Liberty's Outlook

Volume 11 Issue 11 Liberty Coin Service's Monthly Review of Precious Metals and Numismatics November 2, 2005

U.S. Inflation Rate Nearly Doubles!

Precious Metals Protect Owners While Paper Assets Lose Ground

For the 12 months ended September 2004, the official change in the Consumer Price Index (CPI) was a 2.5% increase.

For the 12 months ended September 2005, the CPI, which is widely used to track inflation, rose by nearly double that rate—4.7%!

As you can see in the chart at the right, precious metals have all increased by more than this inflation rate, while paper assets have not performed as well.

Precious metals served as an even better inflation hedge compared to paper assets as owners do not owe income taxes on appreciation until the asset is sold. The same cannot be said for most dividend or interest income received.

In fact, after you pay income taxes on income generated by paper assets, they have almost all lost ground to inflation.

The Consumer Price Index is a faulty indicator of true inflation. A few months back, for instance, I reported that the CPI understated inflation by only looking at residential rents and not including the cost of purchasing a residence.

After *The Economist* commissioned such a study this past summer, it reported that if the CPI included purchased housing costs in the same proportion as there are homeowners instead of renters, that the inflation rate should be three percentage points higher than was being reported.

Despite the faults of the CPI, however, it does give some kind of indicator of inflation over time. What can be stated for certain is that the inflation rate, whatever the accurate number might be, has been much higher over the past 12 months than in the previous 12 months.

U.S. Assets Performance Versus Inflation Rate In The Last Year

As of November 1, 2005

Asset	*Unadjusted Return*	*Inflation Adjusted Return*
Platinum	+11.5%	+6.5%
Gold	+9.4%	+4.5%
NASDAQ	+6.5%	+1.7%
Silver	+6.4%	+1.6%
S&P 500	+6.4%	+1.6%
Palladium	+5.7%	+1.0%
10 Year Treasury Note	+4.7%	0.0%
Dow Jones Ind Avg	+3.7%	-1.0%

This rise in inflation has occurred despite the ameliorating affect of three factors. First, the impact of globalization means that private-sector employees in developed nations can no longer expect to have secure jobs if wages and benefits keep rising to match inflation. Instead, wage increases are more directly tied to productivity increases.

Second, greater international competition, especially from China, means that companies can not as easily raise prices in a domestic market as in years past.

Third, the effects of inflation have been muted by innovation and productivity gains in the private sector. In the absence of inflation, I believe, the overall price level should be declining! Prices on most products and services should be falling, not just the latest high technology equipment.

That statistical records indicate that inflation still exists, though at lower rates than in the late 1970s to early 1980s, tells me that governments have been unleashing much higher rates of inflation than consumers and investors realize. Here's a simple example—if you have a productivity gain of 5% while prices still rise 2%, that indicates an actual inflation rate of 7%.

The Board of Governors of the U.S. Federal Reserve System are aware of how much inflation has grown. They have made fighting inflation their main priority. That is why, for the 12th consecutive meeting since June 2004, The Fed's Open Market Committee raised its short term interest rate another quarter point. It is now at 4% com-

Inside this issue:

(Continued from page 1)
pared to just 1% only 18 months ago. Banks increased their prime rate to 7%, up from only 4% in June 2004.

The U.S. is not alone suffering from rising inflation. The average inflation rate of the G-7 countries (the worlds strongest economies) is at 3.2%, a 13 year high!

The U.S. inflation rate is up even though the U.S. dollar has strengthened against most currencies in the past few months. When a stronger dollar leads to a lower cost of imports, you would expect that to put a brake on rising prices. But little of this standard market adjustment seems to be occurring.

A major reason why the dollar is strengthening is that the Fed is raising interest rates faster than other central banks are raising their rates. A year ago, for instance, the 3-month money market rate in the U.S. was about one-fourth of one percent below the Euro area. The 10-year government bonds were about one-sixth of one percent above those of the Euro area.

Today, the U.S. 3-month money market rate is 1-3/4% higher than in the Euro area and the 10-year government bond rate is about 1-1/4% higher!

With this disparity of interest rates, a lot of foreigners prefer to hold U.S. dollar-denominated debt. This demand for U.S. dollar debt helps the dollar stay strong relative to other currencies and also helps keep interest rates on soaring American private and government debt from climbing faster to even higher levels.

