Sprott

# Monthly Report

October 3, 2019

Paul Wong, CFA
Special Contributor

## Gold's September Pullback is Healthy

Authored by Paul Wong, CFA – Special Contributor; Paul was formerly a Senior Portfolio Manager at Sprott Asset Management and has more than 20 years of investment experience, specializing in investment analysis for natural resources investments. He is a trained geologist and CFA holder.

September saw a healthy pullback in the rally for gold and silver bullion. Gold lost $51.30 to close the month at $1,472, a loss of 3.4%. Year to date (YTD) gold is up 14.8% as of 9/30/19. Silver bullion fell 7.4% for the month, but is up 9.7% as of 9/30/19. Gold equities retreated as well, but have gained 30.9% YTD as measured by Sprott Gold Miners ETF (SGDM).

### Month of September 2019

| *Indicator* | 9/30/19 | 8/30/19 | Change | % Change | *Analysis* |
|---|---|---|---|---|---|
| **Gold Bullion** | **$1,472** | **$1,524** | **($51.30)** | **(3.4)%** | **Short-term correction; support $1,450** |
| **Silver Bullion** | **$17.00** | **$18.36** | **($1.36)** | **(7.4)%** | **Pulled back to breakout level** |
| **Gold Equities (SGDM)[1]** | **$22.95** | **$25.66** | **($2.70)** | **(10.5)%** | **Dollar strength creates headwinds Dollar strength creates headwinds** |
| DXY US Dollar Index[2] | 99.39 | 98.81 | 0.59 | 0.6% | Steady rise |
| Total Negative Debt ($Trillion) | $14.9 | $17.0 | ($2.15) | (12.6)% | Pull back inline with yields |
| CFTC Gold Non-Comm Net Position[3] and ETFs (Millions of Oz) | 116.9 | 115.0 | 1.88 | 1.6% | Buying continues; new all-time high |

**Performance data quoted represents past performance. Past performance is no guarantee of future results so that shares, when redeemed may be worth more or less than their original cost. The investment return and principal value will fluctuate. Current performance may be higher or lower than the performance quoted. Call 866.675.2639 for current month end performance. For standardized performance of the fund please see page 9.**

[1] Sprott Gold Miners Exchange Traded Fund (NYSE: SGDM) seeks to deliver exposure to the Solactive Gold Miners Custom Factors Index (Index Ticker: SOLGMCFT). The Index aims to track the performance of larger-sized gold companies whose stocks are listed on Canadian and major U.S. exchanges. The 30-Day SEC Yield for SGDM was 0.00% as of 9/30/19. The SEC yield is a standard yield calculation developed by the Securities and Exchange Commission that allows for fairer comparisons among funds. It is based on the most recent 30-day period. This yield figure reflects the interest earned during the period after deducting the fund's expenses for the period.

[2] The U.S. Dollar Index (USDX, DXY, DX) is an index (or measure) of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies.

[3] Commodity Futures Trading Commission's (CFTC) Gold Non-Commercial Net Positions weekly report reflects the difference between the total volume of long and short gold positions existing in the market and opened by non-commercial (speculative) traders. The report only includes U.S. futures markets (Chicago and New York Exchanges). The indicator is a net volume of long gold positions in the United States.

## Gold Bullion Consolidates in September

Gold bullion traded in a sideways pattern for most of September before dropping sharply on the last day of the month. Silver, true to its high volatility nature, had a more significant trading range ($18.40 to $17.04). Gold positioning only had a slight pullback which was most likely profit-taking given the relatively small amount. Some hedging occurred likely as well.

Gold bullion remains in its uptrend from its 2018 summer low. The short-term pattern appears to be another consolidation phase. The main inputs in our gold bullion model all show long-term trends unchanged. All factors that we consider to be significantly correlating to gold bullion indicate that we are still in the early stages of a major long-term advance. After a very sharp rise, we see this correction as short term in nature.

