SPROTT FOCUS TRUST INC.
Form N-CSR
March 12, 2019
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF

REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number: 811-05379

SPROTT FOCUS TRUST, INC.

(Exact name of registrant as specified in charter)

Royal Bank Plaza, South Tower

200 Bay Street, Suite 2600

Toronto, Ontario, Canada M5J 2J1

(Address of principal executive offices)

The Prentice-Hall Corporation System, MA

7 St. Paul Street, Suite 820

Baltimore, MD 21202

(Name and address of agent for service)

Registrant s telephone number, including area code: (760) 444-5297

Date of fiscal year end: December 31, 2018

Date of reporting period: January 1, 2018 December 31, 2018

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Item 1. Reports to Shareholders.

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December 31, 2018

Sprott Focus Trust

2018 Annual

Review and Report to Stockholders

sprottfocustrust.com

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Managed Distribution Policy

The Board of Directors of Sprott Focus Trust, Inc. (the Fund) has authorized a managed distribution policy (MDP). Under the MDP, the Fund pays quarterly distributions at an annual rate of 6% of the average of the prior four quarter-end net asset values, with the fourth quarter being the greater of this annualized rate or the distribution required by IRS regulations. With each distribution, the Fund will issue a notice to its stockholders and an accompanying press release that provides detailed information regarding the amount and composition of the distribution (including whether any portion of the distribution represents a return of capital) and other information required by the Fund s MDP. You should not draw any conclusions about the Fund s investment performance from the amount of distributions or from the terms of the Fund s MDP. The Fund s Board of Directors may amend or terminate the MDP at any time without prior notice to stockholders.

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Performance

NAV Average Annual Total Returns

As of December 31, 2018 (%)

FUND	1-YR	3-YR	5-YR	10-YR	15-YR	20-YR	SINCE INCEPTION	INCEPTION DATE
Sprott Focus Trust	(17.01)	7.06	1.82	9.37	6.80	8.63	8.54	11/1/96[1]
INDEX								
Russell 3000[2]	(5.24)	8.97	7.91	13.18	7.89	5.96	8.00	

[1] Royce & Associates, LLC served as investment adviser of the Fund from November 1, 1996 to March 6, 2015. After the close of business on March 6, 2015, Sprott Asset Management LP and Sprott Asset Management USA, Inc. became the investment adviser and investment sub-adviser, respectively, of the Fund.

[2] Russell Investment Group is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group. The Russell 3000 index measures the performance of the largest 3,000 U.S. companies. The performance of an index does not represent exactly any particular investment, as you cannot invest directly in an index.

Important Performance and Risk Information

All performance information reflects past performance, is presented on a total return basis, net of the Fund s investment advisory fee, and reflects the reinvestment of distributions. Past performance is no guarantee of future results. Current performance may be higher or lower than performance quoted. Returns as of the most recent month-end may be obtained at www.sprottfocustrust.com. The market price of the Fund s shares will fluctuate, so shares may be worth more or less than their original cost when sold.

The Fund is a closed-end registered investment company whose shares of common stock may trade at a discount to their net asset value. Shares of the Fund s common stock are also subject to the market risks of investing in the underlying portfolio securities held by the Fund.

The Fund s shares of common stock trade on the Nasdaq Select Market. Closed-end funds, unlike open-end funds, are not continuously offered. After the initial public offering, shares of closed-end funds are sold on the open market through a stock exchange. For additional information, contact your financial advisor or call (203) 656-2430. Investment policies, management fees and other matters of interest to prospective investors may be found in the closed-end fund prospectus used in its initial public offering, as revised by subsequent stockholder reports.

