Coins and Bars – Demand or Supply?

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Good morning, ladies and gentlemen.

First I would like to thank the London Bullion Market Association for this kind opportunity to be part of this year's conference. It is an honour to be in such distinguished company and to address this prestigious forum. The topic I was asked to address today is whether silver coins and bars are part of the demand or supply equation for silver. It is one of those topics that is a bit of a riddle, and I will endeavour to unlock the answer. Before I do, let me briefly tell you about our firm so you can understand our perspective on the market.

Dillon Gage Metals

Dillon Gage is a diversified financial service company based in Dallas, Texas. We provide our customers with platforms to trade in the securities and futures market, and we are one of the largest precious metals dealers in the United States. We also operate a refinery, have a fully, wholly owned independently operated precious metals vaulting facility in Delaware. Dillon Gage has been in the trading business for over 35 years, and we are an international wholesaler of bullion coins and bars, with the bulk of our business being done in the United States.

We are one of a few select authorised purchasers for gold, silver and platinum bullion products from the United States Mint, and we also maintain purchasing agreements with several other national mints. Our clients include banks, brokerage houses, investors, coin dealers, financial planners, jewellers and manufacturers. The diversity of our activity and our clients gives us a good insight into the broader marketplace for metals, and we think this also provides an advantage to our customers.

Reordering the Demand Equation

Robust investor demand has sent physical silver investment soaring as investors seek protection from weakened currencies and faltering equities markets. National mints are struggling to keep pace with brisk demand for silver bullion coins while private mints are working around the clock to meet demand for investment bars, particularly from the United States and Western Europe. Investor demand coupled with further inroads into digital technology has led to a reordering of the demand equation for silver. Photography, for decades one of the three pillars of silver demand, has been pushed aside by silver investment, which has joined industrial applications, and jewellery and silverware as the main pillars of overall silver demand.

A principal factor in the shift in the demand equation is investment demand, which, since 2006, has played an increasingly important role in the overall silver market. The changing, volatile and sometimes scary financial and economic environment that we find ourselves in is in many ways the perfect storm for the bullion industry.

The ever weakening US dollar, disappearing homeowners' equity and diminished retirement accounts, and governments with yawning budget gaps and risking default have created unprecedented demand for precious metals. The influence of precious metal backed exchange traded funds on today's bullion market is profound. The prolonged uncertainty about the global economic outlook continues to push investors into metals as a hedge against uncertainty.

This is certainly true of the silver market. With the April 2006 introduction of the first silver -backed exchange traded fund, the investor base for silver was significantly expanded. The iShares Silver Trust ETF, the dominant product in the market, has amassed over 315 million ounces in the past five years, with global ETF holdings of silver standing at 568 million ounces by the end of this past August.

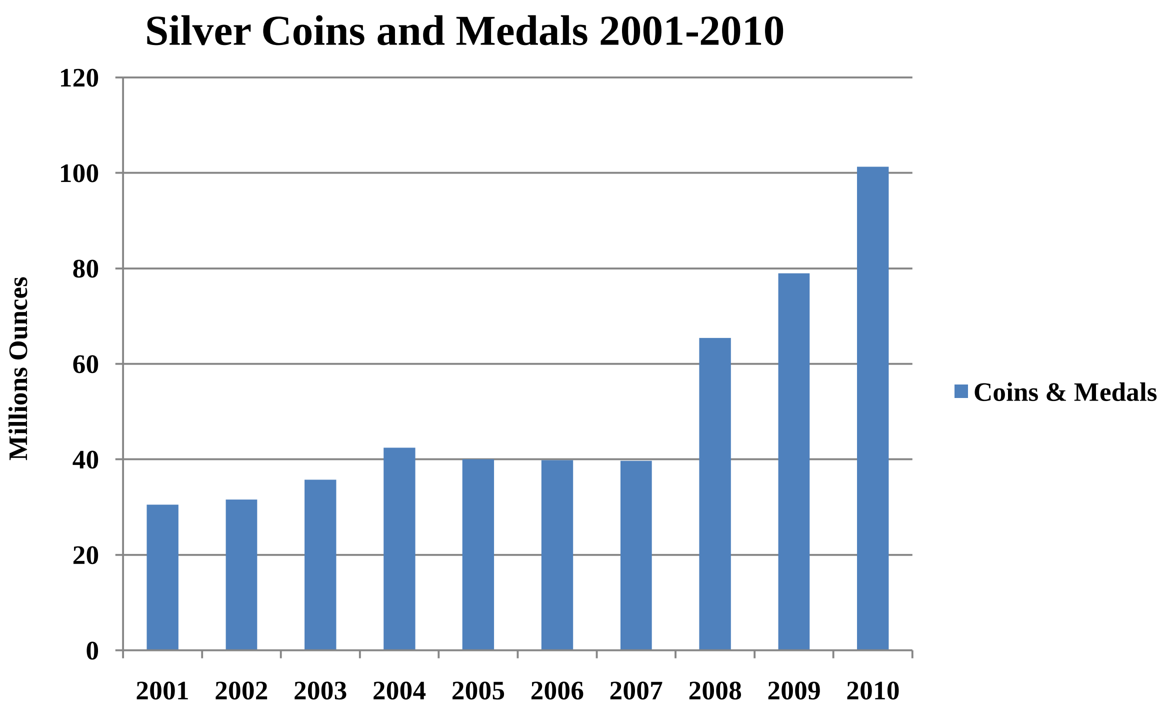
Overview of the Silver Investment Demand

