Liberty's Outlook

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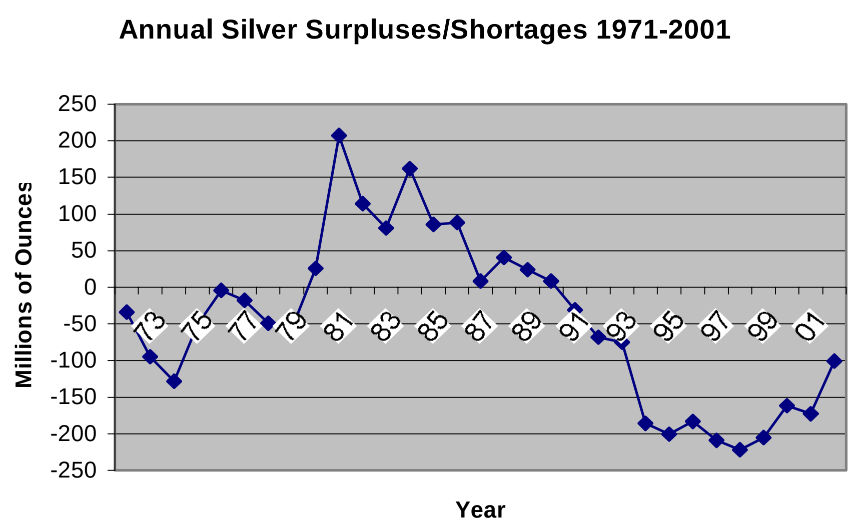
2001 Results In 12th Consecutive Annual Silver Shortage!



Source: CPM Group's Silver Survey 2002

In 2001, for the twelfth consecutive year, there was a huge silver shortage.

Total supplies from mine production, recycling, and government dispositions of 746.4 million ounces fell 100.8 million ounces (11.8%) short of covering industrial and coinage demand of 847.2 million ounces.

In 2002, even if the price of silver jumps sharply before year end, another deficit in excess of 125 million ounces is expected!

At the beginning of 1990, there were about 2.7 billion ounces of silver inventories available to cover shortages. By the end of 2001, only about 1 billion ounces of inventories remain.

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

The shortages in the past twelve years are much larger than those of the 1970s.

On that basis, one could conclude that silver is due to explode in price in the not too distant future.

In fact, after my silver analysis last year I predicted that silver would reach at least $8.00 no later than mid-2002. We have now passed the midpoint of 2002 without the price of silver rising out of the doldrums.

Actually, I have made predictions of a breakout for silver for several years now. Although my timing is off, the long-term price explosion seems inevitable to me. It is a matter of "when" not "if." Here's why.

Silver's Track Record: 1971-2001

There are four major factors that affect silver prices: supply, demand, inventories, and investor psychology. Let's look at each in more detail

1) Supply: New silver supplies come from four sources: primary silver mines, as a by-product of gold, lead, copper, zinc, and other mines, recycling, and government dispositions. In 2001, silver supplies increased 3.1% from 2000 levels. Here are the sources of new silver supplies:

Source	*Millions Oz*	*%*
Primary mines	125.7	16.8%
Secondary mining	377.1	50.5%
Recycling	203.6	27.3%
Government sales*	40.0	5.4%
Total	746.4	100.0%

* This figure includes net exports over imports of 15 million ounces from "transitional economies" such as countries that were formerly part of the USSR, China, and North Korea.

Primary mines: Primary silver mines are only the third largest source of new silver supplies. Production at primary mines hit a peak in 1989 at 128.8 million ounces, declined to 71.1 million ounces in 1994, then has grown since.

Primary mine production is expected to drop in 2002. Low prices are the reason. Although mines in Mexico set a new record for production, the closure of silver mines in the U.S. more than offset this increase. Low prices lead to the suspension of operations at existing mines that have high marginal (or "cash") costs.

Low prices also discourage the development of new mines, a multi-year process.

The decline in new mining operations we are now seeing is a reaction to low prices since late 1998. Even if prices rose dramatically in the near future, it would take until at least 2004 before sizeable

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new mines could go into production.

Secondary mines: The largest category of new silver supplies is as a by-product of gold, lead, copper, zinc, and other mining operations.

In fact, the world's two largest silver-producing mines are the KGHM Polska Miedz *copper* mine in Poland that produced 37.4 million ounces of silver last year, and the BHP Cannington *lead-zinc* mine in Australia that produced 31.1 million ounces of silver last year!

