Liberty's Outlook

Volume 6 Issue 7 Liberty Coin Service's Monthly Review of Precious Metals and Numismatics July 5, 2000

Silver Price Ready To Explode! The Question Is—When?

Page 3: How High For Silver?

1999—10th Consecutive Annual Silver Shortage, Part 2

Summary of last month's Part 1 discussion: In 1999, for the tenth consecutive year, there was a huge silver shortage.

Total supplies of 695.6 million ounces fell 149.7 million ounces (15.8%) short of covering demand of 845.3 million ounces.

For the year 2000, even if the price of silver jumps sharply before the end of this year as the precious metals experts at CPM Group anticipate, we are likely to see another deficit of 115-120 million ounces!

At the beginning of 1990, there were over 2.4 billion ounces of silver inventories available to cover shortages. By the end of 1999, only about 910 million ounces of silver remain in inventories worldwide.

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

The shortages in the 1990s are on a much larger scale than those of the 1970s. (see graph on page 2).

We conclude the analysis of silver's track record from 1971-1999 with a discussion of inventories and of investor psychology.

3) Inventories: The 2.4 billion ounces of silver in inventory at the beginning of 1990 included silver the people refused to sell in 1980 when the price of silver reached $50.00 per ounce.

The inventories at the end of 1999 continue to include silver that was not sold in 1980. In other words, the reported inventories include silver that will not become available except at much higher prices.

The "available" inventories at the end of 1999 are broken down as follows:

Category	*Millions Oz*	*%*
Comex	76.0	8.4%
Tocom	1.4	0.2%
Chicago Board of Trade	4.0	0.4%
U.S. & Japanese manufacturers	32.0	3.5%
Bullion in private U.S. holdings	32.7	3.5%
Bullion in private Europe holdings	50.3	5.5%
Bullion in Berkshire Hathaway	129.7	14.3%
Bullion in Asia and Latin American private holdings	5.0	0.5%
Silver Coins (primarily U.S. 90%)	425.5	46.8%
India Reserve Bank	67.5	7.4%
India Government	19.1	2.1%
U.S. Government	49.8	5.5%
Mexico Government	7.0	0.8%
All Other Government	9.7	1.1%
Total	909.7	100.0%

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

In only three years, from 1997 through 1999, about 55% of all non-coin forms of silver inventories have been consumed in industrial and coin fabrication.

The silver in government holdings is not available for sale at all. The silver held by Berkshire Hathaway is not for sale anywhere near current prices. Also, virtually no silver coins are for sale at today's levels when you consider that the silver price rise above $7.00 in 1998 only increased annual coin liquidations from 2.5 to 18.5 million ounces! If you subtract this silver that is not available, you have barely 200 million ounces of silver available to cover physical shortages of silver at today's prices! That's a smaller amount than was on deposit at the Comex at the end of 1996!

<u>Summary:</u> **For all practical purposes, at the end of 1999 there was less than two years worth of available silver inventories to cover continuing shortages! Available inventories continue to dwindle rapidly.**

Tangible & Intangible Assets Relative Performance Year Ended June 30, 2000

Quick, do you know whether the Dow Jones Industrial Average outperformed the price of gold for the 12 months ended June 30,2000? Or how the NASDAQ average compared to platinum's performance?

Below I rank the relative change for the previous 12 months for some common equities averages against precious metals spot prices and two numismatic categories already popular with the new influx of coin collectors.

Category	*6/30/99-6/30/00 Chg*
1. Palladium	+101.2%
2. 1986-1998 Proof Silver Eagles	+63.0%
3. Platinum	+55.2%
4. 1960-1998 Regular U.S. Proof Sets	+53.6%
5. NASDAQ	+44.7%
6. Gold	+10.1%
7. Russell 3000 Avg	+6.9%
8. Silver	-4.9%
9. DJIA	-6.2%

Silver is no longer a reserve asset for governments. Because of this, they have no incentive to manipulate the price of silver. As a result, silver can respond to market signals more dramatically than gold.

