

Liberty's Outlook

Volume 11 Issue 6 Liberty Coin Service's Monthly Review of Precious Metals and Numismatics June 1, 2005

How Will Coming Chinese Currency Revaluation Affect Gold And Silver?

P.2. Ohio Coin Scandal—The Likely Ramifications

In 1995, the Chinese government fixed the value of its currency, the renminbi yuan, to the U.S. dollar at a rate of 8.28 yuan to \$1.00. The rate has held steadfast ever since.

In 1995, the U.S. government held the world's largest reserves of gold and foreign exchange—\$167 billion. China was down the list behind Japan, Germany, Taiwan, Switzerland, France, and Singapore at \$57 billion.

In the years since, the U.S. dollar has risen and fallen. Here's how the value of the dollar has changed against some currencies since the beginning of 1995:

| | |
|-------------------|--------|
| Mexico peso | +97.8% |
| India rupee | +39.4% |
| South Korea won | +27.2% |
| Taiwan dollar | +19.6% |
| Singapore dollar | +14.6% |
| Japan yen | +8.0% |
| Australia dollar | +2.0% |
| Euro | -0.5% |
| Switzerland franc | -4.9% |
| Canada dollar | -10.6% |
| British pound | -14.0% |

Although it might look like the U.S. dollar has fared relatively well over the past ten years, you must consider that the dollar has gained nearly 10% against many of these currencies in the past two months.

Also, the largest gains were against currencies where the government mismanaged its currency (Mexico), or those of the Far East Asian nations that were clobbered in the currency crisis of 1997 (and who also have an incentive for their currencies to be cheaper than others in order to stimulate exports and economic growth), or against the yen where the Japanese government has

spent hundreds of billions of dollars trying to hold down the value of the yen versus the dollar.

When you compare the value of the dollar against currencies from economically mature nations, the results are not good. Even with the recent surge in the dollar, it is still down compared to the Euro, Swiss franc, Canadian dollar, and British pound.

Which also means that the value of the Chinese currency has fallen against these same currencies.

The relatively cheap Chinese currency has helped fuel that country's massive growth in exports. China now has over \$660 billion in foreign exchange reserves plus acknowledged (which may be lower than actual) gold reserves valued at more than \$8 billion. Total reserves are increasing by a half billion dollars every day! China's central bank has the world's largest reserves, by far.

Most of the increase in China's reserves has been in U.S. dollars and U.S. Treasury debt. The Chinese government has even propped up its weak banking system by infusing U.S. dollars into troubled banks to hold as their reserves.

In a free market, the Chinese yuan would have long since appreciated against the U.S. dollar. It has stayed fixed only because it has been fixed by the Chinese government.

The relatively weak yuan has helped Chinese exports to the U.S. grow substantially, to where they now account for 10% of all U.S. imports.

As China industrializes, it has leveraged its low labor costs to out-compete more developed nations, including the U.S.

With part of the manufacturing job losses in the U.S. attributable to Chinese competition, there has been some political backlash.

Top U.S. officials have been urging the Chinese government to let the value of its currency rise for at least a year.

U.S. government pressure soared within the past two weeks. The Treasury Department released a report May 17 that called China's currency policies "highly distortionary" and called for "substantial alteration" of those policies within six months.

This "request" was made as import quotas were being reimposed on some Chinese textiles.

It is clear that the U.S. government is ordering the Chinese government to raise the value of the yuan soon, or risk a protectionist backlash.

Within days, China's prime minister, Wen Jiabao, referred to the currency policies as a matter of "China's own sovereignty." He said, Any pressure or effort to politicize an economic matter will not help solve problems."

It makes perfect sense for China to determine its own currency policy. It is also true that a rise in the value of the yuan will not magically erase America's huge and growing trade deficit.

For instance, if the yuan appreciates by 10%, that would only increase the cost of all U.S. imports by 1%. That would not be enough to cut the flood of imports into America.

Political rhetoric aside, the Chinese have reasons to want the value of the yuan to rise against the dollar. An undervalued currency causes too many resources to be devoted to exports and too little to meet-

(Continued on page 2)

Inside this issue: Report Knocks Dollar, Promotes Gold page 3
Central Bank Gold Sales Falling Sharply page 4
We Apologize For A Glitch page 4

(Continued from page 1)

ing domestic consumption.

