Is Silver Set to Rally?

Description

Historically, the price of that other precious metal, silver, has been strongly correlated to the price of gold, with silver prices rising whenever gold prices grow. Yet for the year to date, the opposite has occurred. Despite gold's recent rally, seeing its price firm by 6% for the year-to-date, silver's price has softened 2%, indicating it is undervalued and should rally if the historical correlation between the two assets is to be believed.

A key indicator highlights a silver rally is imminent
Another indicator of whether silver is undervalued and could rally is the gold to silver ratio, a measure of how many ounces of silver are required to buy an ounce of gold. At the start of 2013 the ratio was 54, whereas at the start of 2014 it had widened to 61 and since then widened even further to a ratio of 66 ounces of silver to buy a single ounce of gold.

This rising ratio indicates silver is underpriced in comparison to gold and as a result a number of analysts expect silver to rally and the ratio close from 66 to 60 over coming months.

What does this mean for investors?
Investors can take advantage of the expected rally by buying the physical asset, investing in a silver exchange traded fund, or investing in listed silver miners.

For the year to date, silver miners and related silver streaming companies — including **Pan American Silver** (TSX: PAA)(Nasdaq: PAAS), **First Majestic Silver** (TSX: FR)(NYSE: AG), and **Silver Wheaton** (TSX: SLW)(NYSE: SLW) — have seen their share prices remain relatively flat. That is predominantly due to poorer than expected results and weaker silver prices. But any sustained rally in silver prices would drive their share prices higher.

Of the three companies, it is Silver Wheaton that stands out as having the greatest potential. Unlike Pan American and First Majestic, Silver Wheaton is not a silver miner but a precious metals streaming company. This gives it a number of advantages over silver miners, including being able to further diversify its asset base than silver miners, while having significantly lower overhead costs.

This is because Silver Wheaton only needs to manage administrative costs and not be concerned by the actual capital expenditures required to be a sustainable producer. That means Silver Wheaton is able to remain profitable at silver prices that silver miners cannot.

By virtue of being able to diversify its assets through a range of silver streaming contracts across the industry, Silver Wheaton is able to reduce the degree of political risk associated with those assets. Both Pan American and First Majestic have the majority of their silver mining operations and assets located in higher risk jurisdictions in Latin America, notably Mexico.

For the year to date Silver Wheaton's share price has risen a meager 7%, Pan American's has jumped 9%, and First Majestic's has softened 5%. Of the three, First Majestic is the biggest loser over the last year, down by a whopping 39% compared to Pan American's 21% and Silver Wheaton's 28%.

Foolish bottom line
Clearly the performance of silver for the year has lagged behind that of gold and there are a number of indicators silver is set to rally over the remainder of 2014 and catch up with the price of gold. One of the best ways for investors to play the expected rally in silver prices is precious metals streamer Silver Wheaton with its lower risk profile compared to the silver miners and diversified asset base.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:AG (First Majestic Silver)
2. NYSE:PAAS (Pan American Silver)
3. TSX:FR (First Majestic Silver)
4. TSX:WPM (Wheaton Precious Metals Corp.)

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