TOCQUEVILLE
ASSET MANAGEMENT

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On this week's **Consuelo Mack WealthTrack:** *an exclusive interview with Robert Kleinschmidt. The Tocqueville Fund's contrarian portfolio manager discusses where he is betting against the herd to stay ahead of it.*

Guest

Robert Kleinschmidt
CEO, President, Chief Investment Officer
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CONSUELO MACK: This week on WealthTrack, contrarian investor Robert Kleinschmidt is known for galloping away from the herd to find hidden opportunities for the Tocqueville Fund. Where is this Great Investor looking now? An exclusive ride with Robert Kleinschmidt is next on Consuelo Mack WealthTrack.

Hello and welcome to this edition of WealthTrack, I'm Consuelo Mack. This week we have an exclusive interview with Robert Kleinschmidt, long time portfolio manager of the Tocqueville Fund and a self-described "authority resistant trouble maker" who revels in investing where others fear to tread. Kleinschmidt is the CEO, President and Chief Investment Officer of Tocqueville Asset Management, where he oversees assets worth more than $11 billion. He has managed the deep value, stock focused, Tocqueville Fund for more than two decades, beating the market and many of his peers with nearly 10% annualized returns in the process.

On WealthTrack a year ago, his most contrarian call was to be bullish on stocks. It was a time when the financial world and the markets seemed to be falling apart again and the "death of equities" headlines were resurfacing. How wrong they were! This year his sights are set on the Federal Reserve and the impact Fed policy is having on interest rates and the markets.

Many of our guests have called the Fed's unprecedented moves to keep interest rates low "financial repression." The key short term Fed fund's rate has been near 0% since the financial crisis five years ago and the Fed has told the markets it intends to keep it there at least until the unemployment rate drops to 6.5%. Its latest forecasts don't show that happening until 2015. As top ranked economic research firm ISI recently pointed out, there have been nearly 400 stimulative policy initiatives announced around the world by the Fed, other central banks and governments designed to boost economic growth. The great fear among many investors is how the Fed will extricate itself from its stimulative policies without roiling the markets. Enter Kleinschmidt, the consummate contrarian. He pooh poohed fears of a market meltdown over the elections and fiscal cliff last year. Now he's unperturbed by the impact of the Fed's policies. For starters, he doesn't hold the Fed responsible for today's record low interest rates. I asked him why.

ROBERT KLEINSCHMIDT: Well, because the market sets interest rates, and so the Fed controls the monetary reserves. It doesn't even control necessarily the money supply. It controls monetary reserves, and monetary reserves can get translated into the money supply through banks making loans. That's how money supply expands and contracts. So the Fed controls monetary reserves, and they've built up a lot of monetary reserves in expanding their balance sheet.

So that they do control, and the Fed can control very short-term interest rates with the discount rate. Right? But they can't control long-term interest rates, and even with the programs that they have instituted, they're not controlling long-term interest rates right now. Let me give you just a few numbers to help you understand this. The total global government bond market exceeds $100 trillion, and the United States is about a third of that, the total bond market. The municipals and

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states and so that's $100 trillion at least. $85 billion a month amounts to about a trillion dollars a year. Right? So that's not a big incremental thing. Moreover, almost a trillion dollars a day trades in the bond market.

CONSUELO MACK: In which bond market?

ROBERT KLEINSCHMIDT: The global bond market.

CONSUELO MACK: Global sovereign bond market.

ROBERT KLEINSCHMIDT: Right, global bond market. So is you have a trillion dollars a day trading, and you got some entity adding a trillion dollars a month to demand, that's not a lot. That's not a lot and, more importantly, somebody holds this $100 trillion. Somebody owns it. Right? In some cases it's tucked away in places that will never move to maturity, but somebody holds it, so every day those people have to look at their bond portfolio and say, "I don't think bond prices are too high, because if I thought they were too high, I'd be selling it. I'd be adding to the supply."

