Liberty's Outlook

Volume 10 Issue 4 Liberty Coin Service's Monthly Review of Precious Metals and Numismatics April 7, 2004

Up 103% In Past 28 Months To Highest Price Since 1987!

Silver Soars Over $8.00!

Gold Also Hits 16-Year High!

Last month, when discussing the recent strength in the silver market as it reached $7.00, I forecasted even more of the same:

"Now I think there is a solid prospect that silver could pass $8.00 in the next few weeks!"

Twenty-two days later, silver settled in the U.S. markets at $8.12, its highest close since Black Monday—October 19, 1987—when the Dow Jones Industrial Average fell a record 22.6% in one day.

In the past week commodity contracts have changed hands at prices as high as $8.50 per ounce during trading hours.

Silver's close at $8.20 yesterday was its highest since it settled at $8.25 on August 6, 1987. It has jumped 103% from a low of $4.04 on November 27, 2001!

While all this has been going on, gold has also been strong. When it closed at $427.50 on April 1, that was its highest price since it closed at that same level on December 6, 1988.

As silver climbed up over $6.00 and then $7.00 in the past few months, there had been a noticeable absence of investor liquidation that accompanied previous price surges.

It wasn't until silver closed above $7.50 on March 19 that we finally saw an increase in liquidation. As the silver price kept rising, reaching $8.00 on April 1, the floodgates opened.

We rarely, maybe once a decade, send enough silver to refiners to warrant the cost of an armored car to transport it.

In the past two weeks, we have sent two shipments of silver by armored car.

Liquidation soared so high that our March volume ended up being one of our top five months since the bullion price spike of 1979-1980! And April volume thus far is well ahead of March's pace!

Now that silver has reached $8.00, where to now?

Sorry, my crystal ball is foggier than it was last month. I don't have so clear an expectation of what the silver market will do in the next few months. So, let me review factors that could influence prices.

What Could Cause Silver Prices To Stall Or Decline?

There are several influences affecting the price of silver. Let's look at the some of the more important ones.

Demand could fall. Basic economic theory tells us that as a commodity's price rises, demand falls. That will certainly be true with silver. What is important is how sensitive silver demand might be to higher prices.

The overwhelming demand for silver is for manufactured goods where it is only a small component of the overall products. Products where silver is the primary raw material, such as jewelry and sterling silverware, accounts for less than 25% of silver demand. Physical demand for silver for coinage and investment purposes is less than 5% of total demand.

A $50 product that uses maybe five cents worth of silver will be relatively unaffected if the price of silver doubled, tripled, or quadrupled. If silver represented 5% of the cost of a product, a higher silver price would have a larger effect of the price of the final product.

The price of silver spiked to $50.00 in February 1980; it averaged more than $20.00 for the whole year. In inflation adjusted dollars, the annual average price of silver rose 263% from 1976 to 1980, yet

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Summary Of Current LCS Recommendations For Precious Metals and Rare Coins

How much of your total net worth should be in precious metals and rare coins?

Conservative	Moderate	Aggressive
5-10%	10-20%	20-33%

How much to allocate for each category of precious metals and rare coins?*

	Conservative	Moderate	Aggressive
Gold	50%	40%	25%
Silver	50%	50%	50%
Rare Coins	0%	10%	25%
TOTAL	100%	100%	100%

*Platinum and palladium both have volatile markets with long-term supply/demand fundamentals that are not as attractive as those for gold, silver or rare coins. While either or both may outperform gold, silver or rare coins in the short- to long-term, to be conservative we have omitted them from our allocation.

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total silver demand dropped only 29%, from 514.7 million ounces in 1976 down to 379.3 million ounces in 1981.

From this I conclude that a doubling of the price of silver will have a fairly minor affect on continuing demand. I think it would take a silver price of at least $20.00 to have a noticeable impact on silver demand.

Supplies could increase. Once again basic economic theory tells us that as a commodity's price increases, available supplies increase. With all the liquidation we have seen recently, I'm sure that silver supplies are higher today than they were at the start of the year, for instance.

