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collector's market watch BY NEIL S. BERMAN

Profits lie in U.S. rare coin investment market

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Consider the following:

• Since 1970 the average value of a common collectible coin increased 6,049 percent. The value of an average collectible coin has gone up and down as dramatically as the U.S. stock market.

• Since 1994 the average value of a common collectible coin increased 32 percent and the average value of a rare collectable coin, 124 percent.

• Since 2001 the average value of a common collectible coin increased 13 percent and a rare collectible coin, 47 percent.

• Since May 1989, while common collectible coins are still trading down 67 percent from their all-time highs, collectible rare coins are already up some 60 percent. It is in this area that opportunities for great profits lie.

The most serious problem that once plagued the coin industry – coin grading – is now past. There had been no reliable means for a non-professional to determine the actual grade of a coin short of the buyer and seller actually looking at it, as grading was a matter of opinion between dealers.

Thus, a number of grading services were founded but coin dealers sometimes owned all or part of a grading service, creating possible conflicts of interest. To deal with this, two new grading services emerged whose owners and employees were prohibited from simultaneously grading coins for a living and trading coins for profit. This created a basic atmosphere in which the public could participate in the coin market with a high degree of confidence.

Examples of U.S. rare coins. © 2008 Professional Coin Grading Service. Beverly Hills. Used with permission.

These changes placed into the market more than 20 million certified coins worth some $25 billion in declared value in 1990 dollars. While there will always be divergent opinions as to what any particular coin may grade, a consensus of highly trained individuals from one or both of the two grading services put these differences of opinion to rest both quickly and reliably. And the process has also lead to the elimination in the certified coin market of counterfeits, deceptive reproductions and coins that have been tampered with.

While common coins have benefited from the grading revolution, it is the real rarities that are the winners. For example, the John Pittman Collection sold in 1997. Pittman's holdings were so large that for this example let's look at just the 21 proof U.S. gold dollars he owned. Pittman bought these between 1947 and 1970, with an average holding time of 39 years. His total cost was $7,710. In December 1997 these coins sold at auction for $534,000, 6,837 percent profit, or 179 percent per year average annual return on capital. Seven years later, these coins bid $1,067,000, almost 200 percent profit since 1997, or 28.5 percent per year for the seven years.

What follows is an unvarnished history of the U.S. rare coin investment market. It is the world's largest, most sophisticated and well-organized collectible market, with as many as 255,000 prices on all U.S. coins in most grades available daily from several sources to some 5,000 professional dealers. According to the United States Mint, there are 130 million coin collectors in the U.S. And if you add the approximately 20 million to 30 million U.S. coin collectors who are not

American, what you have is a market so broad as to dwarf the second largest collectible – U.S. stamps.

The U.S. rare coin market, like virtually all investment markets worldwide, has suffered no shortage of misinformation and hype. Many of those who have purchased coins who are not collectors have done so with little understanding of either the product or its place in the investment arena.

This is a brief history of the market, and while overall it is a history of a strong and coherent market, it is not all pretty. Investors, collectors, financial advisers and dealers who want to serve clients honestly will benefit from knowing what has happened. An investor can take advantage of the tremendous opportunities in rare coins while avoiding many of those past errors.

THE MARKET BEFORE 1972

While there were coin collectors in North America before there was a United States, collectors calling themselves investors does not predate the late 1950s. So more than a half century is long enough to illustrate several boom and bust cycles and the behavior of a market in a variety of economic environments.

Unfortunately, long-term studies of the market are comparatively rare in the world of numismatics. To my knowledge, there are only three. The first was written and published by myself and Hans Schulman in 1986, and then revised by Silvano DiGenova, economist Dr. Jason Perry and me in 2007. The second was compiled under the direct supervision of numismatist John Dannreuther for the Professional Coin Grading Service around 1987 and has been updated yearly since. The last was written by economist Robert A. Brown in 2003.

