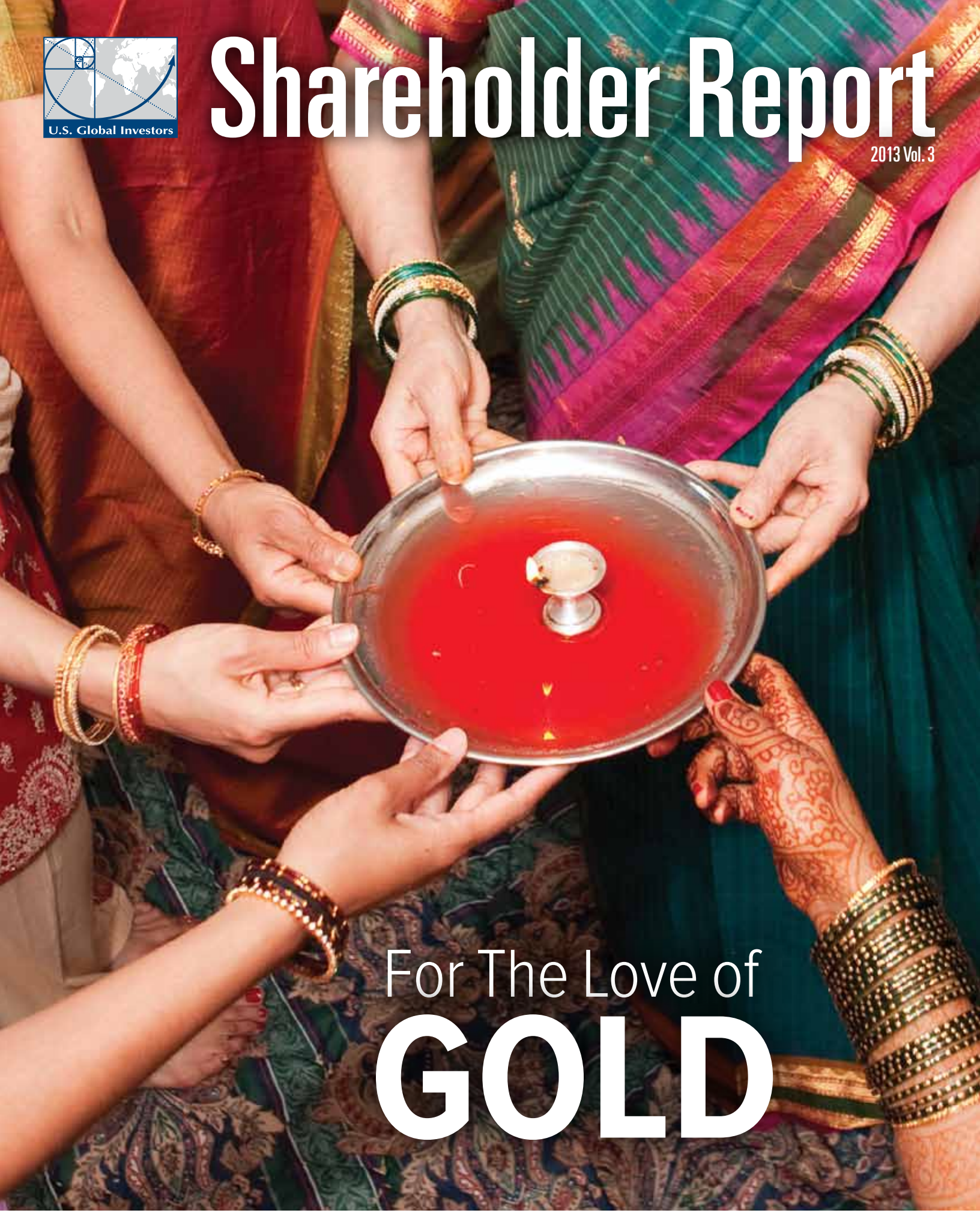
U.S. Global Investors

Shareholder Report

2013 Vol. 3



For The Love of GOLD

Hot Economy, Hot Commodities? | An American Energy Revolution

INSIDE

About the Cover:

Marriages are very important in India, as the wedding not only unites the bride and groom, but their families too. A traditional Hindu wedding can consist of many rituals and ceremonies and is often celebrated over several days. No wedding is said to be complete without gold. In fact, about half of the gold bought every year is for weddings.

www.usfunds.com

The arrow inside means you can find expanded coverage online.

We want to hear from you. Send your questions, comments or suggestions for the Shareholder Report to **editor@usfunds.com**. For account information, call **1-800-US-FUNDS (1-800-873-8637)** or email **shsvc@usfunds.com**.

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.

All opinions expressed and data provided are subject to change without notice. Some of these opinions may not be appropriate to every investor. Diversification does not protect an investor from market risks and does not assure a profit. Holdings in the U.S. Global Investors' funds as a percentage of net assets as of 6/30/13: Concho Resources 0.00%, Diamondback Energy 0.00%, Pioneer Natural Resources (Global Resources Fund 1.23%), SPDR S&P Oil & Gas Exploration & Production ETF 0.00%, SPDR S&P 500 Trust (All American Equity Fund 0.34%, MegaTrends Fund 0.21%). 13-439

GOLD: Like No Other Commodity

It is a portfolio diversifier, a store of value, a finite resource with increasing global demand.

Frank Holmes, CEO and Chief Investment Officer

Dear Shareholder,

When analysts forecast, they can generate a flurry of short-term buys and sells from fickle investors. Take Goldman Sachs, for example. Its analysts created a stir in September when the firm said gold would fall to $1,000 an ounce by the end of 2014. Goldman based this view on the Federal Reserve's expected reduction in bond buying. HSBC analysts have also been bearish on gold.

