SPROTT ASSET MANAGEMENT

SPROTT ENHANCED EQUITY STRATEGY

July 2017 Commentary

July was once again another quiet month for equities and volatility, a trend that not even earnings season could meaningfully change. While earnings season saw broad based strength across sectors, with 5.5% revenue growth, 10% EPS growth and 4.5% earnings surprises amongst S&P 500 companies, stocks generally traded lower on these results (Figure 1). In fact many sectors that delivered the largest positive surprises on the EPS line during the quarter incurred the worst single day performance on the back of those results. This generally supports our narrative that much was "priced in" with "good" being "not good enough" at current valuations. We also note that despite economic data being quite stable, economic surprises decelerated into the summer and only recently started to improve. Figure 2 highlights the drop since March in economic surprises as well as the positive correlation between YOY momentum in equities and broad economic surprises. Although the data has been weak over the past few months, economic surprise indices do show some seasonality. It's not atypical to see economic surprises accelerate into the fall as Figure 3 depicts. We see this potential for modest upside surprises on U.S. economic data as a potential upside catalyst to stocks near-term though we doubt that positive estimate revisions for stocks are likely to occur from current levels, a second important factor we think is needed to get significant upside from here for North American equities.

On the political front, market hopes for a substantial tax reform package this year are losing steam quickly as the Trump administration lurches from one self-inflicted crisis to the next. At this point, there appears to be very little upside for any member of Congress, including Republicans, to be seen as working closely with Trump. Officially, the White House is still talking about launching a new tax bill this fall with a goal of passing it by November but our view is that the first quarter of next year is the best case – and that is assuming no further political blundering by Trump, which, let's face it, feels like a pipe dream.

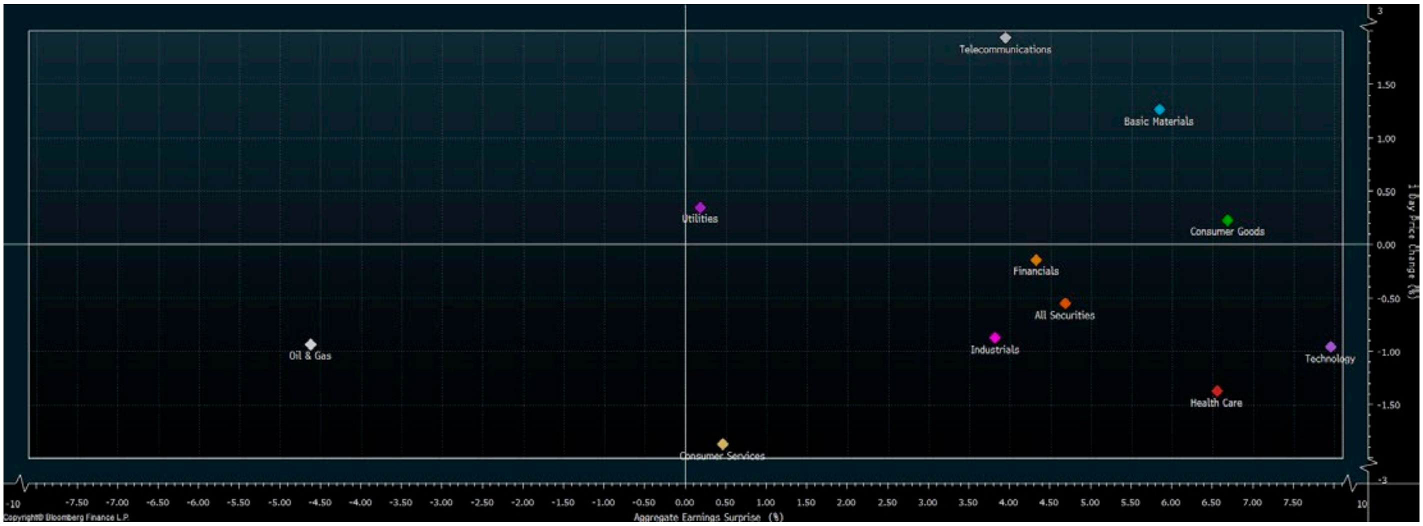
In the Enhanced funds earnings for our companies were largely in line with our expectations. Frustratingly, our most expensive valued holdings continue to be our best performing stocks, while our cheapest (theoretically most compelling) portfolio positions continue to underperform. We are aware that "cheap" does not always mean a stock will outperform, at least not in the near or even medium term. That said, the momentum nature of leadership over the past eighteen months has been difficult for our style which is heavily focused on downside risk and risk adjusted returns. Accordingly, we are focused on weeding out "cheap" holdings without visible near term catalysts and using options to reduce downside on our best performing, more expensive positions.

