

## PRUDENCE: MANAGING CURRENCY RISK WITH SILVER & GOLD

*Ye shall not afflict any widow, or fatherless child. If thou afflict them in any wise, and they cry at all unto me, I will surely hear their cry; And my wrath shall wax hot, and I will kill you with the sword; and your wives shall be widows, and your children fatherless. -- Exodus 22:22-24*

*ABSTRACT: The US dollar's currency risk has so changed investment conditions that conventional investment wisdom no longer works. In fact, it has become a death trap. Fiduciaries – those charged with managing and protecting others' assets – must recognize and manage currency risk, or lose the assets committed to them by dollar depreciation.*

### WIDOWS & ORPHANS

Not long ago a lady came to me with a problem. Age has incapacitated her husband, who is in a nursing home. It takes most of his and her pension to pay his monthly upkeep, forcing her to live very frugally. When she saw the stock market dropping mid-2008, she very timely ordered the stocks in her husband's small IRA sold. But shortly before her husband became disabled, they had been talked into buying a very expensive annuity. It must have bordered on fraud, because she brought suit against the company and has all but won.

Her question to me was, What should I do with the funds from the annuity?

People like this make me tremble, because of the warning you can read above. Yet angry frustration over this lady's situation, and that of millions like her, makes me want to scream, "Get out of dollars! Get out now! Convert everything to silver and gold!"

Why? *Currency risk* has rendered exactly those investments most highly recommended for widows and orphans a *death trap*. Saddest is, whoever ignores currency risk will lose everything as the dollar dies.

What is recommended for widows and orphans? US Treasury securities or high grade corporate bonds, or annuities, or blue chip stocks. But these all rest on one assumption, namely, that *dollars tomorrow will buy as much as dollars today*.

And that is false. It hasn't been true since 1913.

Any investment that promises to pay back dollars tomorrow for dollars today is a *guaranteed loser*. Since we have moved out of the days of 2 – 4% yearly money creation a year to 20% a year, that truth bites even deeper.

What these recommendations fail to take into account is *currency risk*, *i.e.*, the risk that inflation will rob the currency of its purchasing power.

If you loan a friend \$100 on January 1, and he pays you back \$100 on December 31 *but the dollar has meanwhile lost 10% of its purchasing power*, your December-31-\$100 will only buy what January-1-\$90 bought. The loan cost you ten dollars.

### A NEW MONETARY ERA

When Nixon closed the gold window on 15 August 1971, the world entered a new era: for the first time in history, all the world's monies were unbacked *fiat* currencies, adrift on a sea of floating exchange rates.

At the top of international commerce, managers had always known the dangers of currency risk, but now *every* currency became a soft currency. Little by little recognition of currency risk seeped down the knowledge chain, but on the street of personal financial management, even 40 years later not many have caught on.

Maybe that's because all today's hotshot personal financial managers were eleven years old when the last inflation cycle peaked in 1980. At 21 in 1990 they went to work recommending

stocks (“Buy and hold!”), which advice couldn’t miss in the then-raging bull market. From 2000 until now, they’ve been waiting for stocks to recover.

These folks now have twenty years experience – that is, one year’s experience twenty times. Outside the conventional wisdom they know nothing, but under today’s conditions – a quickly dwindling dollar and stock bear market -- the conventional wisdom has become a death trap. Ignorant or afraid to trust their own judgment, unable to come to the truth, these lemmings are streaming over the cliff, taking widows and orphans along with them.

*It is long past time for fiduciaries for widows and orphans, for churches, for charitable institutions, and of course for businesses, to grapple with currency risk and to manage their assets for maximum protection. Those who refuse to face currency risk will be guilty of betraying their trust.*

## THE FATEFUL QUESTION

If the map is wrong, you’ll never reach your destination. That’s why we always have to keep checking our map -- our fundamental presuppositions. In this case, what if we are all wrong about inflation? What if *deflation* occurs instead? What will that do to our gold and silver investments? Or to dollars?

Be careful to understand the terms. *Inflation* is an increase in the money supply that *generally* causes prices to rise. Prices may also rise because crops fail or demand increases. Point is, rising prices do not *cause* inflation, any more than flat tires cause tacks in the street. Nor is inflation rising prices. Inflation (the increase in the money supply) is the *cause*, rising prices the *effect*. Tacks cause flat tires, flat tires don’t cause tacks.

Likewise, *deflation* is not falling prices, but a decrease in the money supply. Generally it causes prices to fall, as in the Great Depression, but many other forces can cause falling prices. A bursting real estate bubble, for example. A financial panic. Technological advances or bumper crops or too many new factories. But falling prices is *not* deflation.

*This is the one question that you must answer correctly to survive this economic crisis: **Will the outcome be inflation or deflation?***

The answer to that question determines your strategy, because it determines currency risk. Under deflation the dollar’s value would increase; under inflation, the dollar’s value would decrease -- utterly opposite outcomes.

## WHY DEFLATION IS UNLIKELY

Currently a debate rages whether this present depression will be inflationary or deflationary. The main problem with the folks who take the deflationary side of that argument, I believe, is that they have *no calendar*.

Right. They haven’t observed that the year is 2009, not 1934. Since 1934 the entire banking, monetary, financial and economic structure of the United States has changed. Terrorized by an untamable deflation that overwhelmed all 1930s attempts to inflate, the US Establishment has since built institution after institution to deflect deflation before it begins.

- In 1934 banks had a 35% reserve requirement, in gold. Today their reserve requirement, when I last checked (before the Fed stopped publishing M3 money supply statistics), was 75/100 of one percent. That means that for every \$100 deposited in banks, the system can create \$13,333.33 in loans. Hardly deflationary.
- In 1934 there were no automatic circuit breakers to begin inflating at deflation’s first whiff. Now there are social security, food stamps, unemployment insurance, student loans, small business loans, loan-loans, Fannie Mae, Freddie Mac, FMHA and an uncounted host of other government spending programs. If those don’t work, government will send the nation on a crusade to build orbiting toilets for astronauts, or put pants on poor naked cats.

- In 1934 the government hardly took part in the economy. By the end of World War II, economic power had been centralized in Washington. Today government spending (mostly for defense) accounts for over half of US output.

In short, since 1934 the entire US monetary, financial, banking, and economic structure has been transformed from the basement up, all with the goal of *everlasting inflation*.

## WHY INFLATION IS LIKELY

The Federal Reserve system was created as *an engine of inflation*. Oh, as Steve Saville says, they also *manage inflation expectations*. That is, the Fed must keep their inflation from hyperinflation by continually gulling the public. So from time to time circumstances permit them & their captive media to float a deflation *scare*.

This exhausts the list of the Fed's weapons: inflation, and blarney (propaganda). At every crisis, the Fed will roll out these weapons and fire them till the barrels melt, be sure of it.

Moreover, events of the last eighteen months have given us concrete and not theoretical grounds to expect the Fed to inflate further. At every crisis so far, the Fed has inflated. It must: it hath no other weapon

- *Look what the Fed has done.* Since spring of 2008, in bail-outs, buy-outs, sell-outs, *etc.*, the Fed has slammed over \$8 trillion dollars into a roughly \$14 trillion M3 money supply. *Right there is the inflation.* The cause, *inflation*, has already happened, but six to 24 months lapse before it shows in prices, the effect.
- *Look what the US government has done.* The administration has responded to economic crisis with the same spending programs that failed Roosevelt – but they did inflate. The Obama administration has committed itself to inflation – and to war, which is also *very* inflationary.
- *Look who the Fed is.* Fed Chairman Ben Bernanke wrote his doctoral dissertation about the Great Depression, and concluded that the Fed failed because it did not inflate *enough*. In a famous November 2002 speech, “Deflation: Making Sure It Doesn’t Happen Here,” Bernanke addressed outlined all the inflationary methods he would use to fight any deflation. ([www.federalreserve.gov/boarddocs/speeches/2002/20021121/](http://www.federalreserve.gov/boarddocs/speeches/2002/20021121/)) As Europe learned after Hitler published *Mein Kampf*, officials will do what they promise they will do. Bernanke has proven as good as his word.
- *What about commercial banks refusing to lend?* No problem, Mr. Bernanke will simply end-run the banks and buy with newly-printed money direct from the market. He will buy Federal government debt directly, calling it “quantitative easing.” No bank needed for that.
- *Look who the Fed will be.* President Obama recently announced that he would re-appoint Bernanke when his term expires in January. Surely we must assume they agree on one strategy: *more inflation*.
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Reasoning from structure and demonstrated official conduct, only one conclusion seems possible: *much more inflation will come, gutting the dollar's purchasing power.*

Since these government measures will only slow down recovery while they inflate, America will likely suffer a long, drawn-out depression *plus* inflation. Given the unprecedented recklessness of Fed actions so far, even a *hyperinflation* is possible, creating so many new that prices rise 50% a month or more. I am not predicting this, only pointing out that now, for the first time in my life, Fed and Government mismanagement make a US dollar hyperinflation possible.

## FIDUCIARIES AND PRUDENT MEN

A “fiduciary” is a person to whom property or power is entrusted for the benefit of another. Fiduciary duty is what a fiduciary (“trustee”) owes to the property owner to administer faithfully the trust's affairs, and most of all, not to lose the money..

Since lawyers abound and results are not always kind, over the centuries a standard has developed for gauging performance of fiduciary duty, the “prudent man rule.” “The prudent man rule directs trustees ‘to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.’” “Under the prudent man rule, when the governing trust instrument [*is silent*], state law is silent concerning the types of investments permitted. The [fiduciary](#) is required to invest trust assets as a ‘[prudent man](#)’ would invest his own property with the following factors in mind: the needs of beneficiaries, the need to preserve the [estate](#) (or [corpus](#) of the trust) and the amount and regularity of income. The application of these general principles depends on the type of account administered. ... Under the prudent man rule, speculative or risky investments must be avoided.” (www.wikipedia.org, “Prudent Man Rule.” In plain English, he must maximize income and minimize risk.

