# Liberty's Outlook

Volume 9 Issue 6 Liberty Coin Service's Monthly Review of Precious Metals and Numismatics June 4, 2003

# Huge Japanese Bank Fails, Other Giant Banks On The Brink!

## P. 2 What Does This Mean For You?

On May 17, Resona, Japan's fifth-largest bank, announced that its capital-adequacy ratio had fallen to around 2%, half of the minimum required for domestic Japanese banks.

That evening, Japanese prime minister Junichiro Koizumi agreed to a plan for the government to buy the equivalent of $17 billion in new shares issued by the bank, effectively nationalizing the bank by taking more than 50% ownership.

Resona had been created just two months earlier by the merger of troubled Asahi Bank and Daiwa Bank, which collectively had previously received almost $10 billion in government bailouts.

As recently as late April, Resona's executives claimed that the capital-adequacy ratio was a safe 6%.

This bad news may only the tip of the iceberg!

The other large Japanese banks are only able to claim that they are adequately capitalized by use of an accounting gimmick! It would not take that much to bring on a virtual collapse of the entire Japanese financial system.

As these banks booked tens of billions of dollars of losses from writing off bad loans, they created the potential for paying lower taxes in the future, but only if the banks make huge profits within the following five years.

The Financial Services Agency (FSA), Japan's financial regulator, allows these banks to report potential future tax savings as Tier 1 capital! In other words, the fact that these banks have lost tons of money in recent years somehow improves their capital structure!

We are not talking nickels and dimes here. As the losses have amounted to tens of billions of dollars, so do the potential future tax savings. Here is the approximate percentage of these banks' Tier 1 capital that is represented by these potential future tax benefits:

| *Bank* | *% of Tier 1 Capital* |
|---|---|
| Mitsui Trust | 85% |
| Resona | 70% |
| SMFG | 55% |
| UFJ | 50% |
| Mizuho | 45% |
| MTFG | 30% |
| Sumimoto Trust | 27% |

But, these potential assets become worthless unless these banks start making boatloads of profits—soon!

So what are the prospects? Well, here is how much these banks lost in their most recent fiscal years ended March 31, 2003.

| *Bank* | *March 2003 Loss (in U.S. $ Billions)* |
|---|---|
| Mizuho | $20.4 |
| Resona | $ 7.2 |
| UFJ | $ 5.2 |
| SMFG | $ 4.0 |
| MTFG | $ 1.4 |
| Mitsui Trust | $ 0.8 |
| Sumimoto Trust | $ 0.6 |
| TOTAL | $39.6 |

Mizuho is the world's largest bank as measured by total assets. The rest are among the world's top 100 banks.

All of the banks other than Resona are forecasting that they will return to profitability in the current fiscal year. But even if they do, it won't be enough unless they magically become enormously profitable.

I just don't see it happening. In fact, I think there is a greater risk that we may see additional failures of major Japanese banks and perhaps even a total collapse of their banking system before we see the banks make enough profits to recoup all of their potential tax savings before they expire. Here is why.

When the FSA nationalized two large banks in 1998, the government absorbed a huge amount of bad loans before selling the "solid" business operations to private investors.

This time, Resona presents several problems. The bank issued an unusually large proportion of their loans to small and medium-sized companies, operations that the Japanese government has made it a policy to support. For the FSA to transfer any such loans to the Resolution and Collection Corporation, the state agency for collecting and liquidating bad loans, would be counter to proclaimed policy.

Then there are the loans to big companies. Any that would be classified as bad debts would put additional pressure on the other big banks to recognize their loans to the same companies as bad.

Resona also financed a large number of quasi-governmental projects in its home market of Osaka, many of which have turned into financial boondoggles. Foreclosing on these loans would hurt local governments and force other big banks to book huge losses.

In sum, there just doesn't seem to be any way for the government to genuinely clean up Resona without acting contrary to existing policy and without pushing other large banks closer to failure. But if no genuine resolution is made with Resona, the process will simply be repeated with the other banks down the road. The Bank of Japan, despite having the largest foreign exchange reserves of any nation on the planet, has nowhere near enough cash to cover a widespread bank collapse.