However, silver can only come from three sources: new mine production, recycling, and government sales.

<u>New mine production</u>: I am sure that today's higher silver price will spur the expansion of primary silver mining operations. However, new mines take 2-5 years to develop, postponing their impact on supplies. Besides, only 20% of new mining supplies comes from primary silver mines.

The other 80% of newly mined silver comes from gold, lead, zinc, copper, and other mines where silver is only a by-product or co-product. The world's two largest silver producing mines for instance are the KGHM Polska Miedz *copper* mine in Poland (2001production 37.4 million ounces) and Australia's BHP Cannington *lead-zinc* mine (2001 production 31.1 million ounces).

For these mines, production levels depend on the prices of the primary metals. Silver prices could double or triple with little impact on supplies from these secondary sources.

Now, prices of these other metals have jumped in the past year, so I do expect silver from secondary mining operations to increase. However, there will be a multi-year lag before production increases would be high enough to cover current supply shortages.

<u>Recycling</u>: When the price of silver hit $50.00 in 1980, companies made enormous investments in equipment to recycle silver. Once prices fell sharply in the early 1980s, it was no longer economical to make such capital investments. However, since companies already had the equipment, they continued to use it. As a result, silver recycling has run at higher levels ever since than the prices of the past two decades would warrant.

Silver recycling could increase, for instance, if more silver were used for X-rays An increase for this reason, though, would be as a result of increased demand, so this would not have the net effect of reducing silver shortages.

The recent surge in the liquidation of investment silver can temporarily reduce silver shortages, but there is almost no chance that it would cover shortages for more than a few months. Such liquidations would have to run about 500% of recent annual levels over the course of an entire year just to bring the supply deficit down to zero.

In the past, sharply higher prices led to a short-term spike in silver liquidation, followed much lower levels of sales—because sellers of silver can no longer sell silver once they have unloaded their holdings

So, for all practical purposes, higher silver prices will not bring enough new supplies of silver onto the market to cover the deficit for more than a few months.

<u>Government sales</u>: Governments worldwide have less than 200 million ounces of silver holdings, a comparatively insignificant quantity. Much of these holdings are for coinage or armaments usage, so it is unlikely that much would be sold simply because the price of silver was higher. Even if it all was completely sold, that would only cover about two years worth of supply deficits.

There simply is not any magic way to increase silver supplies to any great degree in the short-term. Over several years, supplies might rise 25-50%, but this is not enough to halt rising prices today.

The value of the U.S. dollar could increase. Since the Euro peaked in early January, the U.S. dollar has recovered about 5%. With the European Central Bank pronouncements in the past month that it is thinking of cutting interest rates to help drive down the value of the Euro versus the dollar, that would tend to help the dollar increase in value.

But . . .

Since the beginning of 2003, the Japanese central bank has purchased more than a $250 billion (that is $250,000,000,000) in U.S. dollars trying to prop up the value of American currency. Despite spending an amount that is greater than the total reserves held by any but a handful of central banks, the Japanese yen has risen to a multi-year high against the dollar. If the Japanese simply slow down this subsidy of the U.S. dollar, the dollar will decline.

China, which holds the world's second largest cache of currency reserves after Japan, has fixed its currency to the U.S. dollar for the past several years. It is dependent on a relatively weak U.S. dollar to support its current export levels. If the dollar were to rise in value, that would wreak economic havoc in China. It has no incentive to do anything which might increase the value of the dollar.

Of course, a necessary pre-condition for the value of the dollar to rise is an expectation that inflation in the U.S. would remain in check.

U.S. inflation levels would have to hold steady or decrease. In an inflationary environment, prices of goods and services increase (well, technically what is happening is that the currency is depreciating). Government actions that can lead to inflation are huge budget deficits. Huge trade deficits can also indicate that a nation's currency is overvalued.

The current American budget and trade deficits are so huge that economists are virtually unanimous that inflation is ready to roar. The disagreement is in predicting how soon. Some say the prices will be rising before the November elections, while others think they may not hit until next year.