So much for theory. In *practice*, the prudent man rule means “follow the conventional wisdom.” Do what everybody else does. Play it safe, even if playing it safe won’t bring the greatest return.

#### WHEN CONVENTIONAL WISDOM GOES BAD

But what happens when events render the conventional wisdom dead wrong? What does prudence – true prudence -- demand when you discover something everybody else does not know? What if you are an 18th century surgeon, and have learned that bleeding your patient won’t help him – and might in fact kill him? Do you bleed him anyway, to forestall malpractice suits?

Which does prudence follow, conventional wisdom, or the lonely truth?

#### CURRENCY RISK

Because for so many years the US dollar was *relatively* stable (although steadily depreciating since 1914), the investment of choice for “widows and orphans” was US Treasury bonds or other high-rated corporate bonds.

Are US treasury bonds the best protection against a possible systemic collapse? Do they really offer a safe haven, or are they, in the words of Dr. Franz Pick, “certificates of guaranteed confiscation? Have these safe haven investments now become death traps?

#### A SEA CHANGE

August 15, 1971 ushered in a world-wide monetary sea change. On that day President Nixon “closed the gold window.” Under the 1944 Bretton Woods Agreement, only the US dollar was redeemable for gold, and every other currency’s exchange rate was fixed to the dollar. On 15 August 1971 Nixon announced that the US would no longer redeem paper dollars for gold.

For the first time in history, the entire world was floating on an uncharted sea of paper money. No national currency was redeemable for gold, and no exchange rates were fixed. The long over-valued dollar began to sink, while other currencies rose. Amid ups and downs, the dollar has sunk steadily over the decades.

#### A NEW DECISION MODEL: WHICH CURRENCY?

The era of floating exchange rates forced a new model on every investment decision: *which currency should we use?*

If the currency is stable – if we expect the currency’s purchasing power on December 31 to equal its purchasing power on January 1, we never have to ask this question. But in a world of floating exchange rates, “which currency” become the first and most important question.

Suppose you have \$100 to invest on January 1, and you want it back on December 31 with interest. Further, suppose US dollar deposits are paying 12% interest.

Looks like tall cotton, doesn't it?

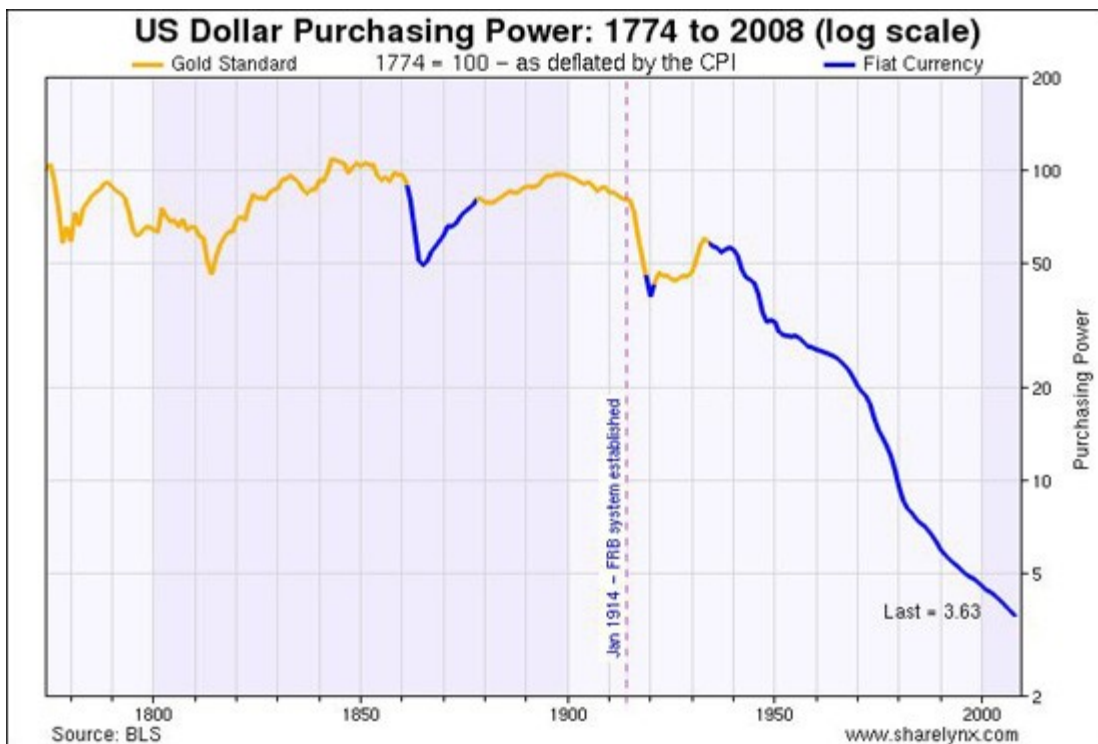
But what about the loss from dollar depreciation? That has to be considered, too, because the future value of any investment equals the interest rate earned plus the principal *but less the expected currency depreciation*.

While a 12% interest rate may sound great, what if the expected dollar depreciation is 15%? Net of dollar depreciation, your gain turns into a loss. Future value equals  $(\$100 \times 12\% \text{ interest} = \$12) + (\$100 \text{ principal}) - (\$100 \times 15\% \text{ depreciation} = \$15)$ .

Your net on 31 December will be  $\$100 + \$12 - \$15$ , or only \$97 in purchasing power. Even high interest rates couldn't overcome the loss from dollar depreciation.

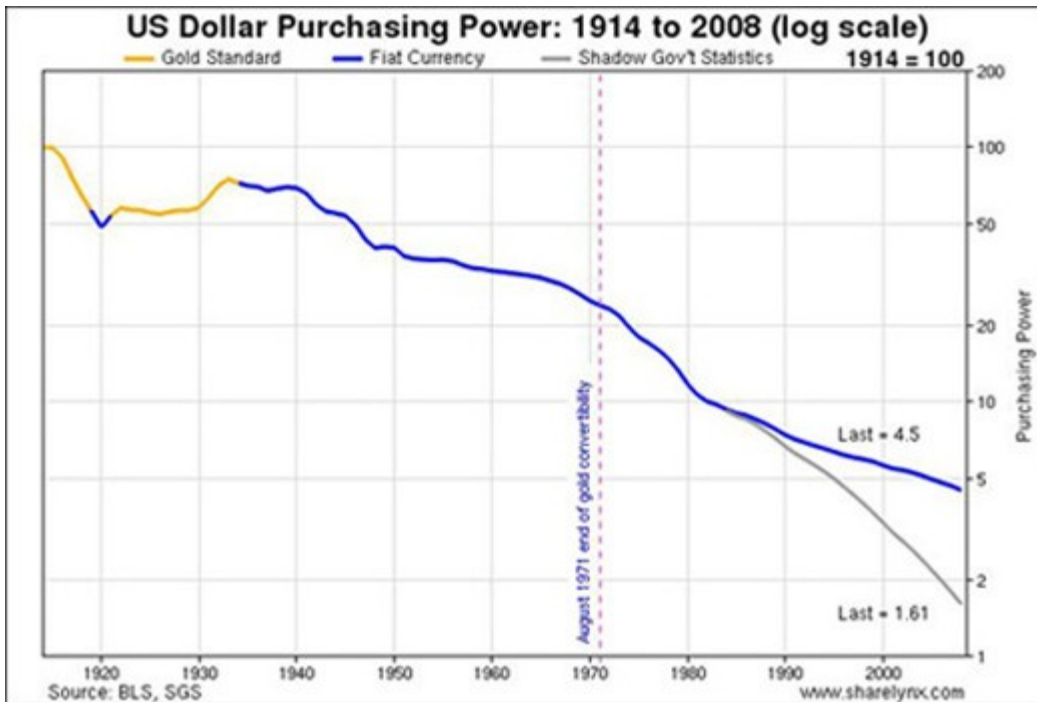
But aren't the Fed's recent money creations only temporary? Won't Bernanke soon withdraw them somehow? As visible proof that the Fed is a *permanent* engine of inflation, I offer these charts from Nick Laird's treasure trove, [www.sharelynx.com](http://www.sharelynx.com). (I strongly recommend you subscribe to his website.)

Look closely at the chart, "US Dollar Purchasing Power: 1774 to 2008." From 1774 to 1914, dollar purchasing power traded between 50 and 100. Only *after* the Federal Reserve was established in January 1914 does the dollar's purchasing power decline below 50, and more sharply since the 1930s, when the government repudiated dollar convertibility into gold. Observe that this chart uses a logarithmic scale, so each tick shows an equal *percentage* distance, not an equal unit distance. (100 units to 200 units is a 100% increase, but so is 5 units to 10 units, so the same distance separates them on the scale. From 5 to 200, however, covers 195 *units*). Source is the US Bureau of Labor Statistics.

