

NEWS & VIEWS

June/July 2001

Forecasts, Commentary & Analysis on the Economy and Precious Metals

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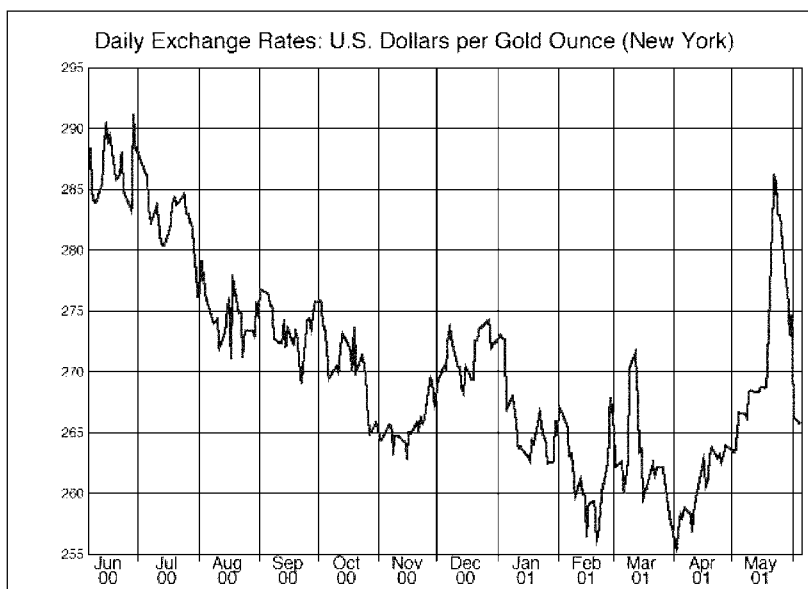
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INTRODUCTION: The month of May was a roller coaster ride for gold, as our graph of the month clearly illustrates. The gold price ended the month at \$265 per ounce after nearly touching the key \$300 mark at mid-month. Although the bulls were disappointed in the retracement, the bears got another scare from the latent strength in gold market--a coiled tiger waiting to spring at the slightest provocation. Graham Birch, who manages the Mercury World Mining Trust in London, told *Bloomberg* succinctly: "You are not in a bear market anymore. Lease rates on gold are up, while rates on other cash have gone down. The metal looks attractive again." Beyond the rate factors that Birch mentions, gold demand has been building for months based on rapidly advancing energy prices, equity market concerns, and monetary and price inflation in most of the world's economies--stress factors that are not likely to disappear anytime soon. For quite some time, we have postulated that gold might rise even in an environment where the dollar remained strong vis-a-vis other currencies, including the euro and yen. In other words, that for gold to go up it was not necessarily required that the dollar go down. Our logic was that the factors mentioned would drive up inflation rates around the world even as these same countries stuck to a currency policy of "competitive devaluation." We theorized that investors internationally would respond to the renewed inflation with the historically proven solution--gold diversification. In my May 3, 2001 **DAILY MARKET COMMENTARY & REVIEW** at our USAGOLD website I remarked that "I wouldn't be surprised to see the gold market jolted some innocent morning with a major price jump. It will come, most likely, when we least expect it. And what the dollar is doing may have little or nothing to do with it." That's precisely what happened on May 18th when the price spiked \$14. We wouldn't be surprised to see that happen again . . . and again . . . and again until the stranglehold which the shorts have on this market is broken. In the end, demand will dictate terms in the gold market. The question for gold remains not "if" but "when." This issue is jam-packed with pertinent gold information. Enjoy. MK

