April 17, 2006

How High Could Silver Go?

Six months ago, in the October 3, 2005 issue, my topic was How High Can Gold Go? Click here to view issue.

This issue, I want to do the same thing for silver. I do this with more trepidation, because silver is much more volatile than gold, and forecasting it is fraught with peril. Nonetheless, I think it is important to have some goal or target in mind when you take a position in an investment. Over the past few years I have taken what is for me a major position in silver, so I want to take this opportunity to think my way through where I think it could go, and how long it could take to get there.

For some background and to give a bit of the flavor of what I will be saying, let's revisit our original official recommendation of silver in the January 15, 2004 issue:

> ***We Recommend Silver***
>
> *But the real winner has been silver. I have thought that silver would be stronger than gold, and our silver stocks are all up around 20% in the last month, as gold stocks have corrected.* ***I continue to think that silver will be an even better investment than gold this year.*** *Silver has been cheap relative to gold for years; now it is busy making up the distance. At the 1980 peak, silver returned to its historical ratio of 16 ounces of silver equaling one ounce of gold. Today, even with the relative recent rise of silver, the ratio is 65 silver ounces to one gold ounce. But the ratio is moving in the right direction: not long ago it was 75-to-1.*
>
> *For those who are comfortable with commodity futures, you may want to buy some straddles: simultaneously buying silver and selling gold of equal amounts. In that way, you would profit if silver continues to rise relative to gold.*
>
> *I don't like to recommend futures to a wide audience, many of whom would not be comfortable or well advised to enter this arena. But if you are comfortable, this should be a profitable trade.*
>
> *Before this bull market is over, I would not be surprised to see silver trading at $187.50 per ounce. How do I get this figure? If gold trades at $3,000 and the 16-to-1 ratio is once again achieved, then we arrive at this. It will not happen anytime soon. It may not happen until well into the next decade. But if things go on as they have been, I think it will happen. This would represent a rise of 2,785% from current levels.*

> *I want to add physical silver to our portfolio. You can buy and store silver at any good European bank, but I am not too well acquainted with any banks in the U.S. that will store it for you. You may want to contact Camino Coin, or any good coin dealer, to determine what method is best for you.*
>
> *I have held off on recommending physical silver in the hopes of allowing you to buy on a dip, but I do not know when the next dip will be. In the meantime, our silver stocks have done very well. However, it is also good to have some physical silver.*
>
> *As for me, I own about $1 worth of silver for each dollar's worth of gold and gold stocks that I own.*

At that time, silver's price was $6.18. As I write this, 2 $^1/_3$ years later, it is $12.90: 108% higher. But can we hope for even more?

I want to explore this from a number of ways. First, I'm going to use the same approaches I did six months ago when I looked at gold. But then, I want to discuss the important area of the silver to gold ratio.

My first "target" was to see a process, Like gold, I wanted to see silver rising in terms of all major currencies, and not just the US dollar. This clearly happened last year. It was clearly the world's strongest currency of 2005. It rose by 29% against the US dollar, but against the Japanese yen it was up 46.9%, against the euro 47.7%, and soared against the Swiss franc by 48.6%. So clearly, even though it is rarely talked of in these terms, this process of silver being a strong currency has clearly been underway for quite some time now.

The 50% Principle

Six months ago when I wrote on gold, its price was $470. I said that the second thing I wanted to see was how gold would handle the $550 mark. This was the level which represented a retracement of 50% from the highest point it reached in the previous bull market ($850) to the lowest point it got in the bear market ($250).

After a huge move in one direction ---like the 20 year gold bear move from $850 to $250-- an asset will rise again and it may rise strongly enough to test the level that represents 50% of the previous move. We see an important indication of the strength of that new move in how it handles the half-way point in the previous fall.

The way it handles this often makes the difference between a "dead cat bounce" and the confirmation of a new bull market.

For gold, after I wrote the October issue, the price duly moved up fast. However, it stuck at the $550 area. For a while it battled with it, rising or falling $10 each way. But in the last few weeks gold finally broke through this area and is now around $600. That's a good sign for its future.

But what about silver? Can we use the same idea there?

On January 21, 1980, silver's London fix price was $49.45.It has never been higher. From there it began a plunge that would take it to a low of $3.5475 at the end of February, 1993. That was a plunge of 92.8% in just over 13 years.

You really can't say that the bull market started back then in 1993, but at least it never fell lower. For the next nearly 9 years, it lay as if near dead from that huge fall and scarcely moved. In November of 2001, silver touched $4.07.

