Liberty's Outlook

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2002—13th Consecutive Annual Silver Shortage!

Annual Silver Surpluses/Shortages 1971-2002 in Millions of Ounces

1971	**-34.0**	1981	114.3	**1991**	**-68.1**	**2001**	**-82.7**
1972	**-94.6**	1982	80.5	**1992**	**-75.7**	**2002**	**-81.3**
1973	**-128.0**	1983	162.6	**1993**	**-183.8**		
1974	**-51.0**	1984	85.7	**1994**	**-200.6**		
1975	**-4.1**	1985	88.2	**1995**	**-182.9**		
1976	**-17.8**	1986	8.4	**1996**	**-207.6**		
1977	**-49.0**	1987	40.8	**1997**	**-221.6**		
1978	**-57.1**	1988	24.3	**1998**	**-205.0**		
1979	25.9	1989	8.3	**1999**	**-161.5**	**Total**	
1980	207.2	**1990**	**-30.8**	**2000**	**-154.9**	**1971-2002**	**-1,445.9**

Source: CPM Group's Silver Survey 2003

2002 brought the thirteenth consecutive year of a huge silver shortage.

Total supplies from mine production, recycling, and government dispositions were 723.5 million ounces, falling 81.3 million ounces (10.1%) short of covering industrial and coinage demand of 804.8 million ounces.

In 2003, even if the price of silver jumps sharply, a deficit of 64 million ounces is forecasted!

Since the beginning of 1990, about 1.9 billion ounces of silver inventories have been used up to cover supply shortages. At the end of 2002, barely 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 thirteen 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, I thought we would have seen much higher silver prices years ago. But, since 1990, the price of silver has only topped $6.00 briefly in 1997 and 1998.

The low silver prices over the past decade have mystified silver market watchers. Looking back, it is now possible to identify some factors that contributed to today's low prices that were not obvious at the time.

Even with this new analysis, I believe that the silver market is poised for huge price increases in the future. Maybe not in the next year or two, but I think it will happen within five years. To better understand this conclusion, let's look at silver's track record.

Silver's Track Record: 1971-2002

There are four major factors that affect silver prices: supply, demand, inventories, and investor psychology.

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 2002, silver supplies decreased 2.8% from 2001 levels, the first supply decline since 1993. Here are the sources of new silver supplies:

Source	*Millions Oz*	*%*
Mines	495.7	68.5%
Recycling	197.8	27.3%
Government sales*	30.0	4.2%
Total	723.5	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.

Mines: Primary silver mines account for less than 20% of all newly mined silver. The bulk of mined silver comes as a co-product or by-product of gold, lead, copper, zinc, and other mines.

With low silver prices, the development of primary silver mines has declined in recent years, despite technological innovations that have improved efficiency and reduced costs. Production from secondary mine sources has declined because the recession knocked down prices for the primary metals being mined. As a result, supplies of silver from secondary mining operations will not likely increase until the world's economy improves.

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New mining supplies cannot increase quickly. At the earliest, new projects take about three years to begin production. When the price of silver spiked to $50.00 in early 1980, it took until 1983 for mine production to increase 10% above 1979 levels!

Recycled silver: Recycled silver from all sources declined 2.8% in 2002 over the year before.

The largest component of recycled silver, about 160 million ounces, comes from spent photographic papers, films, and solutions, old batteries, electrical and electronic equipment, and industrial wastes. Recycled photographic silver supplies fell in 2002 because lower demand for the initial products trimmed available sources.

There are perhaps 16-19 billion ounces of silver in the form of fabricated products. Much of it is in forms that are economically not recoverable. Only a small portion is recovered over time as products become worn or damaged and are sold to refiners. For instance, during the bullion boom of 1979-1980, LCS purchased more sterling flatware in a week that we now purchase in a year!

Melting of coins has also fallen to very low levels, estimated at only 3 million ounces in 2002. The level of recycled scrap in India, the world's largest silver consuming nation, was 4.8 million ounces in 2002.

In 2003, supplies of recycled silver may rise, but only if manufacturing activity improves and higher prices bring out more silver.

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 would barely cover 18 months silver supply deficit at current levels!

The major reason for government dispositions is for coinage. In 2002, a total of 20 million ounces of silver was used for coinage. Government sales should decrease sharply in 2003 as the U.S. government has exhausted its silver stockpile used to produce Silver Eagle Dollars. The Mint now has to purchase silver on the open market to produce Silver Eagles and commemorative coins.

Summary: Silver supplies fell in 2002. With higher industrial production, spurring higher demand for base metals like copper, zinc, and lead, silver production could rise in 2003. However, major short-term increases in silver supply are just not possible, even if the price of silver doubled from current levels.

