



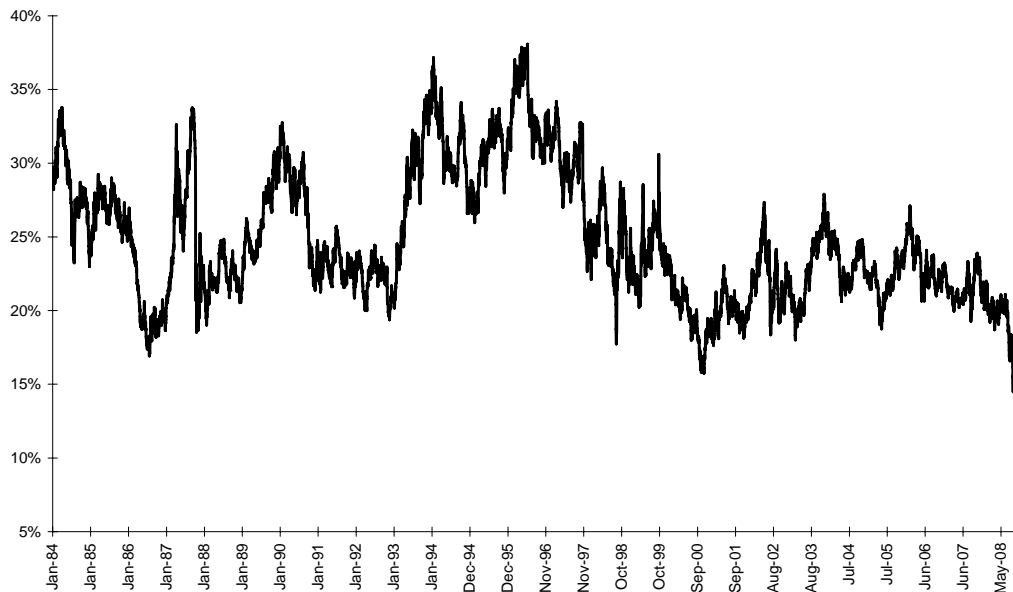
Tocqueville Asset Management L.P.

2008 Year-End Investor Letter

January 2009

In this most tumultuous year for the financial markets, gold bullion rose 5.8%. In so doing, it outperformed all asset classes and investment strategies other than unadulterated short selling. Unfortunately, gold shares lost their traditional connection to the gold price and behaved like stocks. The benchmark XAU index declined 27.7%, and small cap gold stocks did much worse. The chart below depicting the relationship between gold shares and the bullion price shows that gold shares became more undervalued relative to bullion than at any point in the past 25 years.

XAU (PHLX Gold/Silver Sector Index) as a Ratio of Spot Gold (\$/oz)
(Jan. 1984 - Dec. 2008)



Source: Bloomberg

Even though the price of gold bullion rose in U.S. dollar terms, its performance was disappointing in light of the dramatic collapse of high profile financial institutions; the rapidly sinking global economy; the aggressive policy responses by world governments to rampant deflation; and, the obvious disarray in public policy. Surely, in our view, this witches' brew of misfortune should have driven the gold price well above \$1000/oz.

Those of us who confess to disappointment in gold's performance failed to appreciate the power of deflation and the implications of a complete breakdown in all mechanisms for the transmission and distribution of credit. The final six months of 2008 demonstrated unequivocally the dependency of incomes, including individual, corporate and government, on credit in a highly leveraged economy. The hard lesson of this period was that credit = incomes = asset prices.

Credit appears to hang on the slender thread of emergency life support supplied by gullible taxpayers believing in the magic of regime change. As long as asset prices and incomes sink, it seems most unlikely that profit oriented lending institutions will extend a penny of additional credit to borrowers previously deemed creditworthy. The prescription of choice appears to be a government cure likely to be worse than the disease. In this scenario, we find the only question to be the date on which the rubber finally hits the road. When it does, dreaded deflation may well be vanquished by epic inflation.

The investment world huddles today in the perceived safety of cash and treasury bills, accepting non-existent yields in hopes of further dollar appreciation and lower interest rates. In light of record money creation and fiscal stimulus, what strategy could be more ill-advised? The unstated objective of government economic stimulus would seem to be currency devaluation. Success will be defined as inflation that alleviates debt burdens to a degree sufficient to rekindle the appetite for risk in the private sector. Since nobody knows in advance how much inflation is required, it is more than likely that policy makers will overshoot their objective. The results could well be of Weimar proportions.

Gold bullion has held up its end of the bargain, preserving capital in the most adverse financial climate in nearly a century. Moreover, it has risen for eight consecutive years against all paper currencies. Now, world governments have embarked on a crusade to slay deflation via overt currency debasement. It is difficult to think that gold bullion will suddenly turn into a wallflower. In a January 5, 2009 *Financial Times* editorial, noted economist David Hale stated:


There is no country that wants its exchange rate to appreciate. The clear alternative to the dollar in 2009 is not other currencies but that ancient form of money: gold. Precious metals could emerge as a hedge for investors suspicious of central banks and fearful that inflation will be the simplest solution to the challenge of global deleveraging.

Gold shares have historically provided leverage to the gold price. 2008 was the exception that can be explained by margin calls on equities of all descriptions. On several occasions last year we stated that gold shares would come to life once the \$1000/ounce threshold was no longer regarded as a ceiling but as a floor. Shifts in macroeconomic thinking occur these days within nanoseconds. In our view, this particular shift is likely to occur during the nanosecond commonly known as 2009 AD.

Most investors seem willing to wait for clear evidence that the transition from deflation to whatever lies ahead is complete. However, we believe that the rewards of anticipating what seems likely to happen by making an allocation to the gold sector outweigh the clear risks of

sitting tight on a pile of cash and other supposedly “safe” assets. We look forward to much improvement for gold and gold shares in 2009.

With best wishes,

A handwritten signature in black ink, appearing to read 'John Hathaway', with a stylized, cursive script.

John Hathaway
Portfolio Manager and Senior Managing Director
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