SHORT & SWEET. **AT A RECENT LBMA (LONDON BULLION MARKET ASSOCIATION) CONFERENCE HELD IN ISTANBUL,** Herve Farhani of the Bank of France shed light on the thinking of central bankers toward gold: "I do think that some caution is mandated here. One can wonder whether fresh liquidity will be as forthcoming as it has been up to now. There is a markedly different attitude as to gold depending on the main motive from holding it. There is a difference between what I would call policy held gold and portfolio held gold. Why do inflation fighters (central banks) hold gold (essentially an inflation hedge)? Historically, gold was the 0% asset counterparty of banknotes, a 0% liability. Gold holdings meant that paper money was as good as gold. Today, paper money is only as good as the credit extended to the economy. Indeed, the existence of a 0% liability (banknotes) explains that central banks can afford to hold gold, which yields nothing, and partly explains their yield/price insensitivity. They want [gold] to be perceived as the anchor of the system...as an insurance policy against a major dysfunctioning of the global financial system. Somewhat irreverently, one could say that they hold gold

because they don't believe in themselves...or, rather, as gold is held as a substitute to reserve currencies, because they don't believe in the reserve currency issuer capacity (or willingness) to fight inflation [and] as a war chest (if the worst comes to the
(CONTINUED ON NEXT PAGE. . .)



SHORT & SWEET. . . .CONT'D

worst). [Ed. Note: In other words central banks hold gold for precisely the same reasons that you and I do.] **GOLD IS TRENDY.** *The Bangkok Post* reports that “[s]ince the flashback to ‘maximum style’ appeared on Milan and New York fashion catwalks late last year with more gold being used in clothes, accessories and make-up, gold jewellery is expected to establish a new position and become more accessible and fashionable among younger people.”

. **CONNECTING INDUSTRY REPORTS THAT “GERMAN CHANCELLOR GERHARD SCHROEDER**

wants to create a European government as part of a radical shake-up of the European Union. His ideas involve turning the European Commission into a new government while the Council of Ministers, made up of leaders from member states, would become a second chamber. Total control on spending, including the multi-billion pound farm subsidy budget which accounts for half of the EU’s total spending, would go to the European Parliament.” [Ed. Note: Goodbye sovereignty. Hello Big Government and all that it portends.]

WHILE ON THE SUBJECT OF EUROPE, we would like to thank our new European clientele who have decided to do business across the water. What a thrill for us to talk to like-minded individuals in Ireland, Britain, Germany, Austria, Belgium, etc. The support for gold (and the principles attached) around the world is wide and deep indeed. We look forward to working with our friends in Europe, Canada, and Australia and the opportunity for genuine insight that comes with it. **THE FOLLOWING IS AN E-MAIL WE RECEIVED THE OTHER DAY FROM A SATISFIED CLIENT WHO ORDERED FROM USAGOLD/CENTENNIAL PRECIOUS METALS:**

“I received the gold today (in Ireland) and all is in order. As this was my first gold order from USA, I would like to thank you for the courteous efficient and professional way in which it was handled.”

. **YOU MAY RECALL THAT ALEC BALDWIN PROMISED TO LEAVE THE COUNTRY** if George W. Bush were elected president. Well, it seems he has decided to stay and there are those who will not let him live it down. “Less than 24 hours before he assaulted a heckler at Madison Square Garden,” reports the *New York Post*, “Baldwin spoke before a crowd of 300 at a five hour long Town Planning Board public hearing in Amagansett, convened to decide whether the Bistriean Golf Club in East Hampton should be allowed to erect a clubhouse and parking lot. While Baldwin argued against allowing the permit, attendees interrupted him with catcalls, jeers and remarks like, ‘Why are you still here? I thought you were leaving the country!’ When Baldwin at one point complained that the new clubhouse would cause a big traffic headache, one man shouted, ‘Not as bad as when you had the president [Clinton] at your house!’ Baldwin unkempt and unshaven exceeded his

Dr. Moneywise Says:
Consider this: Those a Quarter richer today can be a Dime poorer tomorrow and Never know the Reasons why. While those who put gold away have already Saved for that Rainy Day.

time limit, riling the crowd even more . . . No wonder Baldwin flipped out the next night when fans jeered him at the Knicks game.” **INVESTMENT GURU, WARREN BUFFET, WHOSE HOLDING COMPANY BERKSHIRE HATHAWAY OWNS THE DAILY BUFFALO NEWS,** says that the days of daily hard copy newspapers are numbered due to the internet. The newspapers he said are being drubbed by the internet in terms of content, accessibility

and cost. “The idea that chopping down trees, running them through million-dollar presses... is going to be competitive with some little click on a computer is nonsense,” Buffett said.

