FORGE FIRST
ASSET MANAGEMENT INC

August 9, 2022

July 2022 Commentary

Sometimes, an investor is simply out of step with markets and that's the way it has been of late for the team at Forge First. Aside from our ongoing constructive stance on Energy, given our concerns about stagflation, each of our two funds has maintained their exceedingly cautious net exposures. Obviously, given the strong countertrend rally in equity markets, this positioning hurt the funds during July. After reviewing the numbers, this note will discuss why we remain cautious towards stocks, including a fact check on the outlook for inflation.

	YTD	1 mo	3 mo	6 mo	1 year	2 year*	3 year*	Since Inception*
Forge First Long Short Alternative Fund Series A	-0.57%	-0.60%	-4.74%	-1.81%	-0.58%	10.85%	9.98%	8.40%
Forge First Long Short Alternative Fund Series F	-0.03%	-0.51%	-4.49%	-1.35%	0.32%	11.83%	10.99%	9.36%
Forge First Conservative Alternative Fund Series A	-0.17%	-1.09%	-2.49%	0.03%	-0.98%	10.42%	8.11%	7.45%
Forge First Conservative Alternative Fund Series F	0.34%	-1.03%	-2.28%	0.45%	-0.09%	11.43%	9.09%	8.41%
S&P/TSX Composite Total Return Index	-5.68%	4.66%	-4.40%	-5.29%	-0.20%	13.53%	9.50%	8.28%
S&P 500 Total Return Index (C$)	-12.23%	8.56%	-0.06%	-7.70%	-3.49%	10.52%	11.42%	14.37%

*Annualized | Inception date: April 24, 2019

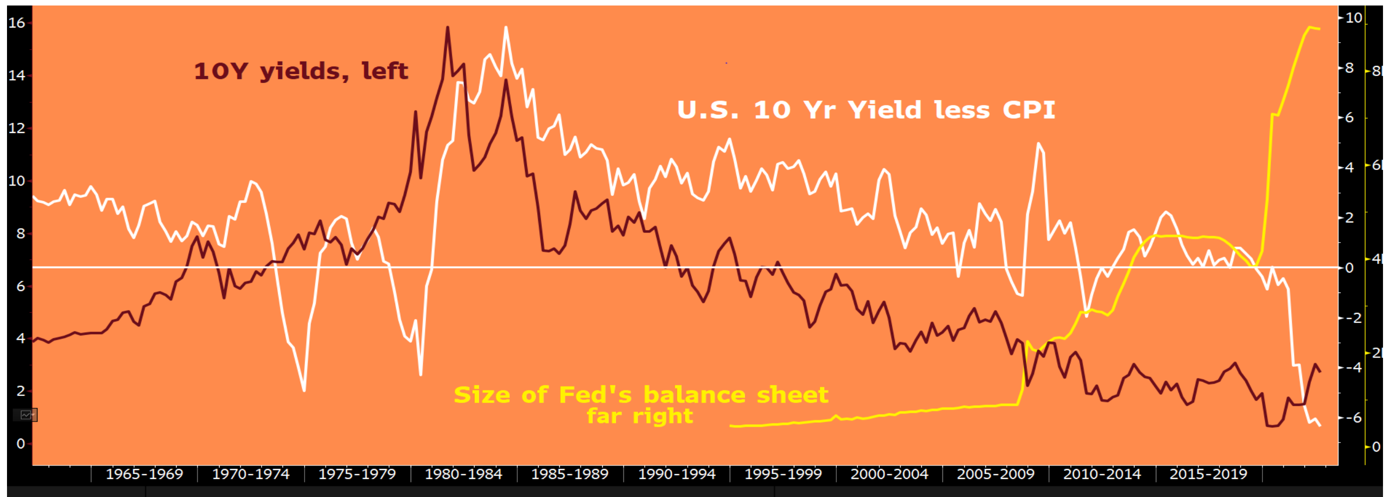
During the month of July, both of our funds enjoyed positive attribution from several sectors, especially Energy and Utilities; however, the losses incurred from single stock and market hedges dwarfed these gains. Factor rotation was the other culprit during the month, as Technology fuelled the outperformance of growth to value, and our funds are definitely weighted more towards the value side of the ledger. As a result, the Series F of our Long Short Alternative Fund declined -0.51% net of fees, reducing its year-to-date net return to -0.03%, while the Series F of our multi-asset Conservative Alternative Fund fell -1.03% net of fees, cutting its year-to-date net gain to +0.34%. During the month, the more directional Long Short Alternative Fund shifted its net exposure from a net short position at mid-month to a 27% net long exposure at month-end, on a gross exposure of 122%. In contrast, the Conservative Alternative Fund remained net short common equities throughout the month, exiting July with an overall net long exposure of 2%, split between an approximate 6.8% net long exposure in its multi-asset sleeve and a -4.7% net short position in common equities. Delta-adjusted gross exposure for the fund was 98%.

