Liberty's Outlook

Volume 12 Issue 7 Liberty Coin Service's Monthly Review of Precious Metals and Numismatics July 5, 2006

As The Price Of Gold Dropped 22% In Five Weeks,

Did The U.S. Government Unload 14 Million Ounces Of Gold Reserves Onto The Market?

China Suspected Of Dumping $75-100 Billion Of U.S. Treasury Debt For Gold And Other Currencies

Gold hit a 26 year peak when it closed in U.S. markets at $719.75 on May 11. Silver also hit its highest price in 25 years that day when it settled at $14.84. The same day, platinum hit another all-time record high of $1,276.00.

With prices moving up so persistently since last November (silver almost doubled in price and gold was up more than 50%), precious metals were ready for a bout of short-term profit-taking. Although platinum struggled up to a new high of $1,308.00 on May 23, precious metals started to give back part of their recent gains.

Then they gave back some more.

Then prices dropped even further.

The rise in precious metals prices was actually understandable, in the context of all the reasons why the value of the U.S. dollar should decline.

Some decline for gold and silver prices was also within the range of normal market fluctuations.

However, the size of the drops from the mid-May peaks were beyond anything I anticipated. I thought $600 for gold and $11.50 for silver would be pretty safe bottom points for the metals.

Gold actually declined all they way down to close at $561.75 on June 14, a 22% drop in five weeks!

The silver price fell even more, dropping 35% to close at $9.65 on June 14.

As metals prices started to slide, investor paralysis set in. Since no one really knows for sure when markets have hit a hard peak or bottom, investors were unsure if they should be selling or buying.

As gold slid under $600 and silver under $11.00, the liquidation of physical precious metals came virtually to a standstill. Instead, smart buyers stepped up to make purchases.

At the recent low points, both gold and silver were still more than 20% higher than they were in early November 2005. Normally, that would not seem to be a bargain. But, these same investors had witnessed how high metals could rise in a short time and didn't want to be left out of the next ascent.

In the past three weeks, the physical gold and silver markets have been overwhelmingly traded in one direction, with long-term investors adding to their holdings. Premiums rose for many of the low-premium forms of gold and silver.

The introduction of the American **Buffalo** 1 Oz Gold Coin in late June added to physical demand.

I think the days of "cheap" gold and silver are numbered. We may already be on the way back up, though only time will tell if there is another round or two of profit-taking before gold and silver climb in earnest.

As the prices of precious metals dropped, there were no changes in the fundamental reasons why gold and silver appear to be in long-term major boom markets.

I have discussed the reasons I think gold and silver are destined for far higher price levels at length in recent newsletters, so let me just quickly summarize some of the points:

- The value of the U.S. dollar is destined to drop, pummeled by huge federal budget deficits, by larger-than-reported increases in the U.S. money supply, a falling real estate market, and a teetering economy.
- The suspicion that the central banks have quietly unloaded tens of millions more ounces of gold on the markets over the past several years than they have revealed, in an effort to hold down prices, is being supported by more evidence as time passes.
- In response to fears of the fall in the value of the U.S. dollar, other nations are slowing the pace at which they add dollars to their central bank reserves, if not actually displacing dollars with gold and other currencies.
- Fears over international terrorism, and whether Iran or North Korea are preparing to unleash an attack on the United States or elsewhere.
- Soaring inflation in the U.S.

These just touch the highlights, but you get the idea.

The decline in precious metals prices was encouraged by the COMEX, which eliminated price fluctuation limits on all contracts on June 5. Another way that the COMEX commodity exchange in New York tilted the playing field towards lower prices was in setting limits as to how many contracts a buyer could acquire, but having no limits in how many contracts that large short traders could sell short!

Observers were also puzzled by the large influx of physical gold onto the market. No party has come forth to claim credit for dumping so much gold, which appears to be at least 14 million ounces, but there are few possible sources that even have that much gold.

If you don't actually know who supplied the gold, you work from the other end and try to identify the largest beneficiary of the appearance of so much gold. The biggest

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benefit of lower gold prices went to the U.S. Treasury, which saw some temporary strengthening of the U.S. dollar.

As the U.S. government was the biggest beneficiary of the drop in gold prices, and possesses the quantity of gold that appeared, it certainly looks suspicious that the U.S. government may be the source of the mysterious gold supply, possibly as a drawdown from the U.S. share of the International Monetary Fund (IMF) gold inventory.

The price of gold, in one sense, represents a report card on the value of the U.S. dollar. The U.S. dollar has been looking pretty weak for the past several years. When gold rose into the $700s in May, I heard rumors that federal officials at high levels were issuing orders to force the price of gold way down.

