Liberty's Outlook

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Gold Hits Seven Year High As U.S. Dollar Falls!

How Soon Will U.S. Debt Bomb Explode?
Silver Jumps To 42 Month High, Platinum To 23 Year High!

In the past three months, the price of gold has jumped 11%, its largest quarterly gain in four years. When gold reached $394.00 during American market trading on Thursday September 25, that was higher than it had closed in the U.S. since May 7, 1996!

There are myriad reasons for the price of gold to rise on its own merits—decreased supplies from mines and central banks and increased demand from investors and jewelry buyers have made multi-year shortages even more extreme in the past couple of years.

Those factors have been driving the gold price, now up more than 50% in the past 31 months!

However, the strongest underlying support to higher gold prices in the past three months has been concern that the building pressures against the value of the U.S. dollar may cause it to crash sooner or later. In the past month, for instance, there a high opposite correlation between the rise or fall of the dollar against the Euro—0.8 out of a maximum possible of 1.0 for perfect correlation. When the dollar fell, gold has risen, and vice versa.

The U.S. dollar is already down 8% against a weighted average of world currencies since early 2002. We are just seeing the beginning of this trend.

As one of my analyst friends recently said, "It used to be the dollar was the safe haven and now the dollar has fallen off its throne, and gold is the new safe haven."

This trend will continue to have a strong impact on the price of gold in coming months. Let's review the background before projecting into the future.

How Did Things Get This Way?

The United States has the world's largest economy by far, even though it does not have the largest population. This higher wealth per capita was made possible by an economy freer of political distortion and control than any of the other major developed nations.

This economic strength and long-term stability (the United States is the only nation in the world where all of its coinage from 120 years ago is still legal tender!) has resulted in the U.S. dollar being highly desired by foreign governments and investors. Governments hold a quantity of foreign exchange so that it can help manage (in theory, at least) the value of its domestic currency. Foreign investors formerly held dollars to seek safety from the value of their assets, denominated in local currencies, depreciating.

(A prime example comes to mind. When the financial crisis hit Southeast Asia in 1997, Indonesia's rupiah dropped more than 75%. Yet those Indonesians holding gold were able to avoid much of the financial hardship and misery.)

The strong economy made it possible for the U.S. to extend massive amounts of credit beyond its borders. In 1980, the U.S. was the world's largest creditor nation.

That has all changed in the years since. Being able to create U.S. dollars simply by printing paper and trading it to other nations for tangible merchandise encouraged massive imports into the U.S. As consumption soared, the U.S. turned into a net debtor nation by the late 1980s.

Still, the U.S. could largely ignore this shift. It has the world's largest and most liquid stock and bond markets. It can borrow in its own currency simply because it is the world's reserve currency. Even when times are hard in the U.S., economic turmoil in other countries almost always seems to be worse.

Advantages such as these allow the U.S. government and private sector to borrow more and at lower interest rates than anywhere else in the world.

This spending spree is having a disproportionate effect on the world economy. *The Economist* recently reported that, since 1995, almost 60% of the cumulative growth in world output has come from America, which accounts for only 30% of world Gross Domestic Product (GDP). Domestic demand has risen in the U.S. at twice the rate of other rich nations during this period.

Another way of putting this is to say that the world has become too dependent on the U.S. economy to bail out everybody else.

This presents the current dilemma.

Where are we now?

What will it take to change?

How bad is it going to get?

What can you do about it?

The Current Dilemma

Where are we now?

√ After the stock market crash in

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early 2000, investment spending collapsed in the U.S. but consumer spending held steady.

- √ American consumer indebtedness is growing twice as fast as incomes.
- √ The "official" Federal budget deficit has soared to 4% of GDP for the current fiscal year. It was in surplus just three years ago.
- √ The current annual U.S. trade deficit has ballooned to about $500 billion per year. We import 50% more than we export. This trade deficit is up to a record 5% of GDP!
- √ Foreign private investors, sensing forthcoming weakness in the dollar, have reduced their new investments in U.S. paper assets other than bonds to less than American investment overseas.
- √ The prime foreign purchasers of U.S. debt are the governments of Japan and China, who buy dollars as a means of subsidizing their own exports.
- √ Current net debt to foreigners is up to 25% of GDP, compared to being a *net receivable* of 10% of GDP in the late 1970s! This level of debt is higher than what forced some Latin and South American nations into financial disaster in the 1980s. Although this percentage is still lower than many other rich nations, at current trends the percentage will rise to 40% by 2007 and 60% by 2013!
- √ At current interest rates, America pays approximately $4 billion per year on net debt to foreigners. However today's low interest rates will not likely continue to attract sufficient additional credit. Rising debt and higher interest rates could lead to net interest costs to foreign creditors of $150 billion by 2007. Thirty-five fold increase in 4 years? Yes, that is not a misprint.
- √ Net foreign direct investment peaked at 1.6% in 2000, but has turned negative now (that is, that foreigners are pulling out of the U.S. more than others are sending in). In the mid-1990s, a survey by *The Economist* found that global investors included about 30% of U.S. dollar assets in their portfolios. That percentage is now up to about 54% of global equity investments and 50% of global bond investments, leaving less room for future increases. From 1998 to 2001, about 80% of new investments by global investors went to purchase American assets.