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MANAGER S DISCUSSION

Sprott Focus Trust

Whitney George

DEAR FELLOW SHAREHOLDERS,

We are disappointed to report that Sprott Focus Trust (FUND) had a challenging year in 2018. Focus Trust lost 17.01% of its net asset value (NAV) for the 12-month period with the bulk of the damage occurring in a difficult fourth quarter (-13.55%). By comparison, our benchmark Russell 3000 Index fell 5.24% for the year and declined 14.30% in the fourth quarter. Not surprisingly, we lost some ground in our ongoing effort to narrow, and ultimately eliminate, Focus Trust s market price discount to its NAV. At year-end (12/31/18), Focus Trust traded at a 13.60% discount compared to an 11.31% discount at the beginning of 2018. This conspired to produce a total shareholder return of -19.15% for the calendar year, not a pleasant result but this is where the bad news ends.

If history is a guide, we believe that 2019 will be a better year for Sprott Focus Trust, and the positive results thus far for the month of January indicate so (10.76% gain in net asset value for the month). The discipline we employ to take advantage of market corrections to refresh Focus Trust s portfolio, should set us up for improvement. We buy while others are selling, in order to capture more than a fair share of an eventual recovery. 2018 marked the fifth time in 20 years that Sprott Focus Trust has posted a negative return. In each of the four previous occurrences of negative annual performance, Focus Trust went on to enjoy two consecutive years of positive performance. There is nothing to convince us that this time will be different. In terms of Focus Trust s current market price discount to NAV, we do have ultimate control over this and will continue to address it. Sprott Focus Trust s longer-term returns continue to be satisfactory in absolute terms, and will improve in relative terms as time distances us from the Federal Reserve s five-year experiment with 0% interest rates. As we have discussed before, we believed the period between 2011 and 2016, when the Federal Reserve held interest rates at or near 0%, produced a suspension of capitalism which is so important to proper business valuation and discounting. While we may have already achieved interest rate normalization, and expect it to positively impact our portfolio of high-quality, undervalued businesses, there is no guarantee that we will not revisit less than 0% real interest rates again. In that event, we would expect our overexposure to hard assets themes to dramatically outperform just as they did in the two years leading up to 2011.

As promised, the Federal Reserve raised short-term rates four times over the course of 2018. Each bump was greeted with progressively more volatility and broader negative market performance. Our two visits with 10-year government Treasury yields over 3%, produced nearly instant market corrections. As the year progressed, market

stresses that showed up initially in only the periphery of emerging markets, ultimately worked their way to the core of U.S. equities with Apple Inc. (pun intended) declining almost 40% at the end of 2018. Also, as promised, President Trump began his attack on trade imbalances; he started with our closest allies, Canada and Mexico, continuing onto Europe and South Korea, and ending with escalating tariffs on China. What was initially viewed as political posturing in an election year, ended up causing a global growth scare of epic proportions. While some softening in Tariff man s attack on China trade materialized in the final weeks of 2018, the markets still need to contend with the March 1, 2019 deadline when the current truce is set to end.

Finally, the government shutdown over an immaterial border wall and the ongoing investigations of the President s closest advisors conspired to round out a long list of worries. Expectations for S&P 500 earnings growth in 2019 are migrating toward zero, given the combination of cooling global economic growth and the unrealistic mark set by 2018 earnings growth, which was bolstered by the Tax Cuts and Jobs Act (signed into law by President Trump on December 22, 2017). The broad market price-earnings ratio (P/E) contracted more than any year since the 1930s.

We began 2019 with a very tall wall of worries after a broad equity market correction that neared a bear market. As longtime contrarian investors, it is hard to imagine a better environment for finding attractive investment opportunities.

Activity

Sprott Focus Trust s portfolio turned over 31% in 2018. This was within our long-term expectation of mid-to-high 20s, derived from our three- to five-year holding target. Remarkably, Focus Trust s churn in 2018 was close to 2017 s rate (29%). We would expect higher turnover during more volatile markets and last year we saw the dramatic return of volatility after its extraordinary disappearance in 2017. Further, merger and acquisition activity, another source of turnover, returned to our portfolio in a minor way in 2018 after a two-year hiatus. Last year we witnessed a noticeable lack of daily liquidity in most of our investments driving intra-day volatility. We made a consensus decision to avoid unnecessary transactions that would carry a higher than normal frictional cost. We expect merger and acquisition activity to pick up at this stage of the market cycle and we will not be surprised if 2019 produces an above-average turnover rate.

