Return on Investment

Equity management

Review of Gold Supply/Demand data for Q1 2011

Metric tons & %	Q1 2010	Q1 2011	Annual change	Q4 2010
Jewellery	545.8	576	5.5%	512
Industrial applications	114.1	113.8	-0.3%	116.2
Investment	252.2	182.3	-27.7%	503.7
Central banks	58.8	129.3	119.9%	-20.4
DEMAND	**970.9**	**1,001.4**	**3.1%**	**1,111.5**
Mining	620.3	663.9	7.0%	703.7
De-hedging	-18.7	-10	N/A	-47.1
Recycling	369.3	347.5	-5.9%	454.9
SUPPLY	**970.9**	**1,001.4**	**3.1%**	**1111.5**
Average gold price (USD)	**1,110.2**	**1387.7**	**25.0%**	**1370.5**

Source: World Gold Council, datas as at 31/03/2011.

Demand highlights

Demand has proved very strong overall (+3,1%) despite a higher gold price (+25% higher). Central banks have been acting as a new force for demand and are continuing to buy. Mexico was the main contributor with 93 metric tons of purchase in Q1, and its gold reserves are now at 3.6% of its total foreign exchange reserves. Since the reset in September 2010, excluding IMF sales (which are now over), members of the Central Bank Gold Agreement have barely sold one metric ton. Governments are increasingly eager to diversify their foreign exchange reserves away from the USD and other troubled currencies.

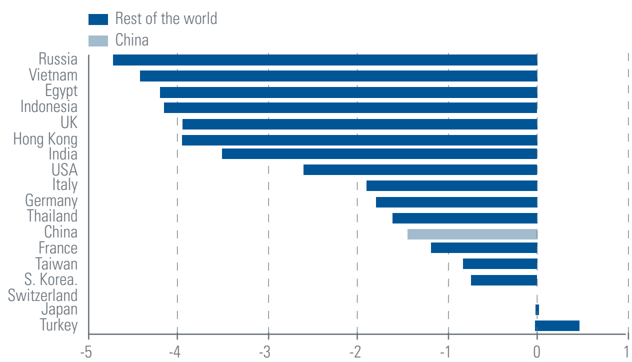
Jewellery gold demand was quite strong (+5.5% to 576 metric tons), with India +12% (to 206 tons) and China +21% (to 152 tons) accounting for 62% of the total.

Investment looks very weak at first sight, which is positive, in a way, as it did not stop the gold price from climbing. So much for the idea that the gold price is purely driven by speculative flows!

What is fascinating in this investment weakness is that physical gold investment demand is very strong (bar and coin demand was up 52% to 366 tonnes). But investors have diminished their financial gold products like ETFs (56 tons net outflow) and OTC products (net divestment). This is certainly healthier for the gold investment market as there are fewer speculators of Wall Street variety.

The investment flow into gold is better explained looking at the following chart, showing that inflation-adjusted 'risk free' rates are negative almost worldwide. Gold usually does well in that environment as it does not suffer from competition with these assets. Gold may not pay interest, coupons or dividends, but it is certainly closer to risk-free status than sovereign debt.

REAL INTEREST RATES



1 12-month deposit rates where possible
2 CPI inflation (YoY%) chg), IMF World Economic Outlook, April 2011

Sources: Bloomberg, central banks, IMF, World Gold Council

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Supply highlights

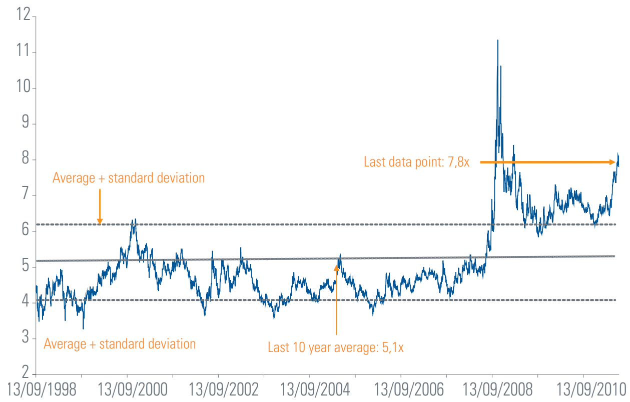
Supply remains pretty unstable. Mined gold production has gone up year-on-year but has been falling compared to the last quarters, since the last quarter of 2010. This validates our long held view that despite a rising gold price, there is no flood of gold mining supply on its way to market. Note, that while the gold price has gone up five-fold since 2000, mining is at roughly the same level as it was back then. We can expect only a moderate annual increase to the tune of 3% or 4%, at most, for the next couple of years.

Contrary to the gold sceptic's belief, the market is also not being flooded with recycled material. Recycling is actually down on a year-on-year and quarterly basis — despite rising gold prices. To persuade holders to take their gold to the refiners, an ever-increasing gold price is required. People – not just in Greece – are increasingly aware of gold's main advantages: diversification and protection. As they rush to buy physical gold, those already holding some are less inclined to sell it.