But while gold took a tumble on these predictions, domestic stocks were booming, as the S&P 500 Index and the Dow Jones Industrial Average continued to make record highs. Extreme predictions can bring out fear and greed impulses, causing investors to wonder if they should keep their allocation to the precious metal.

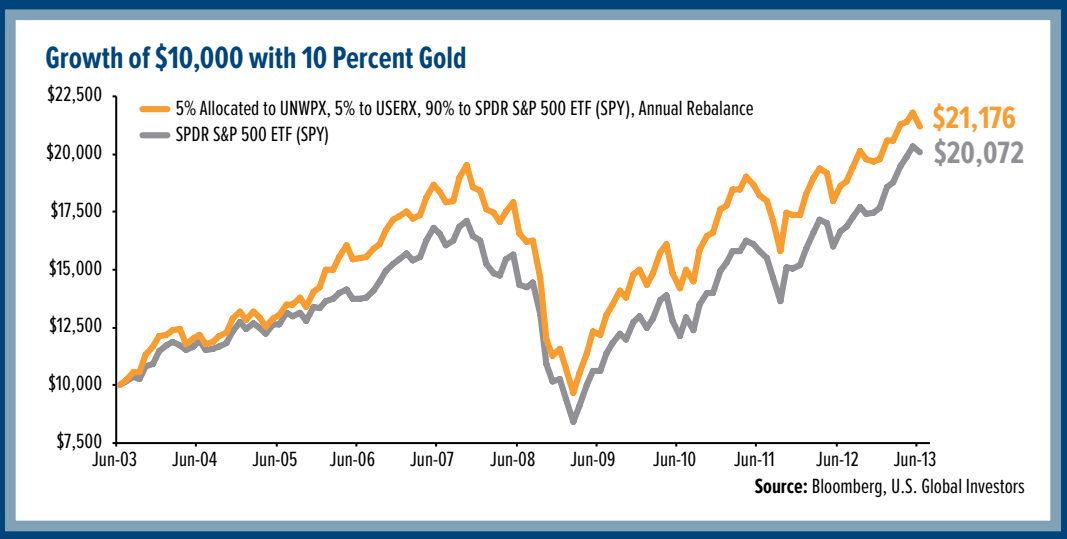
Remember the fundamental reasons to own gold: Gold is a portfolio diversifier and a store of value. It is a finite resource with increasing global demand.

I co-authored a book on gold five years ago based on a lifetime of experience with the metal. My advice hasn't changed: When it comes to gold, moderation is key. Don't try to get rich with the metal because the corresponding risk is simply too high. Limit your exposure to gold as an asset class to 10 percent of your portfolio – no more than 5 percent in bullion and 5 percent in equities. Rebalance each year to keep that level of exposure and use volatility to your advantage.

Investors have benefited from this balanced perspective, as you can see on the next page.

Compare the two hypothetical $10,000 investments for yourself. One shows the growth of $10,000 invested in an S&P 500 Index ETF. The other shows a hypothetical investment with a 5 percent allocation to the World Precious Minerals Fund (UNWPX), a 5 percent allocation to the Gold and Precious Metals Fund (USERX) and a 90 percent allocation to the S&P 500 ETF. Both assume the reinvestment of capital gains and dividends.

continued



The chart illustrates the performance of a hypothetical $10,000 investment made in the funds and strategy during the depicted time frame. Figures include reinvestment of capital gains and dividends, but the performance does not include the effect of any direct fees described in the fund's prospectus (e.g., short-term trading fees) which, if applicable, would lower your total returns. This hypothetical portfolio is presented for educational and illustrative purposes only and is not a recommendation to engage in any particular investment strategy. Past performance does not guarantee future results.

www.usfunds.com

Read why it's still smart to own municipal bonds today.

Over 10 years, regardless of the extreme moves seen in gold stocks, the portfolio that included gold stocks never dipped below the portfolio entirely made of U.S. equities. In addition, the combination of gold stocks and U.S. companies increased the portfolio's return by about $1,100!

Gold companies also offer potential income in the form of attractive dividend yields. Based on our research, about 20 gold companies have an average annual yield of 1.5 percent or more, which is more than the yields of many other sectors of the market.

Looking for an Investment Geared for Relatively Smooth Sailing?

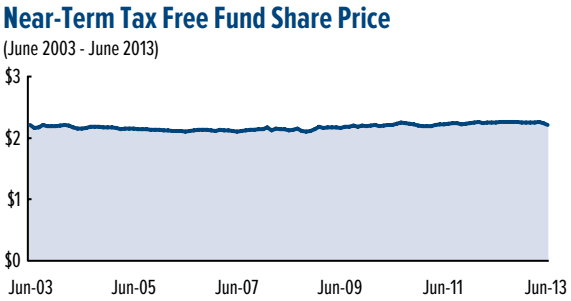
Just as Wall Street analysts can move markets based on their predictions, the Fed has that same ability. Ben Bernanke hinted that he may taper the Fed's bond purchases and investors reacted by selling their gold, emerging markets and bond holdings.

Because of this, we understand that you may be wary of volatility and want a safe place to stash cash.

The Near-Term Tax Free Fund (NEARX) could be just what you need, as it looks to preserve capital and provide stability and tax-free monthly income.

The fund seeks to sail relatively smoothly through turbulence in the markets. In fact, it is rare for the fund's share price to move more than a couple of pennies in a month. See how little volatility there has been in the share price over the past decade.

How does it accomplish all these goals? The fund's focus on shorter average maturities and a share price around $2 typically results in less volatility than bond funds with longer average maturities.



