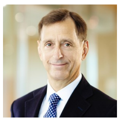
Sprott Diversified Bond Fund

October 2017 Commentary

Investment Team



Mark Wisniewski,
Partner, Senior Portfolio Manager

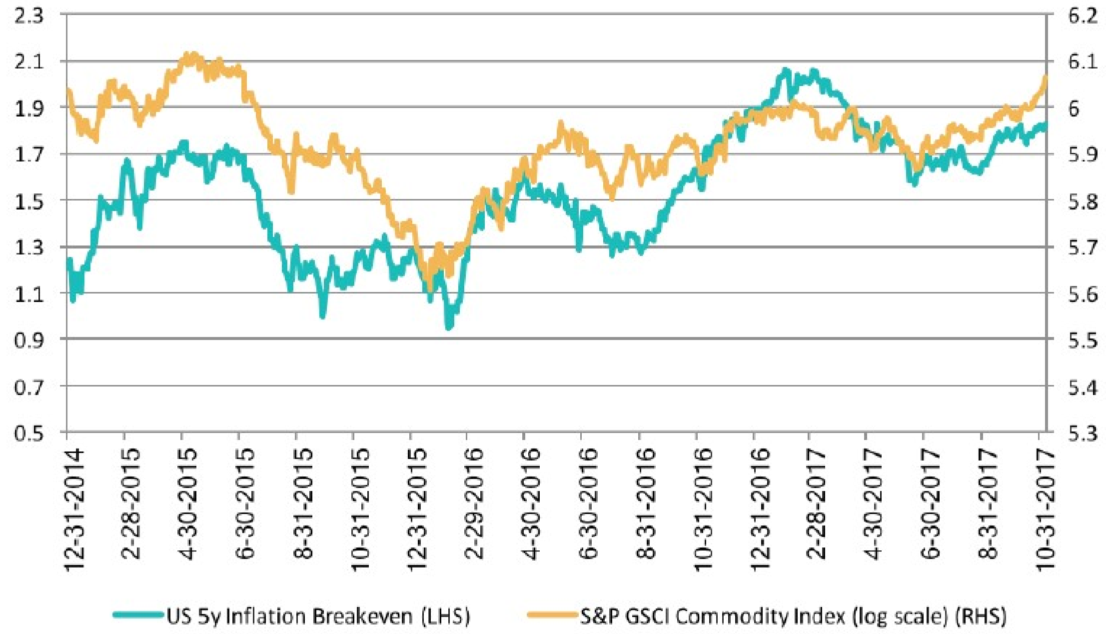
October was a good month for the fund, returning 1.01%. Performance was broad based, driven by credit, FX and to a lesser extent duration.

As discussed last month, the hawkish BoC rhetoric has, for now, run its course, and we were well positioned for its dovish tone. The volte face from Poloz was abrupt; the press conference following the BoC's meeting was decidedly dovish, with the Bank stressing a number of headwinds to the economy (household debt, underutilized labor force, low wage growth, trade protectionism). With inflation still undershooting their 2% target, they are in no hurry to hike, and made sure to highlight their patient stance multiple times. This, along with softer data (it was bound to happen), continued to fuel the selloff in the Canadian dollar. We took advantage of this situation to crystallize some gains on our USD exposure. We retain a small long USD position, on which we intend to take profits relatively soon.

On rates, we continue to think that long term yields are bound to go higher, driven by higher inflation expectations. For now, inflation is still missing-in-action, but the impressive rally in commodity prices, if it is to persist, should vindicate our view (see Figure 1 below). In credit, valuations remain stretched, particularly in high yield (HY). Accordingly, we continue to reduce our HY exposure, recycling capital in investment grade, where we see better (relative) value.

FIGURE 1: INFLATION EXPECTATIONS SHOULD REBOUND

FIGURE 1: INFLATION EXPECTATIONS SHOULD REBOUND



Source: Bloomberg

This month, we are introducing a new tool to help our investors understand how the portfolio changes over time and where we intend to take it. The Table below presents, by asset class and key characteristics, the evolution of the portfolio over the last twelve months, along with what we consider prudent positioning limits. In addition, the last column indicates the direction we intend to take the portfolio in the coming months.]

MUTUAL FUNDS	LIMITS	OCT 2016	DEC 2016	MAR 2017	JUN 2017	SEPT 2017	OCT 2017	OUT-LOOK
Government Bonds	100%	12%	19%	17%	0%	3%	5%	↓
Investment Grade	80%	3%	3%	3%	5%	15%	29%	↑
High Yield	50%	61%	60%	60%	47%	48%	42%	↓
Emerging Market Governments	10%	6%	5%	9%	4%	0%	0%	⟷
Preferred Equities	10%	1%	3%	4%	4%	4%	5%	↑
Common Equities	5%	0%	0%	1%	3%	0%	0%	⟷
Derivatives	+/-2.5%	-0.3%	0.0%	-0.5%	0.0%	0.0%	0.0%	N/A
Exchange Traded Funds	10	0%	0%	1%	0%	0%	0%	N/A
Cash and Equivalents	-	18%	8%	6%	37%	29%	20%	⟷
TOTAL	-	100%	100%	100%	100%	100%	100%	
Duration	2 to 8 years	2.8	4.2	4.4	1.7	2.4	2.8	⟷
Georgraphic (% North America)	>75%	76%	78%	79%	78%	89%	90%	↑

**for illustrative purposes only.*

Consistent with our messaging, we have been reducing HY, which now stands at 42% of the portfolio. As discussed last month, about 1/3 of our HY position is due to mature within a year, greatly reducing portfolio risk. Simultaneously, we have been buying investment grade bonds along with some preferred shares, which now make up 29% and 5% of the portfolio, respectively. Overall portfolio duration is up slightly from September, reflecting a tactical position ahead of the BoC meeting in long term Canadian government bonds. Give our medium term rate view; we intend to keep portfolio duration quite low for the foreseeable future.

Until next month,

The Bond Team: Mark, Etienne and Chris