Liberty's Outlook

Volume 8 Issue 2 Liberty Coin Service's Monthly Review of Precious Metals and Numismatics February 6, 2002

Gold, Silver, Rare Coins Strong As Bankruptcies, Accounting Questions Clobber Paper Assets!

- **Tokyo Nikkei Stock Index Hits 18 Year Low!**
- **Gold Buying Frenzy In Japan As Value Of Yen Keeps Falling!**
- **Gold Mine Supplies To Drop 10% Or More In 2002!**
- **Gold Reaches 2 Year High!**
- **Is This Only A *Preview* Of What Is Coming?**

I'll try not to sound alarmist, but I am personally worried. I hope that I am 100% wrong in this analysis, but fear that many parts will come about.

Last month I warned that there were a number of factors that could cause the value of the U.S. dollar to decline in 2002, a move that could boost the price of gold.

I certainly didn't expect the dramatic events of the past few weeks that have led to the current rush to own gold for "safety" reasons.

The spark was the declaration of bankruptcy by Enron Corp late last year, the largest in American history. The company's demise is attributed to "creative" accounting practices by which many partnerships formed by Enron were kept off Enron's books, thus postponing the recognition of losses. The incentive for such structuring was to keep up the appearance in the eyes of investors that Enron was still growing and flourishing, even when it was no longer true.

In the aftermath of the Enron debacle, further shocks have clobbered the U.S. stock markets.

Tyco International revealed that it had purchased 700 companies in recent years without making any public announcements for any of them. Tyco's current plan to split into four companies has investors wondering what other nasty accounting surprises may be forthcoming.

Then two more major bankruptcies, Kmart Corp. and Global Crossing, Ltd., stunned paper investors.

Right now, there is a mushrooming public outcry for public companies to fully report their off-the-books financial arrangements and commitments such as partnerships and derivatives trading. Such activities became widespread as companies a few years ago tried to do almost anything to come out with quarterly results that satisfied or exceeded frenzied investors' expectations.

As these off-the-books financial data are reported, it is expected that many more companies will file for bankruptcy.

Yesterday, theminingweb.com reporter Tim Wood pointed out that special attention is now focused on JP Morgan Chase, currently trading at a three-year low stock price. The bank may have sustained enough losses on its derivatives trading with Argentina, Enron, and others that within a few weeks it will be forced into bankruptcy. If this comes to pass, or any failure of another major company, the flight of investor money out of paper assets into the safety of precious metals will accelerate.

JP Morgan Chase isn't the only mammoth-sized company whose survival is in question. Other banks and brokerages such as Citigroup, Bank of America, Bank of New York, Goldman Sachs, and Morgan Stanley have seen their stock prices decline right with JP Morgan Chase.

Even Wall Street stalwarts such as AT&T, General Electric, American Express, and Honeywell have taken some hits in the past few weeks.

Such news by itself would be enough to scare investors out of paper assets and into gold. But the U.S. dollar was hit with other bad news in January.

- The Chinese central bank announced that it had added almost 4 million ounces to its reserves and that it would begin an active program to reduce its holdings of US dollars in its reserves—to be replaced by the Euro. In one stroke, China added as much gold to its reserves as the Bank of England sold in one year's worth of auctions.
- The shaky Japanese economy is spurring Japanese investors to liquidate some of their U.S. stock and bond holdings to repatriate the funds. Gold sales in Japan are strong, even though the price of gold in Yen is at a three-year high! In fact, gold trading on the Tokyo TOCOM was halted for a time today as buy orders overloaded the system!
- Yesterday, when gold closed near

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$300, its highest price on the commodities exchanges in two years, brokers reported that a number of investment funds were buying gold as a "flight to safety" asset. For so many funds to purchase gold is a major shift in investment strategy.

