



SPECIAL GOLD REPORT



How Government Policies Affect Gold's Fear Trade

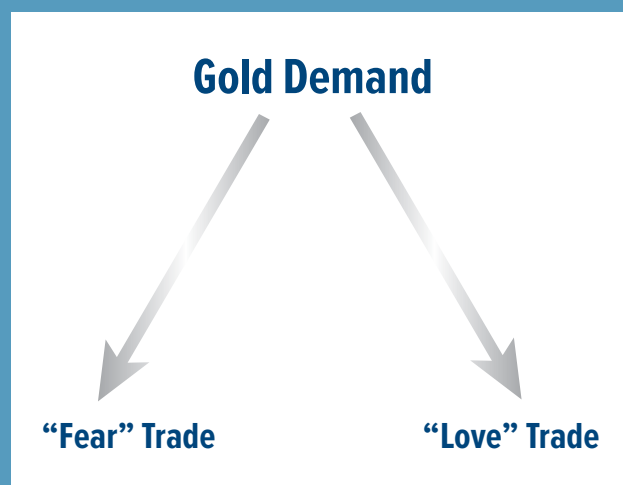
As real interest rates experience an ongoing normalization resulting from a lack of inflationary pressure in developed markets, the bear case for gold seems to be gaining strength. However, this assessment could be premature, causing investors to potentially lose out on a lucrative position in gold.

KEY POINTS:

- Of the two demand drivers, the fear trade sees gold as a store of value.
- Real interest rates play a huge role in gold demand.
- With today's unemployment situation and narrow housing recovery, we expect the Federal Reserve to keep rates low to stimulate the economy.
- While the consumer price index experienced wild swings from 1870 to 1980, a change in reporting may be manipulating true inflation.
- For long-term investors looking for a great portfolio diversifier, gold and gold stocks may be an answer.

There are two gold demand drivers.

The first driver is the Love Trade, which is a group of buyers who purchase gold as gifts for loved ones during holidays and festivals. The other driver is the Fear Trade that buys gold out of fear of war or concern over government policies. This group primarily sees gold as a store of value.



One of the strongest drivers of the Fear Trade in gold is real interest rates. Whenever a country has negative-to-low real rates of return, which means the inflationary rate (CPI) is greater than the current interest rate, gold tends to rise in that country's currency.

Our model tells us that the tipping point for gold is when real interest rates go above the 2-percent mark. Historically, gold and silver performed well in a low or negative real interest rate environment.

Consider the ice cube, which shows how new equilibriums can have significant effects. At 31 degrees, H₂O is a solid chunk, but when the temperature increases, the mass slowly begins to turn into a liquid. Above 32 degrees, ice changes form from solid to liquid, but it's still made of hydrogen and oxygen.

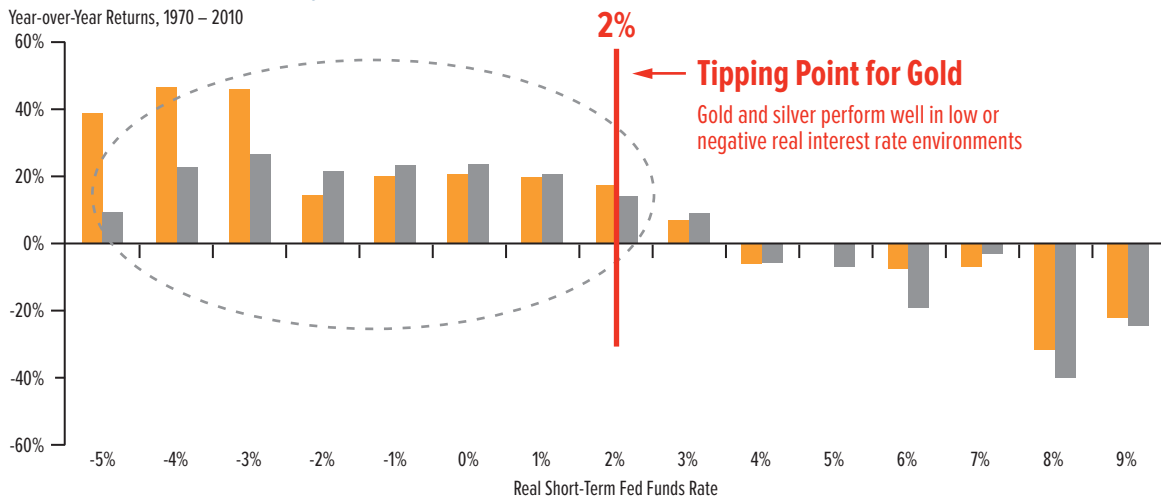
Because money is like water, when many other economic dynamics, such as population growth, urbanization rates and changes in government policies, reach their tipping point, the velocity of money tends to be altered.