4) Investor psychology: With the fundamental supply, demand, and inventory figures showing a near-term critical shortage of silver, why hasn't the price taken

(Continued on page 2)

Inside this issue:

(Continued from page 1)

off?

As I understand the market, here are two minor reasons and the one primary reason for this relative lack of price movement:

A) Past price history: An indicator used almost exclusively by some novice investors is past price history. "Silver's price has been mostly dismal since 1980, so should things change?" is an overly simplistic rationalization.

When silver rocketed up in 1979 and 1980, that didn't mean that it was going to keep going up. That boom was built on eight years of shortages in the 1970s, a shortage that was cured by higher prices.

Similarly, the current silver shortage has grown because of continuing low prices, even though silver today is trading about 40% above its lows of 1993. But the net appreciation is just chicken feed compared to what is on the horizon for silver prices.

Here in 2000, we are in the 11th consecutive year of an enormous silver shortage. It is firmly based on industrial demand, not on speculators and day-traders. Those who avoid silver after considering only its past price history are going to miss out.

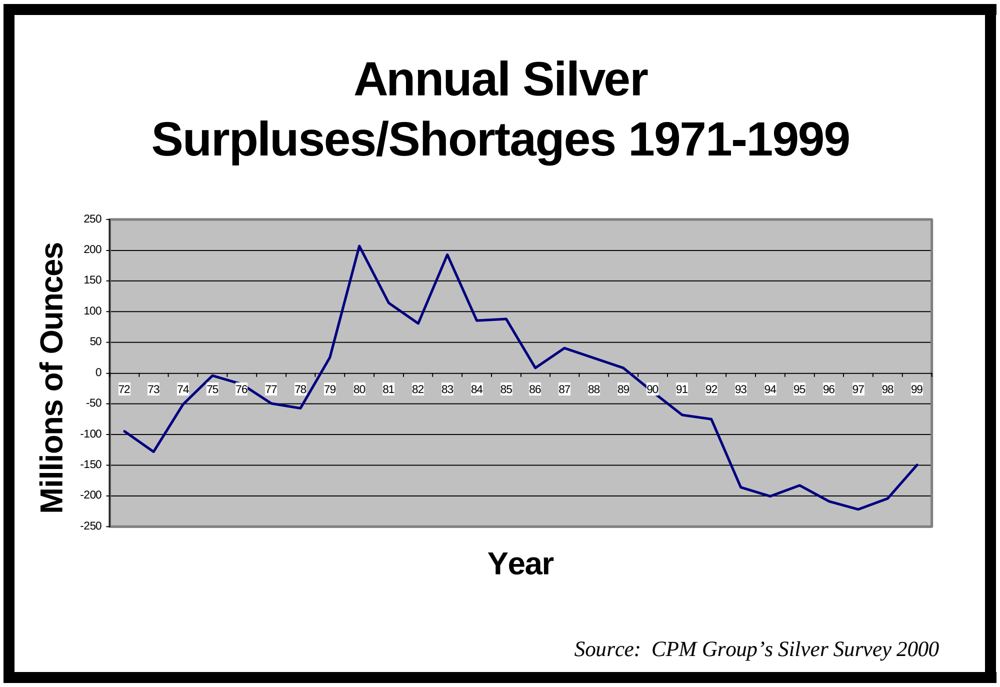
B) Strong stock markets: For the past few years, the strong performance of paper assets such as stocks has attracted most new investment money. In fact, a frenzy of sorts has happened where some investors are taking on enormous amounts of extra debt in order to acquire more stock investments.

I am not a stock market professional. The stock markets may or may not crash from current levels but, at the minimum, I expect the overall stock market to settle closer to its long-term average appreciation.

The stock markets seemingly already have gone in that direction, with the Dow Jones Industrial Average actually down from a year ago and the NASDAQ down more than 20% since its peak!

When stocks lose their luster, there will be some liquidation in order to pay off the risky debt load. Some of the money leaving stock will also be placed into other categories of investments, such as precious metals.

C. Commodities, futures, and options contracts sold short: As I have repeatedly explained, the primary reason that silver prices are still so low is the large number of paper contracts for future delivery of silver where the seller does not have the physical silver to deliver!