We can say that here began the current bull market in silver. However, if you are trying to apply the 50% principle, you use the highest point and the lowest point. In gold's case the low point more clearly coincided with the approximate start of the new bull market. In silver's case it did not. Lots of years came and went first.

However, for our purposes, it really doesn't matter. The 50% mid-point between $49.45 and $3.5475 is $26.49875. Let's call it $26.50. But even if we use the start of the bull market, the 2001 low of $4.07, we find it doesn't make much difference. The mid point between high and low this way is $26.76.

On January 21, 1980, the London fix reached $49.45. But later in the day, the US market cash price never reached that high. It went only to $48. Taking this as the high, and the $3.5475 for the low, you get a 50% point of $25.77. Or with the $4.07 low, $26.04.

So taking all these figures together, I'm going to say that the 50% retracement level for silver is $26. Going from this, we can expect silver to test the general area from $25 to $27.

Warning: Volatile!

This is my next target for silver. However, I want to give silver a lot more leeway than gold. We've seen how volatile silver's moves can be. In 1997 Warren Buffett became convinced that silver was extremely cheap ---it was then $4.40--- and bought 100 million ounces. As he did, however, the price soared to a high of $7.31 in early 1998. Later of course, the price fell back. By November, 2001 it reached $4.07. Buffett held fast and has been amply rewarded, as he usually is when he invests. Many people buying some silver near $7.31 and watching it fall by 44% over the next nearly four years would likely bail out. Especially when so much else was soaring from 1998 to 2000.

I don't know the exact prices Buffett paid, but the very fact of him buying vaulted the price. Before that, during the 1970s the Hunt brothers also became convinced that silver was cheap and started to buy. As it rose more they bought more. Finally, in 1980, they were accused of trying to "corner" the market.

They were true believers in silver, and unlike Buffett, kept buying even as the price soared. The idea of cornering any market is something I wonder about. Can it really be done? To corner a market means to buy most or nearly all of it up. But though you can try this, the price gets progressively higher as you go along. Whether the Hunts were trying to corner the silver market or not, the fact is that they ---and many others like them--- bought more of it the higher it went. At last, the price was far too high. But not to the buyers: with silver at near $50, I remember a major silver "guru" telling me it would go to $100, and he was buying even more. But finally market reality takes over, and the price falls. Those who bought but did not sell are hurt badly.

To me, that's not the way to do things. I prefer the Buffett way. You become convinced that something is cheap, and you take a big position: big for you at any rate. Then you wait. You snore. And when you see everyone else trying to get in, you sell.

That this is the better way is proven by the fact that Buffett is still going strong. The Hunt brothers were broken by their experience, as indeed --sadly-- was my friend, the silver guru.

Old Highs

So keeping in mind that silver's moves are much more wild than gold's, I think sooner or later we will see silver approach the $25-$27 level. If it breaks above this, then the next target would be the old highs of 1980.

But $50 in 1980 is not the same as $50 in 2006. And even though I think silver will once again trade at $50, this may not be for years ---perhaps not for five years, or until 2010, who knows? And if so, who knows how much $50 in 1980 terms would be in 2010 terms? All we can say is how much it is in 2005 terms. Using the Inflation Calculator (http://www.westegg.com/inflation/infl.cgi) we see that $50 in 1980 equaled $126.98 in 2005, the latest year for which you can do this. Using the actual London high of $49.45, we get $125.59.

This is a way of saying that even if silver reaches its old high of around $50, this would still be very much lower in real terms than it was at the peak. And remember, that this real term level of $126 is based on 2005 dollars. Let's say that silver reaches $50 in 2010. It could well be that the price level in 2010 is 50% higher than it was in 2005. If so, then what would be $126 in 2005 would be $189 in 2010.

I have no way of knowing if silver will reach $50 in 2010, but I'm showing that if it does, it could still be cheaper in real terms than it was in 1980. And I can certainly say that even if silver reached $50 per ounce next month ---which I don't expect--- it would be cheaper in real terms than it was the last time it reached that level. Based on the inflation of the dollar as of now, it would have to be about $130 to equal what it was at the highs.

In fact, silver at $50 this year would translate in real terms into less than $20 in 1980 terms. And even with silver at $12.90 in today's dollars, this is only about $5 in 1980 dollars, or just one-tenth the price it actually briefly reached.

$80 Silver?

