

The Sprott Strategic Fixed Income Fund continued where it left off in February by posting another month of solid gains. Most of our strategies posted solid returns and many of our positions which had underperformed in the fall have retraced approximately 50%-60%. Liquidity has been injected back into the financial markets and for the time being the financial system is functioning. Now it's time for policy makers to address the many fiscal and growth challenges that the developed world is facing. This is a longer term issue that will weigh on the markets, but from our perspective this is not an immediate concern. We are still bullish on risk assets in the short to medium term and are constantly looking out to the horizon for signals that the market will turn negative. We'll borrow a description of the current LRTO operations and its effects on the markets from a chief economist we recently met with. The ECB is in effect taking in excess of 1 Trillion dollars of risky asset off the public market and replacing it with cash. This in effect is crushing volatility, which to put another way is driving the cost of risk down and equity prices higher. This is not a market to be short and more importantly it is important to harvest alpha when the opportunity presents itself as these opportunities will not last indefinitely.

Sprott Strategic Fixed Income Fund

We've enjoyed a very strong start to 2012 with the NAV of the fund increasing 1.24% for the month and 3.91% year to date as of February 29th. Recall this fund has far more flexibility than the Sprott Diversified Yield Fund and allows us to invest across more markets including currency options and credit default swaps. One of the lessons we learned from 2011 is the importance of always maintaining "structural liquidity". This is crucial in that while we are sanguine about the prospects for the markets in the coming months we want to ensure that when our view changes we can move the fund to either a neutral or a bearish position quickly.

We managed to generate the bulk of our returns from credit and foreign exchange. Leverage is running at about 2:1 and we've employed various foreign exchange strategies via the options market. Currently our bias is to see interest rates trade in a range, eventually breaking higher and have thus employed trades which will generate positive returns in the event the yield curve steepens.

Presently, the Sprott Strategic Fixed Income Fund has 30% in high yield (both cash and credit default swaps) and 50% in investment grade debt with the balance invested in cash and very short-term investment grade debt. The fund is currently yielding 5%¹.

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¹ The yield expressed is the estimated annual income from the investment expressed as a percentage of the investment's current value. It does not reflect the return of the Fund.

SPROTT STRATEGIC FIXED INCOME FUND

MARCH 2012 COMMENTARY

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