Liberty's Outlook

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2003—14th Consecutive Annual Silver Shortage!

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

1971	**-34.0**	1981	114.3	**1991**	**-68.1**	**2001**	**-82.9**
1972	**-94.6**	1982	80.6	**1992**	**-74.9**	**2002**	**-81.0**
1973	**-128.0**	1983	162.5	**1993**	**-185.9**	**2003**	**-43.5**
1974	**-51.0**	1984	85.7	**1994**	**-200.6**		
1975	**-4.1**	1985	88.2	**1995**	**-183.0**		
1976	**-17.8**	1986	8.4	**1996**	**-208.8**		
1977	**-49.0**	1987	40.6	**1997**	**-221.7**		
1978	**-57.1**	1988	24.3	**1998**	**-205.0**		
1979	25.9	1989	8.3	**1999**	**-161.6**	**Total**	
1980	207.2	**1990**	**-30.8**	**2000**	**-155.0**	**1971-2003**	**-1,494.4**

Source: CPM Group's Silver Survey 2004 for this and other cited data

For the fourteenth consecutive year, the silver market had a huge supply shortage in 2003.

Total supplies from mine production, recycling, and government dispositions were 727.4 million ounces, falling 43.5 million ounces (5.6%) short of covering industrial and coinage demand of 770.9 million ounces.

In 2004, despite already higher silver prices, a deficit of 58 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 2003, less than 1 billion ounces of inventories remain.

the 1970s string of shortages did not end until the price of silver soared above $50.00 in early 1980.

The shortages in the past fourteen years are 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 expected much higher silver prices years ago. But, from 1990 to the end of 2003, the price of silver only topped $6.00 briefly in 1997 and 1998.

When silver rose to $8.20 three months ago, that was its highest close since August 1987. Prices quickly retreated, but still show strength, holding near $6.00. Could this short boom be a foretaste of a much larger boom in the offing?

Maybe.

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. I think there is a good chance we will see a major move in the next year or two, but I advise patience. It may take as long as four to five years for silver to really skyrocket. To better understand this conclusion, let's look at silver's track record.

Silver's Track Record: 1971-2003

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 2003, silver supplies increased 0.5% from 2002 levels, to the second highest annual supply ever (exceeded only in 2001). Here are the sources of new silver supplies:

Source	*Millions Oz*	*%*
Mines	480.3	66.0%
Recycling	217.1	29.9%
Government sales*	30.0	4.1%
Total	727.4	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.

Mines: Newly mined silver production dropped 3.2% in 2003 from 2002 levels.

Primary silver mines account for just 19-27% annually of all newly mined silver. The bulk of mined silver comes as a co-product or by-product of gold, lead, cop-

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per, zinc, and other mines.

For instance, the world's largest silver mine is the KGHM Polska Miedz *copper* mine in Poland. In 2003, it produced 38.5 million ounces of silver! The world's second largest silver mine is the BHP Cannington *lead-zinc* mine in Australia, which has also produced over 30 million ounces of silver in a year.

The major reason for the decline in silver mining from 2002 to 2003 was the low prices, relatively, of silver and of the other metals from which silver is a by-product. Several large silver mines, most significantly in Mexico, were closed because of low prices.

Mexico had been the largest silver mining nation. With its output down more than 10% from 2002, it fell to second place behind Peru. Here is a list of the top seven silver mining nations as of 2003 and how output changed from 2002:

Nation	2003 Million Oz	Chg vs 2002
Peru	88.7	+2.7%
Mexico	81.4	-11.2%
China*	80.0 approx	?
Australia	67.5	+1.0%
United States	38.8	-15.1%
Poland	38.5	0.0%
Canada	37.3	-7.2%

Figures for mine output from China are approximate figures. In worldwide supply figures, only the net exports from China are included—as half of the 30.0 million ounces of government sales.

Even with the current higher prices for silver and for the other metals of which silver is a mining by-product, new mining supplies cannot increase quickly.

New mine projects take about three years to begin production. When silver spiked to $50.00 in early 1980, it took until 1983 for mine production to increase 10% above 1979 levels!

With the higher prices of many metals, some recently closed mines have already reopened. Expect 2004 mining output to rise to about 494 million ounces, less than a 3% increase over 2003.

<u>Recycled silver:</u> Recycled silver from all sources jumped from 197.8 million ounces in 2002 to 217.1 million ounces in 2003, a huge 9.8% increase.

The largest component of recycled silver, about 165 million ounces, comes from spent photographic papers, films, and solutions, old batteries, electrical and electronic equipment, and industrial wastes. This source of silver increased about 3% over 2002 levels.

The largest increase in recycling came from India, where high prices both knocked down demand and led to a surge in liquidation, up from 4.8 million ounces in 2002 to 16.1 million ounces in 2003. Surging demand for industrial silver also led to a rise in melted coinage, from 3.0 million ounces in 2002 to 5.0 million ounces in 2003.

