FORGEFIRST
ASSET MANAGEMENT INC

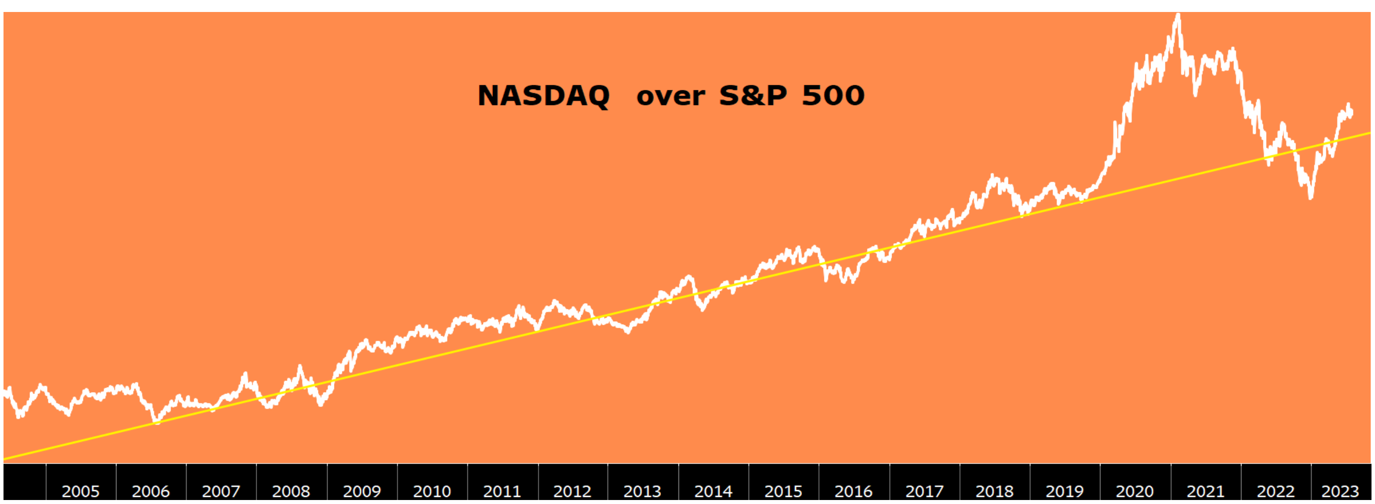
August 10, 2023

July 2023 Commentary

Equities continued to march higher during July as investors became increasingly confident that the forward macro environment would unfold in a manner helpful to stocks. From the Fed shifting its economic outlook to merely a "noticeable slowdown" from a recession to the extrapolation of the recent dovish news on the inflation front affirming big cuts in interest rates next year, the now 4+ month rally in risk assets was maintained. As can be seen from the far-right of the below relative strength graph of growth vs. value, July's performance exhibited a more equal balance between growth and value indices.

Source: Bloomberg

Yet at the same time, the long-term outperformance of the much growthier NASDAQ to the S&P 500 continues, as evidenced by the 20-year graph shown below. While 5% two-year yields modestly tested equity markets in early March 2023, later in this note we'll comment on whether rising longer-term yields could challenge the growth stocks whose valuations have historically been negatively correlated with yields. Regardless, there's little question that this market cycle has unfolded differently than most observers had expected in light of the influence of unprecedented fiscal stimulus and distortions emanating from monetary policy stimulus, be it in the manipulation of rates or the gargantuan pool of liquidity that continues to slosh around the system. However, before delving deeper into markets, let's first recap the month for our funds.



Source: Bloomberg

The Series F of our Long Short Alternative Fund gained +0.83% net of fees for the month of July, pushing its year-to-date net gain to +1.28%. Just over half of the positive performance was sourced from Energy, Financials, and Technology, while market hedges constituted the largest drag on the portfolio. Modest losses were also experienced in Materials, mostly due to shorts in the copper space. On the positive side of the ledger, MSCI Inc. (MSCI.US) and several financial stocks, e.g. CI Financial Corp. (CIX.CA), Fairfax Financial Holdings Ltd. (FFH.CA), and CME Group Inc. (CME.US), chipped in some basis points. Recently the fund has been adding to grocery-anchored REITs and Industrials on the long side, accumulating short exposure within the Consumer sector, the rationale of which will be discussed in the following pages, and writing puts on companies that, if exercised, would increase our exposure to weights we're comfortable with, on pullbacks. The fund exited July with delta-adjusted gross and net exposure of 138% and 20% respectively.

