FORGEFIRST
ASSET MANAGEMENT INC

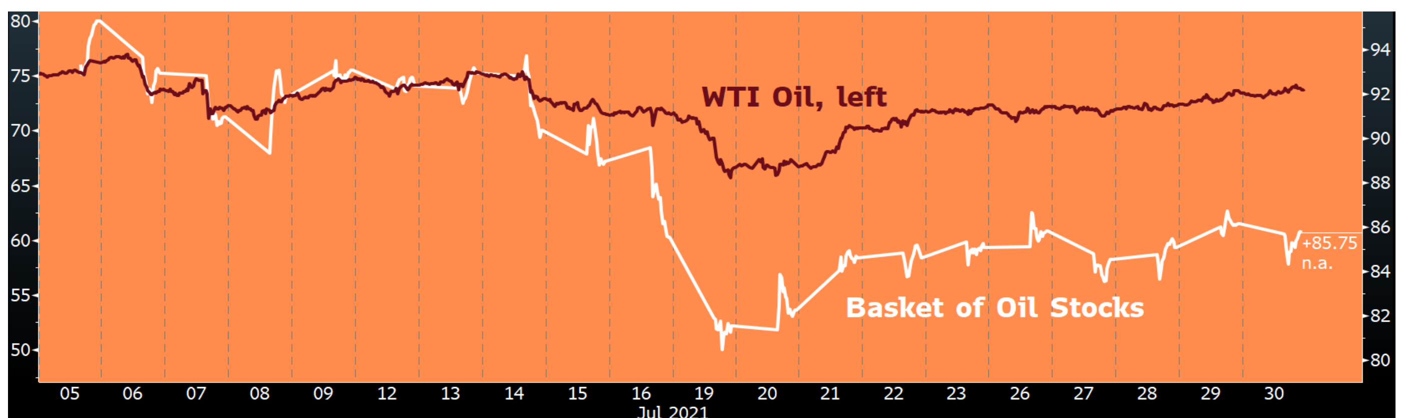
August 10, 2021

# July 2021 Commentary

Led by macro cap technology stocks and long-term government bonds, financial markets added to their year-to-date gains during July 2021 amidst growing concerns that, not only has the rate of acceleration in economic growth peaked, but it is transitioning to markedly slower levels. This note will table some thoughts germane to that discussion, but first let's recap last month. As can be seen from the 18-month graph below, the strong correlation between falling yields and the outperformance of the tech-dominant NASDAQ has continued of late.

Source: Bloomberg

In contrast, while the spot price of oil increased last month (and the 2022 forward strip gained +1.8% to $66.87), as can be see from the graph below of July's trading performance, the commodity recovered from its mid-month swoon, but the stocks failed to follow suit. As implied by the list at the bottom of page two of last month's commentary (June 2021 Commentary) that displayed the top 10 holdings of our Long Short Alternative Fund, each of these examples proved instrumental in the performance of our funds during July. The Series F of our Long Short Alternative Fund suffered its first negative return in 10 months, slipping -0.45% after fees, trimming its year-to-date net return to +11.79% and its trailing 12-month net gain to +24.66%. The decoupling between oil and oil stocks (not the case with gas stocks), plus weakness in the Marijuana sector, overwhelmed gains in Technology and Materials. Simply put, the orientation of the fund towards cyclical and value stocks catalyzed the decline. Exiting July, the gross exposure of Long Short was 119% while the delta-adjusted net exposure was 47%.




Source: Bloomberg

In contrast, the Series F of our lower volatility, multi-asset Conservative Alternative Fund delivered its 16th consecutive month of positive net returns, gaining +0.23%. This performance boosted its year-to-date net return to +9.58% and delivered a rolling 12-month net gain of 24.28%. This fund continues to exhibit an attractive balance between growth and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value in its holdings, with less exposure to cyclicals than our Long Short investment strategy. July performance was driven by positive contributions from long and short equity positions in the capital growth sleeve. The alternative strategy sleeve was roughly flat for the month, while the asset protection sleeve was a net detractor.

Secular compound growers in Technology, Industrials and Communications fueled the positive performance in the capital growth sleeve. With respect to the Marijuana sector, the principal detractor was long-time holding, Trulieve Cannabis Corp. (TRUL.CA). We attribute the weak sector performance to muted support in the Senate to the Cannabis Administration and Opportunity Act. We suspect the wide-ranging, broad legalization proposed in the text did not appeal to centrist Democrats. It is also likely that the blurred treatment of interstate commerce was an issue of contention.

