Sprott Focused US Dividend Class

December 2017 Commentary

Investment Team

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In 2017, the Sprott Focused US Dividend Class generated a total return of 10.8% compared to the S&P 500 Index, which generated a total return of 14.0%.

Returns in the month of December were disappointing on both an absolute and relative basis, with the Fund generating a total return of -2.3% while the benchmark generated a total return of -1.5%. Canadian dollar strength in the final week of the year was the primary driver of weakness over the course of the month.

Through the end of calendar 2017, our USD exposure was unhedged, in line with our benchmark. Our modelling continues to indicate that the Canadian dollar is likely to weaken in 2018. However, recent oil price strength and rising expectations for interest rate hikes from the Bank of Canada has led to Canadian dollar strength. We are looking to add USD/CAD hedges early in 2018, perhaps as rhetoric surrounding NAFTA negotiations heats up, in order to reduce currency-related volatility in the Fund.

Top contributors to the 2017 performance of the Sprott Focused US Dividend Class included Mastercard (+143 bps), Visa (+139 bps) and Unitedhealth Group (+132 bps). Top detractors in 2017 included PG&E (-71 bps), Macquarie Infrastructure (-56 bps) and Disney (-56 bps). Note that we have eliminated all three of these securities due to stock-specific factors that led to the disappointing performance.

One of our top holdings, FedEx (FDX US), generated a return of almost 36% in 2017, propelled by an attractive valuation (despite the rally, the shares trade at only 16.4x FY2019 EPS estimates) coupled with top line growth. With ecommerce in the US a $400 billion growth industry (according to the US Census Bureau), the exceptional demand environment has allowed the Company to announce an average shipping rate increase of 4.9%, effective January 2018, which is supportive of future revenue growth.

Although the corporate adjusted operating margin dipped from 10.0% in FY2016, to 9.0% in FY2017, margins are expected to recover through FY2020. In fact, the Company is currently targeting incremental operating income of $1.2 to $1.5 billion by FY2020 in the FedEx Express segment alone, as the full integration of TNT Express leads to significant global synergies and cost savings.

Recently, FDX has attempted to quantify the impact of the corporate tax rate changes, with the FY2018 adjusted EPS range of $12.70 to $13.30 per share expected to increase by an estimated $0.85 to $1.00 due to the lower effective tax rate. Looking forward, the Company's long-term financial goals to increase EPS by 10% to 15% per year, achieve a 10% or better operating margin, improve cash flows & ROIC and increase returns to shareholders bode well for the stock's continued outperformance.

The Sprott Focused US Dividend Class was concentrated in 28 positions as at December 31, 2017 with the top 10 holdings accounting for approximately 38.2% of the fund. Over the past year, 20 out of our 28 holdings have announced a dividend increase, with an average hike of 24.1%. We will continue to apply a disciplined investment process, balancing various quality and valuation metrics, in an effort to generate solid risk-adjusted returns.

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