SPROTT RESOURCE CLASS

October 2016 Commentary

October was another volatile month for resources. On October 4th gold bullion lost 3.4% in a single day (a 3 sigma event) driven by rumours that the ECB was going to taper their quantitative easing program. This rumour coupled with the likelihood of the US Federal Reserve raising interest rates in December and expectations that the BOJ monetary policy was approaching the limits of its effectiveness caused gold miners to suffer a one-day 10% drop; the largest one-day drawdown in over a year. In hindsight, although we had trimmed our gold exposure in early October, it was clearly not enough.

Although the TSX Capped Energy Index had a positive month in October, it was led by large-caps such as Suncor and Imperial Oil which returned 10.5% and 6.0% respectively. Generally, when the largest constituents of a benchmark are also the best performing, it is difficult to outperform the benchmark. It is not surprising then that almost all of the resource fund peers we track underperformed the blended benchmark in October. The Resource Class was no exception, returning a -4.4% versus 0.7% for the blended benchmark. This underperformance brings up the main topic of this month's comment – active vs passive investment.

Active vs passive has been a very hot topic recently as all the major news and media outlets have called for the demise of active fund management and investors have voted with their wallets (Figure 1 below). As a mutual fund manager, we are obviously biased towards active fund management. However, we are not advocating that all active management is superior. In fact, we agree with the facts that the majority of active managers underperform their passive benchmarks because of fees, closet indexing and a host of other factors. However, we believe the resource sector has enough pockets of inefficiencies to justify active management. In recent months we have spoken at length about our investment process and how we try to identify the hidden gems that may be overlooked by other market participants. It is this process combined with a relatively inefficient resource market that has allowed the Resource Class to outperform its blended benchmark by 12.9% p.a. on a 3-year basis.

This outperformance is not "free", however. Volatility is the price investors have to be willing to pay. In order to outperform, our portfolio has to be significantly different from the benchmark. While we strive to make the best possible investment decisions on a day-to-day basis, there will inevitably be periods, such as October, where we underperform the benchmark. While month-to-month returns may be volatilie, we are confident that over the long-run the Resource Class will outperform the blended benchmark and peers.

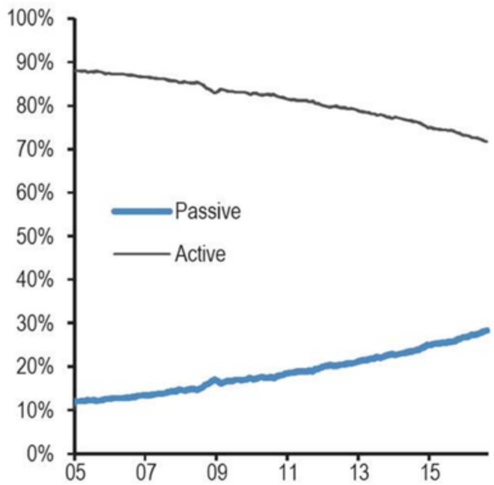

Figure 1: Active and passive funds as % of total AUM. Source: ICI, JP Morgan.

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COMPOUNDED RETURNS (%) AS AT OCTOBER 31, 2016[1]

	1 MTH	YTD	3 MTH	6 MTH	1 YR	3 YR	5 YR	ANNUALIZED INCEPTION (10/17/11)
SPROTT RESOURCE CLASS, SERIES A	-4.4	84.0	2.5	23.9	76.3	12.6	-3.2	-2.4
BLENDED INDEX†	0.7	40.5	0.2	7.6	32.2	-0.2	-3.9	-3.2

SPROTT ASSET MANAGEMENT

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† Blended Index (50/50 S&P/TSX Capped Materials Total Return Index and S&P/TSX Capped Energy Total Return Index) is computed by Sprott Asset Management LP based on available index information.

1 All returns and fund details are a) based on Series A shares; b) net of fees; c) annualized if period is greater than one year; d) as at October 31, 2016; e) 2011 annual returns are from 10/17/11 to 12/31/11.

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