Secondary mine supplies rose slightly last year, despite low silver prices. However, secondary production is likely to decline in 2002 because, despite recent price increases, low gold prices are resulting in production cuts at a number of mines that produce silver as a by-product.

In secondary mining operations, the price of silver is almost irrelevant. Even if silver prices double or triple as we saw in 1980, it would have little impact on overall mining activity.

Recycled silver: Recycled silver from all sources increased 2% in 2001 over the year before.

The largest component of recycled silver comes from spent photographic papers, films, and solutions, old batteries, electrical and electronic equipment, and industrial wastes. These sources increased in 2001.

Nearly offsetting this increase, however, was the further decline in the melting down of coins, down more than 85% from 1999 levels! Refiners purchased an enormous amount of silver coins in the spring of 1998, when silver prices topped $7.00, enough to keep them busy for much of 1998 and 1999. With lower spot prices since, silver coin premiums have grown high enough that little coinage has been bought by refiners. Indeed, the high premiums also indicate that comparatively little investment silver is being liquidated at all!

Much of the capital expenditures for silver recycling equipment were made when silver prices were at higher levels. So silver is being aggressively recycled at today's low prices because the capital costs are already sunk. Thus, a sharp rise in the price of silver will have only a minor impact on increasing recycled silver supplies.

In 2002, supplies of recycled silver are expected to fall slightly.

Government sales: Government sales are only a minor component of supply for the simple reason that, unlike gold, existing government inventories of silver are small. In fact, all government inventories combined are not much more than the silver supply deficit for 2001!

The major reason for government dispositions is for coinage. In 2001, a total of 17 million ounces of silver was used for coinage. Government sales should decrease sharply in 2002 as the U.S. government has exhausted its silver stockpile. As I write this, a Bill is in Congress to allow the Mint to purchase silver on the open market so that it can continue production of Silver Eagle Dollars and silver commemorative coins.

Summary: Silver supplies rose in 2001, despite low prices. However, the medium-term effect of low prices will likely lead to a small decline in silver supplies in 2002.

Major short-term increases in silver supply are just not possible, even if the price of silver doubled from current levels.

Demand: As I have said many times before, it is not really fair to call silver a "precious metal." Although it has a glorious history as a financial metal, it is now basically an industrial metal.

The low prices over the past decade have stimulated research into, and discoveries of, additional uses for silver. Also, demand has grown because of a rising world population and increasing per capita wealth.

For only the second time in the past 18 years, industrial and coinage silver demand declined in 2001, falling 2.7% from 2000 levels. However, demand in 2001 was still strong enough to be the second highest year ever, at a level that is more than a 130% increase from 1983 demand levels:

Category	*Millions Oz*	*%*
Jewelry/silverware	287.6	33.9%
Photography	276.5	32.6%
Electronics/batteries	103.8	12.3%
Coinage	17.0	2.0%
Other	162.3	19.2%
Total	847.2	100.0%

Jewelry and silverware demand rose 0.7% over 2000 while all other categories of demand fell. Photography usage dropped 2.0%, electronics usage declined 9.0%, coinage was down 32.0%, and other uses slipped 14.4%.

Jewelry and silverware: This category of silver demand is the most price-sensitive. Yet when the price of silver rose from $5.00 to $50.00 from 1978 to 1981, jewelry and silverware demand declined less than 50%!

The average price of silver declined 12.4% in 2001 compared to 2000. Low prices led to a sharp increase in demand for silver jewelry and silverware in India, despite the negative impact of the horrible earthquake in the Gujurat state early in 2001. Jewelry and silverware demand in India now accounts for almost 10% of worldwide silver demand!

The recession in the rest of the world led to declines in jewelry and silverware sales there, but not as much as sales rose in India and Thailand

In 2002, look for jewelry and silverware demand to set a new annual record.

Photography: Photography demand in 2001 dropped for the first year since 1991. It fell largely because of the recession. Manufacturers, wholesalers, and retailers all sold down their inventories to help cash flow, reducing demand all along the supply chain. By the end of 2001, though, this process appeared to be reversing. In 2002, higher silver demand for photography is expected to set a new annual record.

Silverless digital photography is growing by leaps and bounds—among the wealthy. The lower silver 28 millimeter Advanced Photo System (APS) is now up to 13% of all film-based cameras sold in the U.S. while 35 millimeter cameras only account for 68% of sales.

