Manager Commentary: On the Gold Market

Continued resilience of gold market in December ends volatile 2014

By: Joe Foster, Portfolio Manager

Fund Review

The International Investors Gold Fund's Class A shares returned 0.76% for the one-month period ending December 31, 2014 (excluding sales charge), while the NYSE Arca Gold Miners Net Total Return Index (GDMNTR)[1] returned 0.35% for the same period. The Fund is actively managed and invests mainly in gold-mining equities. Geologist Joe Foster has been part of Van Eck's gold investment team since 1996. The Fund is managed by a specialized investment team that conducts continuous on- and under-the-ground research to assess mining efficiencies and opportunities.

Average Annual Total Returns (%) as of December 31, 2014

	1 Mo^	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 1/1/56)	0.76	-6.10	-12.47	4.13
Class A: Maximum 5.75% load	-4.99	-11.50	-13.49	3.51
GDMNTR Index	0.35	-11.76	-15.66	-2.01

Average Annual Total Returns (%) as of September 30, 2014

	1 Mo^	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 1/1/56)	-20.10	-8.66	-7.91	5.61
Class A: Maximum 5.75% load	-24.72	-13.88	-8.99	4.99
GDMNTR Index	-19.78	-13.58	-12.87	-0.99

^Monthly returns are not annualized.

Expenses: Class A: Gross 1.46%; Net 1.45%. Expenses are capped contractually until 05/01/15 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. **Investing involves risk, including loss of principal; please see disclaimers on next page. Please call 800.826.2333 or visit vaneck.com for performance current to the most recent month ended.**

Market Review

The recent list of gold detractors was at work again in December: the U.S. Dollar Index (DXY)[2] advanced to new highs for the sixth month in a row; the crash in crude oil prices that began in October continued unabated; the S&P 500® Index[3] reached another record high; and gold bullion exchange-traded products had their fourth straight month of net redemptions. Despite all of that, gold continued to show remarkable resilience, holding around the $1,200 per ounce level. It ended the year at $1,184.86 per ounce for a December gain of $17.45 (1.5%). Helping to support gold have been reports of strong physical demand from Asia, particularly in India, in November. Also, contrary to media speculation that Russia might sell gold to help stabilize its currency, the International Monetary Fund (IMF) reported in November that Russia purchased 19 tonnes, which followed a similar amount of buying in October. Russia now holds about 1,169 tonnes of gold, equivalent to $45 billion, or approximately 10% of their foreign reserves. We would not take rumors of Russian gold sales seriously because such sales would likely be perceived as an act of desperation internationally and internally. We believe it would also go against positioning that President Putin has taken to develop alternatives to the U.S. dollar.

The 0.35% gain in the NYSE Arca Gold Miners Index (GDMNTR) indicates that the stocks of the gold producers were essentially unchanged for the month. Junior gold stocks suffered some year-end selling pressure as shown by the 5.1% loss for the Market Vectors Junior Gold Miners Index (MVGDXJTR)[4].

In our opinion, it was certainly an odd year for the gold market. There was a stark contrast in the drivers of performance between the first eight months and the final four months. Positive momentum had developed for the year through August, driven mainly by geopolitical risk that culminated with the Russian annexation of Crimea and the advances of the Islamic State in Syria and Iraq. Gold gained 6.8% through August, while gold stocks were also having a stellar year, shown by the 26.8% and 36.4% gains in the GDMNTR and MVGDXJTR, respectively.

All of this positive momentum has unraveled since August. The markets began to focus on macro-economic drivers beginning in early September when the European Central Bank (ECB) announced a surprise cut in interest rates and ECB president, Mario Draghi, indicated that quantitative easing (QE)[5] might be necessary to battle deflationary pressures in Europe. This, combined with similar monetary policy developments from the Bank of Japan (BOJ), economic weakness in emerging markets, and economic strength in the U.S. has caused the U.S. dollar to soar.

In addition, the collapse of crude oil prices has created negative pressure on commodity prices in general. As a result, since August, gold is down 8.0%, while gold stocks took a hard fall, shown by the 30.3% decline in the GDMNTR and 41.9% drop in the MVGDXJTR.

Netting out the good and the bad, gold finished 2014 with a loss of $20.79 (1.7%); however, the GDMNTR fell 11.7% and the MVGDXJTR declined 20.8%. While we are very disappointed with the performance of the gold stocks, we are surprised at the magnitude of the loss given the steady improvements in company fundamentals. The fact that gold companies have shown significant progress in controlling costs and hitting production targets in our view meant nothing as the gold market sold off. Nonetheless, earlier performance through August showed what the stocks were capable of in a positive market.

While gold finished down in U.S. dollar terms, in most currencies around the globe gold provided handsome gains in 2014. Some of the better performers include Mexico, Japan, Brazil, and the Euro block, all of which saw double digit gold returns in the 10% to 12% range in local currencies. Russia was the star, where gold gained 74% for the year in Ruble terms.