China's current-account trade surplus was 1.5% of Gross Domestic Product (GDP) in 2001. It rose to 4.2% of GDP last year and is expected to be even higher in 2005. From this perspective, a more valuable yuan is needed to balance the economy.

However, any increase in the value of the yuan carries substantial risk. It will create uncertainty and lead to some financial stress in parts of the economy that depend on growing exports. No doubt some businesses would decline and jobs would be lost.

If the Chinese yuan did appreciate against the dollar, the value of China's foreign exchange reserves would decline, as would the U.S. dollar-denominated capital infusions to the major banks.

The Chinese government is facing a situation with no perfect answers. To allow the yuan to appreciate will cost the government billions of dollars and cause economic turmoil.

To do nothing would simply let the problem grow even larger with an even higher cost to manage it in the future.

On balance, there is every reason to think that the Chinese government should let the yuan appreciate soon. Perhaps that only reason to not do so is that it might be interpreted as the Chinese taking orders from Washington. The Chinese are also not eager to reward speculators who have been taking long positions in the yuan. As a result, look for China to make changes when foreign governments and the markets least expect it. By the way, the various forecasts I have seen project a rise in the yuan somewhere between 7% to 25% this year.

On May 18th, a long-scheduled foreign exchange trading system began in China, allowing Chinese banks to trade in eight currency pairs. Seven involve the U.S. dollar and the other is a euro-yen pair. This could have been the ideal time for China to announce a change in their currency policy. But no change was announced.

In July, China's president, Hu Jintao, may attend the G8 summit in Britain. He is also scheduled to visit America in September. These visits would go much easier if some move in currency policy were an-

nounced beforehand.

There are various ways that the yuan could be appreciated, from simply being fixed at a new higher rate to becoming a completely free-floating currency. It is more likely that any move would be between these extremes, such as setting a higher target value but, for example, letting the currency fluctuate within a 10-20% range.

While I think it is likely that the yuan will be allowed to appreciate against the dollar, I am not really concerned about the nature of the change. However it changes, there will be effects on the U.S. dollar and the U.S. economy:

- Any change will result in the outright decline in the value of the dollar on a world-wide basis. The price of gold is almost certain to rise. If the value of the yuan rose 20%, for instance, gold could climb at least 10%. Remember, when the dollar falls against other currencies, that also knocks down the price of gold in other countries. Foreign investment demand for gold will almost certainly increase.
- U.S. Treasury debt will be less attractive to foreign governments and investors because of the potential for further decline in the value of the debt. As a result, interest rates will have to rise, quite possibly sharply.
- The higher interest rates will put a brake on consumer spending, causing a slowdown in the economy at a minimum and possibly a serious market crash.
- The higher interest rates will also likely hurt the real estate market.

As the yuan may be allowed to appreciate as early as a month from now, I recommend that you re-evaluate your total investment portfolio to see what you can do to better protect yourself against the risks I just listed. Adding to your precious metals and rare coin positions sooner rather than later would be a good idea.

Ohio Coin Scandal—The Likely Ramifications

In 1997, the Ohio Bureau of Workers Compensation (BWC) decided to allocate \$50 million of its \$18 billion investment portfolio into "alternative investments" and solicited proposals.

Tom Noe, a coin dealer in suburban Toledo, submitted a proposal for investment in rare coins that was accepted. In 1998, the state of Ohio transferred \$25 million to a coin investment fund created by Noe. Later, another \$25 million was transferred into a second coin investment fund. The Bureau of Workers Compensation owned the funds; Noe was the general manager.

Under terms of the management agreement, the BWC was to receive 80% of the realized profits, while Noe's company was to get 20% of

the profits to cover expenses and reward Noe and his associates.

Through the end of 2004, the rare coin investment funds generated more than \$13 million in profit distribution to the BWC, which proved to be one of the most lucrative of its investments over that time.

To mask the impact of this much money coming into the rare coin market Noe set up subsidiaries across the country—in Delaware, Pennsylvania, Texas, Minnesota, Colorado, and California—to buy and sell coins. A major way that these companies looked to make profits was by locating certified rare coins that may have been conservatively graded and might grade higher if resubmitted to a grading service.