Plus, the fund has generated consistent positive total returns (yield + appreciation) for investors for over 10 years in a row.

Whether you are looking for great wealth-building ideas or just a place to stash cash, we'd love to help you. What's more, in only a few short months, we'll be rolling out enhanced features and benefits that could open up wide opportunities for long-term investors in only a few weeks. You might not want to miss out. Watch your mail and if you have any questions, feel free to call us at **1-800-US-FUNDS** or visit **www.usfunds.com/importantnews**.

Thank you for your continued trust and confidence in U.S. Global Investors.

Frank Holmes

Frank Holmes
CEO and Chief Investment Officer
U.S. Global Investors, Inc.

Total Annualized Returns as of 6/30/2013

Fund	One-Year	Five-Year	Ten-Year	Gross Expense Ratio	Expense Ratio After Waivers
Near-Term Tax Free Fund (NEARX)	0.29%	3.31%	2.81%	1.25%	0.45%
Gold and Precious Metals Fund (USERX)	-38.58%	-11.68%	7.78%	1.61%	n/a
World Precious Minerals Fund (UNWPX)	-44.43%	-16.25%	6.54%	1.45%	n/a
S&P 500 SPDR (SPY)	20.40%	6.92%	7.19%	0.11%*	n/a

*Expense ratio as stated in the most recent prospectus. The expense ratio after waivers is a contractual limit through April 30, 2014, for the Near-Term Tax Free Fund, on total fund operating expenses (exclusive of acquired fund fees and expenses, extraordinary expenses, taxes, brokerage commissions and interest).Performance data quoted above is historical. Past performance is no guarantee of future results. Results reflect the reinvestment of dividends and other earnings. Current performance may be higher or lower than the performance data quoted. The principal value and investment return of an investment will fluctuate so that your shares, when redeemed, may be worth more or less than their original cost. Performance does not include the effect of any direct fees described in the fund's prospectus (e.g., short-term trading fees of 0.05%) which, if applicable, would lower your total returns. Performance quoted for periods of one year or less is cumulative and not annualized. Obtain performance data current to the most recent month-end at www.usfunds.com or 1-800-US-FUNDS. *For information regarding the investment objectives, risks, expenses and fees of the S&P 500 SPDR, please refer to the fund's prospectus and the information below.*

Foreign and emerging market investing involves special risks such as currency fluctuation and less public disclosure, as well as economic and political risk. By investing in a specific geographic region, a regional fund's returns and share price may be more volatile than those of a less concentrated portfolio. The Emerging Europe Fund invests more than 25% of its investments in companies principally engaged in the oil & gas or banking industries. The risk of concentrating investments in this group of industries will make the fund more susceptible to risk in these industries than funds which do not concentrate their investments in an industry and may make the fund's performance more volatile. Because the Global Resources Fund concentrates its investments in a specific industry, the fund may be subject to greater risks and fluctuations than a portfolio representing a broader range of industries.

Gold, precious metals, and precious minerals funds may be susceptible to adverse economic, political or regulatory developments due to concentrating in a single theme. The prices of gold, precious metals, and precious minerals are subject to substantial price fluctuations over short periods of time and may be affected by unpredicted international monetary and political policies. We suggest investing no more than 5% to 10% of your portfolio in these sectors.

Though the Near-Term Tax Free Fund seeks minimal fluctuations in share price, it is subject to the risk that a decline in the credit quality of a portfolio holding could cause a fund's share price to decline. Tax-exempt income is federal income tax free. A portion of this income may be subject to state and local income taxes, and if applicable, may subject certain investors to the Alternative Minimum Tax as well. Each tax free fund may invest up to 20% of its assets in securities that pay taxable interest. Income or fund distributions attributable to capital gains are usually subject to both state and federal income taxes. Bond funds are subject to interest-rate risk; their value declines as interest rates rise. The tax free funds may be exposed to risks related to a concentration of investments in a particular state or geographic area. These investments present risks resulting from changes in economic conditions of the region or issuer.

The S&P 500 Index is a widely recognized capitalization-weighted index of 500 common stock prices in U.S. companies. The Dow Jones Industrial Average is a price-weighted average of 30 blue chip stocks that are generally leaders in their industry. The MSCI All Country Asia Pacific (excluding Japan) Index captures large and mid cap representation across 4 of 5 Developed Markets countries (excluding Japan) and 8 emerging markets countries in the Asia Pacific region. The Citi Economic Surprise Index is a measure that tries to capture how well the data is coming in relative to economic expectations. The Purchasing Manager's Index is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

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.

Investment objective: The Gold and Precious Metals Fund is an actively managed mutual fund that focuses on gold and precious metals producing companies. The World Precious Minerals Fund is an actively managed fund that focuses on junior and intermediate precious metals exploration companies around the world. The SPDR S&P 500 ETF Trust (SPY) is a passively managed fund that, before expenses, seeks to correspond generally to the price and yield performance of the S&P 500 Index.

Liquidity: The Gold and Precious Metals Fund and World Precious Minerals Fund can be purchased or sold at a net asset value (NAV) determined at the end of each trading day. The SPDR S&P 500 ETF can be purchased or sold intraday. These purchases and redemptions may generate brokerage commissions and other charges not reflected in the ETF's published expense ratio.

Safety/Fluctuations of principal/return: Loss of money is a risk of investing in the Gold and Precious Metals Fund, the World Precious Minerals Fund and the SPDR S&P 500 ETF. Shares of the three securities are subject to sudden fluctuations in value. The SPDR S&P 500 ETF may also be subject to bid-ask premiums or discounts to net asset value (NAV) that could adversely affect a shareholder's actual returns.