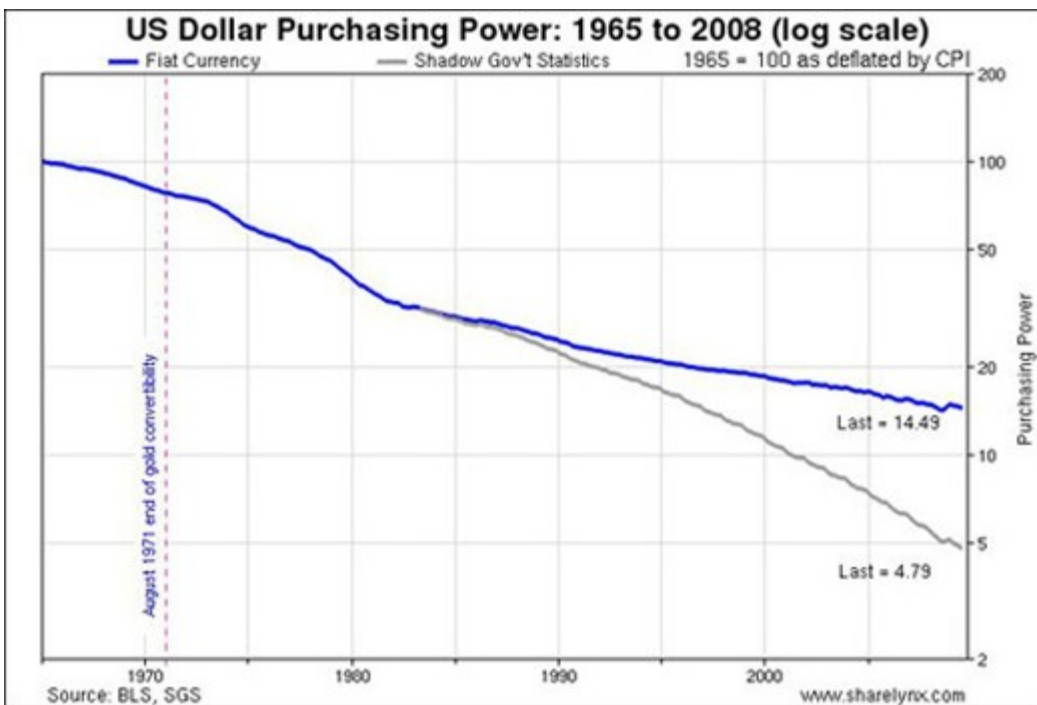


On the next chart "US Dollar Purchasing Power: 1914 to 2008" the chronic, depreciation of the dollar shows plainly. Nick shows data from two sources, the BLS and John Williams' Shadow Government Statistics. Since about 1980 the US government has continually monkeyed with statistics, changing the components to make them look better. Williams' figures take out all those changes and restore the Consumer Price Index series to its original components. Using Williams' figures, from 1914 through 2008 US dollar purchasing power shrank from 100 index

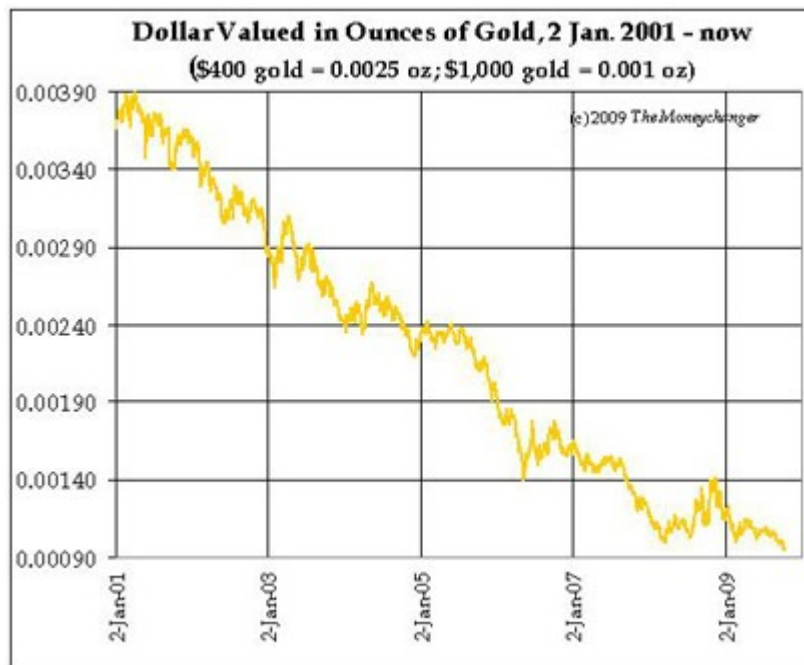
to 1.61, a 98.49% purchasing power loss. Mark how the decline accelerates after Nixon closed the gold window in August 1971.



The last chart from [www.sharelynx.com](http://www.sharelynx.com), “US Dollar Purchasing Power: 1965-2008” shows dollar purchasing power from 1965, when the US abandoned silver. By SGS statistics, 1965-2008 dollar purchasing power declined from 100 to 4.79, a 95.21% loss.



Two other charts, “Dollar Valued in Ounces of Gold, 2 Jan. 2001 – now” and “Dollar Valued in Oz of Silver, 2 Jan. 01 – Now”, clearly depict dollar purchasing power loss since the precious metals’ bull market began.



In 2001, one dollar bought 0.0025 (25 ten thousandths) ounce of gold; today one dollar buys only 0.00095 (9.5 ten thousandths) ounce. Dollar purchasing power has lost 62% against gold.

In 2001, one dollar bought 0.25 (1/4) ounce of silver. Today, a dollar buys 0.05 (five one-hundredths) ounce, an 80% purchasing power loss.

## CHANGING THE NUMERAIRE

The currency we think in is called the “numeraire.” Think of it as the *denominator* in every economic equation. It’s our mental standard of value.

But what happens when the numeraire *lies*? What happens when it loses purchasing power? Then the number dollars we earn every year increases, while we need more and more of them to buy necessities. The numbers say we are richer, but the facts show we are poorer.

When we live against a background of constant central bank inflation – *as every person in the world now does* – we must change our numeraire or remain always blind to value and purchasing power..

*Wait*, it’s hard to abandon the dollar. Prices were fixed in our minds when we were about 15 years old, and we were taught that the “dollar is as good as gold.” Looking at prices today, when a gallon of gas costs more than 10 times what it cost in 1965, we know that the dollar has betrayed us.

We need a new numeraire, a new standard of value.  
If we don’t change with events, events will maul us.

## HISTORY TEACHES

Since 2001 the US DOLLAR INDEX, an index of the dollar’s exchange rate against its major trading partners’ currencies, has fallen from 121 to about 76. That implies the dollar has lost 37% *against the euro, yen, and pound*. This loss only extends the dollar’s primary downward trend since 1913.

What is the greatest risk fiduciaries (and all of us) face today?

*The dollar’s rapid debasement and purchasing power loss.*

Keep funds as dollars, and you maximize risk and minimize income. For the first time in my life, hyperinflation of the US dollar has become a genuine possibility, as insane as that sounds.

What can prudence do? Search out an alternative currency to the dollar, so we can maintain purchasing power of our assets. All the other *fiat* currencies – yen, pound, euro – offer only pale copies of the dollar and perhaps transitory protection, while the hard currencies – silver and gold – have been locked into a primary up trend (“bull market”) since 2001 against *all fiat* currencies.

But what about the fluctuations? The dollar price of metals rises and falls, but this doesn’t constitute an objection to holding them. Turn the fraction upside down. Instead of “gold/dollar”, try “dollar/gold.” In truth an ounce of silver or gold remains an ounce (31.1034 grams), but the dollar fluctuates up and down constantly with every other *fiat* currency. But look: the primary trend of metals’ fluctuation is *upward against the dollar*. This trend should continue until 2014 or 2020.

## FIRST RULE OF INVESTING: FOLLOW THE PRIMARY TREND

The first rule of investing is, *always invest with the primary trend*. That also means, *never invest against the primary trend*.

What is the primary trend? The prevailing trend that carries a market up or down for 15 to 20 years. It’s the investment tide, and you must always launch your boat *with* and not *against* the tide.

For example, after a seventeen year downtrend, the Dow Jones Industrial Average bottomed in August 1982 at 777. From then until January 2000, it rose to 11,722, up 15 times. During that 18 year primary uptrend (bull market), you could hardly make a mistake *as long as you bought stocks*. A rising tide raises all boats.

On the other hand, after a twenty year up trend, from January 1980 until February 2001 gold was locked in a primary *downtrend* (bear market). It sank from US\$850 to US\$252. Buying gold during 1980 – 2001, you were launching your boat *against* the primary downtrend, and you were destined to sink.

Today, the situation has exactly reversed. Stocks and the US dollar are in a primary downtrend, while silver and gold (since 2001) are in a primary uptrend.

For every thing, there is a time and a season.

## THE MYTH OF NEUTRALITY

“Well, everything you say may be true, but I have to do business every day in dollars. I do all my accounting in dollars, so I’ll just stay in dollars.”

There is no neutrality in this world, & no avoiding this decision. Holding US dollars – *deciding not to do anything* -- is also a decision.

## PRACTICAL CONSIDERATIONS

*Transaction costs.* Every time you exchange one currency for another, you incur transaction costs. To move from dollars to physical silver and gold and back to dollars incurs transaction costs of about 7.5%. That means silver & gold must rise 7.5% in dollar terms for you to break even in dollars.

In the short term market fluctuations can be very wide, but over longer time the long-term trend will carry silver and gold up. Thus you should put only long term funds into silver and gold. “Long term funds” means “not to be used for one year or more.”

*What should you buy?* In a bull market, premium always disappears over time. Therefore buy the *lowest cost per ounce* form of silver or gold. Right now, that means US 90% silver coin (dimes, quarters or halves minted before 1965). In gold, buy Mexican 50 pesos or Austrian 100 coronas or Krugerrands. If your dealer doesn’t understand this, get another dealer. *Under no circumstances buy numismatic or collector’s coins, because these will lose premium against gold.* Stay with the basics, the most ounces for the least money.

*Find a trustworthy dealer.* Length of time in business, reliability, understanding, solvency, and business references count more than snazzy Internet presence, price, or a slick sales pitch.

*Where should you store?* Owning physical silver and gold places the safeguarding and storage responsibility directly on you. You can use a bank safe deposit box but better is a concealed, fire-proof safe on your own premises.

