Liberty's Outlook

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The "Empire" Strikes Back— And Strikes Out!

Precious Metals, Rare Coins Stay Strong!

In the past two years, the prices of gold, silver, and platinum have jumped sharply. In January they reached multi-year highs—gold to its highest since 1988, silver since 1998, and platinum since 1980!

At the same time, the rare coin market continued picking up steam.

Since the beginning of 2003, the U.S. dollar has fallen sharply against the Euro, Japanese yen, Swiss franc, British pound, and Canadian and Australian dollars. With the U.S. and other economies struggling to come out of recessions, and a U.S. presidential election looming later this year, the last thing politicians in power want to worry about is the return of high inflation.

Curiously, the governments and central banks of China, European Union, Japan, and the U.S. (which I collectively refer to as the "Empire") all took significant actions in the past several weeks that, together, represent perhaps the most massive assault against rising precious metals prices in the past two decades. Perhaps $100 billion or more was spent and stock market values were put at risk.

Did all this lead to a collapse of precious metals prices?

No.

Prices fell briefly and by only small amounts.

Even worse for the politicians, public attention is now even more sharply focused on the weaknesses of the world's financial system.

So, what happened? And where are we going from here?

The Politicians Attack . . .

China: According to data reported in *The Economist,* distilled from reports by Morgan Stanley, Dean Witter, and others, China's four largest banks hold most of the country's deposits and loans. All are insolvent because loans are frequently made for political purposes to state-owned enterprises rather than on financial merit. The Chinese government itself admits that $290 billion or 23% of the total loan portfolios of these banks are non-performing.

Estimates by credit-rating agencies and investment bank analysts are not so optimistic. Most estimates of bad debts range from $350-500 billion.

Add to that the bad debts of the rest of the financial system, another $500 billion in Chinese government debt, plus a $900 billion to $1 trillion shortfall in government funding for welfare and pension liabilities, and the Chinese government is facing a financial crisis greater than the nation's Gross Domestic Product (GDP)!

In the late 1990s, the Chinese government injected over $200 billion into the banking system to cover bad debts, but did nothing to correct the systemic problem.

China's $400 billion in foreign exchange reserves, which rival Japan's for the world's largest, are simply inadequate to cure the impending banking crisis, even if it all could be allocated to that end.

On January 6, the Chinese government revealed that it had devoted $45 billion of its foreign exchange reserves to partially bail out the two least-troubled banks, China Construction Bank and Bank of China.

That the Chinese government took such a step was not a surprise. What was surprising, however, was the way it was done. So as to not pressure the dollar, these banks are required to keep these new funds in U.S. Treasury debt!

The Chinese government has been under international pressure, especially from the U.S., to let the value of its currency rise (it has been fixed to the U.S. dollar for many years). But a stronger renminbi yuan would hurt Chinese exports, further imperiling the nation's economy (and increasing the amount of bad loans!).

While the Chinese action is an attempt to patch a failing domestic financial system, it also supports the value of the U.S. dollar. Analysts are virtually unanimous that the $45 billion is far too small to have an impact for long. I look for even more U.S. Treasury debt to be allocated this year to the other two large banks. Thus, the January 6 news of the $45 billion support for the Chinese banks and for the U.S. dollar also implied further support for the dollar in the coming months.

European Central Bank: On January 12, European Central Bank (ECB) president Jean-Claude Trichet directed the bank's traders go to on a selling spree to halt the Euro's rise, then approaching $1.30 in U.S. dollars. The effort managed to knock the value of the Euro down by 4% over the next

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week.

However, when several European finance ministers later echoed Trichet's judgment that the Euro was rising too far above the dollar, yen, and renminbi yuan, and risked stunting a European economic recovery, the exact opposite effect took hold. Foreign exchange traders quickly bid up the Euro almost back to where it was before January 12.

I don't have any figures for how many billions of Euros were sold in the effort to hold down its value, but it was sufficient for the financial markets to take notice. Obviously, this one-shot attack was not enough to sustain a devaluation of the Euro. And also, just as obvious, market watchers who make a living from accurate analyses are convinced that the Euro is still undervalued even after its rise of the past two years.