It appears that after significant anticipation and strong YTD sector performance, cannabis reform has once again drifted to the back burner and a lack of notable near-term catalysts has prompted weakness in the sector. We continue to believe broad legalization and cannabis reform is unlikely in the near term; however, we foresee potential for reform to improve financial system access for US-operated cannabis companies; a distinctly positive catalyst. Absent U.S. Federal reform, we still expect Trulieve to deliver compound growth in revenue, EBITDA and cash flow, catalyzed by double-digit organic same-store sales growth in its home market of Florida and accretive acquisition opportunities in new markets.

The Conservative Alternative Fund exited the month of June with gross exposure of 109% and delta-adjusted net exposure of 35%, split among an approximate 35% in the capital growth sleeve, 10% in the multi-asset sleeve, and -10% in the asset protection sleeve.

| | YTD | 1 mo | 3 mo | 6 mo | 1 year | 2 year* | Since Inception* |
|---|---|---|---|---|---|---|---|
| Forge First Long Short Alternative Fund Series A | 11.23% | -0.52% | 3.02% | 11.01% | 23.58% | 15.68% | 12.49% |
| Forge First Long Short Alternative Fund Series F | 11.79% | -0.45% | 3.25% | 11.49% | 24.66% | 16.74% | 13.48% |
| | | | | | | | |
| Forge First Conservative Alternative Fund Series A | 8.99% | 0.16% | 1.73% | 8.14% | 23.13% | 12.97% | 11.28% |
| Forge First Conservative Alternative Fund Series F | 9.58% | 0.23% | 1.97% | 8.64% | 24.28% | 13.99% | 12.26% |
| | | | | | | | |
| TSX Total Return | 18.23% | 0.80% | 6.86% | 18.61% | 29.14% | 14.69% | 12.14% |
| S&P 500 Total Return (US$) | 17.99% | 2.38% | 5.50% | 19.19% | 36.45% | 23.60% | 20.99% |

***Annualized | Inception date: April 24, 2019

We have all read the suggestion that the bond market is telling a different story than the stock market. While a case can be made that there's an element of truth to that statement, we'd argue it's not a clear-cut case. All asset classes continue to be in huge demand, thanks to the unprecedented supply of money that's been made available by Central Banks. In addition, the real economy is replete with imbalances that have caused dislocation relative to the pre-COVID economy.

Years of inadequate capital spending have left many basic material inputs in short supply relative to medium-term demand. Further, a plethora of supply chain disruptions has left many industries in limbo. Consider the flagstone you ordered for your backyard pool that is three to four months late because it is sitting on a dock in India, as the tanker that was supposed to transport the stone is stuck half-way around the world; or your local restaurant that is not able to hire enough serving staff; or finally the most talked-about example, the shortage of semiconductors that has impacted many industries including the OEM automotive sector which in turn has caused car rental agencies to boost daily rental prices by at least 80% so as to enable those companies to repair their financial statements.

