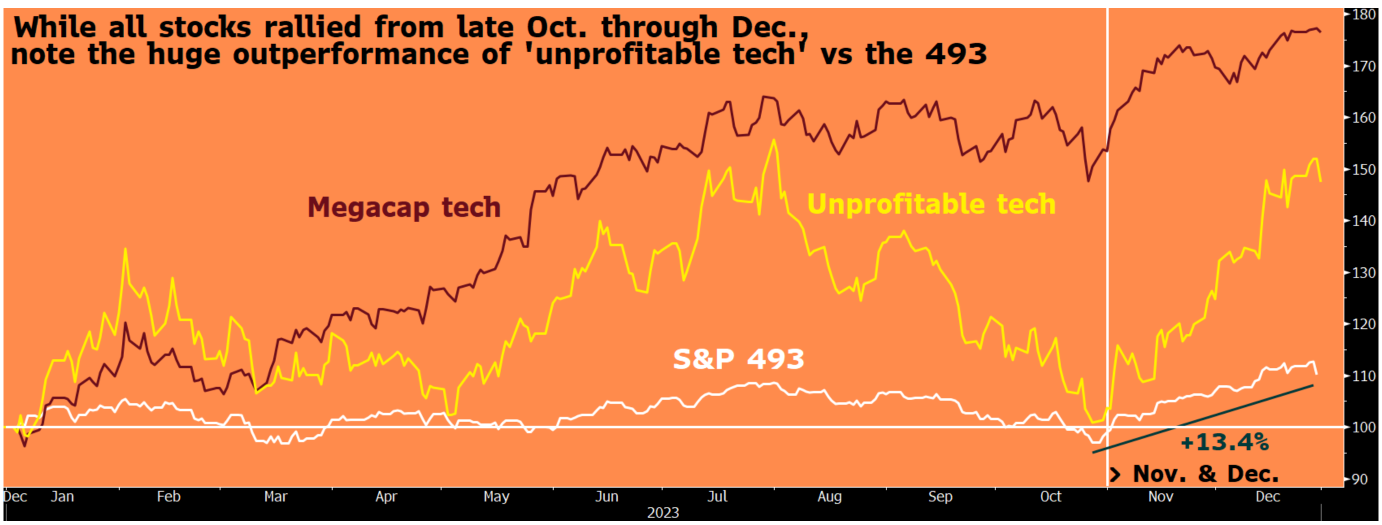
January 10, 2024

December 2023 Commentary & 2024 Outlook

The last 12 months marked a year during which most prognosticators were far off the mark with their forecasts for macro variables, yet still made money given the price gains experienced by pretty much everything financial, except for grain, base metal and energy commodities. The year started with broad agreement that 2022's soaring interest rates could cause recessions in much of the world, inflation would abate (the question was to what degree), and that at 17.6X forward earnings, the S&P 500 was not cheap.

Yet, notwithstanding the bifurcation experienced during the year and M7 dominating the first five months vs. equal-weighted outperformance led by speculative, beta-driven securities during the last two months, equities delivered solid returns to investors. This note will review 2023, discuss the performance of our funds and table our outlook for several sectors and markets overall during 2024.

In reviewing 2023, this note will not list and detail the significant events of the year, i.e., the SVB-led U.S. regional banking crisis to name one. Instead, this commentary will recap select market statistics and address several macro issues. As you know, other than the sizzle provided by the 'Magnificent 7' (M7) stocks and the continued (until late October) hemorrhaging of bonds, the price performance of North American financial assets had been fairly ho-hum for much of the year. One item that became apparent through 2023 was that macro-cap tech became the new 'go-to' defensive stocks for investors, as traditional defensive plays (Utilities, Healthcare and Consumer Staples) were among the worst performers (please see the table two charts below).



Source: Bloomberg

The white vertical line on the right side of the above indexed price graph for 2023 marks the end of October. Note how prior to that date, the S&P 493 was (as were the equal-weight SPX and the Russell 2000) negative year to date, 'unprofitable tech', emblematic of 'high beta' stocks, had given back its year-to-date gains and 'megacap' tech stocks had flatlined for several months. Then geopolitical concerns and the heightened allocation to bills vs. coupon issuance within the Treasury Department's quarterly refunding announcement caused bond shorts to cover and long-onlys to buy. Followed by softer inflation prints and dovish Fed commentary, yields ultimately declined a whopping 100 basis points in a matter of weeks. Stocks joined this party during the last half of October, going on to enjoy their longest (nine weeks in a row) winning streak since January 2004. During this time, the S&P 493 leapt +13.4% above its late October low, a sizeable gain, though dwarfed by the +18% advance by megacap tech and the 50% move in 'unprofitable tech'.

For the year, the S&P 500 posted a +24.2% return (+26.3% with dividends), offsetting 2022's loss of -19.4% (-18.1%), leaving the two-year gain at +0.08% (3.42% with dividends, slightly better than the two-year Treasury rate of +0.73% at the end of 2021). Interestingly, entering 2023, defensive sectors including REITs, Utilities and Consumer Staples were among the most consensus long ideas and turned out to be amongst the worst-performing sectors.

S&P 500 Price Performance	2023	2022	2-year	Last 9 Weeks
Energy	-4.80%	59.05%	51.41%	-1.32%
Materials	10.23%	-14.06%	-5.27%	14.37%
Industrials	16.04%	-7.10%	7.80%	18.26%
Consumer Discretionary	41.04%	-37.58%	-11.96%	11.98%
Consumer Staples	-2.16%	-3.17%	-5.25%	8.32%
Health Care	0.30%	-3.55%	-3.26%	10.88%
Financials	9.94%	-12.35%	-3.65%	19.78%
Technology	56.39%	-28.91%	11.18%	19.05%
Communication Services	54.36%	-40.42%	-8.03%	15.51%
Utilities	-10.20%	-1.44%	-11.49%	7.93%
Real Estate	8.27%	-28.45%	-22.53%	24.06%
S&P 500	24.23%	-19.44%	0.08%	15.85%
Magnificent 7	104.70%	-45.31%		
% of S&P 500's total return	62.20%			
Total return of S&P 493	9.94%			

Source: Bloomberg

As for the M7, they truly were 'magnificent' this year (average total return gain of +104.7% each), accounting for 62.2% of the S&P 500's +26.3% total return (excluding M7 the index return was +9.94% for 2023), which made up for last year when they all declined (average -45.31%), leaving only Amazon.com and Tesla still in the red from the 2021 close. For the two-years, the S&P 500 was up +3.42% (total return), with the M7 accounting for 2.05% of it (leaving the index up 1.37% for the two years without M7). While the majority of the sector performance of Canada's TSX mirrored that of the S&P 500, here at home, Energy (+0.95%) eked out a small positive price return while Utilities fared better and Real Estate fared worse than the data shown for the S&P 500 in the above table. Overall, the total return for the TSX was +11.8% (including +8.12% price).

Shifting to our funds, each fund delivered solid, positive net returns for the month of December and the full year. The Class F Lead Series of our multi-asset, low volatility Multi Strategy LP generated a net return of +3.37% for the month, boosting its year-to-date net return to +6.95%. The three-year net CAGR of the fund now sits at +6.13%. The fund exited 2023 with delta-adjusted gross and net exposure of +131% (79% long, 52% short) and +26% respectively, with the net exposure split between fixed income (+17%) and equity (+9%).