The ECB could make the Euro less attractive by dropping interest rates, but that would be counter to the Bank's partially successful effort to restrain inflation. It could continue to sell Euros, but cannot do so for long enough to make a long-term difference without the cooperation of the U.S. government, which the U.S. will not do. Thus, the ECB is stuck with a strong currency unless it succumbs to higher inflation.

Japan: As Japan's banking troubles worsen, the Japanese government revealed in January that it is preparing legislation that would make bank bail-outs easier, and avoid any more bank failures or closures.

In addition, the Japanese central bank continued purchasing tens of billions of dollars of U.S. Treasury debt over the past few months (I don't have exact figures).

United States: Perhaps the biggest attack on the price of gold happened late in the afternoon on January 28, at the conclusion of the Federal Reserve's Federal Open Market Committee (FOMC) two-day meeting. The FOMC announced that it was keeping short-term interest rates unchanged at 1.0%. However, in a departure from the previous meetings where the rate announcement stated that low interest rates "can be maintained for a considerable period," the comment this time was that the FOMC "can be patient in removing its policy accommodations."

The change in text was immediately interpreted as an indication that the Fed might begin raising short-term interest rates sooner than previously expected, perhaps as early as August instead of after the presidential elections.

Short-term traders seized the window of opportunity.

The gold price promptly fell by more than 1% in after-market trading, closing the next day in the U.S. almost 4% below its previous close.

The U.S. stock and bond markets were still open when the announcement came through. The Dow Jones Industrial Average immediately fell 2%. Long-term bond values dropped almost 3%.

A higher interest rate makes the U.S. dollar more attractive to investors, especially foreigners. By attracting foreign investment, the U.S. government could more easily postpone the inflationary impact of a record high budget deficit and a record high trade deficit.

Summary: I doubt that all these moves were coordinated or, if they were, that their primary impact was to drive down the price of gold. But it would be difficult to conceive a more effective way to try to accomplish that end. So what was the result?

. . . And Strike Out

In late January and early February, the price of gold fell to just under $400 a few times before making solid moves above $400.

Silver fell all the way from $6.61 on January 28 (a six year high!) down to $6.04 on February 2. It has since fully recovered and is now even 2% higher than a month ago.

Platinum dropped almost 5% from January 27 to February 2, but has since regained about half of that, and is again with a few percent of its highest price since 1980!

As for the rare coin market, the price of common-date $20 Double Eagles fell as gold prices retrenched, but stayed well above levels of just 2-3 months ago. Overall, the rare coin market is even stronger than a month ago. A few anecdotes should give you some of the flavor of the current rare coin market:

- Attendance at the New York International Numismatic Convention four weeks ago was 51% higher than the year before! A buying spree was prompted by overseas dealers looking for coins at bargain U.S. dollar prices.
- At the huge Long Beach Exposition two weeks ago, LCS Chief Numismatist purchased an AU-53 1800 Draped Bust Dime for $3,500 and sold it to a dealer for $3,850. The *Red Book* catalogs this coin at about $3,100 and *Coin Values* is $4,000.
- In October 2002, we sold a customer a Choice AU-55 1909-O $5.00 Indian for $2,750. At the Long Beach Show, the same dealer that sold us that coin had another one in stock. His price to Allan: $4,250. *Coin Values* is now $4,600.
- At the Heritage Numismatic Auctions at the FUN show in Orlando in early January, sales topped $30 million, possibly a record for any company at a single convention!

The 6-12 Trillion Dollar Deficit

While analysts worry over the inflationary impact of the 2003 federal budget deficit reportedly in the neighborhood of $500 billion dollars, that is just chicken feed.

Politicians in Washington are worried that the supposed cost of the recently enacted Medicare drug benefits for seniors is not just $400 billion but is actually over $500 billion. They are way off base.