The primary reason for a lack of resources was the difficulty of uniform pricing information. The definition of what constitutes a gem uncirculated, or MS65 coin, differs markedly today from what it did even 15 years ago. Going back more than 25 years, evidence of the use of the numerical grading system, except for U.S. large cents, is scarce. And if we go back more than 30 years, we find very little distinction between the grading descriptions of uncirculated coins at all, primarily because it had almost no effect on the price of a coin. This brings us to grading uncirculated coins.

To recreate the prices for the various grades of uncirculated coins prior to 1986 is a time-consuming and arduous job attempted by very few. When coins were inexpensive, superb gems might have commanded a small premium, perhaps up to 20 percent by those who cared, but with that said, I could probably name those early dealers and collectors who did care on one hand and have fingers left over. While differences in the qualities of uncirculated coins were noticed by numerous numismatists, the first coin dealer to publicly espouse the purchase of quality in addition to rarity was the legendary numismatist David Akers in 1968. In fact, today's overwhelming focus on a coin quality was simply not present in the coin market in any meaningful way before Akers.

The most serious problem that once plagued the coin industry – coin grading – is now past. There had been no reliable means for a non-professional to determine the actual grade of a coin short of the buyer and seller actually looking at it, as grading was a matter of opinion between dealers.

Further, the very core of the market has changed. From the late 1950s through the mid-1960s, coin investors' interest was focused on uncirculated examples of post-1934 issues traded in roll and even bag quantities, which were not rare then and would never become rare due to huge mintages. Silver coins circulated freely, silver dollars were still available from banks in original bags and private ownership of gold was restricted prior to 1975, so one can appreciate why these bulwarks of today's market were virtually ignored by investors of the day.

What can only be called speculation, and not investing, in uncirculated coin rolls of common coins reached a peak during 1963-64, and then prices collapsed. Events moved rapidly from 1964 to the end of the decade. The coinage crisis of 1964-65, with its attending rise in the price of silver, brought on by the conversion from silver coins to clad or non-silver coins, saw virtually all the silver dimes, quarter dollars and half dollars dated prior to 1965 removed from circulation during the late 1960s as the coins were now worth more as metal. The government released the last silver dollars from its vaults in 1964, with the exception of a few million Carson City dollars sold at premiums in the early 1970s. The redemption of silver certificates for silver coins ended by law in 1968.

With all these events taking place, it's little wonder that truly rare coins took a back seat. It was not until the beginning of the 1970s that attention in the numismatic market returned to the rare coins, which had been so unceremoniously ignored. And it's here we begin our review.

THE EVOLUTION OF U.S. COIN INVESTMENT MARKET

Once circulating coinage ceased to be a viable source of coin-collecting material, new collectors who had taken up the hobby in the 1960s were forced to turn to dealers. Type coins, rare date and territorial gold coins, patterns, colonials and commemorative coins were scrutinized and found to be vastly under-priced. Prices climbed steadily.

The Coin Dealer Newsletter, the industry's standard wholesale pricing reference, began to devote space to type and gold coins. Two columns in the "uncirculated" category appeared, one for basic uncirculated (MS60) coins and the second for choice/gem uncirculated (MS65) coins. Price differences were slight, but it signified the birth of a new generation of collectors – interested in quality, not quantity.

Gold bullion fueled the coin market between 1975 and 1978; the market paused in the mid-1970s. There were few declines; the rate of increase simply slowed. In early 1975 the last restrictions on the American public's right to own bullion-related gold coins were lifted, and suddenly Krugerrands were in favor. The price of gold shot up from $100 to $200, and demand began to grow for U.S. Saint-Gaudens and Liberty $20 gold coins. A $10,000 investment in four sets of 10-piece common date MS65 gold coins increased to $14,569 from 1975 to 1978. The rate of return was 13.36 percent a year.

The nation celebrated its bicentennial with special reverses on the quarter, half and dollar, and the general level of sophistication among collectors continued to grow. A new grade, MS63, appeared, reflecting the increasing scrutiny of the coin-buying public. Some dealers questioned the need for such an "in between" grade, as price spreads between MS60 and MS65 coins were still relatively small. Such would not be the case for long.

