Liberty's Outlook

Our 30th Anniversary! 1971-2001

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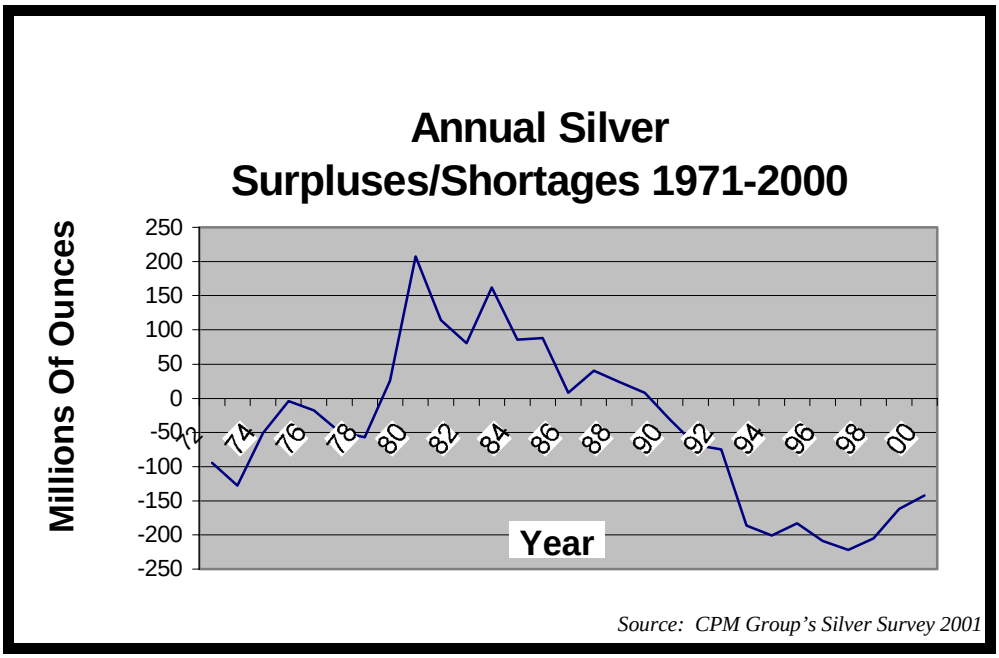
2000 Results In 11th Consecutive Annual Silver Shortage!



Source: CPM Group's Silver Survey 2001

In 2000, for the eleventh consecutive year, there was a huge silver shortage.

Total supplies from mine production, recycling, and government dispositions of 728.1 million ounces fell 142.5 million ounces (16.4%) short of covering industrial and coinage demand of 870.6 million ounces.

In 2001, even if the price of silver jumps sharply before year end, another deficit in excess of 100 million ounces is expected!

At the beginning of 1990, there were about 2.7 billion ounces of silver inventories available to cover shortages. By the end of 2000, barely 1 billion ounces of inventories remain worldwide.

In the 1970s, a string of shortages did not end until the price of silver soared above $50.00 in February 1980.

The shortages in the past eleven years are much larger than those of the 1970s.

The quick conclusion is that silver should be ready to explode in price in the not too distant future. The questions are "when" and "how much," not "if."

I hold to my prediction made last year that, at the minimum, I expect silver to reach $8.00 no later than mid-2002. When it does so, it could easily top $10.00 and may even reach $20.00.

I have been making predictions of a breakout for silver for several years now. Although my timing is off, the result seems inevitable to me.

Here's why.

Silver's Track Record: 1971-2000

There are four major factors that affect silver prices: supply, demand, inventories, and investor psychology. Let's look at each in more detail

1) Supply: New silver supplies come from four sources: primary silver mines, as a by-product of gold, lead, copper, zinc, and other mines, recycling, and government dispositions. In 2000, here is where new silver supplies came from:

Source	*Millions Oz*	*%*
Primary mines	117.2	16.1%
Secondary mining	369.8	50.8%
Recycling	206.1	28.3%
Government sales*	35.0	4.8%
Total	728.1	100.0%

* This figure includes net exports over imports of 15 million ounces from "transitional economies" such as countries that were formerly part of the USSR, China, and North Korea.

Primary mines: Primary silver mines are only the third largest source of new silver supplies. Production at primary mines hit a peak in 1989 at 128.8 million ounces, declined to 71.1 million ounces in 1994, then has grown since.

