



John Hathaway, CFA
Senior Portfolio Manager,
Sprott Asset Management
USA, Inc.

John Hathaway, Senior Portfolio Manager, joined Sprott Asset Management on January 17, 2020, following Sprott's successful acquisition and reorganization of the Tocqueville gold strategies. The Sprott Gold Team welcomes Hathaway, along with Doug Groh, Senior Portfolio Manager, and Victor Huwang, Director, U.S. Operations. The Sprott Gold Team offers world-class expertise in the active management of precious metals equities. Visit sprott.com/gold-team for more information.

No Way Out

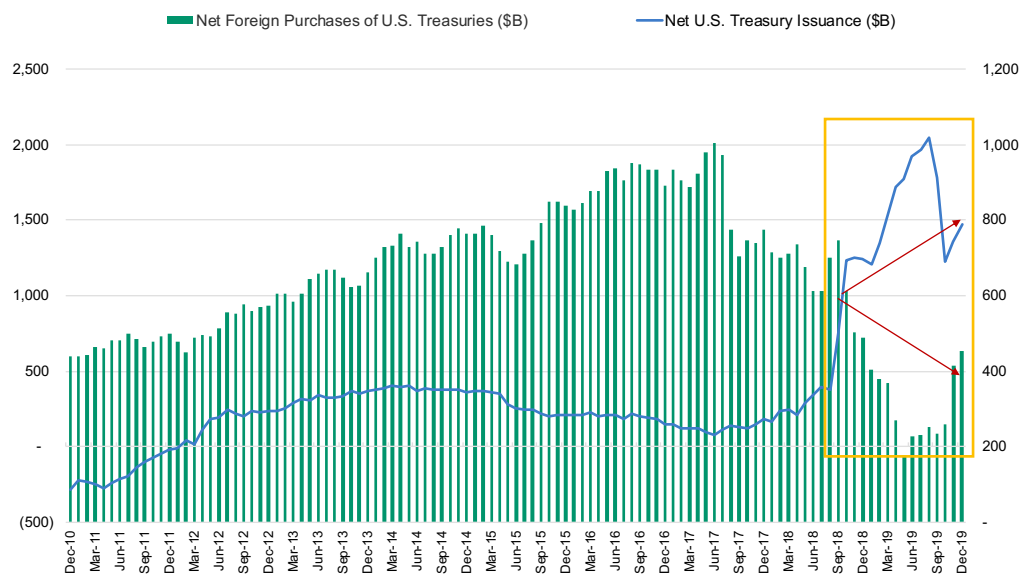
January 28, 2020

On September 17, 2019, overnight repo rates spiked 121 basis points, climbing from 2.19% to 3.40%, providing yet another crucial buttress for the bullish rationale for gold. The spike signaled that the U.S. Federal Reserve ("Fed") had lost control of the price of money. Without subsequent massive injections of liquidity by the Fed into the repo market, out of control, short-term interest rates would have undermined the leverage that underpins record financial asset valuations. Going forward, unless the Fed continues to expand its balance sheet, it risks a meltdown in equity and bond prices that could exceed the damage of the 2008 global financial crisis. Despite consensus expectations, there appears no escape from this treadmill.

The Fed must monetize deficits because non-U.S. investors are no longer absorbing the growing supply of U.S. debt. Ultra-low, short-term interest rates do not compensate foreign investors for the cost of hedging potential foreign currency (FX) losses (see Figure 1). The U.S. fiscal deficit is too high and the issuance of new U.S. treasuries is too great for the market to absorb at such low interest rates. In a free market, interest rates would rise, the economy would stall and financial asset valuations would decline sharply.

