

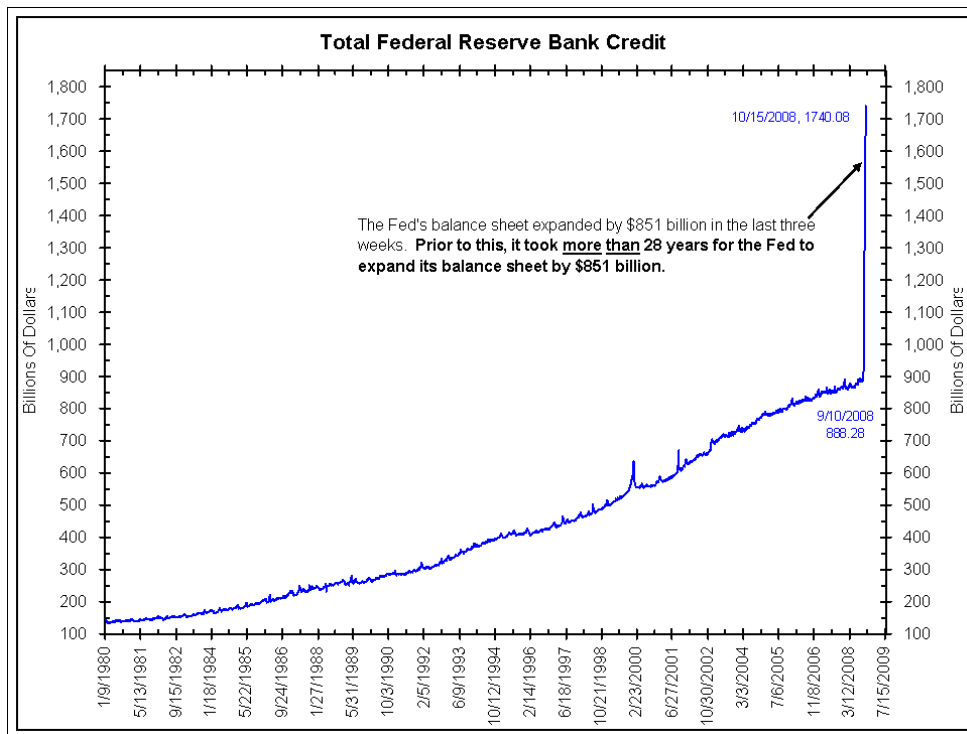


Tocqueville Asset Management L.P.

GOLD THIRD QUARTER 2008 REVIEW October 2008

Gold shares have not escaped the stock market crash. This is disappointing since the gold price itself has held its ground and stands 17.1% above year ago levels. With the decline in commodity prices, especially oil, the cost pressures that have been plaguing gold mining companies are starting to recede and the prospects for improved earnings are good even if the gold price simply stands its ground.

The remedies for the credit crisis are highly inflationary. The Federal Reserve has debased its balance sheet beyond recognition and the U.S. Treasury is well on its way to doing the same. By last count, nearly \$851 billion of high powered money has been created in recent weeks by the Federal Reserve. To put this in perspective, money creation in those three weeks equaled the cumulative amount of money creation of the previous 28 years. (Chart below) The question is when, not if, this money will flow into the economy. When it does, a new cycle of inflation will begin.



Source: Bianco Research, L.L.C.

The U.S. is not alone. World governments are doing their utmost to halt the credit crunch. They can and have created liquidity on an unprecedented scale. However, governments cannot create an appetite for risk in the market place. The willingness to take on risk -- to borrow and to invest -- requires confidence and that is what is missing.

Distrust of financial institutions and government leaders explains why investors are buying gold in record amounts. It explains why yields on government securities are at historic lows, well below reported rates of inflation. These are the unmistakable characteristics of a deflationary spiral. Until financial market fear and paralysis dissipates, it appears that governments will continue to create a flood of liquidity. The tipping point between the deflation of today and the inflation of tomorrow will come when business and consumer confidence recover or, more likely, when foreign holders of U.S. Treasuries sense that the value of their holdings is being undermined by massive money creation. As stated in *Grant's Interest Rate Observer* (10/3/08), U.S. Treasuries are "lottery tickets on a modern debt deflation."

We think the safety of Treasuries is highly suspect. When the emergency, panic-induced government-created liquidity ignites, investors will flee the "safe haven" of Treasuries for tangible assets, especially gold. The objective of government policy, here and abroad, is to effect a transition from the current deflationary tide to one of inflation. There is little doubt that the dollar based system of credit, which has underpinned the world economy for the last several decades, is falling apart before our eyes. Its viability depended entirely on faith, and that has been displaced by distrust and skepticism almost overnight. Policy authorities believe that their only option is money creation and that is what they are doing at a pace so feverish that it is impossible to keep up with the events.

What lies ahead: a deepening deflation or a government engineered inflationary boom? Time will tell, and in our opinion, sooner rather than later. Either outcome would result in a major demotion of the U.S. dollar as the pillar of world commerce. The *Financial Times* headline of 10/16/08 said: "European call for Bretton Woods II." Similar proposals have come from Asia. It is hard to imagine a new world financial order without participation by gold.

Gold shares have become disconnected with the gold price and are being sold for the sake of liquidity. It is important to remember that gold mining shares represent claims on gold in the ground. Earnings are driven primarily by the price of gold. We expect the resolution of the current credit crisis to include a substantial and permanent rise in the gold price. In the process, we believe gold mining shares will undergo a significant rerating. Our gold share holdings are demonstrably cheap based on current gold prices and offer significant upside tied to the price of the metal.

The current environment, stressful though it may be, is presenting value opportunities that we have not seen since the bull market in gold commenced prior to 2000. Forced selling and panic liquidations translate into enormous value opportunities. Our research and due diligence on gold mining companies continues unabated to position client portfolios for what we anticipate is an impending upsurge in the gold price.

We are disappointed that the shares and the metal have not responded more favorably to the credit crisis. However, we believe the story is far from over and that the significant correction in the gold share sector is prologue to a dynamic advance.

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