SPROTT
ASSET MANAGEMENT

SPROTT ENERGY FUND

January 2017 Commentary

There are times when the market gives you a buying opportunity that only with the benefit of hindsight seems obvious. January 2016 was such a time when stocks were selling off by 5%-10% per day and oil strategists competed with each other to see who could have the most obscenely bearish oil price forecast. It was at that time that we took an "all in" approach as we believed that it was overwhelmingly in our favour to have capital deployed given the reward:risk that we saw. We were willing to endure the volatility and potentially underperform our peers in the short-term. While the Sprott Energy Fund fell by 8% that month we went on to rally by over 140% from the January lows.

We believe there are strong parallels between January 2016 and January 2017. Investors returned to work this New Year terrified about the possible implementation of a Border Adjustment Tax by President Trump and of the consequences that it would have on the Canadian (and global) energy markets. Canadian energy stocks were liquidated with many falling by 15%-20% in the month. The biggest of US Fund companies exerted enormous pressure on multiple names as they ran for the hills. The result was that we had our worst month since December 2015 falling by 11.9%. Throughout the month we topped up positions that became the most attractively valued since "peak pessimism" exactly one year ago buying names in which we saw 50%-60%+ upside. While volatility is amplified due to not having cash on the sidelines we reflected on our lesson from last year and that is sentiment can change very, very quickly. If you are not already invested it is impossible to deploy capital and benefit from the predicted upside when sentiment changes. Hence why we decided to and remain fully invested with a bias towards Canadian oil stocks. Just as in January 2016 we have been buying shares from people seemingly panicking over an outcome which we attach very little probability to occurring.

There are several reasons why we do not believe that a Border Adjustment Tax (if even passed) would include oil. Firstly, while US oil producers would receive a 20%-30% premium to global oil benchmarks the negative impact would be the commensurate increase in costs to US refineries. These costs would be passed onto the US consumer and our analysis suggests that it would result in a $500/household after-tax cost in a country where the average US household income is $51,500. There is a very strong inverse correlation between gasoline prices and Presidential approval ratings and given that this would optically be a wealth transfer from the average US family to "Big Oil" the political palatability of this seems highly unlikely. As the US refining complex is setup to process Canadian heavy oil (we send 99% of all of our oil production to the US) the avoidance of such an impact would be impossible. Another impact this would have would be to highly challenge Trump's primary goal of increasing US manufacturing as an oil-inclusive BAT would massively drive up energy costs. Given the presence of Rex Tillerson, the former CEO of Exxon Mobil, as Secretary of State we are confident that he would have the understanding and ability to clearly explain these consequences to the U.S. President.

Given the above it would be easy to ignore other macro considerations. We are weeks away from having the OPEC curtailments become visible in weekly inventory drawdowns (~45 days for a Persian Gulf tanker to reach the US) and OPEC compliance so far has exceeded 80%. We continue to believe that strong demand growth combined with the OPEC cuts and other sources of non-US/non-OPEC supply reductions will see US oil inventories normalize in the next few months and OECD oil inventories to reach "normal" levels by around the end of Q3/2017. While the US oil directed rig count has rebounded sharply from the lows the inevitable production response (not to be really felt until Q3/Q4) will not be enough to void our bullish oil thesis. We remain in an oil bull market for the next several years. Given this positive backdrop and the enormously attractive opportunity that the BAT fears have created we once again have gone "all in" and remind our investors that we might be more volatile in the very short term than our peers. However, just as it happened last year

Continued on next page >

the "turn" occurs very quickly and if you are not invested BEFORE this occurs you will miss it. As many stocks have fallen by 20% over the past month the risk of NOT being invested is our greatest concern as we hold many positions where we see a greater than 60% potential return.

Eric Nuttall

Portfolio Manager

Sprott Energy Fund

COMPOUNDED RETURNS (%) AS AT JANUARY 31, 2017[1]

	1 MTH	YTD	3 MTH	6 MTH	1 YR	3 YR	5 YR	10 YR	ANNUALIZED INCEPTION (04/15/04)
SPROTT ENERGY FUND, SERIES A	-11.9	-11.9	-1.2	8.6	61.2	1.1	-0.6	-1.1	5.4
S&P/TSX CAPPED ENERGY TRI	-8.5	-8.5	-0.4	8.4	30.2	-6.5	-3.6	-1.7	4.1

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[1] All returns and fund details are a) based on Series A units; b) net of fees; c) annualized if period is greater than one year; d) as at January 31, 2017; e) 2004 annual returns are from 04/15/04 to 12/31/04. The index is 100% S&P/TSX Capped Energy TRI and is computed by Sprott Asset Management LP based on publicly available index information.

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