Liberty's Outlook

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Gold And Silver Find A Base—Start Climbing Again!

P. 4 Better-Date U.S. Gold, Silver Coins Sell At Torrid Pace!

From a close at $255.50 on February 15, 2001, the price of gold rose $123.25 (48.2%) to close on February 4, 2003 at $378.75 in the U.S. markets. In Asian markets that night, gold traded at nearly $390.00

The next day, Colin Powell addressed the United Nations, documenting reasons why the U.S. sought another resolution explicitly condoning military action against the now former regime in Iraq. This firm statement saw gold turn the corner.

In a repeat of what we saw in 1991, the build-up and actual military action against Iraq precipitated a decline in the price of gold, all the way down to $321.00 on April 7.

Though it might seem counterintuitive for the price of gold to decline during the uncertainties of war, the level of uncertainty was actually greater before the bombs and bullets started flying. As a whole, investors did not anticipate that the U.S. military would have much difficulty sweeping Saddam Hussein's regime out of the way, but did have more uncertainty over when and how such developments might happen.

The two-year rise in the price of gold included virtually no significant temporary declines, which is highly unusual. I attribute that lack of profit-taking to the same fundamental reasons why the price of gold was climbing:

- Physical demand was rising;
- Supplies were falling.

The war with Iraq has not changed either of those two factors. It simply provided an opportunity for short-term paper traders to profit from a temporary (and a normal and long-overdue) decline in gold prices.

Once the price of gold dipped back under $335, significant physical demand appeared, especially from India. When it tested $320 earlier this month, the physical demand jumped even higher in India and rose noticeably in parts of Asia and the Middle East.

I now see the gold market as being back where we were in late November and early December 2002, when it was trying to break through the $330 level that it had failed to surmount since 1997. Once the fundamentals reassert themselves and gold tops $330, I think we will be off to the races again. This time, I expect gold to top $400.

Silver also reached a seven month high on February 4 when it closed at $4.91. It slowly fell, reaching $4.35 on March 21. As I have noted before, when the silver price has fallen below $4.40 in the past year or so, manufacturers have come onto the market to lock in inventory for future delivery.

For silver, as with gold, the prices at which physical demand rises sharply tend to dictate a short– to medium-term base price.

As I write this, gold and silver are both up slightly from their recent lows. Can they still decline from where they are now? Yes, there is some possibility. If it happens, I expect the price drops to be slight and temporary. But the continuing factors of rising physical demand and falling supplies are almost certain to bring much higher prices over the next couple of years.

I have written about these factors at length over the past year, but let me quickly review them.

Fundamental Reasons For Gold And Silver To Rise

Decline In Gold Supplies: From almost every direction, gold supplies fell sharply in 2002 and are staying at low levels in 2003.

In the 1990s, newly mined gold typically covered only 60-70% of physical gold demand. The shortfalls were covered by mines pre-selling future production and by central banks selling or leasing their gold reserves.

Collectively, the mining companies have pre-sold about 18 months of future gold production. Many contracts are priced below current market. To reduce this impediment to profitability, the mines are delivering against these contracts rather than providing all of their newly mined supplies onto the market.

For instance, Barrick Gold Corporation, one of the top three gold mining companies, allocated about one-third of its 2002 production specifically to reduce its forward sales position. It plans to continue doing so for the next several years.

This shift in mining supplies reduced gold supplies about 10% in 2002 and will likely do the same in 2003.

The central banks have also capped their sales and leasing activities. The Washington Agreement on Gold in 1999 limited central bank gold sales for five years to then existing levels. The signatories and other governments and official agencies that announced they would comply with the Agreement collectively hold about 85% of official gold reserves.

Central banks have significantly re-

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duced leasing activities. Yesterday, Reuters reported that 12-month gold leases were paying only 0.26%, an amount insufficient to cover the risk of capital loss should the borrower default! Several central banks, with the Netherlands being the most vocal, scaled back lease activities by calling in the gold rather than rolling over expired leases. This activity will continue in 2003 as existing leases expire, knocking down supply another 5-10%.

Don't look for increased mine production. Although technological innovation has made it easier and more efficient to find and mine gold, the relatively low gold prices over the past few years have resulted in sharp declines in mine development. As a result, total mine production is barely holding up to prior year levels.

Increase In Physical Gold Demand: Higher gold prices had knocked down demand in India, the world's largest gold consuming nation. However, this decline in physical demand has been more than offset by the rise in demand in China.

The Chinese government revealed huge additions to its gold reserves in 2002, enough to offset all the central bank gold sales under the 1999 Washington Agreement on Gold!

Plus, the Shanghai Gold Exchange began operations in 2002. It is selling so much gold to private citizens and companies that it has changed its rules to allow foreign companies to trade on the Exchange (effectively to expedite imports into China).