This unconfirmed information and the hypothesis as to the source of the gold is perhaps the most logical explanation of what happened to knock down gold prices recently, but it may not be true. What is true is that a lot of physical gold appeared from "nowhere" and that the U.S. government had the most to gain from falling gold prices.

If the truth is that the gold came from some other source, it is almost certain to have come from an anonymous central bank or international government body on the sly.

Of course, there is always the possibility of a widespread conspiracy among central banks because any serious collapse in the value of the U.S. dollar would also wreak economic harm around the globe.

Why Did Gold And Silver Stop Dropping?

The most obvious reason why gold and silver turned around recently is that the decline overshot the mark.

There was also a continuing stream of news that re-emphasized that the long-term reasons why the dollar is falling and gold is rising have not really changed.

- In an issue paper released in April, the IMF effectively conceded that the accuracy of claims made by the Gold Anti-Trust Action Committee that central banks were required to report gold as being in their vaults even if it wasn't there. If central bank A loaned a million ounces of gold to central bank B, then both banks would include that million ounces of gold as being gold reserves in their vaults, no matter where the physical gold actually was located.
- About a week ago, the governor of the United Arab Emirates Central Bank, Sultan bin Nasser Al Suwaidi, told reporters that the bank was preparing to convert up to 10% of its currency reserves into gold, after having almost no gold reserves. Al Suwaidi also said that the UAE was looking to buy euros up to 10% of total reserves. This potential shift of about $4.5 billion is relatively small potatoes in the global economy, but you have to keep in mind that this is only one country among many who are thinking along these lines.
- Even bigger news hit two days ago when Xia Bin, the head of the financial research institute of the Development Research Center, a think tank for top officials of the Chinese government, stated "It is practical for China to increase its holdings of gold by choosing an appropriate time to buy, because compared with other big trading countries the percentage of gold in China's reserves is seriously low." In addition, Bin advocated that the China yuan should be allowed to fluctuate more widely against the U.S. dollar, that the government use part of its $900 billion in reserves to establish an international investment fund, and that Chinese citizens be allowed to buy into this fund. Last, Bin urged that part of the reserves be used to support the global expansion of Chinese companies. The way the Chinese government works, when someone proposes an idea publicly, that usually means that it has already taken place. So there is a real possibility that the Chinese have unloaded as much as $75-100 billion of U.S. Treasury debt in the past two months!
- The Comptroller General of the United States, David M. Walker, recently gave a talk about the U.S. government's deficits getting out of control. By around 2025, he figures (using assumptions that I think are unrealistically favorable to the government and also ignoring the trillions of dollars of actuarial liabilities for Social Security and Medicare payments)) that total U.S. government debt will exceed U.S. Gross Domestic Product (GDP). After that the debt will soar relative to the increase in GDP. Douglas Holtz-Eakin, head of the Congressional Budget Office, also concurs with roughly the same scenario. When even high-ranking accounting officials within the U.S. government are willing to admit that the federal budget deficits are a danger to the U.S. economy, everyone better start worrying. (Many thanks to investment guru Douglas Casey and his researcher Bud Conrad for their investigation of this issue. Casey is head of Casey Research, LLC and the editor of *The International Speculator*.)
- Last for now, but certainly not least, came last week's announcement by the Fed of a 17th consecutive interest rate hike. The Fed had been raising interest rates every meeting for the past two years in an effort to ward off inflation and also to make the U.S. dollar internationally attractive to investors with money to lend. Unfortunately, as interest rates increase, that makes it more difficult for American companies to make profits, possibly leading to a recession or worse. Fed officials began making comments over the first part of 2006 that there was enough inflation fighting, and interest rate hikes were about over. But as the investing public began to fear both inflation and a recession, the Fed became boxed in. It can either chose to hold or lower interest rates to support the U.S. economy, thereby making the U.S. dollar less attractive to foreign investors, or it can raise interest rates and concede that the U.S. dollar is suffering from too much inflation, making the U.S. dollar less attractive to foreign investors. No matter which way the Fed maneuvers, it will eventually fail at its mission of supporting the economy and the U.S. dollar and fighting inflation. In commentary accompanying the announcement last week of the latest rate hike, the Fed said, in so many words, that it would continue fighting inflation a little longer before it allowed the U.S. dollar to go down the toilet while the Fed tried to save the U.S. economy from recession. This announcement was greeted with an immediate response—precious metals rose and the value of the U.S. dollar fell.