						-----------------Annualized----------------			
As of December 31, 2023	YTD	1-mo	3-mo	6-mo	1-year	3-year	5-year	10-year	Inception
Forge First Long Short LP (Class F Lead Series)	8.15%	2.78%	4.91%	7.68%	8.15%	5.96%	9.47%	9.30%	13.09%
Forge First Multi Strategy LP (Class F Lead Series)	6.95%	3.37%	3.06%	5.28%	6.95%	6.13%	8.77%	7.40%	10.42%
S&P/TSX Composite Total Return Index	11.75%	3.91%	8.10%	5.72%	11.75%	9.59%	11.30%	7.62%	8.52%
S&P 500 Total Return Index (C$)	23.27%	1.63%	8.90%	7.86%	23.27%	11.25%	14.97%	14.49%	16.43%

Note: Returns for the Forge First funds are based on the August 2012 Class F Lead Series and are net of all fees and expenses. In a year, up to 12 series can be created within a Class of units. Unitholders are advised to refer to their monthly statement for the net return of their respective Class and Series. All returns are in local currencies.

Positive performance was mainly captured from holdings in Technology, Financials, Industrials and Energy. Particularly strong contributions were generated by positions in Lumine Group Inc. (LMN.CA), a spin-off from Constellation Software Inc.

(CSU.CA), Advanced Micro Devices Inc. (AMD.US) and Secure Energy Services Inc. (SES.CA). In addition to the options book, given the decline in rates and compression of spreads, solid gains were also captured in the fund's fixed income sleeve.

Since the December 13th press conference of Fed Chair Powell, markets have shifted to price in 1) six rate cuts by the Fed during 2024 and 2) a 'goldilocks' economic outcome featuring a further decline in inflation and no recession. In addition, the recent easing in financial conditions boosts the odds of a soft-landing as the market has sharply reduced the cost of debt and equity capital, likely providing near-term tailwinds for economic growth.

This capital preservation-focused fund was well positioned to benefit from this set-up as its net equity exposure sat at year-to-date highs throughout November and December. However, as the month of December was concluding, given our belief that the near-term upside from the 'goldilocks' scenario was mostly priced into markets, the fund lowered exposure to certain high conviction ideas and utilized 4-year lows in implied volatility to increase equity index hedges. Here is a sample of the fund's current market hedges (separate from short positions in credit or equity held in the fund):

<u>SPDR S&P 500 ETF (SPY.US) Hedge</u>:
The fund holds a -5.9% delta-adjusted short position in a SPY 1x1.3 ratio put spread (meaning the fund has purchased 1 put option for every 1.3 puts the fund has sold or shorted). The top strike price is at-the-money, while the bottom strike is 4.3% out-of-the money. The total notional short exposure of the long put in the put spread is ~20% of NAV. The strategy covers both the January and the February 1st meetings of the FOMC. The modest ratio on the put spread reduces the total cost, while adding modest equity exposure on a market pullback in alignment with our positioning views.

<u>iShares Russell 2000 ETF (IWM.US) Hedge</u>:
The fund holds a -2.4% delta-adjusted short position in a IWM 1x1.3 ratio put spread. The top strike is ~2% out-of-the-money, while the bottom strike is 5.6% out-of-the money. The total notional short exposure of the long put in the put spread is ~19% of NAV. This strategy also covers both the January and February meetings of the FOMC. The modest ratio on the put spread reduces the total cost, while adding modest equity exposure on a market pullback in alignment with our positioning views. We added this IWM hedge given the sharp outperformance (up +22%) of this U.S. small cap index during November and December.

<u>iShares U.S. Home Construction ETF (ITB.US) Hedge</u>:
The fund holds a -1.1% delta-adjusted short position in a ITB 1x2 ratio put spread. The top strike is ~2% out-of-the-money, while the bottom strike is ~12% out-of-the money. The total notional short exposure of the long put in the put spread is ~6% of NAV. This strategy has a maturity date in mid-February. The ratio on the put spread reduces the total cost, while adding equity exposure on a market pullback in alignment with our positioning views to a high conviction sector. Similar to the IWM position, we added this ITB hedge in light of the sharp outperformance (up +38.4%) of this ETF during November and December.

Consequently, while the fund still holds positive net equity exposure, the above examples explain one reason the fund is well positioned to protect capital in the event of a Q1 pullback in risk assets. Given our belief that monetary policy easing will support financial conditions and the 'Fed put' is back in place to absorb economic shocks after two years of tight monetary policy, we are inclined to buy such a pullback. In fact, separate from the sample of index hedges noted above, we have sold puts on high conviction single stock ideas to increase equity exposure to acceptable levels on market corrections, while earning premium in the interim. Similar comments apply to the fixed income sleeve in the fund.

The fund's credit positions performed strongly during December. Net exposure to credit was increased throughout 2023 and we expect this segment of the fund to remain a high conviction focus during 2024. Near term, given the strong performance during December, the fund has reduced duration exposure by shorting long-dated government securities. Despite Fed Funds futures implying around six cuts to the U.S. policy rate in 2024, the shape of the U.S. yield curve remains inverted, as 10-year government yields have shifted downward in near-parallel lockstep with yields on two-year bonds.

We believe the shape of the curve is inconsistent with the increased probability of an economic soft-landing, while at a minimum, the rapid rate of easing in financial conditions over the last two months boosts upside risks to inflation. The futures market is pricing >100% odds of a Fed Funds rate-cut in Q1 2024, which when viewed in isolation would suggest more upside risk than downside opportunity to government yields if the policy rate remains unchanged in Q1. The fund continues to own our preferred corporate credit ideas, namely AT1 securities in the Canadian banks, with a two-year to five-year duration tenor.

The Class F Lead Series of our Long Short LP gained +2.78% net of fees, boosting its year-to-date net return to +8.15%. The three-year net CAGR of the fund now sits at +5.96%. The fund exited 2023 with delta-adjusted gross and net exposure of +140% (78% long, 62% short) and +16% respectively.

With the net exposure of the Long Short LP averaging around 10% throughout the month and the strong advance in major indices, the majority of the fund's positive performance was generated by the benefits to our over-allocation to higher beta/soft-landing stocks, especially in the Financials sleeve of the book and positive alpha, particularly in Industrials and Energy. Single name winners included Nuvei Corp. (NVEI.CA), Brookfield Business Partners LP Units (BBU-U.CA) and Atkore Inc. (ATKR.US). The main drags on performance were slippage on the S&P 500 C440/C460 ratio call spread and the premium erosion from puts expiring during 2024 that were being purchased incrementally and slowly throughout the month. It's worth noting that given the rapidity and size of the move higher in the U.S. consumer credit positions held by the fund and discussed in last month's commentary, the fund has exited these positions.

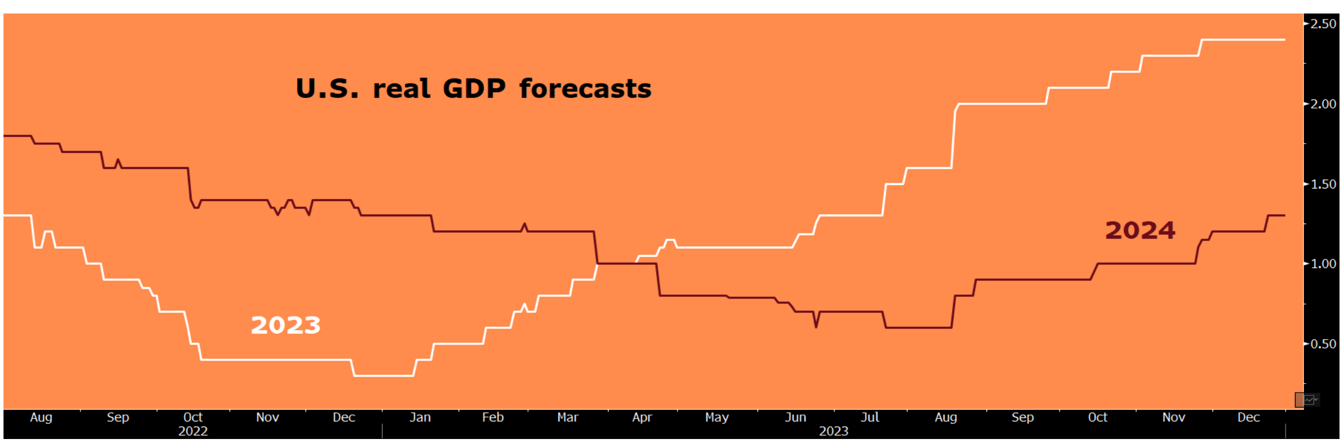
Similar to the Multi Strategy LP, we intend to position the Long Short LP more defensively during January. To that end, the fund has begun to both reduce and hedge the rate-sensitive exposure that has benefited the fund during the past couple of months, partially by increasing its short exposure to U.S. government bonds. In Energy, while our net exposure remains very low, we had noticed how well Canadian energy stocks were holding in relative to U.S. companies amidst the headwinds of tough commodity quotes, and therefore weeks ago we opted to switch from hedging our Canadian exposure with the less economically attractive U.S. names to direct hedging of our Canadian positions. The fund has also added several macro or beta hedges to enable the fund to benefit from any downdraft in stocks. In addition to index-oriented options strategies that may be similar to those tactics discussed above, here are a couple examples of other hedging tactics employed with the Long Short LP:

Banking Sector Hedge:
The fund holds put spreads on each of JP Morgan & Chase Co. (JPM.US), Royal Bank of Canada (RY.CA), and Toronto-Dominion Bank (TD.CA). Collectively a 4% notional short exposure, thanks to very attractive skews on the two Canadian banks, the net cost of this basket is four bps through the 3rd week of April.

Industrial Select Sector SPDR ETF (XLI.US) Hedge:
The fund holds several core positions in the Industrials sector. To hedge this exposure, the fund has added a put spread which includes owning a US$108 put and shorting a US$100 put. This position provides a -7% notional short exposure at the top strike, effective until the drawdown is greater than 8% at a net cost of eight basis points through the end of the 3rd week of June.

Source: Bloomberg

Moving on to the market environment, the biggest macro surprise last year was the absence of economic weakness in the U.S., nary a hint of recession. To that end, note the yellow oval on the right side of the above 60-year graph, which compares the index of Leading Economic Indicators or LEI Index (red vertical bars, left axis) to New Orders from the ISM Manufacturing Index (white line, right axis), still suggests a recession is forthcoming.

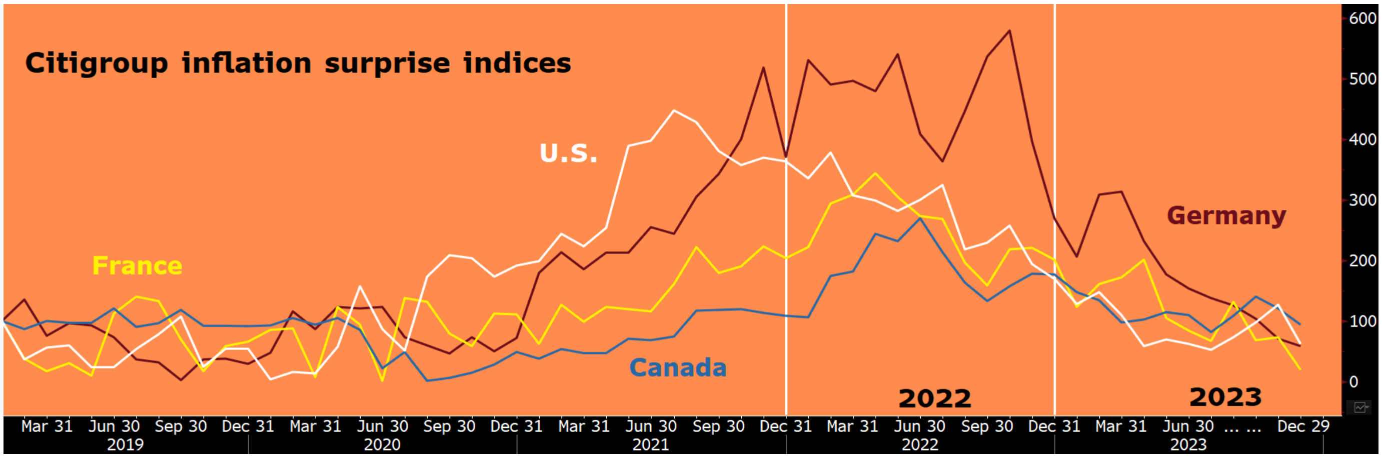


Source: Bloomberg

Yet, the above graph that begins in mid-2022 compares the progression of GDP estimates for 2023 (white line) and 2024 (red line) throughout the year and suggests forecasters have become increasingly optimistic towards U.S. growth for the year ahead. A year ago in our lookahead commentary, we wrote that calling a U.S. recession during 2023 was a "coin toss" (please see the

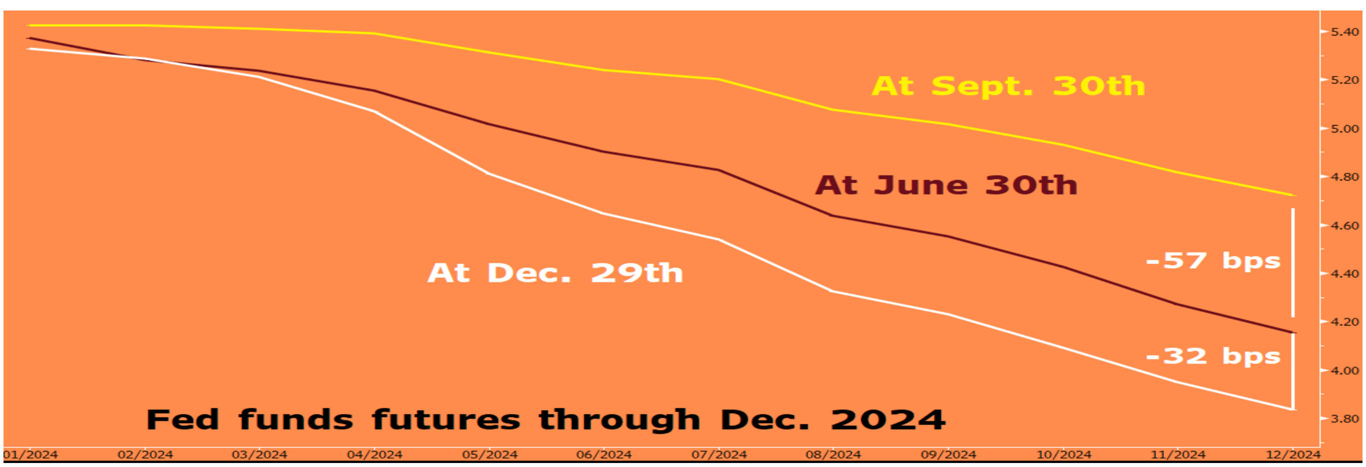
Appendix to this note). We are now of the belief that while slower than 2023, thanks to the decelerating but still decent jobs market and what appears to have become a bottomless pit of 'excess savings', consumer spending will remain supportive of growth this year. In addition, the combined impact of President Biden's massive 'industrial policy' stimulus programs (IRA, CHIPS Act, etc.) and a recovery in the house construction marketplace should once again forestall the onset of a U.S. recession.

The world economy is believed to have grown by $8T to $105T in 2022 and 2023. China will account for none of that gain, the U.S. 45% of the total and 50% for other emerging nations (EMs). Half the gain for EMs will come from just five of these countries: India, Indonesia, Mexico, Brazil and Poland; a striking sign of possible power shifts to come.