On the downside protection front, we recently moved to increase the convexity (convexity is a measure of how quickly our portfolio protection increases in value as markets fall) of our index put protection book and lowered our projected downside capture for the enhanced funds. This was done at a relatively low cost as we covered (bought back) the bottom strike of a put spread we had entered into several months ago anticipating that markets would likely offer a poor risk/reward coming into and after Q2 earnings for the reasons we've discussed in past commentaries. While we like the prospects for long-term earnings growth in our holdings, many of the concerns about the market environment and low volatility will undoubtedly impact these companies. We feel that in this environment it's much more cost effective to hedge a portfolio with broad index hedges vs. individual stocks given the events that "could" derail the current bull market are likely to broadly impact all equities. Volatility to us seems like a reasonable bet at this juncture and we've increased our exposure this month in a very cost-effective fashion.

Until next month,

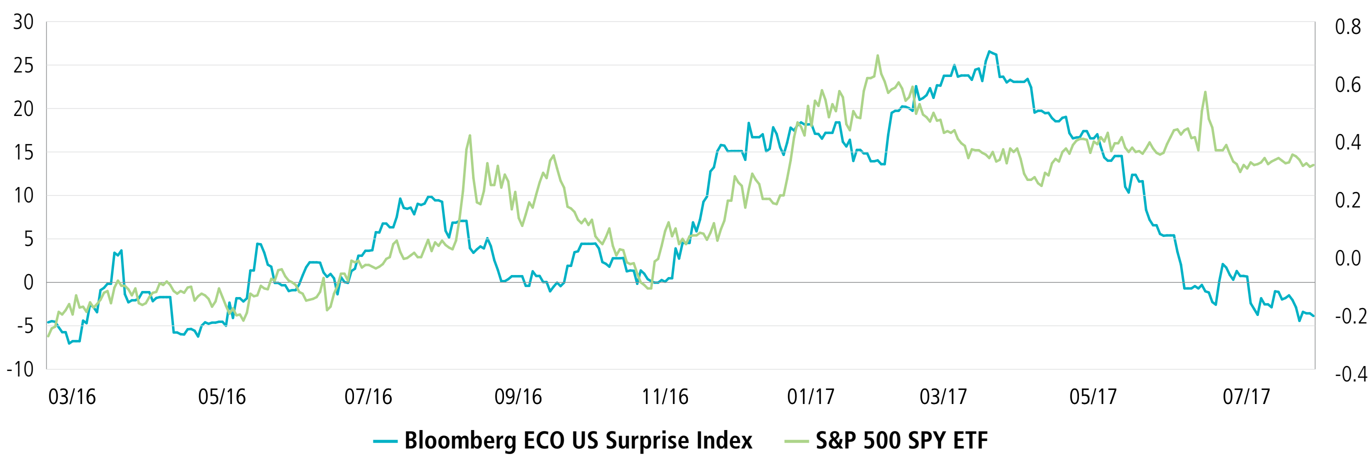
The Enhanced Strategy Team:
John, Colin and Etienne

Figure 1: The more they beat the more they fall…



Source: Bloomberg.

Figure 2: Market Momentum and Beats in Economic Data



Source: Bloomberg.

Figures continued on next page >

Figure 3: US Economic Surprise Seasonality

Source: Bloomberg.

COMPOUNDED RETURNS (%) AS AT JULY 31, 2017*

	1 MTH	YTD	3 MTH	6 MTH	1 YR	3 YR	5 YR	10 YR	ANNUALIZED INCEPTION
SPROTT ENHANCED BALANCED FUND, SERIES A	0.3	0.9	-1.0	1.7	2.3	1.4	4.1	-	3.8
BLENDED INDEX[1]	-1.2	1.6	-3.0	1.6	5.2	6.8	10.2	-	9.8
SPROTT ENHANCED BALANCED CLASS, SERIES A	0.4	1.0	-1.0	1.5	2.5	1.1	-	-	2.1
BLENDED INDEX[1]	-1.2	1.6	-3.0	1.6	5.2	6.8	-	-	9.9
SPROTT ENHANCED EQUITY CLASS, SERIES A	0.2	-0.4	-1.6	1.2	1.0	0.9	4.9	-	4.5
TSX/S&P 500 BLENDED INDEX[2]	-1.0	2.2	-3.5	2.4	8.9	9.3	14.2	-	13.2
SPROTT ENHANCED LONG-SHORT EQUITY FUND L.P., CLASS A	-0.8	2.1	0.0	3.8	2.0	-1.7	3.2	1.6	8.5
TSX/S&P 500 BLENDED INDEX[2]	-1.0	2.2	-3.5	2.4	8.9	9.3	14.2	6.8	7.7
SPROTT ENHANCED LONG-SHORT EQUITY RSP FUND, CLASS A	-0.9	1.8	0.0	3.5	1.4	-2.1	2.8	1.3	3.9
TSX/S&P 500 BLENDED INDEX[2]	-1.0	2.2	-3.5	2.4	8.9	9.3	14.2	6.8	7.6
SPROTT ENHANCED U.S. EQUITY CLASS, SERIES A (USD)	0.8	4.3	2.6	4.2	3.8	-	-	-	-0.8
S&P 500 TRI (USD)[3]	2.1	11.6	4.1	9.5	16.0	-	-	-	10.6

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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 July 31, 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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