No matter who is right, higher inflation levels are all but guaranteed.

Why Silver Could Rise Even Higher

There are a number of other factors that could help hold down the price of silver, but I think you can see from the foregoing discussion that the odds of every single one of them happening are unlikely.

What is more likely to happen is that, at a minimum, silver demand will not drop that much, new supplies will not increase enough, the value of the U.S. dollar is more likely to fall than to increase, and American inflation levels are going to rise.

At the very least, silver should hold its current levels. Most likely, we will see even higher prices in the coming months. There is even a sizeable chance that we could see breakaway prices of $15.00, $20.00 or even higher before the end of 2004!

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Since 1971, when the U.S. government stopped trying to hold down the price of silver by flooding the market from the reserves it formerly held, the average inflation-adjusted silver price is more than $16.00 (in 2004 dollars). Over that time, the supplies of silver have come about 3% short of covering demand.

That tells me that silver, though it may be at a 17-year high, is still ridiculously underpriced.

Another major indicator of a peaking silver price is if the London silver price develops a significant premium to the New York silver price (see the in depth discussion in the March issue). Since there is little difference between the two markets today, I interpret that to mean that there is no supply squeeze. That tells me that we are nowhere near a market peak.

Instead of thinking that you might have missed the boat because you didn't buy silver when the spot price was $4.50 or $5.50 or $6.50, consider that you can own it now for a lot less than it will likely be in the next few years. To me, the downside looks limited and the upside is tremendous.

Gold and Gold Coins

Gold finished today at $422.25, up $22.25 (5.6%) from last month.

Short sellers made one attempt to knock down the price of gold in mid-March, but were thwarted at mushrooming demand when gold prices dropped under $400.

After the American markets closed on March 23, the European Central Bank announced that is was seriously considering dropping a key interest rate. Although it did not drop this rate at its meeting last week, there is a good likelihood that it will occur at the next meeting.

Dropping this rate would have the effect of making the Euro a less desirable currency, thereby reducing its value against other currencies such as the U.S. dollar. With a falling Euro, that would make gold and silver more expensive in Europe, hurting demand. This announcement is one of the strongest measures that central bankers could take to halt a falling dollar.

This news, perhaps the most negative news for precious metals in the past year, led to a quick drop in the aftermarket prices of gold and silver.

However, even this significant development could not stop rising precious metals markets. Three days later, gold and silver prices were back above levels they were at before this announcement. They are even higher today.

No doubt, the recent increase in violence in Iraq is making investors nervous. When uncertainty increases, so does the preference for gold and silver instead of currencies and paper assets. Nonetheless, I suspect that the price of gold is only a few dollars higher than it would have been if the fighting in Iraq were still at levels of earlier this year.

Higher silver prices helped draw attention to how much the price of gold has climbed in the past couple of years. There was a modest increase in investor liquidation, though nothing like the flood of silver coming in.

Along with the increase in investor liquidation, we also saw a modest increase in investor demand. With premiums on several bullion issues remaining at higher levels than they were at the start of this year, that tells me that physical gold demand is much stronger than you might expect since gold has climbed from the $252 level just a few years ago.

The best buys are still the U.S. **American Arts Medallion** (3.9%), Austria **100 Corona** (3.6%), and South Africa **Krugerrand** (3.8%). They are not as plentifully available as a few years ago. In the past, if we were trying to fill an order for a thousand Austrian 100 Coronas, we could have them in days. Now it might take us up to three weeks to find enough sources to fill such an order.

Some popular small European coins such as the British **Sovereign** (7.6%), French **20 Franc Rooster** (8.8%), and Swiss **20 Francs** (8.8%) have held steady in premium, no doubt influenced by the small drop in the Euro. Such coins are well worth considering, especially when you consider that they used to trade at far higher premiums than today. When I bought Sovereigns for my personal account in 1973, for instance, they cost me about 50% above gold value.