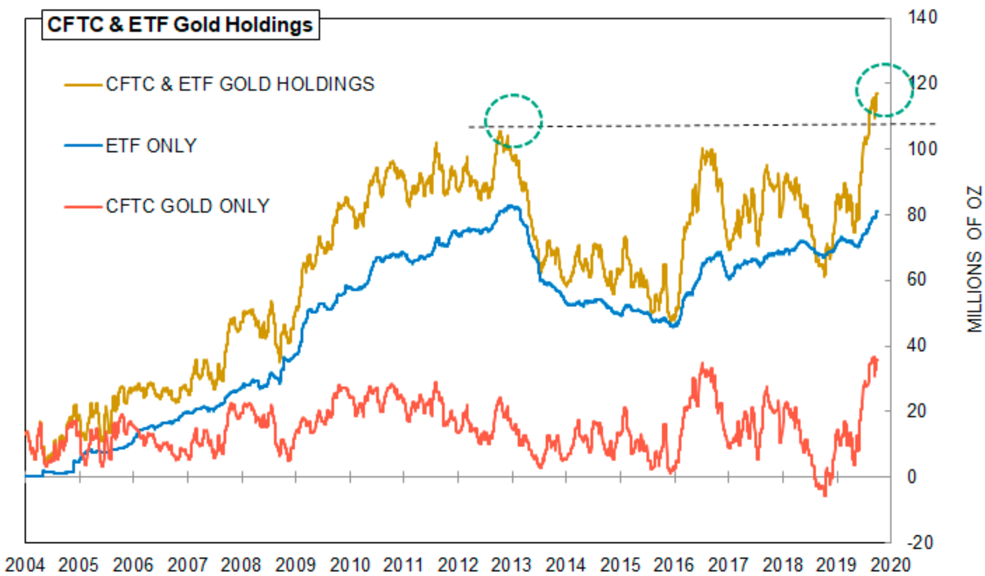
**Figure 1. Gold Correction is Likely Short Term**


Source: Bloomberg as of September 30, 2019.

Our measure of Commodity Futures Trading Commission's (CFTC) net gold bullion plus known gold bullion ETF holdings reached an all-time high since we last published this chart. Accumulation remains steady, given that the long-term direction of yields remains lower, growth indicators continue to weaken and macro risks remain elevated and trending higher.

Despite the gold price consolidating in September, investors continued to aggressively increase their positions. This buying, combined with the 5Y/5Y inflation swap rolling over is very convincing to us. Our view is that gold should continue to move higher, in both the medium and long term.

**Figure 2. Buyers Push Gold Positions to All-Time High**




Source: Bloomberg as of September 30, 2019.

## The Eventful Month That Was: The Macro View

The U.S.-China trade war continued to escalate in September. On September 1, the U.S. imposed a 15% tariff on $112 billion of Chinese consumer goods imports, and China began rolling out tariffs on the previously announced $75 billion of U.S. goods. The U.S. ISM Manufacturing Purchasing Managers Index (PMI)[4] fell into contraction territory at 49.1 versus a 51.3 consensus estimate, a big miss (a reading above 50 indicates expansion, while a reading below 50 indicates contraction).

The OECD (Organisation for Economic Co-operation and Development) cut its forecast for global growth from 3.3% to 2.9% for 2019, and from 3.4% to 3.0% in 2020 – the lowest yearly growth rates since the GFC (global financial crisis). The OECD also noted that downside risks continued to grow, citing the impacts of U.S.-China trade tensions and a no-deal Brexit. Despite the negative news, however, risk assets had a very sharp reversal higher. The news catalyst was a rumor that China and the U.S. would meet in October to resume trade talks. But we believe the more likely catalyst was China's reserve requirement ratio (RRR) cut amounting to about $126 billion to help shore up its weakening economy. This cash injection, however, is unlikely to boost the overall Chinese economy as liquidity is already plentiful; it is the growing pressure from the escalating trade war and sluggish domestic demand that are sapping business and consumer confidence. What the RRR cut did have was an impact on overall market credit liquidity, and this was a factor for the risk-on rotation.

[4] The Purchasing Managers Index (PMI) is a measure of the prevailing direction of economic trends in manufacturing. The purpose of the PMI is to provide information about current and future business conditions to company decision makers, analysts, and investors.

