soaring $63 on the first day of the month. Gold fell $30 on June 7 when Federal Reserve Chairman Bernanke's comments to Congress did not indicate imminent policy action. Gold fell sharply again on June 21 when the Federal Open Market Committee (FOMC) meeting also failed to indicate a new round of quantitative easing. On the final trading day of the month another European summit paved the way for further bailouts of troubled banks. Gold gained $45, as some analysts believe this summit clears the way for the European Central Bank to ease rates or implement more long-term refinancing operations (LTRO) in the weeks ahead.

UBS Investment Research estimates that central banks have added 111 tonnes of gold to their reserves in the first half of 2012. While this is quite positive for the gold market, it is offset by much weaker jewelry demand from India. Economic issues have brought record lows in the Indian rupee in the first half of 2012. We believe this has caused local gold prices to soar to record levels, dampening demand and encouraging scrap to enter the market.

Gold stocks mimicked gold with a 2.4% gain in June for the NYSE Arca Gold Miners Index (GDM). Juniors lagged a bit, as the Market Vectors Junior Gold Miners Index (MVGDXJ) declined 1.3%. During the first half of 2012, gold posted a 2.2% gain, while gold stocks underperformed significantly. Year-to-date, the GDM declined 12.7% and the MVGDXJ fell 21.6%. We believe that a general market aversion to equities along with higher-than-expected first quarter operating and/or capital costs caused gold stocks to underperform. In our opinion, this underperformance is over-done and gold stocks represent excellent value.

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.

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We continue to look for opportunities and spent part of June roaming Nevada in search of attractive juniors. Nevada supplies about 75% of the gold produced in the United States. If Nevada were a country, it would rank sixth in world gold production. The Nevada Bureau of Mines counts at least 100 exploration targets drilled in Nevada in 2010 and likely more in 2011. The vast majority of these targets fail to generate an economic gold deposit. Global Resources Investments Ltd. states in its April commentary: "If we were to merge every gold junior in the world (some 500 companies) into one entity, that company would lose somewhere between two billion and eight billion dollars per year".

While most exploration dollars are wasted, there are also some companies who are able to generate tremendous value for shareholders. Juniors are responsible for roughly half of the discoveries that eventually develop into profitable mines. BMO Capital Markets estimates that the 76 new mines, globally, starting in the next eight years will have an average internal rate of return of 26% (at May 7, 2012 gold prices). We are obviously only interested in the successful juniors and, given their success rate, it helps to have someone picking stocks who can tell the difference between pyrite, pyrrhotite, chalcopyrite, and gold (gold is a noble metal, the others are iron- or iron/copper sulfide minerals that may resemble gold).

Most of the Nevada properties we visited were familiar to us, since we have worked or toured them in the past. Gold deposits, generally, are relatively small and easy to miss. Many discoveries are made after several companies have each worked on a property for a few years, at which point they typically drop or sell the property after some unsuccessful drill campaigns. As knowledge of a property grows, geologists may test new ideas. Allied Nevada's Hasbrouck Mountain project is a good example. A resource at Hasbrouck with grades too low to mine (even at today's prices) had been known by company personnel for years. Allied's geologists identified fault intersections that they targeted at depth with drilling. They found a higher grade core to the deposit that raised the average grade, making it economically viable. In fact, Allied is now planning a heap leach mine[1] that they anticipate will give a 60% internal rate of return at a gold price of $1,000. We came away from Nevada with new ideas to follow and others to avoid.

Market Outlook

Moody's Investors Service downgraded the long-term debt of more than a dozen banks with a negative outlook, including five of the six biggest US banks. Analysts dismissed it as anticipated, and the market shrugged it off. Rather than view this as a non-event, we wonder why Moody's is still compelled to issue this downgrade, given a harrowing credit crisis, Dodd-Frank financial reform, increased capital requirements and stronger bank balance sheets.