With market sentiment about as bad as it could get, equities started moving higher mid-month, initiating their fourth year-to-date countertrend rally. Interestingly, during the 2007-2009 downturn, there were four (perhaps five) of these rallies, with the two-month 12% rip during the Spring of 2008 looking eerily similar to the current march higher. Further back in time, the 2000-2003 meltdown featured three huge countertrend rallies, all of which tallied roughly 20%. But the current leg of this party kicked into higher gear after either the latest communication gaffe by Fed Chair Powell, or perhaps an attempt by the Fed Chair to boost the prospects for Wall Street. At his press conference, post their 75 bps-hike in the Fed Funds Rate, Powell mused that the Fed's overnight rate was now neutral at its 2.25%-2.50% range. Financial assets loved those words, quickly repositioning themselves for a sooner-than-expected Fed pivot. But, think about it, who the heck is he kidding?

As you can see from the more than 50-year graph below, U.S. 10-year real yields (white line, right axis) are even more negative than they were during the two supply shock periods of the 1970s. Even if inflation gets cut in half, these real yields will remain at levels that are the most negative they've been since 1980. Further, note how the Fed has yet to begin shrinking its balance sheet (yellow line, far right axis). Naturally, we're frustrated at our recent performance, but we foresee much more tightening in monetary policy over the next year, and we don't believe equity markets will react kindly to such moves. As discussed in our last commentary, we await lower prices and/or earnings multiples to get more bullish on stocks.

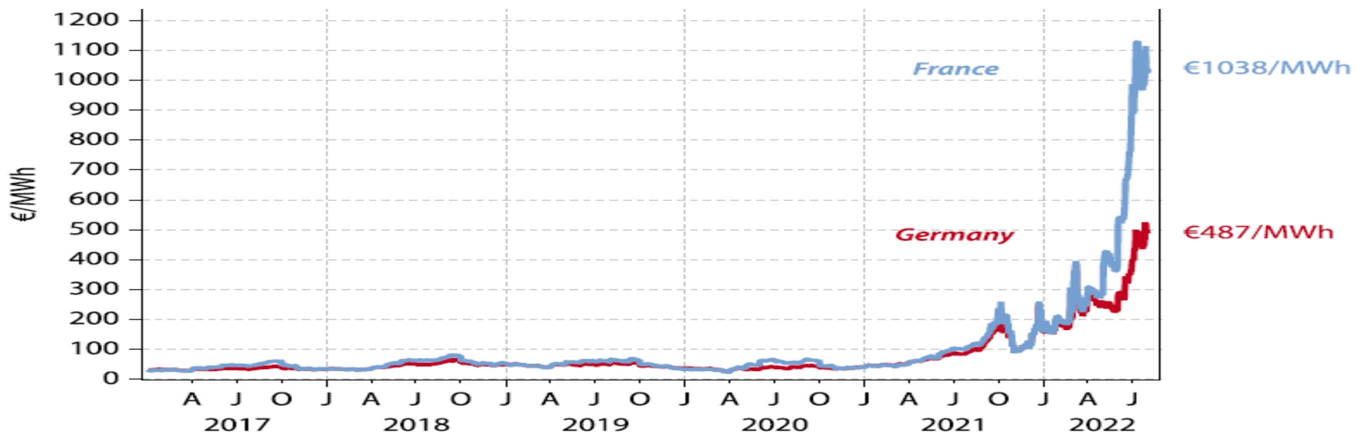
Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

