Sprott

Special Update

March 2, 2020

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.

Systemic Risks Exposed

Authored by John Hathaway, CFA

Last week's selloff created an extraordinary buying opportunity. We believe that even a small, incremental increase in investor focus and capital flows will drive the low valuations of precious metals mining shares considerably higher.

Consider these six key points:

1. Coronavirus Poses Black Swan Threat

Before the coronavirus panic, gold had been rising steadily, up 18.31% in 2019. Gold strength was based on the expectation that central banks had no way to normalize interest rates, as we discussed in our January commentary, *No Way Out*. The outlook for public policy in major economies was for gold-friendly monetary largesse and ever-larger doses of fiscal stimulus, even before the virus threat. A black swan event was not necessary to drive capital flows into the yellow metal but it has surely helped.

2. Paper Currency is Toast

Coronavirus will eventually go away. Global indebtedness will not. A vaccine will be found and the pandemic contained, hopefully in a year or less. More than $240 trillion[1] of public and private sector debt is here to stay and very likely to expand exponentially (the global debt-to-GDP ratio exceeds 318%). Economic growth was weakening well before the virus and will most certainly suffer for the near to intermediate term. This will lead to even larger deficits and stronger handcuffs on policy alternatives. Paper currency is toast, if that were ever in doubt.

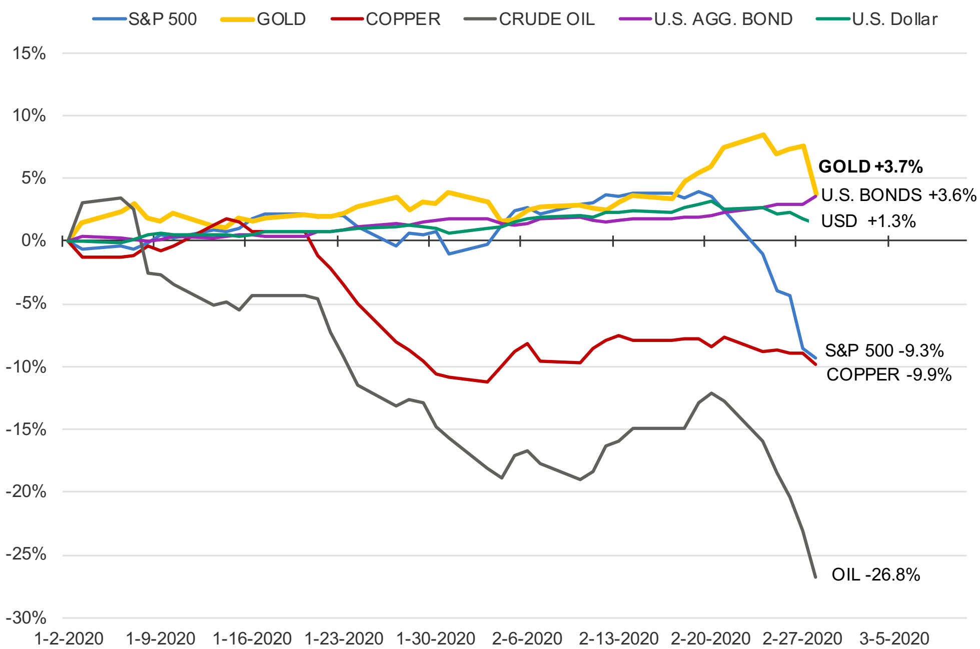
3. Risk-Conscious Investors Turning to Gold and Bonds

Despite gold's excellent performance, investor interest in gold and related mining shares remained muted throughout 2019 because mainstream investment strategies had generated good returns. Coronavirus associated economic risks have served to expose the fissures in the otherwise complacent façade of financial serenity and well-being. Suddenly, it has become apparent that all is not well with conventional thinking.

> "It's time for gold to enter mainstream investment discussion and practice."

The global and U.S. economy, already weakening, are no longer perceived as healthy. The earnings outlook is poor. Equities appear too high. The systemic risks of passive investing are leading to indiscriminate liquidations of securities across the board. Investors are suddenly risk conscious. That will keep the bid for gold strong. Year-to-date, only gold and bonds have withstood the panic and volatility caused by the coronavirus.