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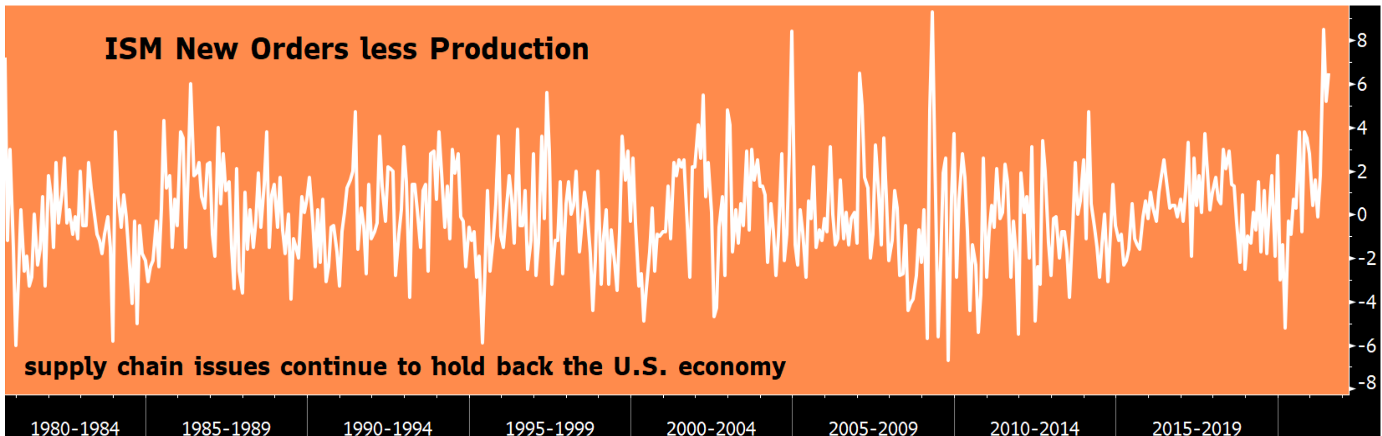
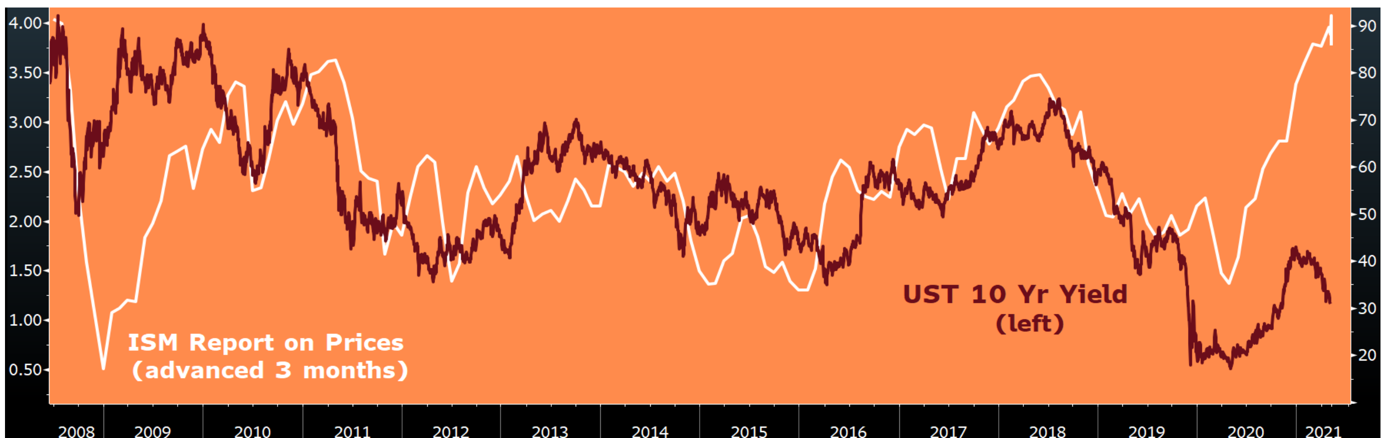



Source: Bloomberg

In the near term, these examples of supply chain issues serve to retard growth and boost inflation. The graph above highlights that the mismatch between orders and production has only been this elevated twice during the previous 40 years. Such imbalances inevitably lead to higher prices; the question is whether these higher prices are sustainable. The white line in the graph below compares the report on prices from the ISM, advanced three months, against the nominal yield on a U.S. 10-year government bond (red line). As you can see, the bond market is telling you the recent spike in inflation is transitory. We remain of the view that labour markets will be the final arbiter as to whether inflation will be sticky or transient and that conclusive evidence will not be available prior to the Spring of 2022.




Source: Bloomberg

Hence, the above gating factors, combined with the fading impact of the fiscal stimulus provided by both Ottawa and Washington, are bound to trigger the recent reduction in the pace of near-term economic growth. At the same time, mobility indicators and manufacturing data suggests the underlying metrics of North American GDP remain comfortably above their historic trends. We posit that supply chain challenges are acting to confuse markets. This view helps to explain the ongoing see-saw battle between growth and value stocks, as value and cyclical stocks require clarity on growth, while we would argue that most growth stocks are fully valued. In addition, stating the obvious, the recent uptick in concerns over COVID-19 also serves to muddy the waters.

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As discussed in past commentaries, aside from the inflation catalyzed by monopolies (governments) and oligopolies (telecom, banks, grocers, to name a few industries), we believe Central Bankers are correct to view the majority of the current spike in inflation to be transient. Consequently, while we presume and hope interest rates will move higher from current levels, we stick with our long-held skepticism that yields on UST 10s would get above 2.25% in the medium term. We say "hope" because it is difficult to believe yields closer to 1% would be indicative of a healthy economy. While such action could push equity valuations higher for a period of time, inevitably, the incremental valuation boost would cause the eventual reversal to be more painful for investors.

Gargantuan liquidity, interest rates and strong earnings remain very strong tailwinds for markets, while the combination of 1) Fed tapering, 2) peaking economic growth, and 3) a resurgence of COVID-19 have the potential to cause more increased volatility. should push equity indices modestly higher from current levels. While our expectation that value and cyclical stocks would outperform growth-oriented equities, we continue to expect cyclicals to rally during H2 of 2021.