Tax features: The Gold and Precious Metals Fund and World Precious Minerals Fund intend to make distributions that may be taxed as ordinary income or capital gains. Under current federal law, long-term capital gains for individual investors in the fund are taxed at a maximum rate of 15%. For the SPDR S&P 500 ETF, long-term capital gain distributions will result from gains on the sale or exchange of capital assets held by the fund for more than one year. Any long-term capital gains distributions you receive from a fund are taxable as long-term capital gains regardless of how long you have owned your shares. Long-term capital gains are currently taxed at a maximum of 15%. Information provided here is neither tax nor legal advice and is general in nature. Federal and state laws and regulations are subject to change.

Take Advantage of the Area's Potential with the Emerging Europe Fund (EUROX)

HOW COMMODITIES MADE AMERICA POSSIBLE

Sean Brodrick,
Resource Strategist
The Oxford Club.

Original article appeared on investmentu.com on September 12, 2013

Boston is one of my favorite towns. I love its historical links to liberty, American independence and... commodities. How do commodities figure into American history?

People forget that the Boston Tea Party was really a protest over price-fixing of a vital commodity.

The American colonists thought drinking tea prevented horrible ailments like dysentery and cholera.

The colonists didn't just like to drink tea. For their health and the health of their children, they thought they needed to drink tea. (Sure, it was the boiling of water for the tea that killed the germs that caused disease. But they didn't know about germs yet.)

The East India Company had a special license to bring tea to the colonies. This was part of a tax the British levied to help pay for the French and Indian War. In Boston, a city of then-15,000 people, only 11 people had a license to import tea. Boy, did that get the colonists boiling mad.

So, in 1773, a group called the Sons of Liberty disguised themselves as Mohawk Indians. They boarded three ships moored in Boston Harbor and subdued the guards. Then they dumped 432 crates of tea overboard. The tea was worth 18,000 pounds sterling – roughly $3 million in today's money.

Commodities and Liberty

That wasn't the only time commodities played a crucial role in America's path to independence. On March 23, 1776, the Continental Congress passed an act that formalized privateers. They're basically pirates who take sides in a war. And every colonist with a leaky rowboat suddenly set out in search of riches.

The seas between America and Europe became a hunting ground for "wolf packs" of privateers who preyed on British merchant fleets. What did they plunder? Guns, powder, cotton, linens, foodstuffs, copper, tin, sugarcane, molasses, rum, whiskey, manufactured goods, jewelry, cash, documents and the ships themselves.

Over the course of the war, nearly 800 vessels commissioned as privateers. They captured or destroyed more than 600 British and loyalist ships.

Those privateers saved the American Revolution.

Without them, American sea trade would have been strangled, and the American Revolution along with it.

Getting Wealthy on the Revolution

Many shrewd investors made a fortune without setting foot in a boat.

Robert Morris was the so-called "Financier of the Revolution." He had a hand in every significant strategic decision made by the Continental Congress. He also invested heavily in outfitting privateers.

Benjamin Franklin helped create a dummy French corporation for the American privateers. This company used privateer profits to help fund and supply the Revolution.

John Hancock was Boston's richest merchant. He was also into the privateering scheme up to his eyebrows. He arranged through an associate to have all prize ships settled and sold at his wharf, netting a nice cut off of each one.

American privateers racked up $18 million in damage to British shipping by the end of the war. That's about $315 million today.

Capitalism made America possible. If it weren't for private enterprise and the profit motive, our high-seas rebellion never would have left port.

Commodities continue to shape America's destiny. That's true in the grain fields of America's heartland; in America's revived oil and gas industry; and in the gold-rich hills of Nevada. ■

Given the recent rising interest rate environment, we wondered how gold, oil, and other commodities have historically performed.

WITH A HOT ECONOMY, WILL WE SEE HOT COMMODITIES?

While some investors may think higher interest rates are a negative for emerging markets, historically, this hasn't been the case, especially in Asia.

Since 1990, there were 35 periods in which U.S. rates rose 50 basis points or more. About 75 percent of the time, the MSCI All Country Asia Pacific (excluding Japan) Index (MXAPJ) climbed higher, according to research from Goldman Sachs.

However, "growth is paramount," as it is a more important driver for Asian equities, says Goldman. The chart below plots Asian countries' sensitivity to growth against their sensitivity to U.S. rates. You can see that the MXAPJ tends to be positively impacted by rising rates in the U.S. and is relatively growth sensitive.

Among all Asian markets, China, Korea and Taiwan are the most positively affected by rising rates, and these three countries are also the highest growth-sensitive areas of the world.

When economies such as China and Korea are growing, their use of commodities tends to expand as well.

The Key is to Take Action Before Rates Rise

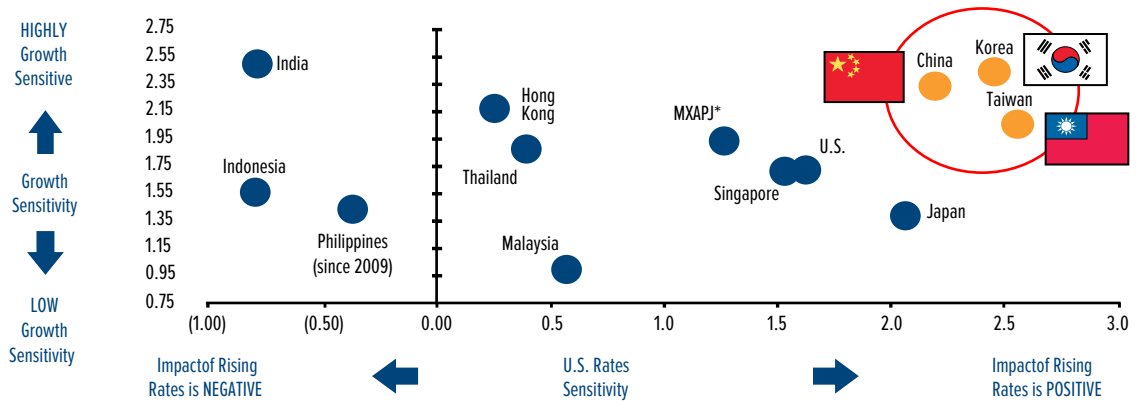
You might not want to wait for the Federal Reserve to officially raise rates, as research shows that investors historically benefited most from materials and energy stocks by getting in before rates increased.

