Sprott Enhanced Equity Strategy

October 2017 Commentary

Investment Team

John Wilson, MBA
Co-CEO, Managing Partner, Senior Portfolio Manager

Equity markets saw another month of low volatility, grinding higher despite considerable news flow from Washington on tax reform as well as a slew of Q3 earnings reports. Market leadership continued to favor the technology sector as well as cyclical sectors such as financials. Despite strong gains in both Brent and WTI crude oil prices, energy stocks were relatively flat during October but have begun to move higher in early November. We have a larger than usual position in the energy sector and recently presented our bullish convictions on the sector at the Capital Markets for Kids conference. Our portfolio has several options strategies that we have used to limit our downside exposure and position for upside as energy stocks move higher. Since we initiated those positions we have seen a roughly 10% rally in the XEG energy ETF and we think we could see another 10% upside from here into early 2018.

Most of the S&P 500 constituents have reported earnings and while averaging a healthy ~5% growth in revenue this past quarter, we expect it to become more challenging to hold this growth rate as companies have now lapped the easiest revenue comparisons for the year. We also note that excluding energy and technology, quarterly revenue momentum would look weaker given both sectors grew revenue 10%+ during the quarter. Defensive consumer goods stocks, a sector we have been avoiding, continue to diverge negatively from the market due to weak topline growth, prompting capital outflows to more cyclical sectors such as energy and financials.

Companies are getting hit more than usual for slight disappointments on the revenue line; we see this as becoming more of a phenomenon as we move deeper into the cycle. Positions in our portfolio which reported quarterly results during October mostly managed to beat consensus expectations for earnings. Bank of America, Danaher and Northrop Grumman were particularly strong earnings beats, with Bank of American continuing to show its ability to cut costs despite a challenged topline environment and Northrop Grumman continuing to improve revenue momentum as past contract wins accelerate the trajectory for growth. United Health, another holding in the funds also had a strong quarter and has traded higher despite a very weak healthcare tape that saw several large cap biotech blow-ups in recent weeks.

The GOP presented their tax bill to the house ways and means committee in early November hoping to try and pass it prior to Thanksgiving. We initially suspected the process of mark ups and negotiation could delay passage of the bill by the House until sometime in mid-December; however, our discussions with several consultants on Capitol Hill suggest that the initial Thanksgiving timeline might now be attainable. We expect the Senate to be a more challenging sell although getting tax reform through the House by year end will still likely be seen by equity markets as a major step forward.

We feel market expectations for a successful passage of tax reform have moved higher recently to somewhere around a 40% probability and while we still see upside potential in the market as a whole should tax cuts get enacted, several sectors over the past two months have moved to such an extent that reform is likely necessary to sustain recent gains. As discussed in our past commentaries, if we were to exclude our current optimistic stance on tax reform, our opinions on corporate profit growth and future market returns would likely be much more muted. We highlight in Chart 1 and 2 how YoY momentum in equity markets and earnings tend to follow momentum in economic indices such as the ISM Manufacturing survey. We suspect that these would likely be peaking if it wasn't for the possible optionality of taxes driving higher capex trends and lower corporate taxes pushing EPS momentum in 2018. 2

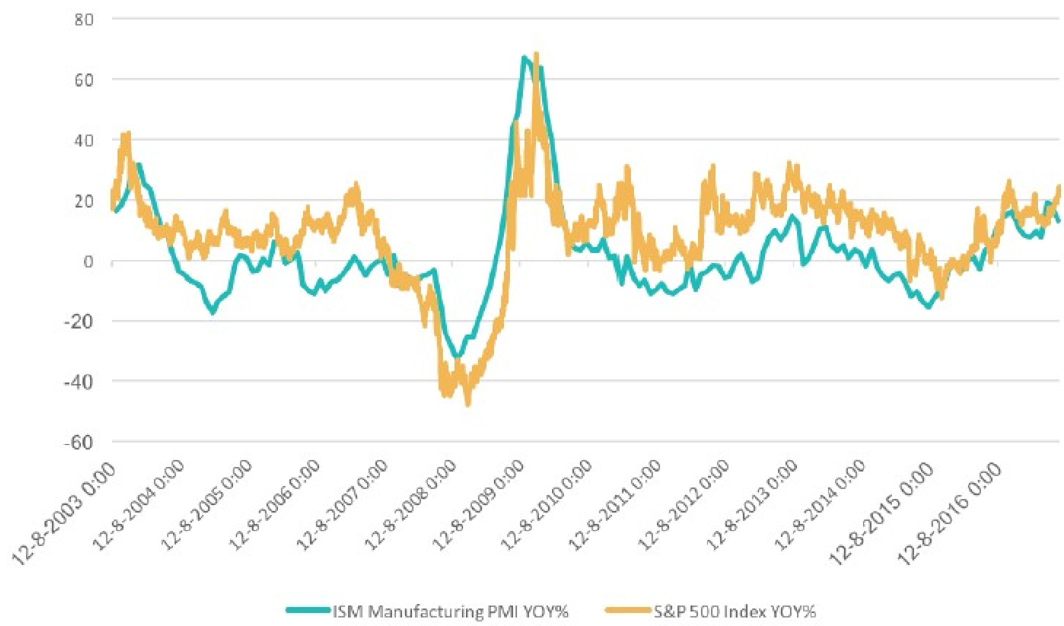
Given this view, we have chosen to add incremental upside exposure through a position in S&P 500 calls into January given our view of a more binary situation near term. This position limits our downside in the event of a sell-off as compared to owning a larger equity portfolio. We structured the position to also limit our cost if even a moderate sell-off was to occur. Meanwhile the position offers considerable upside if we rally through the remainder of the year on a bill passing the House. Very low levels of market volatility over the past few months have made the asymmetry of this position possible: we were able to purchase our position at the lowest levels of volatility they've traded at in measured history.

