Liberty's Outlook

Our 30th Anniversary! 1971-2001

Volume 7 Issue 3 Liberty Coin Service's Monthly Review of Precious Metals and Numismatics March 7, 2001

Volatile Markets = Opportunities!

P.4 Silver Jumps Almost 6% In Five Trading Days!

So much has happened in the past month that it is difficult to know where to begin. Let's see—

- ◊ In mid-February, gold neared its lowest price since September 1999. Then it rose 4.4% in one week as one month lease rates spiked as high as 4.75%!
- ◊ The World Gold Council reported that Fourth Quarter 2000 gold demand set an all-time quarterly record! As a result, annual demand in 2000 almost matched the 1999 annual demand record (it missed by 0.04%)!
- ◊ This morning Dai Xianglong, the director of the People's Bank of China (PBOC), announced that the first gold exchange in China in more than 50 years will be opened in Shanghai in June, ending the PBOC gold trading monopoly.
- ◊ On March 1, silver matched the close of March 1, 1995, the lowest closes since the spring of 1993!
- ◊ Demand for physical silver in the past month has been so strong that LCS was even able to sell 90% Silver Coins to wholesalers at higher than spot prices!
- ◊ After reaching a 14 year high eight weeks ago, platinum's price is down almost 10%.
- ◊ With new supplies coming onto the market, the price of palladium has dropped 30% from its all-time record level set a month ago!
- ◊ This morning, North American Palladium announced that, with higher prices and the completion of a recent drilling program, their 1998 estimate of 1.3 million ounces of palladium resources has been increased to 7.4 million ounces! The company produced 95,000 ounces of palladium in 2000, but expects to ramp up to 330,000-345,000 ounces by 2003.
- ◊ While demand for rare coins priced over $5,000 has softened, desirable inexpensive coins are quickly snapped up by eager collectors. Here at LCS, a Morgan Dollar display in our store that used to be restocked on a monthly basis now has to be refilled twice a week.
- ◊ Ford, General Motors, and Chrysler reported that February new vehicle sales dropped 10% from year earlier levels. All three are planning significant "temporary" layoffs to trim production. Consumer confidence is at its lowest level in years after experiencing its sharpest ever one-month decline.
- ◊ As world stock markets staggered, the NASDAQ fell as much as 60% from its peak less than a year ago.
- ◊ Instead of receiving additional funds from investors, U.S. mutual funds experienced net redemptions in February. This is the first time this has happened in a calendar month for several years.
- ◊ The effort by the Organization for Economic Cooperation and Development (OECD, a group of 29 industrialized countries) to crack down on nations considered to be uncooperative tax and money laundering havens hit a snag at a meeting in Japan in mid-February.

With all the positive news for gold and silver and all the financial worries over paper assets, it just doesn't seem to make sense that we should now be talking about low gold and silver prices.

However, there are reasons for this volatility. The explanations provide opportunities to protect, and even perhaps improve, your wealth.

What Is Happening?

Gold: Among the most important short-term factors affecting gold right now is the declining value of the Australia dollar. Australia is the second gold producing nation. As the value of the Australian dollar has dropped against the U.S. dollar (as it has done almost constantly since the Reserve Bank of Australia converted most of its gold reserves into Far Eastern and other currencies just before the Far East financial crash a few years ago), the price of domestic gold has been soaring.

With the price of gold above A$500, the local mines have aggressively sold future production. This has knocked down gold prices as it appears to increase supplies.

But, in order to fulfill the contracts for advance sales, the mines and their bankers have had to lease ever larger amounts of gold from central banks. When it appeared that the supply of gold available for lease was tightening, lease rates climbed. Higher lease rates, in turn, signaled to traders to cover their short positions, leading to a rise in the price of gold.

This cycle is exactly what happened in February. When the price of gold was above the $262 level, the mines sold. Prices fell. Lease supplies tightened and rates rose. Short sellers covered. Prices rose. Then the process repeated.

If you are looking to buy gold at low short-term prices, it would appear that prices below $262 are the bottom.

However, at some point gold is destined to rise from current levels. Just this morning, an analyst from JP Morgan stated that yesterday's decline was only a very short-term correction. He expects gold to make a near-term move back up to $277.

A major study of gold derivatives commissioned by the World Gold Council last year pointed out what has

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long been obvious to me.

Hedging and forward sales activities in other commodities has little impact on long term prices because it does not reflect any increase in long-term supplies. All the hedging activities do is smooth out price volatility.

However, the introduction of hedging activities in the gold market has wrought entirely different consequences. Paper traders have acted as if forward sales represent a permanent increase in gold supplies, knocking down prices for the last several years!