In 2018, we added five new positions to Focus Trust s portfolio: Arcosa, Stelco Holdings, Centamin, Reliance Steel & Aluminum and Smart Sand. Reliance Steel & Aluminum and gold miner Centamin are former portfolio holdings that we have followed for many years.

Arcosa is a new company in the infrastructure, construction and materials business, spun out from Trinity Industries this past fall. Stelco Holdings is Canada s lowest-cost steel manufacturer after bankruptcy reorganization. Smart Sand is a producer of northern white sand used to frack oil wells. Each of these new investments represents an opportunity created by the uncertainty associated with the 2018 trade disputes. Reliance Steel, Arcosa and Stelco are likely to greatly benefit from any new infrastructure rebuild which we believe is the only area of agreement in Washington for the next two years.

Deletions to Sprott Focus Trust s portfolio in 2018 included Syntel, which was acquired in mid-year 2018 by Atos (now Atos Syntel). TGS-NOPEC Geophysical Company reached and exceeded our valuation target in the first half of the year. Carbo Ceramics was replaced by Smart Sand as a fracking play. Osisko Mining and Fortuna Silver Mines were replaced by the additions of higher-quality, dividend-paying companies in the precious metals allocation of our portfolio. Lastly, Randgold Resources merged into Barrick Gold, creating an interesting new company which we have elected to keep.

During 2018, our top-five contributors to Sprott Focus Trust performance were Syntel, TGS-NOPEC Geophysical Company, Kennedy-Wilson Holdings, Amgen and MKS Instruments. As previously mentioned, Syntel was acquired by Atos, TGS-NOPEC achieved our price target, as did both MKS Instruments and Amgen (briefly). MKS left our portfolio mid-year but returned in the fourth quarter during the large correction in the technology sector. Kennedy-Wilson, a real estate asset manager, remains a top holding of Focus Trust. Collectively our top winners contributed just under 3% of positive performance in 2018.

By contrast, our top-five detractors cost our portfolio nearly 9% and included Thor Industries, Western Digital Corporation, Cirrus Logic, Lam Research and Artisan Partners Asset Management. All of these companies are high conviction, long-term holdings in Sprott Focus Trust and have often been top performers in the past. We took the opportunity to add to all of these names during the severe price corrections each suffered in 2018.

Top Contributions to Performance

Year-to-date through 12/31/2018 (%)[1]

Syntel, Inc.	1.49
TGS-NOPEC Geophysical Company ASA	0.56
Kennedy-Wilson Holdings, Inc.	0.38
Amgen Inc.	0.27
MKS Instruments Inc.	0.24

[1] Includes dividends

Top Detractors from Performance

Year-to-date through 12/31/2018 (%)[1]

Thor Industries, Inc.	-3.10
Western Digital Corp.	-2.55
Cirrus Logic, Inc.	-1.20
Lam Research Corp.	-1.08
Artisan Partners Asset Management, Inc.	-1.02

[1] Net of dividends

Figure 1

An examination of last year s sector performance for Sprott Focus Trust leaves little to cheer about. Only Real Estate and Health Care,

with modest weights, produced positive returns. Financial Services (principally asset managers) Information Technology, Materials and Consumer Discretionary, all detracted by 3% or slightly more. While Materials, mostly our precious metals positions, were recovering by the fourth quarter, nine month gains in energy reversed with collapsing oil prices. Information Technology shares also fell dramatically late in 2018 as a direct result of trade tensions. We took advantage of these opportunities and added to both the Energy and Information Technology sectors.