## Central Bankers Continue to Fuel Easy Money

As the OECD noted, global growth remains weak. As expected, the ECB (European Central Bank) announced a new QE (quantitative easing) program of 20 billion Euros per month in asset purchases for an indefinite period starting November 1, a lowering of deposit rates by 10 basis points to -0.50%, and a call for more fiscal stimulus from EU countries. The ECB also reiterated its inflation targeting goal, to which we remain highly skeptical. The U.S. FOMC (Federal Open Market Committee) meeting occurred the following week, September 18, with the Fed cutting Fed Fund Rates by another 25 basis points, to a range of 1.75% to 2%. Guidance and language were mostly in line with consensus.

In mid-September, Saudi Arabia's main oil processing facility was attacked, resulting in a loss of approximately 5.7 million barrels a day of oil production. The price of crude shot up dramatically, reflecting the significant near-term loss of oil output and most likely finally pricing in the geopolitical risk premium into the crude pricing strip. The main impact for gold would be via lower interest rates as climbing crude prices will act as a higher tax on a global economy that is already slowing rapidly.

At the end of the month, two additional events occurred that will likely impact financial markets going forward. The first is an impeachment inquiry on President Trump. The second was a Bloomberg report of a proposal to restrict or ban Chinese corporations from accessing U.S. capital markets. Possible delisting of Chinese equities, prohibiting government pension funds from investing in Chinese equities and other restrictions of capital were reported. There are more than 150 Chinese-listed companies on U.S. exchanges with a combined market capitalization of more than $1 trillion. Such a proposal would be yet another significant escalation, but this might push us from trade war to financial war.

## Repo Madness and "QE-Lite[5]": A System Starved for Liquidity

At the time of the FOMC September 18 meeting, overnight repo rates (short for repurchase agreement, usually an overnight loan) shot up dramatically well above the Fed Funds Rate. The repo rate is the rate at which the central banks lend short-term money (usually overnight) to banks against Treasuries. Typically, the repo rate should not be materially higher than the Fed Funds Rate in a healthy funding market. The last time we saw repo rates shoot up was back in 2008 during the GFC when financial firms were too fearful of lending to one another.

There is not a very good answer as to why repo rates rose so dramatically last month (10% at the peak, above the 2008 level) and stayed elevated despite numerous Fed injections over the weeks. The best explanation we have heard is that there was a confluence of substantial funding needs at a time when the Fed balance sheet had shrunk too small relative to the amount of Treasuries held by commercial banks.

> "When the allocation mix includes gold, the effect of gold's non-correlated behavior, will lower the portfolio volatility."

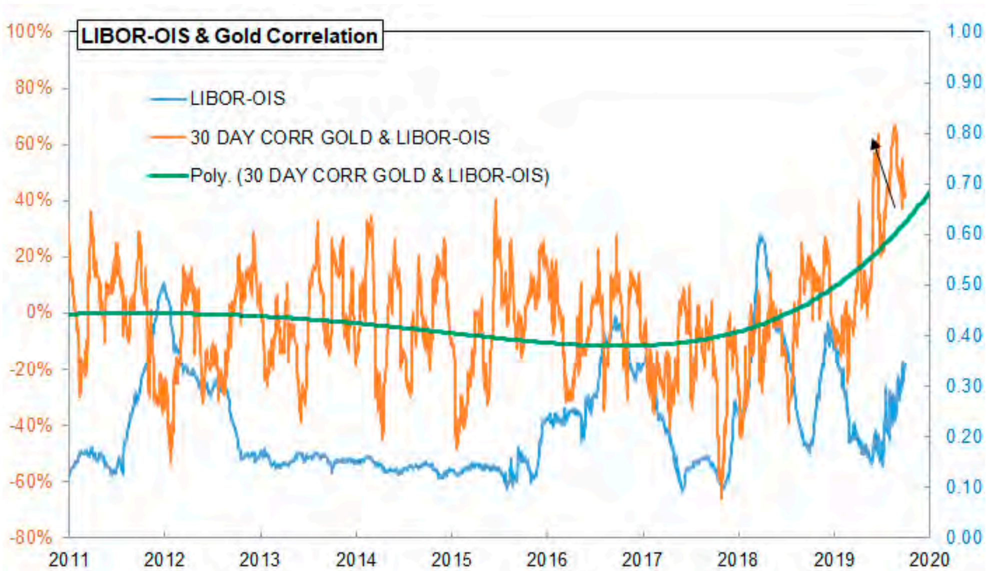
It appears that the funding market is now feeling the effects of the Fed's quantitative tightening (there is always a delayed effect). The disconcerting part is that the Fed does not appear to have a sense of how significant the reserve shortfall was, nor the timing, as witnessed by the number and sheer size of the liquidity injections. The Fed is offering up to $70 billion a day in repurchase agreements until October 10 to provide enough reserve liquidity. If this temporary facility proves inadequate, a program to expand the Fed balance sheet may be in order (i.e., QE) to address this reserve scarcity. A new potential QE round is not (for now) a repeat of QE1, 2 and 3 to "save the economy." This new QE round would be more of a "QE-Lite" to address the current reserve liquidity plumbing problem.