(Note: The advent of certified grading services has not eliminated the need to look at coins. Coin grading is subjective. The Professional Coin Grading Service learned through internal testing that, at best, it would grade the same coin with the same grade only 80% of the time. LCS's policy has always been to look at the coin, selecting only those for our retail customers that could stand on their own merits. As a result, we reject a significant percentage of coins certified by every grading service as not being nice enough for our customers. Because of our fussy standards, we do sell a number of coins to other dealers at our "retail" price, because the purchasers anticipate that the coins may earn a higher grade when resubmitted to a grading service).

In the coin industry, dealers constantly try to mask their moves. If other dealers know that someone is accumulating a particular coin, they will run up the price. If a dealer is trying to liquidate a large position on one item, dealers who know of this may knock down the price of the coin before the dealer can sell them.

Because of the need for keeping "trade secrets" about what coins were in inventory, for instance, Noe's contract with the BWC gave him extensive exemptions from disclosure of trading activity and inventory holdings. Such practices are different than those of investment funds that annually report to the public a list of their holdings.

As the BWC was getting ready to invest another \$25 million, reporters at *The Toledo Blade* uncovered and reported some ugly facts. Among them were:

- Two coins worth more than \$100,000 allegedly disappeared in the mail.
- Another lot of coins, somewhere between 90 and 110, were unaccounted for.
- Two of the individuals that Noe hired had criminal convictions for drug

(Continued from page 2)

dealing, money laundering, fraud, and other charges.

- Noe was suspicious that one of these two men was self-dealing with the fund's coins so that he personally would make most of the profit, not the fund. Noe sent other employees to seize assets and records from this employee, with the result that several lawsuits are pending.
- Other employees had pleaded "no contest" in old civil suits over their business practices.
- Some of Noe's employees had left the subsidiary companies while owing large sums that had been paid as advances against future earnings.
- Some of the money in the coin funds had been loaned to friends or associates of Noe with uncertain or insufficient collateral.

The newspaper, in a Democratic stronghold in a mostly Republican state, also went on to question the reasons why Noe was awarded the contract. Noe was a major Republican contributor, one of the top fund-raisers for President Bush's reelection campaign, had been appointed by the Republican governor to serve on two state boards, and was the chair of the local county Republican party. The officials involved with the decision to invest in rare coins and to give the management contract to Noe had themselves received contributions from Noe in the past or worked under some who had.

A federal probe was started to determine whether Noe had violated campaign finance laws.

Ohio Democrats, sensing the opportunity to make political hay, claimed that Noe was awarded the contract because of political cronyism, ignoring the fact that Noe was probably the best coin dealer in Ohio to manage such funds.

At first, various government officials pointed to the profitable results of the coin investments and pointed out that the details of the operation were exempt from public exposure. The latter attitude was portrayed as stonewalling to protect Noe.

As the newspaper's staff dug deeper, more damaging information came to light. The BWC obtained a court order to inspect the inventory it owned and to obtain an independent appraisal. It has seized the inventory and records at out-of-state locations. But, when employees at the headquarters facility barred the auditors from access to the inventory until Noe's attorneys could be present, the public clamor grew louder.

Last Thursday, Noe's attorney admitted that \$10 to \$12 million of the funds assets

are missing. Criminal charges against Noe are now possible.

Among the most recent revelations is that Noe is a part owner of Numismatic Guaranty Corporation (NGC). Noe's foes are trying to portray the BWC coin funds' use of NGC's grading services as another form of payoff for Noe.

Noe has resigned from the two state commissions, his political leadership position, and from managing the coin funds. He is apparently moving to his Florida residence. His personal assets have been seized by court order.

A new manager of the coin funds has been appointed to wind up operations in such a way as to maximize the prices realized for the funds' holdings.

The BWC Commissioner has resigned.

A provision to repeal Ohio's sales and use tax exemption on the sales of precious metals and rare coins—an exemption for which Noe was the major backer and industry lobbyist—was included in a budget bill that passed the Ohio Senate last night. It is now up for a vote by the full Senate.

When I worked on the successful effort to eliminate bullion and rare coin sales taxes in Michigan from 1995 to 1999, Tom Noe made several visits to Lansing to help out. He has also been active in the national coin dealer trade association, the Industry Council for Tangible Assets, on whose Board of Directors I have served for several years. I have found him to be a strong supporter of both the industry and of the hobby of coin collecting.

While I can understand that Noe may have used poor judgment in some of the people he hired, I find it difficult to believe that he would convert the funds' assets for personal purposes. Still, I have seen others that I held in high regard turn to crime. I await the results of the legal process to learn Noe's fate.