So it's the market that's holding off the $100 trillion. If the market woke up tomorrow and decided that, you know, two percent isn't enough or three percent isn't enough, and I need six percent, then people who own all these bonds would be looking at this bond portfolio, and they'd say, "Jesus, these prices are really too high. I'm going to sell." So what is the Fed going to do if $100 trillion worth of bonds come on the market because the market decides that the bonds are priced too high?

The point is, they can't control that. It's vastly greater than they are, and it's made up of market participants who are making decisions at the margin. So the Fed can have these policies, and I'm not sure that they're necessarily bad. Actually, I think it's a very neat trick if they can get away with it, but it's not the reason that interest rates and longer-term interest rates are low. Longer-term interest rates are low because the market collectively believes that inflation is not a problem, and they believe that rates are not too low. It's as simple as that.

CONSUELO MACK: I mean, context is so important. So therefore, this fixation on the Fed and what its exit strategy is going to be, and we talk to a lot of our guests on WealthTrack, and they are just saying even the mere thought psychologically that the Fed is going to start withdrawing from the bond markets is going to cause interest rates to spike and all sort of dislocations. Not a worry?

ROBERT KLEINSCHMIDT: No, I think that there could be, and psychological is the right word. I mean, I think there can be a psychological impact in a change in their decision making. I think it'll be temporary. In other words, I think that if the market hasn't made up its mind that interest rates are too low, that the Fed's changing its action will cause a blip in the path, but I think that there will be a lot of market participants who will look at a change in Fed strategy, and then as

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a result of that possibly change their own thinking. And so I think it can have an impact on the unwinding.

I don't see a 2008 around the corner. And my guess is, or if I was Ben Bernanke, what I'd do is I'd start to scale it down over a period of years, and so instead of doing $85 billion a month, I'd go to $75 billion a month for a few months. That's sort of the way I would do it, because that way it would not send the strong psychological signals that it might otherwise do if he were to stop altogether, and the reason that you don't want the psychological signals to be that strong is that if interest rates really start going up, governments all over the world are- I'm going to try use a technical financial term here- screwed. So if you know what I mean.

So they have a real issue of how to prevent that psychological message from getting across, and I think probably the best way to do it is to do it very gradually and not to make any significant moves, and that's the handcuffs that the central banks are in, is that their actual actions are pretty insignificant, but the psychological impact of their actions can be pretty powerful.

CONSUELO MACK: Now, you're a stock investor.

ROBERT KLEINSCHMIDT: Yes.

CONSUELO MACK: But also you have views on the bond market.

ROBERT KLEINSCHMIDT: I have views on everything.

CONSUELO MACK: Let's stick with the bond market for the moment. But you think that the bond market is a very risky place to be.

ROBERT KLEINSCHMIDT: I do.

CONSUELO MACK: And it's very expensive.

ROBERT KLEINSCHMIDT: Yeah, I do. So why? Because I think that the realization that the vast increase in the monetary reserves will lead to an increase in the real money supply which will lead to real inflation, will come more or less all at once. I think it'll be the emperor has no clothes kind of moment, in which case I think, you know, bonds are all priced for zero inflation or negative inflation, and once people started to think that the normal rate of inflation going forward over the next several decades is going to be two, three, four even five percent, then these bonds have a tremendous amount of risk in them, and there's not that much upside. You don't get paid much to own them, and the opportunity, it seems to me, to make any capital gains in bonds from here is next to nothing. So no, I thought that, in full disclosure, I thought that a year ago, and I was wrong.

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CONSUELO MACK: So let's talk about stocks, your business at the Tocqueville Fund. When you were last on WealthTrack in 2012, you basically said your most contrarian view at that point was that you were bullish on the stock market, and this is when there were headlines, you know, the death of equities again, everything else. It turns out, you know, good call. So...

ROBERT KLEINSCHMIDT: I'm glad you played that take as opposed to the one where I was bearish.

CONSUELO MACK: So I don't remember that one. It must have been erased at some point. So how bullish are you now about the stock market?