The biggest news in the gold market so far this year was the announcement on February 4 by South African gold mining giant Anglogold that they would reduce their forward sales by 4.5 million ounces by the end of 2002. That, coupled with the formerly announced plans by Newmont Mining that, after the completion of the takeover, it will unwind the 10 million ounces of forward sales made by Australia's Newmont Mining, points to a sharp drop in new mining supplies coming on the market in 2002.

Because of the reduction in forward sales by these and other companies, it is almost certain that the quantity of newly mined gold sold onto the market in 2002 will be 10% lower than in 2001, and could even approach a 15% drop in supply!

In the past seven trading days, gold prices have sliced through resistance levels in the $280s and $290s, climbing almost 10% to as high as $305.00 in London this morning. The last time gold closed this high was on February 22, 2000—in the aftermath of announcements by Placer Dome, Barrick, and other major gold mines that they would be reducing their forward sales!

Is This Only A *Preview* Of What Is Coming?

I fear that the chances are high that we are on the brink of a major currency and paper asset crisis right here in the U.S.

1. The public clamor to uncover off-the-books activities of major companies is almost certain to root out one or more nasty surprises.

2. Shaky U.S. stock and bond markets will encourage foreign investors to liquidate and take their money home, further accelerating any price declines.

3. However, the instability of the major competing currencies, the Euro and yen, will cause some of this repatriated cash to be invested in gold

4. The Dow Jones Industrial Average (DJIA) declined 6.2% in calendar 2000. In 2001, it dropped a further 7.1%. Since the beginning of 2002, it has already lost another 3%. Over the same period, gold has outperformed the DJIA by almost 20%! Nervous American investors are bound to take even more notice of that.

I don't encourage any panicked or knee-jerk investment actions, and if you have been following our advice all along to protect yourself with precious metals, you should be in good shape. But I don't think you have any time to wait to buy gold and silver and maybe rare coins. The risks of delay are just too great!

Triple Play Profit Opportunity With Numismatic U.S. Gold

As bright as the outlook is for gold bullion now, common-date numismatic U.S. Gold Coins may even do much better, if past performance is any guide.

Look at what happened in 1985. On February 25, 1985, the price of gold reached a six-year low at almost the same time that the value of the U.S. dollar hit a multi-year peak.

Over the next nine months, the dollar fell against other currencies.

In that same time period, the spot price of gold rose 15%.

In all Mint State grades, every one of the 11 most common types of U.S. Gold Coins appreciated by more than 15%!

Choice Mint State-63 $20.00 St Gaudens were up 22%.

Choice Mint State-63 $20.00 Liberties shot up 32%!

Choice Mint State-63 $10.00 Liberties jumped 62%!

Why the difference?

The answer is relative rarity.

Physical gold bullion is plentiful compared to the quantity of Mint State U.S. Gold Coins. When the price of gold is rising, demand for U.S. gold coins almost invariably increases. Because of the much smaller supply, prices of U.S. Gold Coins are much more sensitive to shifts in demand.

The U.S. Gold Coins that enjoy greater increases are those that are in tighter supply. A check of the latest Professional Coin Grading Service (PGCS) and Numismatic Guaranty Corporation (NGC) population reports shows the following number of certified Mint State-63 specimens:

$20.00 St Gaudens	316,222
$20.00 Liberty	126,701
$10.00 Liberty	30,246

You can see the general trend that the scarcer the coin type, the higher the appreciation.

It is even possible for common-date U.S. Gold Coins to appreciate in the absence of a rising gold price, giving these coins a two-way profit potential.

But there are even better prospects. **Better-Date U.S. Gold Coins** that sell near the price of common-date coins are enjoying strong collector demand right now. They are almost certain to appreciate if the gold spot price rises or if the common-date U.S. Gold Coins rise. But they may also rise even if neither of the circumstances come to pass. That gives them what I like to call a triple play profit opportunity. They can appreciate for any one reason, or two, or all three!