Jagadeesh Gokhale is a Senior Economic Advisor to the Federal Reserve Bank of Cleveland, currently on a one-year sabbatical. His areas of specialty are Social Security and Medicare. He and former U.S. Treasury economist and current University of Pennsylvania professor Kent Smithers studied the financial impact of the Medicare drug benefit and call it "the most fiscally irresponsible legislation in U.S. history."

The $400-500 billion amounts kicking around Washington are the most optimistic figures and only for the next decade. Adding up the entire present value of this unfunded welfare program, they project a minimum cost of $6 trillion (under the most extreme favorable conditions) and an expected cost of $12 trillion under average conditions.

If the analysts and politicians are worried about the inflationary impact of a $500 billion federal budget deficit for 2003, what are they to make of the actual $6-12 trillion deficit?

Hint: short the dollar and go long precious metals and rare coins.

The Future For Photographic Demand For Silver

At times, photographic use of silver has consumed more of the metal in a year than any other category. The suc-

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cess of APS and digital cameras displacing 35 MM cameras and the rising use of non-silver papers for printing photographs has led some to be concerned that total silver consumption will decline as photography technology moves away from silver film and paper.

The First Quarter 2004 issue of *Silver News* published by The Silver Institute has an article by Dan Franz, Group Publisher of *Photofinishing News* discussing trends in photographic silver usage.

He states that net worldwide silver usage for photographic purposes (gross usage less silver recovered in recycling) was 87.5 million ounces in 2000 and forecasts net usage of 85.4 million ounces in 2008.

Areas where photographic silver usage has declined and will continue to fall include 1) the quantity of rolls of film sold, 2) graphic arts applications, and 3) the quantity of silver-paper prints made from silver films.

However, these declines will be largely offset by other factors such as 1) the increase in the average number of pictures per roll of film, 2) the increased demand for silver paper used to print photographs taken by digital cameras, and 3) the continued increase in silver for X-ray films (despite the growing usage of digital X-ray technology).

So, while the silver consumed in *films* will decline, Franz projects that photographic silver *paper* usage will increase about 1/3 from 2000 to 2008, and the net X-ray film demand will rise slightly!

As the world's population grows wealthier, camera usage is spreading. And, because it costs less to print pictures from digital cameras onto silver paper than it does to print them on non-silver paper in an inkjet printer, overall photographic silver usage will hold relatively steady.

With the rising demand for silver in applications such as water purification, superconducting wires, anti-bacterial solutions and materials, and as a possible non-toxic substitute for current wood preservatives, overall silver demand is, in my view, certain to increase in the coming years.

Gold and Gold Coins

Gold closed today at $410.00, down $11.50 (2.7%) from last month.

As gold tested levels below $400 in the past week or so, demand for physical gold increased noticeably. Normally, as the price of gold rises, you tend to see premiums decline slightly because of increased liquidation. That is not the case now. Investor sales of physical gold in the past few months, with gold at its highest levels in 15 years, has been far below what was being liquidated when gold climbed past $300.

Even with the actions of the various governments to support the U.S. dollar and, at least indirectly, stem the rise in the price of gold, the medium-term prospects for higher gold prices are bright.

The mines are becoming more aggressive at trimming their pre-sold gold positions, reducing new gold supplies that were only covering 60-70% of gold demand. Central bank gold leasing activity is declining as the low lease rates barely cover the risk of loss of capital. And central bank gold sales are holding steady under the 1999 Washington Agreement on Gold.

On the demand side, central bank demand for gold to add to reserves is being led by large purchases by the Chinese. Private demand in China is soaring as the government has eased restrictions against trading and owning gold.

A major impetus for investors now buying gold is for protection against expected inflation. Even the most optimistic analysts look for bad news by early 2005 at the latest.

Among bullion-priced coins, the U.S. **American Arts Medallion** (3.7%), Austria **100 Corona** (3.4%), and South Africa **Krugerrand** (3.6%) are the ones we recommend, as you get the most gold for your money. Among smaller gold coins, there are several European issues that have a history at trading at much higher premium levels, including the British **Sovereign** (7.5%), French **20 Franc Rooster** (8.8%, and Swiss **20 Francs** (8.8%).

