SPROTT ASSET MANAGEMENT

SPROTT ENHANCED EQUITY STRATEGY

June 2017 Commentary

The "quality" rally we discussed in our April and May commentaries, which saw large cap growth stocks such as Facebook, Amazon, Apple and Alphabet significantly outperform overall indices, gave back some of their outperformance as investors rotated capital back into more cyclical "value" sectors such as financials. Global central banks have become incrementally more hawkish almost in unison in recent weeks, causing higher interest rates and a slight steepening of the yield curve, both important positive profit drivers for financial stocks. The strong intra sector moves are a continuation of the highly rotational market we've been in for the better part of the last three years as capital swings between "risk-on" and "risk-off" investments. This month, we started to see a pick-up in implied volatility in the equity market, specifically in technology, a scenario we highlighted as likely to occur as we moved into 2017.

The significant change in tone amongst central bankers was most pronounced here in Canada, where expectations for rate hikes shifted from essentially zero, to several hikes in 2018. Bank of Canada (BoC) Governor Stephen Poloz noted that forward-looking components of economic activity in Canada were near record highs and that "slack is being absorbed" in the economy. This caused a sharp rally in the Canadian dollar as a record short position on the CAD unwound in a relatively short period of time. As discussed in prior monthly commentaries, we remain fully hedged on our US Dollar exposure as we see the exchange rate having the potential to create significant volatility for the fund with too many shifting variables in play to confidently take any exposure.

Figure 1 highlight's how extreme the net speculative short position had become coming into Senior Deputy Governor Carolyn Wilkins hawkish speech in mid-June. The change in tone came as a complete surprise to many given the perceived economic risks of weak commodity prices, the possible break up of NAFTA hurting Canadian exports, household indebtedness, recent concerns over the Canadian real estate market and related financial sector (driven by the Home Capital debacle), as well as persistently low Canadian inflation rates (figure 2). Investors believed all of these forces left the Bank of Canada no choice but to maintain accommodative monetary policy throughout 2018, in an effort to weaken the currency and boost export competitiveness. Central bankers, the BoC included, now seem more focused on the "output gap" as well as asset price inflation. This change in tone marks a clear break from the post 2008 focus on financial stability amid an environment of persistently low global inflation. Figure 3 shows that the global output gap, as estimated by the OECD, has almost closed since 2008 with Canada tighter than average on this metric.

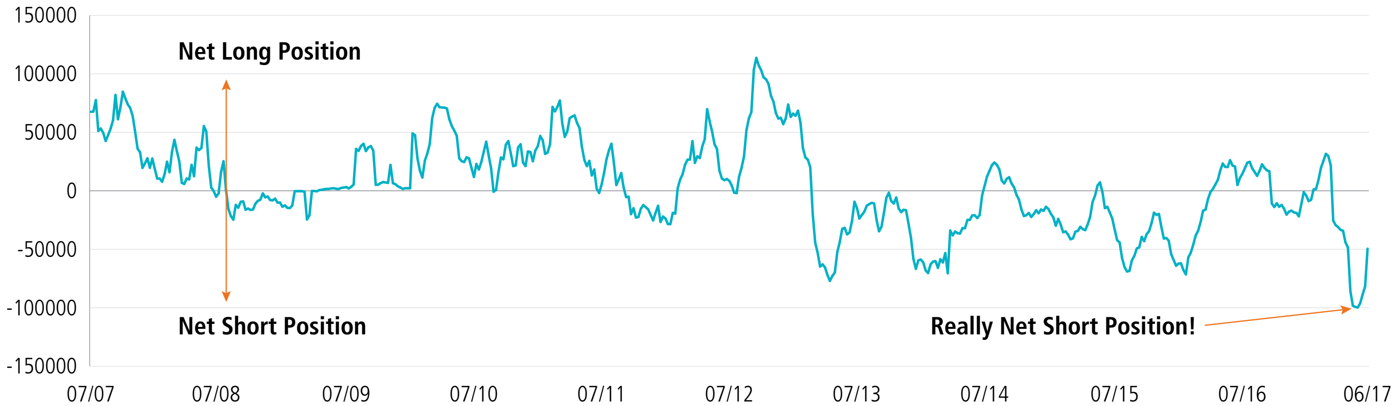
With markets still concerned about an end to the post 2008 business cycle after an almost decade long period of recovery, a central bank driven tightening "mistake" is likely to become more of a narrative in equity markets as we move into 2018. It's still our position that expectations for tax reform are likely to continue to dissipate as we move through the summer, albeit we admit most investors have now muted their expectations. We continue to believe that the current period of unusually low volatility is unsustainable and hold a net long volatility position in the funds, both through upside calls and downside protection on the S&P 500.