. **WE HAVE BEEN TOLD BY A NUMBER OF THE GOLDMEISTERS** that after a few months of reading the USAGOLD website with its news access page (**DAILY MARKET REPORT**), opinion page (**THE GILDED OPINION**), and **DISCUSSION GROUP** (which provides an array of interesting links from posters), that the mainstream press seems shallow by comparison and has become increasingly irrelevant when it comes to financial news. Yes, my friends, if it’s happening, it’s happening at USAGOLD. .

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. **FROM A REUTERS REPORT:** “U.S. oil company officials warned lawmakers that gasoline supply shortages and fuel price spikes could occur this summer if there are disruptions in delivering gasoline.” .

. **“AS THE GLOBAL ECONOMY INCREASINGLY BECOMES A REALITY** with improved communications throughout the world,” says prominent economist Judy Shelton, “individuals in different countries will have less tolerance for the discretionary actions of fallible central bankers that undermine the value of money. Producers and consumers will want to deal directly with each other. A gold standard provides the common denominator for conducting business across national boundaries—a sort of monetary Esperanto. National currencies function as dialects of the same root language, gold-backed money.”.

. **CHARLTON HESTON, PRESIDENT OF THE NATIONAL RIFLE ASSOCIATION, RECENTLY DELIVERED A THOUGHTFUL, COGENT SPEECH TO HARVARD STUDENTS ON THE DEBILITATING ASPECTS**

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OF POLITICAL CORRECTNESS. "As I have stood in the crosshairs of those who target the Second Amendment freedoms," he said, "I've realized that firearms are not the only issue. No, it's much, much bigger than that. I've come to understand that a cultural war is raging across our land in which, with Orwellian fervor, certain acceptable thoughts and speech are mandated . . . [J]ust last month David Howard, head of the Washington, D.C. Office of the Public Advocate used the word 'niggardly' while talking to colleagues about budgetary matters. Of course, 'niggardly' means stingy or scanty. But within days Howard was forced to publicly apologize and resign. As columnist Tony Snow wrote: '*David Howard got fired because some people in the public employ were morons who (a) didn't know the meaning of the word niggardly, (b) didn't know how to use a dictionary to discover the meaning, and (c) actually demanded that he apologize for their ignorance.*' What does all this mean? It means that telling us what to think has evolved into telling us what to say, so telling us what to do can't be far behind. Before you claim to be a champion of free thought, tell me: Why did political correctness originate on America's campuses? And why do you continue to tolerate it?

performing category through Thursday. Indeed, gold funds are seeing their best performance since 1993, when they spiked up more than 81 percent." [ED. NOTE: These funds plummeted when gold fell just as quickly as it had risen, but historically gold funds have led gold bullion higher. Gold stocks and funds are not a proxy for gold ownership. Each has its place in the portfolio with the stocks and funds being a speculation on the price, and gold coin and bullion a hedge against inflation, deflation, currency rot, a bear equity market, etc.]
I HAVE HAD THE PLEASURE OF BEING INTERVIEWED BY JIM PUPLAVA for his San Diego radio show, *Financial Sense Perspectives*. Having done a number of on-air interviews, I can say that it is truly unique to be interviewed by someone who has a solid grasp of the subject matter being addressed. Jim Puplava knows the financial markets. Here's what he had to say recently about the situation developing in the world economy: "If you don't want to be struck by lightning, you don't stand under a tall tree in an open field during a lightning storm. The same wisdom can be applied to the world of derivatives. Our financial markets hang on a thin thread of probability and belief in a bell-shaped curve that such an event will never occur. Yet history reveals otherwise. The lesson of this last decade tell us that rogue waves and rogue traders do hit the financial markets. So far we've managed to survive them. The academics will tell us that their models will help us to avoid them. They have endeavored to convince the financial world of their mathematical certainty. But the real world isn't full of certainty. There will come a day without warning, at a time when nobody expects, when that rogue wave will appear. It will be a day when events overwhelm the financial markets . . . when the house of paper will fall . . . when our financial institutions will be put to the supreme test . . . when the mettle of a man is tested . . . when faith in our institutions will be called into question. It will only be on that day and in that hour, that we will know if the Holy Grail of Finance truly exists."