Just these few snippets reinforce my long-term expectation that the U.S. dollar is doomed to decline while gold and silver soar to levels never seen before.

Last month, I forecasted the possibility that gold may reach $800 and silver $15 before the end of August and that gold might go all the way to $2,000 and silver to $50 by the end of 2007. The short-term predictions looks premature now, but I still stand by the longer outlook.

Today, you still have time to acquire gold and silver for less than you would have paid in May. This situation may continue for a month or two. Or it may not. I think we have seen the bottom for 2006. But I don't think we have seen the top.

One Thing To Keep A Wary Eye On

Despite all the foregoing strong fundamental information for a boom in precious metals, we may not yet be done with major attempts to manipulate prices downward. In the past three weeks, the lease rates for gold have fallen almost in half.

One year lease rates that were a paltry 0.18% on June 15 were today quoted at about 0.10%. One month lease rates that were a measly 0.135% on June 15 were today only 0.070%.

What that means is that there is plenty of gold available for lease if some major market manipulator decided to try to flood the market. Even if the price didn't move, a

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one month lease of a million ounces of gold would only cost less than 60 ounces (gold leases are paid in gold, not in any currency) At today's gold prices, that would mean that $627 million worth of gold would cost less than $36,000 to borrow for one month.

If the price of gold were to drop $10 per ounce within that month, such a manipulator would stand to make almost a $10 million profit. A $50 drop would yield almost a $50 million profit. Not a bad return on a $36,000 cost.

So, don't be surprised if it takes gold a while to climb back above where it reached in May. It may not happen until after the U.S. elections in November.

The ease of manipulating a relatively small market like gold makes it a poor place to put funds for the short-term. But, if you don't have to sell your gold at any particular time, then just ride out these volatile gyrations. Even if gold might take a $50 drop a few weeks from now, I think you will be far better off a year from now having purchased gold at today's price rather than what might be the prices six months from now.

The Rare Coin Market—Some Prices Decline But Activity Is Strong

The 22% drop in gold bullion prices also had a carryover effect on the U.S. Rare Gold Coins market. In the past five weeks, Common-Date U.S. Gold coins have mostly declined.

For instance, the 8-piece $2.50 through $20.00 Liberty and Indian Gold type sets in MS-63 quality are now selling for 8.4% less than they were a month ago. The MS-64 set has fallen even further, down 12.9%. Even the MS-65 set is down 3.2% in the last five weeks.

When I split U.S. Gold Coin Types into Top Recommended, Less Recommended, and Not Recommended, my classification generally was accurate. Although most coins in most grades were down, the best results were for the coins that were most recommended. The poorest results generally were for coins I did not recommend at last month's prices.

There was a temporary pause in the U.S. Gold Coins market as gold spot prices declined. Once the collector coins took a comparable price decline, however, demand took off.

When LCS Chief Numismatist Allan Beegle attended the Mid-American coin show near Chicago two weeks ago, he brought along a number of U.S. Gold Coins that did not meet our strict quality standards for retail sale. Within 24 hours of arriving at the show, virtually all of this unneeded stock was gone. Every dealer who perused Allan's inventory bought at least one coin!

Demand for better date coins was even stronger! For instance, Allan had just purchased a 1908-S $20.00 St Gaudens certified About Uncirculated-50 quality from a dealer for $3,900. He sold it to a dealer at the show for $4,200—a coin with an indicated retail price of just $3,000 in *Coin Values!*

Not everything was on fire. Many Key-Date collector coins have jumped 25-100% in the past couple of years. Demand was noticeably lighter for most of these. However, Type Coins, Silver Dollars, Silver Commemoratives, and many other areas are simply raging hot. The coins need to be solid quality to bring immediate buying interest—and there are just not enough of such coins to meet rising demand.

The paper money market is also doing well. Last month, the two pieces of U.S. Large Size Paper Money each sold for $2.1 million, approximately doubling the previous record high price ever paid for a piece of currency. Two other pieces of paper money sold in auction in June for close to $1 million each.

One thing that the long term collectors working here at LCS have learned is that if you purchase solid quality coins up front, rejecting marginal and so-so pieces, you will enjoy a bonus when you sell in a strong rare coin market such as has been developing for the past few years.

Perhaps the most ardent advocate of this idea among LCS staff is Retail Store Manager Bob Sweet. He has worked for LCS at various times over the past quarter century. But, even when he was pursuing other business ventures, he augmented his income by purchasing nice coins from one dealer and selling them to another dealer for a higher price. (I'm pleased to say that one of Bob's favorite places to find solid quality coins was LCS.) In some instances, he would resubmit certified coins for regarding, with enough upgrades to make an overall profit every year.

