Liberty's Outlook

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Silver Tops $7.00! Nears 16-Year High!

Chinese Industrial Demand For Silver Soars

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Yesterday, silver closed at $7.15, a 64.4% rise in less than a year since it closed at $4.35 on March 21, 2003!

Since July 22, 1988, when silver closed at $7.60, it had only closed once above yesterday's price. That was on February 5, 1998, at the peak of the frenzy created by the Warren Buffet-Berkshire Hathaway silver purchase. Silver closed at $7.23 in the US market that day.

Normally, when prices jump so far in such a short time, there is a tendency for investors to take profits, often stopping the surge or even reversing it. While I am sure that there will be periods of retrenchment, I expect the price of silver to keep going significantly higher in the coming months.

How high?

I don't know.

Two months ago I predicted that silver could easily pass $8.00 this year. Now I think there is a solid prospect that silver could pass $8.00 in the next few weeks!

After considering the long-term fundamental shortage of new silver supplies, for several years I have anticipated that the price of silver would break upward sharply at some point, shooting past $10.00, perhaps $15.00, and maybe even to $20.00 per ounce.

There is every possibility that 2004 could be the year when this happens.

I was optimistic in years past. Why am I even more optimistic now?

One word: China.

Why I Believe Chinese Silver Demand Has Soared

You may not have noticed, but commodity metal prices have been rising in the past year. Here are some examples:

Aluminum	+21.5%
Antimony	+20.0%
Copper	+71.7%
Lead	+54.7%
Nickel	+53.3%
Steel scrap	+77.6%
Tin	+46.5%
Zinc	+35.9%

The Economist commodity price index (as measured in the US dollar) for metals is up 40.7% over the past year, a much stronger showing than for food commodities (up 17.5%) and non-food agricultural products (up 21.3%).

The main reason for the rise in metals prices is the increased demand from manufacturers anticipating higher output as the world's economies improve.

Another significant reason for rising prices is buyers using commodities as a hedge against anticipated inflation of the world's currencies.

Commodity metal prices, including silver—which trades basically as an industrial metal, have risen by a higher percentage than the actual increase in production levels.

When economies falter, manufacturers normally run down their inventories of raw materials to help reduce costs. That magnifies the downward pressure on prices beyond what simple production declines would cause.

Conversely, when economic times improve, manufactures not only increase raw material orders for production, they also tend to increase raw material inventory levels. This increases upward pressure on prices.

Still, the across-the-board price jumps in basic metals in the past year have been greater than many, including me, would normally expect.

There are no easily available statistics on Chinese imports of raw materials. Individual analysts are focusing on their small market niche, and not able to see the big picture. But I have seen all sorts of general comments such as in the February 28th issue of *The Economist*, "China's rapidly expanding economy is gobbling up metals and other commodities for its factories."

Elsewhere in the same issue is a report that, "China's own appetite for trade deals has grown along with its economy. This has been fuelled partly by its frenetic quest for markets, materials and machinery. Chinese companies are especially keen on Australia, since their economy is chronically short of commodities—crude oil, copper, aluminum, iron ore and natural gas—to fuel its breakneck expansion."

Putting lots of little tidbits together from a variety of sources, I see a pattern. I believe that Chinese manufactures are now the largest purchasers of silver on the world silver exchanges—and that they are buying these contracts to take delivery, not to trade paper silver.

This is not a move particularly focused on the silver market. Rather it is part of a broad program to aggressively lock up

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sources of raw materials to keep China's growing industrial capacity running at full tilt.

So long as the world economies continue to improve, such a strategy could prove quite profitable to the Chinese. Manufacturers in other nations that are waiting to stock up on raw materials will end up having to pay the higher prices when they do, making them less competitive.

The Chinese government has more than $400 billion in foreign exchange reserves to help facilitate such a buying spree—and can do so without disrupting world currency trading markets. It has used other tools at its disposal to encourage domestic manufacturing, such as holding down the price of the Chinese renminbi yuan and protecting banks from the harsh effects of their bad debts.