Overall, our market outlook remains cautiously bullish. Bullish because tax reform appears likely and we believe it can boost near term economic growth and corporate earnings. Cautious because we are late in what has been a terrific bull market, valuations are generally elevated and we expect the Fed to raise rates in December and a further three times in 2018. We are OK with that outlook: it is our job to capture some of that available upside while managing the downside exposure of our portfolios.

Until next month,

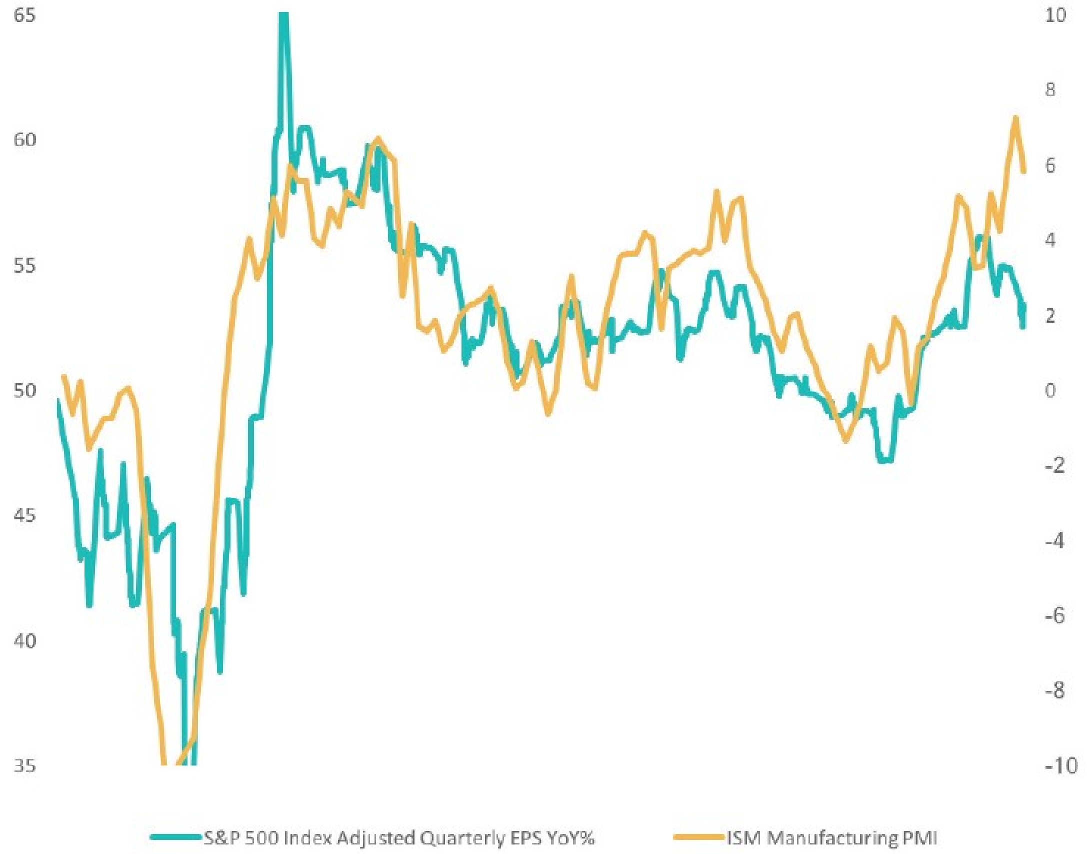
The Enhanced Team

CHART 1: SPX AND THE ISM INDEX YOY %



Source: Bloomberg

CHART 2: EARNINGS MOMENTUM FOLLOWS ECONOMC MOMENTUM



Source: Bloomberg

[1] All returns and fund details are a) based on Class/Series F shares/units; b) net of fees; c) annualized if period is greater than one year; d) as at October 31, 2017; e) inception date for Ninepoint Enhanced Equity Class is 04/16/12. The index for the Ninepoint Enhanced Equity Class; Ninepoint Enhanced Long Short; and Ninepoint Enhanced Long Short RSP is 50% TSX & 50% S&P 500 (CAD) Blended Index and is computed by Ninepoint Partners LP based on publicly available index information. The index for the Ninepoint Enhanced US Equity Class is S&P 500 TR USD and is computed by Ninepoint Partners LP based on publicly available index information.

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