# Manager Commentary: On the Gold Market

## Gold posted new high on May 2, ended month at $1,535.80/ounce

### By: Joe Foster, Portfolio Manager, Van Eck International Investors Gold Fund

**Fund Review**

The Fund's Class A shares decreased by -6.46% for the one-month period ending May 31, 2011 (excluding sales charge), while the NYSE Arca Gold Miners Index (GDM) lost -6.58% for the same period.

| Average Annualized Returns (%) as of May 31, 2011 | | | | |
|---|---|---|---|---|
| | 05/11[1] | 1 Yr | 5 Yr | 10 Yr |
| Class A: NAV (Inception 02/10/56) | -6.46 | 29.76 | 18.85 | 28.53 |
| Class A: Maximum 5.75% load | -11.84 | 22.28 | 17.46 | 27.77 |
| GDM Index | -6.58 | 18.29 | 9.64 | -- |

| Average Annualized Returns (%) as of March 31, 2011 | | | | |
|---|---|---|---|---|
| | 03/11[1] | 1 Yr | 5 Yr | 10 Yr |
| Class A: NAV (Inception 02/10/56) | 1.80 | 50.71 | 20.30 | 30.38 |
| Class A: Maximum 5.75% load | -4.05 | 42.05 | 18.88 | 29.62 |
| GDM Index | 0.61 | 37.42 | 10.40 | -- |

[1]Monthly and quarterly returns are not annualized.

**Expenses: Class A: Gross 1.25%; Net 1.25%.** Expenses are capped contractually until 05/01/12 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 reached an all-time high of $1,577 per ounce on May 2. Later that day, the CME Group raised its margin requirement for Comex silver futures. This triggered a sell-off in silver as well as other commodities. Increasing margin in response to high prices is normal exchange protocol. We believe silver had become overbought due to speculation and the margin announcement was simply a catalyst that enabled the market to begin to consolidate its gains. After topping near $50, silver fell to $32 per ounce on May 12. Gold fell to its low for the month of $1,462 per ounce on May 5, then trended higher to close at $1,535.80 per ounce for a loss of $27.90.

Despite the sell-off, there were several positive developments for the gold market. The World Gold Council reported an 11.4% increase in global gold demand in the first quarter 2011 with improvements in jewelry consumption as well as investment buying. This highlights one of the differences between gold and other commodities. As a monetary asset, gold does not respond to the same supply/demand fundamentals. Rather than demand destruction at high prices, demand has been expanding as people on every continent are finding a need to use gold as a store of wealth.

Foreign creditors holding U.S. Treasuries must contend with low yields, while at the same time face a generally depreciating currency – not an appealing investment for some. Reserve assets of most central banks around the world have a large allocation to U.S. Treasuries. Emerging nations such as China, Russia and India have made large purchases of gold to help diversify away from the U.S. dollar. The International Monetary Fund (the "IMF") reported that Mexico added about 100 tonnes of gold to its foreign exchange reserves in the first quarter. This is the first major gold purchase by a nation in the western hemisphere in many years and further establishes a pattern of central bank buying.

Utah passed the Legal Tender Act of 2011, which makes it legal for its residents to use gold or silver coins as cash with their value based on weight (i.e., true value) rather than face amount. Several other states are considering similar laws. At this point the new law is symbolic, intended to send a strong message to Washington that failed monetary and fiscal policies could lead to severe currency debasement. These states wish to provide a currency alternative that

holds its value. Meanwhile, the European Parliament's Committee on Economic and Monetary Affairs agreed unanimously to allow central counterparties to accept gold as collateral. Ratification of the new regulation may come in the second half. This follows a handful of major banks, exchanges, and clearing houses which now take gold as collateral. All of this points to the growing use of gold as a medium of exchange on par with paper currencies around the world.