As China's population becomes more prosperous and the government liberalizes its restrictions on gold trading and ownership, look for demand to continue growing. Respected analysts project that jewelry demand in China could rise to more than 50 million ounces annually by 2010! When you consider that current physical gold demand worldwide is only about 120 million ounces, and that China now accounts for less than 25% of that total, you get some idea of how much the physical demand for gold is rising.

Another factor for rising demand that I discussed in more depth in the last newsletter is the significant prospect for higher inflation in the U.S. over the next few years. Just because the main military action in Iraq is over doesn't mean that U.S. government expenditures will magically fall. After all, the U.S. military defeated Germany and Japan in 1945—and American taxpayers are still paying to support almost 100,000 troops still stationed in both countries! South Korea has been home for 40,000 American troops for the past half century.

The American presence in Iraq (and Afghanistan) is almost certain to last for years and probably decades. It will consume enormous resources that have to be paid for somehow.

President Bush is unlikely to seek tax increases given his efforts to gain tax cuts. He is also not likely to try to borrow the money because it would drive up interest rates and hurt the economy. That leaves only cranking up the printing presses and inflating the money supply.

The costs of the Vietnam war were a major contributor to raging inflation a few years later, when we saw gold top $800 and silver over $50 at the peak in early 1980. Recent events are running eerily parallel to the stock market crash of 1973-4 followed by the end of the Vietnam war in 1975. Can high inflation be far behind?

Shortage Of Silver Supplies: Silver supplies have not fallen significantly as they have for gold. However, all that means is that the 150-200 million ounce annual shortfall of silver supply to cover industrial and coinage demand that we saw in the 1990s has now declined to *only* 75-100 million ounces per year!

Newly mined silver comes primarily (75-80%) as a co-product or by-product of gold, zinc, lead, copper and other mines. In fact the world's two largest silver producing mines are the KGHM Polska Miedz copper mine in Poland and the BHP Cannington lead-zinc mine in Australia! Changes in silver prices have virtually no impact on production at such mines.

As with gold, low silver prices over the past several years have almost completely halted the search for and development of primary silver mines. If the silver price doubled or tripled, it would take approximately three years for any new mines to be developed and start production.

High Demand For Physical Silver: Silver demand fell in 2001 for only the second time in the past 18 years. Demand in 2002 is unlikely to be much higher. However, demand in the coming years is likely to be much higher for two main reasons.

First, demand today is down because of the recession. Manufacturers, wholesalers, and retailers have cut inventories to reduce costs, magnifying the decline in demand. With any sign of recovery, expect inventories to increase in all three sectors, magnifying the increase in consumer demand.

Second, because silver is such an inexpensive metal, it is being extensively researched for new applications. Among the most promising increases in demand we are likely to see in the next few years are substituting silver for arsenic in wood preservatives, which could increase worldwide silver usage by more than 10%, and the use of silver as a sheath in superconductor wiring, which would also add to demand by several percent. Silver is being investigated for other applications such as water purification, antibiotic uses, and automotive catalysts.

Typically, the amount of silver used in any industrial application is only a small percentage of product cost. Any sharp rise in silver prices would only have a muted impact on ultimate consumer prices.

Summary: As you can see from this brief review, nothing that has happened in Iraq in the past month has changed the fundamental factors for gold and silver, except for the prospects for higher inflation in the next few years.

I remain convinced that we are still in the early stages of the next great bull market in gold and silver (and rare coins). Prices today are likely to be considered bargains within the next few months and beyond. If your hard asset holdings (tangible assets like precious metals and rare coins) don't make up at least 5-10% of your net worth, you may want to add to you holdings today.

New Gold Certificate Program To Promote Gold Demand—Be Careful!

Purchasing precious metals and taking physical possession does entail

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some costs and risks. You may pay for a safety deposit box or you have the risk of theft if kept in your possession.

For these reasons, the convenience of purchase a paper certificate that represents ownership of precious metals in safe store might sound attractive.

Over the years, dozens of firms that sold certificates have gone out of business, leaving their customers with worthless paper. There are a handful of high quality companies that offer insured storage services that have long track records, but their fees scare away most would-be customers.

Two significant programs for selling gold certificates have debuted in the past few months to try to overcome these problems.

The program most relevant to Americans is the Perth Mint Certificate Program (PMCP). It was developed under the auspices of the World Gold Council (WGC) to stimulate gold demand.

The PMCP is flexible in that investors have the option of purchasing:

1. Unallocated unfabricated bullion (gold, silver, platinum, or palladium). You do not own any particular metal. Instead you own a certain amount of metal from a pooled inventory.