During silver's last bull market it went from $1.29 to $49.45. That was a rise of 3,733% in just over 10 years. You can say that the $1.29 price of the 1960s was artificially low by government control; it was the "official" price of silver. We don't have an official price now. But what we do have is much worse levels of debt and other factors that counterbalance what we had then.

However, if we take the low of $4.07 and assume that this bull market is only half as strong in percentage terms as the old one was, that's a rise of 1,867%, or $80. So I think that $80 is a conservative target for this bull market, not even considering the difference in real dollars, discounting for inflation. Of course, it has to get past the $26 level first!

Gold at $3,000 Equals Silver at $187.50

When I recommended silver in 2004, I said that it could rise by 2,785% from the level then existing. This meant a price of $187.50. I got this by thinking about the gold/silver ratio. For the reasons I put in that issue, my price target for gold was and still is $3,000 by 2020. And 3000 is 16 times 187.50. Why did I pick 16? You can see why when you know about the history of the gold/silver ratio.

Throughout the last several centuries, a ratio of silver's value to gold's has always seemed to come back to the 16:1 area, where about 16 ounces of silver equals one gold ounce.

Granted, there have been extremes in the market at certain times. At one extreme was the London market ratio of a mere 6:1 in the first quarter of 1551. Never again was silver valued so highly compared to gold. The reason was that newly discovered Spanish gold was pouring into Europe. While both gold and silver were discovered in the New World, the Spanish naturally focused on gold, it being more valuable. But so much gold came, relative to silver, that silver became relatively more valuable. This extreme in the market, like all extremes, was not to last long. Later that same year the ratio doubled to 12:1.

The other recorded historical extremes came much more recently. It reached over 100 to 1 in the early 1940s, but the metals markets were not freely functioning with the world at war. On the afternoon of February 28, 1991, the ratio reached 100.35:1. At that rate, silver was amazingly lowly valued against gold. This extreme proved equally untenable, and silver began to gain on gold in the next few years. On February 28, 1998, exactly six years later, the ratio stood at 40.92:1. But the normal ratio for most of the past few centuries has been in the range of 14 to 16:1.

For centuries, governments had a bi-metallic standard, with both silver and gold as money at an official ratio between them...nearly always in that 14 to 16:1 area. But this came with a lot of problems. Or should I say just one big problem. The market ratio was not always the same as the official ratio. One time or another, silver became overvalued in relation to gold, or vice versa. Let's say the ratio was set at 16:1. But then the market rate went to 15:1. This made silver actually more valuable than it was officially acknowledged to be.

How did people react to this? The money that was undervalued by the government went into hiding or left the country. We've seen this happen many, many times in the recent past. In 1965, the US removed all the silver from its dimes, quarter and half-dollars. For a brief while the pre-1965 silver coins circulated side by side with the new 1965 coins. But very soon the silver coins became held back by those who owned them. After all, if the government says that a quarter filled with silver is worth the same as a quarter filled with copper, the government is wrong.

Silver is worth more than copper and always has been. Who in their right minds would spend a silver quarter on something if they can spend a coin with the same face-value filled with base metals? So in short order, the pre-1965 coins were withdrawn from circulation and held in private hands.

Melting Copper Pennies

The same thing happened in 1982 with the US copper penny. Until that year pennies had been made of copper. But in 1982 the US government came out with a new penny which reduced the copper value to just 2.5% of the coin. The other 97.5% was zinc. (Actually in 1982 both pennies were minted, but after that only the debased one was. If you come across a 1982 penny, you can tell which is which by the weight: The copper one weighs 3.11 grams and the zinc one only 2.5 grams.)

So what do you think happened? I defy you to find a pre-1982 penny in circulation today. In fact, at current copper prices of $2.8017 per pound, those older pennies currently contain nearly two cents (actually 1.87017 cents) worth of copper. They can easily be melted down for their copper value at big profits.

Indeed, so high have copper and zinc prices risen that even the newer pennies now contain nearly as much in metal value as their face value. As of April 13 zinc was $1.3844 per pound, and has soared in recent months. Therefore, taking both the zinc and the smaller copper contained in the current US pennies, that penny contains 0.78252 of a cent's worth of metal.

If current prices for zinc and copper continue to climb as they have during the past two years, it is very possible that the metal content of the humble penny will again disappear from circulation. If so, then either it will be done away with entirely, or a new penny will be issued with even cheaper ingredients, perhaps the aluminum that pennies minted during World War II had, to conserve copper for the war effort.