GOLD, SILVER RUSH

The second energy crisis brought with it double-digit inflation, and bullion prices went through the roof. From summer 1979 through early 1980, gold soared from roughly $300 to $850 and silver to more than $50 an ounce, a tenfold increase. The buying frenzy sweeping the oil and bullion markets spread to all tangible assets. Prices for rare coins and stamps virtually "added a zero" from mid-1979 to mid-1980. Stocks were out of favor.

In the classic inflationary scenario, too much money chased too few goods. The price of the four sets of common date gold coins stood at $21,301 at the beginning of January 1979. By January 1980 it reached $66,348.

The market peaked in January 1981 with the gold set now valued at $136,867. New England Rare Coin Galleries, then a prominent Boston coin dealership owned by numismatist James Halperin, put together the New England Rare Coin Fund of approximately $350,000 in early 1977 and sold it in March 1980 for more than $2 million.

But there was a dark side. Fly-by-night numismatic investment companies sprouted like dandelions after a spring shower. The majority of the price increases had accrued to the higher-graded (MS65) pieces and virtually all of the promotional activity centered on these specimens. Unfortunately, to the untrained eye, little separated these coveted "gems" from pieces of lesser quality. But the boom of 1979-80 had widened the price spreads between grades from perhaps 50 percent or 100 percent to the 400 percent to 600 percent range. Accurate grading became critical, but many of these "instant advisers" lacked the skill, or desire, to distinguish superior pieces from their slightly inferior cousins.

Third-party grading was available from the American Numismatic Association Certification Service (ANACS) and the International Numismatic Institute (INS). Both services, however, provided only slowly produced non-binding opinions, setting the stage for a major change in the coin industry.

THE MARKET DECLINES

Although bullion prices peaked in mid-January 1981, the rare coin market continued to rally for another three months. Reality knocked at the Central States Show, held April 17-19 in Lincoln, Neb. Tax time had arrived, and many dealers were facing hefty bills. Bullion prices, while still high, continued to fall and suddenly everyone was a seller. Within two years the market dropped by nearly two thirds and lack of liquidity seemed to make matters worse. There were few buyers even at the lower prices. The gold type set fell from $136,867 to $94,109.

By 1983, the general economic recovery that was sweeping the nation had put discretionary funds in the hands of many baby boomers. With memories of the bullion panic still fresh, rare coins held considerable appeal. Silver dollars and gold coins, which had played second fiddle to type coins during the boom of 1979-80, were a particular focus, and bid prices rose substantially for the next three years. Common date silver dollars, which at the beginning of the period were worth around $100, were bid at more than $800 by the end. The gold coin set, having begun in 1983 at some $90,000, soared past its 1981 high and crested close to $220,000 in the fall of 1985. There was a catch. In these years dealers graded the coins they sold. If the buyer, whether a dealer or a collector, agreed with the grade and the price was fair, a sale was likely. Dealers could place bids to buy coins at a specified grade. A transaction took place only if the bidding dealer accepted the proffered coins at the grade.

For example, a dealer might place a bid to buy MS65 Morgan dollars at $350. He could be sent 100 coins, but buy only 10. Ninety could be "rejected" because he did not feel they were MS65s. The following week, he might raise his bid to $375. Again, 100 coins might arrive, equal in overall quality. This time though, he might buy only five, having slightly raised his standard for a coin to qualify as MS65. Wholesale "bid," however, as reported by the Coin Dealer Newsletter, would show a $25 increase. In essence, a dealer could make a self-fulfilling prophecy by promoting an issue, forecasting a price rise, then bidding on that issue himself to raise the price. Very few coins needed to actually trade.

Problems with this system had become obvious by late 1985. "Gradeflation" had eroded the coins' value relative to published bid prices. Most of the coins hadn't really fallen; they just weren't worth the huge prices listed in the sheets.