Primary mine production is expected to drop in 2001. Low prices are the reason. First, low prices lead to the suspension of operations at existing mines that have high marginal (or "cash") costs. For instance, the Sunshine Mine in Idaho, in production since 1884, was closed two months ago.

Second, low prices discourage the development of new mines, a multi-year process.

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The decline in new mining operations we are now seeing is a reaction to low prices since mid-1998. Even if prices rose dramatically in the near future, it would take until at least 2003 before sizeable new mines could go into production.

Secondary mines: The largest category of new silver supplies is as a by-product of gold, lead, copper, zinc, and other mining operations.

In fact, the world's two largest silver producing mines are the KGHM Polska Miedz *copper* mine in Poland that produced 36.0 million ounces of silver last year, and the BHP Cannington *lead-zinc* mine in Australia that produced 32.4 million ounces of silver last year!

Secondary mine supplies rose 19.2 million ounces (5.4%) last year, despite low silver prices. However, secondary production is likely to decline in 2001 because low gold prices will result in production cuts at a number of mines that produce silver as a by-product.

In secondary mining operations, the price of silver is irrelevant. Even if silver prices double or triple, it would have little impact on overall mining activity.

Recycled silver: Recycled silver from all sources declined in 2000 by less than 1% compared to 1999.

The largest component of recycled silver comes from spent photographic papers, films, and solutions, old batteries, electrical and electronic equipment, used ethylene oxide catalysts, and industrial wastes. These sources increased in 2000, largely from photography usage. As photographic demand for silver continues to increase, the amount recovered will also tend to grow.

More than offsetting this increase, however, was the 70% decline in the melting down of coins. Refiners purchased an enormous amount of silver coins in the spring of 1998, when silver prices topped $7.00, enough to keep them busy for much of 1998 and 1999. In the past year, silver coin premiums have grown high enough that little coinage has been bought by refiners. Indeed, the high premiums also indicate that comparatively little investment silver is being liquidated at all!

The Chapter 11 bankruptcy of Handy & Harman Refining Group in March 2000 had little impact on worldwide recycling operations. Refining in the United States fell sharply, but was offset by increases in Europe and Japan.

Much of the capital expenditures for silver recycling equipment were made when silver prices were at much higher levels. What that means is that silver is being aggressively recycled at today's low prices because the capital costs are already sunk. Thus, a sharp rise in the price of silver will have only a minor impact on increasing recycled silver supplies.

Government sales: Government sales are only a minor component of supply for the simple reason that, unlike gold, existing government inventories of silver are small. In fact, all government inventories combined total less than the silver supply deficit for 2000!

The major reason for government dispositions is for coinage purposes. In 2000, a total of 25 million ounces of silver was used for coinage, 40% of that by the U.S. Mint. Of that total, 20 million ounces came from government sales while the rest was purchased on the open market.

Although there has been no confirmation given by India's government, top level precious metals analysts recently reported that the Reserve Bank of India will sell between 32 and 58 million ounces of its holdings in 2001. Including this anticipated one-time sale (the Reserve Bank of India's total silver holdings is only 67.5 million ounces) in the forecast for 2001 is the only reason why the 2001 silver deficit may decline to only 120 million ounces instead of increasing to more than 150 million ounces.

Summary: Silver supplies rose in 2000, more than the rise in demand. Overall supply levels are likely to be higher in 2001 only because of the anticipated Reserve Bank of India sales.

Major quick increases in silver supply are just not possible, even if the price of silver doubled from current levels.

Demand: As I have said many times, it is not really fair to call silver a "precious metal." Although it has a glorious history as a financial metal, it is now basically an industrial metal.

The low prices over the past decade have stimulated research into, and discoveries of, additional uses for silver. Also, demand has grown because of a rising world population and increasing per capita wealth.

For the sixteenth time in the past 17 years, industrial and coinage silver demand rose in 2000 to set another annual record! Worldwide demand has grown from 366.6 million ounces in 1983 to 870.6 million ounces last year. Here is the breakdown for 2000:

Category	*Millions Oz*	*%*
Jewelry/silverware	284.6	32.7%
Photography	283.2	32.5%
Electronics/batteries	111.2	12.8%
Coinage	25.0	2.9%
Other	166.6	19.1%
Total	870.6	100.0%

Jewelry and silverware demand declined 2.4% from 1999, photography usage rose 6.0%, electronics usage jumped 12.2%, coinage fell 15.3%, and other uses increased 5.6%.