Yesterday Japan's Nikkei 225 stock in-

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dex closed at 8564, down over 26% in the past year.

One financial analyst predicts that if the Nikkei 225 drops to 7000, there will be at least one more failure of a major Japanese bank, which would put even more pressure on the stock index to fall further, risking further bank failures.

Before getting into what this all means for you, we also need to review changing auditor attitudes.

## Auditors Bite Back

With all the stock market losses wrought by major corporate failures in the U.S. and around the world in the past few years, there has been a growing call to "do something" to protect investors. Such efforts that have resulted may actually do more harm than good.

**1.** One development in the U.S. was the passage of the Sarbanes-Oxley Act of 2002. This new law imposes many new regulations under the guise of making public company financial reporting more accurate—theoretically better protecting investors.

On the surface, this law seems to have many sensible requirements, but it doesn't look as though anyone did a cost/benefit analysis.

One analyst told me that the costs of implementing and complying with these new regulations would cost small publicly held companies at least $1 million annually! Many small companies that are on the brink of going public to increase their growth will now shy away from being saddled with these costs. Instead, they will likely stay a much smaller operation, no matter how innovative the companies' goods and services might be.

In fact, many smaller publicly held companies in the U.S. are analyzing whether they can afford to stay public. Expect to see many either go private or sell out to a much larger company within the next year or so.

In effect, the Sarbanes-Oxley Act of 2002, in the name of investor protection, is clamping down on the potential for economic growth and higher stock prices. I shudder to think about what would not have happened if this law were in effect when companies like Microsoft, Wal-Mart, Oracle, Dell, Cisco, and Intel were in their infancy.

**2.** There was a reason that Resona's reported capital reserves fell by 2/3 in a matter of a few weeks. The auditing industry, which lost 8% of global auditing revenues in 2002 to settling lawsuits over flawed audits, is clamping down.

Resona's two accounting firms refused to accept bank management's calculation of potential future tax savings to include as Tier 1 capital.

Last month a certified public accountant from Michigan named James Leisenring, who now works for the International Accounting Standards Board, told me that "there are no auditing standards in Japan, and they don't follow them anyway." Even the May 24 issue of *The Economist* said, "Remarkably for Japan, where accountants are notoriously chummy with their clients, the bank's [Resona's] auditors were not convinced by its figures."

Well, auditors in Japan and elsewhere in the world are biting back. Resona's auditors developed some backbone and would not go along with the bank's intended total of huge potential future tax savings in Tier 1 capital.

In Britain, PricewaterhouseCoopers (PwC), one of the world's four largest accounting firms, has dumped dozens of clients. Some were cast off because of concerns about management honesty. PwC resigned from others because the companies' operations were too complex or intangible—particularly banks with large derivative operations and insurance companies.

In the coming year, expect to see many publicly held companies to getting a double squeeze from their auditors—far less acceptance of aggressive accounting policies along with much higher auditing bills. This hardnosed approach will doubtless bring out some additional financial reporting nightmares.

## What Does This Mean For You?

## Newly Developed Uses For Silver

Ever since silver became such an inexpensive metal, researchers and engineers have been finding new applications at what seems to be an ever increasing rate. It is a major reason that demand for silver has been growing almost every year. Here are a few of the latest developments:

**X-Static®:** This silver coated nylon thread quickly kills several strains of bacteria at room temperature and almost instantly destroys them at human body temperature. The anti-bacterial textiles made form this thread have also proved to be comfortable. The major product so far is X-Static® socks. They were used by U.S. rapid deployment forces in Iraq and have been selected as official U.S. Army issue. Athletes from at least 60 countries will be wearing them at the 2004 Olympic games. NASA and European Space Agency astronauts wear them. X-Static® fibers are now being fabricated into clothing in virtually every nation in the world. It is also being inserted in wound care products.

**JMAC:** This combination of silver chloride deposited on inert titanium dioxide provides almost permanent antimicrobial protection. It is being applied as a coating on medical devices that are place inside the human body such as catheters, feeding tubes, dental prostheses, sutures, drain tubing, and the like.