[5] QE-lite is the term used to describe a Federal Reserve policy to increase its purchases of short-term Treasuries in a limited fashion.

Moreover, this funding problem should be addressed quickly; setting a Fed Funds Rate and then having the overnight market rate well above the target range is negating the goal of lower interest rates. The repo market is signaling liquidity stress in the overnight market. If this stress broadens out, a much wider liquidity problem would be more significant to the markets.

A market measure of stress/liquidity we track is the LIBOR-OIS (London interbank offered rate-overnight indexed swap) spread which is the difference between an interest rate with credit risk built-in and the risk-free rate. When LIBOR-OIS spreads are rising, it is a sign that the financial system is under some stress. In the past year and a half, the rolling 30-day correlation of gold bullion to LIBOR-OIS has broken out of its multi-year range and into a much higher correlation range (see Figure 3). Correlations are rising likely as a sign that liquidity and credit conditions are deteriorating.

**Figure 3. Rolling 30-Day Correlation of LIBOR-OIS and Gold Bullion**




Source: Bloomberg as of September 30, 2019.

## Another Macro Secular Trend Change?

S&P 500[6] Index implied stock correlation has broken out of its eight-year-long downtrend. The implied correlation of the S&P 500 constituent component returns has been declining since late 2011. When implied correlations are falling, individual company fundamentals tend to dominate, leading to more of a "stock pickers" market. When implied correlations are rising, it is indicative of macro market forces becoming more dominant in setting market pricing. As macro forces become more assertive in setting stock returns, correlations will rise.

Historically, when correlations rise, volatility tends to increase and the ability for diversification lessens. Rising correlation is not necessarily a bear or bull market call, but it is a potentially significant change in market dynamics. After a period of extended macroeconomic and market consistency, the recent sharp decline in expected economic growth and rising risk is starting to show up in longer-term secular trends. These early signs of potential secular trend shifts are not unexpected given: 1) how late we are in the current market cycle; 2) how dominant central bank policies are in pricing capital market assets; and 3) how synchronized this global slowdown has become.

6 The S&P 500 is a stock market index that tracks the stocks of 500 large-cap U.S. companies.

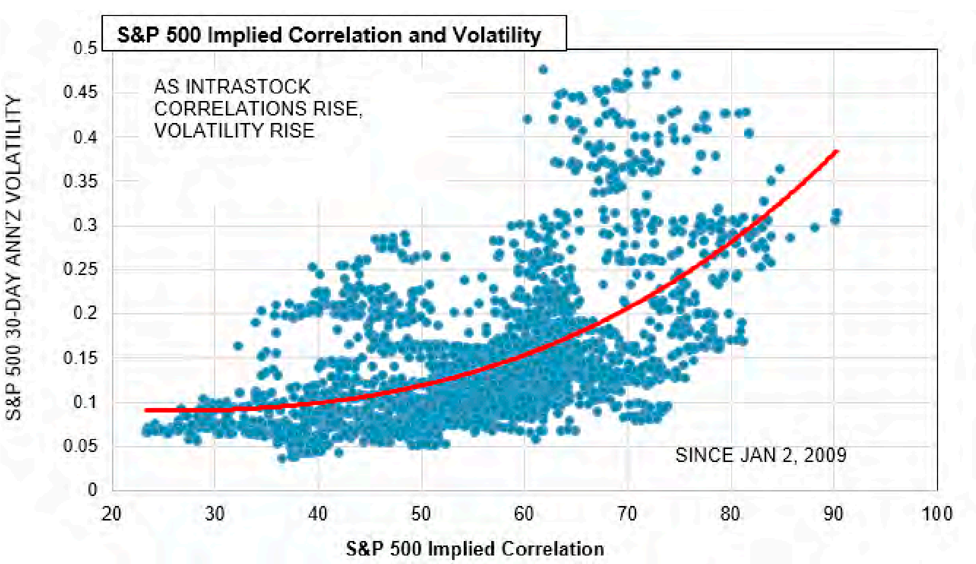
S&P 500 implied correlation is likely ending its secular downtrend and is reversing into a higher correlation regime. As macroeconomic market conditions are expected to deteriorate further, we can expect implied correlations to rise.