Top 10 Positions

(% of Net Assets)

Kennedy-Wilson Holdings, Inc.	4.8
Gentex Corp.	4.8
Lam Research Corp.	4.6
Apple, Inc.	4.3
Pason Systems Inc.	4.3
Helmerich & Payne, Inc.	4.2
Franklin Resources, Inc.	4.2
Cirrus Logic, Inc.	4.1
Thor Industries, Inc.	4.1
Western Digital Corp.	3.8

Portfolio Sector Breakdown

(% of Net Assets)

Materials	19.5
Information Technology	17.2
Financial Services	15.3

Consumer Discretionary	14.8
Energy	12.2
Real Estate	8.6
Consumer Staples	6.3
Industrials	2.9
Cash & Cash Equivalents	2.1
Health Care	1.1

Figure 2

Positioning

As we entered 2019, Sprott Focus Trust was fully invested with a cash position of 2.1%. During the market correction in last year s fourth quarter, we invested in a combination of old favorites and several new positions, as mentioned previously. We placed a heavy emphasis on those securities that were correcting the most aggressively, principally in the Information Technology, Energy and Consumer Discretionary sectors. We currently own 46 equity positions, which is consistent with our historical range of 40 to 50 investments. Materials (19.5%), Information Technology (17.2%) and Financial Services (15.3%) represented our three largest sectors at yearend. Materials, represented mostly by our 10 holdings in the precious metals complex, performed positively, tracking a strong, uncorrelated, advance in gold prices. Technology shares reacted violently to fears of a global slowdown caused by the escalation of trade wars. Financial Services represented mostly by asset management companies, were also under pressure from increased volatility and lower market averages. We significantly overweighted the portfolio relative to our benchmark in Energy and Materials, hard asset themes, and underweighted Health Care and Industrials. Our long-term investors will notice that in comparison to yearend 2017, eight of our top 10 holdings remain although their rankings may have shifted slightly. Of 2017 s top 10, Cal-Maine Foods and Federated Investors have moved to a slightly lower weighting in our portfolio. Cirrus Logic, one of our biggest winners in 2015 and 2016, is now back in the top 10 along with Lam Research, which was a top performer in 2017 and which corrected sharply in late 2018.

Last year we predicted that we were poised for outperformance based on our overall portfolio diagnostics. On average, we owned higher-quality companies at cheaper valuations than our benchmark, the Russell 3000 Index. We were wrong. In 2018, valuation and quality had little effect on performance as investor preference continued to narrow to favor only the largest market-cap technology leaders. We believe that this preference may have ended in the fourth quarter of 2018, as news headline tracked the rout in FAANG stocks (Facebook, Amazon, Apple, Netflix and Google).

As we start 2019, the portfolio diagnostics are more attractive than they were at the end of 2015, our last negative performance year. In 2015, the markets corrected twice. Once in August, when China made a surprise currency devaluation and again in December when Federal Reserve Chair Janet Yellen raised interest rates for the first time in the middle of another China slowdown scare. At 12/31/2018, our portfolio carried a weighted average P/E ratio of 12.2x, a weighted average P/B ratio of 1.8x and a weighted average dividend yield of 2.99%. By comparison at 12/31/15, these ratios were P/E 13.3x, P/B 1.7x and dividend yield 2.34%. Going into 2019, we are pleased that Sprott Focus Trust represents a higher-quality and less expensive portfolio, when one compares its metrics to those of the Russell 3000: weighted average P/E ratio of 16.9x, a weighted average P/B ratio of 2.7x and a weighted average dividend yield of 2.05%.

Meanwhile, the quality of Sprott Focus Trust s portfolio based on return on invested capital (ROIC) and balance sheet leverage has remained high. Currently, weighted average ROIC is 19.58% versus 21.81% in 2015, and the portfolio s leverage ratio is 1.86x versus 1.85x. We believe these metrics have set us up for a very strong performance period

Portfolio Diagnostics

Fund Net Assets	$182 million
Number of Holdings	46
2018 Annual Turnover Rate	31%
Net Asset Value	$6.69
Market Price	$5.78
Average Market Capitalization[1]	$3,434 million
Weighted Average P/E Ratio[2,3]	12.2x
Weighted Average P/B Ratio[2]	1.8x
Weighted Average Yield	2.99%
Weighted Average ROIC	19.58%

Weighted Average Leverage Ratio	1.86x
Holdings ³75% of Total Investments	26
U.S. Investments (% of Net Assets)	69.67
Non-U.S. Investments (% of Net Assets)	30.03

Figure 3

[1] **Geometric Average.** This weighted calculation uses each portfolio holding s market cap in a way designed to not skew the effect of very large or small holdings; instead, it aims to better identify the portfolio s center, which Sprott believes offers a more accurate measure of average market cap than a simple mean or median.