Since Bob returned to LCS two years ago, he has developed a loyal following for finding spectacular coins to fill customer want lists. Sometimes these extra nice coins cost a bit more than you would pay for an average quality specimen, but sometimes they don't cost any extra.

As an experiment, Bob accompanied Allan to the Mid-American coin show to strictly look for nice coins to buy, no matter whether they were needed for an existing want list. As usual, these coins had to be of a grade that also reflected great value, generally the quality just below the one where it takes a major price jump. For many issues, the nice quality MS-64 coins may look just as nice as MS-65 specimens, yet they can be purchased for a fraction of the price of the higher grade coin.

To our delight, Bob brought back over 40 of these special coins, many of which we list in the enclosed offer of **Sweet Deals.**

By the way, there are several ways of finding the "right" rare coins. For instance, I spend a lot of time conceptually analyzing the rare coin and paper money market to identify the most undervalued items. I then make up shopping lists of coins to search for—providing that the quality is solid and price is reasonable. Bob's approach is a lot like mine, except that he looks at coins first, then determines if a nice looking coin represents a good value to be worth purchasing.

One slight variation between the way Bob and I search for coins is that Bob seeks coins with lovely original surfaces that may have some toning but will still satisfy at least one customer, while I look for coins that will generally please every customer.

Bob will be doing more shopping for his **Sweet Deals** which we will be offered first to selected customers. Anyone making a purchase from the enclosed offering will be included on this priority notification list.

Gold and Gold Coins

Gold closed today at $627.25, a drop of $15.25 (2.4%) from five weeks ago. Today's close was the highest for gold in four weeks.

While other commentators are crediting the strong showing of gold in the past few days to the North Korean government's launching of test missiles, I think much of the rise would have occurred anyhow for the reasons I listed earlier. Gold is being supported by a multitude of factors, so the appearance of an unexpected uncertainty actually is less important to the long-term movement in the price of gold than current news coverage would lead you to think.

For instance, the world's premier precious metals consultancy, GFMS, today reported that the first quarter 2006 decline in mining companies' pre-sold gold contracts was a net 4.6 million ounces, more than the decline for all of 2005!

Also today, the World Gold Council release a research report showing that owning gold effectively hedges against inflation and the depreciation in the U.S. dollar. The three primary conclusions include:

1. There is a long-term relationship between the price of gold and the U.S. price level.
2. The U.S. price level and the price of gold move together in a statistically significant long-run relationship, supporting the view that a 1% increase in the general U.S. price level leads to a 1% increase in the price of gold.
3. Following deviations from this long-run relationship in response to short-

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term factors, the gold price has reverted to its long-run inflation-hedge value with remarkable consistency, although this reversion typically takes around five years.

The ultimate conclusion of the study is "If gold is a long-run hedge against inflation, and if it is true that real dollar depreciation against other currencies is inevitable, U.S. wealth holders should profit from holding gold during this period."

As I already said, the lower gold prices we saw in June spurred an uptick in demand for physical gold. Premiums rose for all of the low-premium forms such as the Austria **100 Corona** (2.8%), U.S. **American Arts Medallion** (2.9%), South Africa **Krugerrand** (2.8%), and Mexico **50 Peso** (3.0%).

The new U.S. 1 Oz Gold **Buffalo (5.6%)** is off to a fabulous start, with our first shipments being sold out before they even arrived in our store. So far, the price of the coin is comparable to what you would pay to obtain a 2006-dated U.S. **American Eagle** (5.2%). However, we are already seeing a fall-off in demand for the American Eagle. I would not be surprised to see the premium for that coin to slip in the coming months.

World Gold Coins have also experienced renewed buying demand with the recent fall in gold prices. We were fortunate to acquire an interesting collection containing **500 Years Of French Gold Coins** at prices that may be lower than you will ever see again. We didn't have room to list all the coins on the enclosed flyer, so please be sure to ask about other opportunities we have available.

Silver and Silver Coins

Silver settled today at 11.33, a fall of $1.07 (8.6%) in the past month. Like gold, today's close was its highest in four weeks.

Normally you would think that any commodity whose price falls 35% in five weeks must be an incredible bargain right now. Investors were shocked by this fall, and largely sat on the sidelines until the price fell below $11.00 to resume buying. Even though silver rose above $11.00 this week, there has been virtually no liquidation of physical silver in the past several weeks.

As the price of silver fell, a number of small-scale short sellers of silver closed out their positions. Curiously, The Commodity Futures Trading Commission (CFTC) report of the positions held by four or fewer holders are large short positions have barely changed since early May.