In 1986 Merrill Lynch offered Hugh Sconners' and Kevin Lipton's $7 million Athena Coin Fund I. Wall Street's involvement in rare coins was looked on with great anticipation by coin dealers. For many dealers, modest transactions with individual collectors and other dealers had been the norm. A "good" customer would spend $25,000 to $50,000 a year; "haggling" and returns were part of the deal.

In early 1986, David Halls Professional Coin Grading Service (PCGS) began operations, followed the next year by John Albanese and Mark Salzburg's Numismatic Guaranty Corp. (NGC). These two grading services differed from anything that had come before, or since. First, the coin grading became reasonably consistent, which eliminated obvious outright incompetence and fraud, and they sealed the graded coins in tamper-evident plastic holders called "slabs." It is impossible to open a slab without destroying it.

Therefore dealers could place "sight-unseen" bids for PCGS and NGC certified coins. While many dealers scoffed at PCGS and NGC, questioning the viability of a "standardized grading system," it replaced totally inconsistent grading.

However, after a glimpse of market acceptance, more grading services appeared. Into the fray, which already had ANACS, INS, PCGS, NGC and NCI (Numismatic Certification Institute), came Hallmark, Compugrade, Photo-Certified Institute and others. All touted grading expertise and the "most conservative standards in the industry." At the same time the electronic bidding network evolved with the American Numismatic Exchange (ANE) providing instant transactions for dealers. ANE chose to report only PCGS coin prices, forcing dealers to subscribe to another service, the Certified Coin Exchange (CCE) to get other certified coin prices. ANE disappeared and CCE became the primary service.

The industry was beginning to show signs of orderliness, but the grading revolution had to survive two near fatal events: the much publicized attempted counterfeiting of PCGS holders and the investigation of PCGS by the Federal Trade Commission (FTC). The counterfeiting was foiled, new safeguards instituted and the FTC found no major deficiencies. This cleared the deck of the coin industry's two largest problems, incompetent or unknowledgeable dealers grading coins and the resultant mail order fraud their grading deficiencies caused.

PCGS and NGC became the dominant of the grading services. If fact, they still are the only grading services used by coin dealers who sell to serious collectors or investors. For the first time there was true liquidity in the market. New rules obligated dealers to buy a minimum quantity of coins at their posted bids. Arbitrarily increasing bid levels now came at a price that many dealers were reluctant to pay. This resulted in a two-year adjustment in bid levels for most coins, as market makers learned to cope with the new rules. By early 1988 minor modifications to the trading rules and an adequate supply of certified coins attracted the attention of several prominent Wall Street investment houses. The stage was set for the decade's second great bull market in coins.

WALL STREET EFFECT

In the competition for business,

many coin dealers became "numismatic investment counselors" and virtually ignored the long-time small collector. The 1988 ANA auction looked like a stockbrokers' convention, with myriad blue suits, white shirts and power ties wandering the bourse floor.

Numismatic Ventures Fund initiated a $15 million fund; Kidder Peabody's World Coin Fund acquired $40 million in its first offering, and its second raised $78 million; Shearson Lehman Hutton was in the headlines touting its intentions of marketing rare coins through its network of 11,000 brokers; Continental Investment Group funded $36 million; and Merrill Lynch entered with the Athena Coin Fund II at $50 million. This was only the phase that began in 1986.

There were constant rumors of other Wall Street firms entering the market. The massive influx of new funds had an intoxicating effect. Prices skyrocketed in virtually all series, with coins graded MS65 and higher enjoying the largest gains.

Asset Services Inc. raised at least three separate L.L.P. funds for $3 million and one for $750,000 in this period. The 10-piece gold portfolio soared to nearly $566,000 by June 1989, more than double its price of a year before. Remember that 14 years earlier the bid price stood at only $10,000. The market took a breather in the fall of 1989, but as the new decade dawned, it appeared to be heading north again. Appearances were deceptive.

LONG BEAR MARKET

The advent of the Gulf War in August 1990 created a 500-point drop in the stock market over a two-week period. Wall Street firms, finding their equities positions drastically lower, abruptly ended their commitments to rare coin funds and became net sellers.

