This Key Ratio Highlights Now Is the Time to Buy Silver Wheaton Corp.

Description

I expect silver to rally quite strongly in 2015, with a range of catalysts set to drive its price higher. Key among these is the renewed interest in safe haven assets among investors as the global economy is wracked by macro-economic volatility and geopolitical uncertainty.

But there is one key indicator that highlights just how undervalued silver is: the gold-to-silver ratio.

What is the gold-to-silver ratio?

There is a strong correlation between the prices of silver and gold. This means that as gold prices rise, so will silver prices and the opposite will occur when gold prices fall. The gold-to-ratio measures this correlation by expressing how many ounces of silver are required to buy one ounce of gold.

Historically over the last 10 years, the ratio has averaged between 47 ounces and 50 ounces of silver to purchase one ounce of gold, but there are signs the ratio has moved to an extreme, indicating that silver is significantly undervalued.

Why is silver undervalued?

Over the last year the ratio has widened significantly, moving from 60 ounces of silver to purchase one ounce of gold a year ago to now require 72 ounces of silver. This highlights an extreme disconnect between the ratio and the historical average, signifying that silver is extremely undervalued compared to gold and that the ratio should start to move closer to its historical average.

It can do this one of two ways — either gold will fall or silver will appreciate in value, and it is the later which I expect to occur. This is because a range of catalysts, including those mentioned earlier, are set to support a rebound in gold and other precious metal prices over the course of 2015.

And while I believe it is extremely unlikely the price of silver will rise to see the ratio fall into line with the average over the last 100 years, it is easy to see the ratio closing to around 60 ounces of silver for one ounce of gold. This outlook concurs with the views of a number analysts, and with gold now trading at $1,276 per ounce, silver would need to appreciate to $21 per ounce or 19% higher than its current price.

What are the best ways to play the rebound in silver?

While this is only a relatively modest gain, investors can maximize their returns by investing in a primary silver miner. They offer leveraged exposure to the price of silver by virtue of their fixed costs.

Wall Street is betting big on silver, with hedge funds attracted to primary silver miner **Pan American Silver Corp.** (TSX:PAA)(NYSE:PAAS). The company has survived weaker silver prices and continued to grow production leaving it well positioned to benefit from the impending rebound in the price of silver. Impressively, it has also maintained its quarterly dividend payment of $0.125 per share, giving it a 4% yield. Each of these factors makes it easy to see why hedge funds are attracted to Pan American Silver.

While Pan American Silver certainly is a solid investment opportunity, I believe it is precious metals streamer **Silver Wheaton Corp.** (TSX:SLW)(NYSE:SLW) that offers the best opportunity for investors seeking to bet on a rebound in silver.

As a precious metals streamer it is not directly involved in mining activities. Instead, it lends funds to miners to develop their projects and in return receives a portion of silver production at a fixed price that is well below the market price. This gives it the same leveraged exposure to silver, while mitigating many of the risks associated with mining.

It also gives Silver Wheaton a far lower cost base, with each ounce of silver produced having a cash cost of $4.59 per ounce, which is almost a third of Pan American's $12.29 per ounce. Not only can Silver Wheaton remain profitable at far lower silver prices, but it has the potential to deliver higher earnings from even a slight gain in the price of silver.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. TSX:WPM (Wheaton Precious Metals Corp.)

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