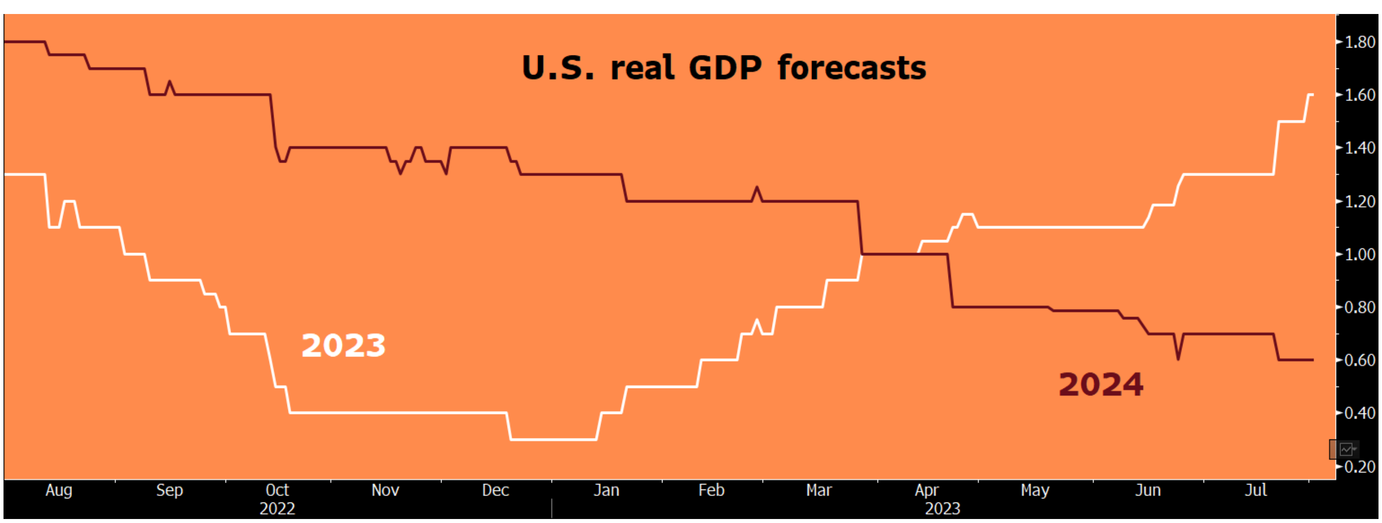
As of July 31, 2023	YTD	1-mo	3-mo	6-mo	1-year	2-year*	3-year*	Since Inception*
Forge First Long Short Alternative Fund Series A	0.64%	0.74%	-0.91%	-0.96%	-3.80%	-2.20%	5.73%	5.45%
Forge First Long Short Alternative Fund Series F	1.28%	0.83%	-0.63%	-0.43%	-2.75%	-1.23%	6.74%	6.44%
Forge First Conservative Alternative Fund Series A	1.20%	-0.08%	0.76%	0.54%	2.42%	0.70%	7.68%	6.27%
Forge First Conservative Alternative Fund Series F	1.73%	0.00%	0.99%	0.99%	3.36%	1.62%	8.67%	7.22%
S&P/TSX Composite Total Return Index	8.43%	2.58%	0.78%	0.95%	8.23%	3.93%	11.73%	8.27%
S&P 500 Total Return Index (C$)	17.40%	2.71%	7.35%	12.18%	16.13%	6.65%	13.01%	12.22%

*Annualized | Inception date: April 24, 2019

The Series F of our low volatility, multi-asset Conservative Alternative Fund was flat for the month, such that its year-to-date net return remained at +1.73%. During July, losses in the capital growth and asset protection sleeves offset gains in the multi-asset sleeve. Positions in Industrials and market hedges were the largest drags on performance, while positions in the Financials and Technology sectors contributed positive performance.

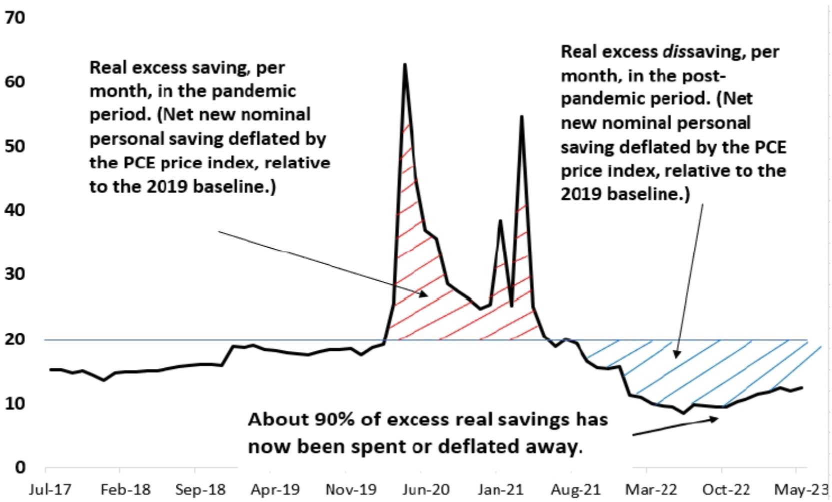
Our holdings in GFL Environmental Inc. (GFL.CA) and Casella Waste Systems Inc. (CWST.US) were negatively impacted by the factor rotation in the market as well as negative reactions to quarterly earnings. These two positions were the largest detractors to performance during July. After rallying greater than 20% year-to-date ahead of earnings, investors were disappointed with GFL's incremental allocation to growth capital expenditure plans plus weak volumes in the quarter. In contrast, we believe the capital is being allocated at an attractive return profile and the weaker volumes were margin accretive, as the dropped volume had been low margin business. GFL continues to have a visible runway to mid-teens or higher compound growth in free cash flow while trading at a mid-teens FCF multiple. Each of our funds used the weakness to increase their position in GFL through the purchase of both shares and equity options. The fund exited July with delta-adjusted gross and net exposure of 113% and 37% respectively, with the net exposure split between common equities (27%) and multi-assets (10%).