2. Unallocated fabricated Perth Mint ingots. In gold you have the option of 1 Oz, 10 Oz, and Kilogram ingots. In silver, you can only purchase 1,000 Oz Ingots. In platinum and palladium, you can only purchase 1 Oz Ingots.

3. Allocated fabricated coins and ingots. Specific product is segregated with the specific owner's name.

The most promoted point for buying precious metals through this program is the security of storage at the Perth Mint, which is wholly owned by the Australian state of Western Australia. The Perth Mint has been in operation for over 100 years, was formerly a branch of the British Royal Mint. It strikes the Australian gold Kangaroo, silver Kookaburra, platinum Koala, and palladium Emu coins. It is definitely not a fly-by-night operation.

A money saving feature is that unallocated purchases are not charged storage fees, though allocated purchases do incur such charges.

There are three North American firms that handle the PMCP. When I compared costs, I found that the buy/sell spreads for typical customer transactions were similar to those of LCS (a significant exception being someone who wanted to purchase tens of thousands of ounces of silver that would be bought and sold in unfabricated form, but even that only saved about 1% over LCS spreads) .

Unfortunately, the PMCP has a number of restrictions. Initial transactions must at least $10,000 US and any subsequent purchase or sale must be for at least $5,000 US. You must deliver good funds in advance before you can lock in a purchase. To sell, you must deliver the Certificates to the broker before you can lock in a selling price. If you wish to take delivery of any merchandise, there are substantial shipping charges to bring it all the way from Australia. If you wish to take delivery of unallocated and unfabricated bullion, you must pay a fabrication charge.

Although I would think that the Perth Mint would be one of the safer places to store precious metals, it does offer significant disadvantages over dealing with LCS. As you can see from the restrictions noted above, you cannot lock in a price to purchase unless you have prepaid. You cannot sell unless you have previously sent the certificates out of your possession. In volatile markets, you could lose several percent by the time the funds or certificates reach the broker. In contrast, at LCS you can lock in buy or sell prices over the phone instantly.

You can also make much smaller transactions with LCS. Shipping costs are also much lower.

Perhaps the biggest disadvantage of a certificate program is that you do not have physical possession of the precious metals. Many Southeast Asian refugees escaped because they had gold to bribe their way out of Vietnam, Cambodia, or Laos. A certificate would have been worthless. A certificate cannot simply be bartered away, it must be reregistered.

And, as I noted earlier, a number of certificate programs have gone defunct. If you have the precious metals in your own hands, it doesn't matter if the company that sold it to you goes out of business—you are protected by physical ownership.

Perhaps the major reason to own precious metals is for insurance against a sharp drop in value in your paper assets. While a certificate program may sound convenient, it still leaves you holding a piece of paper. In calamitous times, you may find that all you own is that piece of paper. That is why we have always recommended that our customers take prompt delivery of their hard asset purchases.

Watch Out For Operation Iraqi Freedom And Other Coin Scams

Last week, LCS was consulted by the Michigan Attorney General's office about an internet offering of an "Operation Iraqi Freedom Commemorative Coin." What was actually being offered was a genuine U.S. Kennedy copper-nickel half dollar with privately superimposed colored artwork on the reverse side to commemorate the military action in Iraq. A slick gimmick in the offering was a claim that one coin would be donated to a serviceman or woman in Iraq for each coin sold.

The ad was carefully crafted to sound like the U.S. Mint had actually struck such a commemorative coin, which is not true.

On April 11, the Michigan Attorney General's office, in cooperation with the U.S. Mint, issued a Notice of Intended Action to sue the company if they did not take immediate action to correct the misleading sales materials. Among the problems cited were the lack of any contract with the Department of Defense for the donation of the coins to military personnel, that the text was written to make it appear that the certificate of authenticity came from the U.S. Mint, and that the mintage of Kennedy half dollars was limited to only 100,000 coins.

The popularity of coin collecting encourages fast-buck artists to try all sorts of tactics. Last summer we saw mini-replicas of the 1933 $20.00 Saint Gaudens being offered at outrageously high prices compared to what other such replicas sell for. If you see offers anywhere that appeal to you, read the fine print. If it still sounds too good to be true, it probably is. If, after close scrutiny, you still have questions,

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please call us for help.

Gold and Gold Coins

Gold closed today at $325.75, down $11.75 (3.5%) from last month.

Gold trading has been fairly light in the past few weeks, magnifying movements. Some paper traders succeeded in driving down the price of gold to levels where substantial physical buying has developed. Other traders have been sitting on the sidelines, waiting for the price of gold to resume its rise but not wanting to commit to the market in case that didn't happen.

American buyers of physical gold have also been quiet. Physical demand increased significantly since gold dropped back under $335, but that has been mostly from Asia and the Middle East. Physical demand in Europe has also stayed at higher levels than we have seen in recent years.

