140 YEARS OF SILVER VOLATILITY

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An interview was published on July 6, 2011, with the title *Eric Sprott – Paper Markets Are a Joke: Prepare for Bullion Prices to Go Supernova.* Interviewer: Chris Martenson, Ph.D. (See: www.financialsense.com/node/5777) One of the questions Martenson asked was gold *versus* silver as an investment. Sprott came out on the side of silver that should trade at the hallowed gold/silver price ratio of 16 to 1. His argument is that gold and silver coins are destined to come back and circulate, so while the gold coinage will take care of large, the silver coinage will take care of small purchases − just as they did when the monetary system of the United States was established at the turn of the 18^{th} century.

Gold at $1900 and silver at $45 gives you a gold/silver price ratio of 46. This suggests that in spite of the fast appreciation of silver for the past year, it has to keep appreciating faster still in the future to meet the target ratio of 16 to 1. Let's accept, for the sake of argument, that Sprott's figure 16:1 is where the gold/silver price ratio will ultimately stabilize. We may as well admit that Sprott's theory is intellectually seductive. However, it is strewn with pitfalls tempting investors to their downfall.

To get a perspective on the gold/silver price ratio, look at the following table showing the interim highs and lows for the past 140 years (previous to that, the ratio was very stable at 15:1, as shown by the chart from which our table was digested, see: www.measuringworth.com). Note that gold/silver price ratio marked 'hi' means an interim *low* silver price, and one marked 'lo' means an interim *high* silver price, that is, the relationship is inverse.

1871	lo	15
1913	hi	40
1919	lo	17
1933	hi	85
1939	lo	50
1943	hi	100
1971	lo	17
1991	hi	90
2011	lo	30

Even if the ratio will continue to fall from here, as it has for the past twenty years, it could have violent reversals of longer or shorter duration, as it has for the past 140 years. Incidentally, the above table shows the unprecedented long-wave volatility in the history of prices driven by pure psychology unrelated to any supply/demand fundamentals.

We may expect volatility to increase, and psychology to continue to reign. Reversals will happen when least expected, often based on nothing more than a crude hoax. For example, a joker could start a rumor on the Internet that new Federal Reserve notes denominated in gold units are already being printed in Washington, including fractional notes, suggesting that the need for subsidiary silver coins has been eliminated. Or a rumor, later denied, that all the gold looted by the Japanese in Asia during World War II has been found in the Philippines, and turned out to be far greater than any previous estimate. Or a rumour that the Chinese are buying all the silver and gold properties in the United States.

Incidentally, the name of the perpetrator of the funniest hoax ever, Toilet Paper King Johnny Carson, was recently connected to the name of Eric Sprott by Bob Moriarty, see his article *Facts on Silver*, www.321gold.com, April 25, 2011, from which the quotations below are taken. In 1971 Johnny, presumably in fulfillment of a wager, suggested to his audience on the syndicated TV shows he hosted, that the United States was facing an imminent toilet paper shortage. Of course, it was a hoax.

"Next day millions of rolls of toilet paper flew off the shelves of every store and by noon there was no toilet paper to be had anywhere in the United States for a whole month…

"Eric Sprott seems to have done something that hasn't happened since the days of Johnny Carson.

"On October 28, 2010, Eric Sprott started his own closed paper silver fund PSLV with an initial public offering of 50 million Trust Fund Units.

"It's still paper silver like SLV or the CEF fund. It has some unique features, not benefits, just features. He has done a brilliant job of promoting it.

"He went on to purchase $300 million worth more physical silver to put in the closed fund. As a result of his excellent promotion, as of last Wednesday when silver was selling for $46, if you bought the CEF silver fund, you had to pay $47.88 (a premium of $1.88) – but if you bought PSLV, the Sprott Silver Trust, then you had to pay an incredible $57.73 (a premium of $11.73 or 25%) for just one ounce of silver!

"I'd say that Eric Sprott's buying $300 million worth more silver at the top was incredible timing. He pocketed probably $60 million in profits.

"Is Eric Sprott bullish on silver? You bet. He has 60 million reasons to be bullish. He could buy right at the top and watch silver fall 30%, while still making money!

"How wise was it for investors to pay a 25% premium for silver? I'd leave it for you to figure out. Eric Sprott is both rich and brilliant."

As for his customers, paying 25% premium, you can certainly say that they are neither. At the time of this writing the price of silver is still falling from $43 as gold is slicing through the $1900 barrier with the flying colors.

Bob did not say that it was unconscionable for Eric to whet his customers' appetite, put them into silver at the top, and make them pay 25% over spot.

What Eric realized, to his customers' chagrin, was that it is so much easier and certainly more profitable to hustle silver around its highs than around its lows, especially just at the time when then price is about to break.

What is the lesson from the 140-year volatility of silver? Wise investors should not touch the highs with a ten-foot pole. Even if the gold/silver price ratio went to 16 today, there is no guarantee that it will not bounce back to 40 tomorrow.

Prepare for supernova bullion prices, as Eric says? I'd say you had better prepare for the zig-zags before we get there.

Beware of the fund manager, crying from his rooftop that the paper silver market is a joke, while down there under the roof he is selling paper silver at a 25% mark-up.

DISCLOSURES. I own no Sprott Trust Fund Units, nor do I intend to buy any during the next 72 hours − nor ever thereafter.

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Calendar of events

The New Austrian School of Economics course in Munich has just been completed successfully. The next course is tentatively scheduled for March/April, 2012. For details, consult: nasoe@kt-solutions.de
See also my website: www.professorfekete.com

The Seminar in Hong Kong has been cancelled. There will be a Seminar in Auckland, and a Conference in Wellington, New Zealand, in November. Stay tuned for details.