As global investors, we watch for changes in these trends to know how to invest in commodities and markets, find new opportunities and adjust for risk.

So, how close to gold's tipping point are we? In other words, what is the real interest rate today? As of July 2014, the 5-year bill yields 1.74 percent and inflation sits at 2.1 percent, making the real interest rate a negative 0.36 percent.

Low Real Interest Rates Historically Fueled Gold

Year-over-Year Returns, 1970 – 2010



Source: Bloomberg Finance LP, Deutsche Bank, U.S. Global Investors



If real interest rates solidly crossed the 2 percent threshold and remained above that tipping point for an extended amount of time, it would likely have a negative effect on gold as an asset class. In a high interest rate environment, gold and silver lose their attraction as a store of value.

In order for that tipping point to happen, rates would need to continue rising above inflation, and inflation would need to remain low. These are the forecasts made by many gold bears today; however you might not want to get too trigger happy just yet, as recent data challenges these assumptions.

Take the monthly unemployment figure, which is one of the primary indicators the Federal Reserve studies when evaluating the economy. But depending on the definition of an unemployed person, the numbers reveal different results.

The official U3 unemployment rate, the exact figure the Fed uses, tracks the total unemployed as a percent of the civilian labor force.

The broadest gauge calculated by the Bureau of Labor Statistics (BLS) is the U6 unemployment rate. For this number, the BLS adds in all those people who are marginally attached to the labor force, plus people working part-time but want to work full-time.

What does “marginally attached to the labor force” mean? These people are neither working nor looking for work but indicate they want a job, are available to work and have worked during some period in the last 12 months. These marginally attached people also include discouraged workers who are not looking for work because of some job-market related reason.

Destructive Force of Inflation

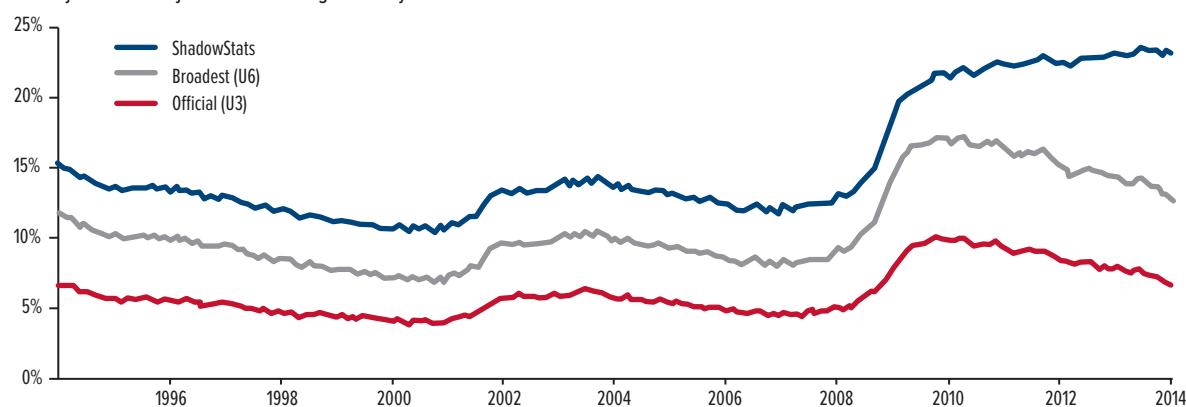


Source: Data from Bloomberg, U.S. Global Investors
5-Year Treasury Yield as of 7/4/14
Inflation as of 5/30/14

Williams' ShadowStats
unemployment rate
shows a noticeably
upward trajectory.