It is known that a large quantity, perhaps 20 million ounces, of silver in the form of silver nitrate was imported into China in 2000 for photography usage, but figures simply are not available. Thus, you should keep in mind that actual demand is higher than reported here, and that this analysis is a conservative picture of the silver shortage.

Jewelry and silverware: This category of silver demand is the most sensitive to price. However, when the price of silver rose from $5.00 to $50.00 from 1978 to 1981, jewelry and silverware demand declined by less than 50%!

Even though the average price of silver declined in U.S. dollars in 2000, it actually rose against the Euro and the Indian Rupee, resulting in lower demand in these major markets.

In 2001, look for jewelry and silverware demand to drop for a third straight year, perhaps as low as 260 million ounces.

Photography: Yes, silverless digital photography is growing by leaps and bounds. And the lower silver 28 millimeter Advanced Photo System (APS) is making inroads against 35 millimeter cameras.

But, as the population grows and becomes more wealthy, they are buying more cameras. Just in the past eight years, silver usage for photography in the U.S. has jumped 50%!

Worldwide, relatively few can afford the digital cameras and the computer equipment necessary to use them. Those who use APS film are actually using a greater amount of silver because they average a larger number of prints per negative!

Look for photography demand for silver to grow steadily for at least the next five years.

Electronics and batteries: Silver is used in connectors, conductors, switches, contacts, relays, fuses, batteries, and lots of other applications.

Growth in silver use has been strong and could rise another 10% in 2001. One factor for the growth has been the soaring price and uncertain supplies of palladium. Silver is one of the metals now being substituted for palladium where possible in electronic equipment.

Because of the dramatic rise in the price of palladium, it is unlikely that silver would lose significant market share, even if prices doubled, tripled, or jumped even higher.

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Coinage: After a rise in demand before January 1, 2000, demand for newly minted silver coins worldwide fell in 2000. Demand was steady in the U.S. and higher in China, but fell in Europe and Japan. Expect another 11% decline in demand in 2001.

Other uses: Silver has a wide range of uses, from catalysts, mirrors, brazing alloys, water purification systems, solders, paints, medications, and so forth.

As more research is done, more practical applications for silver are being developed. For instance, health and medical demand for silver is expected to double in the next five years. One application that should reach the U.S. soon is silver-impregnated automobile textiles that reduce live germs and bacteria.

Total demand for other silver uses is projected to rise 8% in 2001.

Summary: Even though jewelry, silverware, and coinage demand should decline in 2001, overall demand is expected to top 2000 by 10 million ounces!

From 1976 to 1981, the average annual silver price, adjusted for inflation, rose 263%. Despite these soaring prices, total silver demand only fell 29%! How high would silver prices have to rise today to lower demand by 16.4% to bring it into balance with current new supplies?

Inventories: Since the beginning of 1990, silver inventories reported on commodity exchanges have dropped by 169.4 million ounces, even though several formerly excluded depositories now have their inventories included in exchange statistics.

The decline in unreported silver inventories over the past eleven years is even more dramatic: down more than 1.5 billion ounces!

At the end of 2000, here are estimated inventories:

Category	*Millions Oz*
Comex	94.0
Tocom	1.7
Chicago Board of Trade	4.0
U.S. and Japanese manufacturers	34.1
Bullion in private U.S. holdings	30-100
Bullion in Berkshire Hathaway	129.7
Bullion in private Europe holdings	10-70
Bullion in Asia and Latin America private holdings	5-100
Silver coins (primarily U.S. 90%)	450.5
Reserve Bank of India	67.5
India government	19.1
U.S. government	40.8
All other government	16.7
Total	899.7-1,124.7

Note: the above inventory figures exclude holdings which are consumed domestically in China, North Korea, and nations formerly part of the USSR.

The silver inventories above include hundreds of millions of ounces that were not liquidated when silver was $50.00 per ounce in 1980. They were also not sold when silver jumped will over $7.00 three years ago. Therefore, you have to conclude that much of this inventory simply is not available at today's price levels.