ROBERT KLEINSCHMIDT: Well, I'm not bearish, but I'm certainly not as bullish. I mean, what intrigued me was the political uncertainty at the time, and the fiscal cliff and the sequestration and all those things that had people at sixes and sevens. I thought those would come and go, and they'd turn out to be minor events. It would be like Y2K. Right?

CONSUELO MACK: And they kind of were, it turns out.

ROBERT KLEINSCHMIDT: They were minor. So I reasoned that the market would see these things unfold and it would heave a sigh of relief, and they'd begin to focus more on fundamentals, and I think that's sort of what has happened. You know, the market is no longer extremely cheap in my view. It's not extremely expensive in my view, and so it's a little harder to find stocks than it once was, but they're out there. You might not find them if you look for them, but it's very hard to find them if you're not looking for them. So you have to look for out-of-favor situations that may make sense over time, whether you think the market is high or low or in between.

CONSUELO MACK: So as a contrarian deep-value investor and I was looking at some of your top holdings. So how are they looking from a deep-value investor point of view?

ROBERT KLEINSCHMIDT: Here's the thing. It's hard to be a deep-value investor all the time, because you want to buy them... when you're buying stocks, you want to go in looking for stocks that are selling at a big discount to their underlying value, but if you are also only a holder of stocks that are selling at a big discount to underlying value, you don't really own them long enough for them to make any money for you. So what I try to do when I can, particularly large capitalization names like this, is if you can buy those kinds of stocks in periods of stress at decent prices, then you buy them, and you hang on to them, and you need to have a good reason to sell them.

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So I don't think that Microsoft is pricey. I don't think that Exxon Mobil is pricey, although I have had some concerns about the price of oil. You know, Johnson & Johnson is one of many stocks in our portfolios, which includes Pfizer and includes Campbell's Soup.

CONSUELO MACK: DuPont.

ROBERT KLEINSCHMIDT: Well, DuPont is interesting but in a different way, but the Johnson & Johnsons and the Procter & Gambles and the Pfizers and others were big, safe, global companies that had strong balance sheets and paid a nice dividend, and they were great defensive stocks to own, and they had been underperforming for a long time. Well, in this most recent period they've kind of caught up, so that's an area where I'm not sure there's much left in them. I don't mind owning them, but I have trimmed those stocks when they've gotten to be too large of positions in the portfolio. DuPont is an interesting situation, and it's one of our largest holdings, although I just trimmed some yesterday, because among other things it's our only play on the agricultural sector, which I think is an area where you do want to play because there are more people in the world and they have to eat. But they're also one of the many companies that I think will benefit from what is clearly the most important single thing that's been going on which is the return of cheap energy to the United States.

CONSUELO MACK: So energy. Why are you enthused about energy at this point?

ROBERT KLEINSCHMIDT: Well, I'm enthused about the notion that energy... you know, we sort of grew up in an expensive energy era, and I think we may be returning to a not-so-expensive energy era, and I think that makes a lot of difference.

CONSUELO MACK: And this is because of natural gas and...

ROBERT KLEINSCHMIDT: Well, it's certainly because of natural gas, but it's also they're doing the same thing with oil. It's the combination of one old and one not-so-old technology. Horizontal drilling is the not-so-old one, and fracking is a very old one, and the combination of those two things and plus with some, I think, better data they've been able to access resources that everybody knew was there for a long time. As a matter of fact, it was interesting to me that Atlas Shrugged, the book Atlas Shrugged, which I never read but I did listen to going back and forth to the Adirondacks in the car, and at least the first part of that book, one of the heroes of the book was somebody who had figured out a way to exploit Colorado oil shale.

CONSUELO MACK: Oh, amazing. I'll have to revisit the book, right.