Further, they may have to do something about the next-highest coin, the 5 cent piece, called the "nickel" after the metal it has been made of since 1946. However, nickel prices are up too: at the current $7.8975 per pound for nickel, the nickel coin contains 4.49254 cents worth of the metal, or nearly 90% of the face value of the coin. It is also possible that if nickel prices rise to $8.70 per pound it will cost more nickel to mint the coin than the 5 cent face value, and it will disappear too.

In case you were wondering, the lowest metal value vs. the face value of any US coin today is the Sacajawea $1 coin minted since 2000 that no one seems to want. It has a face value of $1, but contains just 4.844 cents worth of base metals. The dime contains 1.614 cents of metal, and the quarter 4.032 cents. So, all these coins are "safe" from going out of circulation. You can keep up on these values by going to http://www.coinflation.com/

Back to the Ratio

I wandered a bit from the topic, but I wanted to show you Gresham's Law is still operating today. Sir Thomas Gresham was a British Treasury agent in Holland in the 16th century, at a time when the British coinage had been debased badly. His job was to get new coins made of purer metal content. Queen Elizabeth wanted to end the inflationary policies of her brother, sister and father and directed Gresham to prepare new coinage with more silver in them. This he did, but in short order these newer silver shillings disappeared from circulation and the older shillings debased with base metals still circulated. Gresham's Law is popularly defined as "Bad money drives out good ". It is often applied in areas outside of money. When a formerly chic resort starts to attract what the chic would call a "lower class" of clientele, the chic move on.

But there is a much better definition to Gresham's Law. It is that "Money overvalued by the state drives money undervalued by the state out of circulation". In 1965 the US government undervalued the silver quarters....they left circulation. Gresham's Law is a law of nature as immutable as the law of gravity. Any government can try to break it, but they are never able to.

So, in a roundabout way, you can see the problems that a strict official ratio of silver to gold caused in money.

From about 1675 to about 1725 the British government (and its American colonies) had an official ratio in a tight range of 15.1 to 15.5 grains of silver equaling one grain of gold (15.1:1 to 15.5:1). The problem was that at that time in the actual market the ratio was 14.9:1. This meant that silver was actually more valuable than the British government said it was. Not by much, but silver was undervalued by the state and gold overvalued. This meant that the overvalued money, gold in this case, drove the silver out of circulation. The problem got even worse as the 18th century wore on. From 1725 to 1760 Brazilian gold

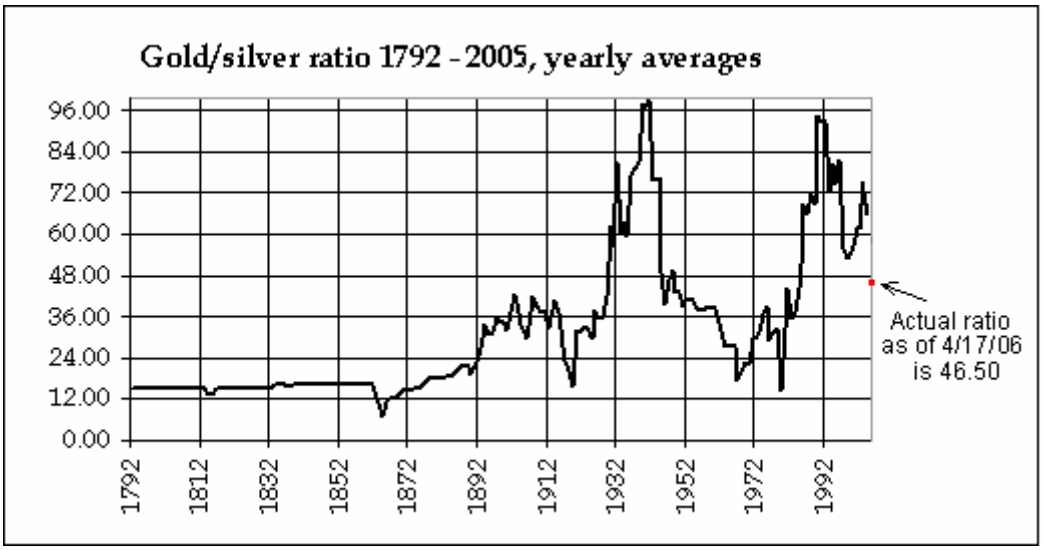
mines increased the gold supply at the same time that Peruvian silver mines decreased production and thus the silver supply fell relative to gold. The ratio reached 14.1:1. But the 15.5 official British ratio held fast, and thus gold became yet more overvalued throughout Britain and America. In the years around the American Revolution, this mismatch in the ratio caused silver to be scarce indeed, and was a cause of the horrible runaway paper inflation of the 1770s.