[2] **Harmonic Average.** This weighted calculation evaluates a portfolio as if it were a single stock and measures it overall. It compares the total market value of the portfolio to the portfolio s share in the earnings or book value, as the case may be, of its underlying stocks.

[3] The Fund s P/E ratio calculation excludes companies with zero or negative earnings (6.5% of portfolio holdings as of 12/31/18).

Outlook

Sprott Focus Trust is off to a strong start in 2019. January s 10.76% gain in net asset value was the strongest monthly performance we have enjoyed since lifting out of the great financial crisis in the spring of 2009. Global equity markets advanced with few exceptions across all regions and market capitalizations. Shortly after raising rates for the fourth time in 2018 and declaring Federal Reserve balance sheet reductions on autopilot, Chair Jerome Powell reversed himself indicating a far more cautious approach. Very quickly, the market consensus view shifted from four rate increases in 2019 to none. Now we are learning that the Federal Reserve may be content holding a permanently larger balance sheet, ending the need for quantitative tightening.

Additionally, trade talks between the U.S. and China have temporarily replaced the expanding tariff wars that began in mid-2018. We believe that markets have already priced in the trade truce, acknowledging that things are not likely to get worse, but markets have yet to respond to any potential for trade to improve. This will be a somewhat binary event over the next weeks.

The U.S. economy appears fairly strong while earnings growth expectations and P/E multiples have contracted sharply. Halfway through the fourth quarter earnings reporting season, we have seen some very positive price reactions to reports that were not as bad as expected. In one year, market sentiment has changed from very high expectations of growth, fueled by Tax Cuts and Jobs Act, to the

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current somewhat skeptical view that there may be no growth in corporate earnings at all. We believe we are investing in a far safer environment than at this time last year.

In 2019, we expect political news to continue to dominate headlines and have short-term impacts on markets. The China trade issue, the ongoing Mueller investigations of President Trump and Brexit are all likely to be short-term market moving events. Considering the longer term, we will need to endure the consequences of political scrutiny of the largest social media companies, geopolitical risks, and the continuing rise of popularism and its effects on our capitalistic system.

In our minds, the greatest long-term risk remains the growing mountain of unfunded liabilities across the U.S. economy. The national debt and expanding deficits, entitlement programs, and growing unfunded pension liabilities need to be addressed at some point. We have pointed out before that our President s approach to problem solving involves turning an issue into a crisis. As we approach the 2020 elections, our national balance sheet issues could easily become short-term campaign fodder. We are already starting to hear rumblings of novel solutions to these issues. One worth following is Modern Monetary Theory (MMT). In short, a country that prints its own currency should never run out. Governments have an obligation to their societies and should prudently issue their currency for the betterment of that society. In short, the U.S. will never run out. Unfortunately, MMT has been tried before with disastrous results. It is no surprise to us that gold has recently performed better.

On a brighter note, we believe that 2019 could bring some new initiatives on long-awaited infrastructure spending. This seems to be one of the only source of agreement within our divided Congress. Late in 2018, we added several new positions that would benefit from a demand increase in steel and other construction materials. Perhaps, once we get past a decision to build or not to build a wall on the Mexican border, Congress might find other projects it can tackle.

Finally, we expect 2019 to see increased merger and acquisition activity, which showed up in our portfolio modestly in 2018 after two years of no activity. Given the shrinking supply of publically traded companies through mergers, buybacks and limited IPO (initial public offering) activity, we expect that consolidation within industries will be a leading driver of growth. Further, the massive appetite for private equity funds almost guarantees buyout activity in that newly raised funds have a finite horizon in which to be invested. We expect to lose a larger number of our holdings to this trend given our preference for unlevered balance sheets and high-quality metrics. While we never look forward to losing a long-term high conviction holding, it is an inevitable (and often highly profitable) part of the investment cycle which we have not seen since 2006-2007.