Official vs. ShadowStats Alternate Unemployment Rate

Monthly Seasonal-Adjusted Rate Through January 2014



Source: shadowstats.com, BLS, U.S. Global Investors

Then there's a measure of the labor market the BLS tracked prior to 1994. This is the seasonally-adjusted alternate unemployment rate that statistician John Williams continued to calculate. It's basically the U6 plus long-term discouraged workers.

While the figures closely followed one another from 1994 through 2009, there's recently been a shift. U3 and U6 have been trending downward over the past few years, whereas Williams' ShadowStats unemployment rate shows a noticeably upward trajectory. Perhaps the official unemployment figure overstates the health of the economy?

Beyond the jobs market, there's been a limited housing recovery that has been slowing down the flow of money. Many people don't realize that the recent real estate market boom was narrowly focused. According to Goldman Sachs research, more than half of the homes sold in 2012 and throughout the first seven months of 2013 were bought with cold hard cash.

In July of last year alone, there were sections of the country that saw significant levels of homes bought with cash. In Florida, "nearly two-thirds of home sales were completed without a mortgage loan," says USA Today. In Nevada, about 65 percent of buyers paid with cash, followed by Maine, where nearly 60 percent of house sales were cash. We would question whether regulation in the banking industry has made the process of getting a mortgage too burdensome for families.

Housing is one of the biggest multipliers for jobs, where \$1 spent in housing results in about \$16 in related economic activity. When interest rates are low, more people apply for mortgages. They build houses, employ moving services and buy new

furniture, which in turn employs more people in multiple industries.

But after interest rates rose quickly, the housing market came to a halt. People who once qualified for a mortgage to build a new home no longer qualify at the higher rates, meaning a potential inventory of new housing may unexpectedly build.

At the same time, big banks are announcing layoffs in mortgage lending. In September, Wells Fargo announced it was going to lay off 1,800 employees as refinancing activity continues to slow. The company had already told 2,300 workers to stop coming to work as rising interest rates curtail demand for new mortgages and refinancing.

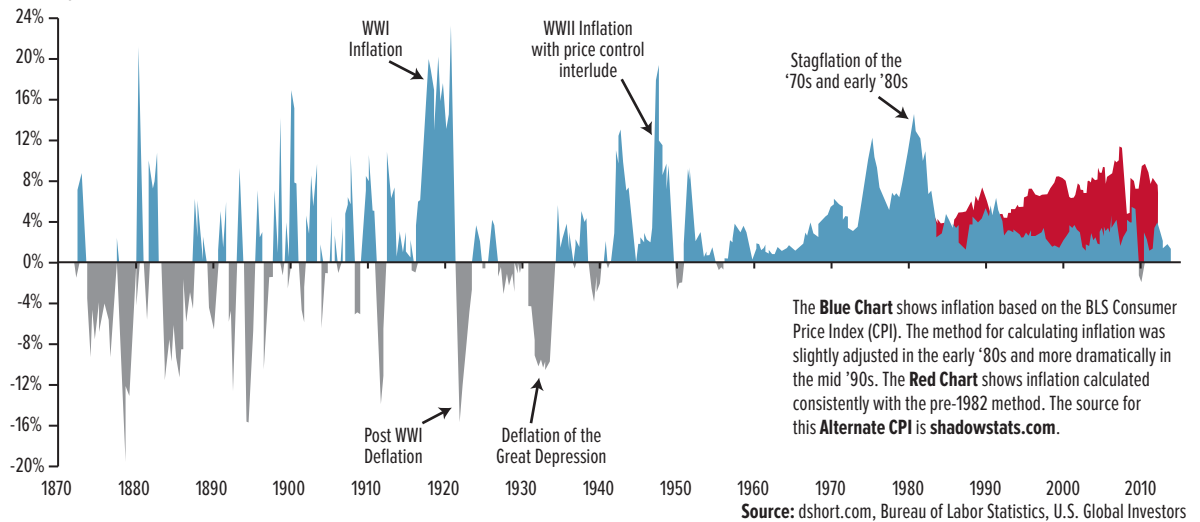
So instead of the Fed quickly tapering its bond purchases and raising rates, this process will likely be very gradual. We believe the government will have to keep interest rates low to stimulate the economy.