William O'Neil & Co. found how critical it was to be invested in commodities prior to rate increases. The firm looked at individual sector performance over four decades, calculating the gains received from six months prior to the initiation of rate increases through the period of the rate increases. In almost every instance, energy and basic materials were the best performing sectors. ■

www.usfunds.com

Read more about how commodities perform in rising rate environments.

Rising Rates and Better Growth Positively Affect Countries that are Proxies for Global Growth



Source: FactSet, MSCI, GS Global ECS Research, U.S. Global Investors
Past performance is no guarantee of future results. *MSCI All Country Asia Pacific (excluding Japan) Index

What Happens When You Tell Indians to Stop Buying Gold

At U.S. Global, we often talk about how the gold trade is really two separate trades. There's the Fear Trade that buys gold out of fear of war or poor government policies. This crowd sees the precious metal as a safe haven during times of crisis, such as when the price of gold rose in September over the fear of a war in Syria, but eased when a much more limited military action became likely.

Then there's the Love Trade. This group gives gold as gifts for loved ones during important holidays and festivals. In India, there is the wedding season that begins in October followed by the five-day Hindu festival of lights, Diwali, India's biggest and most important holiday of the year. In December, millions of people observe Christmas, and in January, there's Chinese New Year.

In India, the affinity for gold is intertwined with fear because of persistently poor government policies. Indians view gold jewelry as more than just an accessory—gold is viewed as the best way to preserve wealth.

Turn the page to read more about India's Love and Fear Trade.

India's Love

for gold can be seen in the second quarter of 2013, as gold demand continued to be strong, despite the government's attempts to hinder imports. The country's demand for gold topped all others, rising to its "highest in the last 10 years," says GoldCore. Jewelry, bar and coin demand capped 310 tons during the period, according to the World Gold Council (WGC).

www.usfunds.com

Gold use extends far beyond bars, coins, and jewelry. From industrial to medical, see the many uses of gold.

During a time that financially traded gold, such as ETFs, experienced redemptions, demand for physical gold grew. In addition to India, people in China, the U.S., Europe, Turkey and the Middle East purchased tons of gold jewelry, bars and coins.

This tells us that like gold, the Love Trade doesn't tarnish; it holds its luster.

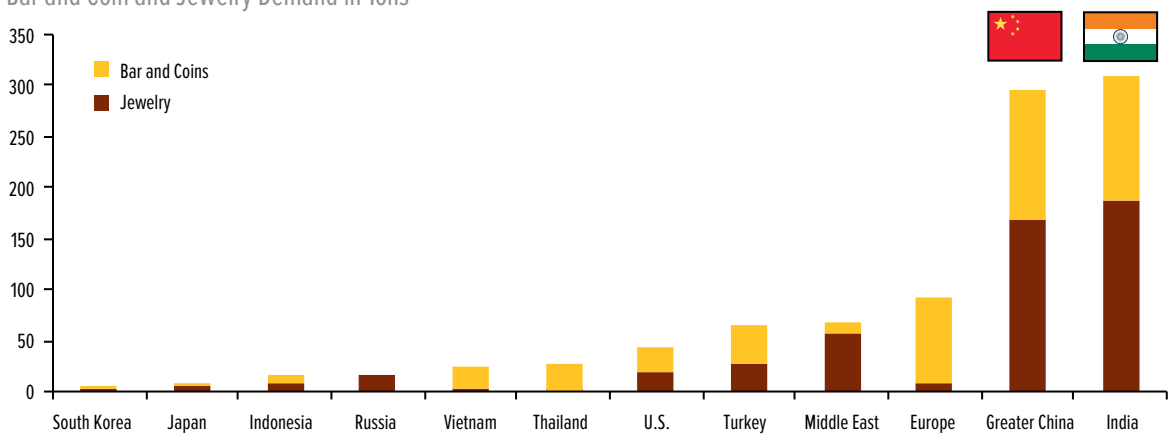
In India, the government has been imposing import tax hikes on gold in an attempt to reduce the country's current account deficit. When the increased duties were first implemented at the beginning of 2012, we were skeptical that gold demand would be curtailed because of India's affinity to the precious metal. Gold has always been a part of India's history, culture and tradition; simply, the country could not be stopped from buying gold. Second-quarter data shows that India's Love Trade came back stronger. According to the WGC, gold jewelry, bar and coin demand in India alone was 70 percent stronger in the second quarter of 2013 compared to the same quarter last year.

For decades, Indian families have celebrated weddings, births, festivals and holidays centered on gold and these traditions are passed down from generation to generation. Take the wedding industry, for example. India's culture is very different from that of many Western countries. Indian weddings are special and unique celebrations among a very tight familial bond. About half of the gold that Indians buy each year is for weddings.

But the record gold buying we are seeing today isn't only out of love. We believe Indians are also buying out of fear due to the country's infamously poor and corrupt government policies.

