



Is Silver Really Worth \$50 an Ounce?

Description

With Wall Street and institutional investors continuing to place some big bets on precious metals, there are growing calls from some analysts that silver is significantly undervalued and is worth \$50 an ounce. This may sound ludicrous to some investors — the metal is now trading at U.S. \$21 an ounce — but there is a rationale behind the argument.

There is a strong correlation between gold and silver prices and while gold has rallied strongly this year after seeing its price collapse after the Fed started unwinding quantitative easing at the end of 2012, the price of silver hasn't kept up. The key driver of this emerging view among analysts is the gold-to-silver ratio, which measures how many ounces of silver are required to purchase an ounce of gold.

At the height of the gold rally in 2011 it took 43 ounces of silver to buy one ounce of gold, but since then the ratio has widened with 63 ounces of silver required to purchase one ounce of gold. But some analysts are claiming the gold-to-silver ratio has historically required 20 to 25 ounces of silver to purchase one ounce of gold and believe prices will adjust to reflect that historical ratio.

I am not so bullish on silver, though there is clearly plenty of room for silver prices to run and I would expect to see the ratio close to below 50.

With gold currently at around \$1,290 per ounce, the narrowing of the ratio to 50 would see the price of silver jump a hefty 29% to approximately \$26 per ounce. Such a significant spike in the silver price would be a boon for battered silver miners who have been feeling the wrath of the market as precious metal prices plummeted.

How do investors take advantage of rallying silver prices?

Investing in silver miners is essentially a leveraged play on silver and offers investors potentially higher returns than investing in the physical metal or an ETF like the **iShares Silver Trust** (NYSE: SLV). This is because the majority of their costs are fixed and already priced into their operations.

But which silver miners are the best bets for investors?

Billionaire investors George Soros and Ray Dalio have placed some big bets on precious metals streamer **Silver Wheaton** (TSX: SLW)(NYSE: SLW), while Soros has also placed a bet on **Pan American Silver** (TSX: PAA)([NYSE: PAAS](#)).

Both represent solid opportunities for investors with Silver Wheaton being a favourite among institutional investors and Wall Street. Although with an enterprise value of 21 times EBITDA it does appear expensive, whereas Pan American Silver is still attractively priced with an EV of nine times EBITDA.

This is also one of the lowest-cost silver miners with first-quarter 2014 all-in sustaining costs of \$15.54 per ounce compared to **First Majestic Silver's** ([TSX: FR](#))([NYSE: AG](#)) \$18.71 and **Silver Standard's** (TSX: SSO)(NYSE: SSRI) \$17.42 per ounce. But these costs are higher than **Endeavour Silver's** ([TSX: EDR](#))([NYSE: EXK](#)) \$12.15 for the same period.

These low all-in sustaining costs will allow Pan American to take full advantage of the spike in silver prices and generate a healthy margin per ounce produced, despite full-year 2014 production expected to remain flat.

Pan American Silver also pays a dividend with tasty yield of 3.4%, which is one of the best among precious metal miners and three times higher than Silver Wheaton's. This dividend will also continue to see patient investors rewarded while the price of silver appreciates.

I believe it is overly bullish to think silver will hit \$50 per ounce, but if the correlation between gold and silver prices returns to where it was at the height of the gold rally, there is significant upside available to investors. This upside will translate into solid improvements in the operations of silver streamers and miners with Silver Wheaton and Pan American Silver being the best picks.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:EDR (Endeavour Silver Corp.)
2. TSX:FR (First Majestic Silver)
3. TSX:WPM (Wheaton Precious Metals Corp.)

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