FORGE FIRST
ASSET MANAGEMENT INC

April 8, 2021

March 2021 Commentary

It's not surprising that Q1 of 2021 was good for equities, the question is whether the optimal conditions that drove stocks higher will move from the front windshield to the rear-view mirror during the remainder of this year. Before we assess that probability, let's review the quarter that marked the anniversary of COVID-19.

In our year ahead market outlook, published in early January, we identified three reasons why stocks would move higher for the foreseeable future. First, interest rates would stay low enough so as to remain supportive of equities. Second, and no prizes awarded for this prediction, we presumed all drivers of stimulus would keep their feet on the gas pedal. Finally, the 'opening up' of the economy would cause the VIX index to decline, catalyzing investors to allocate more capital to equities.

Source: Bloomberg

	January	February	March	Q1
Cyclicals	7.8%	8.6%	3.7%	21.3%
Bond Proxies	1.7%	4.3%	3.6%	9.8%
Secular Growth	3.8%	4.8%	-1.9%	6.8%

Source: Jefferies & Co.

Evidence that our expectation cyclical and value stocks would outperform growth stocks was realized, can be seen from each of the above graph and table. Value beat growth by the widest margin since Q4 2000, although this trend was interrupted during the last couple of weeks due to the perceived impact on demand given Europe's most recent COVID-19 setback. In fact, mid-March witnessed an odd rotation within equity markets, apparently driven by the EU's lockdowns and the market's comfort with the new range for interest rates as 'defensive' equity sectors including staples, utilities surprised as outperformers.

This climate change for markets meant each of the two Forge First funds had a tougher back half than front half of March 2021 as the above-mentioned rotation left market averages intact, serving to eradicate the utility of hedges while offsets were generally not in the sectors in which our funds were net long.

	YTD	1 mo	3 mo	6 mo	1 year	Since Inception*
Forge First Long Short Alternative Fund Series A	5.25%	-0.03%	5.25%	15.84%	33.50%	24.52%
Forge First Long Short Alternative Fund Series F	5.47%	0.04%	5.47%	16.35%	34.70%	26.73%
Forge First Conservative Alternative Fund Series A	5.42%	0.70%	5.42%	15.94%	32.09%	24.12%
Forge First Conservative Alternative Fund Series F	5.66%	0.78%	5.66%	16.48%	33.22%	26.31%
TSX Total Return	8.05%	3.87%	8.05%	17.75%	44.25%	19.40%
S&P 500 Total Return (US$)	6.17%	4.38%	6.17%	19.07%	56.35%	40.38%

*****Inception: April 24, 2019

Having stated that fact, the Series F of our multi asset Conservative Alternative Fund ("Conservative") gained +0.78% after fees, boosting its year-to-date net return to +5.66% and its trailing 12-month net gain to +33.22%. March performance was driven by positive contributions from the capital growth and alternative strategy sleeves, while the asset protection sleeve was a net detractor.

Long-time holdings Canadian Pacific Railway Ltd. (CP.CA) and its announced takeover target Kansas City Southern (KSU.US), combined to enable the Industrials sector to be the largest contributor to performance in the capital growth sleeve of Conservative. We believe this merger will create substantial shareholder value as, going forward, this combination will offer the highest pro-forma compound rates of growth in each of revenue, earnings and free cash flow in the sector. Given the length of time until anticipated closing in mid-2022, markets have yet to reflect the benefits of this 'one-stop-shop' in the price of the shares of CP.

Gains in the alternative strategy bucket of Conservative were balanced between long positions in rate-reset preferred shares, corporate debt, convertible bonds, and a short position in long-dated government bonds. Fund exposures at the end of March, which stood at 114% gross and 52% net, included an approximate 20% net long allocation to bonds, preferreds and SPACs and a 32% delta-adjusted net long position to equities and listed options.

The Series F of our Long Short Alternative Fund ("Long Short") gained +0.04% after fees during the month, such that its year-to-date net return sits at +5.47% and its rolling 12-month net gain is 34.70%. As the fund continues to hold the cyclical, value positioning it eased into during early Q4 of 2020, the mid-month factor rotation trimmed its mid-month gains. Several names in the Consumer sector of the portfolio, many associated with the 'opening up' trade, suffered setbacks during the month, as did selected securities in each of the Materials and Energy sector.

For the month as a whole, similar to Conservative, the largest gains were in the Industrials sector with positive contributions also coming from Financials, specifically Onex Corporation (ONEX.CA) and Intact Financial Corp. (IFC.CA), and Real Estate, and to a lesser degree, Materials and Energy. The largest detractors in the month were ETFs and Utilities. Exposure-wise, Long Short exited the month of March with gross exposure of 127%, on par with the end of February; however, the net long position increased from 40% to 60%.