This material has been published by Forge First Asset Management Inc. It is provided as a general source of information; it is subject to change without notification and should not be construed as investment advice. This material should not be relied upon for any investment decision and is not a recommendation, solicitation or offering of any security in any jurisdiction. The information contained in this material has been obtained from sources believed reliable. The 2022 results are unaudited, net of all fees and expenses, and are based on our best estimates at the time of this report. Index statistics use total return indices. The statements contained herein that are not historical facts are forward-looking statements, which are based on current expectations and estimates about particular markets. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions which are difficult to predict. Therefore, actual outcomes and returns may differ materially from what is expressed in such forward-looking statements. The information contained herein is subject to updating and further verification and may be amended at any time without notice and we are under no obligation to update this information at any particular time. The composition of the Funds' portfolio could differ significantly from an index due to the investment strategy employed, and includes differences such as use of equal weight positions, use of short positions and varying fund net exposure. Source for all index data: Bloomberg.



Source: Bloomberg

Regular readers of these commentaries are aware of our belief that inflation will stay 'stickier' for longer due to rents, energy, food, supply chains and labour markets. Notwithstanding the recent pain in the price of energy commodities and stocks, we view energy prices as ground zero for inflation and believe the supply side of the energy sector implies prices will remain higher for longer. Last week, your author had the good fortune of being in Paris, France. Europe has major economic problems at this juncture. Courtesy of Gavekal Research, the graph below displays electricity, baseload futures contract prices for January 2023. Words are not needed to understand the impact these beyond belief prices are having on companies and consumers. Also, food prices are much higher in Paris than here in Canada and the weakening euro will only exacerbate the inflationary impact on the pocketbooks of society.

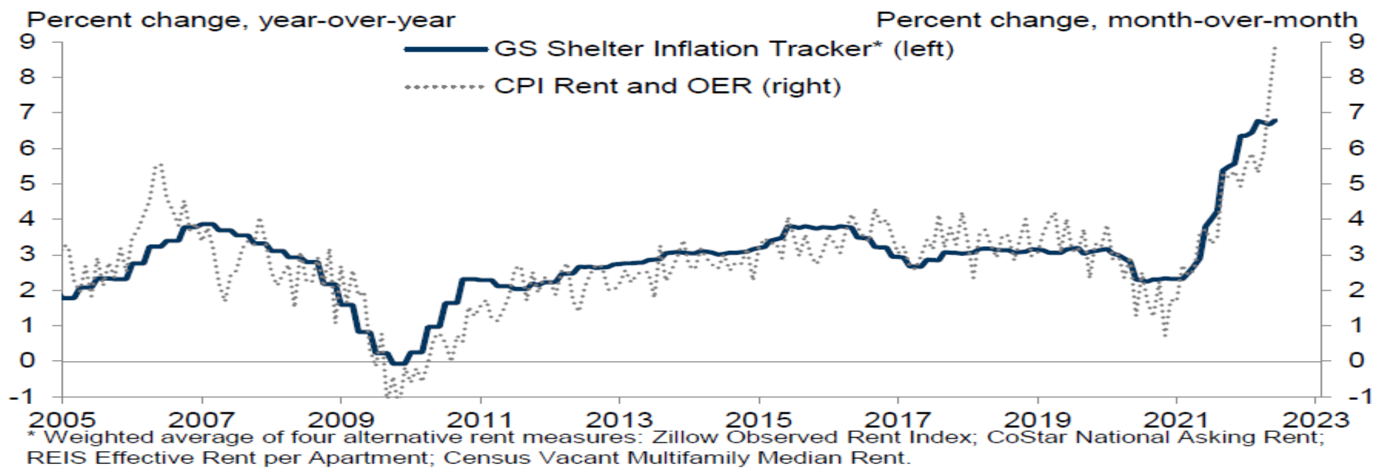


Source: Gavekal Research

Shifting to inflation in North America and the topic of rent, we've written in the past about the historical 12 to 15-month lag between housing prices and rental expenses. According to Goldman Sachs, the following 17-year graph suggests that rising interest rates, continuing firm labour markets and the cessation of pandemic-related anomalies in the structure of the rental marketplace, will cause realized CPI Rent to continue to run hotter than the GS Shelter Inflation Tracker.