Until next month,

The Enhanced Strategy Team:
John, Colin and Etienne

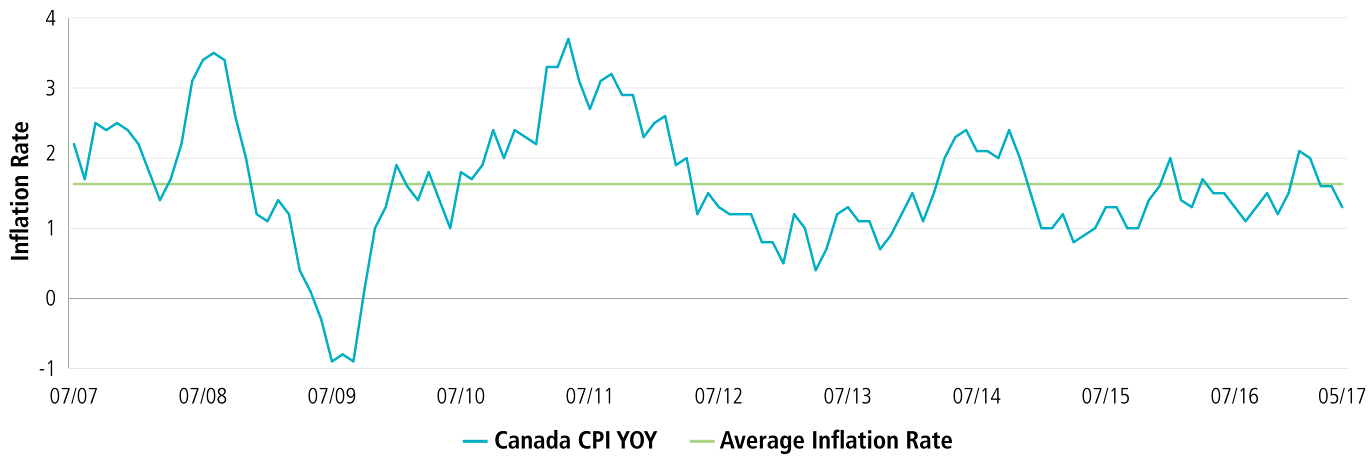
Figures continued on next page >

Figure 1: Net Long/Short Futures Position CAD



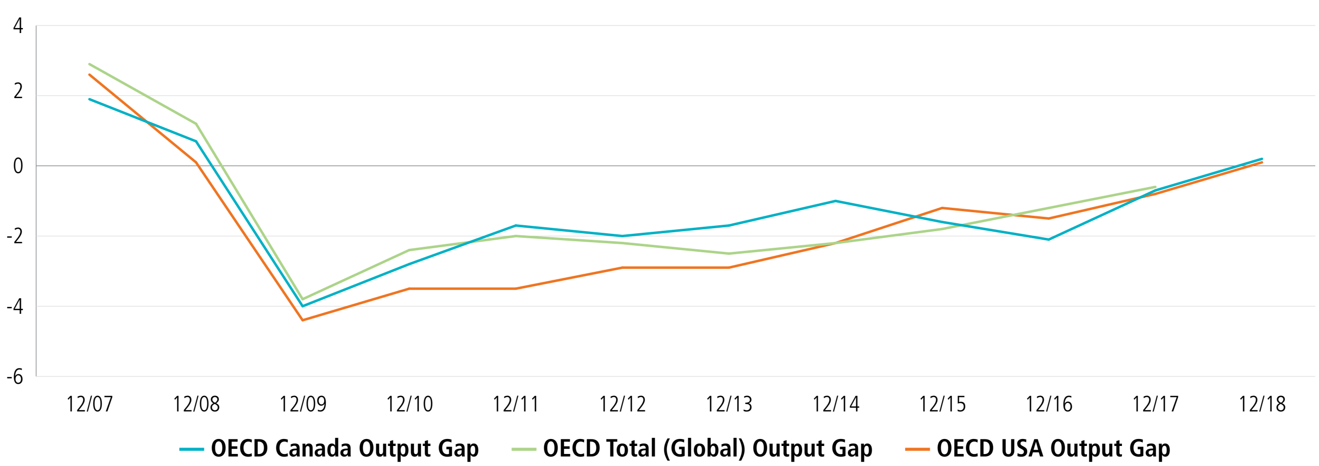
Source: Bloomberg, Commitment of Traders Report.