Figure 1. Treasury Issuance Goes Up, Foreign Purchases Go Down

(2010-2019)



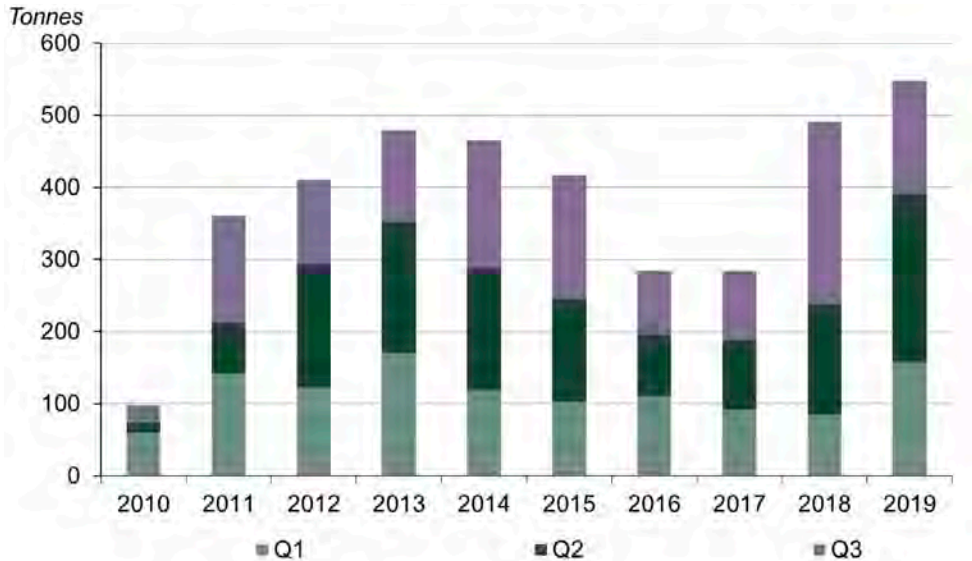
Source: Bloomberg. Data as of 12/31/2019.

Sprott Gold Equities Strategy

Q4 2019 Commentary

The predicament facing monetary policy explains why central banks are buying gold in record quantities, as shown in Figure 2. It also explains the fourth quarter “melt-up” in the equity market, even with Q4 earnings that are likely to be flat to down versus a year ago (marking the second quarter in a row for lackluster results) and the weakest macroeconomic landscape since 2009 (as shown by Figure 3).

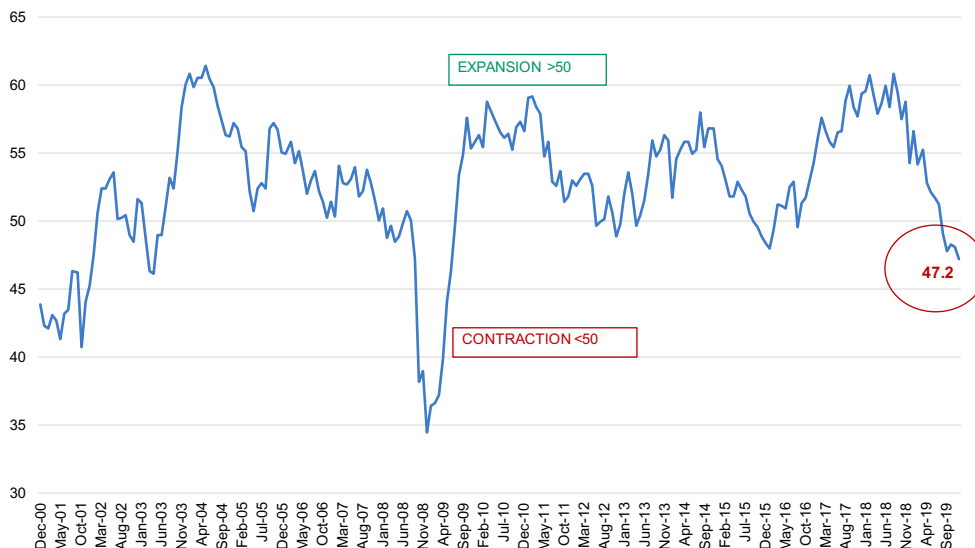
Figure 2. Central Banks Purchases of Gold are 12% Higher than Last Year



Source: World Gold Council; Metals Focus; Refinitiv GFMS. Data as of 9/30/2019.