Source: Bloomberg

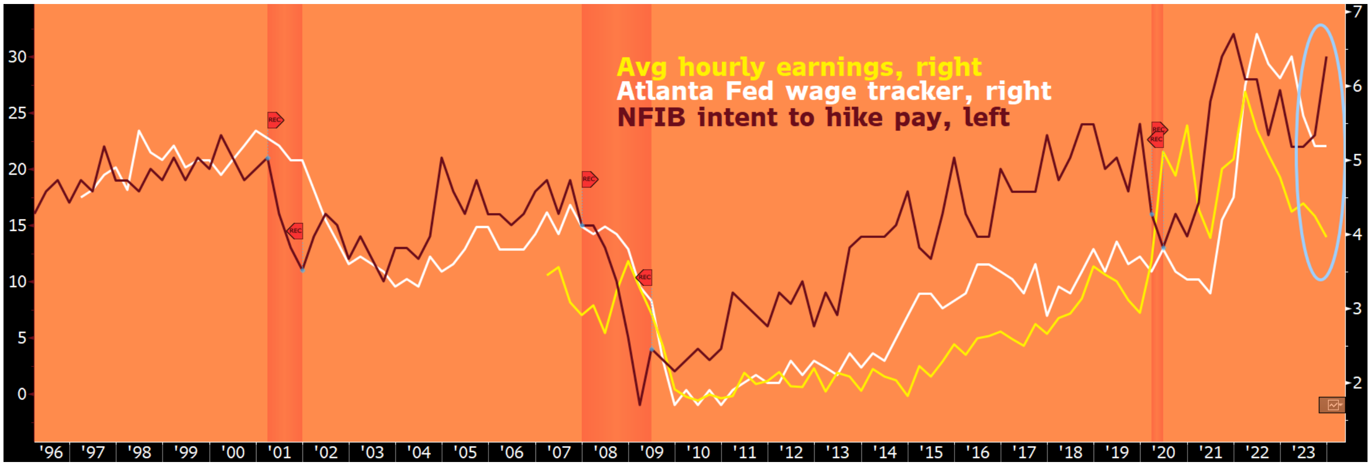
As identified in the opening sentence of last year's outlook commentary, inflation was arguably the key variable to watch in 2023. The multi-year graph above compares Citigroup's inflation surprise index for the U.S. (white line), Canada (blue), France (yellow) and Germany (red). The right side of each of the two white vertical lines denotes the start of 2022 and 2023 respectively. Starting in late 2022, inflation continued to surprise to the downside, of course leading up to the mid-October U.S. inflation print releases discussed earlier in this note. Obviously, the inflation outlook from here continues to be a key determinant for stocks and bonds. Near term, there appears to be little risk that goods pricing will rebound so as to be problematic, hence the key remains the pricing outlook in the services sector. While service-based inflation has remained 'stickier for longer', there's no question that recent releases have been supportive of the Fed's favoured 'supercores', both CPI and PCE, falling into the mid-2s by early 2024. Markets appear to have already taken a 'victory lap' on that front.



Source: Bloomberg

The above graph displays the Fed Funds futures pricing for each of January 2024 (far-left side of horizontal axis) through December 2024 (far-right side) at each of September 30th, 2023 (yellow line), June 30th, 2023 (red line), and December 29th, 2023 (white line). After expectations backed up between June 30th and September 30th, as you can see from the white numbers on the far-right side, during the fourth quarter of 2023 the expected Fed Funds rate in December 2024 declined 89 bps, confirming the implied 6 * 25 bps rate-cuts currently priced into markets.

There is a plethora of both supportive and unsupportive graphs to justify a forward opinion on inflation and as you have read before, our team strives to be pragmatic not dogmatic. However, while trends in rental pricing and airline fares appear favourable right now (to highlight two variables), to us the big driver is hourly earnings. Inflation is slowing, but prices for everything remain sky high. The almost 30-year graph below compares U.S. average hourly earnings (AHE, yellow line, right axis) against the Atlanta Fed's wage tracker (white line, right axis) and the NFIB's (small/mid-size business) 'intent to hike pay' during the next three months survey (red line, left axis).



Source: Bloomberg

Inside the blue oval on the far-right side of the graph, you can see that: a) AHE has declined markedly but remains elevated, b) the Atlanta Fed's wage tracker exhibits strong correlation with AHE and remains high and c) the appetite for small and mid-sized businesses to hike wages appears to be rising once again. Hence, a key reason why our funds have increased hedges and shortened duration is that in the short term, we believe the market has moved "too far, too fast" and is poised for some giveback, a pullback we would buy (outright or via our put writes) given our view that the U.S. economy is okay.

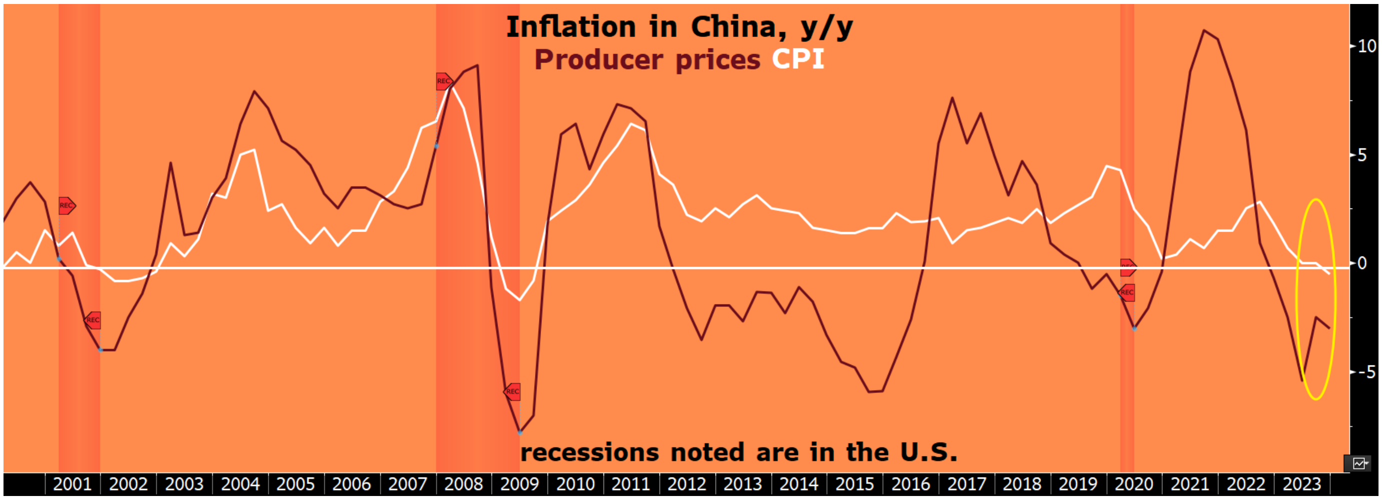
While we believe it's probable the U.S. economy once again bucks a recession, we acknowledge that a) small and medium-sized businesses that account for 75% of U.S. private sector employment are only now just beginning to feel the pinch of rising interest rates (average rate paid of 5.0% at the start of 2022 now sits at 9.3%), b) growth in private nonfarm payrolls, excluding the healthcare sector, has slowed from 6.7% y/y in February 2022 to 1.1% y/y in November 2023 and c) 3rd quarter results for 2023 saw revenue misses (38% of companies) running well ahead of profit misses (only 18%), a likely precursor to layoffs if this trend continues.

Hence, our team will constantly reassess the outlook for the U.S. economy as given current valuations notwithstanding our expectation the Fed would backstop an economic slowdown, equity indices remain highly vulnerable to the earnings downgrades that would accompany a recession. In addition, it remains our view that liquidity conditions will deteriorate during 2024 as reverse repo balances (RRP) drain and the easy funding for Yellen's TGA is over. We will reassess the outlook for liquidity conditions in an upcoming monthly commentary.

