

Manager Commentary: On the Gold Market

Gold traded sideways in January, ended month at \$1,663.65/ounce

By: Joe Foster, Portfolio Manager

Fund Review

The Fund's Class A shares lost 8.57% for the one-month period ending January 31, 2013 (excluding sales charge), while the NYSE Arca Gold Miners Index (GDM) lost 10.23% for the same period.

Average Annual Total Returns (%) as of January 31, 2013

	1 Mo ¹	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	-8.57	-26.66	1.00	14.26
Class A: Maximum 5.75% load	-13.85	-30.87	-0.20	13.58
GDM Index	-10.23	-25.11	-2.73	--

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	--

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 traded sideways for most of January, averaging \$1,671.34 per ounce during the month. Early in the month, the passing of legislation that avoided the full impact of scheduled U.S. tax increases and spending cuts, the so called fiscal cliff, weakened the dollar, and gold advanced along with commodities and equities. However, minutes from the December 11, 2012 Federal Open Market Committee ("FOMC") meeting indicating that some Federal Reserve Bank (the "Fed") officials viewed QE3 asset purchases ending in 2013, put downward pressure on gold and drove it to a low of \$1,646.95 per ounce on January 7. During the rest of the month, gold moved primarily in reaction to U.S. and Chinese economic data releases and in response to additional statements from the Federal Reserve. Gold traded as high as \$1,692.70 per ounce on January 22, but finished the month at \$1,663.65 per ounce, down \$11.70 (0.70%) from the end of 2012.

The gold equities continued to underperform during January. The NYSE Arca Gold Miners Index¹ fell 10.24%. The small cap "junior" companies in the sector were also down during the month, as represented by the Market Vectors Junior Gold Miners Index² which fell 4.22%, but they managed to outperform the larger companies. This is similar to the outperformance of the junior companies in the first couple of months in 2012, likely a reflection of the significantly oversold levels of the junior sector both at the end of 2011, and even more so at the end 2012.

During the month, many companies in the sector released Q4 2012 operating results and 2013 guidance, which in general were below expectations, and likely part of the reason the stocks underperformed relative to the metal. It now appears it may take a couple of more quarters for companies to get their plans aligned with market expectations. We view recent changes in management, and the sector's shift towards a focus on profitability, as supportive of an improved outlook for gold equities.

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 Outlook

Gold stocks continued to lag behind the price of gold in January 2013. After two years of underperformance and negative share price returns, the valuations of gold equities are at historically low levels. Since the end of 2010 to the end of January 2013, the junior gold mining stocks, as indicated by the Market Vectors Junior Gold Miners Index, are down 46.4%. The large and mid-tier companies have fared a bit better relative to the juniors, with the NYSE Arca Gold Miners Index down 30.6% during the same period. This gap between the share price performance of the larger and the smaller companies creates the opportunity for sector consolidation. The larger companies struggling to deliver growth can take advantage of the depressed valuations of their junior peers to buy some of this much needed growth by acquiring them. Of course, the larger companies' share price has declined too, so they are not necessarily eager to issue their shares at these prices to finance acquisitions, constraining M&A activity in the sector.

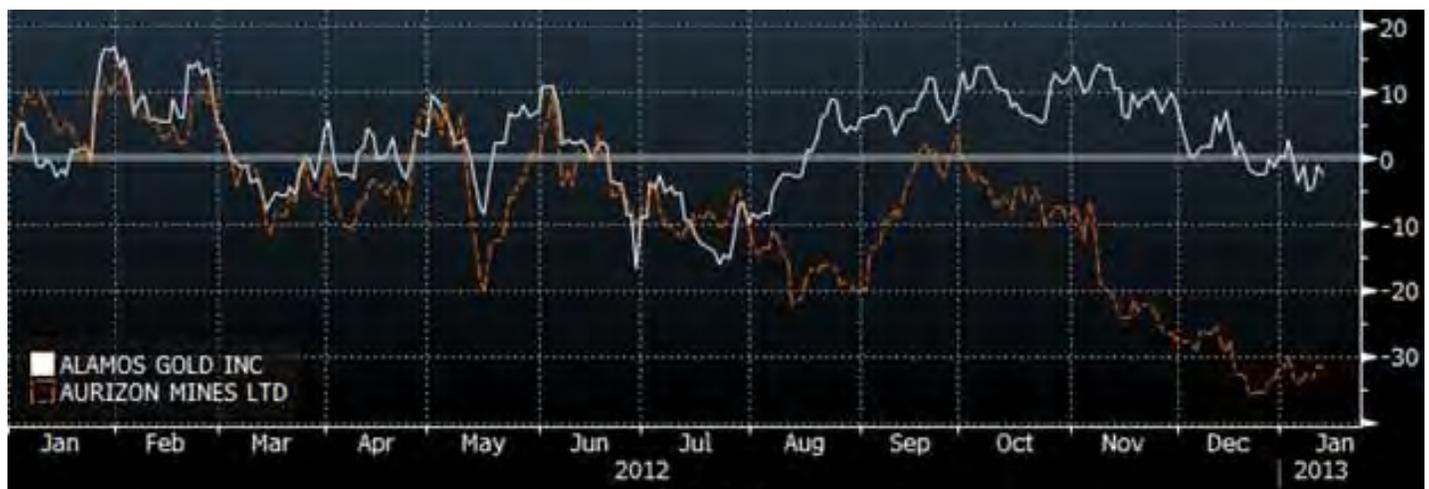
On January 14, Alamos Gold announced its hostile offer to acquire Aurizon Mines for approximately CAD780M in cash and Alamos shares. Chart 1 shows the share price performance of both companies from the end of 2011 to January 11, 2013, the last trading date before the take-over announcement. The chart clearly illustrates the widening gap in the performance of the two companies, with the aspiring acquirer (Alamos) outperforming the take-over target (Aurizon) by almost 30% during the period. So, despite a 36% take-over premium, if successful, Alamos would acquire Aurizon for approximately the same price Aurizon was trading at the end of 2011. We believe the divergence in the companies' market value presented an opportunity that Alamos just couldn't pass up. We estimate their offer represents

approximately Aurizon's current net asset value, giving Alamos the opportunity to acquire a gold producer at par to valuation, something unheard of in this sector. The combined company will enable Alamos to diversify its production geographically and position the company to advance to mid-tier status.

