

November 2015

Dear Clients and Friends:

Carlo Ponzi emigrated from Italy to America in 1903. He had \$2.51 in his pocket, the rest of his life savings having been gambled away during the voyage.

Ponzi was a rascal. He had already done a couple of stints in prison when yet another idea came to him. At that time, if you corresponded with someone abroad, you could pay for their return letter by purchasing an international reply coupon (IRC). If postage was less expensive in your country, there was a net savings when the coupon was redeemed.

After World War I, inflation in Italy had reduced the buying power of the lira in relation to the U.S. dollar. Italian IRCs could be bought cheaply and exchanged for the more expensive U.S. stamps, which could then be sold for a profit. "Arbitrage" is the process of purchasing an asset cheaply in one market, then immediately selling it in another market where the price is higher, an entirely legal activity.

As it turned out, there wasn't enough profit to cover the handling expense of this operation. But Ponzi thought he could sell the idea. He told friends his arbitrage business would double their money in ninety days, and a few people chipped in. Using his own savings, he paid off as promised. More money flowed in, and Ponzi opened an office in Boston, the "Securities Exchange Company," to further the operation.

There were, of course, no IRCs being bought or sold. Money from new investors was used to pay interest to existing clients, who happily reinvested all their profits. By July of 1920, Ponzi was famous and living a life of luxury, reportedly making \$250,000 a day. A month later, the jig was up. He was arrested and pleaded guilty to mail fraud. He spent fourteen years in prison and died penniless in Brazil in January, 1949. But his adventures added a new entry to the Webster dictionary: "Ponzi scheme."

Regards,



Charles M. Shackelford