Common-Date U.S. Gold Coin prices are up in the past month, more or less in line with the change in gold spot. We have not seen a groundswell of public demand. We are aware of some wholesalers stockpiling some of the more affordable elusive issues such as MS-63 and MS-64 $5.00 Liberties, $10.00 Liberties, and $10.00 Indians. It would not surprise us to see prices rise 10-20% by the end of this year over and above the change prompted by a rising gold spot.

Better-Date U.S. Gold Coins have become almost impossible to find, no matter the price. You can find individual coins, but any group is invariably snapped up by the first wholesaler or major retailer who sees it. Although we have been inordinately successful at ferreting out such lots over the past few years, we simply did not find any in the past month.

However, we did have good fortune uncovering two interesting lots of **World Gold Coins**. **Mint State Denmark 20 Kroner "Mermaids"** used to be a really rare coin, until the Norwegian Gold Hoard hit the market in the late 1980s. They are still rare coins compared to other issues from larger European nations, but we can offer a small group at a wonderful price. See our offer for details.

We also snapped up a group of **United Kingdom 1/10 Ounce Gold Britannias**. These were issued as bullion coins, and we offer them for sale as such, but it seems obvious that they are among the least common 1/10 ounce gold coins at such price levels. If we had to chase some down for a special order, they might cost more than we are offering them to you in our flyer.

Silver and Silver Coins

Silver closed today at 8.18, up a whopping $1.02 (14.2%) from four weeks ago. Silver has now soared 37.5% since the end of last year!

Higher silver prices and increased investor liquidations have resulted, as is typical, in falling premiums for silver coins and ingots.

We have seen an increase in investor demand for silver bullion-priced products, but nowhere near the degree that investor sales have soared.

It is quite possible that silver will pause at current levels while this temporary influx of supply masks the long-term shortages. I think that it has held over $8.00 long enough that you will likely see a surge in buying if prices go much below current levels. You *may* have a window of a month or two to add to your holdings.

Today you can purchase bags of U.S. **90% Silver Coin** (0.5%) for just four

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cents per ounce above its intrinsic silver value. With great liquidity and divisibility, it is our most strongly recommend form of physical silver now.

If you are going for a really low premium form of silver, consider U.S. **40% Silver Coin** (-1.6%). It is now selling for 13 cents per ounce below silver value! I hesitate to recommend it because of its bulk and because of potential liquidity problems if the price of silver jumps sharply, but there is no problem with the price.

The premiums for **100-1 Ounce .999 fine Ingots** (5.3-6.1%) are also lower.

Speculative idea: Higher silver prices are really crippling demand for 2004 Silver Eagle Dollars. Mint sales are down about 20% year-to-date, with recent sales down 60% compared to year-earlier figures. It appears that the Mint has already sold close to 5 million coins, which would keep it from being one of the lowest mintage issues. But I think sales for the rest of 2004 will fall even more sharply—because wholesalers have higher than expected inventories. If you don't mind speculating a little bit, you might want to put away some rolls.

As for other U.S. **Silver Eagle Dollars** (21.4%), however, I do not recommend purchasing bulk quantities as a silver investment. Their premium has fallen sharply from the 38% level twelve months ago. Buyers of 90% Coin have done at least 10% better than those who purchased bulk Silver Eagles a year ago.

In the June 2003 newsletter, I recommended taking advantage of the too high gold/silver ratio to swap gold for silver. At the time, the ratio was 80.6. Today it is down to 51.6. Had someone swapped 100 Gold American Eagles for U.S. 90% Coin on June 4, 2003, they could have received $10,500 face of 90% Coin. Today, they could swap that $10,500 face of 90% Coin for 130 American Eagles, a 30% increase that could have been achieved with no cash outlay.

Although I anticipate that the gold/silver ratio will decline further, it would be difficult for it to fall enough to cover the costs of making the swaps. I no longer recommend such swaps.

