Manager Commentary: On the Gold Market

After a strong start to 2012, gold trades sideways to end first half at $1,597.40/ounce

By: Joe Foster, Portfolio Manager

Fund Review

The Fund's Class A shares decreased by 16.67% for the six-month period ending June 30, 2012 (excluding sales charge), while the NYSE Arca Gold Miners Index (GDM) lost 12.73% for the same period.

The Fund, an actively managed portfolio investing in gold mining equities, has a 40+ year track record. Our specialized investment team, led by geologist Joe Foster, who has been a part of the Fund's investment team since 1996, conducts regular on- and under-the-ground research to access mining efficiencies and opportunities.

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

	YTD[1]	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	-16.67	-27.46	7.44	15.59
Class A: Maximum 5.75% load	-21.44	-31.63	6.17	14.91
GDM Index	-12.73	-17.27	4.51	--

[1]YTD 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.

Performance Review

For the semiannual period, gold bullion prices gained $33.70 per ounce, or 2.16%, to close on June 30, 2012 at $1,597.40 per ounce. The precious metal had a strong start to the year, trading to a high of $1,784.23 per ounce on February 28, a gain of 14% since the end of 2011. Gold then primarily traded sideways through the next several months, reaching a low for the semiannual period of $1,539.57 per ounce on May 16. On the last trading date of the semiannual period, June 29, positive news from a meeting of European Union leaders appeared to push gold prices higher.

Despite higher gold bullion prices, stocks of gold mining companies finished the first half of 2012 down. The underperformance of gold stocks relative to the underlying precious metal began in late April 2011 and continued through the first half of 2012, albeit not steadily. From the start of the semiannual period in January 2012 through the end of February, gold shares kept pace with gold bullion, with junior miners outperforming during that time. Then, from the beginning of March through mid-May, gold mining stocks underperformed. From May 15 through June 29, 2012, gold-related equities outperformed gold bullion, as evidenced by the 13.9% increase in the GDM compared to the 3.4% gain in the price of gold bullion.

The extended period of underperformance of gold equities compared to the gold commodity from late April 2011 through June 2012 is unprecedented. We believe one of the main reasons for this unusual stretch has been a general de-rating of the equity sector, wherein valuation multiples have been lower. We also believe disappointing operating performance and guidance by the gold companies, primarily in the form of higher operating and capital costs, have driven the gap. It appears the market has been very focused on cost pressures while ignoring the industry's healthy margins and solid financial conditions. After all, not only did the price of gold bullion move higher during the semiannual period, but the average price of gold during the first half of 2012—$1,651.47 per ounce, which is representative of the average price realized by most gold companies—was 14% higher than the 2011 first half average gold price of $1,448.91 per ounce. We believe this differential should, going forward, translate into increased operating margins and higher cash flows for gold mining companies, allowing for both higher dividends to shareholders and a larger portion of growth projects being financed internally—which together should enhance gold mining companies' valuations.

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.

Market Review

As the new year of 2012 began, gold bullion seemed to have established a positive trend, as prices traded to a high of $1,784.23 per ounce on February 28. Efforts aimed at injecting more liquidity into the global financial system to stimulate economic growth supported higher gold prices, allowing for a rebound from the oversold levels seen at the end of 2011. In January, the Federal Reserve's (the Fed's) decision to hold its federal funds rate near zero through the end of 2014, an extension from its previous guidance of mid-2013, drove a bullish break-out for gold, as we believe investors sought what they considered to be the protection of the precious metal against expected low or negative real interest rates. In February, the Bank of England announced additional quantitative easing through the purchase of securities, the Bank of Japan announced increased purchases of government bonds, and the European Central Bank implemented the second tranche of its longer-term refinancing operation (LTRO). Another source of support came from the oil market, as geopolitical tensions with Iran escalated, driving Brent crude oil to more than $120 per barrel, which we believe, in turn, led investors to turn to gold as an inflation hedge. The gold price of nearly $1,800 per ounce seemed to reflect the precious metal's historical role as a currency alternative and perceived safe haven asset class. However, on February 29, comments by Fed Chairman Bernanke made during Congressional testimony lacked any mention of further quantitative easing in the U.S., marking the end of the early 2012 rally and the beginning of a round of gold price consolidation.

