4 Reasons I Prefer Investing in Silver to Gold

Description

With Wall Street and a number of institutional investors like Ray Dalio and billionaire George Soros placing big bets on a recovery in precious metals, now is likely the time for investors to take the plunge. But the key question remains, which precious metal should they choose?

Gold has remained a firm favourite among investors and Mr. Soros has made a massive US$120 million plunge on the world's largest gold producer **Barrick Gold Corp.** (TSX: ABX)(NYSE: ABX). However, my preference is to invest in silver and not gold. Not only does it share similar characteristics to gold, including acting as an inflationary hedge, being a well of value in uncertain times and a safe-haven asset, it possesses four unique characteristics which could propel its price skyward.

1. Silver's prevailing use is in industry

Unlike gold, which has its biggest use in investing, the prevailing use of silver is in a wide range of industrial applications. In 2013, 54% of total silver demand came from industry, with it predominantly being used in industrial fabrication and electronics. There are signs of growing global economic activity, particularly with China's purchasing managers index, a key measure of industrial activity in the world's largest economy, hitting a six-month high in June 2014.

Even more promising, the demand for silver being used in electronic, electrical and chemical applications is expected to grow, with a range of new technologies requiring the use of silver in their products. Key among them is the rapid growth in the production of photovoltaic solar panels, as silver is a key component of the manufacturing process. In China alone, the quantity of photovoltaic solar panels manufactured has doubled every year since 2003 and with this expected to continue, that industry alone will require around 15 million ounces of silver annually.

2. Silver is in shorter supply than gold

A key driver of silver prices is its rarity, and the amount of available silver is far lower than gold, even though it's 17.5 times more abundant in the Earth than gold. This is because over 90% of all silver ever produced has been consumed primarily in industrial applications.

Even more pressing is that mine production is currently incapable of keeping up with demand, placing greater pressure on scrap metal and recycling. In 2013, despite silver production from mining jumping a healthy 3.5% compared to 2012, it only produced enough silver to meet 76% of the total physical demand in that year. While mine production will continue to grow, this shortage will continue for the foreseeable future with the major silver miners having cut back on investing in the development of new projects after precious metal prices tanked.

The long lead times to bring new silver mines online will also act as a headwind for supply, because even with renewed investment from silver miners in developing new mines, it will take time for them to come online.

These factors, along with growing industrial demand, will certainly act as tailwinds to push the price of silver higher. They are also the reason silver prices are far more volatile than gold, with daily price movements typically being far larger than gold, which means investors must be willing to stomach far larger downdrafts.

3. Silver has failed to maintain its correlation with the price of gold

Silver has been hit far harder than gold since the wheels fell off the bull market at the end of 2012, when the Fed began tapering quantitative easing. While gold is down 31% from its bull market high of $1,873.70 per ounce, silver has plunged 58% from its bull market high of US$48.58 per ounce.

The gold-to-silver ratio, which measures how many ounces of silver are required to buy an ounce of gold, has continued to widen since then. Historically there has been a close correlation between the price of gold and silver, but since the end of the bull market, this close correlation has dropped away and is now well outside of the average ratio of 47 ounces of silver per ounce of gold.

We can see how far the ratio has widened when considering that at the height of the gold bull market it took 44 ounces of silver to buy one ounce of gold, and now the gap has grown to 63 ounces.

4. Silver miners have been hit far harder and are more attractively priced than gold miners

When precious metal prices collapsed at the end of 2012, the prices of precious metal miners plunged, with silver miners being among some of the worst affected. While the majority of gold miners have seen their share prices bounce back nicely since the start of this year on the back of the gold rally, the share prices of silver miners have lagged behind.

This sees a number of silver miners trading with some very attractive valuations in comparison to gold miners. Senior gold miner **Goldcorp Inc.** (TSX: G)(NYSE: GG) trades with an enterprise-value of 30 times EBITDA, whereas **Pan American Silver Corp.** (TSX: PAA)(NYSE: PAAS) has an EV of 9 times EBITDA and **First Majestic Silver Corp's** (TSX: FR)(NYSE: AG) is 14 times.

While Soros and Dalio have placed big bets on precious metal streamer **Silver Wheaton Corp.** (TSX: SLW)(NYSE: SLW) because of its low operating overheads and solid portfolio of precious metal streaming contracts, it is Pan American Silver that has caught my attention.

Pan American Silver is essentially a leveraged play on silver prices and it is one of the lowest cost operators in the industry with all-in-sustaining-costs of $15.52 per ounce. It has also managed to increase production as Q1 2014 production was up 5% compared to the equivalent quarter in 2013, despite capital expenditures for mine development being slashed. This coupled with a low cost structure leaves it well positioned to take advantage of higher silver prices and boost its profitability.

For all of these reasons, along with many of Pan American's costs being fixed and silver already up 6% for the year-to-date I expect to see the company report some solid financial results for the remainder of the year.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:AG (First Majestic Silver)
2. TSX:ABX (Barrick Mining)
3. TSX:FR (First Majestic Silver)
4. TSX:WPM (Wheaton Precious Metals Corp.)

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