We will close this section with one interesting factoid: In the early 1970s and again in the 1980s, recessions struck the U.S. nearly a full year and a half after inflation fell. We wonder if, given there's $750B of mostly IG corporate debt and $500B of commercial real estate debt to be refinanced during 2024, this partially speaks to why some economists predict the economy will ride through 2024 unscathed but pay the price in 2025.

Outside of the U.S., the outlook is less sanguine. Canada will benefit from America's success; however, it is difficult to be bullish on other aspects of our economy. Private sector leverage is high, our housing market presents a left tail risk if interest rates stay 'higher for longer' during 2024, the level of investment in plant and equipment (along with productivity) remains lousy and we can't forget about the potential impact of the outcome of the U.S. Presidential election in November 2024. Of course, while the media plays up how unfriendly Trump could be for our economy, it's important to note that President Biden hasn't exactly been our friend!

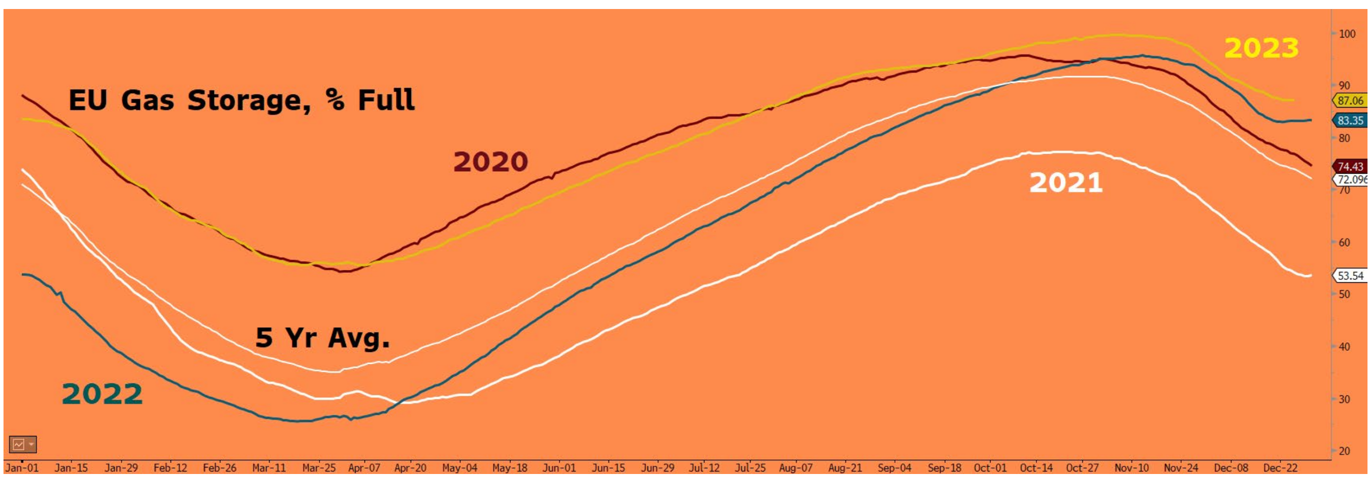
Looking at China, yes, the PBOC will cut interest rates and the Government will enhance credit availability to citizens and local governments early in 2024 in an attempt to boost growth, but the results will be underwhelming. The country's property markets remain in shambles, being only partway through the hangover from years of growing leverage. The bottom line is China's days of driving global growth are over. According to The Economist, China's share of the global economy rose nearly 10X from less than 2% in 1990 to more than 18% in 2021; no nation had ever risen so far, so fast. The reversal then began in 2022, when China's share of the global GDP declined and it is poised to shrink even more significantly in 2024, to 17%. That two-year drop of 1.4% is the largest since the 1960s.



Source: Bloomberg

As shown by the 20+year graph above, despite a depreciating currency (three-year low vs. USD), disinflation, perhaps even deflation has hit China and may hinder Premier Xi's ability to accelerate growth. Similar though different problems continue to haunt the European Union (EU). Inflation statistics have improved markedly for the still hawkish ECB, yet growth remains lousy, partially because the economy of Germany, the EU's juggernaut, is hampered by its ties to Russia, China and Ukraine.

Of interest to Energy investors; however, the graph below suggests the EU is unlikely to have a shortage of natural gas this winter. This seasonal graph (January on the far-left of the horizontal axis, December on the far-right) of the % full EU gas storage capacity is suggesting as of December 27th EU storage was 86.6% full, comfortably above the five-year average of 72.1% and the 83.3% figure of last year.



Source: Bloomberg

Beyond economics, a few items merit consideration when contemplating the outlook for investments. First off, in Washington this month, Congress returns to face another potential government shutdown if a new budget (or stopgap bill) is not reached by January 19th. Also, earnings season begins this Friday, January 12th when the big U.S. banks report Q4 results.

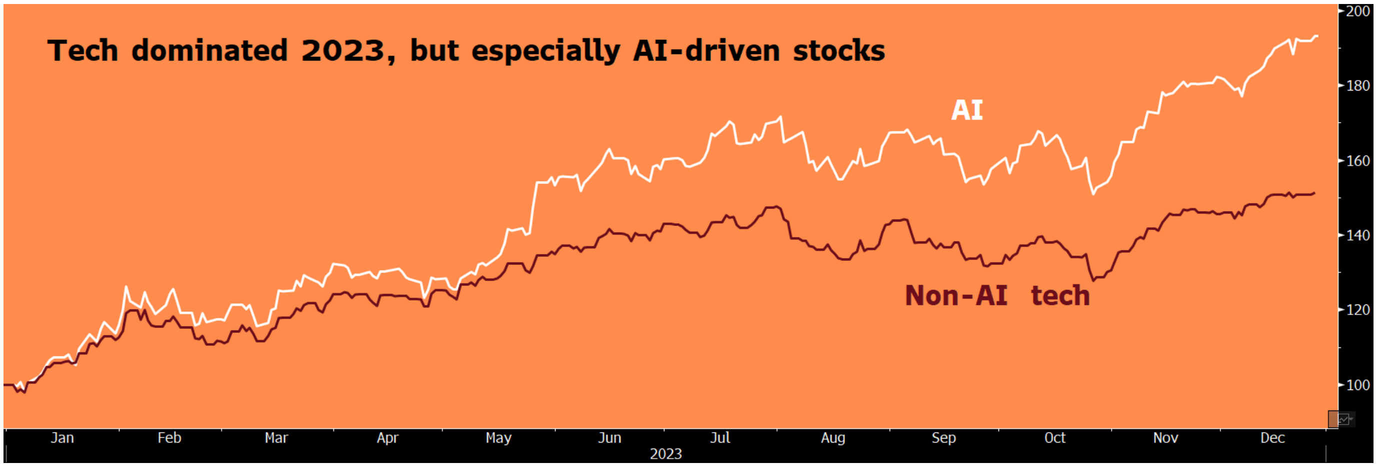
Second, recent talk suggests there is a definite risk that America could materially scale back its global military commitments. If this shift were to happen, it is likely that China, Russia and Iran could collectively try to reap advantage of the resulting power vacuum, especially since recently, these three countries have been working more closely together.

Third, we're all aware of this year's Presidential election. Once the caucus/primary season kicks into gear in Q1, the noise will become unavoidable. Hence, for your calendar, take note that the Iowa caucus is January 15th, the primary in New Hampshire is January 23rd and the South Carolina primary is February 24th. By summer 2024, it's entirely possible that the November election could easily be influencing markets and frankly, predicting the impact is this year's 'coin toss'.

A fourth non-economic item to consider is global weather patterns. The world has just experienced three consecutive "La Niña" years, the name given to the cooler phase of the cycle, helping hold global temperatures down. Meteorologists suggest that it appears almost inevitable a warmer "El Niño" phase will begin sometime later this year, setting 2024 up to be a scorcher.