Summary: ***For all practical purposes, at the end of 2000 there was less than 300 million ounces available to cover future shortages, barely enough to last through the end of 2002!***

Because silver is no longer a significant reserve asset (at today's prices, all government holdings combined are worth only about $600 million), governments have little incentive to manipulate the price of silver. As a result, the price of silver is free to respond to market signals much more than is gold.

Investor psychology: With the fundamental supply, demand, and inventory data showing a near-term critical shortage of silver, why hasn't the price already shot up?

There are several factors:

Past price history: The poor track record of silver prices for the past 20 years scares away a lot of potential investors. On the surface, it is easy to think that something whose price has performed so poorly for two decades must be low for a reason, even if that reason isn't evident.

Strong stock markets: Until a year ago, the strong performance of paper assets attracted most new investment money. Now that the U.S. stock markets have crashed, investors still pay more attention to the political maneuvering to shore up paper assets than they are to protecting themselves with tangible assets like silver. But we have seen the tide turning in the past few months.

Commodities, futures, and options contracts sold short: As I have explained in depth several times, the price of silver is affected by the far larger paper contract market than it is by the volume of physical silver that trades.

In the past several weeks, for instance, short-term traders have used the prospect of silver sales by the Reserve Bank of India to drive down silver prices. Such traders are so focused on their technical trading charts that they may not even be aware of the fundamental shortage of supply to cover physical demand. They also don't care that such a sale would be a one-time event because they plan to have long since closed their positions.

Although some analysts are claiming that the net short positions in the silver market may exceed one billion ounces, I just cannot find it in the statistics. Perhaps there are 100-200 million ounces of paper silver sold short, but I doubt that it is much larger than that.

Still, the physical market is getting close to a crack-up. If some deep-pocket savvy investors don't try a silver squeeze within the next year the physical shortages we are already seeing will become more troublesome and force the issue.

How High For Silver?

In the past 30 years, silver demand has exceeded new supplies by 5%. In 2001 dollars, the average silver price over this time was above $14.00. To me that says that the equilibrium price should be higher than that.

However, silver supplies cannot increase quickly in response to major price jumps. Therefore, when the price of silver takes off, it could easily shoot way past the eventual equilibrium point.

At a speech in Canada on March 11, Jeffrey M. Christian, managing director of CPM Group, a precious metals consultant to central banks and investment houses, predicted that silver will top $6.00 within one year. Even though I consider myself cautious and conservative, I think his projection is way too low.

I also expect the price of silver to break upward by the middle of 2001. But I think prices will easily reach $8.00 and could go all the way to $20.00. Thereafter, I doubt that silver will again trade below $10.00.

At today's bargain basement price, I consider silver to be as close to a "sure thing" as can be found. For this reason, I recommend that silver make up half of your precious metals bullion holdings.

Silver and Silver Coins

Silver closed today at $4.33, down ten cents (2.3%) from four weeks ago.

As I said above, the specter of silver sales by the Reserve Bank of India has made it easy for short-term traders to knock down silver prices in the past several weeks, despite the fact that silver prices were "too low" to start with.

Until this sale either happens or is certain not to happen, I expect the spot price of silver to remain low. Once the sale is over, traders will realize that this "huge" sale did little more than cover a few months of shortages. Prices are almost certain to rise.

If the sale never occurs, silver could easily soar 10% or more in a few days!

In the meantime, purchasers of physical silver are rushing to take advantage of these bargain levels. Demand had been so strong that there are virtually no **100**

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Ounce Ingots (10.4%) or **10 Ounce Ingots** (15.1%) to be found anywhere in the country. Premiums are up significantly from last month. You may have to wait 3-5 weeks for new ingots to be fabricated (assuming that the refiner can come up with the silver to produce them).

The premium on U.S. **90% Silver Coin** (9.2%) has also increased, although supplies are still readily available. This is the form I now recommend both for the lower premium and immediate availability. As the buying binge continues, though, look for premiums to rise further.

Nice affordable numismatic coins are selling almost instantly if dealers are fortunate enough to get them in stock. Despite aggressive efforts for the past six weeks, we have been unable to locate enough pieces of one or a few dates of **Better Date Morgan Dollars** to offer them as we did in January and February. Instead, see our enclosed flyer for the smaller quantities of a wide variety of dates we did pick up.