The 2000 annual report issued by Harmony Gold Mining Company Limited, one of six conglomerates formed from the consolidation of the South African gold mining industry, points out the obvious problem with the way that gold hedging activities have hurt gold prices:

- "Many producers have been high grading [mining their purest quality veins] their reserves to survive the low gold price. As this situation cannot continue indefinitely, producers could start reporting huge write-offs in the near future;
- The industry has taken on significant levels of debt in order to survive; and
- At prevailing gold prices, the risk associated with the development of new projects has increased. To exacerbate the situation, banks have been demanding significant hedging of future production in order to reduce *their* risk."

In sum, the net effect of gold hedging activities knocking down gold prices has been to place present and possible future mining operations in jeopardy! To put it bluntly, new gold mining supplies may decline in the not too distant future!

For instance, Ashanti Goldfields Co Ltd, which almost went bankrupt 18 months ago when its hedging operations led to margin calls when the price of gold jumped, today reported that their loss on mined gold decreased from $184 per ounce in 1999 to *only* $81 per ounce in 2000.

Even though company's cash costs dropped to $187 per ounce in 2000 (well below current gold prices), this disaster continues because 75% of all future production has already been sold in profit-limiting contracts.

Long-term demand for gold continues to grow, though it will be somewhat down this year because of the effect of the massive earthquake in India in January. Newly mined production covers less than 70% of this demand. If production declines, the gap will only get wider.

When hedging activities reach a balance, where old contracts are fulfilled (reducing current supply) at the same rate that future production is pre-sold (increasing current supply) I look for the price of gold to rise significantly. To avoid seeming like a pie-in-the-sky dreamer, let's just say that I forecast gold to reach a minimum of $350 within the next few years. But I personally think it could do much better than that.

Silver: As I told you last month, the paper contract spot price of silver has disconnected from the price for physical silver. Refiners are so desperate for product that they have been paying well above spot price for pure ingots since the beginning of the year. In the past few weeks we have even sold some 90% Silver Coin (which costs them more to process than pure ingots) to wholesalers at above spot prices.

In the past month we have sold the largest quantity of silver bullion-priced ingots and coins to investors than we have sold in any month for at least two years.

At some point, the paper contract price of silver has to come back to real world prices for physical silver. Because the silver market is much smaller than that for gold, prices can be quite volatile. When silver closed at $4.40 on March 1, 1995, it touched off a major rally. By March 31, 1995, silver was up to $5.29, a 20.2% increase. The price kept on going. It peaked at $6.09 on May 4, a 38.4% rally in nine weeks!

In the six years since that rally, a high percentage of available silver inventories have been exhausted covering supply shortages. When the price of silver starts to move next time, the price could easily double in a matter of weeks.

I like silver better than gold for having lower risk and a higher potential appreciation, but I still think that gold is important because of its usage as a financial asset.

Platinum: I consider platinum to be the sanest market of late. After more than a decade of excess supply, this market finally moved into a long-term fundamental shortage a few years ago. Disruption of supply shipments from Russia has pushed up prices (along with palladium) over the past few years.

Now platinum has the opportunity for an increase in demand as a substitute for the now-more-expensive palladium.

Even though platinum prices are still near their highest level in the past 14 years, I think the future looks promising. I would consider owning a small position in platinum, though I am much more attracted by the gold and silver markets.

Palladium: After more than doubling in price during 2000, palladium soared another 15% early this year, touching $1100 at one point.

Since then, the double whammy of decreased future demand (General Motors announced that it expects to halve the amount of palladium per vehicle by 2003) and higher future supplies (such as the North American Palladium announcement) has clobbered the price, as low as $750 in the past few days.

The palladium market scares me. It is incredibly volatile, easily affected by rumors of the existence of or lack of Russian exports. Wholesale spreads for investment ingots are incredibly wide. Compared to gold, silver and platinum, it is a thinner, less liquid market. It seems to me that high prices will continue to hurt future demand, leaving little prospect for appreciation. I recommend leaving this market to the professional traders.

Rare Coins: A funny thing happened with the incredible growth in the number of coin collectors in the past few years. Sales of big ticket coins, such as those priced over $5,000, have been weak.

I'm not talking about the frequent minor peaks and valleys in the market. No, what I am seeing now is mergers between companies and several newly unemployed dealers in the elite coins combing coin shows looking for a job.

Here's one example of what I mean.. At the huge Long Beach Show in California two weeks ago, I purchased an attractive Extremely Fine specimen of a low-mintage U.S. gold coin for a customer. Five specimens of this coin in the same grade passed through major auctions in 1998 and 1999 at prices running from $4,140 to $6.900. I paid less than $2,500 for this specimen.

Yesterday, a dealer friend called to ask us if we might have an interest in

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an incredibly rare coin that used to be $10,000 for around $6,000. We passed.

Right now, if you are considering the purchase of any expensive coins from another source, please call us for our opinion. In the past several weeks, we have gotten several calls from customers who have heard from telemarketers offering what appeared to be a great value in a coin rarity. In each instance, we were able to provide additional information that made the potential coin a lot less attractive.