All of these problems are worse, both relatively and in absolute terms, than they were in the late 1970s, which ended with the price of gold climbing to $800 and silver to $50.

What will it take to change?

Strategy #1: The rate of increase in imports will have to fall to 4%, half of the average rate of increase since the mid-1990s. U.S. exports will have to jump up 11% per year, which if 50% higher than the trend in the past 5-10 years. If both of these happened simultaneously, that would not eliminate the trade deficit, it would merely hold it at around $300 billion per year.

Strategy #2: The U.S. economy would have to grow more slowly than the rest of the world.

Strategy #3: The U.S. dollar would have to fall in value relative to other currencies.

How bad is it going to get?

There are enormous difficulties with any of the above strategies. A Federal Reserve study in 2000 found, for instance, that imports into America rise 1.8% for every 1% increase in spending. In contrast, a 1% increase in spending elsewhere in the world only translates to a 0.8% increase in American exports.

There are many more problems than simply changes in spending patterns. For instance, the Chinese government is piling up huge foreign exchange reserves, now holding the second largest total after Japan. Normally this would suggest that China's currency is undervalued relative to the dollar. However, the Chinese economy is in precarious shape despite its rapid growth. Anywhere from 25-50% of domestic debts owed to Chinese banks are worthless. Any shift in currency value which discourages Chinese exports would make this problem even worse, and could easily lead to a financial collapse there!

For the U.S. economy to grow more slowly than the rest of the world would mean a near standstill on technological innovation, which just is not going to happen.

So that leaves strategy #3, a falling U.S. dollar. That is easier to accomplish because free markets can make adjusts relatively quickly and simply. But how much will it take to get back into some kind of international equilibrium?

The dollar rose by more than 80% from 1980-1984 and peaked in 1985. By the end of 1987, the dollar had fallen by 54% against the German mark and Japanese yen. The slide was finally arrested with significant multi-government intervention to support the dollar.

This time, the most optimistic estimate of how far the dollar must fall from current levels is 15-20%, but even that would only bring down the current trade deficit from 5% of GDP to 3%, higher than almost any time in American history before the last few years.

Ken Rogoff, the chief economist at the International Monetary Fund (IMF), thinks it will take a dollar decline of 35% to bring the balance of trade into balance. Analysts at Goldman Sachs and Deutsche Bank think that declines of 40-50% will not be enough to bring trade into balance.

If the dollar decline happens slowly over several years, a financial collapse might be avoided. But I don't think that the markets will wait that long.

Which means that there is a high risk of a quick fall in the value of the U.S. dollar sometime in the next year or two. When quick drops happen, they almost always overshoot.

What could happen in the U.S? Conservatively, I think there is at least a 25% possibility that the U.S. dollar could fall at least 75% within the next two years. The risk of a dollar crash and subsequent financial meltdown are not negligible.

As the IMF's Rogoff recently commented, "The world is set to jump off the top of a waterfall without knowing how deep the water is below."

By the way, when the value of the currency is falling, inflation is just about guaranteed to take off.

What Can You Do About It?

The best protection against a collapse in the dollar is to shift out of dollar-denominated assets into those that do not depend on the value of the dollar.

Tangible assets have historically been the best protection against currency crises. Among them, gold has

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traditionally been the asset of choice. It helped many Indonesians in 1997 and may help many Americans in the not-too-distant future.

Silver and rare coins are also worth considering, though their values are influenced by a number of non-monetary factors. Still, for the safety of diversity, I recommend some silver along with gold for most everyone. Carefully selected rare coins can serve well both in a financial crisis and take advantage of the current boom in the rare coin market.

When even the IMF reports that the dollar is overvalued, as it did a couple weeks ago, it is long past time to add to your gold and silver holdings.

I do not expect it to take long for gold to pass $400. I also think we are still in the early stages of the next bull market. It won't move in a straight line. But the overall trend is definitely up.

Will Silver Shine If The Dollar Falls?

Some of the investment money fleeing a falling dollar will be directed towards tangible assets. Of that, I expect most will go into gold bullion-priced forms and lower premium numismatic gold coins.

Some will also flow into silver, not because it has a major presence in financial markets today but because I has a past track record as a financial asset.

At today's prices, less than $5 billion of silver is mined each year and available inventories are limited to about $5 billion. Somewhere between $30-40 billion of gold is mined every year, with available inventories of around $50-100 billion.