When time came to establish an independent American currency, the dollar, the founders were very careful to establish a gold/silver ratio that exactly dovetailed with the current market price.

Thus, the Coinage Act of 1792 established the US dollar and defined it officially as a weight of both silver and gold. Specifically, it was defined as 371.25 grains of pure silver and/or 24.75 grains of pure gold. This was a ratio of 15:1. Anyone could bring silver or gold to the new Philadelphia Mint to be coined, and silver and gold were both legal tender at this 15 to 1 ratio. The basic silver coin was the silver dollar and the basic gold coin was the $10 Eagle, which contained 247.5 grains of pure gold. (In fact, copper penny and half-penny coins were also minted, but in limited numbers.)

I thought you might like to know how much the original 1792 silver and gold dollars would be worth now, just in terms of their metals content. There are 437.5 grains per troy ounce, so the silver dollar contained .849 oz, or at current prices, $10.96. I think this shows how cheap silver prices are today. Most things priced in 1792 dollars would be much more today than a factor of 11 times more. The gold dollar had 0.0565 troy ounces, and would today be worth $33.90. Gold is worth 34 times what it was then, but silver is worth only 11 times. I think things are still out of whack and that silver is undervalued.

Now I want to show you a fascinating chart. It is the history of the gold/silver ratio in terms of the US dollar, since its 1792 founding to today.



As you can see, from 1792 to the Civil War in 1861 the ratio looks roughly stable. But there was a wealth of problems with it that the chart does not show. Because in fact, this

ratio might have reflected the market prices of both metals in 1792, but market values, as we all know, change. And change they did. In fact, from the late 1780s through the next 30 years, Mexican mines began to pour out huge amounts of silver. The result was that the market ratio fell to 15.5:1 in 1797 and by 1805 it was 15.75:1.

It doesn't take a rocket scientist to see what happened, armed as we are with Gresham's Law. Silver was actually cheaper relative to gold than the US government "said" it was. Gold was undervalued and gold coins began to disappear from the United States as silver coins from all over the world began to flood in, since the US government was obliged to buy them at a price 5% over what the world market price was. It was a great way to make a quick little profit, so much more because the European monetary system was changing to reflect the market values of their own times.

For instance, in 1803 Napoleon established the Bank of France to stabilize a franc that had been ruined by the paper money inflation of the Revolution of the 1790s. Reflecting the new market ratios, he set the silver/ratio at 15.5:1. Then, in 1816, when the British went back on the gold standard after the wars with France ended at Waterloo in 1815, they reflected the market at that time, and choose a 16:1 ratio. With America still on a 15:1 ratio, overvaluing silver relative to gold, by 1810 and for years after, the US was left with virtually no gold coins. These coins went instead to places which valued them more. Sharp speculators could buy gold officially in the US and sell it in London for a gross profit of 6.7%

To make matters worse for the Americans, even within the world of silver Gresham's Law was operating. This was because Spanish silver coinage was allowed to circulate alongside US coinage. (The phrase "pieces of eight" comes from this, since each Spanish dollar contained eight "bits", and "two bits" equaled a quarter. The US quarter is still today called "two bits".)

But the Spanish silver dollars contained from 2 to 5% more silver than the US ones did. So it paid to take the heavier Spanish dollars to the Mint, have them melted down, pocket the profit, and repeat the process. Very soon only American silver dollars were left in circulation. *At the same time, bizarrely, the fractional Spanish silver coins --the half dollars, quarters and dimes--- contained less silver than their American counterparts.*

This time Gresham's Law operated in reverse: American half dollars and other fractional coins left the country or disappeared into private American hands out of circulation. So all the US was left with was US silver coins and Spanish fractional coins.

And if that was not complicated enough, get this: American silver dollars, even though they contained less silver than the Spanish dollars, circulated as equal value in the West Indies. So US silver dollars were sent to the Caribbean where--overvalued as they were there-- they drove the Spanish silver dollars out of circulation!