Once the recession passes, the growing world population will just keep on buying more cameras. Worldwide, there were about 77 billion photographs taken last year compared to only 4 billion a year in the early 1980s!

Worldwide, relatively few can afford the digital cameras and the computer equipment necessary to use them. Those who use APS film are actually using a greater amount of silver because they average a larger number of prints per negative! This blunts the impact of low- and no-silver photography technology

Even with the impact of digital cameras, look for photography demand for silver to grow steadily for at least the next five years.

Electronics and batteries: Silver is used in connectors, conductors, switches, contacts, relays, fuses, batteries, and lots of other applications.

The decline in silver usage was directly attributable to the recession. The indications for 2002 are that demand will rise perhaps 4% even if economic conditions do not improve quickly.

Growth in silver use is also supported because it is a potential substitute for expensive palladium in some electronic equipment applications.

Coinage: After a plethora of New Millennium silver commemoratives issued in 2000, 2001 silver demand for coinage fell sharply, even more than expected.

Demand for silver coins in China is so strong that demand in 2002 is expected to surpass 2001 by at least 10%!

Other uses: Silver has a wide range of uses, from catalysts, mirrors, brazing alloys, water purification systems, solders, paints, medications, and so forth.

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As more research is done, more practical applications for silver are being developed. For instance, health and medical demand, such as for water purification, is growing. Another application starting to come on-line is silver shielding for superconductors.

Current silver demand for water purification and superconducting only accounts for five million ounces a year. In a few years, demand for these purposes is likely to be many times this figure.

Total demand for other silver uses is projected to rise slightly in 2002.

Summary: As industrial activity starts to recover from the recession, silver demand in every category is expected to rise in 2002. The total increase should be around 4%. It will should come close to the all-time demand record set in 2000.

From 1976 to 1981, the average annual silver price, adjusted for inflation, rose 263%. Despite these soaring prices, total silver demand only fell 29%! How high would silver prices have to rise today to lower demand by 11.8% to bring it into balance with current new supplies?

Inventories: Tabulating inventory levels is difficult, because only a small percentage of inventories are registered and reported on commodities exchanges.

Still, the sharp decline in silver inventories, both registered and unregistered, is unmistakable. It is down well over 1.5 million ounces in the past 12 years. ounces!

At the end of 2001, here are estimated inventories:

Category	*Millions Oz*
Comex	100.5
Tocom	1.4
Chicago Board of Trade	3.7
U.S. and Japanese manufacturers	30.6
Bullion in private U.S. holdings	30-90
Bullion in Berkshire Hathaway	129.7
Bullion in private Europe holdings	10-50
Bullion in Asia and Latin America private holdings	5-90
Silver coins (primarily U.S. 90%)	467.5
Government holdings	127.2
Total	905.9-1,090.9

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

The silver inventories above include hundreds of millions of ounces that were not liquidated when silver was $50.00 per ounce in 1980. They were also not sold when silver jumped well over $7.00 four years ago.

Of silver inventories, about 40-45% is in refined ingots while the balance is unrefined, such as U.S. 90% coin.

Summary: This inventory tabulation is a mid-point of the range from the lowest to highest figures in categories where exact figures are not known. It includes in inventories the silver that owners refused to sell in 1980 at $50 per ounce. It also includes many forms of fabricated decorative silver objects that, for all practical purposes, would not be sold simply because the price of silver rose dramatically.

Whatever the actual level of physical silver inventories, it is certainly less than the quantity of physical gold inventories!

For all practical purposes, at the end of 2001 there was less than 300 million ounces of silver readily available to cover future shortages, barely enough to last through the end of 2003!

Because silver is no longer a significant reserve asset (at today's prices, all government holdings combined are worth only about $600 million), governments have little incentive to manipulate the price of silver. As a result, the price of silver is free to respond to market signals much more than is gold.

Investor psychology: With the fundamental supply, demand, and inventory data showing a near-term critical shortage of silver, why hasn't the price already shot up?

There are several factors:

Past price history: The poor track record of silver prices for the past 22 years scares away a lot of potential investors. On the surface, it is easy to think that something whose price has performed so poorly for two decades must be low for a reason, even if that reason isn't evident.