In the last Commitment of Traders report in June, the CFTC discloses that the four or fewer holders of large short positions were short a total of more than 169 million ounces of silver. This amount now encompasses about 85% of all short positions on the COMEX, and it dwarfs the total current inventory of 102 million ounces of silver registered on the COMEX.

The CFTC is supposed to monitor commodities trading to make sure that the markets "discover" an equilibrium price, rather than be subject to manipulation. Yet the CFTC has apparently ignored this huge short position, even though it is about four times the magnitude of the Hunt brothers silver activity at their 1980 peak. This concentration of a market distorting short position dwarfs that of the copper market, over which the CFTC did take enforcement action.

There is a very real possibility that the COMEX silver market could be hit with a huge default. If one of the major traders is the Chinese government, it has the deep pockets to pay off the default, but if it turns out to be one or more private companies, they simply may not have the assets to pay off a default.

Silver is being withdrawn from the COMEX to be refined to the London market's higher quality standard, then to be shipped over to England to meet soaring demand in that market. The London price has been so much higher than COMEX prices for at least the past two months, that the costs of refining and transportation are easily covered.

The Barclay Bank silver Exchange Traded Fund has already sold shares representing 78 million ounces. It is now 60% sold out, on a much faster pace than almost anyone expected.

With silver transactions going in one direction, the premium on all the lower cost forms of physical silver have increased. U.S. **90% Silver Coin** (1.8%) is almost at a high enough premium where refiners would no longer be able to economically refine it. Should this premium reach 2%, and the premium of the London silver market stay at least 10 cents, that could indicate a potential sharp short-term rise in the price of silver.

U.S. **40% Silver Coin** (1.4%) now has a lower premium than 90% Coin, but I don't recommend this form. You need to purchase a lot more bulk and weight to own the same amount of silver, which means higher shipping and storage costs. Plus, we saw in early 1998 that at least one major refiner, Handy & Harmon, stopped buying 40% coin completely at a time when a lot of silver was being liquidated.

Even **100, 10, and 1 Oz Silver Ingots** (5.3-6.2%) premiums are up. Supplies are so tight that buyers sometimes have to wait a few weeks for fabricators to manufacture new ingots!

Because the silver market is smaller than gold, it is much more volatile. I expect it to generate a higher return than gold, but still recommend major holdings in both metals to be prudent and conservative.

The Month

Gold Range	81.25	12.6%
Net Change	-15.25	
Silver Range	2.75	22.2%
Net Change	-1.07	
Gold/Silver Ratio	55.4	
Net change	+3.6	
Platinum Range	137.00	11.1%
Net Change	+1.00	
Platinum/Gold Ratio	1.97	

Date	Gold	Silver	Platinum
May 31	642.50	12.40	1,235.00
Jun 01	627.50	11.85	1,219.00
Jun 02	635.50	12.04	1,235.00
Jun 05	643.00	12.25	1,248.00
Jun 06	629.50	11.80	1,226.00
Jun 07	627.50	11.85	1,219.00
Jun 08	609.00	11.05	1,180.00
Jun 09	608.25	11.18	1,180.00
Jun 12	607.00	11.04	1,161.00
Jun 13	563.50	9.65	1,111.00
Jun 14	561.75	9.72	1,131.00
Jun 15	566.50	9.95	1,151.00
Jun 16	578.00	10.11	1,134.00
Jun 19	569.50	9.95	1,127.00
Jun 20	576.50	10.25	1,158.00
Jun 21	587.50	10.39	1,182.00
Jun 22	582.25	10.19	1,166.00
Jun 23	584.75	10.27	1,157.00
Jun 26	584.75	10.22	1,175.00
Jun 27	582.00	10.19	1,182.00
Jun 28	578.50	10.15	1,171.00
Jun 29	586.50	10.33	1,198.00
Jun 30	613.50	10.83	1,222.00
Jul 03	619.00	11.10	1,230.00
Jul 04	closed		
Jul 05	627.25	11.33	1,236.00

London Silver Market Premium To New York Silver Market = 20¢

Gold, silver and platinum quotes are working spots at 1:45 EST/EDT each day, quoted in U.S. dollars per troy ounce.

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 Website: www.libertycoinservice.com, E-mail: path@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. All information is derived from sources believed to be reliable, but accuracy cannot be guaranteed. No guarantee of profitability of any investment or recommendation contained herein is made or implied. Liberty Coin Service has been a dealer in rare coins and precious metals since 1971. The publisher, its principals and associates may, from time to time, have a position in items recommended here.