I think appreciation prospects for are excellent for almost any U.S. Gold Coin right now. Many are now selling for a fraction of their peak prices. But if you encounter the rare opportunity to acquire a low-premium better-date U.S. gold coin, consider that a bonus. This month's offering of **Choice Mint State-63 1895 $10.00 Liberties** is a perfect example. The **Mint State 1877-S $20.00 Liberties and 1920 $20.00 Saint Gaudens** are two others.

Silver On Brink Of Major Surge In Demand?

The International Maritime Organization, a United Nations agency, will ban the use of tributyl-tin compounds in marine paints after ratification of the ban by 25 countries that represent 25% of the world's merchant marine fleets. Although this ban will not be binding on naval and coast guard vessels, the U.S. government and many other countries are expected to comply with these restrictions.

The banned compound was used to prevent the growth of marine organisms on marine structures and ships. Unfortunately, it harms marine life. Silver appears to satisfy all the requirements for a replacement biocide. If all tributyl-tin compounds in marine coatings were replaced with silver, worldwide demand could exceed 30 million ounces per year.

Florida, California, Minnesota, and several European countries are considering a ban on the use of arsenic as a wood preservative. Copper arsenate, a toxic chemical, is now widely used in

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railroad ties, utility poles, decking, benches, and playground equipment. Silver-based preservatives are currently being studied as a substitute.

If silver were to replace arsenic in wood products, silver demand would increase about 130 million ounces per year. If creosote were also banned as a wood preservative, as is currently being considered in several European nations, silver demand could rise even further.

Together, these potential new demands for silver could increase worldwide annual usage by more than 200 million ounces—about 25%.

With annual shortages of newly mined and recycled silver against industrial and coinage demand still exceeding 100 million ounces per year, and available inventories now well under 1 billion ounces, these applications could accelerate the rise in silver prices over the next few years.

Gold and Gold Coins

Gold closed today at $297.50, up $14.00 (4.9%) from four weeks ago.

Gold traded today as high as $305.00 in London and $306.50 in the U.S. before profit-taking brought prices back under the $300 psychological level.

Over the past several years, it seemed that almost no news could lead the price of gold to rise. Today the reverse is true. Right now about the only news that causes the price of gold to fall is normal profit-taking after gold reaches a significant plateau.

Market pros did not expect gold to close above $300 on the first day that it breeched that level, and it didn't. But these same experts now anticipate that will top $300 to stay in the near future. With the bleak news for the U.S. dollar, the Euro, and the yen, the shaky stock markets, and the drop in gold supplies in 2002, I think the price of gold has stronger appreciation prospects in the next few months than risk of significant decline.

We have seen some liquidation of physical gold bullion as gold has jumped but these amounts are dwarfed by the volume of trading in the commodities and futures markets. CPM Group, a major precious metals consulting firm, claims that investor liquidations of gold in 2001 exceeded 2000 levels, despite the huge amount of post-Y2K sell-off early in 2000. They expect large investor liquidation to continue in the U.S. into 2002 but it will not be enough to offset the positive news in the gold market.

As can be expected when gold demand is increasing overall, the premiums on the lowest cost forms of physical bullion—U.S. **American Arts Medallion** (2.2%), and Austria **100 Corona** (2.5%) are up slightly from last month.

On the other side, higher gold prices have led to enough liquidation of more expensive bullion issues that their premiums have declined in the past week. Such coins include U.S. **American Eagles** (5.8%), Canada **Maple Leaf**s (5.8%), South Africa **Krugerrand** (2.9%), Mexico **50 Pesos** (3.9%), Austria **Philharmonics** (6.4%) and Australia **Kangaroos** (6.4%) Even the popular small gold coins such as the British **Sovereigns** (6.0%), France **20 Franc Roosters** (7.6%), and Switzerland **20 Francs** (7.6%) have lower premiums this month.

Common-Date U.S. Gold Coins are almost all up this month in response to higher gold prices. Still, in absolute prices and in terms of the premium to gold content, they are close to their lowest levels in the past two decades.

