SPROTT ENHANCED EQUITY STRATEGY

December 2016 Commentary

December was quiet with short cover rallies in several of the underperforming “bond proxy” sectors such as utilities, real-estate and telecom. U.S. 10yr treasuries bonds, which had sold off considerably since the Trump election reversed trend in December sparking money flows back into these sectors. We continued to trim our substantial financials exposure held through options positions during December along with several positions in large cap healthcare. We will be looking to redeploy this capital towards new ideas and core holdings as the New Year progresses.

As we discussed last month, the period from mid-2015 up until the US election was defined by very high levels of sector and asset class correlation which could be triggered by just the slightest change in fed policy expectations. This made for a difficult environment for high active share managers, including ourselves. Going forward we expect U.S. government policy action related to taxation, spending and trade along with broad based economic data to drive market expectations vs. the fed liquidity driven paradigm of the past several years.

While we are optimistic significant tax reform is likely to be passed in 2017, there are several details we expect to show up in the current Republican proposals that have a negative bias for markets. An area of particular concern for us is the potential for “border adjustment” tax policies which would significantly penalize imports and operate as a de facto “tariff” on imported goods. Our research indicates this has a relatively high potential to be included at least in some form in the House GOP plan. While we believe some compromise around this issue is likely to occur given the pain it would put on some major U.S. employers (retail) as well as the potential inflationary consequences, rhetoric is likely to be high around this issue given its strong political appeal. While many are dismissive of this policy being enacted, the tax represents a significant source of revenue to fund a lower overall corporate tax rate for American companies. We’ve seen estimates that the Trump tax plan could cost over $3 trillion dollars over a 10 year window implying compromise on key initiatives or offsetting taxes might be needed to make the plan more palatable. Chart 1 provides an excerpt from a white paper written by Peter Navarro (Head of Trump’s National Trade Council) and Wilbur Ross (Trump’s Secretary of Commerce) highlighting the revenue potential from “trade reform” policies.

Big picture, the current policy changes that are envisioned by the incoming administration represent a paradigm shift in the desired future growth model of the country away from consumption towards net exports and investment. While intentions seem good natured we see the risks of a stronger dollar and potential trade wars as significant negatives that are more than just a tail risk in 2017. To date, markets have considered and begun pricing in many of the positive implications of reform and few of the negatives. We’ve spent significant time trying to understand the net impact of these policies on the holdings in the funds as well as how we rank future investments under the new regime. Many of our holdings we view as insulated from the more extreme negative implications of these policies while benefiting from the potential upside of possible reform. While we hold them because we like the businesses and the relative value, any kicker from tax reform could be an additional tailwind in 2017.

Continued on next page >

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	Cumulative Federal Tax Revenue Increases (2017-2026, Nominal Dollars, Trillions)
Trade Policy Reforms	$1.740
Regulatory Policy Reforms	$0.487
Energy Policy Reforms	$0.147
Total	$2.374

Source: "Scoring the Trump Economic Plan: Trade, Regulatory, & Energy Policy Impacts" https://www.donaldjtrump.com/press-releases/white-paper-on-djt-econ-plan

The Enhanced Strategy Team:
John, Colin and Etienne

COMPOUNDED RETURNS (%) AS AT DECEMBER 30 2016*

	1 MTH	YTD	3 MTH	6 MTH	1 YR	3 YR	5 YR	10 YR	ANNUALIZED INCEPTION
SPROTT ENHANCED BALANCED FUND, SERIES A	1.4	0.7	1.5	3.5	0.7	2.2	-	-	4.1
BLENDED INDEX[1]	1.1	11.6	2.6	6.9	11.6	9.7	-	-	10.7
SPROTT ENHANCED BALANCED CLASS, SERIES A	1.3	0.4	1.7	3.5	0.4	1.7	-	-	2.2
BLENDED INDEX[1]	1.1	11.6	2.6	6.9	11.6	9.7	-	-	11.2
SPROTT ENHANCED EQUITY CLASS, SERIES A	1.7	-1.1	2.1	4.1	-1.1	2.1	-	-	5.2
TSX/S&P 500 BLENDED INDEX[2]	1.8	14.9	5.5	11.2	15.0	12.5	-	-	14.4
SPROTT ENHANCED LONG-SHORT EQUITY FUND L.P., CLASS A	0.9	-9.0	-0.9	1.9	-9.0	-1.2	0.4	2.9	8.7
TSX/S&P 500 BLENDED INDEX[2]	1.8	14.9	5.5	11.2	14.9	12.5	14.7	6.7	7.9
SPROTT ENHANCED LONG-SHORT EQUITY RSP FUND, CLASS A	0.9	-9.5	-1.1	1.6	-9.5	-1.6	0.0	2.6	4.0
TSX/S&P 500 BLENDED INDEX[2]	1.8	14.9	5.4	11.2	14.9	12.5	14.7	6.8	7.8
SPROTT ENHANCED U.S. EQUITY CLASS, SERIES A	1.2	-2.8	1.5	1.1	-2.8	-	-	-	-4.0
S&P 500 TRI (CAD)[3]	2.0	12.0	3.8	7.8	12.0	-	-	-	6.8

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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 December 30, 2016; 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. Inception date July 24, 2015.

[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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