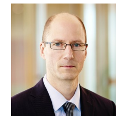
Sprott Global Infrastructure Fund

September 2017 Commentary

The S&P Global Infrastructure Index generated a 9.6% total return in Canadian dollars year-to-date, despite peaking early in June and moving sideways through the third quarter of 2017 (see Exhibit 1 below).

Investment Team



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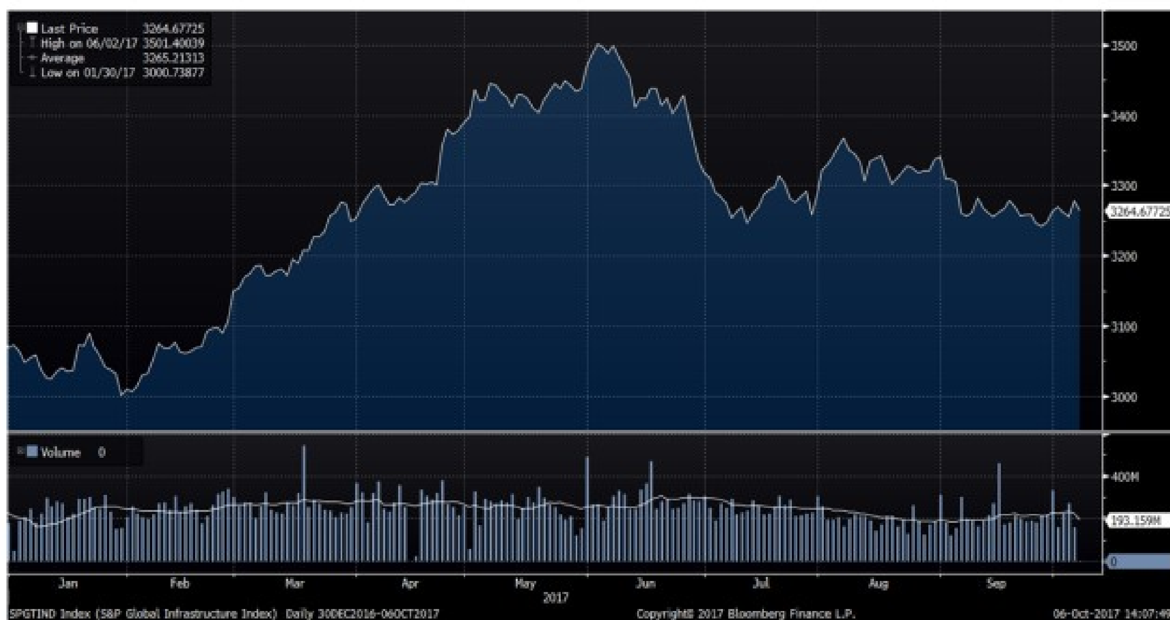

Exhibit 1: S&P Global Infrastructure Index in Canadian dollars year-to-date | Source: Bloomberg

In Canadian dollar terms, the Industrials sector (42.4% weight in the index) returned a total of 19.0%, the Utilities sector (38.7% weight in the index) returned a total of 7.6% and the Energy sector (18.9% weight in the index) returned a total of -2.6%, year-to-date.

At the sub-industry level, European toll roads have been the clear performance winners. Essentially, traffic volumes continued to recover and toll rate increases translated into revenue growth for the concession owners as economic growth improved across continental Europe. Airport services have also been strong performers on a year-to-date basis, however most have corrected from the highs reached mid-year. The pullback can be blamed on slowing passenger traffic growth coinciding with generally full valuations. Oil & gas storage & transportation continued to be a drag on the index, with most major US pipelines and MLPs still in negative territory for the year despite the recent rally in crude oil prices.

In term of country-specific returns, Europe was the place to be, with Germany, Italy, France and Spain outperforming, driven by each country's relatively large exposure to pure-play toll roads and airports. Unsurprisingly, Canada and the United States remain near the bottom of the performance

rankings, given North America's significant exposure to the energy sector.

Looking forward, global output is projected to grow at 3.6% in 2017 and 3.7% in 2018 based on the International Monetary Fund's October 2017 World Economic Outlook. The United States is expected to grow 2.2% in 2017 and 2.3% 2018, upgraded from prior forecasts of 2.1% in both 2017 and 2018, while the Eurozone is currently expected to grow 2.1% and 1.9% in 2017 and 2018 respectively. Although Canada is projected to grow 3.0% in 2017, growth is expected to moderate to 2.1% in 2018.

Overall, the macroeconomic environment, ignoring any temporary impact from unpredictable geopolitical events, is generally quite positive for both equities and income-producing securities. Again, we would point to the relatively flattish US yield curve as evidence of a slower growth, lower interest rate environment (see Exhibit 2 below) for the foreseeable future.

Exhibit 2: US Government 2-year bond and 10-year bond yield spread (white line) and US Government 10-year bond yield (yellow line) | Source: Bloomberg

From a Canadian investor's perspective, currency movements can have a large impact on investment returns and the surprising change in the domestic monetary policy narrative last June was discussed in a prior commentary. The Bank of Canada subsequently followed through on its promise to remove 50 basis points of emergency stimulus and hiked rates in July and September, in 25 basis point increments. Although the Canadian dollar strengthened immediately following the pivot from an easing bias to a tightening bias last June, the second leg of strengthening in September was less intuitive (see Exhibit 3 below) considering that market participants should have been well aware of the Bank of Canada's intentions.