Investment demand for silver is hitting new heights in the absolute value of today's global investments. Demand is of a scale unthinkable a decade ago when investors and silver were capitulating. While ETFs have certainly injected more cash into the precious metals markets, and this has largely been institutions, they have not replaced nor diminished the physical retail trade, but rather enhanced it.

From my vantage point, the real strength of silver investment is underpinned by the cash and carry retail trade. As an example, looking at our trades with customers over the past 12 months, we have seen demand for gold increase 26%, silver increase 58%, while platinum and palladium unfortunately are both reduced and trading lower because of their emphasis on industrial demand.

Why Silver is in Greater Demand

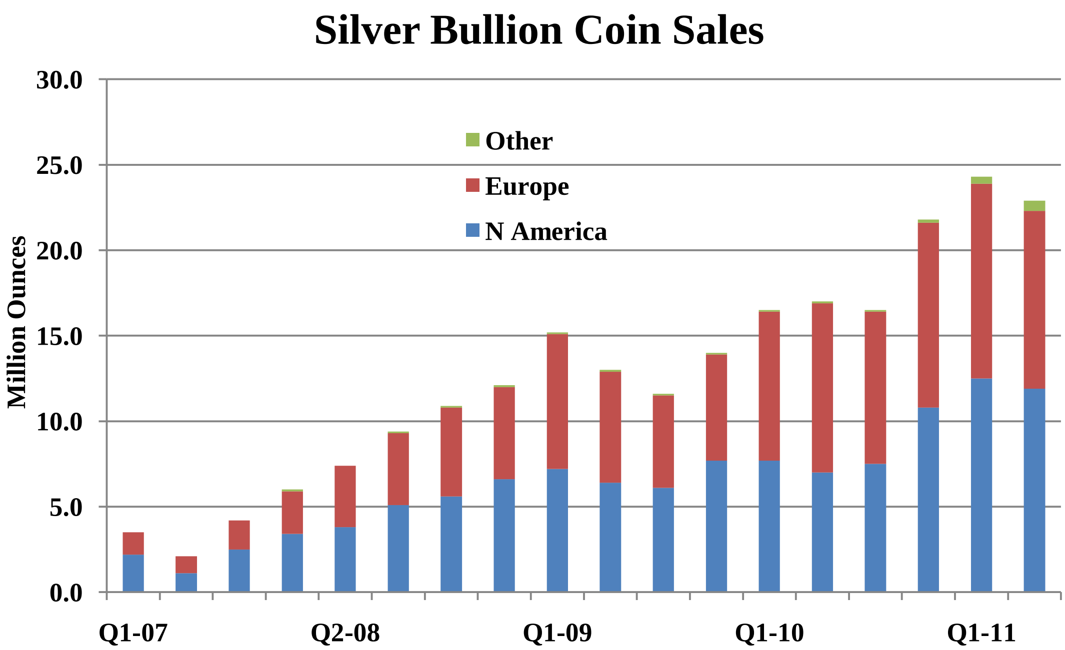
So why is silver in greater demand now than the other precious metals? Firstly, institutional investors and retail investors like the upside potential that silver offers, and its heightened volatility. However, a good chunk of retail investors have turned to silver because they wish to have the hedge that metals offer, but have found gold just too expensive. These investors have turned to silver coins and small investment bars to meet their investment objectives.