We also wonder why the European Central Bank (ECB) is compelled to now accept mortgage-backed securities, car loans, and small to medium business loans with ratings as low as triple-B as collateral. This concerns us, as we believe that risks to the financial system have only risen in the past several years.

Broadly speaking, actions by modern central bankers so far have not been dissimilar to those by used by Rudolf von Havenstein, President of the Reichsbank from 1908 – 1923. Germany found itself heavily in debt following World War I. Mr. von Havenstein began monetizing sovereign debt during the war as a stop-gap measure. He continued monetary expansion after the war in order to prevent a sharp rise in interest rates and an increase in unemployment. This was accepted as sound monetary policy, but eventually led to hyperinflation. The financial devastation brought on by the sub-prime credit crisis was similar in magnitude to that brought on by war. Broadly speaking, actions by modern central bankers so far have not been dissimilar to those by used by von Havenstein.

Historically, the US dollar has been a store of value with the soundness of gold. Stockholders or partners of a bank were responsible for its solvency. The thought of monetizing government debt was taboo. Now markets rise or fall with expectations for currency debasement and monetization of debt, called "QE" or "LTRO". Markets move on whether a bank or sovereign gets more bailout funds. While central bank policy actions seem like piecemeal attempts to avoid the outcomes experienced in the Great Depression, there are a few economists who recognize a broader, more permanent, and perhaps unconscious shift to policies that introduce new risks and uncertainties.

A June 2011 International Monetary Fund paper by Carmen Reinhart et al recognizes a phenomenon called "financial repression", where governments implement policies to channel to themselves funds that would normally go elsewhere. According to Ms. Reinhart, such policies are enacted under the guise of efforts to ensure the health of the financial system. Financial repression requires a high incidence of negative real interest rates to liquidate or erode the real value of government debt. In April, HSBC Chief Economist Stephen King bluntly stated his take on financial repression, summarizing his opinion: "with neither decent economic growth nor coherent fiscal consolidation plans, governments will have to find ways of rigging the financial system to suit themselves, even if there is a cost to the economy as a whole".

In a July newsletter to industry personnel, Portfolio Manager Eric Fine, who specializes in emerging market debt, recognizes an untested and unacknowledged "new financial architecture" that has evolved since the credit crisis. Under the old architecture, if there was a "debt overhang", sovereign default was explicitly on the table, plans for fiscal balance were required, and central banks would never become the endless lender to the fiscal authority. Within the new architecture, bank deposit guarantees were greatly expanded and money market funds and bank debt were guaranteed. The Fed was forced to publish thousands of pages of documents generated during the crisis that shows they issued $16 trillion in "flash money" to guarantee the $700+ trillion derivatives market. This new architecture diminishes the Fed's independence and radically enlarges the Fed's balance sheet to guarantee an overwhelming array of financial assets. We would trace the roots of this new architecture to the late nineties around the time of the Asian financial crisis and Long Term Capital Management crisis in which the Fed began to guard the economy with overly easy monetary policies that came to be known as the "Greenspan put". This continued with the Bernanke Fed and his "helicopter" analogy to printing money in order to avoid a deflationary spiral.

Both the "financial repression" phenomenon described by Ms. Reinhart and the "new financial architecture" identified by Mr. Fine describe fiscal and monetary systems that, in our opinion, are out of control. In such an environment, the potential for misallocation of wealth, value destruction, and asset bubbles are high. There doesn't seem to be any credible plans or true desire to return to a system of sound currencies and market-based financial stability. The risks in such an environment favor gold as a store of value. So far, this has been a difficult year for gold as markets have valued the dollar as a safe haven. However, the US also has sovereign debt, economic, and banking issues that may again take center stage. We would not be surprised to see gold eventually trend through the $1921 highs set last September.

All company weightings as of June 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.

[1]Heap leaching is an industrial mining process to extract precious metals, copper, uranium, and other compounds from ore via a series of chemical reactions that absorbs specific minerals and then re-separate them after their division from other earth materials.

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