To summarize the economic outlook, inflation is much better but if the U.S. economy doesn't slow, there's definitely a risk that the Fed doesn't cut rates in line with the timing and quantity of cuts currently priced into markets. Of course, the same was said a year ago, as the Fed didn't cut, but the price of risk assets didn't flinch. If it happens again that the Fed doesn't play ball with markets, will the lack of cuts matter to markets? We'd suggest not if valuations were lower, but stocks aren't cheap - a topic we will address later in this note after reviewing our thinking on several industry sectors.

Given the dominance of Generative (Gen) AI in markets last year, it's logical to start with Technology. In turn, this almost maniacal focus on Gen AI led to an explosion in demand for AI computing hardware. While semiconductors and certain areas of software have gotten much of the attention, we believe Gen AI could be "the nexus" for almost every industry over the next several years.



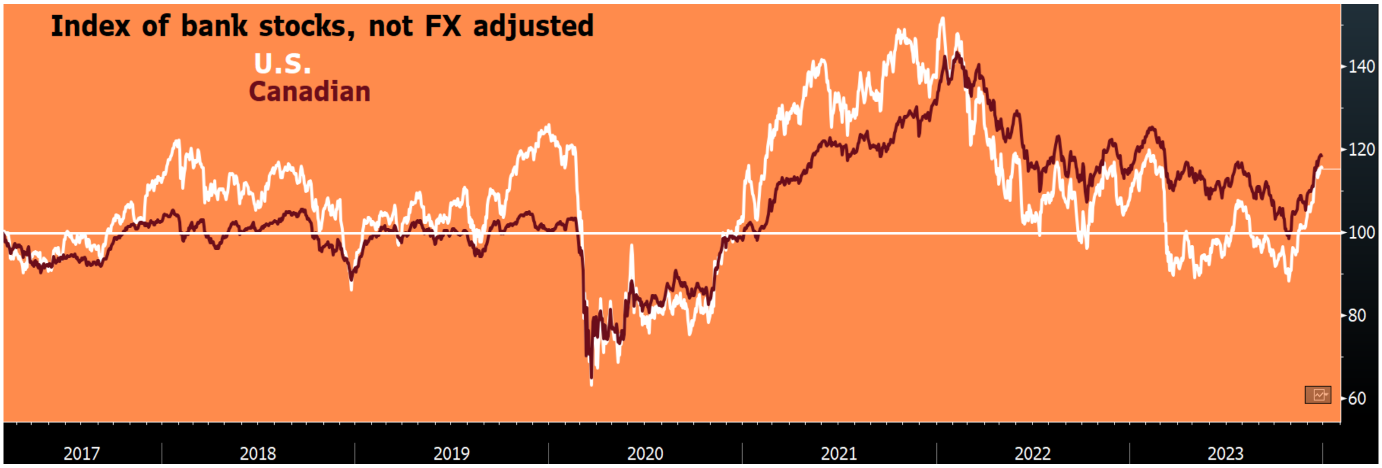
Source: Bloomberg

We expect AI-related spending to be a multi-year tailwind for earnings growth as per other major Tech cycles and we are merely in the early stages of this cycle. Due in part to the new software stack emerging from Gen AI, the shift in AI from the data center to smartphones and PCs is likely to be a "much bigger theme" as high-end smartphones experience a "big step-up" in machine-learning related computing capability and include more memory. We expect that M7 stocks held in the funds will continue to perform, including Meta Platforms Inc. (META.US) and Microsoft Corp. (MSFT.US). However, we foresee more rewarding investment opportunities in the next tier of market caps in semis, software and hardware.

Shifting to energy commodities, the near-term outlook for natural gas remains challenging, on account of very seasonally warm weather in North America and record supply. Heating degree days in the USA through mid-December were -8.5% lower y/y and -5% below the five-year avg. Currently, natural gas storage in the USA is ~7% higher y/y and ~9% above the five-year average. We foresee a reasonable risk that storage levels will exit the heating season 25% above the five-year average (~2000B vs. five-year avg. of ~1600B). Hence, price will have to perform the heavy lifting (downward) to balance supply and demand. Notwithstanding the delay in Exxon Mobil's Golden Pass LNG facility to H1 2025 from H2 2024, and the uncertainty on LNG Canada's start-up date, whether in 2024 or 2025+, the outlook for natural gas in North America does look structurally more supportive over the medium term. Recently, we covered our short position in Birchcliff Energy Ltd. (BIR.CA) and we continue to own Tourmaline Oil Corp. (TOU.CA).

In contrast, ceteris paribus, the near-term outlook for oil is better than gas, but not exactly sparkling. One of the big dampeners to last year's price action was greater than expected supply coming from our southern neighbours. U.S. oil production growth exceeded +1M barrels/day in 2023, a number that is expected to slow to roughly 300K during 2024. Unless there is a surprise increase in the demand for oil, Saudi's excess capacity is just one of the sources of supply expected to keep oil prices rangebound and comfortably below $100 during 2024.

Notwithstanding this blasé view, it is important to acknowledge that the completion of the TMX pipeline represents structural positive change for the Canadian heavy oil industry. Currently, 2024 WCS differentials approximate $16/bbl, with 2H 2024 even tighter. Once TMX is online, and especially if the loonie weakens towards US$0.70, holdings such as Athabasca Oil Corp. (ATH.CA) offer high teens FCF yields. Also, as heavy oil volumes are re-directed, the U.S. Midwest begins to reduce their Mayan exports in support of greater domestic refining capacity. To this end, we are short HF Sinclair Corp. (DINO.US), a mid-con refiner which is heavily dependent upon WCS crude and produces a higher gasoline cut than its competitors. At the same time, we own west coast refiner PBF Energy Inc. (PBF.US). We also expect global refining cracks to remain well supported, led by distillate and jet fuel, where overall inventories remain at five-year lows.



Source: Bloomberg

For the Financials sector, we: a) favour defensive financials that are not exposed to disinflation, b) want nothing to do with banks or life insurance (lifeco) companies and c) use near year-end shorted long U.S. government bonds to hedge rate-sensitive equity exposure. After being long and bullish consumer credit during the now completed fourth quarter, we believe the credit outlooks provided by specialty lenders and banks have become too optimistic and the latter group, which are now fairly valued, will face deposit cost headwinds and tepid loan growth this year. The indexed graph above comparing the price performance of Canadian banks (red line) to the U.S. banks (white line) suggests that prior to the last few weeks, the price of bank stocks was flat with their prices of six years ago. Finally, we are neutral on U.S. lifecos and bearish on Canadian lifecos, as we expect share prices for the latter group to mean revert last year's outperformance.

Preferred segments within Financial Services for our funds include payment companies (Global Payments Inc. (GPN.US) and Fiserv Inc. (FI.US)), exchanges (Cboe Global Markets Inc. (CBOE.US) and CME Group Inc. (CME.US)), insurance brokers (Arthur J Gallagher & Co. (AJG.US) and Marsh & McLennan Cos. Inc. (MMC.US)) and the P&C casualty sector (Intact Financial Corp. (IFC.CA) and Definity Financial Corp. (DFY.CA)). Consistent with 2022, Fairfax Financial Holdings Ltd. (FFH.CA) continues to be one of our largest long positions in Financials.

In the consumer sector, there are two themes we will be monitoring for investment opportunities. First, the health of the consumer, as driven by employment, savings and debt levels, and second, the degree of increased promotional (price cutting) activity. Within the Discretionary sector, tight supply chains during the past couple of years gave manufacturers a high degree of pricing flexibility. This shift enabled merchandise margins to climb 400-500 basis points (bps) above pre-COVID levels. We expect this good fortune to reverse across softlines, large appliances, sporting goods and furniture during 2024.