The market for silver, compared to gold, is so small that even a small shift toward silver will have a huge impact on prices. So, while I think most of the financial activity will happen in gold, silver could rise by a higher percentage than the yellow metal.

New U.S. Circulating Nickel Postponed To 2004

The Mint recently announced that they simply could not be ready to produce the new circulating nickel to commemorate the 200th Anniversary of the Louisiana Purchase before the end of this year. Instead, as now planned, the Mint will issue this coin in early 2004, then change the design of the circulating nickel in mid-year to one honoring the Lewis & Clark expedition. Stay tuned for further developments.

Silver and Silver Coins

Silver closed today at $5.10, up four cents (0.8%) from four weeks ago.

On September 11, the second anniversary of the savage attacks on the U.S., silver closed at $5.32, its highest price in 3-1/2 years! But, while higher gold and rare coin prices also stimulated some investment demand for silver, the industrial demand has remained comparatively quiet.

On its merits, silver should be much higher today than it is. In my calculation, equilibrium is about triple today's levels. Still, the absence of industrial demand is keeping the price of silver down to bargain basement levels.

Premiums for physical silver have remained fairly stable in the past month. U.S. **90% Silver Coin** (4.5%) remains the low price leader and is our top pick to buy physical silver.

U.S. **40% Silver Coin** (9.0%) has an advantage of selling relatively close to face value. But this limitation of downside risk is offset by the large bulk it takes to own silver in this form along with the 60% copper-nickel content.

The **1-100 Ounce Ingots** (13.7-10.2%) are worth considering, especially if limited space is a problem.

High-Grade Common-Date Morgan and Peace Silver Dollars continued to be much in demand. Even though there were few increases in Morgan prices, supplies are disappearing from the market. Peace Dollars enjoyed widespread price increases in the past month. I never expected to find any bargains in them, but made a real find at the Long Beach Exposition two weeks ago. A dealer friend allowed me to pick the nicest coins from a surprisingly large group of **Superb Gem Mint State-66 Peace Dollars** at a very reasonable price. We can offer them for about 87% below their prices at the last major market peak—but only while supplies last. See our flyer for details.

Since 1992, the U.S. Mint has been issuing Silver Proof Sets containing dimes, quarters, and half dollars struck in 90% Silver, just like the old days. Three of the four most recent sets, which have the State Quarters in silver, have soared in price. When that happens, we typically see enormous demand for next year's issue—with the result that secondary market prices are weak.

Before the 2003 Silver Proof Sets were due out in July, we were being deluged with requests for them. Then, after a handful were shipped, the Mint discovered that the certificate of authenticity inserted with the coins had a printing error. The Mint suspended further shipments until a replacement certificate could be substituted. Ten weeks later, the Mint still has shipped only a modest quantity of sets. It will probably take until the end of October to get caught up.

This unexpected delay in delivery is just adding to the public frenzy for these sets. Don't be fooled into thinking they will be profitable rarities. I expect the Mint will keep taking orders well into 2004, selling as many as people want.

A usually profitable coin buying tip. When an annual issue is a dud for appreciation, the very next issue often has far lower original demand, making that one much more valuable down the road. In this instance, it would not surprise me if the 2003 Silver Proof Set is a dud and the 2004 Silver Proof Set turns out to be a real winner.

Gold and Gold Coins

Gold finished today at $384.25, up $10.25 (2.7%) in the last month.

Rising prices encouraged a new flood of investor liquidation and purchases.

The price of gold took a significant jump when the IMF made its scary knock against the value of the U.S. dollar. Although savvy market watchers already knew that the U.S. was running up huge budget deficits and balance of trade deficits, it seems that some people treated the IMF announcement as new information.

Low-premium price leaders continue to be the U.S. **American Arts Medallion** (3.7%), Austria **100 Corona** (3.4%), and South Africa **Krugerrand** (3.6%).

We do not recommend the higher premium coins such as the Austria **Philharmonic** (5.5%), U.S. **American Eagle** (4.8%), Canada **Maple Leaf** (4.5%), and Australia **Kangaroo** (5.5%). The past track record of others issues, such as those mentioned in the preceding paragraph, is that premiums will drop when secondary market liquidations are sufficient to meet new demand. It makes more sense to buy the issues where the premium decline has already occurred.

Common-Date U.S. Gold Coins, especially $10s and $20s, have been selling well over the past month. For in-

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stance, the price of the 8-piece Choice Mint State-63 U.S. Gold Type Set is now up 8.5% from two months ago!