Why do you, who are supposed to debate ideas, surrender to their suppressors? Let's be honest. Who here thinks your professors can say what they really believe? It scares me to death, and should scare you too, that the superstition of political correctness rules the halls of reason." **CBS NEWS REPORTS:** "LIKE A PHOENIX RISING FROM THE ASHES, gold funds have flown to the top of this year's performance charts, returning 15 percent so far in 2001, Lipper Inc. said Friday. After several years in the doldrums, mutual funds investing in gold producers were ahead of both small-cap value funds, up 9.2 percent, and mid-cap value, up 5.8 percent, as the top-

MORE BEAR STOCK MARKET FALLOUT: *Associated News Media* reports that "[m]ore than 25 Microsoft employees have been forced into bankruptcy because they cannot afford to repay loans taken out to buy cut-price shares in the company. The crash in media and technology shares means many of Silicon Valley's one-time paper millionaires now face ruin. Microsoft's shares have slumped by 35% from their high point, way below the price at which staff scrambled to buy. But employees of the giant software group created by Bill Gates are not alone. Staff in companies such as Cisco Systems, Yahoo! and Intel are said to be trying to shield their

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homes from creditors. The bursting of the high-tech bubble has coincided with tax penalties to crush the thousands of employees who borrowed heavily to buy shares at a discount price, only to find their value falling even lower. Silicon Valley accountant Mike Gray, who founded the Employee Stock Options Advisors' Association, said the greed for options has been 'a disaster for I don't know how many people around here. This has been a catastrophe and the companies aren't in a position to offer much help. Some are no longer in business. Others are big names that by law cannot treat one shareholder with losses any differently from another.' ACCORDING TO A REPORT PUBLISHED BY DOW JONES, HSBC BANK PLC SEES THE "[RECENT] SHARP RALLY IN GOLD PRICES AS 'PROBABLY MORE THAN JUST ANOTHER SHORT SQUEEZE,' with concerns over inflation one of the key positive factors likely to lift gold prices further in the long term . . . Including this rally, gold prices have risen 11% since the beginning of April . . . The HSBC report cited the U.S. Federal Reserve aggressively easing interest rates, the Bank of Japan edging toward monetization and confusing signals from the European Central Bank about its policy. Thus, 'market faith in monetary management is starting to erode, and this is a very positive force for gold.' Gold is traditionally used as a hedge against inflation . . . Although gold could fall back toward US\$275/oz in the short term, HSBC suggests investors build fresh long positions should it retrace to US\$278/oz. [ED. NOTE: Gold is trading at \$265 as we go to press.] . . . In the longer term, gold's ascent may continue as the high gold lease rates and lower U.S. short-term interest rates 'make speculative short positions much less attractive, and reduce the incentive for producers to hedge . . . Gold producers also are unlikely to expand their hedge books even if prices rise, particularly after African gold miner Ashanti Goldfields Co. (ASL) was forced to buy gold from the open market to cover its extensive hedge book in September 1999. 'The Ashanti experience highlighted the risks to this strategy with many shareholders criticizing the management