ROBERT KLEINSCHMIDT: Yeah, right, so that's 60 years old, that book, but oil shale and the potential for oil shale has been known for a very, very long time. It's just that they couldn't do it, but now they can, and so the United States is becoming the world leader in natural gas production, taking it over from Russia. They're likely to become the world leader in conventional oil

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production, taking it over from Saudi Arabia, and the likelihood of that having an impact on pricing, you're already seeing it. There were some people who thought, I think incorrectly, that it wouldn't affect oil. It's going to affect oil the same way it affected gas, and that does bring back a lot of business to the United States because the very long supply chains from producing things in Asia, and bringing them over here can be eliminated if you can do it more cheaply here. And, by the way, because for years manufacturing went away, manufacturing in the United States, the wage level is also very competitive. At one point in time, it wasn't. So these combination of factors are very good for the economy, and I remember talking about these a year or two ago, saying that I really thought that this could offset all the bad stuff that governments are doing.

CONSUELO MACK: And is it?

ROBERT KLEINSCHMIDT: I think it's in the process of doing it, but it does mean that energy companies, which we own, are likely to be swimming upstream in terms of pricing. Their product price, I think, will get more and more competitive, and so it makes it tough sledding. You only want the very best companies, I think, in that kind of situation, so an Exxon Mobil is one that I think has proven over the years it's able to operate in different pricing environments, and I think it'll operate okay in this one.

So I'm not in a big hurry to sell that stock even though we bought it very cheaply. We bought it when they made an acquisition of a large gas company, shale gas company, and everybody thought they paid too much money, and everybody thought they wouldn't be able to handle it. My judgment was that Exxon knew more about the oil and gas business than Wall Street analysts did, and so I was willing to bet with them rather than... and I think that's turned out to be more or less correct. But I do think that they will have to negotiate this situation, but they're in a far better position to do it, and they're on the distribution side as well. In the old days, if you controlled distribution in the oil and gas business, that's how you made the money, and that may be the case again in the future. So I'm comfortable owning that stock even though it's become a larger position because it's gone up.

CONSUELO MACK: So let me ask you about Apple, because the last time that you were on as well, you were saying you're probably going to be the last person on earth to own Apple. And guess what?

ROBERT KLEINSCHMIDT: I now ...

CONSUELO MACK: You're now an Apple owner. What's the situation with Apple?

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ROBERT KLEINSCHMIDT: Well, my feeling on Apple, and although I say that the only television shows I ever do are yours, there was a slight miscalculation because I did do a thing with Steve Forbes, but I think it was on the Internet, so it doesn't count.

CONSUELO MACK: Right, so I won't be crushed.

ROBERT KLEINSCHMIDT: But we had a very interesting discussion about six months ago or six or seven months ago about Apple and Microsoft, and my feeling at the time was that Apple- and this was when it was really high- that it was a company that could do no wrong, and it wasn't that it wasn't cheap. On the metrics, it was still cheap even at 700, but there was no contrarianism about it. I couldn't find anybody that didn't love it, and they walked on water, and it wasn't necessarily reflected in the price, but it was certainly reflected in the psychology, but they're just a device maker. Right? They're a very good device maker with software and all the rest, but they reminded me, I thought at the time, for those of your viewers who are old enough to remember, of the way people used to think about Sony in the 1980s. You know, Sony made the best products, and you'd pay more for them. It didn't matter. If you could get a Sony Walkman, you didn't care what Panasonic or anybody else was making, and if you could get Sony TV, a Trinitron, you'd pay...

CONSUELO MACK: And look what happened to them.

ROBERT KLEINSCHMIDT: Yeah, and that's right, and I figured that. So Apple was one missed product away from having a real problem, and so they not only missed on one product, but they might have missed on two, and so the stock has I wouldn't say collapsed but it's come way, way down.

CONSUELO MACK: Way down.

ROBERT KLEINSCHMIDT: Way, way down, and so we started nibbling on it, and we still have a very small position, and we bought some when it broke 500, and we bought some more when it got down to like 420 or so, and we have about a one percent position. So we have a rooting interest, and it is very cheap, even more cheap now on the numbers, but it's no longer deified. On the contrary, people feel very skeptical about Apple these days.

CONSUELO MACK: And that's what you just love.

ROBERT KLEINSCHMIDT: I love that.

CONSUELO MACK: That's where you feel comfortable.