We expect fears surrounding Chinese growth to be assuaged by news of incremental fiscal stimulus comfortably ahead of the Winter 2022 Olympics, partially to counteract weaker-than-expected domestic demand. As for COVID-19, while current concerns could be characterized as being multi-faceted, our analysis of the broader situation suggests it is unlikely the virus will impinge upon the general trajectory of economic growth. Further, the gradual resolution of supply chain issues (kids back to school boosting workforce, semiconductors being installed in autos) will slowly but surely be additive to growth. Finally, as the supply/demand equation for U.S. Treasury bonds becomes more balanced (rundown of U.S. Treasury Department's TGA is now complete), we expect the reversal in the downward trajectory of interest rates to boost sentiment towards growth and cyclicals.

A key component to our call for the outperformance of value and cyclical stocks has been our constructive outlook for energy prices. A great call through the end of June; recently it has been painful. Demand fears related to COVID-19 triggered a severe dislocation between energy commodity prices and energy equities. Obviously, if COVID-19 seeks revenge on the global economy, oil won't be the only asset class to feel the pain.

If that event does not come to fruition, it remains our view that supply/demand fundamentals remain solid due to a steady rebound in demand in the context of effective market management from OPEC and capital discipline amongst private sector producers. Barring mass lockdowns in large oil-consuming nations, the environment isn't there for a violent decline in oil prices and as a result, equities will have to better reflect realistic commodity prices at some point soon, which will take them higher. In addition, through the end of this year, based on discussions with the management of portfolio holdings, we expect shareholder-friendly capital return announcements strategies that should entice generalist investors back into the sector.

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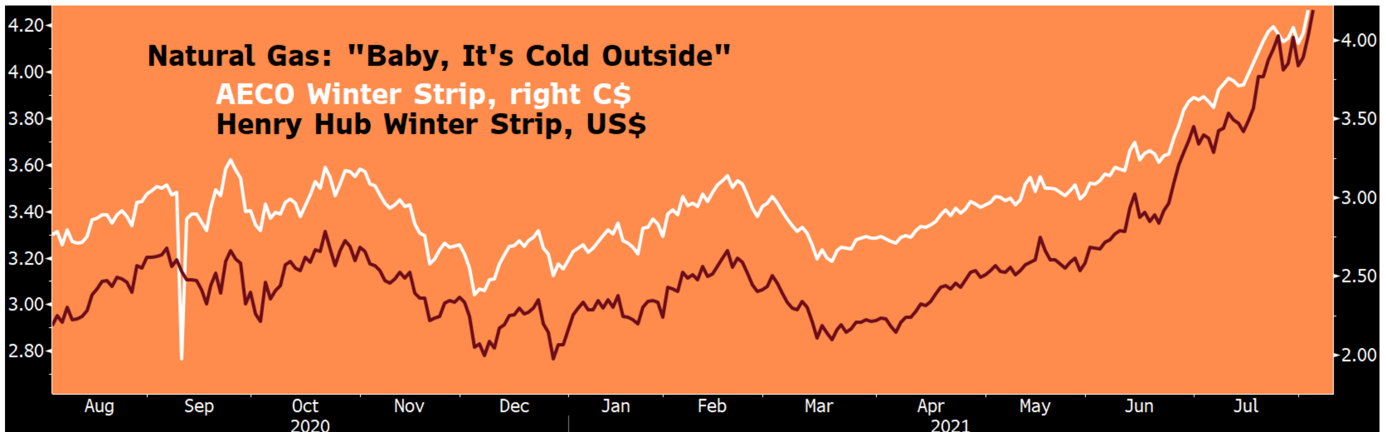

Source: Bloomberg

Meanwhile, the outlook for natural gas remains buoyant as North American inventories remain low for several reasons. The above graph displays the Winter 2022 natural gas strip for Alberta Gas (white line) and Henry Hub in the U.S. (red line). Natural gas prices are currently trading at roughly 60% above their five-year average.

As regular readers know, Forge First funds are about balance and discipline, utilizing a buy and hold strategy of free cash flow generating companies. Hence, be it growth or value that drives the tape during a certain period of time, you can always count on our funds to be pragmatically positioned.

With August 1st, our funds have entered their 10th year of existence. We 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.

Thank you,

Andrew McCreath
President and CEO

Daniel Lloyd
Portfolio Manager

Keenan Murray
Portfolio Manager

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