The government of India is currently trying to eliminate its ban on exporting silver, which would encourage even more liquidation in that country (though see further discussion under Investor Psychology below) in 2004. As industrial fabrication grows, also expect the amount of recycled silver to increase in 2004. Look for total recycled silver supplies to hit a 227.4 million ounces in 2004, the highest levels since 1980, when the price of silver topped $50.00.

<u>Government sales:</u> Government sales are only a minor component of supply for the simple reason that, unlike gold, government inventories of silver are small. All government inventories combined would barely cover 2 months industrial silver demand at current levels! The major government dispositions in 2003 were from China, Russia, and Kazakhstan, which were net exports above what was needed for domestic purposes.

With rising silver demand in China, look for government sales to drop in half in 2004, to only 15 million ounces.

<u>Summary:</u> Silver supplies were fairly steady in 2003, up 0.5% from 2002. Look for supplies to climb another 1.2% in 2004 to around 736.4 million ounces. Remember, 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 before, silver is not a "precious metal." It is sought as an industrial metal because of its <u>*low*</u> price.

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.

Still, because of the weak economy, for only the fourth time in the past 20 years, industrial and coinage silver demand declined in 2003, falling 4.2% from 2002 levels.

Category	*Millions Oz*	*%*
Jewelry/silverware	260.5	33.8%
Photography	249.2	32.3%
Electronics/batteries	104.3	13.5%
Coinage	10.0	1.3%
Other	146.9	19.1%
Total	770.9	100.0%

<u>Jewelry and silverware:</u> Jewelry and silverware demand fell 3.8% from 2002, of which almost all the decline came from lower jewelry demand in India. Thailand also posted a noticeable drop, while the rest of the world reported higher net demand.

This sector of silver demand is the most-price sensitive. However, if India's silver export bans are lifted in 2004, look for worldwide jewelry demand to rise this year by more than 3% from last year's levels.

<u>Photography:</u> Photography demand in 2003 dropped 2.5%, the fourth annual decline since 1991. Virtually all of the decline in this sector came from private and commercial photography.

The photographic use of silver seems to have hit bottom. The use of silverless and low silver photographic technology has and will continue to knock down silver usage. But this is almost offset by the absolute increase in the number of cameras worldwide, the number of rolls of film used, and the increase in the average number and size of prints made (which use silver in the printing process).

Despite the inroads made by digital X-rays for medical, dental, and industrial applications, the total usage increased so much that silver consumption for this purpose only fell 0.4% from 2002 to 2003. Look for demand to hold steady.

Overall, look for silver usage in 2004 to be about the same as 2003.

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

In 2003, silver usage for electronics and batteries declined from 106.0 to 104.3 million ounces, a 1.6% decline. As the economy recovers, look for 2004 demand to jump to 108.9 million ounces, its second highest level ever!

<u>Coinage:</u> Silver used for coinage dropped in half from 2002 to 2003. The U.S. Silver Eagle Dollars is the largest continuing component of this usage. Large increases or declines normally reflect major commemorative coin programs beginning or ending. In 2004, look for 12 million ounces of silver to be used for coinage.

<u>Other uses:</u> 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 flourishing application is silver shielding for superconductors—which soared to perhaps 10 million ounces of usage in 2003 and could double again in 2004.

Silver usage for other purposes declined by 3.5% from 2002, largely a residual effect of the recession. As the economy improves, look for 2004 demand to rise about 6%.

<u>Summary:</u> Overall silver demand in 2003 was down 4.2% from 2002 levels, with the biggest drops coming from coinage and from India's jewelry demand. Look for 2004 demand to rise at least 3%.

From 1976 to 1981, the average annual silver price, adjusted for inflation, rose 263%. Despite these soaring prices, total

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silver demand only fell 29%! Silver could double or triple from today's levels with only a modest impact on demand for the simple reason that silver is typically only a small cost component in most products..

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 about 1.9 billion ounces in the past 14 years.

At the end of 2003, here are mid-range estimated inventories potentially available for industrial and coinage uses:

Category	*Millions Oz*
Comex	124.3
Tocom	0.7
U.S. and Japanese manufacturers	19.9
Bullion in private U.S. holdings	38.0
Bullion in Berkshire Hathaway	129.7
Bullion in private Europe holdings	20.3
Bullion in Asia and Latin America private holdings	35.0
Silver coins (primarily U.S. 90%)	497.5
Government holdings	120.0
Total	985.3

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 include hundreds of millions of ounces that were not liquidated when silver was $50.00 per ounce in 1980!

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.