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for taking action that made them worse off when the gold price rose. Hedging activity virtually disappeared last year.' . . . *Investor confidence in the U.S. economy and U.S. policy makers is likely to have eroded, as the Fed's aggressive monetary easing took place 'in an environment of an upward drift in core inflation, higher unit labor costs, and persistently high energy prices,'* HSBC said. 'Gold, on the other hand, is an asset that is not a liability of any government, and is thus the ultimate hedge against poor monetary management.' THE TRADING DESK DIARY SUMS UP HOW GOLD STOCKS ARE NOT ALWAYS WHAT THEY SEEM TO BE (as alluded to earlier) and why gold itself--instead of stocks--might be the best vehicle for playing the gold market: "Yesterday it was revealed that Centaur Mining and Exploration, an Australian company, filed

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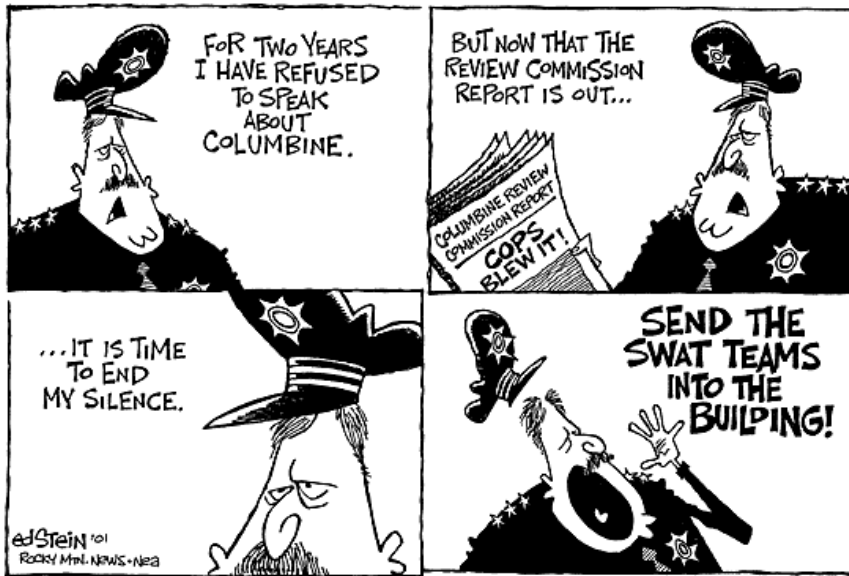
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SHORT & SWEET. . . .CONT'D

for bankruptcy protection with a huge short position in gold on its books. There were rumors in the gold markets that Centaur has hedged as much as five times its assets. That's a hedge? Hardly. But call it what you will. Either way, if you're a creditor of the bankrupt Centaur, you are implicitly short a lot of gold. That's because if gold goes down, Centaur's big 'hedge' will pay off and there will be lots of money for all the creditors. But if gold goes up, Centaur's assets get wiped out by trading



losses and the creditors end up with nothing. The only thing for the creditors to do is to protect themselves by buying gold. And apparently that's what they did yesterday--in size. And of course other gold-market participants (being the friendly, altruistic sort) held out a helping hand to Centaur's creditors by front-running the living daylighters out of them. It's called a short squeeze. The last time something like this happened was in September 1999, when a similar short-squeeze involving the South African mine Ashanti sent gold from 255 to 340 in just two weeks." [ED. NOTE: I want to make sure that the core message doesn't get lost in the overall discussion. This does not mean you should shun gold stocks, but simply that you should find an expert who knows the difference between the good ones and the bad ones. You do not want to go into a gold stock thinking that it's a bet on gold rising when in reality it is a bet on gold falling.] **SOMETHING TO THINK ABOUT FROM PRNEWswire:** "The threat of bankruptcy is real! This year more people will file for bankruptcy than will graduate from college. And as a result of the economic downturn, stock market devaluation and thousands of corporate layoffs, a growing number of families have reached the brink of economic crisis. The two lowest quintiles, representing about 40 percent of Americans, earned on average \$12,338 after taxes and net on average \$20,808 in 1999. That's roughly 32 million households running an annual deficit of \$8,160. This debt is primarily