Correlations underpin the multitude of algorithmic-driven risk-parity type portfolios.[7] Depending on how quickly correlations change, there is a risk of a disorderly reversion in asset prices.

### Figure 4. S&P 500 Implied Stock Correlation Breaks its Trend


Source: Bloomberg as of September 30, 2019.

### Figure 5. As Correlation Increases, Volatility Rises




Source: Bloomberg as of September 30, 2019.

[7] Risk-parity funds refer to a set of rule-based investment strategies that combine stocks, bonds and other financial assets. They are a counterweight to traditional portfolio investment strategies where investors are split between equities and bonds but equities end up carrying more of the risk.

### Gold Bullion and Gold Equities Offer Low Correlation to the S&P 500

What does this mean for gold? There are two considerations. The first is that as correlations rise, non-correlated assets will become more valuable. Both gold bullion and gold equities have historically low to negative correlation to the S&P 500 and continue to exhibit this characteristic to date. Secondly, as correlations rise, volatility will likely increase.

Rising volatility will have significant ramifications for risk parity type funds. Risk parity funds focus on the allocation of risk, usually defined as volatility, rather than allocation of capital. During periods of rising volatility, allocations are reduced to bring down overall portfolio risk. When the allocation mix includes gold, the effect of gold's non-correlated behavior, will lower the portfolio volatility. In addition to lower volatility, gold is likely to make the portfolio more efficient, especially if the overall market correlation is rising — yet another factor as to why gold is attractive now.

## Two Unique ETFs to Invest in Gold Stocks

Sprott ETFs provide investors with access to innovative and unique indexes that are designed to outperform passive market cap-weighted offerings.

**Sprott Gold Miners Exchange Traded Fund (NYSE: SGDM)** seeks investment results that correspond (before fees and expenses) generally to the performance of its underlying index, the Solactive Gold Miners Custom Factors Index (Index Ticker: SOLGMCFT). The Index aims to track the performance of larger-sized gold companies whose stocks are listed on Canadian and major U.S. exchanges.

**Sprott Junior Gold Miners Exchange Traded Fund (NYSE: SGDJ)** seeks investment results that correspond (before fees and expenses) generally to the performance of its underlying index, the Solactive Junior Gold Miners Custom Factors Index (Ticker: SOLJGMFT). The Index aims to track the performance of small-capitalization gold companies whose stocks are listed on regulated exchanges.

## Two Unique Indexes

Each Index is designed using specific **Factors** *that* **Matter**™ for a particular strategy. These customized factors are selected because they have historically proven to be strong predictors of stock performance.

**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 LP, a leading, long-time gold sector investor, and Solactive AG.

**SGDM**

NYSE ARCA

**Sprott Gold Miners ETF**

- Stocks weighted in the Index based on quarterly revenue growth and long-term debt to equity.
- Index is reconstituted quarterly.

**SGDJ**

NYSE ARCA

**Sprott Junior Gold Miners ETF**

- Stocks weighted in the Index based on revenue growth and price momentum.
- Index is reconstituted semi-annually.