Demand: Although silver 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 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 third time in the past 19 years, industrial and coinage silver demand declined in 2002, falling 2.7% from 2001 levels.

Category	*Millions Oz*	*%*
Jewelry/silverware	270.9	33.7%
Photography	255.5	31.7%
Electronics/batteries	108.5	13.5%
Coinage	20.0	2.5%
Other	149.9	18.6%
Total	804.8	100.0%

Jewelry and silverware demand fell 5.8%, partly because of poor monsoons in India. Photography usage was virtually unchanged (down just 0.4%) while electronics and batteries usage jumped 6% despite the recession. Demand for other industrial uses slipped 9.3%.

Jewelry and silverware: This category of silver demand is the most price-sensitive. It is also the most sensitive to the impact of the monsoons in India—as Indian accounts for almost 10% of worldwide demand for jewelry and silverware. The 2002 monsoon season in India was the driest in more than 15 years. Normally, 60-65% of silver demand in India comes from rural areas. But with lower crop yields because of lack of rain (and also the impact of the falling value of the Indian rupee making silver more expensive), rural area demand fell sharply in 2002 (and liquidation of silver holdings increased).

Demand in other parts of the world also declined, as consumer incomes were hit by the recession. In 2003 and future years, expect demand to increase as economies improve.

Photography: Photography demand in 2002 dropped 0.4%, only the third time since 1991. It fell largely because of the recession. Manufacturers, wholesalers, and retailers continued to hold the line on inventories to help cash flow, reducing demand all along the supply chain. As the economy improves, demand will rise again.

The major use of silver in photography is for private and commercial photos. This demand consumed 160.0 million ounces in 2002, an all-time record—despite the recession. Demand has grown every year since statistics have been kept, in spite of the inroads made by digital cameras. As the world grows more populous and wealthy, more people own cameras and take more pictures. As the economy improves, demand should rise more quickly.

Demand for silver for medical, dental, and industrial X-rays dropped slightly in 2002 to 83.5 million ounces, mostly reflecting technological innovations that use silver more efficiently than in the past.

The use of silver in graphic arts applications has fallen from 40 million ounces annually a decade ago to only 12 million ounces in 2002. Usage declined again in 2002 as the graphics arts industry suffered from the recession.

Even with the impact of digital cameras, look for photography demand for silver to resume growing as the economy improves.

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

Even with the recession, many new uses for silver are emerging. Silver even substitutes for the use of palladium in some electronic equipment applications.

Coinage: There was a recent peak in demand in 2000 as mints issued a variety of coins to commemorate the new Millennium. But, after falling in 2001, demand rose 17.6% in 2002.

U.S. Silver Eagle Dollar sales have continued at very strong levels in the past few years. Demand for silver coins in China is so strong that the Chinese Mints have added a variety of issues in the past couple of years.

Although coinage demand may not return to 2000 levels, it should remain solid in 2003.

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

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—although the recession has held down demand thus far.

Current silver demand for water purification and superconducting only accounts for five million ounces a year. In a few years, demand for these purposes may top 100 million ounces.

The coming ban on the use of arsenic in wood preservatives has opened another possible application for silver, which could use as much as 100 million ounces annually. However, in addition to silver, at least two other less expensive metals are being tested as substitutes. Although there may be an increase in silver demand for this application, don't count on it in evaluating silver's future prospects.

As the economy improves, silver demand for these uses will rise.

Summary: As industrial activity recovers from the recession, silver demand in almost every category should rise in 2003 and beyond.

From 1976 to 1981, the average annual silver price, adjusted for inflation, rose

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263%. Despite these soaring prices, total silver demand only fell 29%! How high would silver prices have to rise today to lower demand by 10.1% 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 about 1.9 billion ounces in the past 13 years.

At the end of 2002, here are mid-range estimated inventories potentially available for industrial and coinage uses:

Category	*Millions Oz*
Comex	107.4
Tocom	1.7
Chicago Board of Trade	3.9
U.S. and Japanese manufacturers	31.3
Bullion in private U.S. holdings	60.0
Bullion in Berkshire Hathaway	129.7
Bullion in private Europe holdings	30.3
Bullion in Asia and Latin America private holdings	55.0
Silver coins (primarily U.S. 90%)	487.5
Government holdings	120.0
Total	1,026.8

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 and Silver Eagle Dollars.

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 excludes many forms of fabricated decorative silver objects that, for all practical purposes, would not be sold simply because the price of silver rose dramatically. Even so, only part of this total inventory would be available to meet new shortages.

Practically speaking, at the end of 2002 there was less than 300 million ounces of silver readily available to cover future shortages at current prices, barely enough to last through the end of 2004!

Because silver is no longer a significant reserve asset (at today's prices, all government holdings combined are worth only about $550 million), governments have little incentive to manipulate the price. As a result, the price of silver is free to respond to market signals much more than gold.