Investors liquidated a lot of silver last year to help cover the supply shortage. **Silver inventories held by U.S. and Japanese manufacturers and in private U.S., European, Asian, and Latin American holdings declined about one-third from the end of 2002!**

Some of this silver was turned into 10 million ounces of silver coins, mostly Silver Eagle Dollars, and into a net 12 million ounce increase in silver reported on commodity exchanges. Overall, though silver inventories declined in an amount about equal to the annual supply shortage, 40-45 million ounces.

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. Thus, only part of this total inventory would be available to meet new shortages.

After excluding this unavailable silver, at the end of 2003 there were perhaps only 400 million ounces of silver available to cover future shortages at current prices, enough to last for just a few more years!

Because silver is no longer a significant reserve asset (at today's prices, all government holdings combined are worth only about $730 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- and long-term shortage of silver, why hasn't the price already exploded? When will it do so?

Beyond the simple data of supply, demand and inventory levels, there are several factors of investor psychology to consider.

The silver market does not operate in a vacuum. When considering investments in physical silver, investors look at fundamental data on supply and demand plus silver's past track record, the overall economy, concerns over rising inflation, the relative attractiveness of the stock and bond markets, the availability and relative ease of trading physical silver, and at possibly trading paper contracts for silver.

The silver price spike to over $50.00 in early 1980 grabbed the attention of a lot of new investors. In the following years, industrial demand for silver declined because of it. At the same time, high prices brought more product onto the market. This surplus of supply lasted throughout the 1980s, gradually forcing prices down further, despite high investor interest.

When lower silver prices eventually spurred demand and discouraged liquidation, the silver market turned into a shortage situation beginning in 1990. Even though the fundamentals had changed, many investors would not consider owning silver because of its poor returns in the 1980s.

However, overall investor psychology has changed markedly in the past two years.

When the stock and bond markets dropped in 2000 and stayed weak for the next couple of years, many investors looked anew at alternative places to invest what was left of their portfolios.

The data on fundamental long-term shortages in the silver market worked like a magnet, resulting in substantial new demand for physical silver. For instance, LCS sold record quantities of silver in the first half of 2003.

At the same time, the psychology of existing silver investors was changing. For much of the 1990s, any temporary jump in the price of silver would lead to a flood of liquidation. That is not happening now. As silver rose in the past year, investor liquidation (which is a major source of silver covering the annual shortages) has slowed down—just as we saw in the late 1970s!

Whereas a spot price of $5.00 might have brought out noticeable liquidation in the 1990s, that didn't happen after silver reached that level after hitting a bottom of $4.28 on October 10, 2002.

Instead, investors as a group started to sense that silver could be ready to make a major move. Liquidations declined, and did not really resume until the spot price reached $7.50 in the middle of March this year. Now that silver has dropped back into the high $5 and low $6 range, almost nothing is being sold.

As I said, that is eerily reminiscent of the 1979-80 silver boom. Investors who had been ready sellers of silver at prices around $5.00 in 1977, were no longer willing to sell at $10.00 in 1978 and 1979. It took a price of $20.00 before liquidation noticeably picked up, and really didn't turn into a frenzy until silver passed $35.00. In fact, most of the selling did not occur until after silver topped $50.00 and was on the way back down!

Not only are investors in today's market behaving a lot like those in the late 1970s, which helped push up the silver price then (contrary to public perception, the Hunt brothers didn't try to corner the market in silver; they pretty much stopped buying once silver passed $11.00), there is an extra boost that the silver market may soon experience.

As I said earlier, the government of India is trying to work out regulations to end its ban on silver exports. There has been more liquidation of silver in India in the past year than the market can quickly absorb. It is my belief that this export ban has actually reduced silver demand in India, the world's second largest silver-consuming nation.

People are leery of investing in something if it may be difficult to liquidate. The best example of how much difference it makes happened when Japan eliminated its export ban on gold in 1979. At the time, the "experts" predicted a flood of liquidation. Instead, knowing that the market was more liquid, investors jumped in to buy—almost immediately tripling demand for gold in that country. So, I would not be at all surprised to see silver demand surge in India once the export ban is gone.

How High For Silver?

In the past 33 years, silver demand has exceeded new supplies by 5%. In 2004 dollars, the average silver price over this time was above $16.00. To me that says that the equilibrium price should be that or higher.

Silver supplies cannot increase quickly in response to major price jumps. Therefore,

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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. I have seen other forecasts that range all the way from $8.00 to $220.00 per ounce.

Especially with the change in investor psychology, I feel much safer this year predicting that silver will top $10.00 by the end of 2005, and possibly 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.

In making these predictions, I consider myself to be conservative. There is always a possibility that we could see prices soar a lot higher.

By the way, one factor that I do not include in my evaluation is the claim by some analysts that there is a huge shortage in the paper contracts silver market. To the extent there may such an extraordinary shortage, that will only increase the potential heights that silver may reach.