In its World Silver Survey 2011 Report, GFMS, Thomson Reuters noted that silver coins and medals as a category had a new record high last year, up 28%, reaching 101.3 million ounces. As they noted, in just three years the global total has risen by nearly 62 million ounces, with an annual growth rate of 38%. Brisk retail demand from Western Europe and the United States has been the principal driver behind that growth.

Principal Markets

The principal markets for silver bullion coins are North America and Western Europe, while other major retail markets, China and India, favour small bars over coins. Any discussion of the silver bullion coin market would centre on the US Mint's American Eagle Bullion Coin Program, which celebrates its 25th anniversary this year. Since the product launch in 1986 these bullion coins have become the dominant bullion products in the global market for physical bullion coin investments. The US Mint has produced nearly 35 million ounces of the coins last year, and could have sold more had they not experienced shortage of blanks. The Eagle's principal competitors are the Canadian Maple Leaf, the Austrian Philharmonic and the Australian Kookaburra. The Eagle outsells these competitor coins collectively at about a 3:1 ratio.



While the US Mint will likely hit a new record high this year for its silver bullion coins, as much as 40 million ounces, I think more could be done to boost demand for the mint's offerings. First, the mint needs to overcome its production problems and ensure that it has a reliable stream of blanks to meet its production needs. Secondly, the Treasury Department should work to find a way to level the playing field for bullion investors with respect to tax treatment.

American Silver Eagles

Earlier this year I testified before the US Congress, and recommended that it give a competitive edge to the American Eagle bullion products by adjusting the capital gains treatment of these investments. Current tax law imposes a maximum rate of 28% on bullion investments held one year rather than 15% levied on securities in mutual funds. By lowering the rate, Congress could substantially boost the market potential for the American Eagles. It should be noted that, while the United States is the major market for Silver Eagles, investors in Western Europe prize them too, as do our friends here in Canada.

Silver Investment Choices

Some investors have long preferred investing in small bars and coins because of the portability and the anonymity that comes with such investments. That is particularly true in Northern America and Western Europe. However, the landscape is shifting in other parts of the world. Indian investors who have long favoured jewellery and silverware for their silver investments are now starting to include small bars in the mix, but not coins. China, which has liberalised its silver market in the past two years, has seen investors begin to invest in small bars.

The United States has a rich history of silver mining and silver investment. American investors have long favoured physical silver investing, preferring coins and bars to convert investment cash. They like the security of owning physical coins and bars versus alternative vehicles such as exchange traded funds and other paper investments. At the heart of it today there is growing concern by investors about potential intervention by government into the physical metals market.

The United States physical investment in silver is dominated by the purchase of one-ounce bullion coins and 100 ounce silver bars. The bars are almost entirely produced by accredited refineries. However with the surge and demand over the past three years a number of other private mints and industrial manufacturers have produced bars to capture a share of the rising market. In terms of the coin market, this is dominated by the production of the US Mint's one-ounce Silver Eagle bullion coin.

A number of other national mints' one-ounce bullion coins have also proved popular in the United States, particularly the Canadian Maple Leaf, although, for example, the Austrian Philharmonic and Australian Kookaburra have each achieved some success with even more limited production. Demand for silver is extremely strong among our customers. Investors are seeking everything from one-ounce coins to 1000 ounce bars and everything in between. We have also observed strong demand in the old 90% silver US coins dated 64 and earlier, and the US silver dollars.