Figure 1. Gold Holds Up

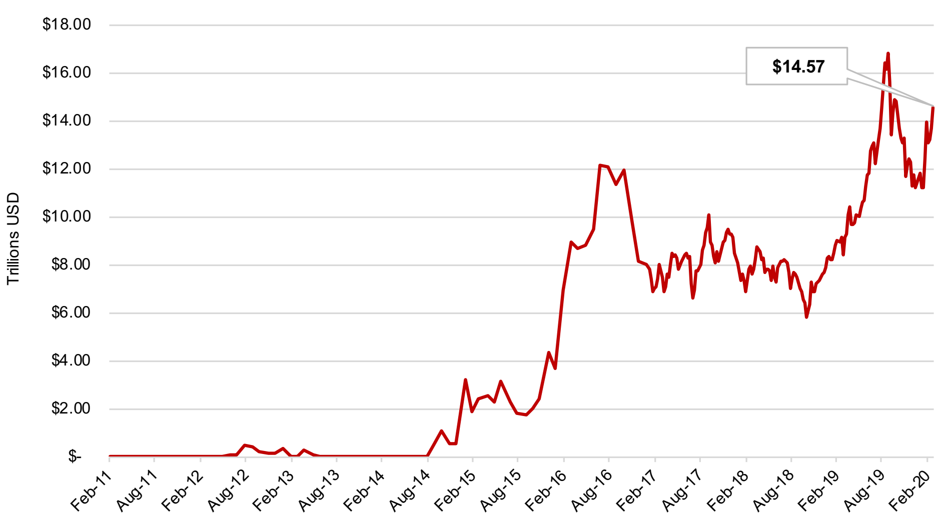


Source: Bloomberg. Data as of 2/29/2020.

4. $14 Trillion and Counting

Capital flows are pouring into sovereign debt seeking safety. Negative yielding sovereign debt is approximately $14.57 trillion at last count. In a weakening economy, credit defaults of lower-rated debt will rise. Compromised balance sheets cannot be saved by reductions on the short end of the curve in a business contraction. Creditors will not wait for the promised eventual recovery. Many dreams will go belly up before the Federal Reserve cavalry can save them.

Figure 2. Negative Yielding Global Debt Tops $14 Trillion



Source: Bloomberg. Data as of 2/29/2020.

5. Gold Miners are Healthy

While earnings of most companies and economic sectors are likely to decline this year, those of precious metals miners are rising strongly and likely to climb further. The global cost of mining an ounce of gold is roughly $1,000 an ounce.

The average gold price rose from $1,270 in 2018 to $1,394 in 2019, a gain of 9.83% and a margin increase for miners in general of approximately 46%. If current metal prices hold, earnings would rise again by approximately 47%. In this deflationary environment, costs are likely to remain stable and may even decline. Margins could expand more than expected. Cash flows are robust, balance sheets are improving and dividends are on the increase. It is a story unlikely to be told in other economic sectors.

6. Precious Metals Equities Offer Compelling Upside

Gold, silver and related mining shares will benefit from this mix of circumstances and events. The sector is just awakening from a multi-year slumber measuring back to the prior peak in 2011. Gold still trades below its all-time high of 9 years ago. Bonds and stocks are in bubble territory and trade at record high valuations.

Gold and mining shares are underweighted and underrepresented in almost every investment discussion. **From a tactical and strategic perspective, now is the time for gold to enter mainstream investment discussion and practice.**

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About Sprott

Sprott is a global asset manager providing investors with access to highly-differentiated precious metals and real assets investment strategies. We are specialists. Our in-depth knowledge, experience and relationships separate us from the generalists. Sprott's specialized investment products include innovative physical bullion trusts, managed equities, mining ETFs, as well as private equity and debt strategies. We also partner with natural resource companies to help meet their capital needs through our brokerage and resource lending activities. Sprott is based in Toronto and has offices in New York, San Diego and Vancouver. Our common shares are listed on the Toronto Stock Exchange under the symbol TSX: SII. For more information, please visit **sprott.com**

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

[1] Source: Bloomberg as of Feb. 29, 2020.