February 2016

In this presentation, we discuss certain economic and market factors that we think investors should focus on in the medium term. This presentation is not meant to be an exhaustive economic overview. Outlook as of February 2016.
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The Case for Gold in 2016

Gold shares have been in their worst bear market in 100+ years, but have shown signs of life in early 2016. It is time to update the case for and against gold shares.

**Supportive Factors**

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<th>Macro</th>
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<td>Low or negative real interest rates are typically good for gold: rates have been negative or very low in Europe since 2015; they turned negative in Japan in January 2016 and may be peaking in the U.S.</td>
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<td>Potential loss of confidence in central banks due to their inability to generate normal economic growth or inflation. The withdrawal of quantitative easing (QE) in the U.S. may be causing a recession</td>
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<th>Fundamental</th>
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<td>Deflation in the costs of labor, material, and services</td>
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<td>The currencies of commodity producing countries have fallen hard in 2015-2016</td>
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<td>Gold share valuations are at multi-decade lows</td>
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<th>Technical</th>
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<td>Gold shares currently have technical support</td>
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Despite these positives, we think that gold must break through $1,225 an ounce to definitively break out.
Lower interest rates in the U.S. could be good for gold

Have real rates in the U.S. stopped rising?

Source: Bloomberg. Data as of February 2, 2016. Past performance does not guarantee future results; please see important disclosures at the beginning of this presentation.
Lower interest rates in the U.S. might also lead to a weaker U.S. Dollar

Source: Bloomberg. Data as of February 2, 2016. See index descriptions at the end of this presentation.
Past performance does not guarantee future results; please see important disclosures at the beginning of this presentation.
Historically, gold has maintained (or increased) value in a world of negative interest rates.

Source: Bloomberg (left); Financial Times, JP Morgan (right). Data as of February 2016.
Past performance does not guarantee future results; please see important disclosures at the beginning of this presentation.
"Clearly, QE has not worked. We have not had one year of 3%+ growth since the Great Recession and are barely averaging 2%. Yes, if your measure is the stock market and other financial assets that have inflated, then QE has worked quite well. But the boost QE was supposed to deliver just hasn't reached Main Street.

One of the basic tenets of QE and other related policies is that if you want to increase consumption, you lower the cost of borrowing. But if out-of-control borrowing was the original problem, then QE as a solution is kind of like drinking more whiskey in order to sober up.

And if you reduce the earnings of those who are savers so that they are no longer able to spend, the whole purpose of the original project - to foster economic growth - is defeated.

But we (central bankers) can't acknowledge that, because if we did, we'd have to admit that our theories don't work. And we all know, because God knows, that our theories are correct."

Is this the beginning of the loss in confidence in central banks?

Source: John Mauldin, Thoughts from the Frontline – Tokyo Doubles Down; Steve Blumenthal, CMG.
Why the mojo: Why are gold shares behaving better?

- Operating costs, which rose during most of the bull market and squeezed profitability, have declined in this current market cycle.
- New leadership now in place across the industry as many CEOs and senior executives were replaced.
- There has been deflation in the costs of labor, material, and services needed in gold mining.
- The currencies of commodity producing countries have fallen hard in 2015-2016.
- **THIS TREND CAN CONTINUE:** Gold equities can benefit in deflationary periods from declining costs of labor and materials. In the 1930s, shares of Homestake Mines (the major gold equity of the time) rose significantly as the company was able to expand profits during this period due to their falling cost structure. Shares of Homestake Mines increased from $65 in 1929 to $544 in 1936.¹

¹Source: Casey Research. Past performance does not guarantee future results; please see important disclosures at the beginning of this presentation.
Gold producer cash costs have come down considerably

- Global producer-reported total cash costs (TCC) for the first nine months of 2015 fell by 7% year-on-year, from $733/ounce to $680/ounce

Past performance does not guarantee future results; please see important disclosures at the beginning of this presentation.
Gold shares have their mojo back:
Leveraged to the price of gold bullion after getting costs under control

Source: Bloomberg. Data as of February 9, 2016.
Past performance does not guarantee future results; please see important disclosures at the beginning of this presentation.
Gold equities currently reflect attractive valuations

Source: Dow Jones, Barron’s (left); Company Reports, Scotiabank GBM estimates (right). Data as of February 2, 2016 (left); February 2016 (right).
Past performance does not guarantee future results; please see important disclosures at the beginning of this presentation.
A technical bottom…?