Figure 2: Canadian CPI YOY



Source: Bloomberg.

Figure 3: OECD Measured Output Gap in Canada, Global, USA



Source: Bloomberg, OECD.

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COMPOUNDED RETURNS (%) AS AT JUNE 30, 2017*

	1 MTH	YTD	3 MTH	6 MTH	1 YR	3 YR	5 YR	10 YR	ANNUALIZED INCEPTION
SPROTT ENHANCED BALANCED FUND, SERIES A	-1.2	0.6	0.0	0.6	4.1	1.0	4.1	-	3.8
BLENDED INDEX[1]	-1.7	2.7	-0.1	2.7	9.9	7.6	10.6	-	10.2
SPROTT ENHANCED BALANCED CLASS, SERIES A	-1.4	0.6	-0.2	0.6	4.1	0.8	-	-	2.1
BLENDED INDEX[1]	-1.7	2.7	-0.1	2.7	9.9	7.6	-	-	10.5
SPROTT ENHANCED EQUITY CLASS, SERIES A	-1.5	-0.7	-0.7	-0.7	3.4	0.5	4.8	-	4.6
TSX/S&P 500 BLENDED INDEX[2]	-2.1	3.2	-0.5	3.2	14.8	10.0	14.5	-	13.7
SPROTT ENHANCED LONG-SHORT EQUITY FUND L.P., CLASS A	-2.6	2.9	2.1	2.9	4.9	-1.8	3.3	2.0	8.6
TSX/S&P 500 BLENDED INDEX[2]	-2.1	3.2	-0.5	3.2	14.8	10.0	14.5	6.8	7.8
SPROTT ENHANCED LONG-SHORT EQUITY RSP FUND, CLASS A	-2.6	2.6	2.0	2.6	4.2	-2.3	2.9	1.7	4.0
TSX/S&P 500 BLENDED INDEX[2]	-2.1	3.2	-0.5	3.2	14.8	10.0	14.5	6.8	7.8
SPROTT ENHANCED U.S. EQUITY CLASS, SERIES A (USD)	0.1	3.4	1.8	3.4	4.5	-	-	-	-1.3
S&P 500 TRI (USD)[3]	0.6	9.3	3.1	9.3	17.9	-	-	-	10.0

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* All returns and fund details are a) based on Class/Series A shares/units; b) net of fees; c) annualized if period is greater than one year; d) as at June 30, 2017; e) inception date for Sprott Enhanced Equity Class is 04/16/12; f) inception date for Sprott Enhanced Balanced Class is 09/13/13; g) inception date for Sprott Enhanced Balanced Fund is 04/16/12; h) inception date for Sprott Enhanced Long-Short Equity Fund L.P. is 04/07/04; i) inception date for Sprott Enhanced Long-Short Equity RSP Fund is 09/30/05; j) inception date for Sprott Enhanced U.S. Equity Class is 07/22/15.

1 40% S&P/TSX Composite TRI; 30% S&P 500 TRI CAD; 30% FTSE TMX Canada Universe Bond Index™ and is computed by Sprott Asset Management LP based on available index information.

2 50% of S&P/TSX Composite TRI; 50% of S&P 500 TRI CAD and is computed by Sprott Asset Management LP based on available index information.

3 Indices are computed by Sprott Asset Management based on publically available index information.

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