Strong stock markets: Until two years ago, the strong performance of paper assets attracted most new investment money. Now that the U.S. stock markets have crashed, investors are still paying more attention to the political maneuvering to shore up paper assets than they are to protecting themselves with tangible assets like silver. But we have seen the tide turning.

Commodities, futures, and options contracts sold short: As I have explained in depth several times, the price of silver is affected by the far larger paper contract market than it is by the volume of physical silver that trades.

There are some analysts who claim that the net short positions in the silver market may exceed one billion ounces. I cannot find it in the statistics. Perhaps there are 100-200 million ounces of paper silver sold short on a net basis, but I doubt that it is much larger than that.

Still, the physical market is getting close to a crack-up. If some deep-pocket savvy investors don't try a silver squeeze within the next year the continuing physical shortages will eventually force the price up sharply.

How High For Silver?

In the past 32 years, silver demand has exceeded new supplies by 5%. In 2002 dollars, the average silver price over this time was above $14.50. To me that says that the equilibrium price should be higher than that.

However, silver supplies cannot increase quickly in response to major price jumps. Therefore, when the price of silver takes off, it could easily shoot way past the eventual equilibrium point.

There are any number of ways to predict a future price of silver. You can look at gold and calculate on the basis of the gold/silver ratio. You can take historical levels and adjust for inflation. You can extrapolate from the amount of known silver reserves in the ground. And so forth.

In truth, predicting how high silver might go is impossible. I have seen expert forecasts ranging all the way from $8.00 to $220.00 per ounce.

To me, it will be certain that silver is breaking out of its slump once it exceeds its February 5, 1998 peak of $7.23 in the U.S. (the London market was about $7.60 that day). Once it surpasses that resistance level, it would be off to the races.

Conservatively, I would expect silver to then pass $10.00. It would not be unreasonable for silver to rise to at least $20.00. But, on a long-term equilibrium basis, I expect silver to settle somewhere around $12-16.00 per ounce. I also expect the gold/silver ratio to settle somewhere in the 30:1 to 40:1 range.

At today's bargain basement price, I consider silver to be as close to a "sure thing" as can be found. That may be why mega-billionaires Bill Gates and Warren Buffett have made huge investments in silver.

For all these reasons, I recommend that silver make up half of your precious metals bullion holdings.

U.S. Currency Change Starting Next Year!

The Bureau of Engraving and Printing recently announced that it will once again change U.S. currency. Subtle background colors will be added to the notes that will allow the addition of more counterfeit deterrents. The first denomination to be released will be the $20, possibly appearing as early as the fall of 2003. Revised $50s and $100s would then come out 12-18 months later. The $5 and $10 denominations may be revised later; the $1 and $2 notes will not change.

The Bureau stated that it has no plans to

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recall or devalue existing notes. Instead, deterioration from usage will retire most of the predecessor notes.

When the U.S. government prepared to change its currency in the mid– to late-1990s, I was concerned that it would be mishandled and that large quantities of foreign-held U.S. currency would be repatriated. Those fears were relatively groundless. I am less concerned this time around.

Silver and Silver Coins

Silver closed today at $5.03, up nine cents (1.8%) from five weeks ago.

The silver market has been fairly quiet in the past month, seeming to wait for direction from gold. Silver did not break down below the $4.80 level that seemed to be its limit on the high side for so much of the past year. In the past week it has shown renewed strength, climbing back above $5.00 yesterday.

There has been modest volume in the physical silver bullion market. Premiums are little changed from last month.

U.S. **90% Silver Coin** (5.4%) is still the recommended choice because of its lower premium, divisibility, greater liquidity, and ready availability. U.S. **40% Silver Coin** (7.8%) and **1-100 Ounce Ingots** (11.9-9.3%) are also worth considering.

Nice numismatic coins continue to be hot, hot, HOT! There were five auctions associated with the Long Beach Exposition in early June. Between them, they sold almost $20 million, a huge amount of inventory. Instead of knocking the market into a tailspin because of the huge amount sold, the coins were quickly absorbed and dealers were back to scrambling to find more inventory to fill customer want lists.

Better Date Morgan Dollars, Silver Commemoratives, Proof Walking Liberty Halves, and Proof Mercury Dimes remain some of the strongest categories.

Sometimes a bargain can pop up in the most unexpected place. Our offering of the Australia 2000 Silver Kilo Kookaburra is just such an opportunity. See our flyer for details.