Better-Date U.S. Gold Coins, as discussed earlier have a strong following among collectors. The difficulty is locating nice coins.

Last month, when we offered a handful of **foreign gold coins struck from 1933 to 1974, the "Forbidden Era"** when it was largely illegal for Americans to own gold coins, we could have sold them several times over. We found some more for your this month.

Once again, we struck a responsive chord when we offered the one-year Mint State 1918-I India Sovereigns last month. During the course of our diligent efforts to locate more of them or of the scarcer Canadian Sovereigns, we were offered a small hoard of **Choice Mint State-63+ 1896-M Australia Sovereigns.** Veiled Head Victorian Sovereigns such as these are almost never found in Mint State. Yet because of our fortunate purchase, we can offer them at a huge discount to catalog value. See our flyer for details.

Silver and Silver Coins

Silver settled today at $4.36, down 35 cents (7.4%) from last month.

As I forecasted last month, silver spot climbed high enough for profit-taking to set in to stop the rally. Silver slid all the way down to $4.23 on January 31. Since then it has been rising in sympathy with gold, rather than on its own merits.

Silver today is almost entirely an industrial metal. New coinage demand accounts for less than 5% of annual usage. As we are witnessing right now, gold is getting almost all the attention from investors seeking financial safety.

However, any major financial crisis is almost certain to increase investor demand for silver, especially among those with smaller budgets. One reason is that investors who think they missed buying gold before it started to rise, will look at silver as a second chance. Plus there are still lots of silver bugs who remember the days when silver coins actually circulated.

CPM Group reports that investor liquidations of physical silver have declined from 2000 to 2001. They expect this trend to continue simply because there is less silver inventory available to liquidate.

The CPM report mirrors our experience. LCS has sold a sizeable quantity of silver bullion-priced products to the public over the past few months. We have had to purchase most of it on the wholesale market as very little is being sold to us by the public.

With the decline in the silver spot price, premiums on U.S. **90% Silver Coin** (10.0%) and U.S. **40% Silver Coin** (11.2%) have increased. Still, they are selling for a lower price per ounce of silver content than **100, 10, and 1 Ounce Ingots** (11.9-14.9%). Because of the price advantage, I still recommend 90% Coin for most purposes.

Some of our national competitors have found it easier to sell lower-priced silver coins than gold coins. For the past year or two, their marketing promotions have been almost exclusively devoted to a variety of rolls and bags of silver coins.

With the long-term fundamental shortage of silver supplies, their efforts have enjoyed success—enough to push up prices on several products.

For example, we formerly recommended Mint State rolls of common-date Franklin Half Dollars when they were selling for $69 or less. Now that they would cost at least $89, we don't think they represent good value.

There are still niches where you can acquire some interesting and historic silver coins without having to pay hyped-up prices. Our offer of **"Out Of The Limelight" Silver Coin Bargains** gives

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you two excellent examples.

Ford's $1 Billion Palladium Write-Down—Some Unanswered Questions

Ford Motor Company recently announced a major restructuring of company operations. Somewhat buried in all the hoopla was a $1 billion write-down for precious metals.

The official line, as discussed in some detail in today's *The Wall Street Journal,* is that the company went overboard in buying palladium near the market peak just before the company's engineers changed catalytic converter specifications to use a lot less palladium in each vehicle. Ford also did not hedge their purchases against falling prices. Since then, the price of palladium fell as much as nearly 70% and is still almost 65% below its peak.

The media seem to be accepting Ford's statements at face value, without trying to calculate if the whole $1 billion write down in precious metals is possible.

According to the Johnson Matthey report *Platinum 2001—Interim Review,* net 2000 palladium demand for worldwide automotive applications came to 5.41 million ounces (which fell to 4.55 million ounces in 2001). Generously assuming that Ford bought 1 million ounces of palladium and paid a very high average price of $800 per ounce (from November 2000-March 2001), the maximum they could have lost would have been less than $500 million before tax, or barely $300 million after tax.