Chindia Dominated Gold Demand in Second Quarter 2013

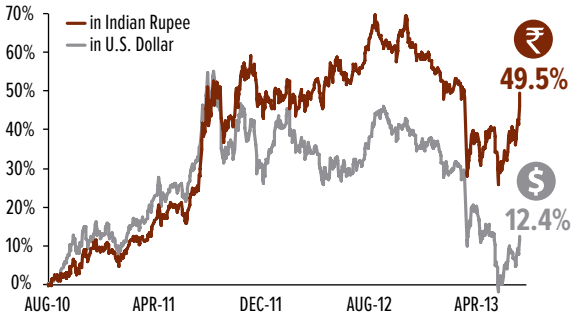
Bar and Coin and Jewelry Demand in Tons



Source: World Gold Council, U.S. Global Investors

Gold Held Up Well in Indian Rupees

Daily Data, 8/16/2010 through 8/16/2013



Source: Bloomberg, U.S. Global Investors

We often say how government policies can be precursors to change. Good policies can drive economic growth and markets respond positively. Bad policies can have the opposite effect. At the same time Indians buy gold out of love for their family and close friends, they are also buying gold out of protection.

Take a look at the chart above, which shows gold's return in Indian rupee compared with gold's return in the U.S. dollar. In the U.S., where the dollar has strengthened, gold has increased only 12 percent on a cumulative basis over the past three years. But in a country with a significantly weakening currency, gold gained nearly 50 percent.

We'll see if Delhi gets its way. With the government in India raising its import tax for gold to 10 percent this summer, Indians will likely continue indulging in gold, even if they have to smuggle it in.

Trading vs. Holding Gold

Often when Frank Holmes talks to the anchors on Bloomberg Radio or CNBC, he is asked if it is wise for investors to follow the gold buying patterns of George Soros and John Paulson.

For people focused on investing for retirement, we would say no. These hedge fund managers are making huge short-term bets. We have always advocated that investors hold gold over long periods of time, maintaining a small 5 to 10 percent weighting in gold and gold companies, and rebalancing annually. ■

The Indian Wedding Season: A Short Guide to Gift Giving

In India, the love for gold is unique, dating back for centuries. Gold is a symbol of wealth and financial security, but more importantly serves as a lavish staple for the wedding season. We see this directly affecting gold demand in what we like to call the Love Trade.

This remarkable tradition of presenting newlyweds with valuable gifts during their wedding, in which events can last for several days, is highly important to the Indian culture. But what are some of the most common gifts that wedding guests bring?

Gold. According to wedding planner Divya Chauhan in a 60 Minutes interview, "The bride is ready, the groom is ready, the venue is set, the food is set, but if you don't have gold, there is no wedding." Of all the gold that Indians buy each year, half is bought for weddings. Every Indian bride is dripping in diamonds and gold, whether it is a necklace, pendant, ring or bracelet. With an estimated 10 million weddings taking place every year in India, the country sees a lot of gold buying out of love.

Cash. Money is one of the most traditional gifts, usually placed in a nice gift envelope. While money in Western societies is viewed differently, in India it is considered a thoughtful and appropriate gift. For good luck, it is customary to gift money in amounts ending with "1." In the U.S., this would mean that $100 isn't nearly as meaningful as $101.

Electronic Items. This gift choice seems to be more popular than ever for brides and grooms. Whether it is a food processor, a cell phone or even an iPad, these gifts are well liked and often times are bought in groups, with everyone donating to the cost of the item.

★ AN AMERICAN ENERGY REVOLUTION ★

In Texas these days, there's a feeling of absolute and unwavering confidence in the concept of an American energy revolution. From the depths of reserves to the richness of the energy, an incredible transformation is taking place.

We've been talking about the significant impact of the U.S.'s oil production for a while now, but the buzz about shale oil and gas is only getting louder. At Morgan Stanley's energy forum in Houston in August, Director of Research John Derrick and Portfolio Manager Evan Smith said shale was the prevailing topic.

One area that's driving this game-changing trend is located only hours from our headquarters. It's the Permian Basin located in western Texas and southeastern New Mexico, covering an enormous area.

Three component parts make up the Permian: the western Delaware, Central Basin and eastern Midland. If you overlay the Eagle Ford and Bakken basin areas over the Permian, you can see that both the Bakken and the Eagle Ford shale formations easily fit inside.