**AgION:** This silver/zinc-zeolite substance provides a durable adherent bactericidal surface to stainless and carbon steel sheet. A research hospital for bone marrow transplants is being constructed in Duarte, California using this coated steel. Other applications are air conditioning ducts, shipboard water supply systems, refrigerator interiors and exteriors, humidifiers, ice dispensers, and machinery in food processing facilities.

**Alagon™:** This silver-containing alumina is mixed with cement and concrete to give them antibacterial properties. It is also being used in swimming pool filters. Because it is non-toxic, it is being investigated as an ingredient in deodorants and cosmetics.

**Disinfecting Washing Machine:** Samsung Electronics has begun production of the Ag Plus Washing Machine line. When these machines are set on "Silver Sterilization", silver nanoparticles kill off most of the bacteria and mold without the need to use hot water. Tests have shown that clothes washed in these machines have no bacteria after a complete washing cycle. The company expects to sell at least one million washers in the South Korean and other markets.

In the age of new diseases such as SARS (severe acute respiratory syndrome), silver is likely to find even more applications. Silver inhibits the growth of bacteria by a physical process, which means that bacteria cannot become immune to it through mutation.

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What if . . . ?

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The world is full of uncertainties. In many respects, there are signs that most of the bad news may be over for U.S. economy and stock markets and that it is time to tilt your investment portfolio more towards equities.

But—what if the Japanese banking crisis turns in to a full-blown meltdown of their financial system? We might see the Bank of Japan unloading massive quantities of U.S. dollars to support the yen, causing the dollar to plummet even further than it already has.

But—what if a major U.S. bank suddenly finds itself without an auditor willing to report on the financial statements unless it records huge loss reserves for derivatives trading? Would a failure of Citigroup or JP Morgan Chase be in the offing, with its cascading effect on the entire U.S. financial system?

But—what if the Euro continues to appreciate, encouraging more central banks to unload dollars from their foreign exchange reserves to be replaced with Euros? As dollars were being repatriated to the U.S., the value could drop sharply.

As long-time readers already know, the bottom-line reason to own precious metals, rare coins, and hard assets, are as insurance to protect against the uncertainties, the "what ifs," that might occur to hurt the value of your paper assets. While any particular problem may never happen, over time you are almost certain to be affected by some of them.

For the average investor, I suggest that 5-10% of your net worth be allocated to precious metals and numismatics.

For the aggressive investor, who likes the long-term fundamental shortages of gold and silver supplies and the growing expansion of the rare coin market, putting up to 20% of your net worth in hard assets is worth considering.

If you don't yet have enough "insurance protection" in the form of precious metals and rare coins, call us today to get it taken care of.

## London Bullion Market Association Meeting—Report And Analysis

The London Bullion Market Association (LBMA), the world's largest gold and silver trading exchange, held its annual meeting in Lisbon, Portugal Monday and Tuesday this week.

At this meeting, the movers and shakers in the gold market have the chance to tout or trash the prospects for gold prices, usually in balancing doses.

This year, the speakers were almost all of the doom-and-gloom school.

Kamal Naqvi, a precious metals analyst at Macquarie Bank in Britain expressed typical sentiments. He observed the decline in volume in gold contracts traded on exchanges around the globe and said, "It suggests that the broader investment community does not yet believe that a gold price in excess of \$325/oz is sustainable." However, Naqvi did admit that three events combined might spur higher gold prices—weaknesses in stocks, bonds and real estate, especially if gold continues to outperform those markets, and a leadership position from a prominent investor (such as when billionaire George Soros recently reported that he was selling the U.S. dollar and replacing his holdings with Euros, Canadian, Australian, and New Zealand dollars, and gold).

At the last session, a panel was led off by Mitsui precious metals analyst Andy Smith with his characteristic bearish comments on gold. He was followed by Kevin Crisp, the commodities analysis for Dresdner Kleinworth Wasserstein. Instead of hearing an upbeat presentation to counter Smith's remarks, Crisp warned that gold is in grave peril of permanently falling off the radar screens of investors.

He reviewed all of the events of the past two years that were extremely bullish for gold yet lamented that investor demand for the yellow metal has not exploded (when Japanese demand soared early last year, for instance, it was offset by falling demand in India).