Then there's the suggestion of inflation manipulation. Even though the U.S. has been reporting a low inflation number, things feel more expensive to many Americans. Inflation has been growing at a faster pace than disposable income in recent years; perhaps that's why many people feel "squeezed."

Consider Williams' chart on the next page. It shows monthly inflation data going back for more than a century. The blue and grey shaded areas represent BLS' historical Consumer Price Index (CPI). You can clearly see the wild swings of inflation and deflation, especially during World War I, the Great Depression, and World War II, as well as the stagflation of the 1970s and early 1980s.

Is Today's Inflation Manipulated?

Monthly Inflation from 1872 to Present



However, shortly after disco, bell bottoms, and episodes of "All in the Family" faded from memory, the U.S. adjusted CPI, not once but twice, first in the early 1980s and again in the mid-1990s. If you use the pre-1982 calculation, you end up with a much different inflation picture. This is the area shaded in red.

What Deflation?

Deflation talk is "overdone," says David Rosenberg of Gluskin Sheff. In one of his daily notes, he found it difficult to reconcile deflation with the latest data on wages and prices, as labor costs and various inflation expectation readings have been trending up.

In addition, according to a release by the Cleveland Fed, there's been a recent increase in Fed-implied inflation, measured by the spread between Treasury Inflation Protected Securities (TIPS) and similar maturity Treasury Notes. This could be signaling an imminent rise in inflation, as Rosenberg finds the

five-year inflation expectation measure reported by the Cleveland Federal Reserve has an incredible 99 percent correlation with actual inflation. As you can see, this particular reading bottomed in March and is now at the highest level since July 2011.

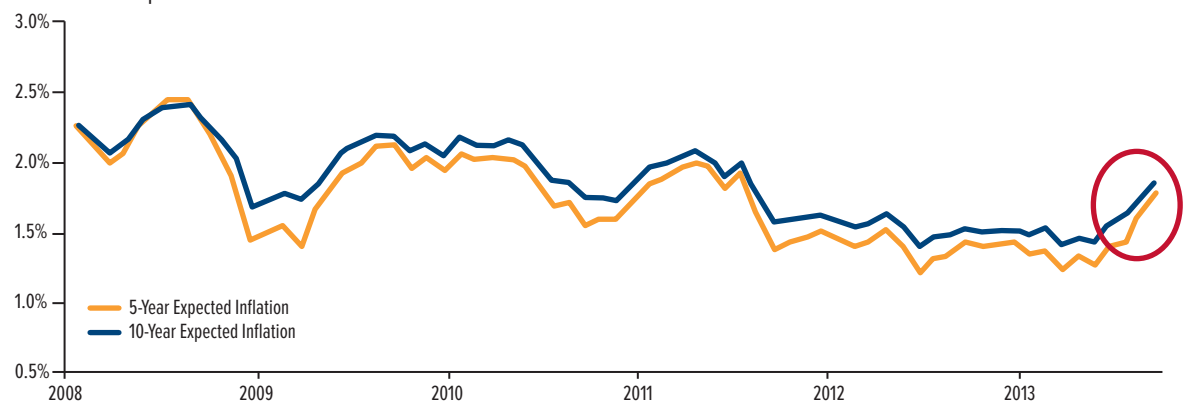
Figures don't lie, but liars figure.

Way back in 1889, statistician Carroll D. Wright, in addressing the Convention of Commissioners of Bureaus of Statistics of Labor, talked about the impartial and fearless presentation of its data. He said, "The old saying is that 'figures will not lie,' but a new saying is 'liars will figure.' It is our duty, as practical statisticians, to prevent the liar from figuring; in other words, to prevent him from perverting the truth, in the interest of some theory he wishes to establish."

When reviewing today's inflation and deflation data, Wright's speech seems particularly relevant.

Will Rising Inflation Rates Drive Gold Higher?