At the same time, price elasticity should come home to roost for companies in the Staples sector, especially given that food prices are expected to remain high. In addition, it's possible a wider adoption of GLP1 drugs will exacerbate price-driven volume declines with household products expected to fare better than packaged foods. We remain short Campbell Soup Co. (CPB.US) and have recently shorted U.S. Foods Holding Corp. (USFD.US).

Source: Bloomberg

Shifting to Basic Materials, with supply disruptions as a fundamental backdrop, the graph above highlights how Copper has reversed a two-year downtrend, recapturing both its 50- & 200-day moving averages, bouncing off a six-month base which double bottomed just above 350. We believe the 'red metal' is in the early days of a multi-month uptrend defined by higher highs and higher lows. The next major level of resistance is just above US$4 with a close above US$4.01 confirming this uptrend. Large cap copper stocks remain on our radar. Meanwhile, our funds own shares in Agnico Eagle Mines Ltd. (AEM.CA) and Franco-Nevada Corp. (FNV.CA) for their exposure to gold. The shiny metal advanced 12% last year and offers a degree of protection in the event the U.S. economy underperforms, and the Fed aggressively cuts rates.

As for the markets overall, prior to assessing the absolute valuation of stocks, courtesy of Bespoke Investment Research, the table below displays the forward performance of the S&P 500 after the Fed's last rate hike. During the current rate-hiking cycle the Fed's last rate hike was July 26, 2023. Since then, the S&P 500 advanced 4.44% through year-end vs. the median increase of +2% (see last row). Of the eight rate cycles displayed in the table, there was a 50/50 experience of the market rising or falling six months after the last hike. Expanding the analysis to include the one, three and 12-months timeframes, while the results have generally been positive, the price performance hasn't exactly been barn burners.

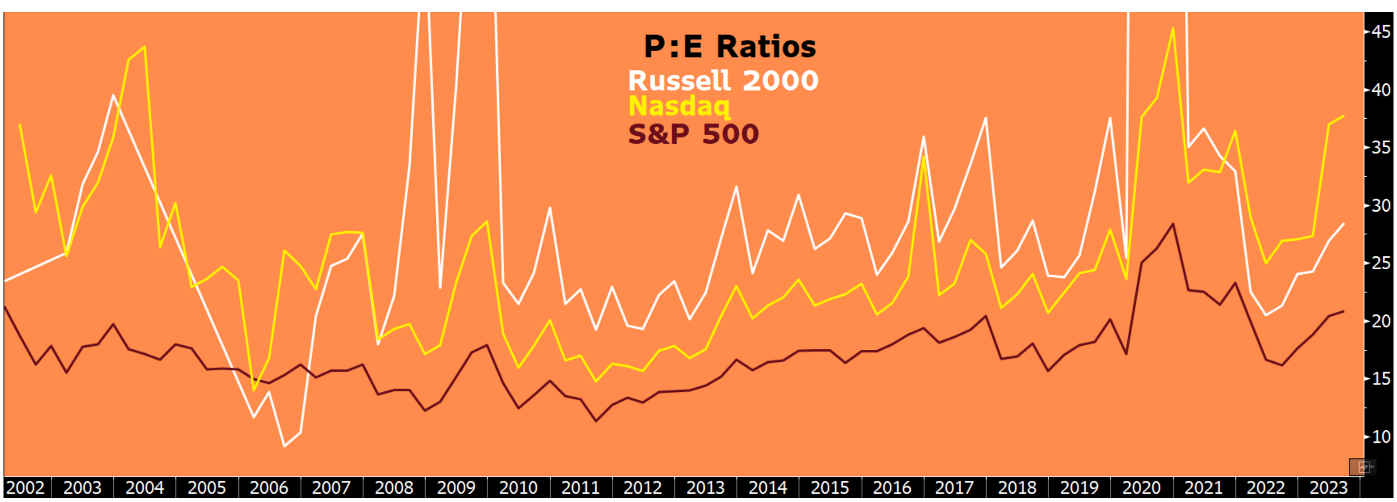
S&P 500 Performance After Peak Fed Fund Rate (%)

Date of Peak	Peak Upper Bound	1-month	3-months	6-months	1-year
06/28/1974	13.00%	-4.20%	-24.50%	-21.90%	10.20%
05/29/1981	20.00%	-0.50%	-6.40%	-5.70%	-15.60%
10/01/1984	11.75%	1.70%	1.60%	10.10%	12.40%
06/02/1989	9.75%	-2.30%	8.70%	7.70%	11.60%
07/05/1995	6.00%	2.10%	6.50%	12.70%	20.10%
01/02/2001	6.50%	5.20%	-10.70%	-3.60%	-10.00%
09/17/2007	5.25%	4.40%	-2.10%	-13.50%	-21.70%
07/30/2019	2.50%	-2.90%	1.10%	9.00%	7.70%
Median		**0.60**	**-0.50**	**2.00**	**9.00**

Periods when FOMC announced policy decisions in real-time

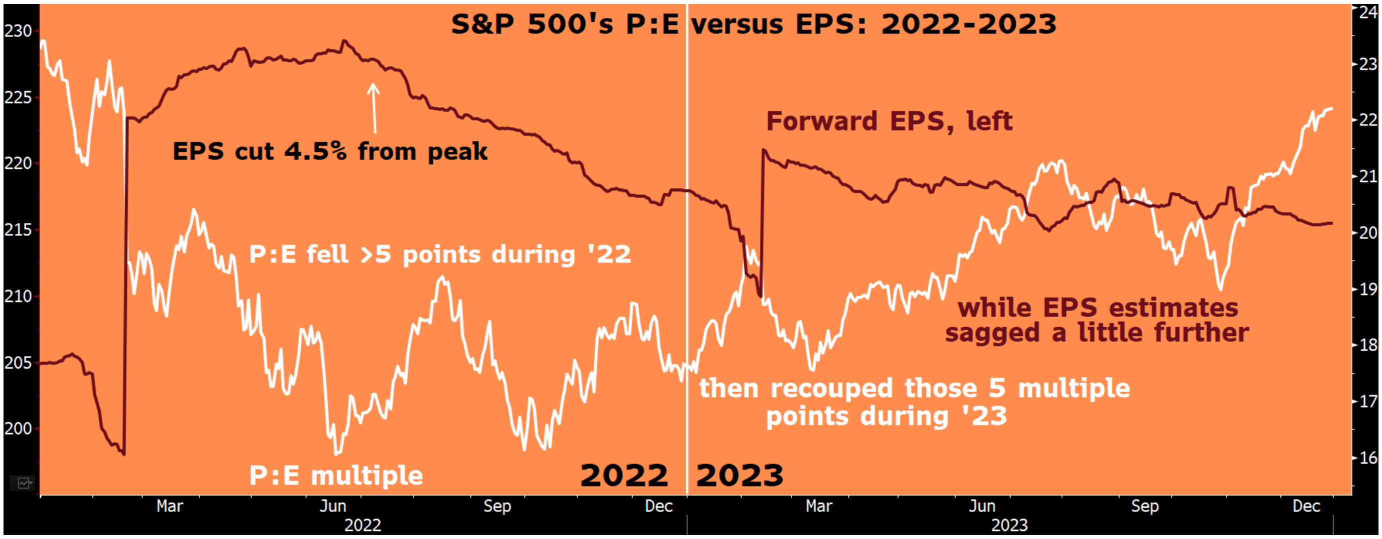
Source: Bespoke Investment Research

On 2024 "reported" EPS estimates, the year-end 2023 P:E multiple for the S&P 500 was 21.7X. On 2024 EPS estimates prior to extraordinary items, the following 21-year graph displays the P:E multiples for NASDAQ, the S&P 500 and the Russell 2000 as being 37.8X, 20.8X and 28.5X respectively. As you can interpret from the graph, multiples sit at the higher end of the range, especially if receding inflation hampers corporate pricing power and causes double-digit EPS estimates for 2024 to be too optimistic.