Crisp quoted Philip Klapwijk, managing director of Gold Fields Mineral Services, "There is a feeling of, if it doesn't happen now then when's it going to happen?"

Crisp listed the number one problem with increasing investment demand for gold as the sheer difficulty of buying it. In many countries such as the U.S., few banks sell it.

The most bullish presenter was Wayne Murdy, CEO of Newmont Mining Corporation, the world's largest gold mining company. He expects gold prices to continue rising over the next few years because of a weak U.S. dollar and low interest rates, supported by declining gold mine output.

While I don't brush aside the overall tone of the LBMA meeting, I actually find it encouraging. Many of the speakers represent or provide services to entities that that have huge short positions in the gold market. Current higher gold prices are hurting their businesses, even forcing losses on some of them. Their biases were showing. That their representatives are trying to find reasons to bad mouth gold may be a sign of the desperation of the short-traders.

Besides, to quote from analyst Alex Wallenwein's internet editorial yesterday, "This time, gold will rise . . . The main reason is that it is no longer in the interest of the most gold-heavy central banks in the world—the central Europeans central banks—to support a low dollar-gold price."

In Wallenwein's view, the return of the Euro to its current all-time highest value is the final step that makes the fall of the U.S. dollar inevitable. The European Central Bank is required to have gold reserves equal to 15% of outstanding currency, though Euros are not redeemable for gold. This stronger gold backing will, over time, persuade a growing number of central banks to displace dollars in their foreign reserves with Euros. With significant gold holdings, the European Central Bank has no incentive to hold down the price of gold and would actually benefit from a rise in price.

There is also a major new program designed to overcome the difficulty of buying gold. A newly formed Australian company called Gold Bullion Ltd began listing Gold Bullion Securities on the Australian Stock Exchange on March 28. Each Security represents 0.1 ounces of gold, which is physically stored in the HSBC vaults in London, England. This program, developed in coordination with the World Gold Council, makes is possible for investors to purchase gold just as easily as they now buy stocks. There is no minimum trading volume requirement, but you must have 10,000 ounces or more on account to take physical delivery. These Securities incur a management fee of 0.02% per month to cover storage and insurance costs. Now that stock brokers have a financial incentive to sell these Securities, it is possible that

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there could be a significant increase in investor demand for gold.

Two months ago I detailed significant reservations about holding gold certificates in lieu of physical gold. I have similar concerns about these Securities. Even so, they may help push up the price of gold.

## Gold and Gold Coins

Gold closed today at $362.50, up $10.25 (2.9%) from three weeks ago.

Gold is now up almost 13% since hitting bottom at $321 two months ago. There has been some profit-taking as gold has breached $370 in the past few weeks but also a surge in buying demand when the price dipped below $360.

For the next little bit, the price of gold may remain rangebound in the $360s, but I wouldn't be surprise to see it top $370 to stay by the end of this month.

The lowest premium issues continue to be the U.S. **American Arts Medallion** (3.7%), Austria **100 Corona** (3.4%), Mexico 50 Peso (3.9%), and South Africa **Krugerrand** (3.8%). Premiums held steady on the first two; the Krugerrand fell slightly as supplies were liquidated at higher gold prices.

Premium levels were likewise steady among the lower premium small gold coins. The British **Sovereign** (7.5%) has the highest volume, while the French **20 Franc Rooster** (9.0%) and the Swiss **20 Franc** (9.0%) are also in demand. These are all gold coins that have histories of trading at 50-100% above gold value, offering the possibility of higher premiums in the future. Demand in Europe has been much stronger in the past year for such coins.

**Common-Date U.S. Gold Coins** had a big jump in late 2002 and early 2003 as the price of gold was rising. They spent the next few months retreating, reaching a plateau over the past month. Now we see evidence of renewed demand in the $1.00 through $10.00 denominations. In fact, Allan Beegle located a fresh original roll of **Mint State-62 and –63 1910-D $10 Indians** at the huge Long Beach Exposition last week, then looked around for additional specimens. He found that a number of dealers were hunting for common-date $10 Indians for upcoming promotions. Don't be surprised if prices jump in the next few months. That would make our group of somewhat better date coins even more attractive. See the flyer for details.