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ROBERT KLEINSCHMIDT: Well, you have to be on the opposite side of the consensus. The consensus isn't always wrong, but it's very hard to make money when you're in the consensus. You have to be standing there waiting for the consensus to turn and come back to you, and so my guess is that Apple- and I think they're sort of leading the way to some extent- that if they can't make great new products on the level they did in the past, and I'm not saying that they can't, but they have a lot of financial flexibility to do other things to bring value to the shareholders which they're doing right now.

CONSUELO MACK: With their dividend.

ROBERT KLEINSCHMIDT: Well, their dividend. Just yesterday they sold $17 billion worth of bonds at I think 2.8% for over 30 years to add to the $100 trillion total that we were talking about earlier. Right? And people were standing in line to buy them. I was not, but people wanted to own it, but at least they're thinking about ways to create value and return value to shareholders which is what companies should do if their greatest growth streaks are behind them, and I have been an active investor in the big name technology stocks for a long time, because I think they all should...

CONSUELO MACK: Cisco and Microsoft.

ROBERT KLEINSCHMIDT: Cisco, Microsoft, this one now, because I think that's what they all should be doing. They have all accumulated enormous amounts of cash that they cannot redeploy. Now, they might redeploy them making silly acquisitions, and that's always been the risk, but if they redeploy them intelligently and figure out a way to get money back to the shareholders either through special dividends or dividends or possibly through buybacks, although I have some issues with buybacks because I think they tend to be abused, but still there's a way to provide real value to shareholders given these companies, and after all, they still have great balance sheets, and they have great market shares, and they have great metrics, financial metrics, and maybe they aren't growing like they once were, but unless a new technology comes along and really knocks them off the box, they're going to be around for a while.

CONSUELO MACK: One investment for a long-term diversified portfolio, and it was Microsoft the last time, so what would it be today?

ROBERT KLEINSCHMIDT: Well, you know, I was thinking about that. Of course, whenever you ask a question like that, the temptation is to pick something that has a lot of risk but a lot of potential upside, right? Now, that's not what you would do if you were going to go buy one stock and go on a desert island, and so I'm not really sure the right way to answer this, but I think in terms of big up side and maybe not that much down side, I sort of like Nokia. You know, it's a three-dollar stock. It's a $12 billion market capitalization. On the sum-of-the-parts basis, you've got about $5 billion or so in net cash, and you've got about $6 billion present discounted value of a royalty stream that they have through their patent portfolio, and then you've got maybe another

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couple billion or so in their joint venture with Siemens, so the point is, if you buy Nokia, you're paying really nothing or next to nothing for their phone business which is what everybody knows them for, and so they have a phone business. They've got a smart phone business and a not-so-smart phone business. They're not-so-smart phone business has led the world for years, but that's a declining business. Their smart phone business is really more or less a joint venture with Microsoft and then Microsoft provides the software.

And if that can be successful, and there are some reasons to believe that it can, not least of which because the phone market shares have bounced all over the place over the last many years, this is like having a warrant on Microsoft's operating system and, you know, when you can buy a company like Nokia and not pay anything for its basic business, you know, you're not really risking a lot, and maybe you can make a lot of money. So we'll see what that looks like in a year.

CONSUELO MACK: See what happens. Robert Kleinschmidt, thank you so much for joining us once again.

ROBERT KLEINSCHMIDT: Great pleasure to be here. Thanks.

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One-year	*27.92%*
Three-year	*15.08%*
Five-year	*17.67%*
Ten-year	*8.66%*
Gross Expense Ratio	*1.28%*
Net Expense Ratio	*1.26% **

Fund holdings are subject to change at any time. As of June 30, 2014, the Fund's top ten holdings were:

Top Ten Holdings	*% of assets*
Microsoft Corp.	3.20
General Electric Company	3.03
Schlumberger Limited	3.02
Johnson & Johnson	2.68
NextEra Energy, Inc.	2.62
Exxon Mobil Corp.	2.58
Alkermes PLC	2.58
E. I. du Pont de Nemours and Company	2.51
XEROX Corp.	2.39
Applied Materials, Inc.	2.31

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