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

There are several factors:

Past investor history: Silver was bought by many investors in the 1960s in anticipation of higher prices after the U.S. government two-billion ounce stockpile was exhausted. When prices rose in the 1970s, peaking in early 1980, investors were net sellers. The high silver prices prompted investors to be net purchasers through the 1980s, even though higher supply levels resulted in surpluses every year of that decade. In the 1990s, investors again became net sellers because silver had not provided another round of massive profits. This selling held down prices in recent years.

The recession: Demand for silver-containing products has declined along with other consumer goods during the recession. Businesses have responded by reducing silver inventories. Until the world's economy recovers, silver demand will be restrained, leaving investors little incentive to buy silver now.

Strong bond and stock markets: Until three years ago, the strong performance of paper assets attracted most new investment money, muting demand for investment in silver.

Because of this record, a large number of investors consider only paper assets such as bonds or stocks. Bonds have done well in the past two years and there is possibly new life in stock markets now.

What is not seen is how this has affected the silver wholesale market. As trading in silver paper contracts and in physical silver declined, many banks and brokerage firms have reduced or eliminated their silver trading operations. CPM Group, a widely respected advisor to central banks and others on precious metals issues, estimates that, over the past 13 years, about 300-500 million ounces of physical silver was sold onto the market as banks and brokerages closed out their inventories when they closed their silver trading operations.

Shortage of suppliers of physical silver: CPM Group reports that they have received a number of contacts from investors seeking to purchase physical silver in amounts as small as $100,000 who have difficulty finding a dealer who can handle transactions of that size at a reasonable fee. Apparently, one European bank is quoting a fee of 18% of the amount of the transaction to provide physical silver to clients!

As we have seen in the rare coin market in the past two years, growing demand from collectors and investors has prompted more people to become coin dealers. As rising industrial demand for silver starts to push up the price, I would expect to see more brokers and banks return to the physical silver market. In doing so, they will increase silver demand as they establish inventories for their own accounts.

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.

Paper traders have made sizeable profits shorting the silver market in the past 13 years. When industrial demand again starts growing, I expect that a lot of short positions will be closed out, if not actually turned into long positions. If (I think when) this happens, the paper traders will help push up silver prices much like they helped push them down in the 1990s.

How High For Silver?

In the past 32 years, silver demand has exceeded new supplies by 5%. In 2003 dollars, the average silver price over this time was above $15.00. To me that says that the equilibrium price should be higher than that.

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.

Knowing how high silver might go is impossible. Expert forecasts range all the way from $8.00 to $220.00 per ounce.

It may take a few years for silver to break out of the doldrums. But it is possible that it could even happen this year.

At a minimum, I would expect silver to pass $10.00. It might even pass $20.00. 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.

I currently recommend that silver make up half of your precious metals holdings.

New Jefferson Nickel Likely By End Of 2003

The U.S. Mint has announced that they are doing everything possible to produce the newly-designed nickels by the end of 2003. To expedite the process, the head of Jefferson will remain as it is now, not to be changed until 2004. It looks like the reverse will honor the Bicentennial of the Louisiana Purchase by depicting two hands (one an Indian) shaking underneath crossed Indian peace pipes. The Mint intends to produce Proof and circulation strikes of this coin.

Because of the close timing to the end of the year, there is a distinct possibility that

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this coin could become a low-mintage instant rarity. It might be worth putting some away if you can acquire them without paying a huge markup.

Silver and Silver Coins

Silver closed today at $4.57, up seven cents (1.6%) from four weeks ago.

The silver market has been fairly quiet in the past month, even as gold tumbled and found a new base. However, the huge demand to buy physical silver over the previous six months largely dried up in June.

With lower demand, the premium fell for U.S. **90% Silver Coin** (8.0%). As a result, it is selling for $30 less per bag than it was a month ago, despite the higher spot price. It continues to be our top recommendation for physical silver.

U.S. **40% Silver Coin** (8.3%) is also down slightly in price and premium. **1-100 Ounce Ingots** (15.3-11.4%) premiums have dropped only slightly.

Both Classic and Modern Silver Coins continue to be in strong demand. If I were to identify the one criteria that seems to most attract collectors is would be low mintages and better dates. Many prices are up 10-20% in the past year, which I think is only a preview of the boom yet to come.

We are fortunate to offer two groups of lower-mintage coins this months. The **Gem Mint State-65+ 1997 Silver Eagle Dollars** are the 3rd lowest mintage U.S. Silver Dollar in the entire series. But its price has not yet soared as has the slightly scarcer 1996 Silver Eagle.

