Sprott | **Gold Report**
February 1, 2018

Why Gold and Gold Equities Can Thrive in 2018

Authored by Shree Kargutkar, Portfolio Manager, Sprott Asset Management LP

Gold Bullion Gained 3.23% in January

With the beginning of the new year, we have entered a seasonally strong period for gold bullion and gold equities. Gold bullion posted a strong gain of 3.23% in January, ending the month at $1,345.15 per ounce. While sentiment towards gold has improved from frigid to lukewarm, sentiment towards precious metals equities remains downright bearish.

We view this as a positive sign for precious metals equity investors with a long-term horizon because a shift in sentiment towards an asset class is usually followed by robust gains, which are primarily driven by re-rating of its valuation multiples. In the case of precious metals equities, multiples have continued to trend lower, making stocks cheaper while gold bullion has appreciated in price. We track investor positioning using a number of metrics including fund flows, gold futures trading and ETF flows. Gold bullion ETF flows serve as a good proxy for investor positioning, and options trading on the largest gold miners ETF[1] helps us to gauge sentiment. As shown in Figure 1, the shares outstanding in gold bullion ETFs are currently at a three-year high. When seen against the backdrop of rising asset prices, the increase in gold bullion holdings, is merely par for the course.

Figure 1: Total Known ETF Holdings of Gold (Oz)
(1/2015 – 1/2018)

Source: Bloomberg. Data as of 1/26/2018.

Curiously, the shares outstanding in the largest gold miners ETF,[2] which is the largest gold mining ETF, remain near their three-year low, reinforcing our thinking that North American investor positioning in the precious metals mining space remains relatively lean. On the same note, silver, which has often acted as a high beta[†] cousin to gold bullion, has not attracted much investor attention of late. Total silver bullion ETF holdings have continued to languish over the past 18 months. This serves to inform us that while investors have continued buying bullion as an insurance policy for their portfolios, investors are not currently seeking leverage to their gains from the potential rise in the price of gold, which gold and silver mining equities have typically provided. Similarly, we see relatively neutral levels of participation by investors and speculators in the gold futures market.

2018: Not Likely to be a "Normal" Year

Normally, these developments might indicate that we are in for a "normal" year for gold. 2018, however, is not likely to be a normal year in our estimation. With the passage of the Tax Cuts and Jobs Act in the U.S. at the end of 2017, the Republican Party signaled its willingness to dive deeper into debt during a time of economic expansion. The cost of this bill is expected to top $1.5 trillion over the coming decade. On top of this colossal debt burden, there is signaling for further additions to the deficit as the House and Senate try to put together an infrastructure plan which would cost upwards of $1 trillion. The lack of fiscal restraint was well telegraphed by the incoming Trump administration in 2016, at a time when the economy was gaining steam and monetary expansion was firmly in place.

Signs of Inflation are Materializing

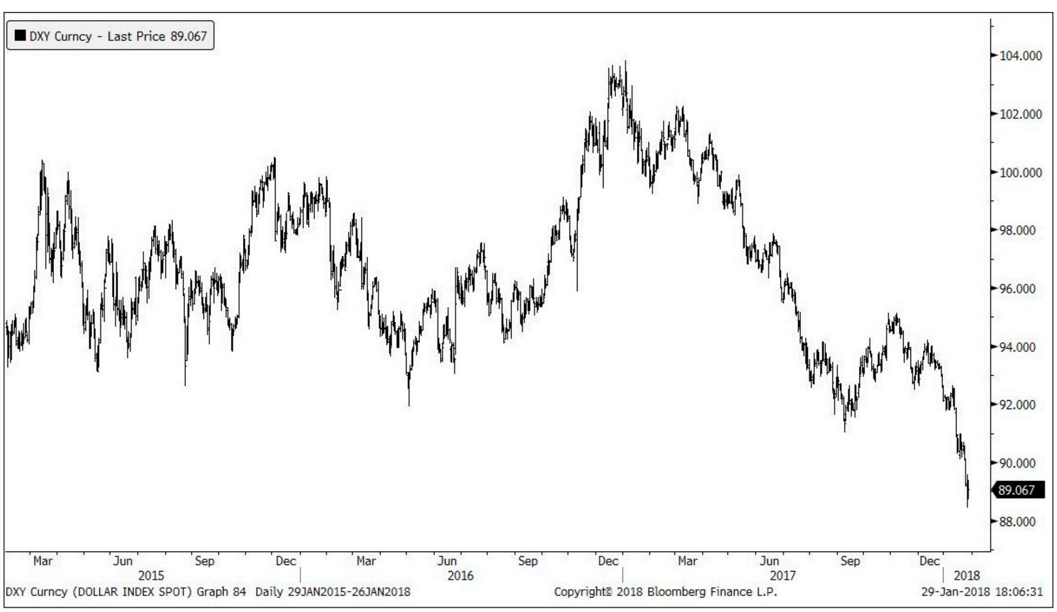
Fast forward a year, and we now have a situation where the U.S. Federal Government's balance sheet continues to expand, the Federal Reserve remains dovish, the fiscal deficit is set to rise quickly and the U.S. economy continues to hum. Has anyone mentioned inflation yet? We are beginning to see inflation materialize. Energy prices are up, producer prices are on the rise and against all odds, wages are finally beginning to increase. It is no wonder that the combined effect of the factors above are weighing heavily on the U.S. dollar.