The absence of any firm indicators kept market participants on the sidelines and kept gold bullion trading in a sideways pattern through mid-May. Gold bullion prices reached a low of $1,539.57 per ounce on May 16. Price volatility was significant, with 1% to 2% daily moves in either direction being fairly common. The single most important driver of such a pattern seems to have been varying expectations around further economic stimulus. Frequent moves in the gold price in either direction also depended on global economic indicators released on any given day, with the market looking at Gross Domestic Product (GDP) growth, employment data and statements from central bank officials to gauge the likelihood of central banks across the globe engaging in further quantitative easing. Gold's subdued behavior overall appears to have reflected the market's lack of conviction in the direction of the global economy and the ever-changing assessment of financial risk. During these months, gold traded primarily as a risk asset rather than as a safe haven asset, and gold prices seemed set to end the first half of 2012 relatively unchanged.

Physical demand, which was mixed during the semiannual period, failed to provide a push to gold prices. While demand in China appears to have remained strong, demand out of India was impacted significantly by a weaker rupee, which increased the local cost of U.S. dollar-denominated gold and reduced consumption. Further, the focus of the market had turned to the deteriorating sovereign debt situation in Europe. The markets initially were trying to figure out and to price in the impact of a potential exit of Greece from the monetary union, and subsequently began trying to assess the outlook for other countries in trouble, such as Spain and Italy, and the ramifications of potential debt defaults and a slowing Eurozone on the global economy. All the bad news out of Europe increased demand for the U.S. dollar and U.S. Treasury securities, leaving gold to trade as a risk asset.

However, on June 29, 2012, the last trading day of the semiannual period, news from a meeting of European Union leaders where they agreed to the formation of a Eurozone banking sector supervisory authority and plans to contain Spanish and Italian debt costs, was interpreted positively by the market. Indeed, such news fueled a rally for equities, commodities and the euro. The U.S. Dollar Index (DXY) was down 1.4% on the day, the euro rose 1.8%, and gold prices advanced $45 per ounce to a close of $1,597.40 per ounce for a daily gain of 2.9%.

Fund Attribution

The Fund's underperformance of the GDM was due primarily to its greater exposure to small-cap stocks than the benchmark index. While junior, or small-cap, mining stocks outperformed gold bullion early in 2012, they underperformed both the precious metal and the GDM for the semiannual period as a whole, as evidenced by the 21.6% decline in the Market Vectors Junior Gold Miners Index (MVGDXJTR) for the six months ended June 30, 2012. At the end of June 2012, approximately 28% of the Fund's net assets were invested in the stocks of junior miners. Among the junior mining stocks that disappointed most was Tahoe Resources (2.2% of Fund net assets†), whose shares fell 20.1% during the semiannual period. Its shares declined following a misleading news article toward the end of June suggesting the Guatemalan government intends to acquire up to a 40% stake in resource projects in the country. Tahoe Resources' management indicated that they do not expect the company's Escobal project to be affected by the proposed reforms and that the project remains on schedule for first production in the fourth quarter of 2013. Escobal is a world-class silver deposit, which we anticipate will establish Tahoe Resources as a mid-tier producer, and thus we maintained the Fund's position in the company.

All that said, there were a handful of junior mining stocks that performed well during the semiannual period. These were led by Argonaut Gold (2.5% of Fund net assets†), whose shares gained 11.0% during the semiannual period. Argonaut Gold's strong relative performance reflected the company's cash flow generation, relatively simpler, lower risk projects, which are financed internally, and good execution.

Also, while merger and acquisition activity was light in the gold mining sector due to low equity valuations, one of the best junior performers was Trelawny Mining and Exploration. We sold the Fund's position in the company following Iamgold's takeover announcement on April 27, 2012 in which it stated it would acquire the junior miner at a 38% premium to the previous day's stock price.

Among the Fund's top ten equity holdings, two were outstanding performers during the semiannual period. Royal Gold (4.5% of Fund net assets†) and Yamana Gold (3.4% of Fund net assets†) saw their shares gain 16.3% and 4.8%, respectively. Royal Gold benefited from the low exposure of its royalty business model to the industry's cost pressures. Yamana Gold's portfolio of relatively lower risk, lower capital expenditure projects renewed investor interest in its prospects.