Central banks raise interest rates to fight inflation. In theory, the more it costs consumers to borrow money to spend on goods and services, the less they will end up spending. This decline in demand will ease the pressure leading to higher prices. At the same time, higher interest rates discourage some companies from taking on riskier ventures, reining in demand for employees.

The U.S. Treasury has been strictly controlling the increase in the narrow and broad definitions of the money supply over the past year (especially when compared to other countries). That would tend to support a strong currency.

However, the increase in government debt to cover its huge overspending (i.e. budget deficit) will eventually have the opposite effect of what we have seen recently.

The U.S. dollar is almost destined to depreciate to inflation at ever faster rates as time goes on. Other paper currencies will pretty much face the same problem.

The reports of the U.S. inflation rate nearly doubling in the past 12 months are likely to stir more investors to seek wealth-preserving alternatives to dollar-denominated paper assets.

Even before these latest inflation numbers were reported, LCS has been seeing an increase in the number of first-time purchasers of gold and silver. I think it is highly unlikely that unfolding events will have the effect of restraining inflation, prompting even more investors turn to hard assets such as rare coins and precious metals.

Gold and silver are popular inflation hedges. One reason is that they are assets that are not a liability of someone else (as is the case with paper money, bonds, CDs, and savings accounts). An ounce of gold today will still be an ounce of gold next year, no matter what governments do. Precious metals do not depend on the financial strength or survival of any particular government or political system.

Gold and silver in your immediate possession is worth a lot more than paper assets in crises like widespread power failures, terrorists attacks, tsunamis, earthquakes, or hurricanes.

For insurance against calamities hurting the value of your paper assets, you should own some hard assets like gold, silver, and rare coins. For most people, it makes sense to allocate 5-10% of your net worth to precious metals. The more aggressive may consider going as high as 20%.

Even though gold and silver have both risen more than 70% over the past 3-1/2 years, I think there is much more appreciation to come. For details I refer you to my in-depth analyses of these two metals in the September and October newsletters.

If you don't already own enough gold or silver, the time to start buying it is right now. Give us a call or stop by.

How Safe Are Your Retirement Assets?

For the past decade, I have occasionally warned that the underfunded retirement plans of private companies were a time bomb waiting to explode. *Time* recently did an exposé on this issue, reporting how companies could legally short-change funding their retirement obligations. The actuarial present value unfunded retirement obligations of General Motors Corporation, for instance, exceeds the total market value of the company.

To make matters worse, a number of major corporate bankruptcies in the past few years (of which many airlines are perfect examples) have succeeded—or are in the process of trying—to dump these retirement shortfalls onto the government, meaning the bills would ultimately be paid by the taxpayers.

In addition to the hundreds of billions in underfunded private retirement plans, there are hundreds of billions more in underfunded state and local government retirement plans. The city of San Diego, for instance, is more than a billion dollars short all by itself!

Some retirement plans are being used to raise capital for the sponsoring company, whose major, if not only, asset is stock in the plan's sponsor. All too many of these have become worthless (think Enron and Polaroid, among many others), leaving retirees unable to even recover their own money they put into the plan. The government's Pension Benefit Guaranty Corporation, set up in the 1970s to guarantee that retirees get their expected retirement pay even if the employer fails, has already run up a huge deficit of around $30 billion and growing.

The safest type of retirement plan, from the perspective of the employee, is one where the funds are paid into the account when owed, are fully vested and also under the direct investment control of the employee.

Major companies just don't operate that way. At best, often, the employee is granted limited ability to select from a list of allowable investments. At worst, the company uses unrealistic assumptions about investment returns to avoid fully funding plans, then controls the retirement plan's investments.

If you are or are hoping to be the beneficiary of a retirement plan where the plan's assets are out of your control., you may want to put away some assets on your own. Gold, silver, and

(Continued from page 2)
rare coins would make an excellent alternative for the following reasons.

- You defer taxes on precious metals or rare coins until you sell, over which you have substantial control.
- You can have more financial privacy than if you put these same assets in a brokerage account or a retirement account.
- Precious metals and rare coins provide some insurance against the risk of loss in the value of your paper assets.
- The recurring bills introduced in Congress to impose a 15% tax on all retirement assets, or some other variation of asset confiscation, would not apply to gold, silver and rare coins held personally—if it ever comes to pass (a possibility which I regard as likely to happen someday).

For those who are government employees, the prospects of losing your anticipated retirement benefits are not quite so dire. The governments have the ability to raise taxes, which private employers cannot do. Alternatively, they can issue bonds to raise funds to make payments to retirees, such as the cities of Philadelphia and Pittsburgh are already doing.