attributed to large amounts of short-term liquidated credit. Furthermore, the Federal Reserve reports that consumer debt has now reached \$1 trillion, or nearly \$9,000 per U.S. family." **I RECENTLY RAN INTO THIS INTERESTING FREDERICK VON HAYEK ANECDOTE PUBLISHED BY THE HOOVER INSTITUTE** in an essay titled, *The Hayek Century*. "Economist and Hoover honorary fellow Friedrich Hayek spent seven decades extolling the supremacy of capitalism over socialism. For most of those decades, Hayek was a voice in the wilderness. Yet as John Cassidy explains, by the end of his life, Hayek was vindicated to such an extent that 'it is hardly an exaggeration to refer to the twentieth century as the Hayek century.' If there are two things most people can agree on these days, they are that free market capitalism is the only practical way to organize a modern society and that the key to economic growth is 'knowledge.' So prevalent are these beliefs that their origins are rarely examined, which is somewhat surprising, since both statements can be traced back, in large part, to one man, Friedrich August von Hayek, a reserved Austrian economist who died in 1992. In November 1989, when the Berlin Wall came down, Hayek was a frail but mentally alert 90-year-old living in Freiburg im Breisgau, Germany, a picturesque town in the Black Forest. Hayek didn't issue any public statements,

but he thoroughly enjoyed watching the television pictures from Berlin, Prague, and Bucharest. 'He would beam benignly, and the comment was 'I told you so,' said Hayek's son.' **'PLANNING LEADS TO DICTATORSHIP,' HAYEK WROTE, 'BECAUSE DICTATORSHIP IS THE MOST EFFECTIVE INSTRUMENT OF COERCION** and the enforcement of ideals and, as such, essential if central planning on a large scale is to be possible.' If these passages evoke memories of George Orwell, it is hardly surprising. Orwell reviewed Hayek's book favorably, and in many ways *The Road to Serfdom* was the nonfiction precursor to *Animal Farm*, Orwell's 1945 fable about the dangers of collectivism.' **DONALD ECKERT OF J.P. MORGAN CHASE & CO. IN NEW YORK STATES:** "The funds are tripping over themselves to buy gold." I think that is the kind of behavior we can expect in the future. Whenever gold rallies, the herd will thunder into the market. **INTERNET FAVORITE BILL FLECKENSTEIN ON GOLD (6/1/01):** "The precious metals edged higher, about a quarter of a percent. The gold bulls got a little good news in that the open interest was down another 6,000. So, we have completely flushed out all the recent speculators. Could it be that this was the final, nauseating decline before the market really starts to work higher? That's what the bulls would like to believe. That is my present belief also, and my hope, as I added to my gold position today.' **"GIVEN THE FUNDAMENTALS OF THE CURRENT**

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BITS & PIECES. . . .CONT'D

INTERNATIONAL FINANCIAL PICTURE,” says Reg Howe of the popular *Golden Sextant* website, “gold looks ready to resume its historic role as the financial asset of last resort, the only financial asset that is not another's liability. All these recent straws in the wind sound like the gold train blowing its whistle and preparing to leave the station. When it does, the dollar-dominated financial world we have come to assume will change forever. Its great hero, Alan Greenspan, will take his rightful place in history alongside John Law. Don't miss the gold train. It is one train that even my FJ1200 superbike can't catch.” *THE TIMES NEWSPAPERS* RECENTLY PUBLISHED THE FOLLOWING ON THE LITIGATION WOES OF MAJOR WALL STREET BANKS: “Wall Street banks are facing an avalanche of expensive litigation, with as many as 100 class-action lawsuits, demanding tens of billions of dollars in damages. The banks are being accused by investors of allegedly rigging the flotations of Internet companies during the dot-com boom of the late 1990s. An investigation by *The Times* has found that 21 separate lawsuits have already been filed against ten different banks in
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APRIL GOLD REVIEW **NEW**
by Jay Taylor/*Jay Taylor's Gold Review*