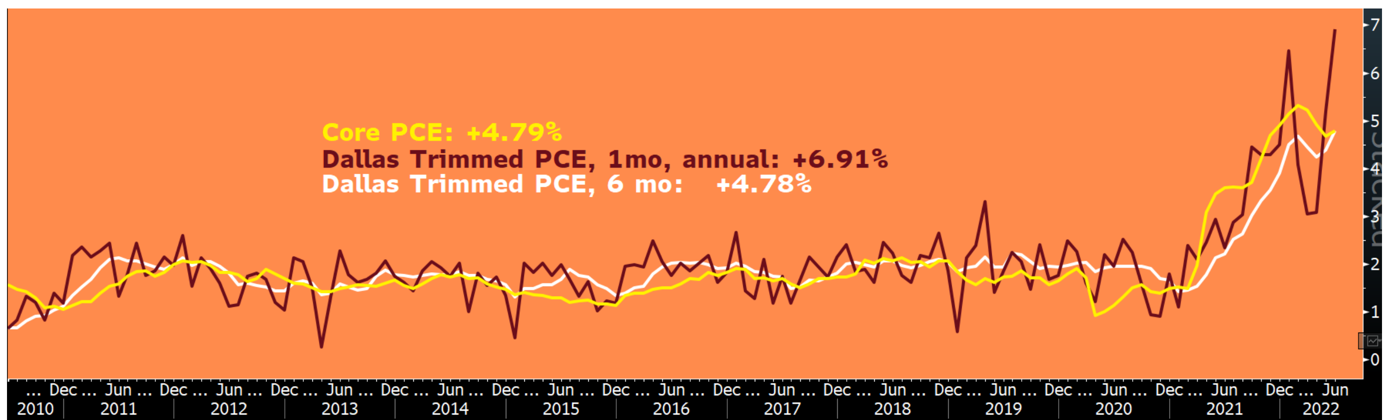
Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

This material has been published by Forge First Asset Management Inc. It is provided as a general source of information; it is subject to change without notification and should not be construed as investment advice. This material should not be relied upon for any investment decision and is not a recommendation, solicitation or offering of any security in any jurisdiction. The information contained in this material has been obtained from sources believed reliable. The 2022 results are unaudited, net of all fees and expenses, and are based on our best estimates at the time of this report. Index statistics use total return indices. The statements contained herein that are not historical facts are forward-looking statements, which are based on current expectations and estimates about particular markets. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions which are difficult to predict. Therefore, actual outcomes and returns may differ materially from what is expressed in such forward-looking statements. The information contained herein is subject to updating and further verification and may be amended at any time without notice and we are under no obligation to update this information at any particular time. The composition of the Funds' portfolio could differ significantly from an index due to the investment strategy employed, and includes differences such as use of equal weight positions, use of short positions and varying fund net exposure. Source for all index data: Bloomberg.



Source: Goldman Sachs

Also, inflation diffusion indices imply the number of variables that are exhibiting rising price pressures are increasing relative to the number that are falling. For example, the Dallas Fed Trimmed PCE has hit new highs, be it the one-month annualized number (red line) or the six-month rate of change (white line). We suspect one factor driving this rising breadth is the supply chain. We have read many stories discussing the negative impact on global supply chains arising from China's relentless fight against COVID-19. The same applies to the energy shortages in Europe, as forced production cutbacks are gating supply chains and boosting the price of available supplies.