That meant that after 1810 Gresham's Law had left America's monetary system in a mess. There were no US gold or silver coins and only the Spanish fractional silver coins circulated. This was to prove ruinous in the War of 1812. Not enough silver and no gold circulated, so individual banks printed paper money to finance the war. This caused

horrible inflation. Prices soared by an average of 50% during the war. Worse, after August, 1814 banks did not have to pay out gold or silver at all if people holding the paper money came to ask for it. This act exacerbated the inflation, which in turned caused mal-investments (as it always does). And this resulted in America's first Depression, the Panic of 1819. The month of August, 1814 was a terrible one for America. This was the month where an invading British army entered Washington DC and burned the White House and Congress to the ground.

But our story is the silver/gold ratio here. Monetary chaos and inflation continued through the 1820s, until Andrew Jackson (1829 -1837) decided to do something about it. The Coinage Act of 1834 changed the 15:1 ratio to 16:1, better reflecting market realities. (You can see this on the chart.) There was one problem with the way this was done. Instead of up-valuing silver they de-valued gold. The gold dollar was devalued by 6.26%, from 24.75 grains to 23.2 grains of gold. The silver dollar was left as it was. This was a populist move: the cry went around the land to "leave the dollar of our fathers" alone. It would have been better to re-value silver upwards rather than gold downwards. This 1834 devaluation of the gold dollar set a bad precedent that would come back to haunt America exactly 100 years later.

Silver was not actually 16 to 1 vs. gold in 1834's world markets. It was 15.79 to 1. These difference overvalued gold by only one percent, and was thus not worth the cost to buy here and sell in Europe. And to take this into account, there was a slight adjustment in 1837 to make the ratio 15.998 to 1. Things went well. For the first time since the 1790s America had plenty of gold and silver coins circulating.

But then came 1848. Gold was discovered in California in huge amounts. A few years later, gold was discovered in Victoria, Australia and Russia. All this new gold coming in cheapened it in terms of silver. The silver-gold ratio declined from 15.97 in January 1849, when the first '49ers arrived in San Francisco, to an average of 15.37:1 from 1853 to 1860. The one percent difference became an average of over 4% and as high as 7%. Silver now became undervalued and it left the US fast. Gold coins were flowing into the US, since gold was now overvalued, but this caused a problem. With no small change and only larger value gold coins available, lots of new paper money was issued by banks in smaller denominations.

This near-constant headache was starting to tire Americans. Either gold had disappeared, or silver had, or some times both had. There had to be a better way. The days of the official bi-metallic standard in the US were numbered. A choice had to be made to either monetize one metal or the other. The one not made the official money would still circulate by weight. The wealthy and powerful wanted a pure gold standard, with the dollar defined in gold alone, with smaller silver coinage freely circulating by weight.

The Civil War intervened, giving America more to worry about than coin shortages. But a few years after the war, the "gold lobby" struck.

You see on the chart how after 1872 the ratio starts to soar out of the 14-16:1 range. In 1872 it became apparent to a few smart investors and even some wise officials in the US

Treasury that the silver to gold ratio, which had held steady at about 15.5 to 1 since 1861, was about to change drastically. Silver was about to lose much of its value.

One reason was the discovery of huge silver mines in Nevada, recently admitted to the Union with the motto, then as now, as The Silver State. New techniques were enabling miners to get more silver out than ever before.

But savvy globally minded men saw what was going on in Europe. Briefly, silver was being dethroned as money. First, starting in 1865 the world broke up into two factions. One wanted to continue bi-metallism as before, even with all the Gresham's Law problems. The leaders of this group were the US and France. France formed the Latin Union with Belgium, Switzerland, Italy and Greece to have a common ratio of 15.5:1 silver to gold ratio. Further, the coins of one were to be accepted by all. But the other faction, led by Britain, wanted to do away forever with official ratios and go straight to the gold standard, with the national currencies defined only in terms of gold. Newly unified Germany joined them, as did Russia, Holland and Scandinavia. As 1873 opened, it was clear to smart people that the Latin Union was having Gresham Law style problems.

Silver is Dethroned: The Ratio Soars

Taking advantage of this, the gold lobby passed a law in February 1873. It discontinued the minting of any more silver dollars. A year later, another law revoked the legal tender status of any silver coin above $5. Silver was effectively demonetized in America.
The market timing was perfect, because it was in 1874 that silver's ratio to gold rose above 16:1 for the first time. Silver was pouring out of the mines, and Europe was increasingly moving away from silver as official money, so they needed less of it.