Common-Date U.S. Gold Coins rose sharply in late 2003 and the first few weeks of 2004. When the price of gold dropped, so did several of these coins, especially the large $20.00 Double Eagles. Although prices are higher than they were last fall, in many instances they are still less than 30% of their prices at the last major market peak in June 1989. I would recommend them wholeheartedly, but for the even more attractive opportunities (if you can find them) in **Better-Date U.S. Gold Coins**.

LCS Chief Numismatist Allan Beegle picked up some real bargains in Better-Date U.S. Gold Coins at the Long Beach Exposition two weeks ago. See our offerings of the 3-coin sets of the low mintage **Near Perfect Proof-69 Ultra Cameo 1984-P,D,S $10.00 Olympic Commemoratives** or the small groups of Double Eagles in the **Hot Rare Coin Bargains, Part 2**.

Silver and Silver Coins

Silver settled today at $6.55, up 13 cents (2.0%) from four weeks ago. This strength in the price of silver is even more impressive when you consider that silver had previously climbed 20% in the past six weeks, the largest short-term increase in the price of silver since 1998!

Volume has been moderate and steady in the past month, with sellers about balancing buyers. As a consequence premiums are little changed.

Our top recommendation is still U.S. **90% Silver Coin** (2.6%). It enjoys a price advantage of at least 26 cents per ounce compared to **100-1 Ounce .999 fine Ingots** (6.7-7.8%). 90% Coin also has greater liquidity and divisibility than the other forms.

U.S. **40% Silver Coin** (3.6%) is also at a reasonable premium, and it has low downside risk because of its high face value. However, in a sharply rising silver market, 40% Coin can have liquidity problems. When the price of silver jumped over $7.00 six years ago, the refiners were taking in so much silver that they stopped buying low purity silver coins such as these.

Many **Numismatic Silver Coins** are currently selling at a fraction of past peak prices. Our flyer on **Hot Rare Coin Bargains, Part 1** gives you some great examples.

Michigan Quarters And "Cans For Quarters" Debut!

The long awaited Michigan Statehood Quarter debuted on January 26 at a ceremony at the State Capitol here in Lansing. LCS was closed until 2 PM that day so that everyone could attend the festivities.

LCS General Manager Pat Heller was on hand at the side of the stage as a member of the Michigan Quarter Commission. His son Daniel was also there for having participated in the Michigan Quarter Ceremonial Strike Ceremony at the Denver Mint on January 8, becoming perhaps the youngest person to ever strike a U.S. coin.

Speakers included Dr. William Anderson, director of the Michigan Department of History, Arts, and Libraries, Michigan State Numismatic Society President Richard Watts, an officer of Capital Bancorp (the financial underwriter of the cere-

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mony and the first bank to have Michigan Quarters available for public distribution), Michigan history storyteller Larry Massie, U.S. Mint Director Henrietta Holsman Fore, and Michigan Governor Jennifer Granholm. A local middle school choir sang the national anthem and Daniel's first grade class from Resurrection School recited the Pledge of Allegiance.

Activities continued in the afternoon at the Michigan Library and Historical Center, with Michigan Quarter Commission members Pat Heller and Craig Whitford sharing photographs and stories about the experience of working on the design for the Michigan Quarter and of attending the Ceremonial Strike Ceremony at the Denver Mint.

When LCS opened at 2 PM, a large crowd of people was waiting to bring in food and cash donations to The Greater Lansing Food Bank in exchange for free Michigan Quarters. State Representative Steve Bieda (D-Warren), who is Michigan's only living designer of a U.S. coin (the reverse of the 1992 U.S. Olympic Half Dollar) honored us by making the ceremonial first donation to the food drive.

Cans For Quarters is off to a fast start, with food donations already over 3,000 pounds and cash donations of about $3,000. It will continue through April 3. Donors in our store are eligible to enter a drawing for a variety of prizes including a U.S. $10.00 Series 1929 National Currency issued by the Capital National Bank of Lansing, Michigan, and featuring the printed signature of Oldsmobile founder R.E. Olds.