Since the Chinese have the motivation and the means to carry out a massive campaign to purchase raw materials, and credible reports indicate that is what is happening in other niches, I consider it a safe bet to rely on reports that the Chinese are also purchasing huge quantities of silver.

If this is indeed true, I think the Chinese are helping accelerate the jump in silver prices that would have happened more slowly anyhow!

Here's why.

A Small Silver Market

In 2002, the last year for which figures are available, worldwide silver demand was a little over 800 million ounces. Even at today's higher prices, that means that the annual global silver demand is less than $6 billion! Available above-ground inventories are less than a billion ounces even if you include a lot of fabricated products that might by recycled if the price of silver skyrocketed. At today's prices, that is around $7 billion.

While such figures are huge to you and me personally, they are peanuts in the world of international finance. World gold inventories (government and private combined), in comparison, are close to $2 trillion.

Thin markets are more volatile than larger ones. With silver, for example, its price rose over worries about the falling value of the dollar in early 1987. On March 20, 1987 silver closed at $5.55. Only 24 trading days later, on Friday April 24, 1987, it closed at $9.65, a 74% rise. On Monday April 27, silver opened in the US markets at $11.00, quickly jumped to $11.25, then collapsed to close the day at $8.20 after "administration spokesmen" commented that the value of the dollar would be defended from falling further.

When Berkshire Hathaway bought a mere 130 million ounces of silver in 1997 on contracts for delivery in March 1998, at a cost of around $650 million, silver rose from $4.18 on July 16, 1997 to a peak of $7.23 on February 5, 1998, a 73% rise. The price then dropped quickly as Berkshire Hathaway let sellers who were scrambling to cover their short sales off the hook—probably in exchange for a significant cash payment plus a continuing liability to deliver the silver on a more delayed basis.

So, as you can see, any significant increase in physical demand in a thin market like silver could cause a severe supply squeeze. Even though the price of silver is up substantially in the past year, it has been slow and steady rather than fast and sharp.

As I see it, no matter which way the world economy goes, the silver price is due to rise sharply. If the economies improve and silver demand rises further, the price will go up. If the world financial system is crippled by inflation, I expect investment demand for silver to soar as investors recall how silver fared in the 1979-1980 boom.

But wait a minute. What if the Chinese stopped buying such large quantities of commodities like silver? Wouldn't that reduce industrial demand and lead to falling prices? Or what if rising prices bring huge new quantities of silver onto the market?

While I won't say that is impossible, I consider it only a remote possibility. First, the Chinese economy is steadily expanding, which means that they will continue to need ever larger quantities of raw materials to manufacture products. The Chinese government is counting on that trend continuing, and has shown the willingness to use its $400 billion foreign reserve to maintain a growing economy. See last month's discussion on the Chinese bank bailouts for an example.

Second, only 20% of newly mined silver comes from primary silver mines. The other 80% of newly mined silver comes from gold, lead, zinc, copper, and other mines where silver is only a by-product or co-product. For these latter mines, production levels depend on the prices of the primary metals. The price of silver could double or triple with little effect on output.

Recycled silver already accounts for than a quarter of new silver supplies. When silver prices were much higher 25 years ago, companies invested in silver recycling equipment. When silver prices fell afterwards, the capital costs were already sunk, so silver recycling continued at very high levels. Sharply higher silver prices would have only a small impact on increasing recycled silver supplies.

How To Tell If Silver Has Peaked

When everybody in the world wants to buy silver, that will indicate that the market is nearing a peak. One indicator I use to watch for this is the difference between London and New York silver spot prices. Silver ingots delivered on the London Metals Exchange must be refined to .9999 purity, while the New York Comex only requires .999 purity.

In order for Comex silver to be delivered in London, a buyer would have to take delivery on a contract, have the metal refined to the higher standard, then pay to transport the silver across the Atlantic Ocean. This whole process takes time and would cost around 7-10 cents per ounce.

The London silver market is the world's largest physical silver market—by far. Because of that, purchasers of large quantities of silver almost always make their acquisitions in London. Any silver supply squeeze that might develop would almost certainly happen in London first.

