

After the spike in volatility in March, the high yield credit market seems to have found its footing in April. The BofA Merrill Lynch US High Yield Index performed steadily through the month, posting a total return of 1.13%.

The Diversified Bond Fund continued its strong run and posted a solid 1.7% for the month of April. All three of our major attribution buckets – credit, duration, and foreign exchange – contributed positively to our performance. The fund was given a big boost by our foreign currency exposure as the loonie dropped nearly 2.5% against the greenback.

We suspect that the same April returns will be harder to repeat in May. Credit and equity markets are not particularly cheap. We also feel that while the Canadian dollar might remain under some pressure, the same rate of decline in the Canadian dollar will be harder to come by. As a consequence we have trimmed our large short Canadian dollar position in the early days of May.

Over the next few months longer term interest rates will likely move modestly higher. Yields declined in March and April as a result of one sided positioning (everyone was short), and soft US and Chinese growth. The U.S. economy expanded at a meagre rate of 0.7% (annualized) in the first quarter of 2017, lowest in three years. Consumer spending grew at just 0.3%, the slowest pace since 2009. However, the disappointing GDP data was in part attributed to seasonal factors – unseasonably warm weather leading to lower energy consumption – and market participants shrugged it off after the initial jitters. With the Fed likely to tighten in June and the weak global growth impulse fading rates should drift higher. We have trimmed our duration profile and may tactically look to short bonds. Our only concern against higher long term rates stems from China and in particular the pressure that the tightening of Chinese monetary policy is having on global commodity prices. We will monitor accordingly.

Equities and credit reacted positively to a solid earnings season. According to Factset, by the end of April, 58% of companies in the S&P 500 had reported their first quarter earnings. Based on these reports and earnings estimates of the other companies, Factset estimated an earnings growth rate of 12.5% of S&P 500.

Market sentiment was further boosted by the result of the first round of presidential elections as the independent centrist, Emmanuel Macron, beat the populist candidate, Marine Le Pen.

Closer to home, alternative mortgage lenders garnered a lot of attention in late April after Home Capital Group (HCG) addressed allegations of fraud and quickly saw dramatic redemptions from its high-interest savings accounts. Although the initial market reaction was quite mild, the bottom fell out of the stock and bond prices when the company announced that it had secured an expensive line of credit from the Healthcare of Ontario Pension Plans (HOOPP). HCG's stock price dropped 65% and the bonds fell \$20 - \$25 on the news. The bonds have since recovered as the market anticipates a restructuring, and a rather quick one, that would result in bondholders being made whole or close to it.

HCG's news also had an impact on other alternative lenders, with spreads widening for HCG's closest competitors, like First National and Equitable. However, markets have remained stable for the Big 6 Banks, with spreads just marginally wider over the last few weeks.

While the rapid decline of HCG has worried some investors, fearing a contagion through the entire mortgage market and even the broader Canadian financial system, we believe that talks of a collapse of that magnitude are overdone. There is no denying that the Canadian housing market has seen a massive rise in recent years and HCG has been a major player in the alternative mortgage lending market. However, the chances that problems of one alternative mortgage lender, even the largest one, spilling over to the entire Canadian mortgage market remain low barring any revelations of fraudulent activity.

SPROTT DIVERSIFIED BOND FUND

April 2017 Commentary

Finally, we do not anticipate the Bank of Canada to adopt a tightening bias at this time, but rather preferring to wait and observe how the recent weakness in global commodity prices and the effect the uncertainty associated with HCG is having on the Canadian economy.

Scott, Chris, and Aly

COMPOUNDED RETURNS (%) AS AT APRIL 28, 2017¹

	1 MTH	YTD	3 MTH	6 MTH	1 YR	3 YR	5 YR	ANNUALIZED INCEPTION (08/05/10)
SPROTT DIVERSIFIED BOND FUND, SERIES A	1.7	3.2	2.8	3.7	6.8	3.4	4.4	4.4
BLENDED INDEX*	1.2	3.6	2.6	4.1	10.9	4.8	6.2	6.8



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* Blended Index is 75% of the BofA Merrill Lynch US High Yield Index and 25% FTSE TMX Canada Universe Bond Index™ and is computed by Sprott Asset Management LP based on available index information.

¹ All returns and fund details are a) based on Series A units; b) net of fees; c) annualized if period is greater than one year; d) as at April 28, 2017; e) 2010 annual returns are from 08/05/10 to 12/31/10.

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