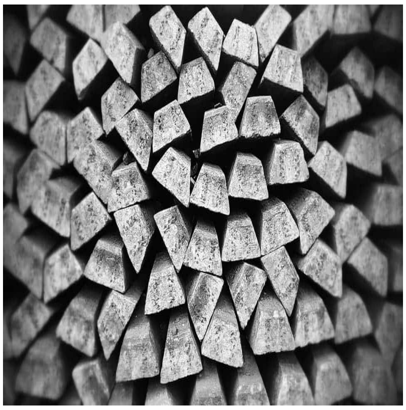

What Is Wrong With Silver?

Description

In recent weeks, gold has surged ever higher on the back of growing geopolitical tensions and fears that Trump will be unable to deliver his pro-business fiscal stimulus, including considerable infrastructure investment and corporate tax cuts. The yellow metal is now trading at about US$1,329 per ounce**,** which is not far off its highest price since September 2016.

While it is up by 15% for the year to date, its poor cousin silver has only risen by 12% and is trading 7% lower than it was when gold traded at US$1,320 per ounce in September 2016. This has sparked consternation among investors because the traditional close correlation between gold and silver appears to have broken down, making silver an unattractive investment.

Now what?

The long-term outlook for silver remains bullish, despite its recent lacklustre performance, which can be attributed to silver being a far more volatile than gold. That volatility is being magnified by the tremendous volume of paper silver that has flooded markets.

You see, paper silver essentially offers exposure to silver without providing physical bullion. It includes exchange-traded funds, unallocated bullion programs, futures, and other derivatives. In some circles, it has been estimated that the volume of paper silver could be as high as 250 times greater than the volume of physical bullion.

Meanwhile, data from the Silver Institute shows that the volume of paper silver traded in 2016 was 136 times greater than silver bullion, and this has created considerable liquidity which is responsible for the massive spike in volatility. One of the best ways to measure the volatility of an asset is by calculating the standard deviation. Over the last 40 years, silver’s annual rate of return has a standard deviation of 32%, or almost double the 19% recorded for gold.

The massive derivatives market for silver means that its price is open to considerable manipulation, which becomes apparent when it is considered that the price of silver is indifferent to supply and demand fundamentals. For the past four years, there has been a deficit of physical bullion, and another is forecast for 2017**,** yet the price of silver between 2013 and 2016 declined by 39%.

These allegations gained further weight with **Deutsche Bank AG** in 2016 settling a lawsuit that claimed it manipulated gold and silver prices. A more recent lawsuit from late 2016 saw those claims widened to include **UBS Group AG**, **HSBC Holdings Plc**, and **Bank of Nova Scotia**, among other firms that are alleged to have rigged the silver market.

While there is a lack of concrete evidence, there is certainly something amiss with the price of silver. This can't even be attributed to the surge in popularity of digital currencies such as Bitcoin, which some pundits claim has attracted investors who chose to own silver.

So what?

Along with the existing supply deficit, growing industrial demand for silver, and a higher gold-to-silver ratio, which means it takes 75 ounces of silver to buy one ounce of gold compared to a 40-year average of 62 ounces, this means that silver appears to be undervalued. This has created a buying opportunity for long-term investors who can tolerate the white metal's considerable volatility.

One of the best investments is precious metal streamer **Wheaton Precious Metals Corp.** (TSX:WPM)(NYSE:WPM), which earns 54% of its revenue from silver and the remainder from gold.

It provides investors with the same leverage as miners to silver but is far less volatile and risky. This is because it doesn't engage in hazardous mining activities; instead, it lends money to miners in exchange for a right to buy the silver and gold produced at a significant discount to its market price. It currently has 24 streaming agreements in place to purchase silver and gold, giving it reserves of 728 million silver ounces.

Wheaton also has another advantage over physical bullion — it pays a regular dividend of 2%, which makes it an attractive income-generating investment.

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