# Sprott Monthly Report

October 3, 2019

## Sprott Gold Miners Exchange Traded Fund

### Performance History: Average Annual Total Returns* (%)

| MONTH END AS OF 09/30/19 | 1 MO | 3 MO | YTD | 1 YR | 3 YR | 5 YR | S.I.[2] |
|---|---|---|---|---|---|---|---|
| Sprott Gold Miners ETF (Net Asset Value) | -10.56% | 4.41% | 30.92% | 47.66% | -1.24% | 3.66% | -1.10% |
| Sprott Gold Miners ETF (Market Price)[1] | -10.72% | 4.47% | 30.93% | 46.97% | -1.34% | 3.57% | -1.14% |
| Solactive Gold Miners Custom Factors Index TR (Benchmark)[3] | -10.40% | - | - | - | - | - | - |
| Sprott Zacks Gold Miners Index (Legacy Index)[3] | -11.73% | 6.32% | 33.84% | 51.30% | 0.00% | 4.78% | -0.06% |
| S&P 500® Total Return Index | 1.87% | 1.70% | 20.55% | 4.25% | 13.39% | 10.84% | 10.41% |

| QUARTER END AS OF 09/30/19 | 1 MO | 3 MO | YTD | 1 YR | 3 YR | 5 YR | S.I.[2] |
|---|---|---|---|---|---|---|---|
| Sprott Gold Miners ETF (Net Asset Value) | -10.56% | 4.41% | 30.92% | 47.66% | -1.24% | 3.66% | -1.10% |
| Sprott Gold Miners ETF (Market Price)[1] | -10.72% | 4.47% | 30.93% | 46.97% | -1.34% | 3.57% | -1.14% |
| Solactive Gold Miners Custom Factors Index TR (Benchmark)[3] | -10.40% | - | - | - | - | - | - |
| Sprott Zacks Gold Miners Index (Legacy Index)[3] | -11.73% | 6.32% | 33.84% | 51.30% | 0.00% | 4.78% | -0.06% |
| S&P 500® Total Return Index | 1.87% | 1.70% | 20.55% | 4.25% | 13.39% | 10.84% | 10.41% |

### Expenses as of 07/19/2019

| | |
|---|---|
| Management Fee | 0.35% |
| Other Expenses[4] | 0.28% |
| **Total Annual Fund Operating Expenses** | **0.63%** |
| Fee Waiver/Expense Reimbursement | 0.13% |
| **Net Total Expense Ratio[7]** | **0.50%** |

## Sprott Junior Gold Miners Exchange Traded Fund

### Performance History: Average Annual Total Returns* (%)

| MONTH END AS OF 09/30/19 | 1 MO | 3 MO | YTD | 1 YR | 3 YR | S.I.[5] |
|---|---|---|---|---|---|---|
| Sprott Junior Gold Miners ETF (Net Asset Value) | -9.27% | 1.41% | 23.87% | 28.58% | -8.66% | 6.16% |
| Sprott Junior Gold Miners ETF (Market Price)[1] | -9.71% | 1.12% | 22.89% | 27.50% | -8.98% | 5.99% |
| Solactive Junior Gold Miners Custom Factors Index TR (Benchmark)[6] | -9.19% | - | - | - | - | - |
| Sprott Zacks Junior Gold Miners Index – TR (Legacy Index)[6] | -13.68% | 7.47% | 31.64% | 36.88% | -6.23% | 8.35% |
| S&P 500® Total Return Index | 1.87% | 1.70% | 20.55% | 4.25% | 13.39% | 10.46% |

| QUARTER END AS OF 09/30/19 | 1 MO | 3 MO | YTD | 1 YR | 3 YR | S.I.[5] |
|---|---|---|---|---|---|---|
| Sprott Junior Gold Miners ETF (Net Asset Value) | -9.27% | 1.41% | 23.87% | 28.58% | -8.66% | 6.16% |
| Sprott Junior Gold Miners ETF (Market Price)[1] | -9.71% | 1.12% | 22.89% | 27.50% | -8.98% | 5.99% |
| Solactive Junior Gold Miners Custom Factors Index TR (Benchmark)[6] | -9.19% | - | - | - | - | - |
| Sprott Zacks Junior Gold Miners Index – TR (Legacy Index)[6] | -13.68% | 7.47% | 31.64% | 36.88% | -6.23% | 8.35% |
| S&P 500® Total Return Index | 1.87% | 1.70% | 20.55% | 4.25% | 13.39% | 10.46% |