Ultimately, if is the responsibility of each person to look out for their own retirement nest egg. Counting on Social Security or a retirement plan outside of your control could backfire on you.

If you have a retirement plan that could potentially be lost, as has happened to some LCS customers, you may want to investigate your options before it may be too late. If you can do something now, consider doing it, then you can sleep better at night.

The Search For Terrorist Money Laundering—Governments Don't Have A Clue!

In-depth articles in recent issues of *Forbes* and *The Economist* have discussed how U.S. and international efforts to cut off the transfers of money to terrorists and terrorist organizations are a failure and are mostly counterproductive.

In theory, banks in most countries have adopted procedures to identify customers making sizeable transfers and report such activity to their government.

What has happened in reality is that funds transferred through the banking system often go through front organizations rather than direct to the leaders of terrorist cells. It is much easier to pay an invoice for innocent-sounding non-existent merchandise rather than to make a straight cash transfer, for example.

In addition, much of the funds transferred happen outside of the banking system.

There is a global network of informal money-transfer systems known in some countries as hawalas. They are popular with overseas workers sending remittances home. Someone wishing to send money would visit their local hawala and give that merchant the money. That merchant keeps the money, then notifies a correspondent hawala merchant at the destination to release the specified funds to the designated recipient. In this way, no cash actually goes through the banking system or across international borders. The merchants settle up later by other money laundering techniques.

These hawalas are largely unregulated and, indeed, in many instances their existence is kept secret from the authorities. So, no matter how many hundreds of millions of dollars are spent by financial institutions and their customers to submit government paperwork, the terrorists don't have to worry about drawing attention to themselves through their financial activities.

In fact, the costs of complying with government reporting may represent a victory for the terrorists. As Graham Dillon of the British operations of KPMG, an international accounting firm said, "The cost to our global economy is so large, they've already had the effect they wanted. The increasing costs of compliance and technology are a form of terrorism. We're damaging ourselves."

Bank Note Sells For More Than A Million Dollars!

For the first time ever, a piece of paper money has sold for more than a million dollars.

At an auction on October 21, a series 1890 $1,000 Treasury Note, one of only three known surviving specimens, went for $1,092,500. This same note had set a then-highest price for a bank note when it sold in a 1998 auction for $792,000.

Two other notes in this same auction also realized high prices. An 1863 $1,000 Legal Tender Note, the only known specimen with the 1862 date on its face, sold for $747,500. One of two known 1880 $1,000 Silver Certificates with the Bruce-Wyman signature combination brought $667,000.

The paper money market has expanded substantially since we made our major recommendation in 1988 that they were undervalued. Back then, the highest price for any bank note was just over $200,000 and large auctions might realize $3 million. The sales that included the notes listed above realized more than $10 million altogether. Another currency auction company has rung up more than $31 million in sales thus far in 2005.

I don't yet think it is time to cash in your profits on your holdings, as I expect prices to continue to rise right along with rare coins. However, you are certainly welcome to contact us to get current values on what you have.

Gold and Gold Coins

Gold closed today at $462.75, down $3.25 (0.7%) from four weeks ago.

When gold settled at $477.00 on October 11, that was its highest close since January 25, 1988!

Short-term traders try to make their living by taking large positions either higher or lower than the current market, hopefully encouraging the market to go in that direction by taking the position.

For instance, when gold made a good run such as when it rose from $431.00 on August 30 to $477.00 six weeks later (a 10.7% increase!), the market was overdue for a correction. Sensing that, short term traders sold gold short. That is, they sold gold that they did not own, hoping that the apparent appearance of more inventory on the market might cause prices to drop, at which levels they could profitably purchase their gold to fulfill the contract.

That is exactly what happened. Gold fell all the way back down to close at $461.00 on October 20. At that level,

(Continued on page 4)

(Continued from page 3)

physical buyers stepped in to snap up gold at the relative bargain price. That spurred short term traders to close out their short positions and to purchase contracts.

This extra apparent demand helped propel the price of gold back up over $470 within three trading days.

Gold stayed over $470.00 through the balance of last week. This week, gold slid back down, in anticipation of the Fed Open Market Committee raising short-term interest rates for the 12th consecutive meeting. When the Fed announced the interest rate increase, gold hit bottom, closing yesterday at $459.50.