THE CASE FOR GOLD
by Doug Casey/*International Speculator*
A NEW PARADIGM FOR THE OLD ECONOMY
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“Gold SHOWING SIGNS OF LIFE”
by Leanne Baker/*Salomon Smith Barney*

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BITS & PIECES. . . .CONT'D

Manhattan federal courts.” **AT PRESENT, INDIA IS THE LARGEST GOLD MARKET IN THE WORLD WITH ANNUAL DEMAND IN THE 800 TON RANGE. NOW ALONG COMES CHINA TO CHALLENGE THE SUBCONTINENT FOR GOLD SUPREMACY.** From the *China Daily*: “Gold is used by the People’s Bank of China, the central bank, as a foreign exchange reserve, but later this year a gold exchange will be launched. Individuals will then be able to buy, sell or hold gold bars for the first time since the founding of the People’s Republic of China in 1949, when the practice was banned. Demand is expected to rise to 800 tons a year over the next 10 years after the deregulation, said sources from the World Gold Council . . . Previous years have seen demand lingering at around 200 tons, largely because of tight government controls on the gold market. The need to relax controls and allow gold to play a role as a common commodity and an investment tool for individuals grows alongside China’s increasing capability of earning foreign exchange. The first step towards deregulating the market should be setting up a national gold exchange, and this could be launched later this year in Shanghai, China’s financial centre.” [ED. NOTE: We will monitor progress in China and keep you posted through this newsletter.] . . . **THE SINGAPORE STRAITS TIMES PUBLISHED THIS REFRESHINGLY BULLISH SCENARIO FOR GOLD.** A good summation of where we’ve been and perhaps where we are headed, it is a fitting conclusion to this month’s issue. “After many years of lacklustre prices, gold is suddenly gleaming again. As a result, Singapore unit trusts that invest in gold-mining stocks have made shining gains. Gold fever last gripped investors during the late 1970s and early 1980s, when the precious metal went for as much as US\$850 an ounce. Now it hovers around US\$270 an ounce. At that steep discount, it almost puts the Great Singapore Sale to shame. And investors are rolling up, keen to have a bar or two of the metal. The price is even more attractive considering that gold touched a 20-year low of around US\$240 an ounce in July last year. In the rebound that followed, it touched a 15-month high of US\$298.50 an ounce just a fortnight ago. (Please see graph on front page.) But last Wednesday, speculators then rushed in to sell it off, causing the price to tumble US\$7.70 or 2.8 per cent--the biggest drop in 1 1/2 years. Despite that, the

fundamentals of gold investing look good, according to industry experts. A May 24 report by the London-based World Gold Council (WGC) said demand in the first quarter of this year for gold jewellery and personal investment set a record of 826 tonnes. Mr Koh Tong Huat, the WGC’s area manager for Singapore, Malaysia and the Philippines, says: ‘*We are projecting a bullish scenario for gold.*’ The amount of gold produced by the world’s mines lags behind demand by 600 to 700 tonnes a year, a shortage met partly by sales of gold reserves by central



banks, he adds. Logically, sooner or later, gold prices will have to reflect the shortage of supply, he notes. A privately published Australian newsletter, www.the-privateer.com, said in a commentary a fortnight ago: ‘The overriding fact is that gold has bottomed. The stage is perfectly set for a return to the gold markets of the 1970s.’ **WITH THAT VERY ENCOURAGING FORECAST, WE’LL BRING THIS ISSUE IN FOR A LANDING.** As you can see, there has been a profound shift in the prevailing attitude toward gold. In the years to come we may look back at May, 2001 as something of a turning point for the yellow metal. Most surprising is the bullish mind-set developing at major brokerages and international banks. I would like to thank our clientele for doing business with Centennial Precious Metals and making these pages possible. Happy Trails, my friends, until we meet again.

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GERMAN 10 MARKS (WILHELM I)



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