The Almighty U.S. Dollar?

Indeed, in our estimation, one of the most significant developments of 2017 was the decline of the U.S. dollar, which lost almost 9.87% (DXY[3]) of its value when measured against a basket of other major currencies.

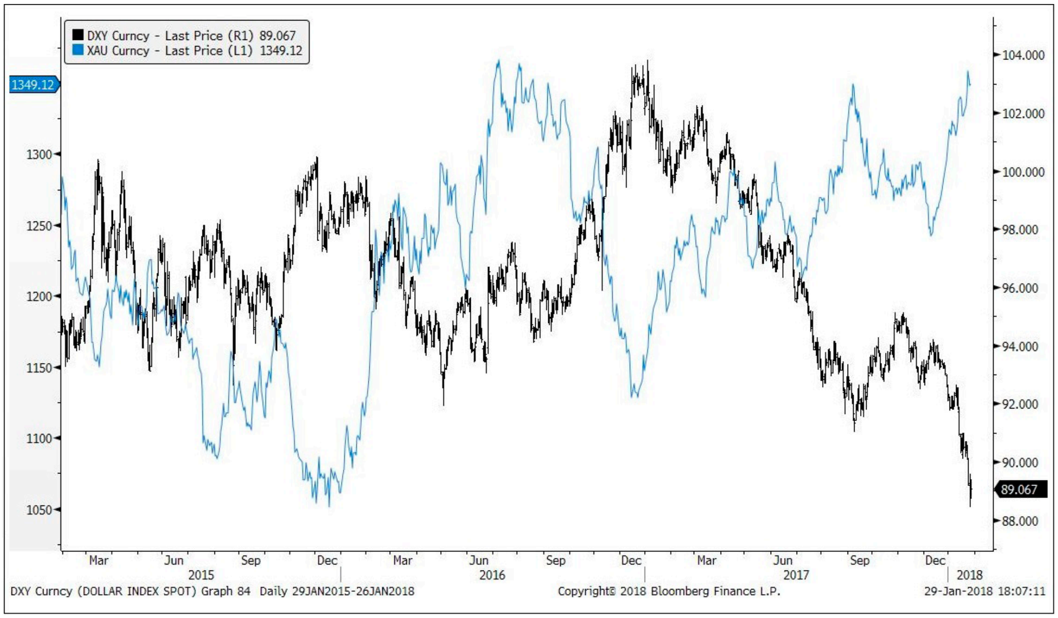
Figure 2: The Declining U.S. Dollar

DXY Index Measured Daily



Source: Bloomberg. Data as of 1/26/2018.

Figure 3: U.S. Dollar (DXY) vs. Gold (XAU[4])
(1/2015-1/2018)



Source: Bloomberg. Data as of 1/26/2018.

As you can see from Figure 3, a declining U.S. dollar benefits gold prices. We believe that 2018 will see pressure on the U.S. dollar continue on the back of increasing inflationary pressures, non-existent fiscal restraint and a dovish incoming Fed Chair (Jerome Powell). In January, the U.S. dollar broke below the important 90 threshold, and declined 3.25% (from 92.124 to 89.133 based on the DXY).