Source: CPM Group's Silver Survey 2000

The volume of silver traded in paper contracts dwarfs the physical market. For instance, in 1999 the New York Comex traded 19.2 billion ounces of silver in futures contracts! At the end of 1999 the Comex had contracts outstanding for the future delivery of 381.9 million ounces of silver (with only 76.0 million ounces on deposit to deliver against these contracts!).

Then there are options contracts. The Comex traded 3.7 billion ounces of silver on options contracts in 1999. At year end, there were open options for delivery of 321.0 million ounces of silver.

And these are only the reported contracts! As *CPM Group's Silver Survey 2000* says, "[The data] do not take into account the much larger over-the-counter market. . . . They also are believed by many to largely omit the large proprietary positions held at times by bullion dealing banks and brokerage companies . . . ."

Unfortunately, it is not possible to come up with a total of how many hundreds of millions (or even billions?) of ounces of silver have been sold on paper contracts for future delivery that are not backed by any physical silver.

In normal circumstances, short-term commodity traders simply buy back their futures contracts before they mature and replace them with a new contracts sold for delivery farther in the future. Options do not require delivery unless the owner of the put or the call exercises the option. Typically, most options expire unexercised.

Such an imbalance in paper contracts cannot continue indefinitely, but it can last for a very long time.

The reason that the imbalance can last a long time is that the investment firms who handle and finance the futures and options contracts make a steady income as long as the market price continues to trade in a relatively narrow range. They make no income if traders are forced to close our their positions and stay out of the market. Even worse, their customers may go bankrupt in a major market move, leaving the investment firms with large losses.

This exact situation occurred in the gold market last September and October as part of the fallout of the Long Term Capital Management collapse. When the price of gold jumped 27.7% in only fifteen days, many short sellers (which included a number of gold mines that had sold future production at low prices in contracts that included provisions for margin calls if the gold price rose) were bankrupt or insolvent. Literally, they were unable to meet their margin calls.

Major banks and investment firms technically were supposed to foreclose on the contracts that were in default. If they did so, however, they would have to book hundreds of millions of dollars

(Continued on page 3)

(Continued from page 2)
of bad debts. To avoid taking the hits on their own books, the banks and investment firms simply chose not to foreclose! Instead, they extended the time to required to meet margin calls.

A single mining company, Ashanti Goldfields Co. was on the hook for hundreds of millions beyond its ability to pay. As I understand matters, it is still being given extensions to meet margin calls from last fall!

When the banks and investment firms changed the rules in the middle of the game, that took pressure off the requirement to deliver immediate physical gold. Gold then gave back about half of its gains. Many would-be bankrupt and insolvent firms survived.

If there was a concerted effort to take advantage of the huge paper contract short sales of silver, I suspect that the investment firms would once again change the rules to protect themselves against absorbing massive bad debts.

When Warren Buffett's Berkshire Hathaway acquired contracts for 129.7 million ounces of silver in late 1997 and early 1998, almost all of it was for delivery in March 1998. He crossed up traders by actually requesting delivery instead of rolling over contracts farther into the future. The price of silver climbed more than 40% as the delivery date neared. Shortly before the deadline, the crisis evaporated, with March delivery deadlines pushed back into the future. I suspect that Berkshire Hathaway extracted substantial fees for making such an accommodation.

Warren Buffett may have acted too soon to force a sustained major push in the price of silver. Had he waited until now, with inventories so much lower, the same size of purchase would have a stronger impact on the market. In fact, anyone with a strong , relatively debt-free financial empire could put $500 million into silver contracts today, ask for delivery, then watch the silver price explode!

Can this scenario of an investor or an investment group trying to corner the silver market happen? Yes. Will it occur? I don't know. More important, *it doesn't matter.*

The physical market imbalance is getting close to a crack-up. If a trading squeeze isn't attempted within the next two years, physical shortages will develop and force the issue.

I expected the price of silver to break out of the doldrums for the past several years. The longer it takes to jump, the larger will be the explosion.