Ford blames most of their precious metals loss on palladium. If the most liberal interpretation can only come up with a loss that is less than half of that reported by Ford, it simply is not possible to have lost enough on platinum and rhodium to add up to Ford's total write-down.

Publicly held companies that are taking a bath in write-downs often try to include extra charges. By doing so, they leave some cushion to help improve future results. I cannot prove it, but I have a strong suspicion that this may have happened with part of Ford's precious metals write-down. If this turns out to be true, this example of misleading financial reporting would give investors one more reason to be uncomfortable about holding paper assets.

The Month

Gold Range	$20.25	7.1%
Net Change	+14.00	
Silver Range	.48	10.2%
Net Change	-.35	
Gold/Silver Ratio		68.2
Net change		+8.0
Platinum Range	34.00	7.0%
Net Change	-26.00	
Platinum/Gold Ratio		1.54

Date	Gold	Silver	Platinum
Jan 09	283.50	4.71	483.00
Jan 10	287.25	4.70	485.00
Jan 11	287.50	4.69	485.00
Jan 14	285.50	4.52	478.00
Jan 15	284.50	4.55	473.00
Jan 16	287.25	4.56	481.00
Jan 17	284.50	4.45	484.00
Jan 18	283.00	4.35	481.00
Jan 21	closed		
Jan 22	281.50	4.28	476.00
Jan 23	279.00	4.27	468.00
Jan 24	278.00	4.27	463.00
Jan 25	279.00	4.30	465.00
Jan 28	278.25	4.25	461.00
Jan 29	281.25	4.30	454.00
Jan 30	282.00	4.29	458.00
Jan 31	282.00	4.23	452.00
Feb 01	286.00	4.31	451.00
Feb 04	289.50	4.29	452.00
Feb 05	298.25	4.40	456.00
Feb 06	297.50	4.36	457.00

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.

Banks Charging To Deposit Coinage

A story in our local newspaper last month reported that a credit union customer who wanted to deposit $150 of rolled coinage into his account would have been charged a $15 fee (10% of face value) for doing so. The article went on to comment that a large number of banks, credit unions, and the like are charging fees for depositing coinage.

We have since verified that such fees are being charged by many financial institutions, although most charges are less than 10% of face.

The reason for the fees is that there is a glut of coinage in circulation. Banks and the like simply do not need coins from depositors. When they receive them, they have to pay to have these coins hauled elsewhere. In the past, banks may have buried this cost and made it up in other fees, but no longer. With many banks offering "free checking," many former complimentary services now incur fees.

Lots of people find it inconvenient to carry change, often emptying their pockets every night into a jar or piggy bank. If you are one of them, it might be prudent to try to regularly spend your change at face value rather than risk a fee for trying to deposit them all at once.

Mail Irradiation Damages Paper Money

The electron beam irradiation being used by the U.S. Postal Service to kill possible anthrax spores is damaging paper money and other paper products contained in packages.

According to Susan Maltby, a private conservation consultant from Toronto, the dose of radiation needed to kill anthrax is several times higher than the lethal human dose. As organic material such as paper is exposed to heat and radiation, it can experience a physical breakdown of the cellulose molecule. These reactions cause the paper to become, brittle, discolored, and acidic. Some mail so treated has almost disintegrated while others have fused together. Photographs are also affected.

Metal coins are not affected by the process, but the paper and plastic packaging can suffer.

Other items susceptible to damage include live plant specimens, computer disks, DNA samples, mineral specimens, and glass.

So far, this technology is only being used for mail going through post offices where anthrax was detected. But that includes Washington, DC where mail going to the Bureau of Engraving and Printing and to the Smithsonian Institution have been affected.

If your post office is one of those affected, please let us know when you are making a purchase. We should be able to work out an alternative means of delivery.

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