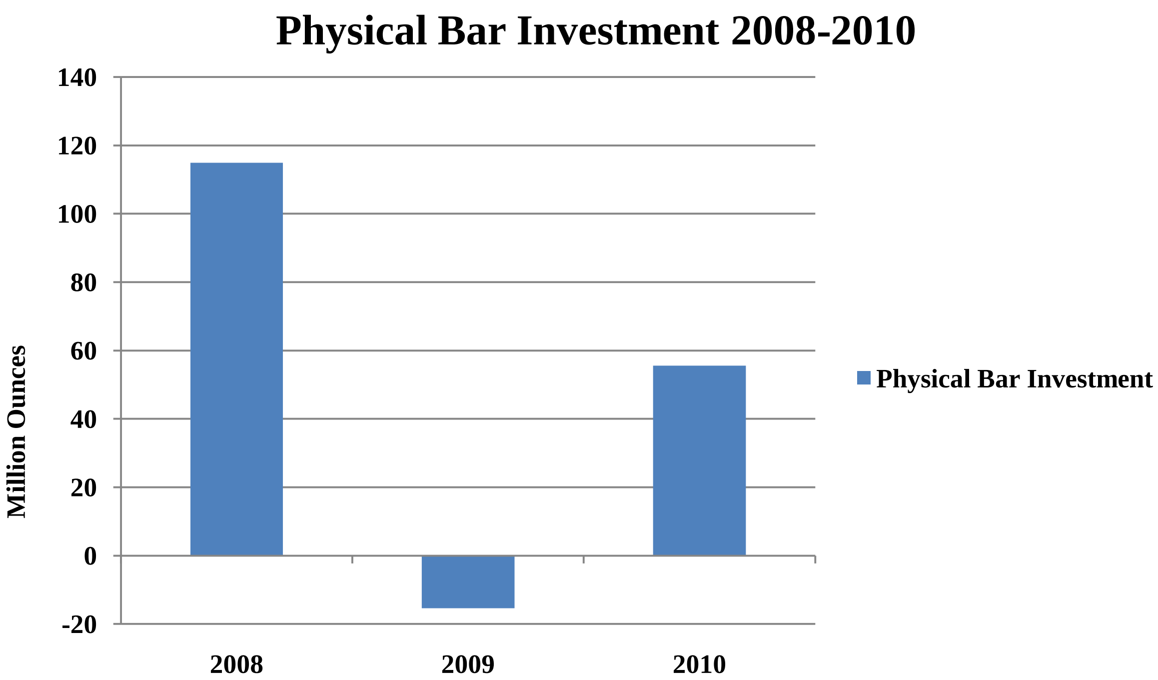
US Mint sales of silver are up to 26% this year over the past year. This increase in demand forced the Mint to continue to allocate their inventory of Silver Eagles to the authorised buyers because availability of blanks is not able to meet demand. We see no relief in sight as the situation has become more pronounced this year. Lack of availability of these key investor products puts a strain on other manufacturers of invested silver as they try to ramp up production to meet worldwide demand.

For instance, the Canadian Silver Maple Leaf, the Austrian Philharmonic and the Australian coins are consistently delayed, along with some other speciality silver mint coins minted by these various mints and other private mints. With demand outpacing supply, we have seen premiums increase both from the mints and the secondary market.