How High For Silver?

In the past year we have seen a rush of physical buying for industrial purposes when the price of silver gets much below $5.00. Short-term traders and investment firms have been able to short-circuit rallies that got much beyond $5.40.

By continuing to act in concert, short-term traders and their financiers can continue this trading range for several months. But I expect something to give within the next 12-24 months.

In the 29 years from 1971-1999, demand for silver exceeded silver supplies by 4%. For the entire period, silver averaged over $13.00 as measured in 1998 dollars. As this price was too low to balance supply and demand over time, I think the long-term equilibrium price will be at least $14.00.

However, supply cannot increase quickly even if prices rise. Because of this , when prices rise they will almost certainly shoot way past equilibrium.

I believe the long-term silver shortage will reach crisis proportions within the next 24 months. The only way to cure the crisis will be a massive rise in silver prices!

By the middle of 2002, I think that the silver spot price could easily top $20.00. Once the traders who have sold short are forced to close out their positions, I doubt that silver will again trade below $10.00!

At today's silver price around $5.00, I consider silver to be as close to a "sure thing" as can be found. I consider a price explosion to be a matter of when, not if. The downside risk is almost non-existent. For this reason, I recommend that silver make up half of your precious metals bullion holdings.

Gold and Gold Coins

Gold settled today at $283.75, a decrease of $3.50 (1.2%) from last month.

The recent strength in the price of gold reinforced the typical late spring slowdown in bullion trading. However, lower trading volume has been masking some significant developments.

First, the Swiss central bank has been selling gold steadily—already almost two million ounces—with no detectable impact on the world price. As I have explained in the past, these sales are necessary to avoid a supply disruption rather than representing a glut of gold on the market.

Second, an interesting article in the June 26 issue of *Barron's* compares the price of gold over the past 45 years against changes in the U.S. money supply, inflation rate, and the stock market valuation. The summary of the article is that gold is undervalued and the stock markets are at a peak of overvaluation. As investment money shifts from stocks to gold, the monetary oversupply will spark inflationary pressures.

The article concludes, "With exposure to the stock market at an all-time high, investors may wish to adjust their allocation strategies, given historical precedent. If they do, they will have affirmed one of Bernard Baruch's invaluable maxims: 'I made my money by selling too soon.'"

In the body of the article, the author states that gold, "at $288 an ounce is as inexpensive relative to the Monetary Base in the year 2000 as it was at $35 an ounce in 1970."

This one article is not going to boost the price of gold, despite its appearance in the financial press heavyweight *Barron's*. Rather, the article simply correlates 45 years of financial data and says that inflation is on the horizon.

Soaring gasoline prices have grabbed public attention. The prime interest rate is 22% higher than it was at the beginning of 1999. These could be the early signs of renewed inflation.

In years past, gold was considered *the* hedge against inflation. Although the financial markets have developed a myriad of products to cope with inflation, gold is still the bedrock protection for most of the world's occupants. It is certain to be an important counterbalance to the next round of inflation.

If you do not yet have a core position of bullion-priced gold, start today. If you already have a position, now may be a good time to add to it.

The lowest premium forms of gold continue to be the Austria **100 Corona** (2.0%), U.S. **American Arts Medallion** (1.8%), and South Africa **Krugerrand** (2.2%).

U.S. **American Eagles** (3.5%) have been popular at their low relative premiums. The ready availability of pre-2000 dated coins at such low premiums has brought demand for higher-priced 2000-dated coins to a virtual standstill.

(Continued on page 4)

(Continued from page 3)

Among smaller gold coins, the British **Sovereign** (5.2%), French **20 Franc Rooster** (6.2%), and Swiss **20 Franc** (6.2%) are the best buys.

Scarcer issues of American Arts Medallions like the **1983 Alexander Calder Half Ounce** are at their lowest prices since 1986. With the influx of new collectors in the past 18 months, prices could recover quickly.

Common-date U.S. Gold Coins continue to firm up after reaching bottom two months ago. The third auction of the Bass collection recently hit the market without causing any liquidity problems that accompanied the second Bass auction in October 1999. A few years from now, I think we will look back and consider today's prices as real bargains.