The stockpiling of **High-Grade Common-Date Morgan and Peace Silver Dollars** continues. Prices are up in a number of types and grades in the past month. **Mint State Rolls of Morgan and Peace Silver Dollars** are also on the way up.

In such a strong silver market, it can be difficult to find bargains. Wholesalers either do not have anything to offer or they are stockpiling coins for coming promotions.

Fortunately, we came up with two sizeable groups of **Mint State Pre-1967 Canada Silver Dollars** at the bid side of the wholesale market. We offer them here at prices closer to their silver value than a number of government-issued 1 ounce silver coins.

The Month

Gold Range	$32.00	8.0%
Net Change	+22.25	
Silver Range	1.15	16.1%
Net Change	+1.02	
Gold/Silver Ratio	51.6	
Net change	-4.3	
Platinum Range	46.00	5.0%
Net Change	-46.00	
Platinum/Gold Ratio	2.06	

Date	Gold	Silver	Platinum
Mar 10	400.00	7.16	917.00
Mar 11	400.50	7.17	897.00
Mar 12	395.50	7.05	901.00
Mar 15	399.50	7.13	908.00
Mar 16	402.25	7.15	898.00
Mar 17	406.75	7.24	901.00
Mar 18	411.00	7.45	891.00
Mar 19	412.50	7.54	884.00
Mar 22	417.25	7.61	891.00
Mar 23	419.75	7.69	905.00
Mar 24	417.00	7.64	910.00
Mar 25	416.50	7.59	905.00
Mar 26	422.00	7.70	904.00
Mar 29	417.00	7.61	882.00
Mar 30	421.25	7.76	889.00
Mar 31	427.00	7.92	901.00
Apr 01	427.50	8.12	910.00
Apr 02	421.00	8.12	895.00
Apr 05	415.25	8.10	881.00
Apr 06	418.25	8.20	874.00
Apr 07	422.25	8.18	871.00

London Silver Market Premium To New York Silver Market = 1¢

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

Everybody wants to find coins that they can purchase at bullion-related prices with the prospect of one day selling them for a rare coin premium. Mint State Pre-1967 Canadian Silver Dollars offer that potential. See our flyer for details.

LCS's Heller Earns 2004 Entrepreneurial Award Of Greater Lansing

At the 2004 10th Annual Entrepreneurial Awards of Greater Lansing ceremony on March 18, Liberty Coin Service's owner and general manager Pat Heller was recognized with the Socially Responsible Entrepreneur award. In announcing the award, Chris Holman, publisher of *The Greater Lansing Business Monthly,* cited Heller's work involving students and the general public is several steps of the process of selecting a design for the 2004 Michigan Quarter and the recently concluded "Cans For Quarters" program where LCS gave away Michigan Quarters to those bringing in cash and food donations for the Greater Lansing Food Bank.

Although LCS is not the first coin dealer to give away state quarters for food bank donations, it did receive enough publicity that numismatists in two other Michigan cities started their own programs. The weekly newspaper *Coin World* urged other dealers and collectors to follow LCS's example when their state quarters appear.

In accepting the award, Heller noted that LCS's growth and success over the years would not have been possible without the tremendous support and inspiration from family members and co-workers.

The Cans For Quarters program is now over, though a few donations are still trickling in. Nearly 6,000 pounds of food was collected and over $6,500 in cash. We thank everyone for their generous support of the Greater Lansing Food Bank.

Liberty's Outlook is published monthly by Liberty Coin Service, 300 Frandor Ave., Lansing, MI 48912. Telephone: National 800/527-2375 Fax: 517/351-3466 Internet: www.libertycoinservice.com, E-mail: path@libertycoinservice.com Patrick A. Heller, Editor. Subscriptions $79.00 per year (12 issues). Send subscription orders and changes of address to the above address. All information is derived from sources believed to be reliable, but accuracy cannot be guaranteed. No guarantee of profitability of any investment or recommendation contained herein is made or implied. Liberty Coin Service has been a dealer in rare coins and precious metals since 1971. The publisher, its principals and associates may, from time to time, have a position in items recommended here.