As a result, the 1990 ANA sale was a disaster. Dealers awaiting millions from the funds and partnerships were left abandoned. From August through November 1990 the coin market was in free fall. Stunned dealers dumped their coins; others held their inventories, certain the declines would abate. When they didn't, these dealers discovered the value of their coins had fallen by nearly 50 percent.

Cash was king and no one in the numismatic marketplace had it. By the end of 1990, the free fall had ended, but many of the major market makers had been crippled. Their liquidity was nil and the market value of their inventories was, in most cases, well under their cost, which in many cases was mortgaged to the hilt.

From 1991 to 1994, the market fell steadily. While certainly not the bloodbath of 1990, the declines were unremitting and over the four-year period rare coin values halved again. The gold coin portfolio, which had crested at around $566,000 in mid-1989, and had fallen to $235,000 by the end of 1990, slid to $126,468 by the end of 1994. All was not despair and gloom however. Coins continued to trade, and as they approached "bargain" levels, many collectors began to return to the market. MS65 Morgan dollars at around $100 looked a lot more appealing than they did at $350.

After five years of adjustment, the market reached equilibrium. Demand began to build for coins at their 1995 values, and while not strong enough to bring on another bull market, it was sufficient to halt the declines. 1996 saw continued support at these base levels and the word "recovery" began to appear in newsletters. The overall rare coin market remains near its low point. But as the Eliasberg and Pittman auctions, the purchase of the Trompeter collection and the 1998 ANA show revealed, better grade investment-quality rare coins are being snapped up and prices are steadily increasing.

U.S. COINS – OPPORTUNITIES IN THE YEARS AHEAD

Starting in January 1999, the U.S. Mint introduced the 50 State Quarters® Program, a 10-year celebration of the 50 states. A series of five quarter dollars with new reverses will be issued each year from 1999 through 2008, celebrating each of the states. The coins will be issued in the sequence that the states became part of the United States of America. This program has brought great excitement to the industry with an influx of hundreds of thousands of new and younger collectors.

If just some of these people become seriously interested in collecting rare coins, could a new rare coin boom cycle be far behind?

In 2000, the Capital Coin Fund I raised $25 million and the following year the Capital Coin Fund II raised another $25 million. While these funds profited, to the tune of more than $13 million, they were closed do to alleged malfeasance by the directors. Other funds took their place, including, but not limited to, one in Delaware for more than $25 million and another in New Jersey for $50 million. And still there are others rumored to exist.

In February 2007, the Avarae Global Fund in London raised approximately $12 million to invest in coins. The fund invests solely in global coins and seeks investors looking to diversify their holdings with an "uncorrelated alternative asset" to invest in. Merrill Lynch has taken a 15 percent stake in Avarae Fund on behalf of two of its investment clients. The fund is currently 60 percent invested. A similar fund, the KJC Fund of Australia, claims to have an offering pending, and in May of this year the New York Times reported a hedge fund, The Art Trading Fund, that is trading fine art in the same manner.

One thing is certain when it comes to the rare coin market, the only constant is change. Any move in the price of gold or in the inflation rate, or the long overdue correction in the stock market, or continued interest in the state quarters' program, could move the rare coin market in a big way.

The market is a coiled spring. There is substantial potential for energetic growth. Looking at the trend from the mid-1970s, we see the coin market is where it's supposed to be. We view the risk now as minimal. It does not appear the rare coin market will be headed any lower, and given any external stimulus whatsoever, could easily make a strong upward move.

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Some of the information in this series was provided by the following coin dealers: David Hall, John Albanese, Mark Salzberg, Silvano DiGenovia, Steve Ivy, James Halperin, Jeffery Issac, David Akers, Kevin Lipton, Harvey Stack and Barry Suppler.

Collector's Market Watch is a semi-monthly column. Neil S. Berman of Cross River is an expert numismatist and a dealer in rare coins. Comments and questions may be directed to him at neil@neilsberman.com or on the Web at www.neilsberman.com.