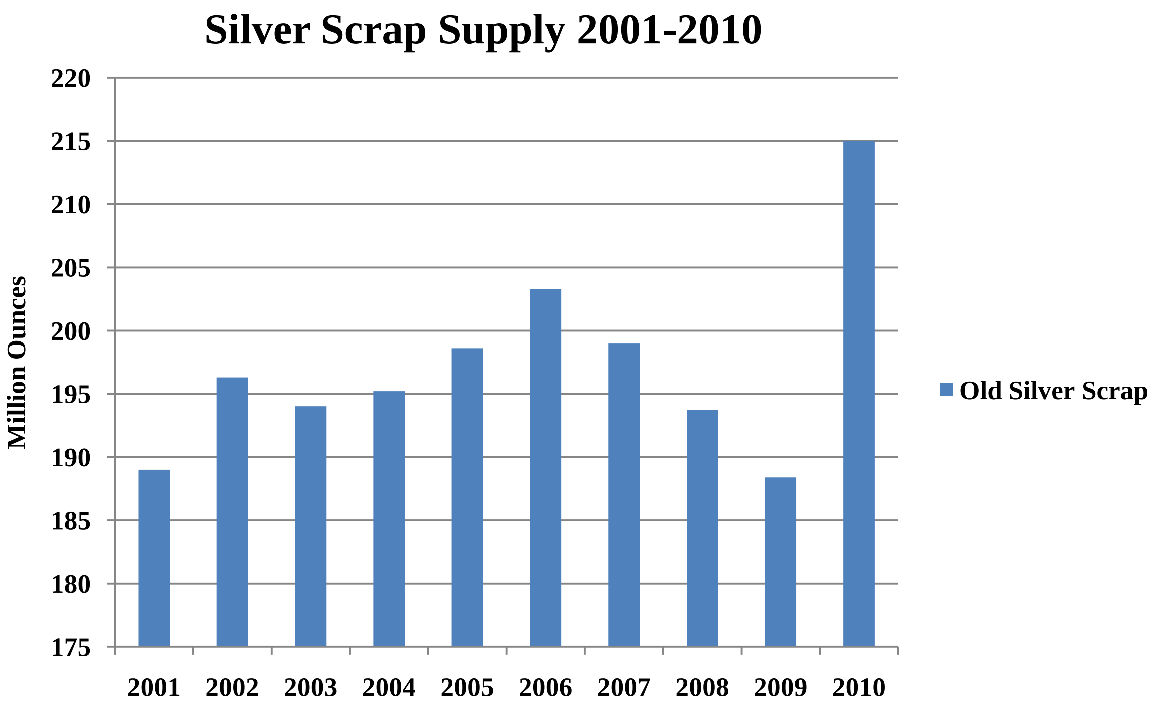
In October 2010 the United States Mint raised its Silver Eagle premium to first line buyers from $1.50 an ounce to $2 an ounce. This was only the second increase in premiums since the inception of the programme in 1986. As for private minting companies within the United States, they are running three shifts daily in an effort to meet demand. However, even with these efforts, delivery of product is still several weeks out.

At these prices, some might expect to see higher than normal volumes of coins and bars going to melt. It has not been the case. Shortages of metal to satisfy investor demand have resulted in just about everything that comes in going right back out. Supply simply is not keeping pace with demand. Private mints are churning out silver rounds to meet demand and it is still not enough. Little is going to melt save for backyard bars of uncertain provenance and damaged coins.

Turning to investments in physical bars, in the immediate three preceding years we can see that it is anything but a consistent story. GFMS's most recent annual report on the global silver market, World Silver Survey 2011, produced for the Silver Institute, shows physical bar investment on a net basis. The financial crisis in 2008 took a toll on the bar market, and also in the following year when margin calls forced the bigger players to the sidelines in liquidation of accounts.



We saw somewhat of a rebound last year with net demand in the US and Western Europe, which was in part offset by bar disinvestment in India. To put the retail bar market in perspective in the United States, sales arguably totalled less than 20 million ounces, which is half the anticipated output this year for the US Mint Silver Eagle Program.



2010 reversed a three year downward trend in scrap supply, rising 14% over the 2009 total, hitting the highest level in 10 years. This gain was attributable to sustained higher prices for silver, which mainly came from increases in industrial scrap and consumers reaping gains from unwanted pieces of jewellery and silverware. It was not the result of silver disinvestment.

Future Prospects

What is ahead? Our view of the market is that we expect demand to remain high for retail silver investments, and will look to see the price possibly push past $50 an ounce later in the fourth quarter. We are optimistic for 2012 as well. From our vantage point we see an expanding market of buyers of coins and small bars. These are investors who are just realising the advantages of a portfolio diversified with precious metals. Beyond them is a larger target market that our industry can cultivate into first time buyers and hopefully long-term investors. To do that, however, will require product, and that has sometimes been in short supply. If our industry is serious about meeting demand, it will need to produce more products in a range of weights to meet the continued demand.

This is obviously an outstanding time to be in our business. The physical trade is brisk, the upside potential is encouraging. I wish you all the best of fortune. The team at Dillon Gage looks forward to the opportunity of working with you.

Thank you very much.