Cleveland Fed Expected Inflation Estimates



Source: Cleveland Fed, U.S. Global Investors



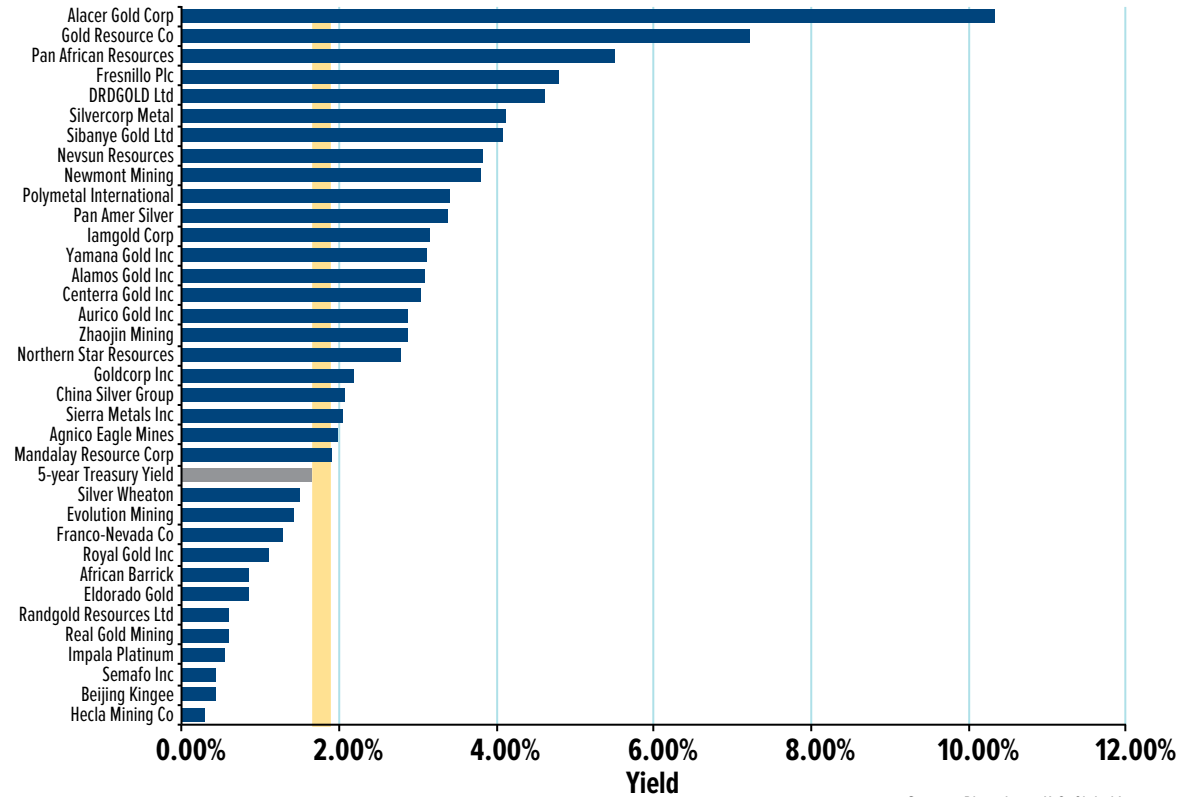
Dividend-Paying Gold Companies as a Solution to Government Policies

For patient, long-term investors looking for a great portfolio diversifier, gold and gold stocks may be just the answer. To manage the inherent short-term rallies and corrections, we suggest investors maintain a modest weighting of 5 to 10 percent in gold and gold companies and rebalance once a year.

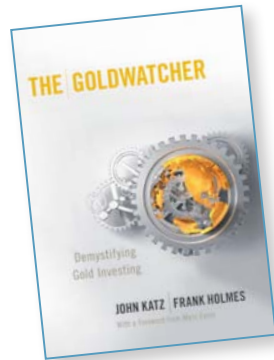
Today, there’s an additional reason to hold gold equities. Over the past decade, the world’s top gold miners have increased their dividends. Now, you can find plenty of companies that have paid attractive dividends, many higher than the 5-year government yield, currently sitting at 1.74 percent.

