3 Reasons Why I Remain Bullish on the Outlook for Silver

Description

For some time, I have been bullish on the prospects of precious metals including gold, with growing market volatility, geopolitical crises, and economic uncertainty making safe-haven investments increasingly popular. Though gold may be the most recognized safe-haven investment, I am more bullish on silver, as I believe it offers better long-term potential. Let’s take a closer look at why silver is a better opportunity than gold.

1. The gold-to-silver ratio continues to widen

The gold-to-silver-ratio represents the correlation between gold and silver prices by expressing how many ounces of silver are required to buy one ounce of gold. Over recent years, this ratio has widened, now requiring 66 ounces of silver to purchase one ounce of gold, indicating silver remains undervalued in comparison to gold.

But the key questions are: What is the correct ratio, and how far can the ratio close?

There are those analysts and market pundits who claim the historical ratio is 16-to-1 and it will eventually revert to this level. If it did, with gold trading at $1,268 per ounce, it would require the silver price to spike more than threefold to $79 per ounce. While this thesis is supported by the amount of recoverable silver reserves in the Earth’s crust being only around 11 times those of gold, I believe it appears a far too optimistic assessment, particularly when the volatility of silver prices is considered.

Over the last century, there has been a range of factors affecting silver demand causing its price to oscillate wildly and the gold-to-silver ratio to fall as low as 20 in 1970 and then peak at a high of 89 in 1991. Even at the height of the gold bull market, when the price of silver closely correlated to that of gold, it only closed to a ratio of 43 ounces of silver to purchase one ounce of gold. But even at that level, it indicates there is a minimum of 35% upside in silver.

However, what is clear is the widening gold-to-silver ratio, in conjunction with some extraordinary supply and demand fundamentals, highlights that silver is heavily undervalued and offers considerable upside for investors.

2. The supply and demand fundamentals are extraordinary

What is difficult to understand is how the gold-to-silver ratio continues to widen yet the supply of silver remains heavily constrained, with demand continuing to outstrip supply. This is because unlike gold, silver is an industrial commodity with a wide range of uses, the most important being its use as a central component in the manufacture of photovoltaic cells, all of which saw silver demand in 2013 outstrip supply by 11%.

Many analysts expect this to continue because of growing industrial demand primarily driven by exponential growth in the manufacture of photovoltaic cells as solar power grows in popularity. Furthermore, supplies remain constrained with silver miners reticent to invest in developing new mines because of soft silver prices.

This lack of investment can be seen in the second-quarter 2014 results of three of the largest pure silver miners, with **First Majestic Silver Corp.**'s (TSX: FR) (NYSE: AG) expenditures down a massive 56% compared to the equivalent quarter in 2013, whereas **Pan American Silver Corp.**'s (TSX: PAA) (Nasdaq: PAAS) were down 17% and **Endeavour Silver Corp.**'s (TSX: EDR) (NYSE: EXK) plunged a walloping 66%.

Furthermore, with all three miners generating narrow margins or even a loss with all-in sustaining costs of $18.18, $18.23, and $20.48 per ounce, respectively, compared to a silver price of $19.17 per ounce, it is difficult to see any of them boosting expenditures any time soon.

3. Institutional investors continue to bet big on silver

Wall Street continues to make significant bets on silver miners with two companies catching its attention, Pan American Silver and **Silver Wheaton Corp.** (TSX: SLW) (NYSE: SLW). Both George Soros and John Hussman have bet $10.7 million and $4 million, respectively, on Pan American Silver. Along with Ray Dalio, they have invested big on Silver Wheaton, with investments totaling $9.4 million, $7 million, and $6.6 million, respectively.

Clearly, Wall Street sees a rally in silver coming and has hedged its bets accordingly, making now the time for investors to take the plunge.

What is the best option to cash in on a rally in silver?

In previous articles, I have extolled the virtues of Pan American Silver and still believe it is a worthy investment, but it is Silver Wheaton that has caught my eye at this time. This is because it retains a cost structure that is significantly lower than any of the miners, with the company being a precious metals streamer rather than a miner — this essentially means that it is not required to sustain significant capital expenditures to bolster production.

For the second quarter, this saw it operating with cash costs of $4.64 per ounce produced compared to Pan American's $12.06, First Majestic's $9.63, and Endeavour's $9.87 per ounce. All of this allows Silver Wheaton to generate a superior margin per ounce of silver sold than any of the miners, making it a far more profitable and superior investment opportunity for investors seeking exposure to the impending rally in silver.

CATEGORY

1. Investing

TICKERS GLOBAL

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

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