Incidentally, the Michigan Quarter was first U.S. coin ever to debut in Michigan. Now, just 16 days later, a second debuted this morning—the 2004 Thomas Edison Commemorative Silver Dollar at the actual laboratory where Thomas Edison invented the light bulb 125 years ago, no preserved at Greenfield Village in Dearborn, Michigan. I had the honor of attending the ceremony and being one of the first to acquire some of the coins.

More Honors For LCS

At the Michigan State Numismatic Society (MSNS) Fall Convention last Thanksgiving, MSNS president Richard Watts announced that I, Pat Heller, was recipient of the 2003 George Hatie Memorial Award, MSNS's highest honor that is only awarded on special occasions. The plaque and medal were presented two days ago by MSNS Governor (and LCS employee) Dany Rothfeld.

In late January, the Immediate Past President of the American Numismatic Association, John Wilson, extended an invitation to me to be appointed to the ANA's Future of the Hobby Committee. Upon accepting the invitation, Wilson, the Committee's chair, announced that membership of the Committee was complete. It consists of just seven members including Wilson, the editors of both weekly coin newspapers, presidents of two numismatic organizations, a numismatic researcher, and me as the only full-time coin dealer.

Yesterday, we learned that LCS and I have been nominated for the 10th Annual Entrepreneurial Awards of Greater Lansing. The winner of this award will be announced March 18.

The Month

Gold Range	$23.50	5.6%
Net Change	-11.50	
Silver Range	.57	8.9%
Net Change	+.13	
Gold/Silver Ratio	62.6	
Net change	-3.1	
Platinum Range	47.00	5.5%
Net Change	-13.00	
Platinum/Gold Ratio	2.05	

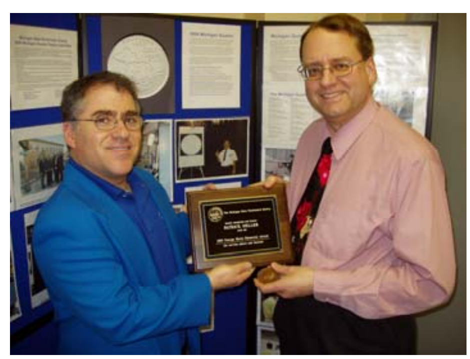
Date	Gold	Silver	Platinum
Jan 14	421.50	6.42	854.00
Jan 15	408.50	6.21	848.00
Jan 16	406.50	6.32	852.00
Jan 19	closed		
Jan 20	412.25	6.31	854.00
Jan 21	411.00	6.20	853.00
Jan 22	410.00	6.34	858.00
Jan 23	407.75	6.34	856.00
Jan 26	406.50	6.30	848.00
Jan 27	410.00	6.55	853.00
Jan 28	414.50	6.61	848.00
Jan 29	398.50	6.23	819.00
Jan 30	402.25	6.25	827.00
Feb 02	398.75	6.04	811.00
Feb 03	399.25	6.11	824.00
Feb 04	401.00	6.15	819.00
Feb 05	398.00	6.12	814.00
Feb 06	403.50	6.27	825.00
Feb 09	406.75	6.42	832.00
Feb 10	406.25	6.38	832.00
Feb 11	410.00	6.55	841.00

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.

February 11, 2004—U.S. Mint Director Henrietta Holsman Fore and Pat Heller at the Thomas Edison Commemorative Silver Dollar Debut at Greenfield Village in Dearborn, Michigan. "Thomas Edison" is in the background.

January 26, 2004—Michigan Governor Jennifer Granholm between boys Mason Langton and Daniel Heller and surrounded by Pat Heller (center left in back), other members of the Michigan Quarter Commission, and State Rep. Steve Bieda (2nd from left).



MSNS Governor Dany Rothfeld presenting Pat Heller with the 2003 George Hatie Memorial Award Plaque and Medal.

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