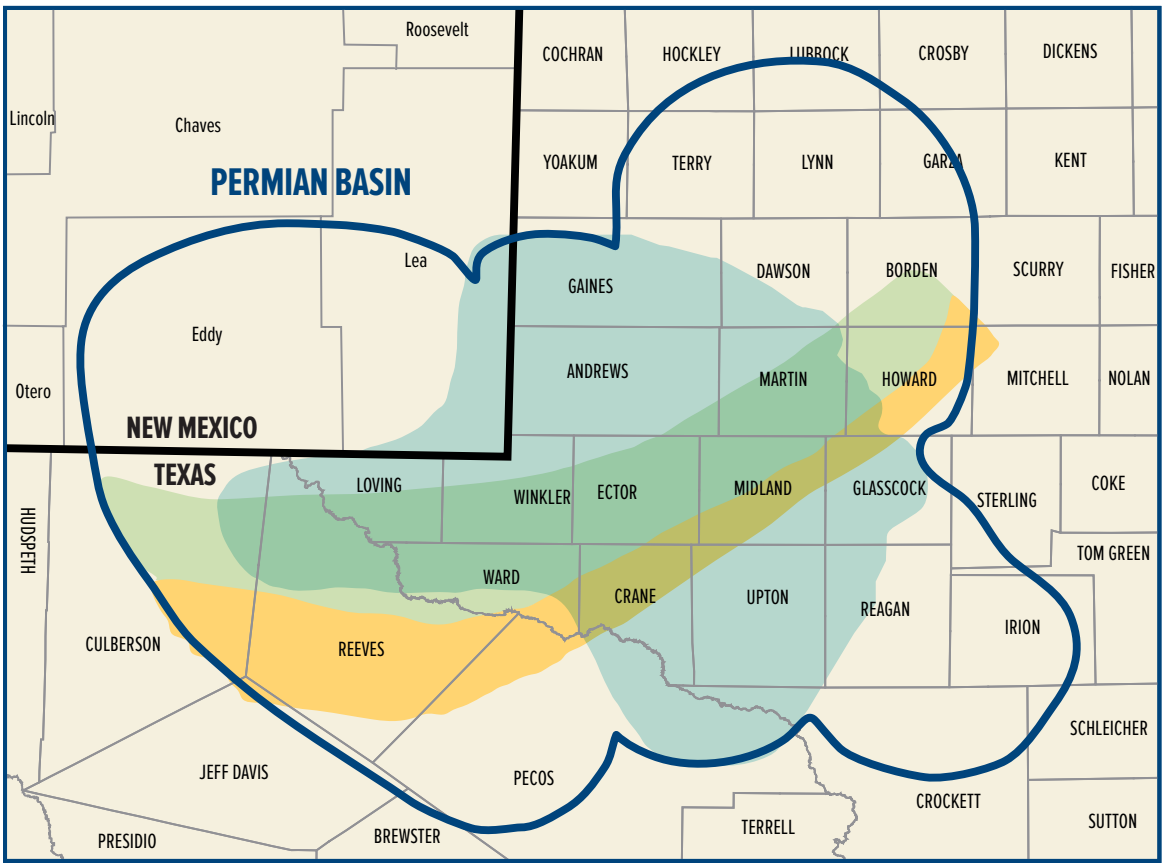
The area isn't new to the oil industry, as companies have been drilling in the Permian area for almost a century. Back in the 1970s, oil production reached 2 million barrels per day, but fell to 800,000 barrels per day in 2007. It wasn't because the oil wells had dried up, but companies couldn't get at the resource. But now since the introduction of shale technology, oil production began increasing once more to 1.2 million barrels per day by 2012.

And as more data are released, the more convinced we are that this incredible growth will continue. According to Tudor Pickering Holt & Co., by 2025, oil production is projected to more than double to more than 3 million barrels per day. That's about as much oil that is produced these days by Kuwait, the third-largest oil producer in OPEC.

When it comes to investment plays, "the Permian is red hot right now," says Global Hunter Securities. The research firm finds that, on a year-to-date basis through August, if you had invested in the "pure-play" companies, including Concho Resources (CXO), Diamondback Energy (FANG) and Pioneer Natural Resources (PXD), that have a resource base in the Permian area, your portfolio would have been up an incredible 39 percent.

By comparison, over the same timeframe, the SPDR S&P Oil & Gas Exploration & Production ETF (XOP) increased only 15 percent. The S&P 500 Index, which has had a great run so far, rose 16 percent.

Permian Basin is Bigger than Eagle Ford and Bakken Combined



Source: Tudor Pickering Holt & Co., U.S. Global Investors

We're seeing savvy investors already taking advantage of the nation's incredible energy shift. You might not want to miss out.

The Global Resources Fund (PSPFX) has benefited from its long-term holding of Pioneer, which has returned about 60 percent so far this year. And while we continue to be bullish on the company due to its substantial presence in the Permian, there is no guarantee that it will continue to succeed. However, Pioneer has a net resource base of about 7 billion barrels of oil equivalent across more than 40,000 drilling locations in the Permian, according to Global Hunter. This enormous resource base translates to decades of drilling ahead.

Here in San Antonio, we've personally witnessed several economic benefits that have positive repercussions for the entire U.S. Locally, there's been a rapid monetization of energy assets. Businesses have been building incredible expertise and creating a growing number of high-paying jobs. For the rest of the country, the effects of cheaper gas and readily available energy create enormous potential for a more competitive United States of America.

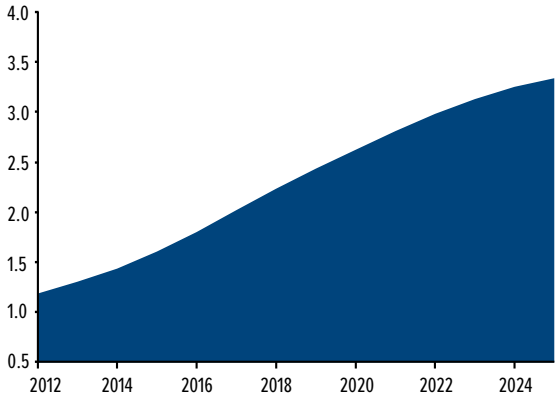
One solution that aims for better growth potential and lower volatility is the Global Resources Fund, which takes a balanced approach to the energy and materials sectors. ■

www.usfunds.com

Watch Frank Holmes discuss the energy play with Canada's Business News Network.

Permian Basin Oil Production May Reach More Than 3 Million Barrels of Oil Per Day by 2025

Forecasted base oil production, in million barrels of oil equivalent per day



Source: Tudor Pickering Holt & Co., U.S. Global Investors

Moscow, Russia

After Europe's lengthy period of stagnant growth and lackluster results, the gradual crescendo of improving economic data commands attention. Director of Research **John Derrick, CFA** talks about how the region is on the road to a sustained recovery and which countries stand to benefit.

What positive news about Europe piques your interest?