Experienced collectors sometimes rely on old information about rarity and value of a coin which leads them to undervalue a coin. If you examine current data on **Superb Gem Mint State-66 San Diego Commemorative Half Dollars**, you will see what I mean. Please see our offering.

Gold and Gold Coins

Gold finished today at $258.500, down $3.50 (1.3%) from last month.

Last month's high lease rates for gold (one-month rates rose for a normal 1.5% to as high at 6%) pinched supplies enough that gold rose all the way to $272.25. It seems obvious that some central bank must have taken advantage of the high lease rates by providing more gold to the market—because prices fell quickly.

Harmony Gold Mines stated in their latest annual report that they are against hedging future gold sales even though 10% of all their production for the next five years has already been sold. The company recently announced a major expansion in their hedging activities.

News like that and the continuing strength of the U.S. dollar make it easy for short-term paper traders to knock down the gold price.

At the annual Financial Times World Gold Conference in Rome last month, participants were subdued about the near-term prospects for gold prices.

In my experience, it is when sentiment is the most bearish that you have the most opportune time to buy gold.

Many customers have made sizeable gold purchases in the past few weeks, with the result that some have had to wait a few days for more stock to come in from wholesalers. Many premiums have increased.

The low-premium buys remain the U.S. **American Arts Medallion** (2.7%), Austria **100 Corona** (2.9%), and South Africa **Krugerrand** (3.1%).

Common-Date U.S. Gold Coins are up in price, even with the drop in gold spot prices. Supplies have tightened.

The most dramatic increase has been the $2.50 Indian in Choice MS-63 quality (a coin we recommended last fall). It's price has increased from $525 to $725 in the past two months in response to some coordinated promotions by telemarketers! Other coins have not gone up as much. It might be worth swapping these coins for MS-63 $5.00 Liberties, $10.00 Liberties, and $10.00 Indians which often sell for about the same price at the $2.50 Indian. But right now, you could get another nice coin and at least $100 back. This opportunity is not likely to last long.

Speaking of swaps, some investment writers are suggesting the swap of both gold bullion and gold collector coins into silver bullion. Yes, the gold/silver ratio is higher now than I expect it to be in a few years. However, the high premiums for physical silver makes most such swaps marginal at best. If you are interested, please call us to review the potential. (Tax note: a swap from gold into silver is considered a sale for tax purposes. If you have a loss position in your gold, you could get some tax benefits in 2001 from such a swap.)

Rarely do American collectors have the opportunity to acquire coins issues during the "Forbidden Era" from 1933 to 1974. There are two reasons for that. First, it was illegal for Americans to acquire them at the time, so such coins were distributed elsewhere. Second, there were few gold coins actually issued during this era. See our offering of **1968 Thailand 600 Baht Gold Commemoratives** for a perfect example.

Buffalo Spring

In a little over the Indian Head or Buffalo Nickel that was struck from 1913 to 1938.

The Month

Gold Range	$ 16.25	6.2%
Net Change	-3.50	
Silver Range	.21	4.8%
Net Change	-.10	
Gold/Silver Ratio	59.7	
Net change	+0.6	
Platinum Range	48.00	5.4%
Net Change	-15.00	
Platinum/Gold Ratio	2.21	

Date	Gold	Silver	Platinum
Mar 07	262.00	4.43	585.00
Mar 08	265.75	4.48	595.00
Mar 09	271.25	4.51	590.00
Mar 12	272.25	4.43	582.00
Mar 13	268.00	4.44	580.00
Mar 14	263.25	4.44	583.00
Mar 15	260.50	4.35	579.00
Mar 16	258.50	4.30	579.00
Mar 19	260.25	4.31	577.00
Mar 20	261.00	4.32	573.00
Mar 21	262.50	4.33	578.00
Mar 22	261.75	4.34	569.00
Mar 23	262.25	4.35	567.00
Mar 26	262.50	4.37	571.00
Mar 27	261.50	4.41	575.00
Mar 28	260.25	4.35	570.00
Mar 29	259.00	4.33	557.00
Mar 30	258.25	4.30	550.00
Apr 02	256.00	4.30	547.00
Apr 03	257.00	4.31	565.00
Apr 04	258.50	4.33	570.00

London Silver Market Premium To New York Silver Market = 3¢

Gold, silver and platinum quotes are working spots at 2:45 EST/EDT each day, quoted in U.S. dollars per troy ounce.

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