The strength in equity markets appears predicated on the 'thread the needle' belief that growth will remain decent, inflation will recede into the mid-2s, and the Fed will take a hatchet to interest rates during 2024. To that end, note how the following graph suggests that the uptick in projections for U.S. GDP growth in 2023 have largely borrowed from the deteriorating outlook for growth during 2024. Similar to other pundits, we clearly underestimated the near-term resilience of North American consumption and capital investment to withstand tighter monetary policy.



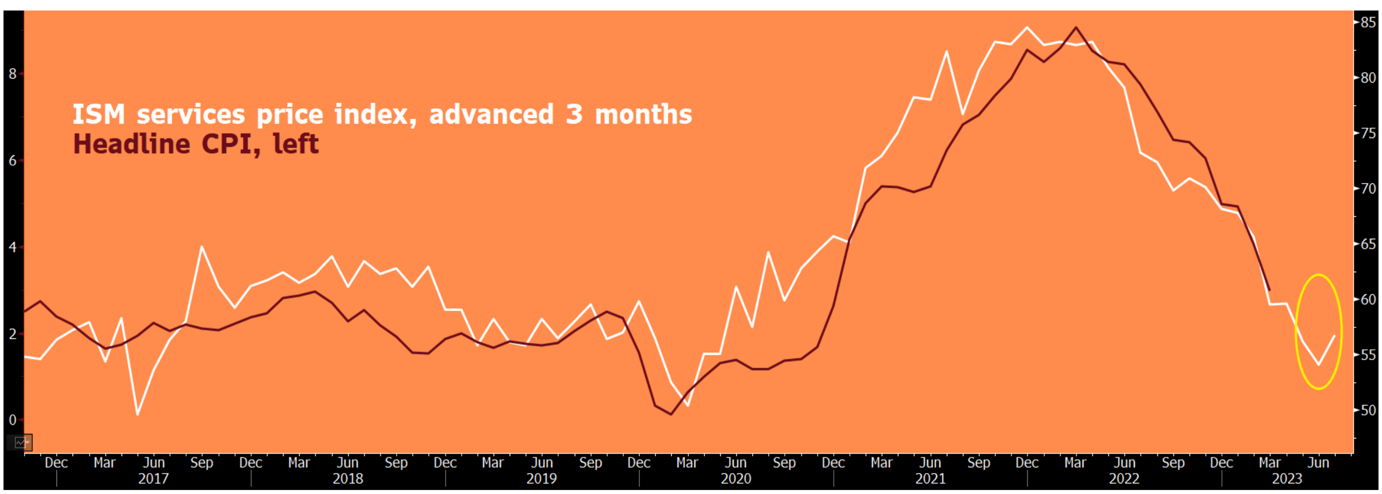
Source: Bloomberg

Looking ahead, while real wage growth has recently turned positive, it is tough not to envision much lower U.S. consumer spending in 2024 due to the impact of higher interest rates (30-year mortgage rates at a 30-year high at the time of writing), the eradication of excess COVID-19 savings (please see graph below) and a lower go-forward contribution from fiscal stimulus; and remember it's the rate of change that matters for the latter as opposed to the absolute dollar value.