If a supply squeeze develops in London, its price will start to rise above the New York price. Once the London premium is high enough to cover the cost of bringing silver over from New York, the 7-10 cents I mentioned above, supplies in London can rise. However, because of the time it takes to take delivery of New York ingots, get them refined, and ship them to London, supplies will not start to rise overnight. In February 1998, for instance, the London silver price jumped as high as $7.60 on the day when it peaked in the US at $7.23.

However, a London premium above New York of around 15 cents would indicate one major potential market peak. If the silver demand is so strong that even new supplies from New York would not be enough to meet demand, you will see that New York prices will rise right along with London's. Any sudden spike in the premium is a clear sign of a market near a peak. That would be a good time to take profits.

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To help you track the London premium over New York silver prices, we report that figure each month at the bottom of our spot prices table on page 4 of this newsletter. You can also refer to your current day's newspaper for London silver prices, then go online to our website, www.libertycoinservice.com, to check our daily quotes page for the New York silver price of the same day, then do the math yourself (although this might not be accurate if the time of day of the London price does not coincide with the close of U.S. markets).

Banks—The Coming Storm

Many major banks have recently reported higher earnings, helping fuel the apparent economic recovery.

While the banks are quick to tout their growth in earnings, they do not dwell upon the increased risks they assume to help them realize those gains.

Bank profits have fallen from the declines in yields on corporate debt and reduced commission-based activity. To offset that, they are putting more of their capital into riskier investments that have higher potential yield. In theory, the banks are protecting themselves by trading derivatives to minimize how much they might lose.

Banks are using value-at-risk (VAR) models that supposedly help them manage the risk of a major loss of capital. The VAR, which banks are required to report in their financial statements, supposedly show how many millions of dollars a bank might lose should markets turn against them.

In their latest reports, UBS, JP Morgan Chase, Citigroup, Morgan Stanley, Goldman Sachs, and Credit Suisse First Boston all report VAR amounts in excess of $50 million, all at record levels for these companies.

However, what the banks report and what is reality are not necessarily the same thing. According to a widely reported statement by Michael Thompson, a strategist at RiskMetrics, a company originally founded by JP Morgan Chase to create risk management models used by banks, the banks' present situation "is not dissimilar" to the one that preceded the collapse of Long Term Capital Management (LTCM) in 1998. Thompson says banks are "walking themselves to the edge of the cliff". He reports that all past financial crises have shown that the risk-management models used by banks woefully underestimate the effects of market shocks, when everyone is trying to sell their positions at the same time.

The VAR is calculated by assessing the volatility of the assets held by the bank and the amount of correlation between them (less correlation is less risky). Because markets have been less volatile in the past two years than in the decade before, VARs have declined. As a result, banks making greater investments in hedge funds and the like to increase profits.

To reduce the volatility of banks' investments, in the late 1990s large banks got rid of their internal hedge fund activities. Invariably, the employees who worked in such departments formed independent hedge funds into which the banks then invested, to the tune of billions of dollars. By being considered an outside investment, these activities are not considered for the VAR calculations.

These hedge fund activities and other high-risk investments are safe only so long as the economy is stable.

What could cause these investments to go awry? Lots of things—a significant drop in the value of the US dollar, a spike in oil prices, a major developing nation getting into financial difficulty (Brazil, Venezuela, Mexico, Indonesia, Argentina, Thailand, and the like) to name a few.

Unfortunately, these riskier investments are relatively illiquid. Any shock that would lead a bank to try to sell these investments would have the same impact on all such banks. Because they would all be trying to sell at the same time, losses would be magnified far beyond levels reflected in the VAR model. Even if potential losses are supposedly safely covered by derivatives trading (and that is a mighty big if), they just cannot cover the size of potential losses that have actually occurred.

How large can these losses be? In 1998, Credit Suisse First Boston lost $1.3 billion dollars from the collapse of LTCM. In 2002, Allied Irish Banks lost almost $700 million from the activities of a single foreign exchange trader.