Today's silver price isn't as low as it was two years ago, but looking to the future 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.

Silver and Silver Coins

Silver closed today at $6.11, up 49¢ (8.7%) from four weeks ago.

On June 30, the Federal Reserve's Open Market Committee raised a key interest rate from 1% to 1.25%, the first increase since May 2000.

A higher interest rate signals two things. First, that it costs more to hold assets like precious metals that do not earn periodic income, making them less attractive. Second, that it is an indicator of higher inflation (U.S. producer prices were up 4.9% for the 12 months ended in May) which makes tangible assets more attractive than paper assets.

Although silver dropped slightly in the middle of last week, it quickly recovered as bargain hunters moved into the market. Looking to the future, I believe that silver is currently near the lowest price that you will ever see again. At worst, I don't think silver will go much below $5.50. Instead, look for silver to again top $8.00, though perhaps not until after the U.S. elections in November.

Low investor liquidation means that supplies of physical silver remain tight, with premiums higher than in years past. The best value in silver is U.S. **90% Silver Coin** (4.4%), which has the best liquidity, divisibility, and lowest cost per ounce of the most popular forms. Also worth considering are **100, 10, and 1 Oz Ingots** (7.9-9.8%) for those with limited storage capacity.

Collectors and investors are scrambling to acquire both the Blue Chip ("generic") silver numismatic coins as well as the individual rare date coins. For months we have been warning that supplies are getting tighter—and wholesale inventories are continuing to dwindle. We have two offerings this month of some **Better Date Gem Mint State-65 Morgan Silver Dollars** and **Classic U.S. Silver Commemoratives** that can be purchased today for a fraction of their past peak prices. Unfortunately, at these bargain levels, it is getting ever more difficult to locate enough coins to make such an offering. Once again, we are likely to sell out. See our flyers for details.

Gold and Gold Coins

Gold finished today at $402.25, up $18.25 (4.8%) from last month. Gold continues to show strength, repeatedly testing the $400 level before short-term profit-taking knocks it down slightly.

Perhaps the strongest underpinning to the gold market now is the broad worldwide demand for physical gold. Instead of huge liquidations at prices that are much higher than two years ago, we are seeing little sell-off. On the other side, demand is steady, not declining as will often happen when the price of gold moves up as much as it has since 2002. This investor sentiment merely reinforces my evaluation that we remain in the early stages of a boom market for gold.

Next month, I hope to devote significant space to discussing gold's long-term fundamentals of supply and demand.

Among bullion-priced issues, the low premium leaders are still the Austria **100 Corona** (3.5%), South Africa **Krugerrand** (3.7%), and U.S. **American Arts Medallions** (3.9%). I do not recommend higher premium forms such as the U.S. **American Eagle** (5.2%), Canada **Maple Leaf** (5.0%) and others as I expect their premiums will fall, as happened with the lower premium forms.

The entire numismatic U.S. Gold Coin market is solid. Demand is much stronger than supply, with some prices continuing to rise. If you can find a nice coin at a reasonable price, go for it.

I earlier recommended the scarce issues of U.S. American Arts Medallions, but warned against paying huge premiums for super nice quality pieces. We can now offer an incredibly nice group of the lowest mintage of the half ounce Medallions, **the 1984 John Steinbeck Half Ounce American Arts Medallion**. The recent lot we acquired was so nice that we had them certified, with a number of pieces coming back in Near Perfect MS-69 quality, the nicest Steinbecks certified by any major grading service! Best of all, we can offer them at reasonable prices. Check our offering for details.

The Month

Gold Range	$19.50	5.1%
Net Change	+18.25	
Silver Range	.55	9.8%
Net Change	+.49	
Gold/Silver Ratio	65.8	
Net change	-2.5	
Platinum Range	40.00	5.0%
Net Change	-10.00	
Platinum/Gold Ratio	1.97	

Date	Gold	Silver	Platinum
Jun 09	384.00	5.62	803.00
Jun 10	386.00	5.74	797.00
Jun 11	closed		
Jun 14	383.50	5.66	791.00
Jun 15	388.00	5.73	774.00
Jun 16	384.50	5.73	778.00
Jun 17	389.00	5.92	794.00
Jun 18	395.00	5.98	808.00
Jun 21	394.00	5.86	814.00
Jun 22	395.00	5.86	805.00
Jun 23	395.00	5.87	805.00
Jun 24	403.00	6.17	809.00
Jun 25	402.75	6.12	798.00
Jun 28	400.50	5.90	784.00
Jun 29	392.50	5.86	776.00
Jun 30	392.75	5.78	786.00
Jul 01	396.00	5.94	782.00
Jul 02	398.00	6.00	777.00
Jul 05	closed		
Jul 06	392.50	5.96	774.00
Jul 07	402.25	6.11	793.00

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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