Figure 3. The U.S. ISM PMI Index Indicates Economic Contraction

The U.S. ISM Manufacturing Purchasing Managers Index (PMI)¹ ended the year at 47.2, indicating that the U.S. economy is in contraction territory (a reading above 50 indicates expansion, while a reading below 50 indicates contraction).



Source: Bloomberg. Data as of 12/31/2019.

Sprott Gold Equities Strategy

Q4 2019 Commentary

Liquidity injections will result in more debt, both public and private sector, but not necessarily enhanced economic growth:

“As these forms of easing (i.e., interest rate cuts and QE [quantitative easing]) cease to work well and the problem of there being too much debt and non-debt liabilities (e.g., pension and healthcare liabilities) remains, the other forms of easing (most obviously currency depreciations and fiscal deficits that are monetized) will become increasingly likely ... [this] will reduce the value of money and real returns for creditors and will test how far creditors will let central banks go in providing negative real returns before moving into other assets [including gold].”

– Ray Dalio, Paradigm Shifts, Bridgewater Daily Observations, 7/15/2019

Gold Bullion and Miners Shine in 2019

Though overshadowed by the rip-roaring equity market, precious metals and related mining equities also had significant gains in 2019 (up 43.49%)². Gold’s 18.31% rise last year was its strongest performance since 2016. More significantly, after two more years of range-bound trading, the metal closed out 2019 at its highest level since mid-2013, and within striking distance of \$1,900/oz, the all-time high it reached in 2011.

The investment world has taken little notice. Despite gold’s strong performance, GDX³, the best ETF (exchange-traded fund) proxy for precious metals mining stocks, saw significant outflows over the year as shares outstanding declined from 502 million to 441 million (or 12%) over the twelve months, despite posting a 39.73% gain, well ahead of the 31.49% total return for the S&P 500 Total Return Index⁴.

It has been our long-held view that until mainstream investment strategies run aground, interest in precious metals will continue to simmer on low, notwithstanding the likelihood that 2020 may be another very good year for the precious metals complex. The many reasons why mainstream investment strategies could unravel are not difficult to imagine. They include the emergence of meaningful inflation, further slippage of the U.S. dollar’s nearly exclusive reserve currency status, and market-driven interest rate increases or a recession. Any or all of these could disrupt the continued expansion of the Fed’s balance sheet, triggering a rapid reversal in financial asset valuations. Each possibility deserves a more complete discussion than space here allows, but evidence strongly suggests that none can be ruled out. While timing the zenith in complacency is risky, we feel confident that a reversal of fortune for high financial asset valuations awaits unsuspecting investors sooner than they expect.

“We believe that there is a strong case to expect gold mining shares to outperform the metal in the years ahead...”

We are even more confident that a bear market will generate far broader investment interest in gold. Considering that institutional exposure to gold and related mining stocks hovers near multi-decade lows, the slightest uptick could easily drive the metal and related precious metals mining shares to historic highs. Today, the aggregate market capitalization of precious metals equity shares is \$400 billion, an insignificant speck on the current market landscape.

Investors outflows from precious metals mining stocks in 2019, even as gold rose 18.31%, suggests skepticism that the current rally is sustainable – perhaps hardened by the wounds of years of middling performance. Contrarian analysis would regard such bearishness as grounds to be very bullish. In our opinion, investors have overlooked that the 2019 rise in gold prices has restored financial health to sector balance sheets, earnings and cash flow. Gold stocks offer both relative and absolute fundamental value and growth potential that compares very favorably to conventional investment strategies [independent of their added torque to precious metal prices].

Sprott Gold Equities Strategy

Q4 2019 Commentary

We believe that there is a strong case to expect gold mining shares to outperform the metal in the years ahead by a substantially wider margin than they outperformed in 2019. With continued advances in precious metals prices, the return potential from these still unloved orphans and pariahs of the investment universe should prove to be very compelling.