### Expenses as of 07/19/2019

| | |
|---|---|
| Management Fee | 0.35% |
| Other Expenses[4] | 0.46% |
| **Total Annual Fund Operating Expenses** | **0.81%** |
| Fee Waiver/Expense Reimbursement | 0.31% |
| **Net Total Expense Ratio[7]** | **0.50%** |

**See following page for footnotes.**

**Performance data quoted represents past performance. Past performance is no guarantee of future results so that shares, when redeemed may be worth more or less than their original cost. The investment return and principal value will fluctuate. Current performance may be higher or lower than the performance quoted. Call 866.675.2639 for current month end performance.**

* Returns less than one year are not annualized.

1 Market Price is based on the midpoint of the bid/ask spread at 4 p.m. ET and does not represent the returns an investor would receive if shares were traded at other times.

2 Inception date of 07/15/2014.

3 Effective 7/22/2019, SGDM began tracking the Solactive Gold Miners Custom Factors Index (SOLGMCFT). Historical Index data prior to 7/22/2019 is for the Sprott Zacks Gold Miners Index (ZAXSGDM). Index data on or after 7/22/2019 is the Solactive Gold Miners Custom Factors Index (SOLGMCFT), which was created by Solactive AG ("Index Provider") to provide a means of generally tracking the performance of gold mining companies whose stocks are traded on Canadian and major U.S. exchanges. An investor cannot invest directly in the Index. SGDM was reorganized from ALPS ETF Trust into Sprott ETF Trust on or about 7/19/19. SGDM is a continuation of the prior fund and, therefore, the performance information shown includes the prior fund's performance.

4 Other expenses are based on estimated amounts for the current fiscal year and are calculated as a percentage of the Fund's net assets.

5 Inception date of 03/31/2015.

6 Effective 7/22/2019, SGDJ began tracking the Solactive Junior Gold Miners Custom Factors Index (SOLJGMFT). Historical Index data prior to 7/22/2019 is for the Sprott Zacks Junior Gold Miners Index (ZAXSGDJ). Index data on or after 7/22/2019 is the Solactive Junior Gold Miners Custom Factors Index (SOLJGMFT), which was created by Solactive AG ("Index Provider") to provide a means of generally tracking the performance of junior gold mining companies whose stocks are traded on Canadian and major U.S. exchanges. An investor cannot invest directly in the Index. SGDJ was reorganized from ALPS ETF Trust into Sprott ETF Trust on or about 7/19/19. SGDJ is a continuation of the prior fund and, therefore, the performance information shown includes the prior fund's performance.

7 Sprott Asset Management LP, the investment adviser to the Fund, has contractually agreed to waive the management fee, and/or reimburse expenses so that Total Net Expense Ratio After Fee Waiver/Expense Reimbursements (not including distribution (12b-1) fees, shareholder service fees, acquired fund fees and expenses, taxes, brokerage commissions and extraordinary expenses) do not exceed a maximum of 0.50% of the shares average daily net assets through June 30, 2021.

# Sprott Monthly Report

October 3, 2019

Sprott ETFs
Factors *that* Matter™

IMPORTANT DISCLOSURES & DEFINITIONS

**An investor should consider the investment objectives, risks, charges and expenses carefully before investing. This must be accompanied or preceded by a Prospectus. 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 Funds are not suitable for all investors. There are risks involved with investing in ETFs including the loss of money. The Funds are considered nondiversified and can invest a greater portion of assets in securities of individual issuers than diversified funds. As a result, changes in the market value of a single investment could cause greater fluctuations in share price than would occur in diversified funds.**

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 Funds will be concentrated in the gold and silver mining industry. As a result, the Funds 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.

ALPS Portfolio Solutions Distributor, Inc. is not affiliated with Sprott Asset Management LP.

SPT000554 10.31.20

1019418 10/19_SAM_ART_SMR_ETF