Source: MacQuarie Group

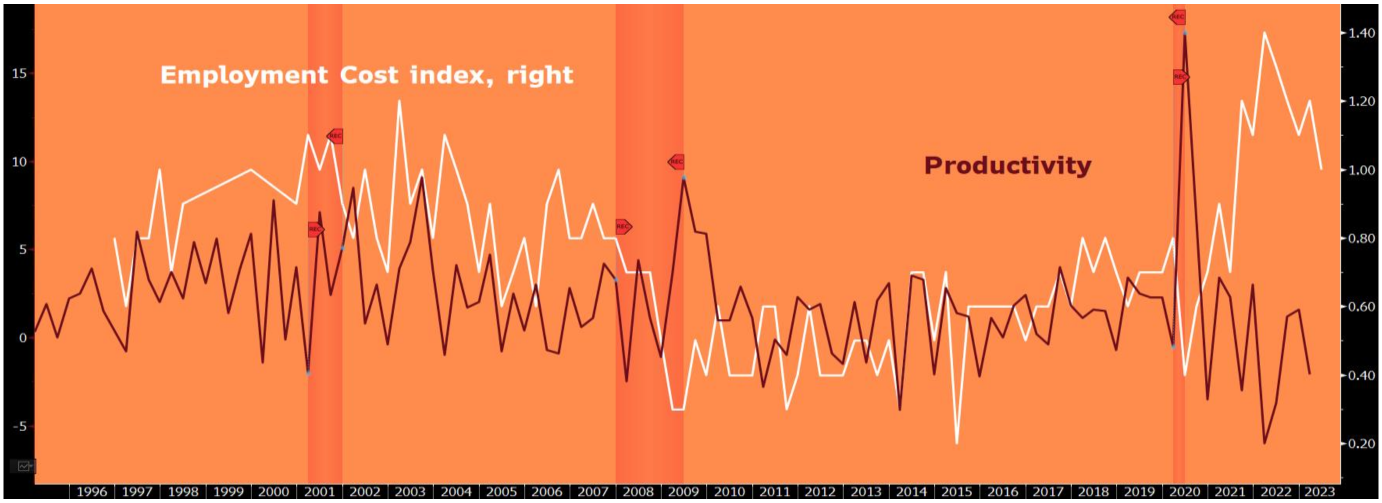
Shifting to inflation, as we suggested many months ago, the path to 3.5% inflation was likely to be easy, but the road to the low 2s is liable to be more difficult. In the print being released this morning, headline inflation was expected to tick higher, as the base effect becomes less positive for July CPI. A key reason for this expectation is the 8% drop in gasoline prices of a year ago which falls out of the numbers vs. when U.S. CPI declined by 0.03% month-over-month in July 2022. Looking ahead, if CPI stays flat month-over-month, it will rise from 3.0% year-over-year in June to 3.1% year-over-year in July. If monthly increases in CPI of +0.2% month-over-month are assumed, as was the case in June, headline inflation will rise to +3.3% year-over-year in July and will still be +2.8% year-over-year by December 2023.



Source: Bloomberg

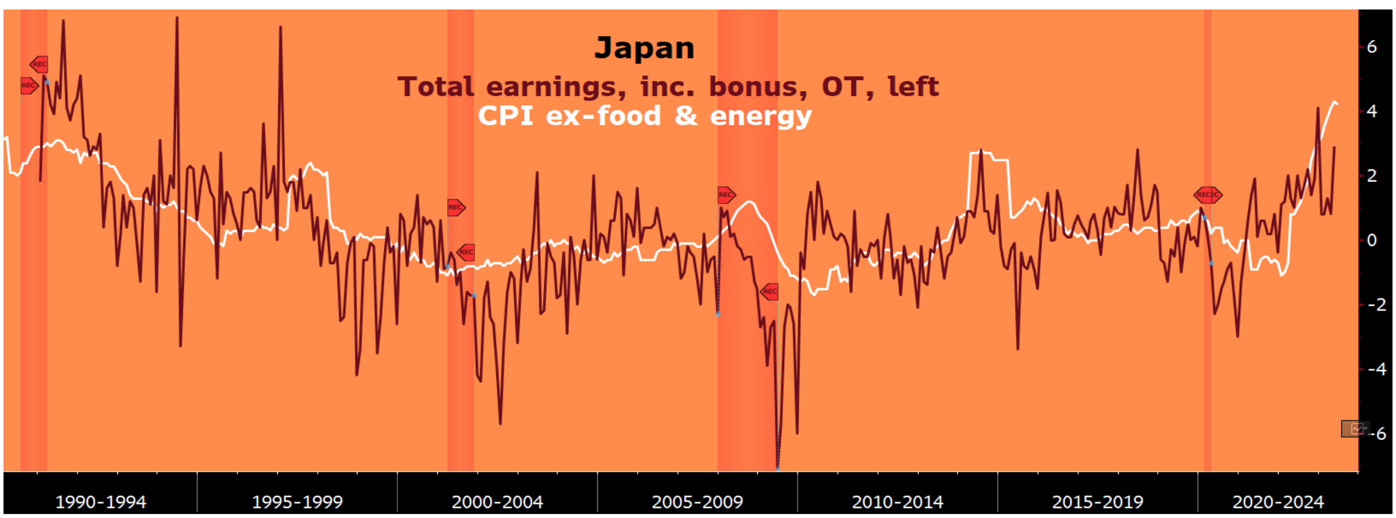
The graph above begins in late 2016 and compares headline U.S. CPI (red line, left axis) to the ISM services price index (white line, left axis), advanced by three months. The fit between these two variables suggests headline price pressures will further relent near term prior to a bit of a bump. While the progress to date on headline inflation has been impressive, Core Services ex-Housing measures of pricing have continued to be on the sticky side. We'd thought this scenario would be the case due to wages.

The Phillips Curve suggests that strong employment growth implies high inflation such that as labour markets slow, so will price pressures. However, our thinking remains that current wage pressures are being driven by challenges in the supply of labour vs. the demand for labour. Consequently, we found it interesting that during Chair Powell's recent press conference, he suggested the Fed now expects that wages will play a significant role in determining the path of future inflation. This view is in sharp contrast to Fed staff reports stating wages were not a key determinant of inflation. Hence, while the Fed undoubtedly breathed a sigh of relief at the most recent Employment Cost Index print (white line, right axis) shown in the graph below against productivity (red line, left axis), we note July's jobs report saw wages sticky at 4.4%; no increase in the participation rate and initial claims data that have barely lifted themselves off the mat. We also note the most recent Beige Book stated input cost pressures continue to persist for service-based businesses.