**Better-Date U.S. Gold Coins** are selling so readily that it has become almost impossible to find them in quantity. We only managed to acquire the 1910-D $10 Indian lot by being in the right place at the right time. Typically, rare date Gold Coins can only be located one piece at a time.

**World Gold Coins** are selling more readily than when gold was lower in the past few years. Part of the reason has been the resurgence of physical demand in Europe resulting from the strength of the Euro. Although we did not find any large bargain purchases, we can offer **More World Gold Coin Bargains**, a follow up to our popular offering two months ago.

### The Month

| | | |
|---|---|---|
| Gold Range | $19.75 | 5.6% |
| Net Change | +10.25 | |
| Silver Range | .36 | 8.7% |
| Net Change | -.36 | |
| Gold/Silver Ratio | 80.6 | |
| Net change | +8.1 | |
| Platinum Range | 41.00 | 6.1% |
| Net Change | +7.00 | |
| Platinum/Gold Ratio | 1.83 | |

| Date | Gold | Silver | Platinum |
|---|---|---|---|
| May 14 | 352.25 | 4.86 | 655.00 |
| May 15 | 352.50 | 4.77 | 658.00 |
| May 16 | 354.50 | 4.78 | 652.00 |
| May 19 | 364.00 | 4.81 | 656.00 |
| May 20 | 366.25 | 4.76 | 671.00 |
| May 21 | 372.00 | 4.72 | 670.00 |
| May 22 | 368.00 | 4.66 | 664.00 |
| May 23 | 368.75 | 4.65 | 664.00 |
| May 26 | closed | | |
| May 27 | 367.50 | 4.63 | 678.00 |
| May 28 | 365.00 | 4.64 | 663.00 |
| May 29 | 369.25 | 4.57 | 638.00 |
| May 30 | 364.50 | 4.53 | 641.00 |
| Jun 02 | 366.00 | 4.50 | 637.00 |
| Jun 03 | 365.25 | 4.50 | 652.00 |
| Jun 04 | 362.50 | 4.50 | 662.00 |

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.

## Silver and Silver Coins

Silver settled today at $4.50, down 36 cents (7.4%) from mid-May.

Silver has encountered significant selling pressure by paper contract traders when it has reached $4.80 in the past nine months. With the long-term fundamental shortage of supply, I expect we will eventually see the price explode upwards. But I don't know if it will happen in the next few months.

The gold/silver ratio has jumped to more than 80:1 for the first time in many years. I expect the long-term equilibrium between the two metals to be somewhere between 30:1 and 50:1. At today's high ratio I think it sensible to consider swapping your gold bullion for silver bullion. Let me give you an example.

On February 4, 1998, the closing spot prices of gold and silver were $299.75 and $7.00, respectively. On that day, you could have purchased $1,000 face value of U.S. 90% Silver Coins at $4,880 (at 2.5% below its silver value!) or purchased 15.5 Ounces of U.S. American Arts Medallions for $4,825.

Had you purchased the 15.5 Ounces of Medallions then, you could have traded them to us today for approximately $1,575 face value of U.S. 90% coin, almost a 60% gain in your silver bullion holdings! If you are interested such a possible swap, call us for specific quotations. Keep in mind, though, that the IRS considers a swap of gold for silver to be a taxable event that is reportable on your personal tax returns. But, if you are like many investors that have tax loss carryovers to use up, this could be the right opportunity for you.

U.S. **90% Coin** (10.6%) continues to be the low premium favorite, even though the premium has increased with the decline in spot silver. **100 Ounce Ingots** (11.6%), cost an extra 4 cents per ounce without the same divisibility or liquidity.

**Numismatic Silver Coins,** especially better dates and higher grades are hot, hot, hot, and almost impossible to find! About the only things that are cooling off are coins that have already appreciated at least 50% in the past two years. We managed to find some smaller quantities of U. S. and World Silver Coins. See our offerings of **Bargains In Silver** and **Canadian Olympic Silver Commemoratives** for specific details.

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