How often do these shocks occur, especially in these "stable" times? A couple of lesser shocks have already happened this year—rising oil prices and the falling dollar. It would not take much more to have a serious effect on banks' bottom lines.

The risk of major bank calamities is just one more reason to hold a portion of your net worth in tangible assets like precious metals and possibly rare coins.

Follow Up On Last Month's Report

Japanese central bank intervention to prop up the value of the US dollar in 2003 was much larger than I thought—over $170 billion.

By the way, the Japanese central bank also bought another $67 billion in US Treasury debt in January this year, the largest one month purchase ever!

Gold and Gold Coins

Gold finished today at $400.00, down $10.00 (2.4%) from four weeks ago.

When gold closed at $392.50, that was its lowest close since just before last Thanksgiving. Short sellers attempted to push prices down into the $380s, but there was simply too much demand for physical gold.

Although I cannot point to hard data to confirm this, some experienced traders have been telling me lately that supplies of physical gold in New York, London, and Zurich are unusually tight. I am not surprised.

Customer liquidation of gold at these near 15-year high prices has been nominal. In fact, it is demand that has grown!

By the way, the 1999 Washington Agreement on Gold (WAG) expires at the end of September. The agreement to limit central bank sales to 400 tons per year was signed by or informally adhered to by governments that held almost 85% of the world's central bank reserves.

There is strong sentiment to renew the Agreement, along the lines of the current one. There is some possibility that the limit could be raised to 500 tons per year because analysts realize than any lower level of sales is simply too small to try to cover continuing long-term gold supply shortages. If the Agreement is renewed at its current 400 tons or lower, look for the price of gold to quickly rise at least 10%.

One effect of strong demand for physical gold has been a rise in premiums for most low-premium gold issues. The U.S. **American Arts Medallion** (3.9%), Austria **100 Corona** (3.6%), and South Africa **Krugerrand** (3.8%) are all up about 75 cents per coin relative to spot in the past month. Supplies are tighter now than we have seen in the past 25 years!

On the other hand, the strong Euro has helped hold the line on premiums for some popular small European coins such as the British **Sovereign** (7.5%), French **20 Franc Rooster** (8.8%), and Swiss **20 Francs** (8.8%).

1 Ounce Canada Maple Leaf warning: The Canada Maple Leaf is made of

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pure gold, which is very soft compared to alloyed gold coins. If dropped on a hard surface from more than a few inches away, they will dent.

Pure gold coins dominate gold coin trading in the Far East. However, condition of the coins is very important. They have to be in virtually perfect condition. The 1 Ounce Maple Leafs were never packaged in individual protective holders as were other pure gold coins such as the China **Panda**, Australia **Kangaroos**, Australia **Lunar Year** issues, and even the fractional Maple Leafs. As a result of poor packaging, a high percentage of Maple Leafs have been handled enough that they are no longer deliverable to Far East customers. Such coins still have full gold content, but they may trade for a few dollars less than the nice condition specimens.

Two weeks ago, one national bullion wholesaler stopped trading Maple Leafs because of this problem. Some other wholesalers only have inferior coins unless you buy Mint-fresh current year issues. If you own Maple Leafs now, please do not handle them any more than necessary. If you must purchase pure gold coins, you should consider other issues that are in protective holders.

Some **Common-Date U.S. Gold Coin** prices declined as the price of gold slipped into the $390s, especially among $10.00s and $20.00s. However, we are seeing renewed demand by wholesalers looking for large quantities for upcoming promotions.

Some of the **Better-Date U.S. Gold Coins** that trade close to Common-Date coin prices are also down slightly. This may be your last chance before prices rise steadily. Large groups are almost impossible to find, but we managed to acquire a few **Mini-Hoards Of Better-Date U.S. Gold Coins**. See our offer.

We also picked up a one-shot bargain purchase of the **Canada 1998 "Family of Eagles" 1/10 Ounce Gold Maple Leaf**. These coins are safely packaged in large hard plastic holders. They were originally commissioned from the Royal Canadian Mint by a Texas firm that charged very high prices for them. You can own them for much less today.