*What about precious metals storage services, or the Exchange Traded Funds?* Owning a *claim* to gold and silver isn’t the same thing as holding the physical metal. Do not buy gold or silver ETFs. The only storage service in the entire world I recommend is James Turk’s GoldMoney at [www.goldmoney.com](http://www.goldmoney.com). However, before you buy that, first accumulate physical metal in your own hands.

*Why hold a sterile investment?* Silver and gold are the ultimate cash, and as cash they pay no interest or dividend. In holding them you are waiting for their price to rise. However, by swapping silver for gold and gold for silver you can increase the number of ounces you hold while waiting for the price rise. These trades only take place every three or four years, but they are very lucrative. Except for the brief transit times when you swap, the metals remain in your own hands. For a complete explanation, visit our website, [www.the-moneychanger.com](http://www.the-moneychanger.com), and scroll down the home page to the link, “Why Silver Will Outperform Gold 400%.”

-- F. Sanders

## HYPERINFLATION: POSSIBILITIES & STRATEGIES

*"My father was a lawyer," says Walter Levy, an internationally known German-born oil consultant in New York, "and he had taken out an insurance policy in 1903, and every month he had made the payments faithfully. It was a 20-year policy, and when it came due, he cashed it in and bought a single loaf of bread." The Berlin publisher Leopold Ullstein wrote that an American visitor tipped their cook one dollar. The family convened, and it was decided that a trust fund should be set up in a Berlin bank with the cook as beneficiary, the bank to administer and invest the dollar.*

– **Adam Smith** (George J. W. Goodman), *Paper Money*

In 1989 I visited Nicaragua, gripped by a Sandinista-created hyperinflation. At the airport the government forced us to exchange US\$60. We received an inch and a half thick stack of bills, 20 *cordoba* notes overprinted in heavy black ink, "20,000: 1.2 million *córdobas*."

Over the next two weeks I tried frantically to spend 1.2 million *córdobas*. With beer at 24¢ a bottle, cigarettes US\$1 a pack, tortillas cheaper than playing cards, and the only souvenir a gallon-sized stuffed Central American toad, I couldn't. Our group of 20 went to a fancy restaurant for supper. The restaurant featured a running creek complete with live caymans. We ordered lobster, oysters, and all the trimmings. Our bill came to about 1.5 million *Córdoba's*. We just left 2 million with the balance as a tip.

Many houses had stacks of concrete blocks in the front yard. Curious, I finally asked our guide what those were.

"Nicaraguan savings accounts," he replied without hesitating. "Those people plan to build on to their houses some day, but if they save money it won't buy anything. So whenever they have a little extra money, they buy concrete blocks. They never lose their value."

That's no surprise. In a hyperinflation, prices are rising 50% every month. Even at lesser rates, here's what that means:

- At 10% monthly price inflation, the pound of hamburger that cost \$3.50 on January 1 costs \$10.98 a year later.
- At 20% monthly price inflation, the pound of hamburger that cost \$3.50 on January 1 costs \$31.21 a year later.
- At 50% monthly price inflation, the pound of hamburger that cost \$3.50 on January 1 costs \$454.11 a year later.
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### BUT NEVER IN THE UNITED STATES?

I never forgot what I witnessed in Nicaragua. It has happened all over the world, but when I tell people about it they all say, "That could never happen in the United States!"

That is exactly why a hyperinflation would crush so many Americans. They don't believe it can happen here.

But why *not*? We have exactly the same sort of monetary system, with a money-creating central bank. In fact, hyperinflation that ends by destroying the currency unit is the near-universal fate of *fiat* currencies. People forget that when German suffered hyperinflation 1920-1923, it had one of the world's most highly industrialised economies.

### WHEN A HYPERINFLATION?

In the past 20 years, economic/monetary crises have grown more frequent, and of greater amplitude. When *will hyperinflation come*?

The answer is, nobody knows. Our *fiat* money only has value because the public places confidence in it. Confidence – *faith* – is a human phenomenon, subject to change abruptly, without notice. Why does a whole nation decide suddenly that they love bell bottom pants, when for 40 years they wouldn't touch them?

Confidence in paper money works the same way. At some “tipping point,” the weight of public opinion tips over the edge *against* the dollar and a flight out of the dollar commences. No one can predict that.

Four months ago it cost \$35 to fill up Tojo, our Isuzu Trooper. Without warning, it cost \$50 to slake his thirst. Last Saturday, it cost \$74.85 to top him off. Right now, Tojo has a drinking problem.

Spooked, I reflected that hyperinflations begin in just this way. Under pressure of World War I, German prices tripled from 1914 to 1919. They doubled again in only five months in 1922. From March 1923 the inflation really took off and by November the *Reichsmark* was worth only one-trillionth of its pre-war value.

Certainly, there will be signs on the road to hyperinflation, some of which we are already beginning to see: chronic US balance of payments deficits, chronic government budget deficits, a declining dollar, economic dislocations, world-wide concern about a dropping dollar, reports of the middle class being squeezed economically, suddenly rising commodity prices, and especially, soaring silver and gold prices. *Whoops!* We already have all of those. Problem is, some of these forecast hyperinflation, but most are merely concurrent symptoms.

#### PREPARE: THE FIRST PRINCIPLE OF SELF-PROTECTION

Happily, we are in the midst of a silver & gold bull market, so preparing for a hyperinflation doesn't take us far from the investment strategy we would follow anyway.

To prepare for hyperinflation, you must follow a single principle:

***Dollars will be worth less tomorrow – a lot less.***

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The currency's purchasing power (real value) drops at breathtaking speed, so always owe currency and never own currency. Every dollar you hold is costing you value every day. You must get used to holding funds in an alternative currency, not dollars.

- In other words, *never hold dollars or dollar denominated assets*. That includes bank accounts or deposits, insurance policies, annuities, certificates of deposits, government or corporate bonds, *and pensions*.
- Invest any dollars you received *immediately* in things – inventory or tools and equipment for your business, silver, gold, concrete blocks, anything useful.
- Don't keep dollar balances in banks.
- Once a hyperinflation begins, it should not last more than 12 months, but by the end the unwary and unprepared will have lost all their capital.

To that end, James Turk's GoldMoney.com offers a safe harbour. It's a way to keep cash balances not in US Dollars, but in silver and gold with 48 hour liquidity. See [www.GoldMoney.com](http://www.GoldMoney.com). There are other on-line silver & gold storage programs, but I recommend only GoldMoney for two reasons. First, over nearly 30 years in the silver & gold business, I have seen dozens of storage schemes fail, taking their depositors' money down with them. Second, I know James Turk's integrity and GoldMoney's system of third-party auditors.

As a matter of fact, over the past seven years you would have profited by holding excess cash balances in silver and gold, except in the short term. Short term, dollar price volatility might have made you liquidate at a slight loss, thanks to transaction costs or sudden dips, but over the long term you would have only benefited by holding cash balances in silver or gold because silver & gold were continually gaining value. That state of affairs will continue as long as metals remain in a bull market against the dollar, hyperinflation or not.

Transactions costs to exchange one currency (silver or gold) for another (dollars) is what you must primarily consider. For physical silver & gold, that ranges from 7.5% to 10%. The market must rise 7.5% to 10% for you to break even. In spite of the slightly higher cost, you are better served to take physical delivery of gold and silver, rather than to rely on someone else storing it.

You can pay physical silver or gold directly to sellers as well. Our problem will be working out how much to pay them. That's why long ago Catherine Austen Fitts and I built the website

[www.silverandgoldaremoney.com](http://www.silverandgoldaremoney.com). There you can type in any US dollar amount and instantaneously convert it to silver and gold at current market prices, telling you how much to pay in US 90% silver coin, American Eagle gold coins, and other silver and gold coins and bullion.

## PROTECT YOURSELF AGAINST THESE DANGERS

*Functional currency disappears.* As hyperinflation rapidly erodes the currency's purchasing power, functional currency becomes more and more scarce. *Money disappears*, even for daily business.

*Goods disappear.* As money disappears, *goods disappear*, too. Sellers realize they are better off waiting to sell for higher prices, or refuse to sell for withering currency. Go to your kitchen. Open all the cabinet doors. Count the cans. Open the freezer door and add up all the meat.

Now figure how many days your family would eat if currency and goods disappeared. If the answer is "Seven days or less" you probably ought to buy some long-term storage food.

*Return to barter.* Without currency, people will quickly resort to barter. Never mind that they don't know how to barter *now*, they will learn quickly *then*. Better than barter is *money*, especially *silver money*. US 90% coin is the natural choice here, since it is recognized everywhere and (unlike silver rounds) it is self-authenticating. Fourteen dimes contain an ounce of silver – fourteen separate transactions.

*Moral decline.* Hyperinflations also erode morality. Vultures and hyenas prosper while old lions, deer, and sheep die. Speculation and an "eat, drink, and be merry" mentality takes over. Some will make fortunes, many more will lose them. Crime rates soar and theft explodes, along with police corruption. Political violence becomes common –the Nazi Party staged its first takeover attempt in 1923, at the hyperinflation's height. Nobody will protect your family but yourself.

*Pensions disappear.* Who does a hyperinflation hit hardest? Those on pensions or fixed incomes. Hyperinflation literally makes those pensions worthless.

## ARE STOCKS A HEDGE?

To the extent stocks represent real assets, they operate as a hedge against hyperinflation. However, based on 1920-1923 German experience and other inflations, stocks come nowhere near keeping up with the inflation, much less outperforming precious metals. However, speculation will flourish in stock markets, so resist the temptation.