Source: Bloomberg

While inflation is definitely improving in the U.S (and Canada), that's not the case in Japan. The 30+ year graph below compares total earnings of Japanese workers (red line, left axis) against CPI ex-Food & Energy (white line, right axis). Base effects are expected to drive inflation towards an estimated 2.5% during 2024. If it doesn't, something is going to have to give! During the 10-year tenure of recently retired Governor Kuroda, the Bank of Japan ("BoJ") engaged in a quantitative easing ("QE") program roughly seven times larger (in terms of GDP) than the Fed's program. The result is Japan's central bank now owns more than 50% of all Japanese government bonds. Reversing this largesse, which is estimated to have supplied excess liquidity to the banking system equal to the country's GDP, will be especially challenging without hiking the policy rate markedly from current levels. Look out if inflation doesn't co-operate!



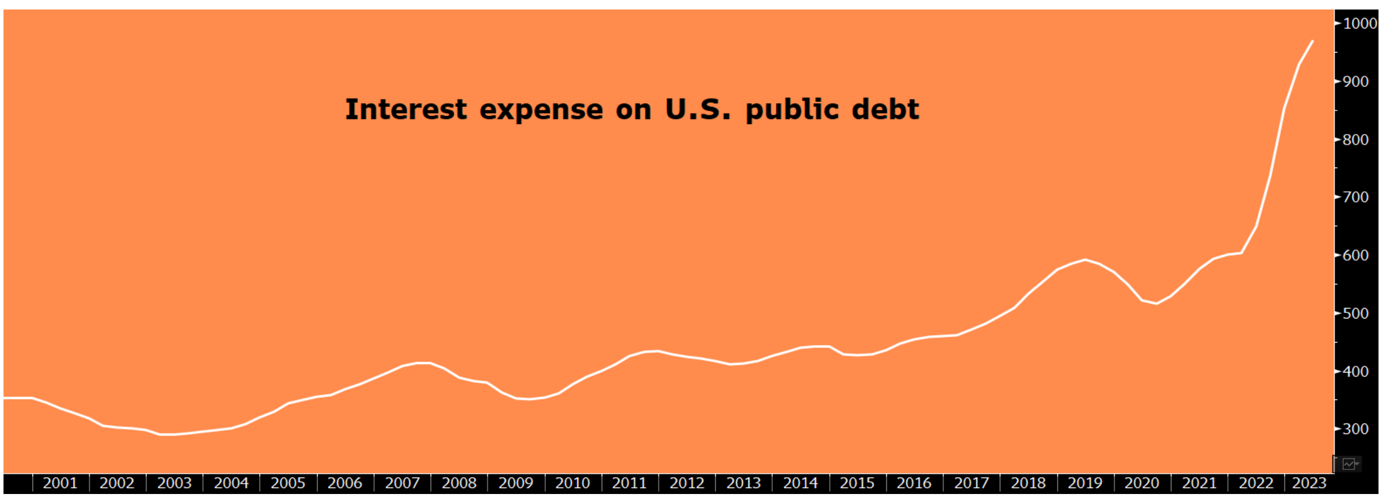
Source: Bloomberg

The recent easing by the BoJ of the 50-basis point ceiling on the yields for 10-year government bonds in Japan has certainly played a role in pushing yields on other sovereign bonds higher. One reason is attributable to the 'carry trade', a tactic which sees an investor short Japanese government bonds, given their 'locked down' yields, to fund the purchase of a plethora of other assets including other bonds. Hence, the recent relative easing by the BoJ on the ceiling yield of domestic government bonds undoubtedly forced some traders to cover their shorts and sell their longs, the latter pressuring yields on the owned bonds higher. However, that's not the only reason yields have taken a significant leg higher lately.

Ultimately, rising yields relate to changes in the supply vs. demand of bonds. Treasury Secretary Yellen recently materially increased the level of expected gross issuance by the U.S. government through year-end to an astounding US$1.59T! In addition, inflation expectations have been edging higher and the net speculative short position against bonds sits at record levels. The resulting impact is displayed in the following 30+ year graph of the yield on a U.S. 30-year bond; the epitome of a potential breakout from a long-term trading range, one that if sustained could arguably have an ugly impact on stocks, especially high-priced growth stocks.