Compared to the elite coin doldrums, the market for more affordable collectors coins could hardly be more opposite. The day I arrived at the Long Beach Show, dealers asked me in worried tones if the low gold and silver prices would hurt demand for collector coins. The next day, no one asked me that question; they were too busy selling coins to retail customers. By the end of that day, the promoters of this show announced a record public attendance for a Thursday.

In the last great rare coin boom in 1989, when prices often rose 5% a week, we saw a lot of demand for rare coins because the market had price momentum. Now collectors are scrambling to fill their want lists because the supply of nice coins is too small at today's bargain price levels. Some prices have increased, but still think almost all appreciation is in the future.

For my recommended list of U.S. rare coin categories that I will think will outperform the average, see last month's newsletter.

The general economy: It was obvious to me a long time ago that many specific stock values had no basis in reality. Many have returned to comprehensible levels while others still have some room to fall.

However, there has been and will continue to be a tremendous amount of technological innovation creating more wealth. It is not due to government gimmickry such as inflation or deficit spending.

These advances will not evaporate as the economy wrings out inflation-induced misallocation of investments. Because of this, a great number of companies will attain even higher stock prices in the future.

In think the psychological reaction of investors will carry far more impact than the actual changes in profitability of companies. An extreme example might be where an investor is no longer willing to pay a price equal to twenty times the hoped-for profits ten years down the road and instead will only pay five times the worst profit level in the past ten years.

One area where government could do great harm to the economy is in unneeded changes in rules and regulations. The OECD effort to crack down on some small nations as tax and money laundering havens is an excellent example.

Last summer, the OECD published a blacklist of nations that were given until July 31, 2001 to implement changes in domestic tax laws, reporting requirements, oversight of banking activities, and other demands. Nations that did not meet the July 31 deadline would be subject to economic and other penalties from the OECD.

At the mid-February meeting in Japan, several Pacific island nations on the blacklist rejected the timetable for compliance. A postponed deadline was requested to allow time for negotiations with the OECD. According to Noel Levi, secretary of the Pacific Islands Forum, the OECD is not applying the same strict standards to OECD members who are tax and money laundering havens, such as the United States.

This contention was bolstered by a December report from the U.S. General Accounting Office (GAO) that in the 1990s more than $1 billion flowed from the Russian mafia into about 2,000 Delaware corporations, then back out.

For example, the Republic of the Marshall Islands has had no offshore banking operations since the mid-1980s. Yet the nation is on the list because the U.S. State Department claims that some accounts have ties to the Russian mafia. Says Baron Bigler, manager of the Marshall Islands Trust Company, "If you lumped all the Pacific jurisdictions together, it still doesn't compare with the amount of money laundering that goes through the U.S."

As matters now stand, the OECD will reduce global competitiveness after July 31, without regard as to whether there is further deterioration in financial privacy in the United States. We are all likely to be a little bit poorer for that action.

Conclusion

In the long-run, supply must balance demand. Prices are the mechanisms that bring markets into equilibrium. To me, gold, silver, platinum, and rare coins are destined for higher levels.

A 5 or 10% difference in the price you pay now will make little difference down the road if the price doubles. What would make a difference is to never get around to buying gold or silver because short-term volatility makes an investor afraid to act.

Gold and Gold Coins

Gold finished today at $262.00, down $1.25 (0.5%) from last month.

At current low price levels, demand has jumped for many bullion-priced coins. Supplies for all sizes of Mexican issues have dried up; premiums have increased.

Bullion coins dated 2000 are also up in premium.

The low-premium buys are the U.S. **American Arts Medallion** (2.7%), Austria **100 Corona** (2.9%), and South Africa **Krugerrand** (3.1%).

Among the smaller gold coins, the British **Sovereign** (6.2%), French **20 Franc Roosters** (7.8%), and Swiss **20 Francs** (7.8%) continue to have the lowest premiums.

Common-Date U.S. Gold Coins are getting a little tighter. At the Long Beach Show, I talked with a dealer friend whose company imports U.S. Gold Coins from Europe. He said that the rise in the Euro against the U.S. dollar meant that they were being quoted higher prices. With the continuing softness in prices in the U.S., they have passed on several deals. Unfortunately, that meant he had few coins to show me.

Prices for Double Eagles have been stable at current levels. In the past few weeks, though, demand has picked up for the smaller issues. Supplies are tightening, higher prices cannot be far behind.

The story is even more dramatic for **Better-Date U.S. Gold Coins.** Any nice coins in a dealer's stock that are priced reasonably sell right away. I was fortunate to come across a small group of **Choice Mint State-63 1914-D $20.00 St Gaudens** in the inventory of the very first dealer I visited at Long Beach. Though I examined many coins during the rest of the show, I was only able to locate five more acceptable specimens. Here's a coin with fifty times the rarity of the common 1924 date, yet doesn't cost that much more. See our offering for details.