## CAN YOU OPERATE A BUSINESS?

If you own or run a business, hyperinflation will destroy it quickly unless you make plans to handle it. You sell an item for \$20 and re-order only to find it now costs \$40. Cash management becomes more important than enterprise management. Money must be constantly reinvested in inventory, no credit can be issued, and employees' wages must be secured. Price controls may suddenly put you out of business.

Here's a book that explains how to do business under a hyperinflation: [\*The Hyperinflation Survival Guide: Strategies for American Businesses\*](#) by Gerald Swanson (ISBN: [0974118001](#)). Published more than five years ago and largely ignored, you can find used copies at [www.abebooks.com](http://www.abebooks.com) for \$10 or less. WHAT DOES THIS HAVE TO DO WITH MANAGING CHURCH FUNDS?

Although the Church is the body of Christ with a mission transcending this world, the church must still function in this world. A church is an enterprise that must pay its pastors and workers. More than that, in a hyperinflation the social dislocation and economic hardship would require the church to care for destitute members and strangers.

The question is, can your church continue to carry out its Gospel mission if money dies?

## SUMMARY

Hyperinflation is the inevitable tendency of all *fiat* money systems, so it is always *possible*. The dollar and the US economy are being stretched to the breaking point of confidence.

Is a hyperinflation *likely* within the next two years? Hyperinflations seem to start as comedies of errors, where feckless people make stupid and arrogant mistakes and are unable to change or recognize their errors. Arrogance, bad policies, and wrong theories certainly preside in Washington today. If the wrong chain of events begins, it could explode.

On the other hand, the Establishment that runs the US fears financial catastrophe, and is alert to its danger. Hiring the brightest and best to keep their system working, they have kept it alive and well since 1913. That and inertia are powerful factors for stability. However, given the policies and the cast of characters today big mistakes seem more and more plausible.

Whether hyperinflation or “slow burn” the next 5-10 years of dollar depreciation will cost most Americans all their capital, and with it, their future. Far better to emerge on the far side of monetary madness with your capital intact, ready to build a new and stable economy on the ruins of paper money.

-- F. Sanders

**More reading:** *The classic depiction of a hyperinflation is [Fiat Money Inflation In France](#) by Andrew Dickson White, published by the Foundation for Economic Education. Another interesting but hard to find book is [When Money Dies](#) by Adam Ferguson. A quick read about the 1920 – 1923 German experience is [The Great Inflation](#) by Guttman and Meehan. Schuettinger’s [Forty Centuries of Wage & Price Controls](#) is also helpful. The most thorough technical study of hyperinflationary Germany is Constantino Bresciani-Turroni’s [Economics of Inflation](#). Most of these you can find on [www.abebooks.com](http://www.abebooks.com).*

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## **WHY SILVER WILL OUTPERFORM GOLD 400% & HOW YOU CAN JOIN THE PARTY**

By Franklin Sanders  
© 2006, *The Moneychanger*  
[www.the-moneychanger.com](http://www.the-moneychanger.com)

*Abstract: Over the course of the present bull market in silver and gold, probably another 10 years, silver should rise about four times as fast as gold. That forecast arises from silver's historic performance, especially during the 20th century, as well as its present fundamentals. The best way to profit from that trend is to swap back and forth from silver to gold with the rise and fall in the gold/silver ratio. That strategy will convert a sterile investment into one that pays dividends, and possibly double the ounces you own over the life of the bull market.*

### **GOLD vs. SILVER**

*Alas*, poor silver is the Rodney Dangerfield of precious metals – *it can't get no respect*. It certainly should merit respect, since its 20th century performance has far outpaced gold. Its volatility and superior fundamentals ought to make it much more attractive than gold.

The fact is, gold bugs (with their blind, monomaniacal devotion to gold) miss the point. They are so ideologically wedded to the yellow metal that they overlook both history and facts. It is not a monometallic gold standard that history overwhelmingly demonstrates, but bimetallism. Shortly after I wrote *Silver Bonanza* for Jim Blanchard in 1993 but before it had been published, Jim teased this gem out of Nobel Laureate economist Milton Friedman: “The major monetary metal in history is silver, not gold.” (I remember it well because the statement struck Jim so strongly that he had it printed up on a sticker and inserted it on the flyleaf of the original 8-1/2 by 11 version.) Friedman was right, of course. For most of mankind throughout most of history, silver has been the much more important monetary metal, familiar as the metal of daily commerce. Gold was used only for very, very large payments, which most people make only rarely, if ever.

Both silver and gold are monetary metals, *i.e.*, they both benefit from monetary demand. (Monetary demand is also called “investment” demand. It is demand for silver *as silver*, and as an ingredient making something.) Most analysts miss silver's monetary demand because they focus on silver's use in industry. Certainly, since silver was *politically* demonetized beginning in the mid 1870s a vast amount of purely monetary demand disappeared. Today, most silver is used in fabrication, roughly split three ways among silverware and jewellery, photographic, and other industrial uses. But when confidence in central bank issued *fiat* money begins to fade, when fear strikes investors' hearts, they run not only to gold, but also to silver. Especially in America.

That demand profile makes monetary demand for silver *more* important, not less. Why? Because all of that monetary demand hits silver *at the margin*. Fundamental demand changes only slowly, but monetary demand comes out of nowhere, adding huge, insistent demand for silver *at the margin*. Because the silver market is so much smaller than the gold market, a new

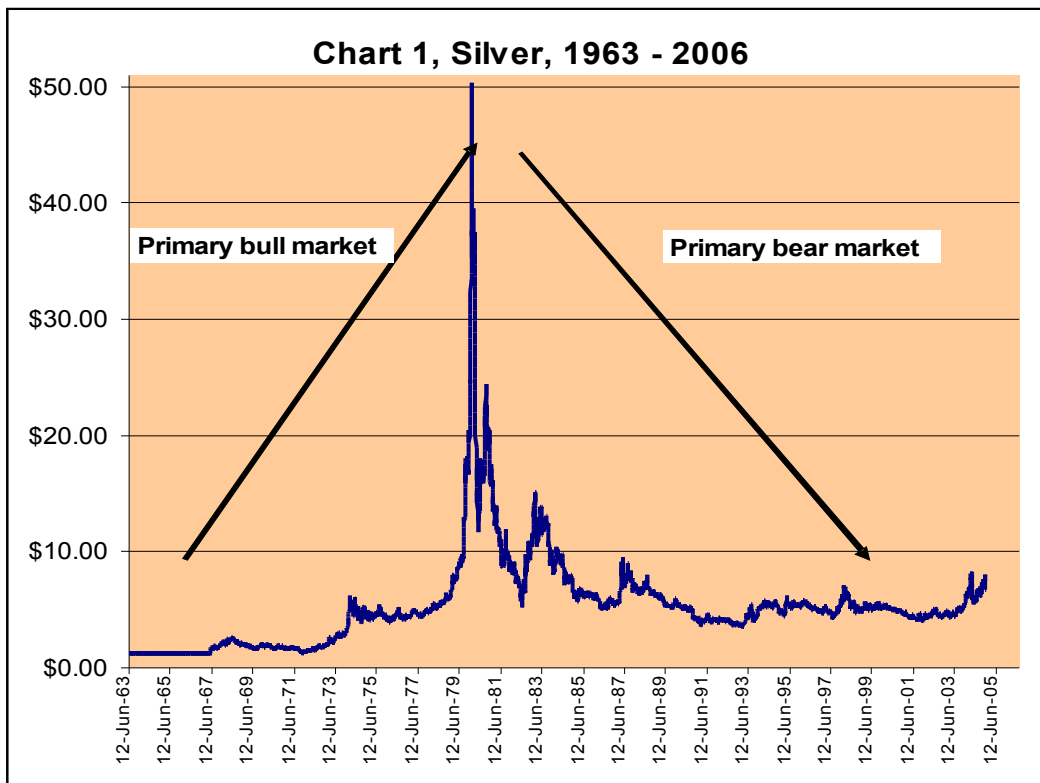
dollar invested in silver also has a much greater affect on the price. That makes silver more volatile than gold, which wears on your nerves but swells your profits.

Be advised, I am not arguing for investing in silver *only*, but rather for a more subtle strategy. I want to show you a way to invest in BOTH metals, swapping them back and forth at the appropriate time, possibly *doubling* your return over the life of the bull market, which is probably another 9 – 10 years.

When I began musing over this article, the gold/silver ratio was hovering around 60 (it took 60 ounces of silver to buy one ounce of gold). By the end of this bull move, I expect that ratio to drop to 16:1 (16 ounces of silver will buy one ounce of silver). In the meantime, the ratio will zig and zag, and we'll take advantage of those moves, too, by trading the ratio.

### THE ONE GREAT SECRET OF INVESTING

There is one Great Secret of Investing that you must not ignore: *always invest with the primary trend*. Look at Chart 1, **SILVER, 1963 – 2006**. It offers a good picture of a primary uptrend (“bull market”) and a primary downtrend (“bear market”).