In the meantime, the publicity of this scandal is starting to have some fallout on the coin industry.

- The Democratic National Committee has requested that President Bush return all contributions received from Noe. This wrangling at the federal level may kill a bill that would allow certified rare coins into Individual Retirement Accounts.
- The Ohio sales tax exemption is in jeopardy and might impede the effort to enact a similar exemption in neighboring Pennsylvania.
- With the grading services getting publicity about their less than consistent grading results, they just might implement somewhat tougher grading standards over the next few months.

- Demand for the kinds of rare coins sought by the funds will drop, and supplies will increase as the inventories are liquidated. As a result, prices are likely to drop in the near term. Prices in other areas may drop in sympathy, but to a lesser degree. Examples of areas where I expect to see some weak prices in the coming months are in coins priced over \$5,000, common-date Morgan and Peace Dollars in MS-62 to MS-68 grades, the better-date Morgan Dollars that I listed as "hold or sell" in the February newsletter, Carson City Mint issues, other coins that we have warned as being perhaps overpriced, and other super rarities.

The coins that I have recommended as the best values should be among those least affected by the fallout from this scandal. If prices do drop a little bit, consider that a bonus buying opportunity.

I personally think that a \$50 million rare coin investment by the Ohio Bureau of Workers Compensation was inappropriate.

The secretive nature of coin trading doesn't fit well with a government investor that needs a greater degree of openness than a private investor

It is true that the infusion of \$50 million into the rare coin industry helped accelerate some price hikes. However, I don't think that was a large enough amount to cause a market boom by itself. There is simply too much money coming into rare coins from a number of directions.

Just like I don't think the \$50 million coming into the rare coin market changed the long-term trend, I don't expect that the liquidation will cause the market to fall. I expect the rare coin boom market to continue for at least the next several years, though with occasional bumps in the road such as wrought by the Noe scandal.

Gulf Research Center Report Knocks U.S. Dollar, Promotes Gold

A recently released report by the Gulf Research Center in Dubai, titled "The Role of Gold in the Unified Gulf Cooperation Council Currency" predicts that any current efforts to manipulate and suppress the rise in the price of gold will fail, just as the London Gold Pool failed to halt the drain on Western gold reserves in the 1960s.

The report advocates that central banks in the Gulf Cooperation Council countries accumulate gold reserves.

The study has a powerful conclusion: "The paper dollar standard is a dead man walking. Its debt, accumulated over the re-

(Continued on page 4)

(Continued from page 3)

cent decades, is too high to be effectively repaid. It will either default or be inflated to such an extent that it will not 'hurt' to pay it back. Therefore, the accrued imbalances in global finance and the inherent weakness of worldwide growth models that rely on a continuance of U.S. deficit spending are likely to usher in a serious crisis of currency systems in coming years."

"Gold will be a suitable means of asset protection and ultimate payment in such a scenario. It will preserve the wealth of individuals and central banks alike and will ensure important maneuverability for the latter."

Gold and Gold Coins

Gold closed today at 415.25, down \$13.75 (3.2%) from last month. That was its lowest close in almost five months.

As spot prices have sagged, we have experienced an increase in both retail liquidation and new investment.

CPM Group, a respected consultant to central banks, investment brokers, and mining companies, projects that central bank gold sales for 2005 will be 6-8 million ounces, far short of the 16.1 million ounce quota under the renewed Agreement.

With news about supply shortages like this and the prospects of higher gold prices from the Chinese currency revaluation, I am raising my projection for gold prices this year. I am more confident that gold will top \$500, and give it about a 75% chance of reaching \$600 before year end!

The best buys in gold bullion-priced items are still the Austria **100 Corona** (3.5%), South Africa **Krugerrand** (3.7%), and U.S. **American Arts Medallion** (3.7%). Among smaller coins, I like the **British Sovereign** (7.7%).

With the lower spot price and the concern over the impact of the Noe scandal, the prices of a number of **common-Date U.S. Gold Double Eagles** in circulated and Mint State grades have declined, some by 10% in the last month. On the other hand, **Better-Date U.S. Gold Coins** are still in strong demand. Our offers of the **Choice Mint State-63 \$5.00 Liberty Rarities** includes tougher dates that you can own at the same price as common issues.