For the first time in more than two decades of searching, we acquired a small lot of **Choice Mint State-63+ 1955-D Washington Quarters.** This is the lowest mintage U.S. Quarter in the past 62 years, but it doesn't cost much more than the high-mintage 1964-D Washington Quarters. See our flyers for details.

Gold and Gold Coins

Gold finished today at $351.50, down $11.00 (3.0%) from last month.

The decline reflects more the strength of the U.S. stock markets and of the dollar in the past month, rather than any weakness in gold. As gold tested $340.00, significant physical demand appeared in Asia, pointing to an interim floor.

In the past 48 hours gold had perked up. Yesterday, the Mumbai (Bombay) office of the World Gold Council passed along the report from the India Meteorological department that the country had received 6% more than normal rainfall between June 1-25. The expectation of good crop yields points to a significant increase in India's gold demand over last year. As India is the world's largest gold consuming nation, that news definitely affects professional traders' assessment of the gold market.

In June, we experienced significant net liquidation of gold bullion coins and ingots by sellers fearful that the bottom was going to fall out of the gold market. Now that these "weak hands" are on the sidelines and the news from India is positive, we just might see gold reach $400 in the next few months.

This liquidation did not bring out many of the low-premium forms of gold such as the U.S. **American Arts Medallion** (3.7%) and Austria **100 Corona** (3.4%). Instead, what we saw being sold were the U.S. **American Eagle** (4.8%), Canada **Maple Leaf** (4.5%) and South Africa **Krugerrand** (3.6%). Premiums fell on all three of these.

Circulated Common-Date U.S. Gold Coins, especially $10s and $20s, are near their lowest premiums in some time. In fact, some are priced at a lower cost per ounce that some of the smaller gold bullion coins! They are definitely attractively priced**.**

Like silver coins, the watchwords for the hot gold coins are low mintages and better dates. Example: we recently offered a retail customer an 1861-S $20.00 Liberty certified Choice Extremely Fine-45 by NGC. The coin was conservatively graded but had a noticeable scratch by Liberty's nose. The customer passed at $725. Last week, Allan Beegle sold the coin to a dealer at the Mid-America Expo in Chicago for $750.

Lesson: if you find a solid-quality low-mintage or better-date gold coins at reasonable prices, it may be better to snap it right up rather than hope for another coin at a lower price or in higher quality at the same price.

We recently acquired the largest group of **Mint State-60 1888 $20.00 Liberties,** a coin that is almost 300 times as rare as the 1904 in Mint State but sells for not that much more. See our offer for details.

After going decades with no groups of Pre-1972 Brazil Gold Coins, six months ago we scooped up a group of 1856-dated 10,000 Reis. They sold out quickly. A few weeks ago, a different Michigan dealer offered us an even nicer group of **Extremely Fine 1867 Brazil 10,000 Reis**. If you missed out before, you have another chance.

If you took my advice about swapping gold into silver last month, you have already gained about 4.5%. I expect the gold/silver ratio to drop further from current levels.

Mint Releases Preliminary Michigan Quarter Designs

As a member of the Michigan Quarter Commission, on June 20 I received advance copies of the U.S. Mint's preliminary designs for the five possible Michigan Quarters that will be issued next January.

When the designs became public on June 24, we posted them on the internet at www.michiganstatequarter.com so that more people could examine them and offer comments.

Timing is incredibly tight, so modifications from these preliminary designs will be minor. After the last panel in Washington evaluates the five candidate designs in mid-July, the approved designs will be returned to Michigan Governor Jennifer Granholm to select the winning design. You can visit the website for the latest developments.

The Month

Gold Range	$24.75	6.8%
Net Change	-11.00	
Silver Range	.14	3.1%
Net Change	+.07	
Gold/Silver Ratio	77.1	
Net change	-3.5	
Platinum Range	26.00	3.9%
Net Change	+9.00	
Platinum/Gold Ratio	1.91	

Date	Gold	Silver	Platinum
Jun 04	362.50	4.50	662.00
Jun 05	368.50	4.50	665.00
Jun 06	363.50	4.54	658.00
Jun 09	361.75	4.51	656.00
Jun 10	352.25	4.47	656.00
Jun 11	355.50	4.50	651.00
Jun 12	353.00	4.50	652.00
Jun 13	356.50	4.57	660.00
Jun 16	359.00	4.61	667.00
Jun 17	362.75	4.61	660.00
Jun 18	357.00	4.56	664.00
Jun 19	361.25	4.56	677.00
Jun 20	356.25	4.53	665.00
Jun 23	353.00	4.55	665.00
Jun 24	346.50	4.51	670.00
Jun 25	349.25	4.56	663.00
Jun 26	343.75	4.52	656.00
Jun 27	345.00	4.50	665.00
Jun 30	346.00	4.56	663.00
Jul 01	351.50	4.57	671.00

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.

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