Producing gold companies have historically traded at multiples to their estimated net asset value (NAV). Of course, the figures depend on gold prices, discount rates and other assumptions, which vary among analysts. However, despite these variations, most estimates have historically shown share prices that represent a premium to the companies NAV. Canaccord Genuity research estimates a historical (for about the last 10 years) average price to NAV ratio for the senior and intermediate gold producers of 1.35. To succeed in the acquisition of a producing company in the sector, the acquirer's offer typically needs to represent a significant premium to its share price, which in turn represents an even more substantial premium to NAV. For example, BMO Capital Markets research suggests an average historical premium for a group of over 100 acquisitions in the sector of 160% or a 1.6 multiple to NAV. Looking at these figures, Alamos' proposed take-over of Aurizon at an estimated NAV multiple of 1.0 would indeed appear too good an option for Alamos to pass up.

Another important factor to consider when looking at sector consolidation is the impact on risk profile. To acquire an already producing asset typically comes at a higher cost than the organic development of an asset to production, but the higher cost would generally be justified by the significantly lower risk associated with future production, and the likely higher valuation premiums that the market would assign to such assets.

Chart 1: Alamos Gold and Aurizon Mines Share Price Performance
January 1, 2012 - January 11, 2013



Source: Bloomberg

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The development of a gold deposit to production is a long process, filled with technical, operational, financial and execution risk, and it can take as long as a decade (sometimes much longer) from discovery to production. Consider the uncertainty brought about by the labor, energy and water constraints and the cost inflation, permitting, environmental, and community related pressures the sector faces in the development of gold deposits. Couple this with the increasing difficulty in finding new deposits, and it is easy to see the appeal in adding a source of immediate production at known operating parameters to a company's pipeline.

Estimating the value of a company in the gold sector is a complex task, involving many factors, parameters and assumptions. Unlike the production of industrial items or the delivery of services, the production of a gold mine is constrained to the finite amount of gold that can be extracted from a given deposit, and production can vary significantly over a mine's life. Therefore, unlike other sectors, where current cash flows and earnings can be an effective valuation metric, gold sector valuations require not just an estimate of the cash flows for the next few years, but an assessment of the value of the gold in the ground. The key questions are how much gold will be extracted from the deposits the company owns, and at what cost.

How much gold is there? Valuation estimates typically assume that production will come from the company's reserve base. This is the amount of gold that has been determined, with the highest level of confidence, to be contained in the ground. Further, material that is considered reserves has also been deemed economic to mine, which explains why production forecasts are generally based on reserves. However, historically, gold companies have continuously expanded their reserve base, so that the life of a mine extends well beyond original estimates based on previous reserves. It is this characteristic of gold companies, we believe, that explains why gold companies should trade at a premium to valuation. When investors buy a gold stock, they are investing in the current proven and probable reserves, but they are also investing in future reserves. They are investing in the ability of the company to drill further to increase the level of confidence and upgrade resources to reserves; they are also investing in the company's so called "exploration upside", its ability to explore and discover new deposits that will eventually become reserves. The better the quality of the assets and of the teams operating those assets, the higher that valuation premium should be.

As the price of gold increases, the valuations of gold companies should increase significantly. There are several reasons for this. All other factors equal, as gold rises, the company's profitability growth outpaces the gold price increase. But in addition to this leverage, a higher gold price means more resources become mineable and therefore can be considered reserves. Also, higher gold prices translate into increased free cash flow, which allows the company to spend more money in exploration, improving its potential for new discoveries that can lead to even more gold reserves.

How much will it cost to produce those reserves? The second part of the cash flow equation, production cost, is just as important. Costs, both capital and operating, can vary significantly across operations. Thus, companies with similar reserve bases and production profiles can have very different valuations as a result of their different cost structures, demonstrating that "not all ounces are created equal". The market should pay less for companies with higher costs of production and therefore lower margins, and thus a company that may appear "cheap" could very well be fairly valued or overvalued if its total costs of production are relatively higher.

A comprehensive valuation estimate derives the company's value by forecasting free cash flows (revenues minus all costs) generated by the company over the assumed life of its mines. Gold sector valuations are at historical lows, despite gold having risen for twelve consecutive years now. Although there are obviously many factors affecting share price performance, in general, those gold companies that can consistently demonstrate their ability to increase reserves and produce gold at attractive margins should outperform relative to both the sector and gold.

Gold companies have fallen out of favor with the market and we believe valuations for many companies verge on the ridiculous. Aurizon has reported higher costs than expected and its share price has suffered. However, we estimate Aurizon will produce 130,000 ounces in 2013 from its Casa Berardi mine, generating operating cash flow of around \$80M annually from a reserve base of 1.5 million ounces of gold. Alamos sees an opportunity. It is surprising we haven't seen more acquirers take advantage of this extraordinary market.

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¹NYSE Arca Gold Miners Index (GDM) is a modified market capitalization-weighted index comprised of publicly traded companies involved primarily in the mining for gold.

²Market Vectors Junior Gold Miners Index (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.

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