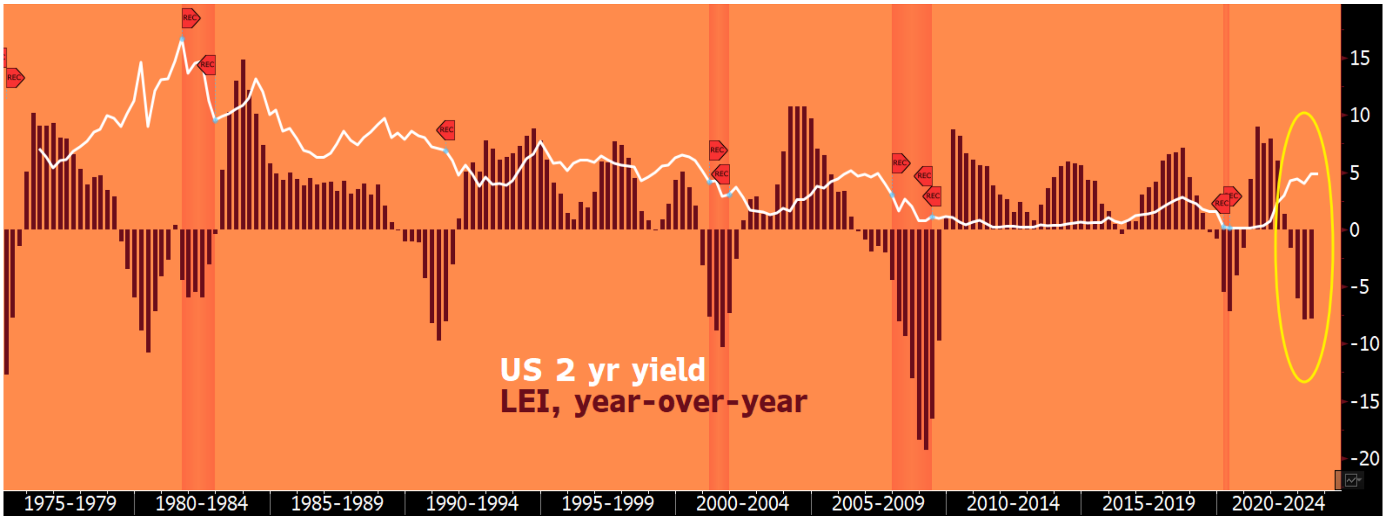
Source: Bloomberg

Of course, another impact of rising interest rates is the implied future decreasing room of governments to juice their economies via fiscal stimulus. Granted it's only just shy of 4% of GDP, but the graph below indicates that prior to year-end, the annual interest expense of the U.S. government will exceed US$1T on a run-rate basis. We continue to believe Central Banks 'rang the bell' during the Fall of 2021, warning markets that the medium-term outlook for monetary policy was going to be very different from the previous several years. Interest rates have obviously increased markedly, yet the promised reduction in liquidity has yet to happen. This latter fact has decidedly helped stocks year-to-date; however, according to Powell, the Fed will now withdraw greater than US$1T from the system during the next 12 months.



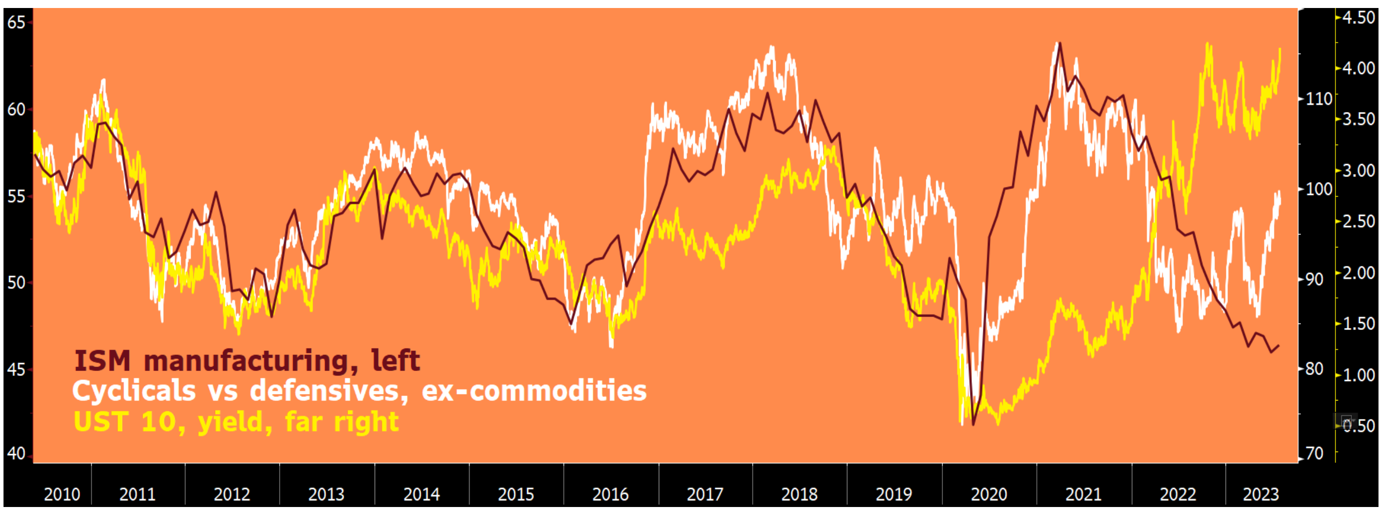
Source: Bloomberg

We'd like to share one last graph pertaining to interest rates and growth. To get our point, you'll have to look closely at this almost 50-year graph below. The vertical shaded bars mark recessions against the yield on a two-year U.S. government bond (white line) and the year-over-year change in the Leading Economic Indicators ("LEIs") (red line, right axis). Notice how, as a recession is approached, the white line falls but only after the red bars have gone negative and they don't turn up until those same red bars have also advanced, except for the far-right side of the graph, today! Interest rates have been climbing for a year now, even though the LEIs continue to fall. This graph illustrates the difference of this cycle vs. others, given the gargantuan fiscal stimulus and distortions emanating from monetary policy on both rates and liquidity.