Gold and Gold Coins

Gold finished today at $314.50, down $6.25 (1.9%) from last month.

Almost all of the action in the gold market has been related to the rise and fall of the U.S. dollar and the U.S. stock markets. The largest drop in gold came on June 28, when U.S. and European central bankers intervened to support the value of the dollar. Still, the dollar is approaching multi-year lows against the euro and the yen.

The U.S., Japanese, and European central banks have spent tens of billions of dollars in the past few months supporting the U.S. dollar, with the side effect of holding down the rise in the price of gold. As we have seen repeatedly, such currency manipulations almost always fail. Don't bet against the central banks in the short term, but it does make sense to buy gold now before the higher prices that will likely prevail once currency intervention ends.

When gold neared the $310 level last week, buying increased noticeably in India, signaling a near-term floor price. At LCS, we also experienced a flurry of buying from customers taking advantage of temporarily lower prices to add to their holdings.

This increased demand has led to slightly higher premiums on the low premium buys: the U.S. **American Arts Medallion** (2.8%), Austria **100 Corona** (2.9%), and South Africa **Krugerrand** (3.0%).

Because of the strength of the euro, some **Common-Date U.S. Gold Coins** are actually being shipped back to Europe to take advantage of higher prices there! Weak demand in the U.S. has led them to bargain-basement prices here. With falling supplies, we are already starting to see slightly higher premiums on the less expensive coins. This trend is likely to continue.

"New Buyers Chasing Rare Coins" is the headline of the July 5 issue of *the Coin Dealer Newsletter*. They especially point out the strong demand for **Better-Date U.S. Gold Coins** coming from newer collectors and investors. This should come as no surprise to regular readers of *LO*. Sizeable deals of any kind, no matter the price, are almost impossible to find right now. We had two small groups of **Mint State-61 1907 No Motto $10.00 Indians** fall into our lap recently. See our offer for details.

Several hoards of European gold coins have also dried up. Chief Numismatist Allan Beegle was fortunate to uncover an original hoard of **Gem Mint State-65+ 1902 Russia 5 Roubles** at the Long Beach Exposition. Refer to our flyer

U.S. Mint Sent 500 Million Sacagawea Dollars To Ecuador

In the spring of 2000, Ecuador abolished its own inflation-riddled currency. The U.S. dollar has since been the official currency in the South American nation.

Typical Ecuadorians do not use a wallet. Instead, they will crumple up paper currency and stick it in their pocket.

The Sacagawea Dollar coins have proved far more practical than dollar bills in Ecuador. To help, the U.S. Mint shipped to the Ecuador government 500 million of the 1.3 billion "Golden" Dollars that were struck from 2000 to 2001.

This transaction represents almost pure profit to the U.S. Treasury, even more than it would have earned had it supplied $1.00 paper notes instead.

The Month

Gold Range	$14.00	4.4%
Net Change	-6.75	
Silver Range	.22	4.5%
Net Change	+.09	
Gold/Silver Ratio	62.5	
Net change	-2.5	
Platinum Range	52.00	9.5%
Net Change	-30.00	
Platinum/Gold Ratio	1.65	

Date	Gold	Silver	Platinum
Jun 05	321.25	4.94	550.00
Jun 06	325.00	4.99	564.00
Jun 07	324.50	4.97	564.00
Jun 10	318.75	4.90	554.00
Jun 11	319.75	4.87	556.00
Jun 12	320.25	4.92	556.00
Jun 13	317.75	4.84	556.00
Jun 14	319.00	4.83	562.00
Jun 17	317.50	4.82	562.00
Jun 18	319.00	4.85	565.00
Jun 19	319.75	4.84	570.00
Jun 20	323.25	4.87	570.00
Jun 21	324.50	4.85	562.00
Jun 24	324.25	4.86	561.00
Jun 25	320.25	4.83	561.00
Jun 26	320.50	4.85	547.00
Jun 27	319.25	4.87	541.00
Jun 28	314.50	4.83	539.00
Jul 01	314.00	4.87	531.00
Jul 02	312.75	4.93	529.00
Jul 03	311.00	4.93	527.00
Jul 04	closed		
Jul 05	closed		
Jul 08	312.00	4.96	519.00
Jul 09	316.00	5.04	518.00
Jul 10	314.50	5.03	520.00

London Silver Junket Premium To New York Silver Junket = 3¢

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

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