All in all, supply and demand fundamentals are very supportive of a strong gold price, and potentially a higher one.

A striking development this year has been the poor performance of gold equities when compared with the strong performance of gold itself. This, we believe, has created a valuation gap (as can be seen below) which should narrow in favour of gold equities.

RATIO GOLD PRICE / GOLD EQUITY INDEX XAU



Source: Bloomberg

To put this de-rating of gold equity against the gold price in context, we are back to valuation levels last seen in December 2008. In order to get back to the long-term average valuation (a ratio of 5 times), gold equities would have to rebound by 50%. Another way to see it is that gold producers currently value gold at a price of $1000 USD/oz.

Several factors explain this de-rating:

1- Absent inflows into gold equity

Gold equities comprise just 1% of global market capitalisation and are under-represented in generalist equity funds. However, we believe that the next few quarters at the current gold price will show very strong results that should attract more capital to the sector.

2- Cost inflation in the mining industry is not helping margins

Average mining costs are probably growing this year by roughly 10% (closer to 20% in South Africa). But this means costs are higher by around $60/oz, whereas the average gold price so far this year is +$200 USD/oz over last year, i.e. margins are still expanding.

Since the late 1990's, gold margins have gone from barely $100/oz on average to above $800. With margins multiplied 8-fold in 10 years, the de-rating of gold equities against the gold price seems unjustified with the industry strengthening.

3- Barrick's much criticised acquisition of the copper company Equinox

This investment has not only hurt sentiment on Barrick (shareholders want a gold company 'as pure as gold') but the gold industry overall. Will there be more deals with gold miners buying base metal assets? Are gold juniors overvalued, if Barrick prefers to go into copper?

We think this deal is an opportune one-off. True, Barrick has got so big it is now hard to grow its gold business. But in the end, base metal contributions to Barrick's earnings will remain below 25%, which is roughly what other large gold companies (such as Newmont, Newcrest) offer.

If anything, we would expect gold-centred M&A deals to pick up speed with the strong cash generation we anticipate from large gold producers in the coming financial quarters.

4- An increasing list of gold producing countries with issues so far this year

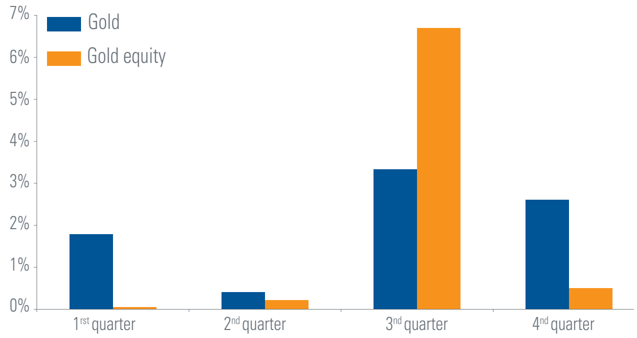
Civil war on the Ivory Coast, violent riots in Burkina Faso and Egypt, risk of mining tax hikes in Peru and Tanzania contributed to higher gold prices — but at the cost of an increased risk premium on gold equities.

Geopolitical risk is inherent in a commodity fund and we have nearly 50 companies in the portfolio to diversify country and stock specific risks.

Conclusion

In pure valuation terms, gold mines are as cheap as they were back in December 2008. We expect two catalysts to drive a re-rating: good financial results (leading to dividend increases) and a better season for gold this time of the year (see below).

AVERAGE QUARTERLY PERFORMANCE SINCE 1993



Source: Edmond de Rothschild Asset Management.

As of 29th June 2011, Edmond de Rothschild Goldsphere's B share had returned 58.32%[1] in EUR since inception (30 September 2008) compared to 49.33%[1] for its benchmark (FTSE Gold Mines).

[1] Source: Edmond de Rothschild Asset Management at 28/06/2011. Past performance is not a reliable indication of future returns and is not constant over time.

EDMOND DE ROTHSCHILD GOLDSPHERE: CHARACTERISTICS

Legal form
Mutual fund
Inception date
30/09/2008
ISIN codes
'A' unit (USD): FR0010657890
'B' unit (EUR): FR0010664086
'I' unit: FR0010664078
Management fees
'A' & 'B' units: 2% net
'I' unit: 1% net
Variable management fees
15% of performance above that of the benchmark index

Minimum initial subscription
'A' and 'B' units: 1 unit
'I' unit: EUR 500,000
Front load charges
Maximum 4.5%
Redemption charges
None
Benchmark
FTSE Gold Mines
Recommended investment horizon
Over 5 years

PRINCIPAL INVESTMENT RISKS

Capital loss risk, discretionary management risk, liquidity risk, equity risk, emerging country risk, risk from the currency in which the fund's shares are denominated, exchange rate risk and credit risk.

THE INVESTMENT TEAM

Emmanuel Painchault
Lead manager.
Raphaël Dubois
Co-manager.

CITYWIRE RATINGS

Emnanuel Painchault: a renewed talent

FUND REGISTERED IN THE FOLLOWING COUNTRIES