The ratio now began to soar and reached an amazing 42:1 by 1900. By that time the only major countries that held to the silver standard were Mexico, which produced the most of it, and China, which had long historical ties to it. Mexican silver was particularly prized in Northern China, but it made up the bulk of circulating money throughout the country. Many attempts were made to get both countries off silver and onto gold, but they failed. One in particular was made in 1903, where the Americans tried to get the Europeans to join them in buying up massive amounts of Mexican silver in an attempt to make the Chinese currency rise too much in value. The Europeans were not happy at this attempt to subsidize US exports to China. Further, they coveted the Chinese markets for themselves and wanted to stay on good terms with the Chinese government. (It all sounds like what is going on a century later.)

This failing, the US went after Mexico. Knowing that Gresham's Law would work, they got the Mexicans to pass the Currency Reform Act of 1905, which effectively made gold coins cheaper than silver ones, and thus undervalued silver, which fled the country and stopped being produced as much. This left Mexico with a gold coin standard.

So that left China as the only major power on the silver standard. And it almost caused a war. The Western powers invaded China to put down the Boxer Rebellion in 1900. They then foisted on the defeated Chinese a bill of $333 million. The Chinese started to pay this back in cheaper silver, and this enraged Britain, Japan and the US. Britain even

threatened war if China did not pay gold. The Chinese saw that a switch from silver to gold would only harm their economy. They defied the West and had their own Currency Reform in 1905, which replaced the old Mexican silver no longer coming out with their own silver currency, the tael. This is a measure of silver still in use in China. In Shanghai the new Silver Exchange will trade in taels, which is 50 grams of silver. And if China ever embraces silver money again, as it might, this could be the name of the currency.

So you see how seemingly far removed history has a real bearing on today's world. But back to the silver/gold ratio, look at the chart after 1900 and you see an odd thing. Each time the ratio rises it always is followed by a decline, however short, back to the traditional ratio area.

From 42:1 in 1920 it plunged to 16:1 a few years later. It briefly soared to nearly 100:1 in 1942, as gold was overvalued at $35 per ounce during this time. Silver then began to gain in relative value again in a long wave. It is interesting that 1942 marks the start of a huge bear market in bonds, just as it does as a bull market in the relative value of silver to gold. More interestingly, both silver and bonds go to extremes again about the same time.

For silver, the fall in the ratio from near 100 ended when silver briefly touched nearly $50 an ounce, and gold was around $850. The actual low came on January 31, 1980, when the ratio was 14.82:1. (Soon after, silver began a huge bear market relative to bonds as well as gold, which would take it up as high as 100:1 in 1991).

I want to point out that this 14.82:1 ratio came at the peak of the last silver bull market. It follows the pattern in having the ratio go back to the traditional area of 14 to 16:1. The low in silver against the dollar was reached in 1993 and the low against gold was reached in 1991.

Certainly you can see by the chart that the ratio has been swinging back toward silver's favor since then. It has risen much faster than gold for years now. As I write this the ratio is 46.44. It thus matches the sharp rise in silver's value relative to gold that we saw in the few years after 1942. Then as now the ratio fell to about this current level and then started to fall more slowly over the next 30 years until the big blowout in 1980, when, again, we saw the ratio as low as 14.82:1.

I think we will see this area reached again. Whether it is 14.82, or 15 or 16, I think that silver will continue to rise faster than gold and the ratio will end up, even briefly, back in this traditional area.

So if we take a more conservative 16:1 ratio, and if gold reaches a high of $3,000 during this bull cycle, this means $187.50 silver. Of course, this is just a guess at this point. Who knows where gold will end up by the time this bull market is over? It could be $4,000, in which case a 16:1 ratio would be $250 silver.

It's all rather pie-in-the-sky now. I'm content to watch and wait and see where this bull market will take both metals.

Towards A New Monetary System

I think it is clear that the post-1971 experiment of global paper currencies completely untied from gold or silver is a failure. In the years to come, when these currencies lose value at startling rates, it will become apparent to all.

This could be the bull market in the metals that ends with a realization that unbacked paper money just is not stable. As time goes on, there will start to be debates about new currency reforms to replace them. I think silver and gold will once again play important roles in this system.

However, I wanted to show in great detail the limitations of the fixed silver to gold ratio that ruled the monetary world for centuries until the 1870s. Gresham's law wreaked havoc on this and I would not like to see a return to a fixed bi-metallic standard.

