Are China and the United States a Threat to the Success of Silver Wheaton Corp.?

Description

One of the primary reasons I am not a fan of investing in precious metals is because of the business model behind them. You dig them up, which costs a lot of money, and then put it all into a giant concrete box underground, which also costs a lot of money. This is why I've always hesitated to buy stock in these kinds of companies.

However, **Silver Wheaton Corp.** (TSX:SLW)(NYSE:SLW) has always been an intriguing exception to that rule because of its business model. Instead of running its own mines, it agrees to buy gold and silver from other mines before those operations even launch, giving the miners operating funds to get digging. In exchange, Silver Wheaton gets its precious metals at a significant discount.

This explains why the company has historically had high operating margins and profits. However, in the past year profit margins have dropped by 33% due to a decrease in silver demand. To offset this, Silver Wheaton has diversified and also now acquires gold from mines.

Here's the thing: there's a good chance that China and the United States could have a negative impact on the growth of the company. Here's how:

For China, industrial growth is slowing. The country only saw a 7% growth in economic activity year over year in the first quarter, which is the slowest growth in six years. Naturally, China intends to invest to try to boost this, but there are some analysts who are skeptical that it can actually make a difference.

If industrial growth slows, the demand for silver will drop even further than it already has. On top of that, China has always been a heavy silver buyer due to it being a fixed investment. If the economy slows, purchasing silver as a store of value or a hope for appreciation might not occur.

In the United States, rising interest rates could have an impact on the price of gold. The primary reason for this is because gold doesn't actually *do* anything for investors. As I described above, you buy it,hold it, and nothing happens. With bonds, they at least pay interest to the investor. If interest rates rise,there might be a move away from these fixed investments into bonds.

Now, people have been talking about rising interest rates for years, but it does appear that the Fed is getting close to making this decision. And if it happens, Silver Wheaton could get hit twice, both with the price of gold dropping and potentially the share price dropping as investors diversify.

What Should You Do?

I'm still a believer in Silver Wheaton and I do really like its business model. Based on how the stock has behaved in the past 18 months, this is a decent place to buy shares. However, what will likely happen is the stock will rise toward $30 and then drop again. This predictable trading pattern could allow you to play around with buying and selling the stock rather than just buying and holding.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

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

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Date
2025/08/04
Date Created
2015/05/07
Author
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