Silver and Silver Coins

Silver ended up today at \$7.50, up a strong 52 cents (7.4%) from four weeks ago.

The Month

| | | | |
|---------------------|-------------|---------------|-----------------|
| Gold Range | \$13.75 | 3.2% | |
| Net Change | -13.75 | | |
| Silver Range | .58 | 8.3% | |
| Net Change | +.52 | | |
| Gold/Silver Ratio | 55.4 | | |
| Net change | -6.1 | | |
| Platinum Range | 30.00 | 3.4% | |
| Net Change | -8.00 | | |
| Platinum/Gold Ratio | 2.08 | | |
| Date | Gold | Silver | Platinum |
| May 04 | 429.00 | 6.98 | 872.00 |
| May 05 | 429.00 | 7.04 | 873.00 |
| May 06 | 426.00 | 6.94 | 869.00 |
| | | | |
| May 09 | 426.00 | 7.05 | 874.00 |
| May 10 | 427.00 | 7.10 | 875.00 |
| May 11 | 427.00 | 7.08 | 877.00 |
| May 12 | 421.75 | 6.94 | 868.00 |
| May 13 | 419.75 | 6.92 | 861.00 |
| | | | |
| May 16 | 418.75 | 6.94 | 847.00 |
| May 17 | 419.50 | 7.02 | 860.00 |
| May 18 | 421.50 | 7.19 | 859.00 |
| May 19 | 420.50 | 7.12 | 863.00 |
| May 20 | 417.50 | 6.98 | 859.00 |
| | | | |
| May 23 | 417.50 | 7.01 | 859.00 |
| May 24 | 417.50 | 6.99 | 866.00 |
| May 25 | 418.75 | 7.12 | 860.00 |
| May 26 | 418.00 | 7.15 | 861.00 |
| May 27 | 419.75 | 7.29 | 863.00 |
| | | | |
| May 30 | closed | | |
| May 31 | 416.25 | 7.44 | 856.00 |
| Jun 01 | 415.25 | 7.50 | 864.00 |

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

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

In the past month, LCS has experienced solid demand and little liquidation of physical silver. This demand has continued, even as the spot price rose.

As a result, premiums have held up rather than declining as we usually see in a quickly rising market. Are we in the early stages of the breakout boom I expect this year? We will only know for sure later.

In the meantime, we came up with a couple groups of the **Mint State 1977-1979 Mexico 100 Pesos** featuring the portrait of the "George Washington" of Mexican Independence. With the recent jump in silver prices, these coins are an even better deal than they were last week.

We also have a modest group of **Mint State Eisenhower Silver Dollars** at a price that is a

fraction of what you would pay for Morgan or Peace Dollars. See enclosed flyers for details.

We Apologize For A Glitch

Last month we announced the availability of a new toll-free quotes line, 800-825-8930. We know that many of you tried to call us, because you let us know when you were unable to get through.

To free up our other telephone lines, this toll-free number rings in onto our fax telephone number. In theory, if a fax message is coming in, it will be answered by the fax machine. Calls to the quotes line were supposed to be answered by the answering machine with the quotes message.

Well, the equipment was being set up as the last issue went to press, and the splitting technology did not function as it was supposed to. All calls were being answered by the fax machine, so there was no way to reach the quotes line.

During the past month, we worked with our telephone carrier to install distinctive rings to help the existing equipment work as intended, but that did not cure the problem.

At the moment, we're trying to locate a supplier of two kinds of equipment, either one of which should work. We expect to have the quotes line up and running soon, possibly by the time you get this newsletter. It ought to be working in a few days.

By calling the quotes line, which will be available at your convenience 24 hours a day, you can learn the latest U.S. closing spot prices for gold, silver, and platinum, as well as our selling price for U.S. American Eagles and bags of U.S. 90% Silver coin.

To get the latest spot prices and current quotes on products or to confirm trades, you will still need to call our Trading Desk toll-free at 800-LCS-2375 (800-527-2375).

Thank you for your patience.

Call our New Toll-Free Quotes Line:

800-825-8930

for spot prices at the U.S. market close and price indications for U.S. 1 Oz Gold Eagles and U.S. 90% Silver Coin Bags.

For a more detailed list of prices, check Computer Quotes on our website

www.libertycoinservice.com

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. Copyright 2005, all rights reserved.