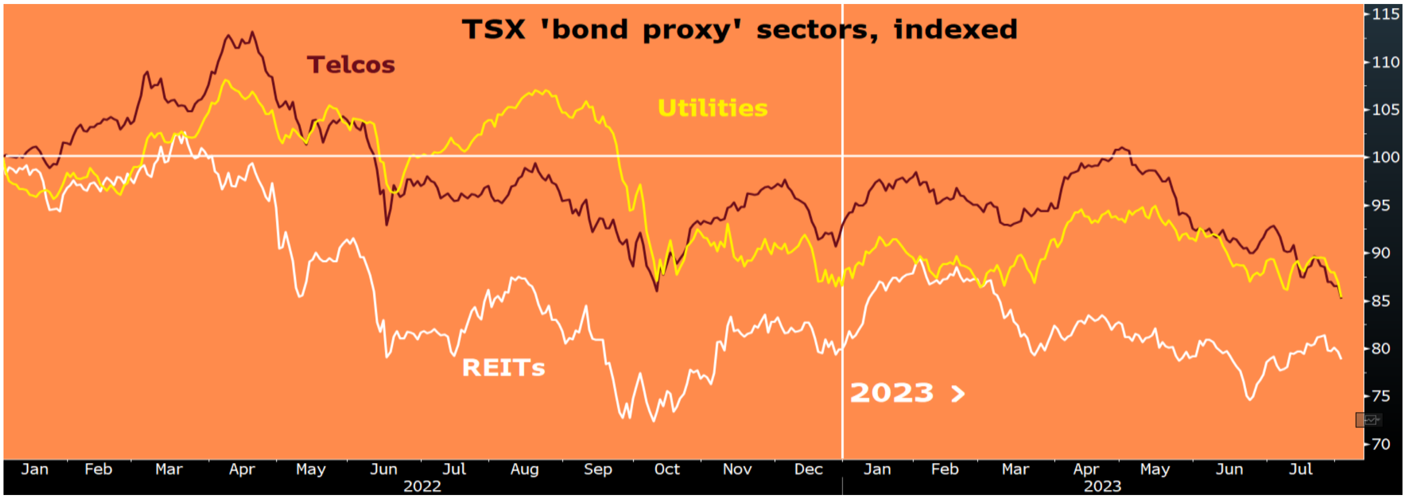
Source: Bloomberg

The impact of these distortions can be seen in the following graph that begins in 2010. It compares the ISM Manufacturing Index (red line, left axis) against the yield on a 10-year U.S. government bond (yellow line, far-right axis), and the relative price strength of cyclical stocks, excluding commodities, over defensive stocks (white line, near-right). Up until the last year, the fit between the three lines was logical and obvious; however, the three lines have now markedly decoupled.



Source: Bloomberg

Given its capital preservation and low volatility-focused mandate, our Conservative Alternative Fund typically has only modest holdings in resource stocks in contrast to our Long Short Alternative Fund, which will typically have greater exposure to commodities. Given the above macro, at this juncture, the Long Short Alternative Fund holds a mid-single digit net long exposure to the Energy sector (long oil sands, offshore services and domestic service companies), Industrials that benefit from Biden's Inflation Reduction Act including Encore Wire Corp. (WIRE.US) and Quanta Services Inc. (PWR.US), net short a basket of generally lower quality copper stocks with a degree of an offset with our long-held position in Freeport-McMoRan Inc. (FCX.US), and a recently reduced net long exposure to Gold.