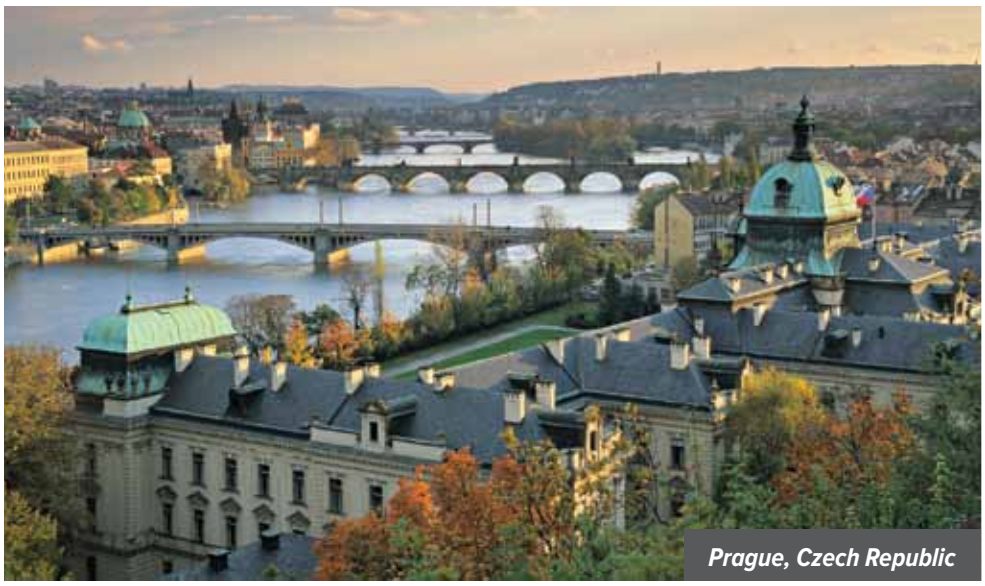
For one, economic releases have been beating expectations, as shown in the eurozone's spiking Citigroup Economic Surprise Index. GDP is recovering too, with expectations that the year-over-year growth rate will significantly improve over the next year and a half.

Manufacturing also appears to be on the mend. Over the summer, the purchasing manager's index (PMI) was at a two-year high and topped the 50-mark. This indication of expansion hasn't happened since July 2011. And, Europe's PMI expanded at a faster pace than estimated.

Economic confidence in the region has also been rising. In July, it reached a 15-month high. Generally, when sentiment turns positive, businesses invest more and consumers spend more. We believe this improving confidence will help spur positive economic growth.

Is it just European companies that benefit?

It's not only European stocks that will likely see a bounce. We believe the improvement in Europe is positive for emerging markets overall. If you look at historical relationships among European economic activities, you will see a tighter correlation with emerging market economic activity than you will with that of the U.S.


Prague, Czech Republic


Istanbul, Turkey

If we can get Europe growing again, that will be a positive dynamic for emerging markets. That helps China, for one, which in turn helps a slew of other countries.

Why China?

While many think the U.S. is receiving most of the Chinese-made goods, Europe is actually China's largest export partner. About 22 percent of China's exports head to Europe, contributing nearly 6 percent to China's GDP; only 17 percent of exports from China are shipped to the U.S. So when Europe's growth was in a deep freeze, China was feeling the pain. And now with Europe growing, China should benefit.

What about other emerging markets?

Emerging Europe especially benefits from a European recovery, as these developing countries are economically tied and export dependent to their western counterparts through established export trade.

For example, more than 80 percent of Czech and Hungarian exports head to Western Europe and about 50 percent of Polish and Turkish goods are exported to Western Europe.

In addition, there are many countries that are in the process of integrating into Europe, working to meet the European Union's standards that include living standards, GDP, environmental standards, regulatory standards and infrastructure. As Barron's puts it in a recent article about Europe, the pursuit of becoming a member is a "vote of confidence" for Europe and its institutions. We look forward to Latvia joining the EU and giving up its own currency in exchange for the euro. Lithuania is also expected to join the euro.

How could the Emerging Europe Fund (EUROX) benefit?

A portion of the Emerging Europe portfolio seeks companies located in emerging Europe that have strong ties to Western Europe. Many of these are manufacturing companies producing automobiles and appliances, which are then shipped to Western Europe. An improving France and Germany, for instance, means consumers will likely buy more goods manufactured in the eastern part of the area. ■

www.usfunds.com

See how the Emerging Europe Fund could benefit from a European recovery.

John W. Derrick, CFA, has become a go-to expert on emerging markets for the radio show VoiceAmerica. Over the past few months, he's been featured as a guest numerous times to discuss the political turmoil in Syria, rising oil prices and their effect on Russia, and economic data out of China. As the director of research, John oversees not only the Emerging Europe Fund, but also U.S. Global's All American Equity, MegaTrends and Near-Term Tax Free Funds.

Shareholder Report
U.S. Global Investors
P.O. Box 659405
San Antonio, TX 78265-9604

MAPPING IT

WHERE'S THE THIRD-LARGEST CITY IN CHINA?

All of these Chinese cities have populations of over 4 million inhabitants. Can you match each city to its location on the map?

Shanghai	15.8 million
Beijing	11 million
Guangzhou	9.4 million
Shenzhen	8 million
Tianjin	7.5 million
Wuhan	7.5 million
Hong Kong	7 million
Chongqing	6.7 million
Shenyang	5 million
Dongguan	4.9 million

Answer Key: (a) Shanghai, (b) Beijing, (c) Guangzhou, (d) Shenzhen, (e) Tianjin, (f) Wuhan, (g) Hong Kong, (h) Chongqing, (i) Shenyang, (j) Dongguan

Source: http://www.nationsonline.org/oneworld/china_cities.htm (2010 data)