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A year ago, I was able to find some nice bargain lots in World Gold Coins. Premiums are up and supplies are thin. Still, I was able to come up with a modest quantity of **Mint State Prussia 20 Marks** that we offer at our lowest price since the 1970s. See the enclosed flyer.

Silver and Silver Coins

Silver closed today at $4.43, down eighteen cents (3.9%) from four weeks ago.

With the shortage of physical product around, I find it hard to comprehend why silver should now be near its lowest price in the past eight years. All I can say is that when the pent-up pressure for higher prices finally gives way, there will be no stopping a major jump. It might make what happened to palladium prices in the past two years look tame.

Almost no silver is being liquidated by investors at today's low prices. As a result, the premium for physical silver has increased. The best buys are still U.S. **90% Silver Coin** (7.2%) and **One Hundred Ounce Ingots** (6.8%). As supplies tighten, I expect even higher premiums in the near-term. If you haven't purchased your core silver holdings yet, do it soon.

Better Date Morgan Dollars are strong favorites with collectors now. I was unable to find enough of any dates at the Long Beach Show for any offerings this month. Sorry.

However, I was able to pick up a small hoard of **Superb Gem Mint State-66 1928 Oregon Trail Commemorative Half Dollars**. Even though almost any nice silver commemorative would be a good value at today's price, I especially love this date. It has a low mintage, and low MS-66 population, and sells for less than more common commemoratives. Best of all, you can own one for a huge discount from its peak price. See our enclosed flyer for details.

At Long Beach, I also snapped up an interesting group—**1997 China 1 Oz Silver Unicorns**. These were the last of only four years of production of these desirable "good luck" coins. Even though the Chinese numismatic market is showing some signs of life again, the Unicorn series has not been restarted. Earlier issues catalog as much as $75. I got a wonderful buy on them. Please review our offering.

The Month

Gold Range	$ 12.25	4.7%
Net Change	-1.25	
Silver Range	.21	4.6%
Net Change	-.18	
Gold/Silver Ratio	59.1	
Net change	+2.0	
Platinum Range	32.00	5.4%
Net Change	-9.00	
Platinum/Gold Ratio	2.23	

Date	Gold	Silver	Platinum
Feb 07	263.25	4.61	594.00
Feb 08	260.50	4.57	584.00
Feb 09	260.50	4.56	586.00
Feb 12	261.25	4.56	583.00
Feb 13	260.50	4.56	587.00
Feb 14	260.00	4.51	587.00
Feb 15	255.50	4.52	589.00
Feb 16	258.50	4.49	593.00
Feb 19	closed		
Feb 20	256.50	4.42	596.00
Feb 21	258.50	4.42	595.00
Feb 22	259.00	4.42	593.00
Feb 23	261.25	4.44	592.00
Feb 26	266.50	4.45	596.00
Feb 27	267.75	4.43	605.00
Feb 28	267.25	4.49	604.00
Mar 01	265.75	4.40	594.00
Mar 02	262.75	4.42	577.00
Mar 05	263.00	4.42	573.00
Mar 06	260.50	4.41	578.00
Mar 07	262.00	4.43	585.00

London Silver Market Premium To New York Silver Market = 2¢

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

"Buffalo Nickel" Commemorative Dollar Due In Spring

In a little over two months the U.S. Mint will begin selling Commemorative Silver Dollars that are virtual replicas of the Indian Head or Buffalo Nickel that was struck from 1913 to 1938.

The only design change on the front will be the 2001 date. On the reverse, the motto "E Pluribus Unum" will be moved from above the buffalo's back to under its chin so that "In God We Trust" can be added below "United States of America." At the bottom of the reverse, the denomination will read "One Dollar" instead of "Five Cents."

The 1986 Statue of Liberty Commemoratives, the States Of the Union Quarter series, and the Sacagawea Dollar proved to be extremely popular and attracted new collectors to the hobby. I think there is an excellent chance that the "Buffalo Nickel" Silver Dollar will also have a strong positive effect on the hobby.

In the past few months, we have seen a surge of interest in Buffalo nickels of all grades and price ranges. Supplies are drying up. When the commemorative is finally released, don't be surprise to see some nice price jumps.

More Financial Privacy Lost

The U.S. Customs Service has imposed new entry document requirements. Now, Americans who purchase goods from businesses with overseas addresses, such as foreign mints, are required to provide their Social Security or Federal Employer Identification Number on the order form. This number will included in the documents accompanying the merchandise through Customs inspection.

Though these numbers are supposedly only for Customs Service purposes, all sorts of public and private mayhem becomes possible when your Social Security number goes off around the globe.

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