What is the primary trend? Like the tide in the ocean, the primary trend is the long term -- 10 to 20 year -- move where the *general* trend is up or down. Just as you wouldn't want to try to

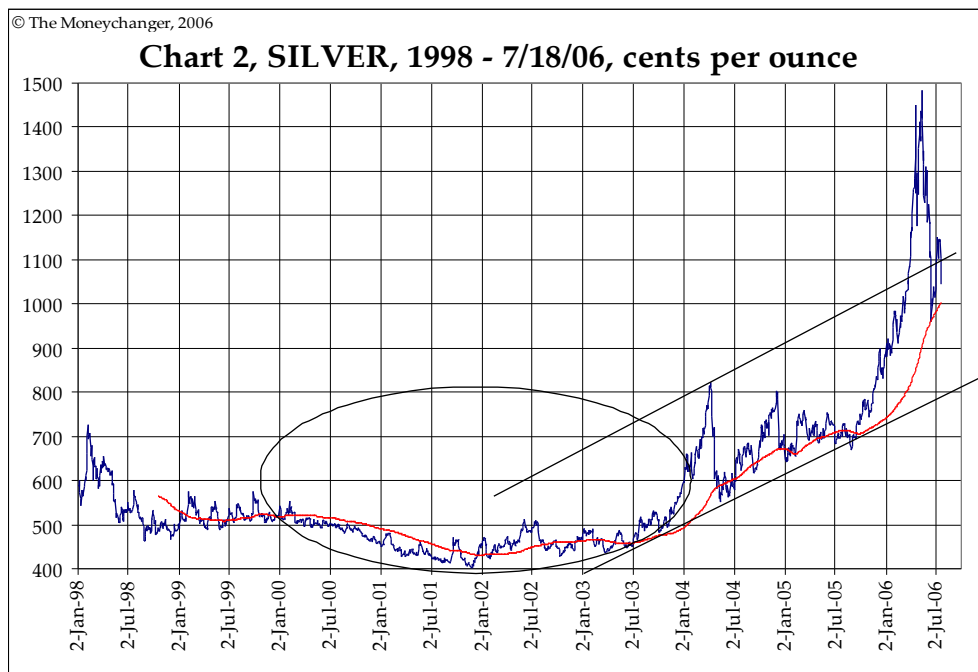
launch your boat *against* the tide, you never want to launch your investment boat against the primary trend. Within that trend, like waves on the tide, are zigs and zags up and down. We can also ride these waves to profits, but must be much more careful with them since they move so much faster. Our strategy keeps your money invested with the tide, but takes advantage of waves on the tide as well.

Stocks' primary trend turned *up* in 1982. Without exercising a great deal of discriminating brain power, you could have bought almost any stock in 1982 and made huge profits by 2000. How could you have helped it? Measured by the Dow Jones Industrial Average, stocks rose 12,000% over that 18 years. A rising tide lifts all boats, even the garbage scows.

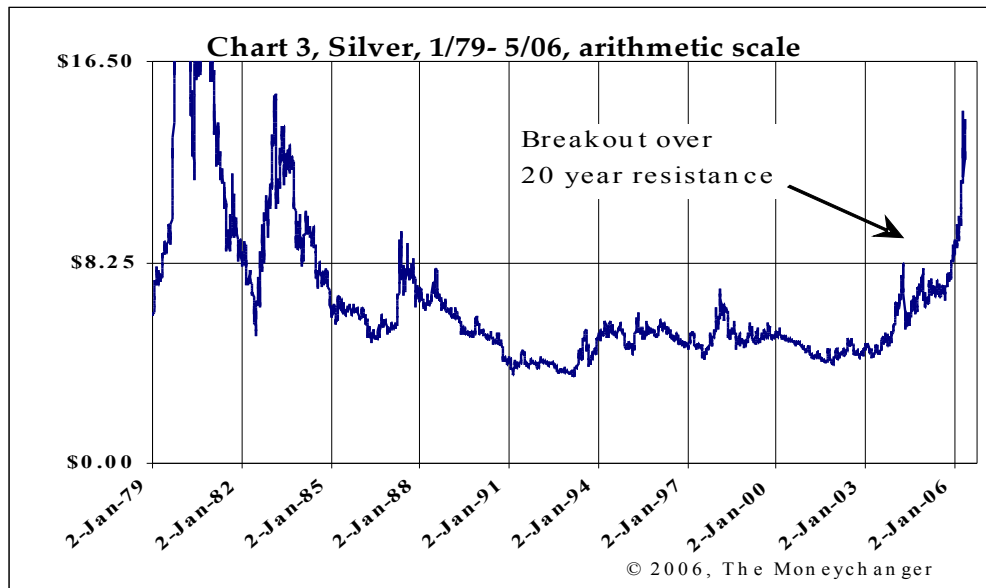
Likewise, it makes no sense to buy stocks now. A primary downtrend ("bear market") commenced in 2000, and it must work itself all the way to exhaustion. That process will take from 10 to 15 years, and not even the almighty Federal reserve creating tidal waves of money out of thin air will keep the stock market up. The rule of thumb says that a bear market will give up 50% to 95% of the foregoing bull market rise. Do the math, and you will come to a Dow target of roughly 6,000 to 1,250. Do you really want to buy stocks now, and hang around for Dow 6,000? Or Dow 1,250?

### IS SILVER IN A PRIMARY UPTREND?

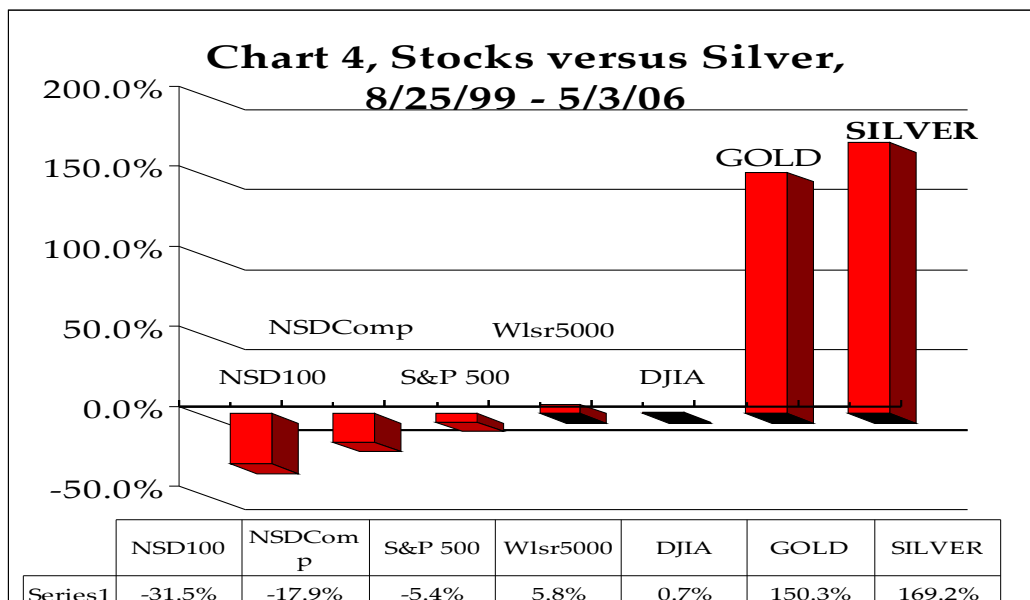
First we have to answer this question: Is silver in primary uptrend? Let's look at the charts. Chart 2, **Silver, 1998 – now, cents per ounce**, shows a very long, rounding bottom. This formation is typical of bear market bottoms, and very reliable. Not only did silver emerge from that rounding bottom in an uptrend, it has also now burst through the top of that uptrend.



Now look at Chart 3, **Silver, January 1979 – June 2004, arithmetic scale**. Again, notice the long rounding formation beneath \$8.25 resistance. For about 20 years that \$8.25 resistance turned silver back time and again. You can see that in April, 2004, when silver first touched that line, it fell back back, correct and then challenged \$8.25 again. When it finally broke through \$8.25, it ran away to the next resistance at \$15.00.



Comparing silver’s performance to stocks’ over the last 6-1/2 years offers us another witness that silver is in a primary uptrend. Chart 4 shows **Stocks versus Silver, 8/25/99 – 5/3/06**. The little flat pancakes (and drooping slag-sickle) on the left show how various stock indices have performed. The towering stacks on the right depict the performance of silver & gold. While stock indices have dropped by as much as a third, or done nothing at all, gold has risen 150.3% and *silver has risen 169.2%* (2.69 times where it began).



Lest I be accused of bias, let's see how silver and gold have performed against some other investments. Look at Chart 5, **Investment performance as of 30 April 2006**. Only the HUI, the unhedged gold stock index, has outperformed silver in the last one, three, or five years. What about the Dow, the S&P 500, and the US Dollar Index? Silver has left them in the dust.

<b>Chart 5, Investment performance as of 30 April 2006</b>							
		<i>% change</i>		<i>Annualized % change</i>			
	<b>4/30/06</b>	<i>Month</i>	<i>YTD</i>	<b>1 year</b>	<b>3 years</b>	<b>5 year</b>	<b>10 year</b>
Dow	11,367.14	2.3%	6.1%	11.5%	10.3%	1.2%	7.4%
S&P 500	1,310.61	1.2%	5.0%	13.3%	12.7%	1.0%	7.2%
HUI	378.79	12.6%	36.8%	112.8%	44.8%	46.5%	n/a
XAU	158.11	11.6%	23.5%	89.3%	34.3%	23.5%	1.0%
US \$ Index	86.11	-4.0%	-5.6%	2.0%	-4.0%	-5.8%	-0.2%
CRB	379.53	4.9%	9.1%	25.0%	17.7%	12.1%	4.0%
Gold	\$ 644.00	10.7%	25.5%	47.8%	24.1%	19.6%	5.1%
Palladium	\$ 364.00	9.6%	42.8%	83.8%	32.6%	-12.0%	10.7%
Platinum	\$1,145.00	6.4%	18.7%	32.1%	23.8%	14.0%	11.1%
<b>Silver</b>	<b>\$ 13.38</b>	<b>16.1%</b>	<b>50.2%</b>	<b>93.2%</b>	<b>42.3%</b>	<b>25.1%</b>	<b>9.7%</b>

## HISTORICAL OUTPERFORMANCE

If I had a chart 45 feet long on which every foot represented 100 years of human history, the gold/silver ratio would remain under 16:1 for all but the last 15 inches. In fact, for the first 40 feet (until about 1500) the ratio oscillated *under* 12:1, and spent most of its time between 8:1 and 12:1. Only after the discovery of huge silver deposits in the Americas does the ratio begin to climb above 12:1. I can only speculate about the reasons for the ratio's relative stability. Probably it arises from the relative ratio of silver to gold in the earth's crust, which geologists estimate at 17.5:1.<sup>111</sup>