In closing, this note is necessarily brief as the Tocqueville gold team completes its transition to its new home at Sprott Inc., following more than two successful decades at Tocqueville Asset Management. The effective date of this change was January 17, 2020. Speaking for myself, as well as Doug Groh and Victor Huwang, key team members for most of those two decades, we look forward to many years ahead of fruitful collaboration with our new Sprott partners and colleagues.

Authored by John Hathaway, CFA



John Hathaway, CFA
Senior Portfolio Manager

Sprott Gold Equities Strategy

Q4 2019 Commentary



Please contact the Sprott Team at **888.622.1813** for more information. You can also email us at invest@sprott.com.

- ¹ The Purchasing Managers Index (PMI) is a measure of the prevailing direction of economic trends in manufacturing. The purpose of the PMI is to provide information about current and future business conditions to company decision makers, analysts, and investors.
- ² Sprott Gold Miners ETF (NYSE Arca: SGDM) seeks investment results that correspond (before fees and expenses) generally to the performance of its underlying index, the Solactive Gold Miners Custom Factors Index (Index Ticker: SOLGMCFT). The Index aims to track the performance of larger-sized gold companies whose stocks are listed on Canadian and major U.S. exchanges.
- ³ VanEck Vectors[®] Gold Miners ETF (GDX[®]) seeks to replicate as closely as possible, before fees and expenses, the price and yield performance of the NYSE Arca Gold Miners Index (GDMNTR), which is intended to track the overall performance of companies involved in the gold mining industry.
- ⁴ The S&P 500 or Standard & Poor's 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies.

This content is intended solely for the use of Sprott Asset Management USA, Inc. for use with investors and interested parties. Investments, commentary and statements are unique and may not be reflective of investments and commentary in other strategies managed by Sprott Asset Management USA, Inc., Sprott Asset Management LP, Sprott Inc., or any other Sprott entity or affiliate. Opinions expressed in this presentation are those of the presenter and may vary widely from opinions of other Sprott affiliated Portfolio Managers or investment professionals.

This content may not be reproduced in any form, or referred to in any other publication, without acknowledgment that it was produced by Sprott Asset Management LP and a reference to sprott.com. The opinions, estimates and projections ("information") contained within this content are solely those of Sprott Asset Management LP ("SAM LP") or its affiliates and are subject to change without notice. SAM LP makes every effort to ensure that the information has been derived from sources believed to be reliable and accurate. However, SAM LP and affiliates assume no responsibility for any losses or damages, whether direct or indirect, which arise out of the use of this information. SAM LP and affiliates are not under any obligation to update or keep current the information contained herein. The information should not be regarded by recipients as a substitute for the exercise of their own judgment. Please contact your own personal advisor on your particular circumstances. Views expressed regarding a particular company, security, industry or market sector should not be considered an indication of trading intent of any investment funds managed by SAM LP or its affiliates. These views are not to be considered as investment advice nor should they be considered a recommendation to buy or sell. SAM LP and/or its affiliates may collectively beneficially own/control 1% or more of any class of the equity securities of the issuers mentioned in this report. SAM LP and/or its affiliates may hold short position in any class of the equity securities of the issuers mentioned in this report. During the preceding 12 months, SAM LP and/or its affiliates may have received remuneration other than normal course investment advisory or trade execution services from the issuers mentioned in this report.

The information contained herein does not constitute an offer or solicitation to anyone in the United States or in any other jurisdiction in which such an offer or solicitation is not authorized or to any person to whom it is unlawful to make such an offer or solicitation. Prospective investors who are not resident in Canada or the United States should contact their financial advisor to determine whether securities of the Funds may be lawfully sold in their jurisdiction.

The information provided is general in nature and is provided with the understanding that it may not be relied upon as, nor considered to be, the rendering of tax, legal, accounting or professional advice. Readers should consult with their own accountants and/or lawyers for advice on the specific circumstances before taking any action.

®Registered trademark of Sprott Inc.

Sprott Asset Management USA | 500 Fifth Avenue, Suite 3020, New York, NY 10110 | Toll Free: 888.708.0237 | sprott.com