The sovereign debt crisis in Europe continues to lend support to the gold market. The focus returned to Greece and how to avoid a default that bankrupts peripheral EU nations, their banks, and their counterparties throughout Europe. Even after a €110 billion bailout last year, Greece is still set to run out of funds in mid-July, then again in 2012, and again in 2013. Standard and Poors cut Greece's long-term credit rating to single-B. Now, in our opinion, another bailout deal to avert a default looks likely. In a recent strategy publication, BMO Capital Markets economist Don Coxe summarized "The euro is the first paper currency without the specific, unconditional backing of any government, taxation system, army or navy. It is backed only by a theory …". On May 25, 2011, the Euro price of gold rose to a new all-time high of €1086.

### Market Outlook

We are often asked if gold and other commodities are a bubble that is about to burst. It's a good question. The Federal Reserve Bank (the "Fed") has kept interest rates artificially low for a prolonged period. We believe this has caused real rates to remain negative, dollar weakness, and hot money to flow into emerging markets. If the price of money is set too low, individuals and corporations are encouraged to borrow, as there is no perceived cost to them. Government's propensity to borrow and spend seems to know no bounds. The result can be overinvestment and overconsumption – a bubble. Bubbles of global significance are rare. We characterize gold in 1979, the Japanese real estate and stock markets in 1989, tech stocks in 1999, and U.S. real estate and credit markets in 2007 as bubbles. A bubble is a mania where certain investments become popular across a wide spectrum of investors and prices move to very high valuations. Signs of impending doom might be when a tech stock IPO doubles or triples, then another IPO does the same, and another and another. Or when your neighbor lists their house on Monday and it sells above the ask price in a three-way bidding war on Tuesday.

It is hard to imagine a bubble in gold when gold shares have underperformed the metal by 13% in 2011 and gold stock valuations are at historic lows. Glencore is a large mining and metals trading company valued at $59 billion at its IPO in May. The company generated $4.4 billion in operating profits last year and is expected to generate around $10 billion by 2012. Amid a historic bull market for commodities, Glencore's stock ended the month down 3.0% from its IPO price. It seems investors should look elsewhere for a bubble.

LinkedIn is a social networking website valued at $4.2 billion at its IPO, also in May. The company generated $243 million in revenue and net income of $15 million in 2010. The stock more than doubled the day of the IPO and ended the month with an 81.3% gain. Why did this outperform Glencore? Did LinkedIn and its bankers grossly misprice the IPO or is the market grossly overvaluing the stock? Is this bubble material? No one knows with certainty how to recognize a bubble in a post-credit crisis economy. With high unemployment and sluggish growth, perhaps a mania will be more subdued – a stealth bubble? Maybe it arises overseas with little recognition – a tsunami bubble? Can the Fed's meddling in the debt markets create a treasury bubble? If the massive government stimulus since 2008 is creating a more subtle bubble, will the crash be as devastating? History may prove these concerns over a bubble to be unfounded. Nonetheless, these questions allude to some of the risks in the financial system, which creates an environment that may continue to draw investors to gold.

Gold entered a period of consolidation in May. Since 2008, consolidations in the gold market have been relatively mild, as buying from emerging markets placed a floor under the price. We would like to be buyers at lower levels, but our concern is that this correction proves to be another shallow one. Some thought the end of QE2 and an improving economy would create dollar strength and weakness for gold. That outlook is unraveling as recent data shows the economy may be entering another period of decline. Both service and manufacturing sector ISM indices were below expectations, as was industrial production and durable goods. Home values and housing starts fell again. Revised Q1 GDP was below expectations and ADP employment showed a deceleration in hiring activity. Perhaps prices at the gas pump have something to do with it. Meanwhile, the May countertrend rally in the U.S. Dollar Index (DXY) has rolled over already. We have said that analysts may be talking about "QE3" in the fourth quarter 2011 if the economy slows without the help of fiscal or monetary stimulus. Now, perhaps we will hear such talk in the third quarter. Given recent history, we believe it is likely that the government will respond if the economy weakens. Gold could react positively to any indication of further Fed stimulus.

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