## BIMETALLISM & ALL THAT HOGWASH

Reading the standard economics and history texts you would think that bimetallism led the 19th century into a riot of monetary confusion, but that is hogwash. It wasn't bimetallism, but state action that caused the problem. Rather than following the market ratio (as the US monetary system was designed to do) England and France set their official mint ratios at different levels, so whichever metal was temporarily cheaper in one country would drain out to the other country. This chronic misevaluation tended to drive out of circulation the more under-valued metal – generally silver. After about 1815 the ratio began to fall (silver gained value against gold). Though small by today's standard, that drop sped up in the 1830s and 1840s as huge new gold deposits were discovered in Carolina, Australia, and California. The price of silver in gold dollars (\$1.00 in gold = 0.048375 troy ounce) rose from \$1.29 in 1848 to 1.35 by 1857<sup>11</sup> (the ratio *fell* because it took fewer ounces of silver to buy an ounce of gold). Silver's rising price forced the US to make its fractional coin (half dimes, dimes, quarters, halves) *subsidiary*. Since silver bought more gold as bullion than at its face value, speculators were melting the small silver coin. Dollar coins had already disappeared. Congress reduced the silver content of the fractional coin by 6.5% (from 0.7734 ounce per dollar to 0.7234 ounce) just to keep small coin from disappearing.

So the cause of the bimetallic problems was not a rising supply of silver from the Comstock Lode (the red herring usually trotted out), but a rising supply of new gold. More disruptive than that, however, was the policy of setting official mint ratios *politically* rather than following market determined prices. After the US demonetized silver in 1873, followed shortly by Germany and other nations, the ratio of course rose. The loss of monetary demand for silver sharply reduced overall demand, and therefore price, although silver didn't fall as quickly as you might expect.

Chart 6, **Gold/silver ratio 1792 – 2005, yearly averages**, shows how the ratio behaved during two centuries. What interests us most as we try to devise an investment strategy is the pattern. The ratio trades in a *range*, with tops at 100:1 separated by 50 years, and bottoms at 16:1 *or lower* in 1919, 1968, and 1980.



From this chart we can draw tentative conclusions about the ratio's behaviour. (I say "tentative" because nothing is sure in markets until *after* it has happened.) In bull markets, silver always *outperforms* gold; in bear markets, silver always *underperforms* gold.<sup>[1]</sup>

A closer look at price action refines our perspective. Look at Chart 7, **Gold/Silver Ratio daily, 6/1963 – 5/2006**. In the five year bear phase of the market from 1968 to 1973, the ratio rose from 13.76 to 46.96. However, in the following seven year bull phase the ratio returned to 14.91 at the very top of the metals bull market in January, 1980. In the following bear market, for eleven years the ratio rose to 99.81 in 1991 as money drained out of silver and gold. From there it turned down and has steadily fallen.

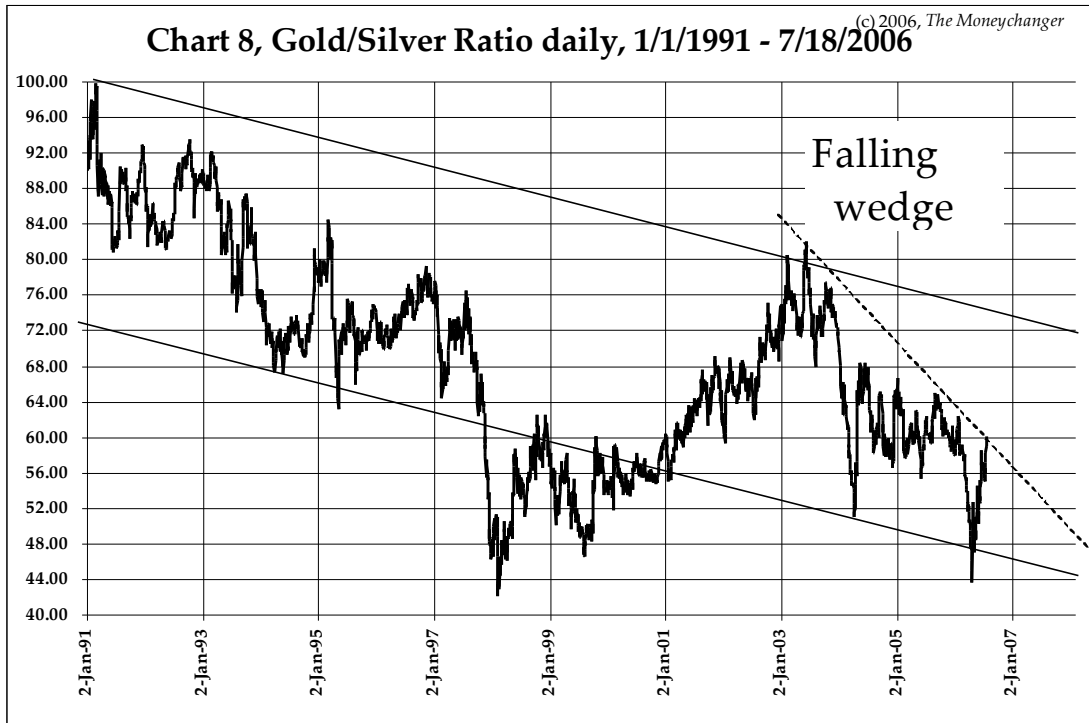


For a closer, more recent view, look at Chart 8, **Gold/Silver Ratio daily, 1/1/1991 – 5/6/2006**. Today's chart shows a falling wedge pattern, that usually resolves in a breakout to the *upside*. That implies that after the recent fall to 43.6, the ratio should spend a long time rising to the *upper* side of the trading channel. (In fact, that's what it has indeed done, through July 2006.)

**Our swapping strategy takes advantage of the ratio's moves from the top to the bottom of this trading channel. Near the channel's top, where silver is cheap in terms of gold, we swap gold into silver. Near the channel's bottom, where gold is cheap in terms of silver, we swap silver into gold.**

From Chart 7 you can tell that the upper line of the trading channel has moved outward. When the ratio first began declining from its 1991 peak, it declined at a steeper rate. Because that top channel line lay lower down on a steeper angle, we began making trades out of gold into silver at

60:1, and continued all the way up to 82. That proved to be the uppermost extent of the move, and enabled us to draw a new upper channel line for the downtrend. Now glance at Chart 9, **Gold/Silver Ratio daily, 1 June '00 – 3 May '06**. The ratio plunged fairly quickly to 51, and I made a big mistake. Not realising how many hedge funds had put on the long silver/short gold ratio trade, I was waiting for the logical target, 50:1, to swap silver for gold.



However, all the big players bailed out at 51. the ratio turned around on a dime and never looked back, so we missed our silver-to-gold trade in 2004.



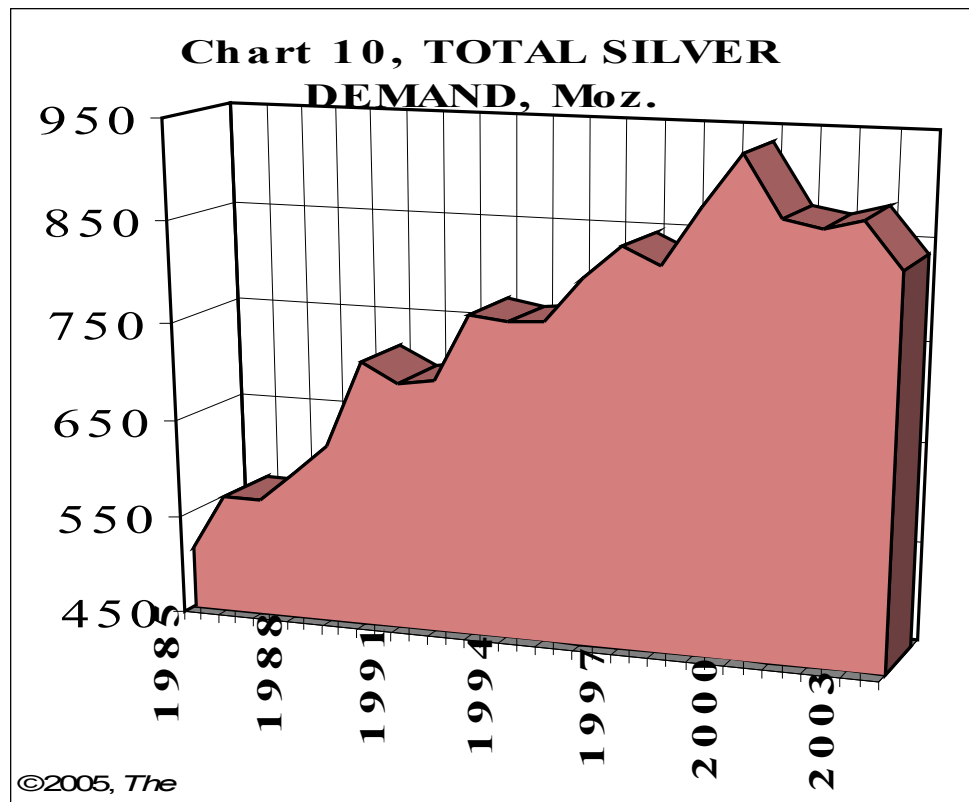
A long sideways correction followed, from April 2004 through August 2005, ending at 64.93:1. I was targeting 43 or 40 to 1 for the bottom of the next move, but my friend Bob Ladone (see his article, "Ode to Beauty," in the January 2006 *Moneychanger*) made such a persuasive argument for 46:1 that I moved my target there. As it turned out, we had only four (4) days to make the trade at 46:1 or better, and wouldn't have gotten to do them if we had waited for 43.