Source: Bloomberg

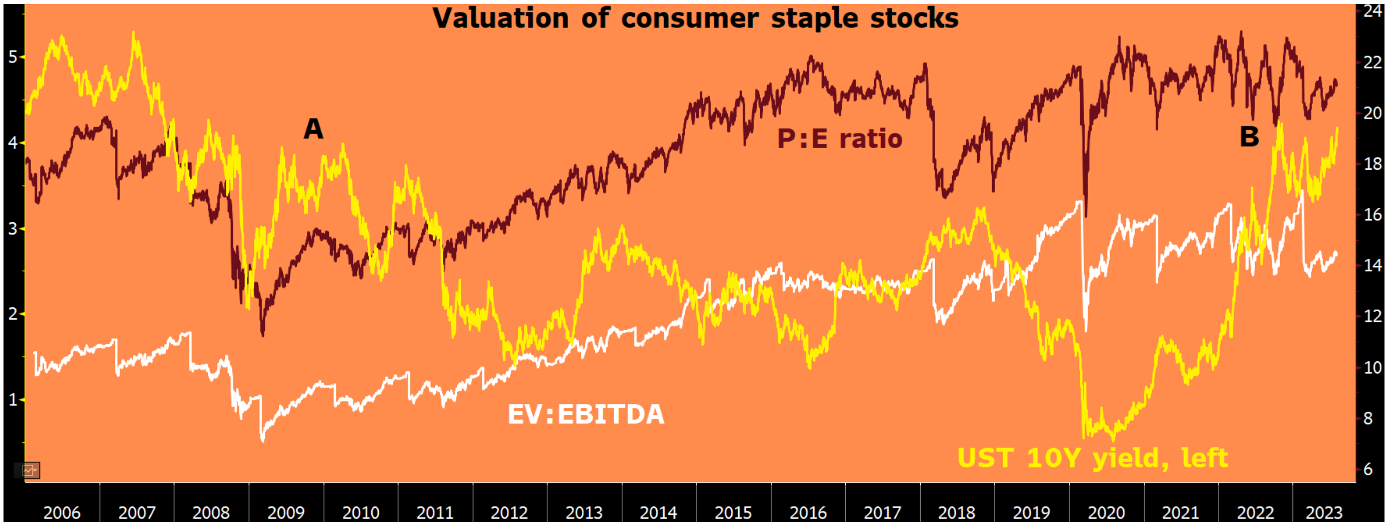
The Long Short Alternative Fund has also increased its allocation to the grocery-anchored retail REIT segment of the Real Estate sector to complement its long-held position in Boardwalk REIT Units (BEI-U.CA), by purchasing RioCan REIT (REI-U.CA) and First Capital REIT (FCR-U.CA). In contrast to the outlook for other segments of Real Estate, we foresee significant upside to rents on renewal, especially for RioCan. On a stacked basis, rent per square foot increased only 6% from 2019 to 2022. Given the lagged nature of rents (thanks to renewal intervals), we believe this space is poised to capture strong growth in rents over the next five years with the majority of these benefits flowing directly to net operating income. Within the Consumer sector, based on our expectation of a pending slowdown in consumer spending, the Fund continues to add to its list of short positions, including a put spread position on the ETF, Consumer Staples Select Sector SPDR Fund (XLP.US) in the U.S.

Organic Sales Growth of Consumer-Packaged Goods

	Q ending 30-Sept-22	Q ending 31-Dec-23	Q ending 31-Mar-23	Q ending 30-Jun-23
Kellogg's North America	14	15	14	4
Price	13	13	14	14
Volumes	2	2	-1	-11
Proctor Gamble	7	5	7	8
Price	10	11	11	9
Volumes	-3	-6	-3	-1
Campbell Soup	6	15	13	5
Price	11	16	14	12
Volumes	-4	-1	-2	-7
Colgate North America	4	5	4	2
Price	9	11	11	9
Volumes	-6	-6	-7	-7
General Mills	10	11	16	5
Price	16	19	17	11
Volumes	-6	-8	-1	-6

Source: Forge First and Company Reports

The table above highlights overall corporate revenue growth plus a division of this variable between price and volume. As we all know from grocery shopping, the cost of purchasing groceries, especially packaged foods, has climbed markedly during the past few years. We believe the products of these companies have approached levels from which additional price hikes will become increasingly difficult to capture. Furthermore, the table shows steady erosion in the number of units sold. Meanwhile, the valuation graph below suggests that these staple stocks are very expensive.



Source: Bloomberg

The above graph compares the yield on a U.S. 10-year bond (yellow line, left axis) against the EV:EBITDA (white line, right axis) and P:E ratio (red line, right axis) for the S&P 500 Consumer Staples sector. Note the valuation of this sector today (marked by the letter 'B') compared to 2009 when bond yields were at the same level they are today. The level of both valuation metrics is materially higher today, even though the previous table showed a marked deterioration in the fundamentals of these companies. It is this dynamic that explains the rationale for our put spread positioning on the XLP ETF.

As announced in our last commentary, each of our two funds 'listened to the market' and has taken action to increase the gross and net exposure during the past month. Our goal was to increase the opportunity set of the funds without a commensurate increase in the beta of either fund. The balance of 2023 will determine whether the current 'sanguinity' towards a 'soft landing' is justified or not. Unless the Fed buckles and cuts interest rates earlier in 2024 vs. later next year, as per the remarks made by Powell during his most recent press conference, we suspect this optimism may be misguided and a more dramatic outcome is the more likely scenario. Consequently, at roughly 20X forward earnings and rising bond yields, we encourage investors to not forget Warren Buffett's remark that it is wise for investors to be "fearful when others are greedy, and greedy when others are fearful".

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	Daniel Lloyd	Keenan Murray
CEO, CIO	Portfolio Manager	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 2023 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. **PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.** The information about the performance of the Funds is not, and should not be construed to be, an indication about the future performance of the Funds or any other portfolio advised by us. This information is presented solely for illustrative purposes and should not be construed as a forecast or projection. No assurance can be given that any portfolio advised by us will maintain similar performance as that depicted. 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.