But a strange thing happened. Since the prices of gold or silver have only temporarily dipped each of the previous 11 times the Fed raised interest rates, physical buyers were ready to jump into the market when prices fell this time. Yesterday was our highest volume gold selling day in the past two months!

Apparently such demand has already had an effect. Gold rose $3.25 today.

Going forward, with so much demand for gold around $460, I think gold is going to keep trying to break higher. It could still reach $500 by the end of December.

The recommended low premium gold continue to be the Austria **100 Corona** (3.4%) and U.S. **American Arts Medallion** (3.6%). Demand for the out-of-production South Africa **Krugerrand** (3.9%) had dried up supplies, with the premium up noticeably. Demand for the U.S. **American Eagle** (5.4%) is so strong that it is difficult to locate pre-2005 dated coins.

On the other side, demand for the Canada **Maple Leaf** (4.4%) had declined as had the premium.

Among smaller coins, the British **Sovereign** (7.6%) is a low-cost choice.

Last month, I told you of the significant jump in Common-Date U.S. Gold Coin prices and that I expected even further rises. Well, I was mostly correct. Because of the large number of Double Eagles around, those prices have mostly declined from last month.

The Month

Gold Range	$17.50	3.8%
Net Change	-3.25	
Silver Range	.40	5.4%
Net Change	+.11	
Gold/Silver Ratio	61.5	
Net change	-1.3	
Platinum Range	28.00	3.1%
Net Change	+21.00	
Platinum/Gold Ratio	2.02	

Date	Gold	Silver	Platinum
Oct 05	466.00	7.42	912.00
Oct 06	472.00	7.54	922.00
Oct 07	474.50	7.72	931.00
Oct 10	475.00	7.78	936.00
Oct 11	477.00	7.82	939.00
Oct 12	473.75	7.78	940.00
Oct 13	471.00	7.68	928.00
Oct 14	469.00	7.80	921.00
Oct 17	474.00	7.82	928.00
Oct 18	472.00	7.78	926.00
Oct 19	463.50	7.60	920.00
Oct 20	461.00	7.62	915.00
Oct 21	466.50	7.65	924.00
Oct 24	465.00	7.66	930.00
Oct 25	472.75	7.78	936.00
Oct 26	471.00	7.82	936.00
Oct 27	473.50	7.80	935.00
Oct 28	473.00	7.79	934.00
Oct 31	465.00	7.55	935.00
Nov 01	459.50	7.46	920.00
Nov 02	462.75	7.53	933.00

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.

But the smaller coins are up! The MS-63 $5.00 Liberties that we offered at $699 last month are now selling for $825! Overall, the 8-coin $2.50-$20.00 Liberty and Indian Gold type set is up 7.7% in MS-63 quality and up 8.0% in MS-64 condition in the last four weeks even though the $20s are lower. In the past two months, for instance, MS-63 $10.00 Indians have climbed from $725 to $1,200—and there are virtually none to be found anywhere! In just the last eight weeks, the 8-coin U.S. Gold Type Set is up 24.8% in MS-63 condition and up 23.2% in MS-64 grade!

Despite these substantial increases, prices are still a fraction of what they were in mid-June 1989. The MS-63 $10.00 Indian, for example, was selling for $3,500. For the long term, I think that most $1.00-$10.00 U.S.Gold Type Coins in MS-63 and MS-64 quality are great values at today's prices. We may see some profit-taking that will knock down prices in the next couple months. On the other hand, supplies are so tight that they may not fall.

Classic World Gold Coins are getting harder to find. We were fortunate to find some small groups of less than common coins that we offer this month. See our flyer for details.

Silver and Silver Coins

Silver finished today at $7.53, up 11 cents (1.5%) from last month.

Like gold, silver is building a solid base that may well help it top $8.00 by year end. Demand continues to be solid, though not as high this week as it has been for gold.

U.S. **90% Silver Coin** (3.1%) continues to be the best value in physical silver. It has the lowest cost per ounce of silver content, the greatest divisibility, and is also the most liquid. The **100, 10, and 1 Oz Ingots** (5.6-6.5%) cost more but have an advantage of occupying slightly less space.

Demand has remained steady for **Common Mint State Morgan and Peace Silver Dollars**. Expect to see more price increases over the next few months.

Demand for any kind of numismatic silver coin lots, U.S. or domestic, is so strong that it is almost impossible to find anything.

We were fortunate to acquire a nice collection of **Deep Mirror Proof-Like Morgan Silver Dollars**, the most beautiful of all Morgans. Please see our offer for dates and grades.

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.