With little physical liquidation happening, premiums have remained higher than they were six months ago. The lowest premium issues continue to be the U.S. **American Arts Medallion** (3.2%), Austria **100 Corona** (3.3%), Mexico 50 Peso (3.8%), and South Africa **Krugerrand** (4.2%).

European bullion gold coins such as the British **Sovereign** (8.0%), French **20 Franc Rooster** (8.9%), and the Swiss **20 Franc** (8.9%) are among the lower premium small-size gold coins that have histories of trading at 50-100% above gold value. While I don't expect to see premiums rise to those levels again, there is a definite possibility that they could rise above today's levels.

Common-Date U.S. Gold Coins have been relatively quiet in the last month, with buyers apparently waiting for the price of gold to show solid sides of bottoming.

Better-Date U.S. Gold Coins, on the other hand, are a different story. If you are lucky enough to find them, they sell quickly—often at higher prices.

Our recent offerings of two of the rare U.S. American Arts Medallions Gold Commemoratives have been quick sellouts. They are so rare that it has been difficult to fill waiting lists.

The Month

Gold Range	$16.50	4.9%
Net Change	-11.75	
Silver Range	.19	4.3%
Net Change	+.02	
Gold/Silver Ratio	72.7	
Net change	-3.5	
Platinum Range	82.00	11.9%
Net Change	-68.00	
Platinum/Gold Ratio	1.90	

Date	Gold	Silver	Platinum
Mar 18	337.50	4.46	687.00
Mar 19	336.00	4.42	672.00
Mar 20	333.00	4.41	655.00
Mar 21	326.50	4.35	654.00
Mar 24	329.50	4.36	645.00
Mar 25	328.50	4.40	638.00
Mar 26	330.00	4.39	637.00
Mar 27	328.50	4.38	633.00
Mar 28	331.50	4.42	630.00
Mar 31	335.75	4.46	643.00
Apr 01	334.50	4.43	636.00
Apr 02	329.50	4.40	628.00
Apr 03	325.00	4.41	615.00
Apr 04	325.25	4.41	614.00
Apr 07	321.00	4.42	605.00
Apr 08	322.00	4.48	619.00
Apr 09	325.50	4.48	622.00
Apr 10	326.50	4.48	619.00
Apr 11	327.25	4.49	619.00
Apr 14	324.25	4.54	622.00
Apr 15	324.75	4.52	618.00
Apr 16	325.75	4.48	619.00

London Silver Market Premium To New York Silver Market = 2¢

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

Two weeks ago we were fortunate to locate a quantity of another rare issue—**Gem Mint State-65+ 1982 Frank Lloyd Wright Half Ounce American Arts Medallions**. By obtaining them at lower gold prices, we can pass along more savings to you. See our flyer for details.

World Gold Coin deals are drying up. We were unable to find any quantity lot of a world gold bargain but did pick up a few small deals. See our **World Gold Bargains** offering.

Silver and Silver Coins

Silver settled today at $4.48, up a modest 2 cents (0.4%) from four weeks ago.

Physical silver remained in strong demand, selling at its highest volume in over 20 years! It has kept premiums at higher than normal levels. The lowest premium forms are U.S. **90% Silver Coin** (12.4%) and **100 Ounce Ingots** (11.6%). Despite the difference of three cents per ounce, I recommend the 90% Coin as it is far more divisible than the large ingots, and is more liquid.

Engelhard has not manufactured any 100 Ounce Ingots in about 15 years. They are unlikely to restart production unless they can be assured of strong long-term demand. Johnson Matthey restarted its production of 100 Ounce Ingots a year ago. To fill the shortage of 100 Ounce Ingots, two new brand names have appeared: Wall Street Mint and Metallor. Both are backed by major wholesalers. They are priced at significant savings to Engelhard.

Numismatic Silver Coins are still selling at a torrid pace, with prices climbing slowly and surely. We just acquired our largest group of Mint State 1926 Peace Dollars in our history. Dealers who learned of this exciting purchase have been badgering us to try to get us to sell it to them. We would much rather offer them to your. See our flyer.

LCS Store Manager Earns Another Award

LCS Store Manager and Senior Numismatist Paul Manderscheid earned another honor this month when the Michigan State Numismatic Society (MSNS) bestowed upon him the Roethke Memorial Award for the Best Mich-Matist Article of 2002. His research article, titled *Michigan Lumber Tokens*, was 30 pages long.

Paul has done extensive numismatic research and authored dozens of articles over the past 30 years. He is also the author of the book, *Lansing's Money*. He is credited as a research contributor to several numismatic references.

Winning awards for his articles is nothing new for Paul. Among past honors was the 1999 National Active Token Collectors Association (NATCA) for the best article in 1998 when we wrote about Civilian Conservation Corps Camp Tokens.

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