# Sprott Gold & Precious Minerals Fund

## February 2018 Commentary

The calm of the equity markets across the world was rudely interrupted by a sudden spike in volatility, which impacted virtually every asset class. Volatility across equities, bonds, currencies and commodities all rose sharply in February and continue to remain elevated into March. For the month of February, the Sprott Gold and Precious Minerals Fund lost 4.38% versus the TSX Global Gold Index, which declined by 7.61% in the same period. Gold bullion, measured in U.S Dollar terms, remained surprisingly resilient through February, losing only 1.99% of its value over the course of the month. The lack of volatility in gold merits further discussion and we will touch on this topic later in our commentary.

### Investment Team

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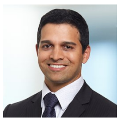

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The top performers for the fund were Kirkland Lake Gold, Saracen Mineral Holdings and Chakana Copper Corp. Kirkland Lake continued its outperforming trend and reported fiscal 2017 year-end reserve and resource update. Company-wide reserves grew 36% year-over-year with the change driven by growth at the Fosterville mine in Australia. Fosterville has been very successful in delineating high-grade reserves – they doubled to over a million ounces at approximately two ounces per tonne. We are excited by Kirkland Lake's prospects going forward and it continues to be one of our top positions. Saracen reported financial results for the six months to the end of December 2017 and provided a 7-year outlook for its operations. The Company's ambition is to grow production at least 30% and this can be achieved through exploration success delineating high grade ore and a mill expansion at one of their operations. Saracen is an attractively valued mid-tier producer. Chakana Copper is relatively new holding and the Company's focus is a highly prospective copper-gold-silver Soledad project in Peru. Initial drilling results are demonstrating the presence of mineralized tourmaline breccia pipes with high values of copper, gold and silver.

The top three detractors for the month of February were Osisko Mining, Randgold Resources and West African Resources. Osisko announced its 2018 exploration budget and development schedule for the Windfall Lake and Osborne-Bell projects. The Company pushed out the Windfall Lake updated resource estimate by six weeks due to slower-than-anticipated turnaround times at the assay lab. The updated resource is now expected in May, followed by a PEA in June and a feasibility study in Q1 2019. Randgold suffered from increased political instability in the DRC and proposed changes to the mining code. West African reported more high-grade drilling results from its Sanbrado project in Burkina Faso, but the stock consolidated after outperforming in previous months.

The month of February provided a wake-up call to the markets as the period of historically low volatility came to an abrupt end. Investors had grown accustomed to the lack of volatility in equity markets over the course of the past 15 months. The chart below illustrates the realized volatility on the S&P 500. Realized volatility (using a 90 day running average) in the S&P 500 has averaged 13.4% since 2011. The December 2017 low of 5.49 was one for the history books and to put this into context, equities were acting as benignly as high-quality investment grade bonds!


Source: Bloomberg

Since 2011, the widely followed VIX index has averaged 16.3. As central banks begin to reduce their balance sheet holdings and raise short-term interest rates, risk premiums across asset classes should normalize and so will volatility. At the time of writing, it sits at 16.9. Volatility has simply reverted back to its mean while the environment of exceptionally low volatility is likely behind us.

At Sprott, we have long been proponents of holding precious metal bullion and equities as a portfolio hedge against general market volatility and the events which transpired in February underscore our point even further. Volatility across many asset classes, including North American equities, global equities, treasuries and currencies rose in February and remain elevated today, with the single exception being gold bullion, which saw its volatility move by just under 3%. In the same time-frame other asset classes saw their volatility increase by as much as 235%.

Precious metals equities were affected by the general equity volatility and sold off in February. This was to be expected. However, the profitability of the precious metals equities is predicated by bullion prices and with bullion prices remaining firm and maintaining their uptrend there has been no change in the fundamentals of gold equities. In fact, we have pointed out in our previous notes that while gold bullion has continued to climb, the vast majority of precious metals equities have lagged the metal. Indeed, gold equity valuations sit at levels we have not seen in our careers and we posit that it is just a matter of time before these valuations normalize.


Source: Bloomberg

As market volatility rises, investor complacency falls. As complacency falls, investors begin paying attention to developments, especially those which have the potential to have an impact on the economy and on the markets, both positive and negative. I would argue that the weight of negative factors which can lead to further market declines over the medium term continues to rise. My colleague, Trey Reik, who writes with much more eloquence than I ever can, just published a note titled, "Oopsie Daisy! Equity Markets Stumble in Early February". I would strongly encourage our clients to read his note as it does a wonderful job of summarizing the build-up of factors which are negative for both the equity and bond markets including rising consumer stress, rising equity market stress from higher rates and last but not the least, the ballooning U.S. fiscal debt.

The declining U.S dollar and rising inflationary pressures continue to provide a favorable tailwind for gold. Gold's relative lack of volatility has not gone unnoticed by investors. While large ETFs such as SPY and EFA have seen billions in outflows over the past few weeks, money has begun flowing back into the GLD and GDX. We would encourage others to look into the precious metals equities space. You would be surprised at how profitable some of these companies are with gold above $1250/oz.

[1] All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at February 28, 2018; e) 2001 annual returns are from 11/15/01 to 12/31/01. The index is 100% S&P/TSX Global Gold Total Return Index and is computed by Ninepoint Partners LP based on publicly available index information.

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**natural resource company risk; sub-advisor risk; substantial unitholder risk; tax risk; uninsured losses risk.**

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