Source: Bloomberg

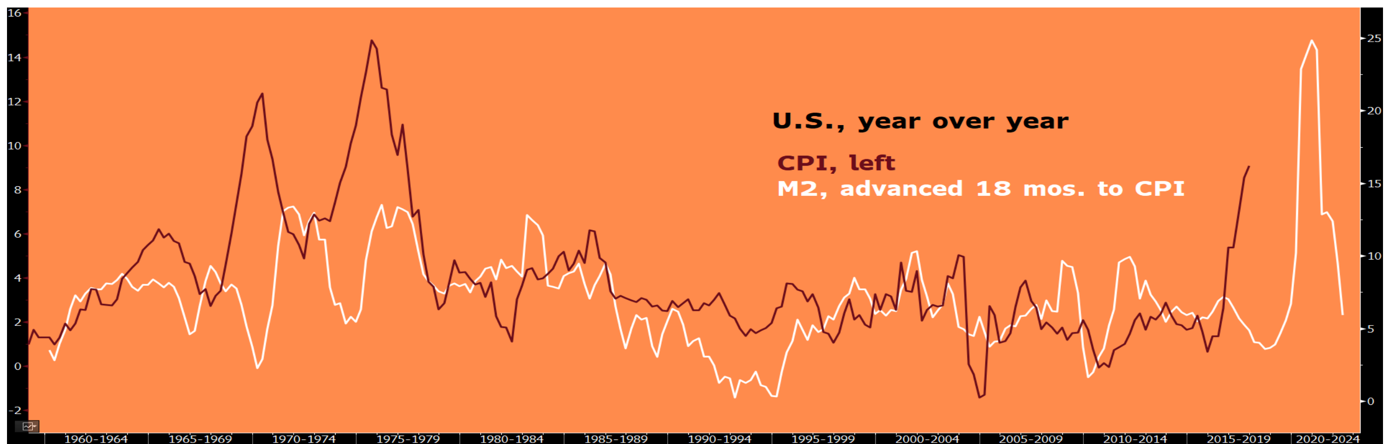
Finally, another Parisian anecdote, this time about labour markets. Prior to COVID-19, restaurants and bars in Paris stayed open well past midnight. Now, however, similar to North America, employers can't find the workers. As a result, restaurants were closing up shop by 10 pm, even on weekends. In addition to limiting economic growth, it's presumably inflationary as employers have to boost wages in an attempt to increase the supply of workers. Shifting back to growth, luxury goods retailers stated Chinese tourists were few and far between, given that the Chinese government has been very restrictive on allowing Chinese citizens to travel. Obviously this hurts the growth of the economy.

At the same time, there's little question rates of inflation will fall from their current lofty levels due to a combination of satiated demand for products (versus services), retailer discounting due to excess inventories and the fact companies are telling us that consumers are balking at paying even higher prices. There's a more macro reason too. The following 60-year graph illustrates the long-term relationship between U.S. CPI (red line, left axis) against the M2 measure of money supply. Note that these lines are year-over-year rates of change and that M2 is advanced 18 months to CPI. The recent plunge in the growth rate of M2 suggests inflation should recede prior to the end of 2023.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