Silver and Silver Coins

Silver closed today at $7.16, up 61 cents (9.3%) from last month.

Higher prices have not brought any waves of liquidation as we have seen in years gone by. This reinforces my contention that the "weak hands" silver owners have mostly already sold. That means that physical silver is now more likely being held by "strong hands" investors who are unlikely to sell until silver reaches much higher levels.

As the price of silver has climbed, investor demand has slackened. As a result, premiums have fallen slightly. U.S. **90% Silver Coin** (1.4%) is now selling retail close enough to silver value that it trades for less than metal value on the wholesale market. Refiners can again profitably melt it down. U.S. **40% Silver Coin** actually sells almost right at its silver value now (0.1%), but I hesitate to recommend it because of its bulk and because of potential liquidity problems if the price of silver jumps sharply. The premiums for **100-1 Ounce .999 fine Ingots** (6.0-7.0%) are also lower.

Refiners tell us that if silver jumps upward, they expect that ingot premiums will fall more than for 90% Coin, though all will fall to some degree. That confirms our experience in past boom markets, giving us all the more reason to make 90% Coin our recommended form of physical silver to own.

A few months ago, I advised you that wholesalers were quietly stockpiling **High-Grade Common-Date Morgan and Peace Silver Dollars**. They are still chasing them. In the past month, we also detected more aggressive buying activity in **Mint State Rolls of Morgan and Peace Silver Dollars** and even for circulated silver dollars. Prices are up 5-10% in the past month.

Such coins are the bread-and-butter inventory for mass-marketers. I anticipate a rise in such promotions in the coming months, at higher prices than today. Fortunately, we purchased a huge accumulation last week of **Mint State and Circulated Early Morgan Silver Dollars**. By acquiring them at the bid side of the wholesale market, we are able to offer them at last year's prices. See our flyer for details.

Collectors seem to becoming more urgent at adding to their collections. Generally, they figure that coin prices are lower today than they will be in the not-to-distant future. To some degree this can be a self-fulfilling prophecy—somewhat along the lines of what we saw in the boom of 1989.

However, the market right now is much different. In 1989, there were several potential "Wall Street Funds" being organized as a new way to attract investment dollars into rare coins. A number of "get-rich-quick" investors jumped in before the funds started buying. When none of the major funds came to fruition, the boom ended.

This time, the boom has been sparked by the increase in the number of coin collectors encouraged by the introduction of the State Quarter series. These collectors are having fun with coins, with financial considerations only secondary. They are far more likely to stay for the long-term and their numbers will keep growing with the introduction of this year's new nickels and other coin and currency design changes currently in the planning stages.

The Month

Gold Range	$23.50	5.7%
Net Change	-10.00	
Silver Range	.66	10.1%
Net Change	+.61	
Gold/Silver Ratio	55.9	
Net change	-6.7	
Platinum Range	81.00	9.6%
Net Change	+76.00	
Platinum/Gold Ratio	2.29	

Date	Gold	Silver	Platinum
Feb 11	410.00	6.55	841.00
Feb 12	413.50	6.62	847.00
Feb 13	410.25	6.57	845.00
Feb 16	closed		
Feb 17	416.00	6.77	859.00
Feb 18	412.00	6.69	857.00
Feb 19	409.75	6.65	851.00
Feb 20	397.50	6.53	836.00
Feb 23	399.00	6.49	837.00
Feb 24	404.50	6.62	853.00
Feb 25	396.00	6.53	848.00
Feb 26	395.25	6.70	861.00
Feb 27	396.25	6.69	882.00
Mar 01	399.25	6.93	898.00
Mar 02	393.50	6.72	875.00
Mar 03	392.50	6.74	883.00
Mar 04	393.00	6.75	879.00
Mar 05	401.25	6.97	879.00
Mar 08	400.50	6.97	885.00
Mar 09	404.00	7.15	889.00
Mar 10	400.00	7.16	917.00

London Silver Market Premium To New York Silver Market = 1¢

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

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