Exhibit 3: price of 1 US dollar in Canadian dollars year-to-date | Source: Bloomberg

However, the odds of additional rate hikes are in question given more recent comments out of the Bank of Canada regarding the strengthening Canadian dollar and its negative impact on exports (down 1.0% on a month over month basis and down 0.2% on a year over year basis in August) and the Country's trade balance ($3.4 billion trade deficit in August, worsening from the $2.98 billion trade deficit in July). With falling expectations for rate hikes in Canada and rising expectations for rate hikes in the United States over the balance of the year, the Canadian dollar may weaken slightly from current levels.

PORTFOLIO UPDATE

As we've discussed previously, The Sprott Global Infrastructure Fund has taken a total infrastructure approach, broadening the investable universe to include businesses that share similar attributes as traditional infrastructure investments.

Currently, the Fund is underweight the Energy sector relative to the benchmark (12.9% compared to 18.9%), underweight the Industrials sector relative to the benchmark (27.2% compared to 42.4%) and underweight the Utilities sector relative to the benchmark (26.4% compared to 38.7%). This positioning has freed up capital for a 3.1% allocation to the Consumer Discretionary sector, a 3.5% allocation to the Financials sector, a 16.7% allocation to the Information Technology sector, a 6.2% allocation to the Real Estate sector and a 3.3% allocation to the Telecommunications sector. All of these positions are consistent with our global infrastructure mandate but are also more representative of the growing importance of data, communication, ecommerce and security in a modern, developed economy.

Top contributors to the year-to-date performance of the Sprott Global Infrastructure Fund included Atlantia (+87 bps), Vinci (+84 bps) and Visa (+81 bps). Top detractors year-to-date included Macquarie Infrastructure (-48 bps), Keyera (-37 bps) and Nextdc (-36 bps). Note that we have eliminated our positions in both Macquarie and Nextdc due to stock-specific factors that led to the disappointing performance.

Our top contributor, Atlantia Spa (ATL IM), has outperformed since the Italian constitutional

referendum last December, helped in part due to a recent takeover offer for its Spanish rival, Abertis Infraestructuras SA. As a standalone entity, Atlantia is a pure play on global infrastructure, managing 51% of Italy's toll roads (over 3,000 km) and operating the ADR Airport System (Fiumicino and Ciampino in Rome) that provides connections to 240 locations around the world. Internationally, Atlantia owns a 1,500 km toll road network in Brazil, a 313 km of toll road network in Chile, a 110 km toll road network in India and a 61 km toll road network in Poland. Atlantia also owns the ACA Airport System, which consists of the Nice, Cannes-Mandelieu and Saint Tropez airports in the south of France.

In September, the Group made a voluntary tender offer for the entire issued share capital base of Abertis (ABE SM). It is a full cash offer, capped at 90% of the total shares outstanding at a price of €16.50 per share of ABE, subject to a minimum acceptance of 50% +1 total shares. There is a partial share alternative available, limited to 23% of total shares, with an exchange ratio of 0.697 ATL shares per share of ABE. The transaction has just received approval from the Spanish Stock Exchange Commission and the acceptance period of the offer extends through October 24, 2017, with closing expected in the fourth quarter of 2017.

The rationale behind the acquisition is twofold. First, the transaction provides geographic diversification to fourteen new countries with over 9,000 km of toll roads, creating the largest global transportation infrastructure owner by EBITDA. It expands Atlantia's development pipeline of new projects significantly, adding approximately €4 billion of expansion opportunities to an already robust backlog. Second, the transaction significantly lowers the combined entity's cost of debt, from 4.5% to 3.6%, pro-forma the underwritten credit facilities tied to the deal. Management has been extremely clear that the transaction, once closed, will be accretive to dividend per share growth. They explicitly highlighted the "potential for additional dividend per share growth of up to 30% from year 1 on top of the current dividend policy".

We are supportive of the transaction and hope the deal closes before yearend, as expected. However, we acknowledge the potential risk of a competing bid and, in light of the stock's solid performance yearto-date, we have trimmed some of our position.

PORTFOLIO OUTLOOK

Although the S&P Global Infrastructure Index experienced relatively disappointing performance in Canadian dollar terms since mid-year, we are pleased to have gained some ground relative to the benchmark. Through the remainder of the year, we may employ tactical currency hedging in order to mitigate foreign exchange related volatility and protect some of these relative gains.

The FED is expected to hike rates at least one more time in 2017 but the yield curve should remain relatively flattish since inflation expectations remain subdued. However, we suspect that the Bank of Canada may be on hold for the balance of the year, having already removed 50 basis points of emergency stimulus.

Based on the composite PMI data from September, the US and the Eurozone are both still in expansion territory at 54.8 and 56.7 respectively. Earnings growth is expected to remain positive for the balance of 2017, with the S&P 500 (adjusted for companies with negative earnings) at 17.6% and the MSCI World at 22.9%. However, with the S&P 500 trading at a forward P/E of 19.3x compared to the MSCI World at 17.75x, we currently see more attractive valuations relative to growth expectations in Europe.

The Sprott Global Infrastructure Fund was concentrated in 30 positions as at September 30, 2017 with the top 10 holdings accounting for approximately 38% of the fund. Over the past year, 23 out of our 30 holdings have announced a dividend increase, with an average hike of 13.4%. Using a total infrastructure approach, we will continue to apply a disciplined investment process, balancing valuation, growth and yield in an effort to generate solid risk-adjusted returns.

[1] All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at September 30, 2017; e) 2011 annual returns are from 09/01/11 to 12/31/11.

The Fund is generally exposed to the following risks. See the prospectus of the Fund for a description of these risks: capital depletion risk; concentration risk; credit risk; currency risk; cybersecurity risk; derivatives risk; exchange traded funds risk; foreign investment risk; income trust risk; inflation risk; interest rate risk; liquidity risk; market risk; regulatory risk; series risk; short selling risk; small company risk; specific issuer risk; tax risk.

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