### SILVER SET TO OUTPERFORM, AND ALREADY OUTPERFORMING

Silver will always show greater volatility – the violence and size of moves and their sudden reversals -- because it is so much smaller market than gold.

In the teeth of the common wisdom that there's plenty of silver available, there is far less silver aboveground and ready to come to market than there is gold. According to Gold Fields Mineral Services in Dec. 2005, Central Banks claim 29,000 tonnes gold reserves, about 935 million ounces ("moz"). Call that "ready to come to market" stocks.

My guess is that that at most there is about 900 moz aboveground, ready-to-come-to-market silver stocks, or about same as supply of gold. (Others whose opinions I respect estimate as little as 300 moz.) Valued at the 3 May 2006 market (665.90 & 13.704), the gold was worth about \$622.3 billion, the silver only about \$12.3 billion, or about 2% of the gold. Therefore only a small amount of money flowing into silver has a huge



impact. A billion dollars flowing into gold would raise the price of an ounce only about 90 cents or about 1/10 of one percent. The same billion bucks flowing into silver would raise the price 90 cents an ounce, but that amounts to 6.5% of the current price.

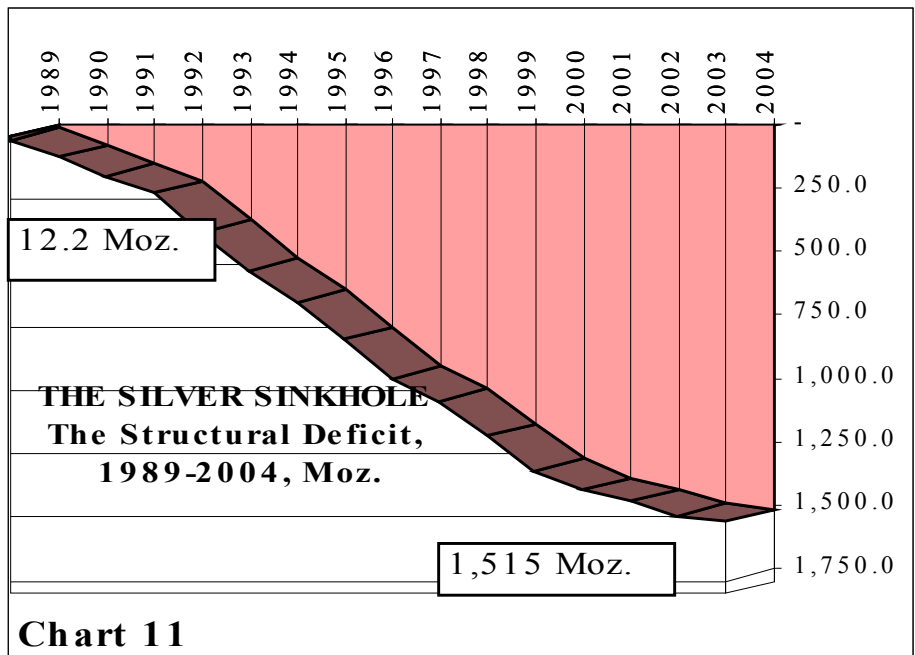
**NOT FUNDAMENTAL BUT MONETARY DEMAND**

As I pointed out before, it is not fundamental but monetary demand that drives silver and gold prices. *Keep that point in mind and never forget it. It is monetary (or investment) demand that drives both silver and gold, not fundamental.*

Fundamental demand only needs to be neutral or favourable to silver, and not negative, *because it only changes slowly*. In other words, we don't want to see any big silver surpluses or hoards overhanging the market, as Indian silver and the US silver hoard did in the 1960s and 1970s. Neither of those is a problem any longer.

Monetary demand really drives silver's price crazy because it hits at margin as incremental demand, & changes *very quickly* -- so suddenly that supply has no time to adjust, so only the price can adjust – upwards. (It takes 5 – 10 years to bring a new silver mine into production.)

At present we have all those conditions. **Total Silver Demand** (chart 10) runs around 800 million ounces yearly, and is not dropping. Moreover, since 1989 silver has been in structural deficit (“more silver consumed than produced”), as chart 11, **The Silver Sinkhole**, plainly shows. Over those 16 years the yearly shortfall has averaged 12% of consumption. By now that shortfall has consumed some 1.5 **Billion** ounces, far and away enough to



consume the surplus brought to market during the 1980s. We know that monetary demand has already hit, because of silver's performance in the last couple of years. Refer back to Chart 5, **Investment performance**.

## JOINING THE PARTY – OUR INVESTMENT STRATEGY

If silver is going to rise faster than gold, then we want to own more silver than gold. If the Gold/Silver ratio (the price of gold in terms of silver) rises and falls within an overarching downward trend, we can also use that to our advantage.

Our goal is (1) to own and hold *physical* (not paper) silver & gold throughout the bull market and (2) to increase the number of ounces we hold while we wait for prices to rise. Our tool is *arbitrage*.

Arbitrage is “the simultaneous purchase and selling of an asset in order to profit from a differential in the price.” Usually it involves buying in one market and selling in another to take advantage of price discrepancies. (Actually, we are doing exactly what the arbitrageurs did in the 19<sup>th</sup> century when they shipped silver from England to France to take advantage of its higher gold price there.) We either trade from gold to silver, or from silver to gold. I admit, arbitrage is, strictly speaking, simultaneous, but we trade from gold to silver and silver to gold *over time* based on the primary trend. (Remember trading from top to bottom in the ratio trading channel?)

- When silver is relatively cheap to gold (ratio is relatively high), we buy silver with gold
- When gold is relatively cheap to silver (relatively low), we buy gold with silver.

### Chart 12, REALISED SWAPS FROM GOLD TO SILVER

<b>Trade No. 1</b>	<b>GOLD</b>	<b>Ratio</b>	<b>SILVER</b>
Began 2003	(78.0312)oz	63	(4,915.97)oz
Ended 2006	<u>100.0000oz</u>	49.16	4,916.00 oz
	<b>21.9688oz. gain =</b>	<b>-28%</b>	

<b>Trade No. 2</b>	<b>GOLD</b>	<b>Ratio</b>	<b>SILVER</b>
Began 2003	(20.0000)oz	73.28	(1,465.60)oz
Ended 2006	<u>27.6316oz</u>	52.47	1,449.83 oz
	<b>7.6316oz. gain =</b>	<b>-38%</b>	

<b>Trade No. 3</b>	<b>GOLD</b>	<b>Ratio</b>	<b>SILVER</b>
Began 2/03	(561.0000)oz	70.52	39,562.88 oz
Began 4/04	(500.0000)oz	63.9	(31,949.78)oz
Ended 2006	<u>1,559.2354 oz</u>	46.77	72,930.00 oz
	<b>498.2354oz. gain =</b>	<b>-47%</b>	

On Chart 8 **Gold/Silver Ratio daily, 1/1/1991 – 7/18/2006** look at the trading channel. We trade gold for silver toward the top of channel, and silver for gold at the bottom.

## THE TEST

Does it work? As always, the proof is in the pudding. In Chart 12, **Realised Swaps from Gold to Silver**, you will see some actual swaps that we executed. They include all expenses *except* taxes. What taxes you pay depends on too many variables for me to predict. In fact, if you sold gold or silver you had bought at higher prices, you would actually have a capital loss on your trade-in. If you pay taxes, they will range from 10% to 28% *of the gain*. However, don't take my word for it, but see your tax expert.

In these three actual trades we averaged gains from 28% to 47%. The first half of these trades (swapped from gold into silver) was done two to three years ago, so some patience is needed with this strategy. Observe that the strategy works for large investors or small.

**Our goal is to convert a sterile investment – silver or gold – that throws off no dividend or interest into a paying investment. While we are waiting for the price to rise, we make that sterile investment fertile by swapping back and forth from silver to gold to increase the total number of ounces we hold at the bull market's end.**

## GOLD/SILVER RATIO SWAPPING STRATEGY

Here's my strategy in a nutshell:

- We always own & hold precious metals, for the duration of bull market.
- We swap gold for silver or silver for gold when the price is right, to increase the total number of ounces we hold.
- *Worst risk:* we swap too soon, and end up holding gold instead of silver when the ratio reaches its low at 16:1.
- *Another refinement:* As silver market offers opportunity, we swap from one form of silver to another, increasing the number of ounces we hold. (From 25 years experience in the silver and gold market, I know one thing is true: "Premium always disappears." Therefore whenever any form of silver or gold develops a large

premium over its metal content, I'm going to swap that off for something cheaper to increase the number of ounces I hold.)

- Goal: To end the bull market holding mostly silver (70% or more), because it will rise faster.
- Goal: To double the number of ounces we hold over life of the bull market.

So far, so good.

F. Sanders  
18 July a.d. 2006

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❏ I find that 1968 bottom very curious. The US government probably precipitated that bottom. In a silver bull market the government was trying to escape its obligation to redeem silver certificates for physical silver. In 1967 Congress decreed that silver certificate holders had only one year to cash in their certificates for silver. That loosed a feverish speculation in silver certificates and silver. The ratio bottomed at 13.76 on 11 June 1968, just ten days before silver certificate redeemability expired.

❏ James U. Blanchard III & Franklin Sanders, *Silver Bonanza: How to Profit from the Coming Bull Market*. Jefferson, Louisiana: Jefferson Financial, Inc., 1993.

❏ American Geological Institute Data Sheets for Geology in the Field, Laboratory, and Office, Third Edition, Data Sheet 57.1, "Abundance of Elements," on average the naturally occurring ratio is 17.5:1.