When the currency of a nation declines from increasing debt in an environment of easy money policies and artificially low interest rates, the perfect environment is created for gold to thrive. This is what we are facing today, in a repeat to what we saw between January 2003 and December 2006 which saw gold prices climb more than 80%, from $350 to $635 per ounce, while the U.S. Dollar Index (DXY) lost 18% of its value. It is no surprise that the rapid appreciation in gold also attracted speculative interest in gold equities, which saw the widely followed HUI Gold Index rise 142% in the same period.

As my colleague Trey Reik recently said:

"Of all the combinations of market fundamentals which can prove supportive of gold prices, none are more potent than a slumping U.S. dollar amid concern for a deteriorating U.S. fiscal positon. ***This is total nirvana for gold****."*

Shree Kargutkar is a Portfolio Manager at Sprott Asset Management LP.

[†] Beta is defined as a sensitivity measure based on how the value of one asset moves in relation to another.
[1] SPDR Gold Shares (GLD) is an exchange-traded fund and is used as a benchmark to measure gold bullion prices.
[2] VanEck Vectors Gold Miners ETF (GDX) tracks the overall performance of companies involved in the gold mining industry.
[3] The U.S. Dollar Index (USDX, DXY) is an index of the value of the U.S. dollar relative to a basket of foreign currencies.
[4] XAU is an index of precious metal mining company stocks that are traded on the Philadelphia Stock Exchange.

Two Unique ETFs to Invest in Gold Stocks

Each Index:

- Seeks to outperform purely passive representations of the gold and silver mining industry
- Uses transparent, rules-based methodology designed to overweight gold stocks with attractive investment merits relative to the other stocks in the index
- The stock selection and index weighting criteria were co-developed by Sprott Asset Management, a leading, long-time gold sector investor, and Zacks Index Services

SGDM
NYSE ARCA
Sprott Gold Miners ETF

- Stocks weighted in the index based on quarterly revenue growth and long-term debt to equity
- Reconstituted quarterly

SGDJ
NYSE ARCA
Sprott Junior Gold Miners ETF

- Stocks weighted in the index based on revenue growth and price momentum
- Reconstituted semi-annually

SPROTT ETFs

Sprott ETFs provide investors with access to innovative and unique indexes that are designed to outperform passive market cap-weighted offerings. Each Index is designed using specific **FACTORS** *that* **MATTER**™ for a particular strategy. These customized factors are selected because they have historically shown correlation to stock performance.

Sprott | ETFs
Factors *that* Matter™

IMPORTANT DISCLOSURES & DEFINITIONS

An investor should consider the investment objectives, risks, charges and expenses carefully before investing. To obtain a Statutory Prospectus, which contains this and other information please contact your financial professional or call 1.855.215.1425. Read the Statutory Prospectus carefully before investing.

Sprott Gold Miners ETF and Sprott Junior Gold Miners ETF shares are not individually redeemable. Investors buy and sell shares of the Sprott Gold Miners ETF on a secondary market. Only market makers or "authorized participants" may trade directly with the Fund, typically in blocks of 50,000 shares.

The Fund is not suitable for all investors. There are risks involved with investing in ETFs including the loss of money. The Fund is considered nondiversified and can invest a greater portion of assets in securities of individual issuers than a diversified fund. As a result, changes in the market value of a single investment could cause greater fluctuations in share price than would occur in a diversified fund.

Micro-cap stocks involve substantially greater risks of loss and price fluctuations because their earnings and revenues tend to be less predictable. These companies may be newly formed or in the early stages of development, with limited product lines, markets or financial resources and may lack management depth.

The Fund will be concentrated in the gold and silver mining industry. As a result, the Fund will be sensitive to changes in, and its performance will depend to a greater extent on, the overall condition of the gold and silver mining industry. Also, gold and silver mining companies are highly dependent on the price of gold and silver bullion. These prices may fluctuate substantially over short periods of time so the Fund's Share price may be more volatile than other types of investments.

Funds that emphasize investments in small/mid cap companies will generally experience greater price volatility.

Funds investing in foreign and emerging markets will also generally experience greater price volatility.

There are risks involved with investing in ETFs including the loss of money.

Diversification does not eliminate the risk of experiencing investment losses.

ETFs are considered to have continuous liquidity because they allow for an individual to trade throughout the day.

ALPS Portfolio Solutions Distributor, Inc. is the Distributor for the Sprott Gold Miners ETF and the Sprott Junior Gold Miners ETF.

SPT000442 2.20.19

0218060 02/18_SAM_ART_GR_ETF