The remaining positions among the Fund's top ten equity holdings did not perform as well, with few stocks of gold producers posting positive performance. Among those that underperformed most were Osisko Mining (5.1% of Fund net assets†) and Iamgold (4.5% of Fund net assets†), whose shares declined 28.5% and 25.6%, respectively, during the semiannual period. Osisko Mining posted good share price performance during the first quarter of 2012, but problems at its processing facility, which once again delayed the much-awaited production ramp-up of its Malartic gold mine in Quebec, came as a disappointment during the second calendar quarter. We have met with the management of Osisko Mining and believe that, following modifications to the plant, its operations will be optimized to deliver expected production. Iamgold was primarily impacted during the semiannual period by a downward revision of ore grade, resources and expected average production at its Essakane mine in Burkina Faso. Also, changes to Iamgold's mining method at Westwood, which were guided and intended to optimize the project, were perceived negatively by the market. We believe that despite the revisions, Iamgold's portfolio remains attractive and represented good value at the end of the semiannual period. Positively, in our view, Iamgold took advantage of the junior sector's historically low valuations to enhance its portfolio. As mentioned above, Iamgold announced on April 27 a friendly all-cash takeover of Trelawney Mining and Exploration, one of the relatively few merger and acquisition transactions in the sector during the first half of 2012.

Market Outlook

Although news from the Eurozone summit at the end of June 2012 brought some relief to the markets in the short term, it is clear that significant risk remains for the region over the longer term. There still needs to be definition around how and when these new strategies will be implemented, and there is a lot of uncertainty about how successful these measures will ultimately be in improving such a complex situation.

The difficult problems faced by the Eurozone nations in fighting a sovereign debt crisis, implementing austerity measures, trying somehow to sustain economic growth and maintain the monetary union, will no doubt take time and many more summits to tackle. In addition, the market's focus on Europe has diverted its attention from the sovereign debt and economic problems in the U.S., which we believe are just as serious. In a report issued toward the end of the semiannual period, the Congressional Budget Office concluded that a 2013 recession is inevitable if proposed U.S. tax hikes and spending cuts, popularly known in the media as the "fiscal cliff," take effect as planned on the first of January 2013.

It appears that amidst these conditions, gold continues to gain recognition as a monetary asset. Okayama Metal & Machinery has become the first Japanese pension fund to make public purchases of gold, initially allocating 1.5% of its portfolio to gold-backed exchange-traded funds. The State of Missouri General Assembly is expected to soon vote on the Missouri Sound Money Act of 2012, which would make gold and silver legal tender within the state. Central banks in countries such as Mexico, Russia, Kazakhstan and the Philippines continued to add to their gold reserves. China imported a record 103.6 tonnes of gold from Hong Kong in April 2012. Finally, a proposal from the German Council of Economic Experts circulating in Europe calls for European debtor states to pledge their gold reserves as collateral within a so-called European redemption fund, financed mainly by Germany. We doubt such a fund will materialize, as it is hard to imagine a sovereign handing its country's gold over to Germany in a worst-case scenario. Nonetheless, all of these events or proposals point, in our view, to the continuing loss of faith in a fiat currency system that we believe is based on irresponsible fiscal and monetary policies.

While we anticipate price volatility within the gold market to continue, we believe all the fundamental drivers of a gold bull market remain in place. The global economy continues to struggle under the ongoing weight of a deflationary credit contraction. The uncertain outlook for global economic growth, the potential for further monetary easing and negative real interest rates, the impact these factors may have on fiat currencies, and the high level of financial risk still present are collectively supportive, we believe, of increasing future demand for gold as a safe haven asset and currency alternative. Given the historically low valuations seen at the end of the semiannual period, we expect that in a rising gold price environment, gold mining equities should appreciate from these low levels and outperform the underlying gold bullion.

†Fund net assets as of June 30, 2012.

All indices listed are unmanaged indices and do not reflect the payment of transaction costs, advisory fees or expenses that are associated with an investment in the Fund. An index's performance is not illustrative of the Fund's performance. Indices are not securities in which investments can be made. The NYSE Arca Gold Miners Index (GDM) is a market capitalization-weighted index comprised of publicly traded companies involved primarily in the mining for gold U.S. Market Vectors Junior Gold Miners Index 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.

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.

Please call 800.826.2333 or visit vaneck.com for performance information current to the most recent month end and for a free prospectus and summary prospectus. An investor should consider the Fund's investment objective, risks, and charges and expenses carefully before investing. The prospectus and summary prospectus contain this as well as other information. Please read them carefully before investing.

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