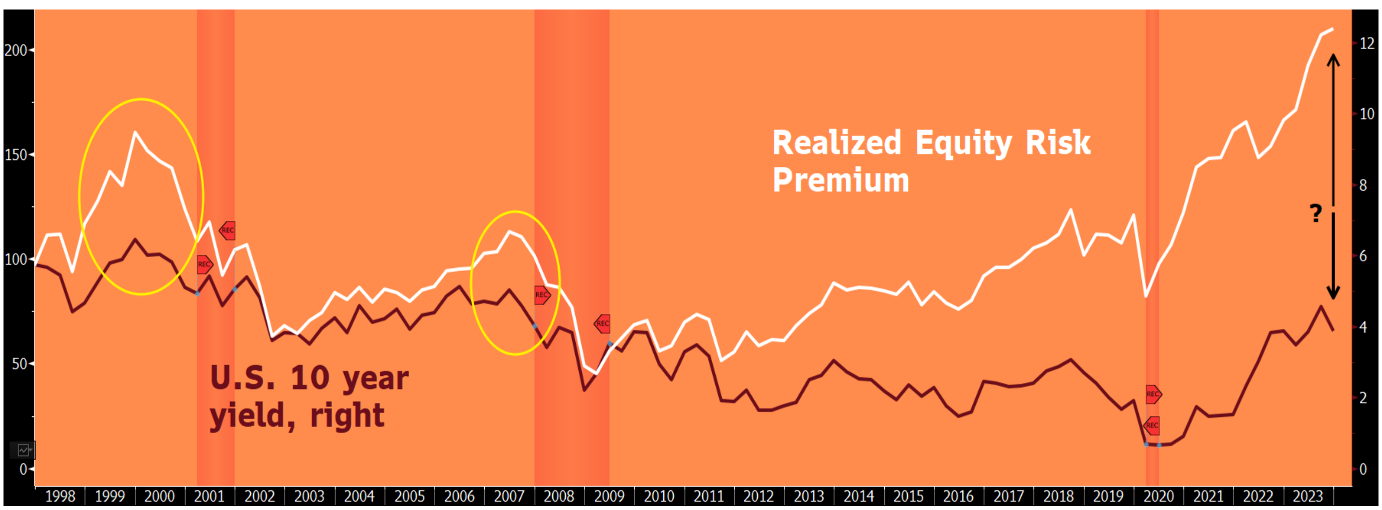
Source: Bloomberg

The graph below disaggregates the price performance of the S&P 500 during the last two years between EPS (red line, left axis) and P:E ratio (white line). The vertical white line in the middle of the graph denotes December 31st, 2022. Note that earnings estimates have been grinding lower, especially for the S&P 493 vs. the M7, since mid-2022 while the market's P:E multiple ended 2023 back at the level it was entering 2022. Of course, yields on US2s and US10s were 0.73% and 1.51% at the start of 2022 vs. 4.25% and 3.88% at year end 2023.



Source: Bloomberg

Speaking of the current valuation of equities, the following 25-year graph compares the realized equity risk premium (ERP, white line, left axis) of stocks to the yield on a US 10-year bond (red line, right axis). In theory, the white line should be modestly above the red line as that would imply a reasonable risk premium for holding stocks over bonds. However, similar to the LEI graph used earlier in this note, it appears several highly correlated historical relationships have broken down, perhaps partially attributable to the lingering impact of unprecedented liquidity courtesy of central banks. Based on actions discussed in this note, specifically, shorting government bonds and a willingness to buy dips in stocks, we believe the likely breaking point for this relationship resides with bonds (higher yields) as opposed to equities. In turn, this price action would occur because the U.S. growth remains okay, inflation refuses to take that last fall, and bond markets get spooked.



Source: Bloomberg

In recapping our thoughts on markets and hence the positioning of our funds, we: 1) are pleased with the risk-adjusted net returns generated by our funds last year, 2) believe the strong rally in equity and credit markets experienced during the last two months has largely discounted a goldilocks outcome for the U.S. and caused markets to have moved “too far, too fast”, becoming vulnerable to a Q1 pullback, 3) expect the pullback in bond prices will exceed the decline in stocks and 4) believe that, as discussed in this note, our funds are well positioned to benefit from a pullback with ample capacity to purchase that dip.

Our job at Forge First is to generate a competitive net return and protect your hard-earned dollars when turbulence hits markets. The almost 12 years of performance track records of each of our two investment strategies indicate we have delivered on these goals. **In light of the current pricing of markets and our belief that neither bonds nor cash offer the upside and protection they did six to nine months ago, we encourage investors to reflect upon the reinvestment risk inherent to short-term fixed income cash equivalents. We believe our proven product solutions merit hard consideration for inclusion in a diversified portfolio targeting both return and protection**.

From the team at Forge First, may 2024 be a year of good health, happiness and success for you and your loved ones.

Thank you for your business and interest in our funds. For more information, please visit our website at www.forgefirst.com or call us at 416-687-6771 should you have any questions.

Andrew McCreath	Keenan Murray	Richard Roth
CEO, CIO	Portfolio Manager	Associate Portfolio Manager

APPENDIX

2023 Outlook thoughts from our December 2022 market commentary

For the second consecutive year, predicting the rate of inflation should prove to be the most important variable for investors to consider as we enter 2023.

Otherwise, with rising credit card debt, US$30T of financial market losses last year, declining housing prices, negative real wage growth, and a personal savings rate of 2.4% (lowest since September 2005), it's tough to be bullish on consumer spending.

The bottom line is that it's a coin toss as to whether the U.S. will officially enter a recession during the next 12 months, but the 20-year graph below suggests the probability is as high as it has been since the turn of the millennium.

Looking at key regions in the rest of the world, previous commentaries have discussed the structurally challenged outlook for continental Europe. Looking across the Channel, Britain has gotten itself in a nasty 'muddle', be it lack of growth, even worse inflation than the continent, and housing and labour markets that are exhibiting a lot of pain. That leaves China, and this almost 30-year graph below suggests miserable consumer confidence has led to weak retail sales and a very challenged housing market. In other words, China's 'go-go' years are over.

On inflation: "goods pricing is likely to exhibit negative year-over-year prints during 2023. Services is a different story and presents a very mixed bag when it comes to inflation" – "overall, we believe it will take longer to reduce stubbornly high wage growth because employees have simply suffered too much pain from the cumulative price hikes of food, rent and utilities".

"If oil prices move back to our 2023 forecast price level of US$95" – we were definitely wrong on this call!

The next big question is how determined the Fed is to keep its terminal rate in place for an extended period of time. The longer the Fed keeps rates at terminal levels, the greater the risk of a hard landing. Yet, if we're right on wage growth and inflation staying stickier for longer, the Fed is likely to keep rates at terminal levels into 2024. We are aware that markets are pricing in cuts during H2 of 2023; time will tell who is right and the answer will come down to inflation. Getting US inflation towards 3.5% should be straightforward but forcing it toward 2% will be a challenge. Regardless, there's little doubt that the era of free money is over.

"The yield curve is expected to remain historically unexciting for banks".

The real world rarely works out as simply as planned. We believe that EPS estimates will bottom out with the Q1 2023 reporting season. In addition, that is likely to approximate when the Fed will have attained its targeted terminal rate and when China's re-opening begins to have an impact on the global economy and related commodity markets. If this scenario played out as discussed, equity markets could bottom this spring, followed by a decent rest of the year. We say decent because several reasons suggest the 'other side' of this bear is likely to be uninspiring.