What I think would be the best solution for the world is to do away completely with national currency names like the "dollar", "pound", "euro" and "franc". None of them means anything anymore, or anything that you can count on. It's far better to have gold and silver coins circulating together under regular units of weight. Whether that weight is in ounces, grams or grains doesn't matter, as long as each coin has a fixed weight. Maybe nations could still mint them, but they would circulate around the world freely. Or maybe private companies would gain the reputation of providing beautiful coins with consistent weights. If this simple method were done, it would do away with all the problems of debasement and Gresham's Law which have wreaked havoc with the money of mankind for centuries.

It would mean having governments give up their powers to destroy their currencies. And governments never give up their powers without a fight. Yet if we see national currencies all start collapsing in terms of gold and silver in the next generation, perhaps the time will be ripe for a move to this system I'm talking about.

This may sound like an unattainable dream, and perhaps mankind is fated to suffer under bad currency systems forever. Yet towards the end of the 19th century there was a movement to do just this: a series of international monetary conferences trying to move the world to a simple system of gold and silver grams, each with national currencies beginning as multitude of each other, and then finally units of weight alone being used.
There is no reason we can't start this idea again.

Metals: How Much Should You Own?

In life, as in investments, you divide things into what you know to be true and what you believe or think is true. I know that I have been very lucky that I got into the precious metals five years ago this month, and exactly a year after I got out [got stopped out] of the internet stocks.

This was a time when almost no one thought they were going higher, including the people in the mining industry itself. Believe me, I know this. In April, 2001 I only told a couple people that I thought gold had finally bottomed. They were both long time mining

executives still in the business. I knew I would get blank stares from most people, but even these two did not agree with me.

The past five years have been very good. And I think that the future decade or so will be great for them as well. But I don't know this, I only believe it. Again, that is an important distinction.

I think that the precious metals are still toward the beginning of a huge bull market. And I think that silver will test the $25-$27 area at some point. If it can get above this, then I will be more confident. We're all in the dark here: no one knows the future. But I continue to think and believe that both silver and gold will be much higher than they are now. My target is for gold to go to $3,000 and silver to $ 187.50, and by 2020.

But I could be wrong. So how I have played it is to bank my original invested principal as soon as any of my metals stocks have at least doubled. Most of the recent money I have pulled out this way I've put into the US dollar, since I had a very small percentage of my cash in the dollar before this. For those who buy metals because they are sure the dollar is about to collapse, I don't know what to say.

I just don't think in those terms. It may collapse, along with other paper currencies. If it does, then the metals I hold will be worth very, very much. But if the dollar doesn't collapse? Then the money I have put out at interest rates that have been rising makes me more dollars than before.

I've said this before many times, but the way I like to think goes like this: **I want to be able to profit from trends that I think and believe will happen. But I don't want to be hurt in case I am wrong.**

Each person has to decide for himself how to play this. To anyone who asks me if it is too late to buy, I say this: I think everyone should have some gold and silver, and some mining stocks. But that exact percentage will and must differ with each individual. You should not have so much of it that you won't be able to sleep at night when they plunge and stay low for a year or more. Notice that I said "when" they plunge and not "if". Silver especially has been and will continue to be a volatile roller-coaster. Times will come when it almost certainly will plunge by 25% in a few days. If you have too much, you will be prone to panic and sell.

In fact, it is quite possible that the new silver ETF will make silver even more volatile. If during a natural correction of say, 20% in a few days takes place, many ETF holders could easily panic and sell their shares. And since the US ETF backs its holdings up by actual silver, they may be forced to dump silver on the market and cause the price to plunge even more. It's possible we will see price plunges of 50% over a very short time.

So how much silver should you own? Some will find that 5% of their net worth in this area is the amount that will allow them to sleep calmly through any correction. For others, with more cast-iron stomachs who are prepared to ride anything out, it could be 50%. There are as many situations and personalities out there as there are investors. But you only have to know and be comfortable with your own.

If you are young, have few expenses and a good income, then you can afford to take more chances. You can buy on margin, or on the futures markets, and put more of your money here. But older people, or those who already have more than enough to last them for their retirement, or those who don't have so much to lose in case they are wrong...these people would be better off not taking big chances. Then, in addition to your net worth situation, there is the question of How Strong Is Your Stomach? And only you can answer that.

Yes, we've been lucky so far. But always in the back of my mind I remember the saying, "you make your own luck". I want to be sure I don't lose everything in the future in case my analysis is wrong. That's why I am happy to stay with the metals I've got. I'm not selling any of them, but I've got enough so I have no need to buy more either.

Everything tells me that this bull market will vault gold and silver to levels unimaginable to most people before it is over. Prepare yourself both to prosper if this does happen, and not to get hurt if it does not.

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