Demand for **Better-Date U.S. Gold Coins** is even stronger than before, if that is possible. We recently acquired the highest quality lot of the rare **U.S. 1983 Alexander Calder Half Ounce Gold American Arts Commemorative.** They were so nice that we sent them off to be certified by the Independent Coin Grading Company (ICG), with almost all of them coming back certified lofty MS-67, MS-68, or MS-69 quality. We believe that we may be the only coin dealer in the nation that can offer Calders certified in such high quality. Yet, we offer these top condition certified specimens at still reasonable prices. See our enclosed offering..

After a several year hiatus, we also managed to snap up a lovely hoard of **Mint State France 20 Franc Gold Angels.** These beauties depicts the Angel Genius as the "Spirit of Liberty" inscribing the French Constitution on a tablet. These coins have also been popular gifts, often mounted in a bezel to hang as a pendant on a necklace. Please refer to our brochure.

The Month

Gold Range	$14.25	3.8%
Net Change	+10.25	
Silver Range	.31	6.1%
Net Change	+.04	
Gold/Silver Ratio	75.3	
Net change	+4.7	
Platinum Range	21.00	3.0%
Net Change	0.00	
Platinum/Gold Ratio	1.85	

Date	Gold	Silver	Platinum
Sep 03	374.00	5.06	709.00
Sep 04	373.00	5.01	711.00
Sep 05	377.50	5.12	710.00
Sep 08	375.00	5.09	703.00
Sep 09	381.50	5.24	704.00
Sep 10	380.00	5.24	699.00
Sep 11	379.50	5.32	696.00
Sep 12	376.00	5.20	693.00
Sep 15	374.50	5.19	692.00
Sep 16	373.50	5.21	694.00
Sep 17	376.00	5.27	691.00
Sep 18	376.50	5.25	697.00
Sep 19	381.50	5.28	694.00
Sep 22	387.25	5.26	701.00
Sep 23	385.75	5.23	703.00
Sep 24	387.25	5.30	703.00
Sep 25	384.75	5.21	712.00
Sep 26	380.75	5.13	693.00
Sep 29	382.25	5.07	700.00
Sep 30	385.25	5.13	703.00
Oct 01	384.25	5.10	709.00

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.

Governor Granholm Selects Michigan Quarter Design

In mid-September, the U.S. Mint announced that it had approved all five of the candidate Michigan State Quarter designs submitted by former Michigan Governor John Engler in April 2002.

Unfortunately, because the results from the Mint were so late in coming, current Michigan Governor Jennifer Granholm was asked to inform the Mint of the final design by September 30 instead of allowing her a month as originally promised.

The members of the Michigan Quarter Commission, appointed by Engler, met on September 26 to make their recommendation among the five designs. Yesterday, I was one of four people who met with the Governor to relay this information, answer her questions, and hear her confirm her choice of the simplest of the five designs—the textured state of Michigan surrounded by the five Great Lakes plus the motto 'Great Lakes State."

The coin was designed by U.S. Mint Sculptor-Engraver Alfred F. Maletsky, whose many previous coin design credits include the New York and New Jersey State Quarters.

In a process as open ended as creating a state quarter design from scratch, many people will not be satisfied that other design elements were not used or that the artistry is not quite good enough—no matter which design was selected. Some negative feedback has already been reported by the media.

This flak almost entirely misses the point of creating a design for the quarter. The design area is only 1/2 inch by 3/4 inch in size. Various designs blown up to two feet in diameter may look beautifully detailed, but would be a disaster at the size that the public would see on a quarter. Also, Michigan is special for so many natural, historic, or industrial features that highlighting one or two would be a slight to not include others.

The main reason for the coin to feature the outline of Michigan is that it is the most distinctively shaped state in the country. It is the only state that can be identified easily from 100 miles up in space. It is the only state composed of two major peninsulas.

The Great Lakes were and continue to be a major factor in Michigan becoming the economic powerhouse in so many industries over the centuries. Without the Great Lakes—the largest body of fresh water in the world—fur trapping and lumber would not have been as efficient; the state would not be a national leader in the production of so many agricultural crops; industries such as the automobile, copper and iron mining, cereal, chemicals, office furniture, baby food, pharmaceuticals, household appliances, and many more would not have flourished, and the state would not enjoy a huge tourism industry.

In essence, any other design element that could have been included on the Michigan Quarter probably became important because of Michigan's unique geography and the Great Lakes. Depicting only those two themes on the coin suggests all the other natural and man-made wonders in the state. And it will look beautiful on the quarter, due for release three months from now.

The U.S. Mint normally begins shipping the state quarter that is released in January on the 2nd of the month. Preparation for the Michigan quarter is so far behind schedule that a Mint official recently told me that it may not come out until mid-January.

To see a picture of the final design, I would normally direct you to www.michiganstatequarter.com, a website of the Michigan State Numismatic Society that is hosted here at LCS. With our computers still down and the new ones not installed yet, we won't be able to post it on the website for a few weeks In the meantime, send an inquiry to me at path@libertycoinservice.com. I will email the artwork direct to you.

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