We continue to be optimistic about the prospects for Sprott Focus Trust as evidenced by our own large ownership position. The Sprott Group, along with my family and I, currently own approximately 9 million shares, or over 35%, of the Fund s outstanding common stock; this compares to 7.75 million shares at the end of 2018. Many thanks to all of our fellow shareholders for your patience and support.

Sincerely,

W. Whitney George

February 6, 2019

The views expressed above reflect those of Mr. George only through the end of the period as stated on the cover of this report and do not necessarily represent the views of Sprott Asset Management USA, Inc. or any other person in the Sprott organization. Any such views are subject to change at any time based upon market or other conditions and Sprott disclaims any responsibility to update such views. These views may not be relied on as investment advice and, because investment decisions for the Sprott Focus Trust are based on numerous factors, may not be relied on as an indication of trading intent on behalf of the Sprott Focus Trust.

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PERFORMANCE AND PORTFOLIO REVIEW	**SYMBOLS**	**MARKET PRICE**	FUND **NAV**
			XFUNX

Average Annual Total Return (%) Through 12/31/18

	1-YR	**3-YR**	**5-YR**	**10-YR**	**15-YR**	**20-YR**	**SINCE INCEPTION (11/1/96)[1]**
FUND (NAV)	(17.01)	7.06	1.82	9.37	6.80	8.63	8.54

*Not Annualized

Relative Returns: Monthly Rolling Average Annual Return Periods[1]

15 Years through 12/31/18

On a monthly rolling basis, the Fund outperformed the Russell 3000 in 65% of all 10-year periods; 61% of all 5-year periods; 53% of all 3-year periods; and 53% of all 1-year periods.

*Average of monthly rolling average annual total returns over the specified periods.

Market Price Performance History Since Inception (11/1/96)[1]

Cumulative Performance (%)

	1-YR	**3-YR**	**5-YR**	**10-YR**	**15-YR**	**20-YR**	**SINCE INCEPTION**
Sprott Focus Trust (MKT TR)[2]	(19.15)	25.59	7.70	119.00	145.93	422.89	541.47
Sprott Focus Trust (MKT Price)[3]	(27.02)	(0.34)	(24.15)	25.65	(31.84)	18.56	32.11

[1] Royce & Associates, LLC served as investment adviser of the Fund from November 1, 1996 to March 6, 2015. After the close of business on March 6, 2015, Sprott Asset Management LP and Sprott Asset Management USA, Inc. became the investment adviser and investment sub-adviser, respectively, of the Fund.
[2] Reflects the cumulative performance experience of a continuous common stockholder who reinvested all distributions and fully participated in the primary subscription of the Fund s 2005 rights offering.
[3] Reflects the actual month-end market price movement of one share as it has traded on Nasdaq.

Calendar Year Total Returns (%)

YEAR	FUND (NAV)
2018	-17.0
2017	18.5
2016	24.8
2015	-11.1
2014	0.3
2013	19.7
2012	11.4
2011	-10.5
2010	21.8
2009	54.0
2008	-42.7
2007	12.2
2006	15.8
2005	13.7
2004	29.3
2003	54.3
2002	-12.5
2001	10.0
2000	20.9
1999	8.7

Important Performance and Risk Information

All performance information reflects past performance, is presented on a total return basis, and reflects the reinvestment of distributions. Past performance is no guarantee of future results. Current performance may be higher or lower than performance quoted. Returns as of the most recent month-end may be obtained at www.SprottFocusTrust.com. The market price of the Fund s shares will fluctuate, so shares may be worth more or less than their original cost when sold. The Fund normally invests primarily in small/mid cap companies, which may involve considerably more risk than investing in larger-cap companies. The Fund also generally invests a significant portion of