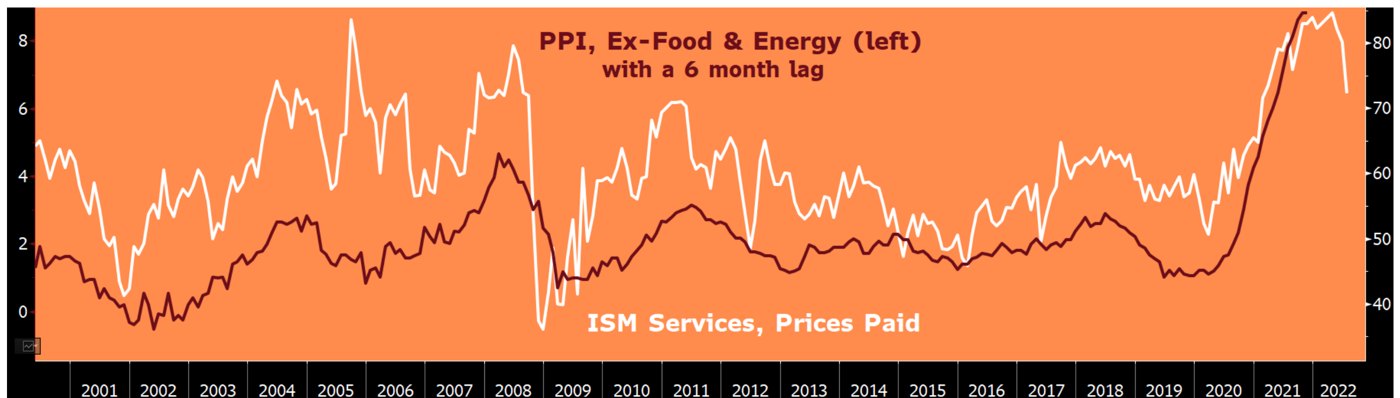
This material has been published by Forge First Asset Management Inc. It is provided as a general source of information; it is subject to change without notification and should not be construed as investment advice. This material should not be relied upon for any investment decision and is not a recommendation, solicitation or offering of any security in any jurisdiction. The information contained in this material has been obtained from sources believed reliable. The 2022 results are unaudited, net of all fees and expenses, and are based on our best estimates at the time of this report. Index statistics use total return indices. The statements contained herein that are not historical facts are forward-looking statements, which are based on current expectations and estimates about particular markets. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions which are difficult to predict. Therefore, actual outcomes and returns may differ materially from what is expressed in such forward-looking statements. The information contained herein is subject to updating and further verification and may be amended at any time without notice and we are under no obligation to update this information at any particular time. The composition of the Funds' portfolio could differ significantly from an index due to the investment strategy employed, and includes differences such as use of equal weight positions, use of short positions and varying fund net exposure. Source for all index data: Bloomberg.

FORGE FIRST
ASSET MANAGEMENT INC



Source: Bloomberg

The growing inability to continue to be able to push more price hikes on end users referenced in the last paragraph has begun to be seen in metrics such as the ISM Services, prices paid (white line, right axis) shown in the 20-year graph below against U.S. PPI, ex-food & energy, lagged six months (red line, left axis). For inflation statistics this is good news, but it's likely to make it tough on earnings. As of late in the week ended July 9th, at 9%-10%, Q2 EPS growth for the S&P 500 has been strong at the headline level, but down sharply below the surface.



Source: Bloomberg

Taking out three unusually large items, quarterly EPS trends look less favourable. The Energy sector added greater than 10% to overall earnings growth, the return to profitability for pandemic-impacted companies chipped in a further 2%, and the drag from banks provisioning for loan losses subtracted 4%. Excluding these items, underlying earnings growth for the rest of the S&P 500 was just 1.2%. Adjusted for seasonality, sequentially, earnings have fallen 4.5% quarter-on-quarter. Looking ahead, we foresee negative earnings revisions, given continued supply chain issues, weakening economic growth, ongoing input cost pressures and a growing inability to hike selling prices.

Adding all this together, with the S&P 500 trading at >18x currently projected earnings and our belief that monetary tightening has just begun, it's tough for us to get bullish on stocks. Yes, this countertrend rally has been tough on the very recent performance of the funds but knowing our job is to protect capital in tough markets and generate a competitive net return, entering our 11th year of successfully managing client capital, we will stick to our well-researched beliefs.

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
President and CEO

Daniel Lloyd
Portfolio Manager

Keenan Murray
Portfolio Manager

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

This material has been published by Forge First Asset Management Inc. It is provided as a general source of information; it is subject to change without notification and should not be construed as investment advice. This material should not be relied upon for any investment decision and is not a recommendation, solicitation or offering of any security in any jurisdiction. The information contained in this material has been obtained from sources believed reliable. The 2022 results are unaudited, net of all fees and expenses, and are based on our best estimates at the time of this report. Index statistics use total return indices. The statements contained herein that are not historical facts are forward-looking statements, which are based on current expectations and estimates about particular markets. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions which are difficult to predict. Therefore, actual outcomes and returns may differ materially from what is expressed in such forward-looking statements. The information contained herein is subject to updating and further verification and may be amended at any time without notice and we are under no obligation to update this information at any particular time. The composition of the Funds' portfolio could differ significantly from an index due to the investment strategy employed, and includes differences such as use of equal weight positions, use of short positions and varying fund net exposure. Source for all index data: Bloomberg.