Market Outlook

Except for a sluggish housing market, economic reports issued in December showed the U.S. economy in overall good shape. Payrolls, manufacturing, auto sales, retail sales, and consumer sentiment all came in above expectations. It appears Americans are enjoying cheap energy prices and have repaired their balance sheets. The Federal Reserve Bank (the "Fed") reports that household debt as a percentage of disposable income is at levels last seen in 2003. Third quarter gross domestic product (GDP)[6] was revised higher to 5.0%. The Organization of the Petroleum Exporting Countries (OPEC)[7] seems powerless to prevent a further slide in oil prices. Monetary policy makers, mainly in Europe and Japan, are set to open the cash spigot by the most in four years. Credit Suisse figures that in 2015 the top four central banks will pump at least $1.3 trillion into the financial system through QE. With U.S. interest rates among the highest of developed countries and the Fed poised to raise rates, in our opinion there is a good chance that much of this QE winds up in U.S. assets. The parabolic rise the U.S. dollar has experienced since September looks set to continue, inflation is nowhere in sight, and the stock market is strong. We believe it is hard to argue with anything but a rosy outlook for the U.S. economy.

This is not a good macro-economic environment for gold, in fact, we could scarcely imagine a worse scenario. In order to see lasting strength in the gold price, typically investors must sense problems with the U.S. economy or fundamental cracks in the U.S. financial system. Without these, are there any opportunities for gold investors?

First, in my opinion, gold should be used mainly as a portfolio diversifier and hedge against tail risk. It has little correlation with other financial assets. When other parts of a portfolio are doing well, expect gold to perform poorly. Conversely, when mainstream investments struggle, gold may perform well. We think of gold as a form of portfolio insurance. Just ask anyone in Russia holding gold if they are happy to have it in their portfolio this year. As turns in the gold market are notoriously difficult to time, many investors simply keep gold as a permanent allocation.

Secondly, the rosy outlook expressed earlier is not new. Elements of it were a factor when gold first collapsed in April 2013. The improving U.S. economy is now reality and part of the broader market consensus. Much of this outlook may already be in the gold price. This could be the reason gold is proving so resilient around the $1200 per ounce level where it has hovered for the past 18 months. Physical demand from Asia seems content to accumulate gold around these levels. Perhaps the gold price is biding time until events unfold that generate the next consensus—when the post-rosy outlook comes into view.

Finally, over the course of 2015, we believe it is possible that the outlook could become even rosier as the global economy responds to QE and joins the U.S. in a blissful world of synchronized global growth. This scenario would probably be a further nightmare for gold. However, despite the good intentions of policy makers, there are a number of risks that might keep this scenario from happening. The most immediate risk is the election in Greece currently set for late January, which may produce a government that is hostile towards European Union austerity and may seek to default on sovereign debt.

Looking further out, in our view, Russia has proven itself unpredictable and willing to engage in aggression that goes against Western norms. Low oil prices could weaken the Russian economy to some sort of breaking point where leadership becomes increasingly irrational and disruptive to the global economy.

In our view, the biggest risk to financial well-being are the radical monetary policies that are ongoing. While the Fed has ended QE, the BOJ and ECB are expected to print Yen and Euros that amount to over a trillion equivalent U.S. dollars to buy sovereign bonds and other financial assets. The Swiss National Bank has introduced negative interest rates aimed at devaluing the Swiss franc. The intended benefit to local economies may not materialize. In the U.S., QE was effective at pumping up asset prices that mainly benefited the wealthy, but, in our view, was not so good at stimulating the real economy from the bottom up. Last month, we questioned whether bubbles have formed in luxury condos, art, tech stocks, and bonds. The new ECB and BOJ liquidity and rate cuts could unintentionally fuel further excesses in the U.S. where returns are relatively attractive and foreign investors could be led to invest in a reach for yield.

While the consensus is calling for Fed rate increases in 2015, since the 2008 credit crisis the Fed has always found a reason to postpone the increase. There are some interesting parallels between the current global economy and that of the 1997 – 1998 Asian financial crisis. Both periods share weak economies in Asia and Russia, falling commodities prices, and a robust U.S. economy. The late '90s saw the tech revolution, while today we are experiencing a revolution in energy through unconventional drilling technology. Despite the strong U.S. economy and benefits of technology, the Fed chose to cut rates in late 1998 in response to the weak global economy and a sharp drop in U.S. stocks. This helped propel a bubble in tech stocks that collapsed catastrophically less than two years later. It will be interesting to see whether international events again influence the Fed to pursue accommodative policies in 2015, as it did in 1998.

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[1]NYSE Arca Gold Miners Index (GDMNTR) is a modified market capitalization-weighted index comprised of publicly traded companies involved primarily in the mining for gold. [2]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. [3]S&P 500® Index consists of 500 widely held common stocks covering industrial, utility, financial, and transportation sectors. [4]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. [5]Quantitative easing (QE) is an unconventional monetary policy used by a central bank to stimulate an economy when standard monetary policy has become ineffective. [6]Gross Domestic Product (GDP) estimates are commonly used to measure the economic performance of a whole country or region, but can also measure the relative contribution of an industry sector. [7]Organization of the Petroleum Exporting Countries (OPEC) is an international organization and economic cartel whose mission is to coordinate the policies of the oil-producing countries.

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