Dividend-Paying Gold Companies

12-Month Trailing Dividend Yield



Source: Bloomberg, U.S. Global Investors



The Goldwatcher: Demystifying Gold Investing

Frank Holmes, one of the world's authoritative voices on gold, is co-author of this fascinating book. Gold does not yield interest, dividends or rental income, and it costs money to hold. Yet, its price has surged to record levels in recent years. Why is that, and how can investors put gold to work in their portfolios? Available wherever books are sold, including amazon.com.



Special Gold Report: Time to Mine for Gold Mining Opportunities?

Since the recent collapse of the gold price, miners were given a final wake-up call, precipitating major cost control initiatives across the industry. These measures will likely tighten gold supply and, with demand for gold unhindered, higher prices are likely. Learn more about the gold mining industry in this special report. Call us to request the report at 1-800-US-FUNDS.

Please consider carefully a fund's investment objectives, risks, charges and expenses. For this and other important information, obtain a fund prospectus by visiting www.usfunds.com or by calling 1-800-US-FUNDS (1-800-873-8637). Read it carefully before investing. Distributed by U.S. Global Brokerage, Inc.

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The Consumer Price Index (CPI) is one of the most widely recognized price measures for tracking the price of a market basket of goods and services purchased by individuals. The weights of components are based on consumer spending patterns. Diversification does not protect an investor from market risks and does not assure a profit.

There is no guarantee that the issuers of any securities will declare dividends in the future or that, if declared, will remain at current levels or increase over time. Note that stocks and Treasury bonds differ in investment objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return, and tax features.

Fund portfolios are actively managed, and holdings may change daily. Holdings are reported as of the most recent quarter-end. Holdings in the Gold and Precious Metals Fund (USERX) and the World Precious Minerals Fund (UNWPX) as a percentage of net assets as of 6/30/2014: Agnico Eagle Mines Ltd. (USERX 1.61%, UNWPX 0.57%); Alacer Gold Corp. (USERX 2.46%); Alamos Gold Inc. (UNWPX 0.06%); Aurico Gold Inc. (USERX 1.76%, UNWPX 0.38%); Barrick Gold 0.00%; Beijing Kingee 0.00%; Centerra Gold Inc. 0.00%; China Silver Group Ltd. 0.00%; DRDGold Ltd. (USERX 0.46%); Eldorado Gold Corp. (USERX 1.81%, UNWPX 0.43%); Evolution Mining 0.00%; Franco-Nevada Co. (USERX 2.45%, UNWPX 1.16%); Fresnillo Plc 0.00%; Gold Resource Co. 0.00%; Goldcorp Inc. (USERX 0.07%, UNWPX 0.07%); Hecla Mining Co. 0.00%; Iamgold Corp. (USERX 0.10%, UNWPX 0.09%); Impala Platinum 0.00%; Mandalay Resource Corp. (USERX 1.88%, UNWPX 1.44%); Nevsun Resources 0.00%; Newmont Mining. (USERX 0.12%, UNWPX 0.11%); Northern Star Resources (USERX 2.50%, UNWPX 0.24%); Pan African Resources PLC (USERX 0.85%, UNWPX 0.97%); Pan American Silver (USERX 0.39%, UNWPX 0.16%); Polymetal International 0.00%; Randgold Resources Ltd. (USERX 2.09%, UNWPX 1.34%); Real Gold Mining 0.00%; Royal Gold Inc. (USERX 3.14%, UNWPX 0.91%); Semafo Inc. (USERX 3.27%, UNWPX 1.13%); Sibanye Gold Ltd. 0.00%; Sierra Metals 0.00%; Silver Wheaton (USERX 1.18%, UNWPX 0.39%); Silvercorp Metal 0.00%; Yamana Gold Inc. (USERX 1.42%, UNWPX 0.56%); Zhaojin Mining 0.00%. 14-262

Discover U.S. Global Investors' Two Gold Funds



The Gold and Precious Metals Fund (USERX) is the first no-load gold mutual fund in the U.S. and seeks opportunity in gold mining, investing in proven gold producing companies.



The World Precious Minerals Fund (UNWPX) gives investors increased exposure to junior and intermediate mining companies involved in precious minerals such as gold, silver, platinum group, palladium and diamonds for added growth potential.

Contact us to learn more:

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