Better-date U.S. Gold Coins, especially those that sell for close to the price of the common-date issues, keep getting more difficult to locate. If you can find them, I think you will be smiling in years to come.

Silver and Silver Coins

Silver closed today at $4.98, down twelve cents (2.4%) from a month ago.

Again this month demand for bullion products remained slack. Premiums are low, and the London silver price is at a small premium to New York levels. There are no indicators that a price jump is imminent.

Quiet markets often prove to be the best time to buy. Premiums and prices both tend to be at low levels. That is certainly the situation right now.

The best buy continues to be U.S. **90% Silver Coin** (1.5%). Not only is it the lowest premium form, it also has the greatest divisibility, greatest liquidity, and is the most widely traded form of silver.

U.S. **40% Silver Coin** (5.5%) and **100, 10, and 1 Ounce Ingots** (4.0-11.0%) are also worth considering.

Among numismatic coins, Mint State Rolls of U.S. Silver Coins are bound to be as popular with the new collectors as they are with established numismatists. If you can find bargains such as rolls of **Mint State 1964 Kennedy Half Dollars**, consider putting away a modest quantity.

The Month

Gold Range	$ 9.75	3.4%
Net Change	-3.50	
Silver Range	.16	3.1%
Net Change	-.12	
Gold/Silver Ratio	57.0	
Net change	+0.1	
Platinum Range	41.00	7.6%
Net Change	-5.00	
Platinum/Gold Ratio	1.85	

Date	Gold	Silver	Platinum
Jun 07	287.25	5.10	529.00
Jun 08	284.25	5.07	536.00
Jun 09	283.50	5.04	534.00
Jun 12	286.25	5.02	540.00
Jun 13	285.25	5.00	537.00
Jun 14	291.25	5.07	526.00
Jun 15	289.50	5.06	525.00
Jun 16	288.75	5.07	530.00
Jun 19	285.75	5.02	544.00
Jun 20	285.75	5.02	555.00
Jun 21	285.50	4.96	550.00
Jun 22	285.00	4.97	556.00
Jun 23	282.75	4.94	547.00
Jun 26	283.50	4.97	560.00
Jun 27	285.50	4.95	550.00
Jun 28	292.50	4.99	565.00
Jun 29	289.00	5.00	560.00
Jun 30	290.00	5.02	548.00
Jul 03	closed		
Jul 04	closed		
Jul 05	283.75	4.98	524.00

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

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

LCS And An LCS Employee Receive Awards

Two weeks ago, the local daily newspaper, *The Lansing State Journal (LSJ)*, reported the results of their annual "Best Of The Best Survey." Liberty Coin Service was honored by voters with a third-place finish in the category of "Best Bargain in Lansing."

The reporter who wrote the article on this category was surprised at our popularity. The first-place award went to the Lansing Lugnuts, the popular local minor league baseball team that receives almost daily media coverage. The second-place award went to three area Target stores that have inserts in every Sunday paper plus regular television ads. How did LCS, a single-location local business with comparatively little local advertising, get so many votes?

The explanation was obvious to us. We have sold tens of thousands of folders, maps, and other holders for the new Statehood Quarters and Sacagawea Dollars. Since the beginning of last year, thousands of people have visited our store for the first time.

Once in our store, these visitors were delighted to obtain limited quantities of the newest quarter issues and the dollar coins for face value—even before they can get them from their banks. They also learned we offer coins and supplies for prices well below those advertised on television or in the Sunday papers.

LCS has made a lot of new friends in the past 18 months. We are honored by their endorsement.

At the awards ceremony at the Michigan State Numismatic Society, LCS employee David Hartung was honored with an expenses-paid trip to the American Numismatic Association (ANA) Summer Seminars in Colorado Springs, Colorado. Next week he will fly to Colorado Springs for the week-long seminar "Grading United States Coins." Congratulations David!

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 Patrick A. Heller, Editor. Subscriptions are available at $79.00 per year (12 issues). Send subscription orders and changes of address to the above address.