- Gold shares are down nearly 75% from their 5-year high and off nearly 24% from the 1-year high
- Using February 8, 2016 prices, gold shares still need to rise 30% to get to their 12-month high (after already rising 38% from their low to this point)
- Gold shares need to rise 280% from here to get to their five year highs
Current gold bear market compared to recent cycles since rf c 1970s

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<tr>
<th>Dates</th>
<th>Bull market</th>
<th>Bear market</th>
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<td></td>
<td>Length (months)</td>
<td>Cumulative return</td>
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<tr>
<td>Oct 1976-Feb 1980</td>
<td>41</td>
<td>721.3%</td>
</tr>
<tr>
<td>Mar 1985-Dec 1987</td>
<td>33</td>
<td>75.8%</td>
</tr>
<tr>
<td>Apr 1993-Feb 1996</td>
<td>35</td>
<td>27.2%</td>
</tr>
<tr>
<td>Oct 1999-Sep 2011</td>
<td>144</td>
<td>649.6%</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>63</strong></td>
<td><strong>385.1%</strong></td>
</tr>
<tr>
<td><strong>Median</strong></td>
<td><strong>41</strong></td>
<td><strong>451.4%</strong></td>
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Bull market is defined as a period where the U.S. dollar gold prices rose for at least two consecutive years and bear markets as the subsequent periods where the price generally fell for a sustained time.

†Excludes the period from September 2011 to present.

Past performance does not guarantee future results; please see important disclosures at the beginning of this presentation.
Up to now, recent gold market rallies have lacked lasting global impact

- Gold market rallies short-term on geopolitical or financial risk events
- In 2016, risks in the global financial system could lead to a more sustainable increase in the gold price

Source: Bloomberg, Van Eck Research. Data as of December 31, 2015. See index descriptions at the end of this presentation. Past performance does not guarantee future results; please see important disclosures at the beginning of this presentation.
All indices listed are unmanaged indices and include the reinvestment of all dividends, but do not reflect the payment of transaction costs, advisory fees or expenses that are associated with an investment in a Fund. An index’s performance is not illustrative of a Fund’s performance. Indices are not securities in which investments can be made.

**NYSE Arca Gold Miners Index** (GDMNTR) is a modified market capitalization-weighted index composed of publicly traded companies involved primarily in the mining for gold. The Index is calculated and maintained by the New York Stock Exchange.

**Market Vectors Junior Gold Miners Index** (MVGDXJTR) 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.

**Philadelphia Stock Exchange Gold and Silver Index** (XAU) is a capitalization-weighted index which includes the leading companies involved in the mining of gold and silver.

**S&P 500® Index** (S&P 500) consists of 500 widely held common stocks, covering four broad sectors (industrials, utilities, financial and transportation).

**Gold Spot** (GOLDS Comdty) is quoted as U.S. Dollars per Troy Ounce.

**U.S. Dollar Index** (DXY) indicates the general international value of the U.S. dollar. The DXY does this by averaging the exchange rates between the U.S. dollar and six major world currencies: Euro, Japanese yen, Pound sterling, Canadian dollar, Swedish kroner, and Swiss franc.

**Barron’s Gold Miners Index** (BGMI) consists of publicly traded companies involved primarily in the mining for gold.

The Federal Funds Rate is “the interest rate” in the U.S. at which depository institutions actively trade balances held at the Federal Reserve, called federal funds, with each other, usually overnight, on an uncollateralized basis. Institutions with surplus balances in their accounts lend those balances to institutions in need of larger balances.

Margin Debt is the dollar value of securities purchased on margin within an account. Margin debt carries an interest rate, and the amount of margin debt will change daily as the value of the underlying securities changes.
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