Looking ahead, we continue to expect equities to grind higher. Huge amounts of stimulus accompanying the re-opening of the economy imply easy financial conditions and explosive earnings growth during 2021. We've now entered the "eye" of that hurricane with the highest ever ISM Services print (please see graph below), validating the high single digit, even low double digit annualized real GDP rates of growth expected in the U.S. during the remainder of this year.

Source: Bloomberg

In turn, 2021 SPX earnings growth is expected to climb more than 40%, including all-time high quarterly profits in each of Q3 and Q4. Further, Q1 saw the largest inflows to equity funds on record and as you can see from the graph below, U.S. equity margin debt as a percent of the market capitalization of the S&P 500 is approaching the levels last seen ahead of the global financial crisis of 2008 and the tech bubble of 2000. Sure, markets are frothy yet in the past when frothiness led to significant corrections, yields on government bonds were markedly higher than equity yields and economic growth was visibly late cycle. While other signs such as rising market concentration and the 'new era' narrative of many developments in the tech sector are supportive of the 'bubble' scenario, our analysis suggests equities still have room to run.

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Source: Gavekal

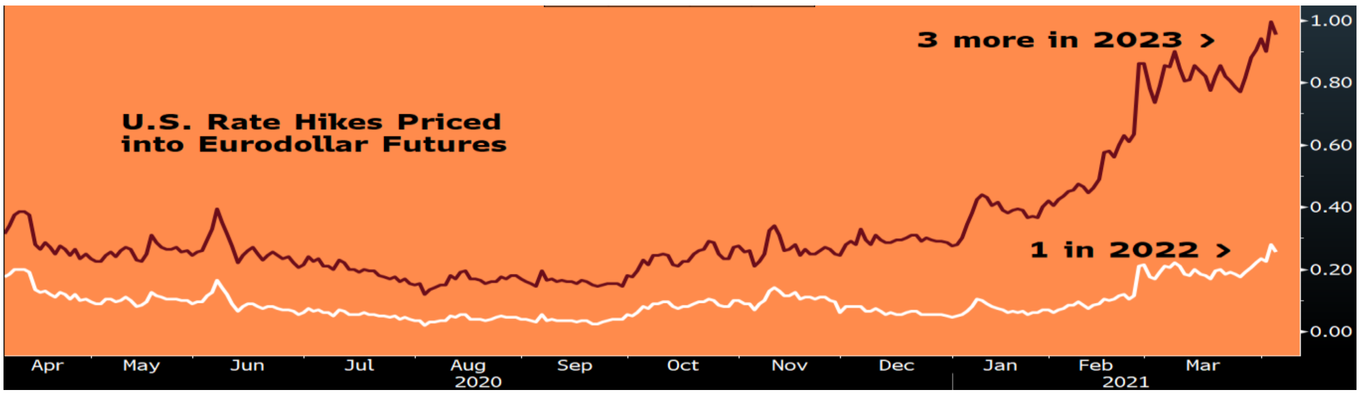
Beyond fundamental momentum, there remains a 'wall of cash' on the sidelines. Total institutional money market cash sits at US$3T, the highest since June 2020, with an additional US$1.5T in retail money market accounts. While our funds continue to own long-held growth stocks including Microsoft Corp. (MSFT.US), Alphabet Inc. (GOOG.US), and Visa Inc. (V.US) among others, our common equity positioning remains biased towards cyclical and value-oriented securities.

For our Long Short Fund, this positioning includes 'best in class' energy companies Canadian Natural Resources Ltd. (CNQ.CA), Tourmaline Oil Corp. (TOU.CA) and Parex Resources Inc. (PXT.CA), along with Freeport-McMoran (FCX.US) for copper and Stelco Holdings Inc. (STLC.CA) for steel. On oil, despite the recent pullback that has been driven by concerns over near-term demand, our analysis suggests the world remains short oil, the degree to which will increase markedly during H2 of this year, notwithstanding the decision of OPEC+ to increase supply during the next several months. With respect to Stelco, we increased our position early in 2021 because at that time, in our minds, the shares of Stelco reminded us of the situation with shares of Interfor Inc. (IFP.CA) last Fall. At that time, investors didn't believe that high lumber prices would persist. Of course, lumber markets have remained tight and we sold our holding in Interfor earlier this year at markedly higher prices.

Source: Bloomberg

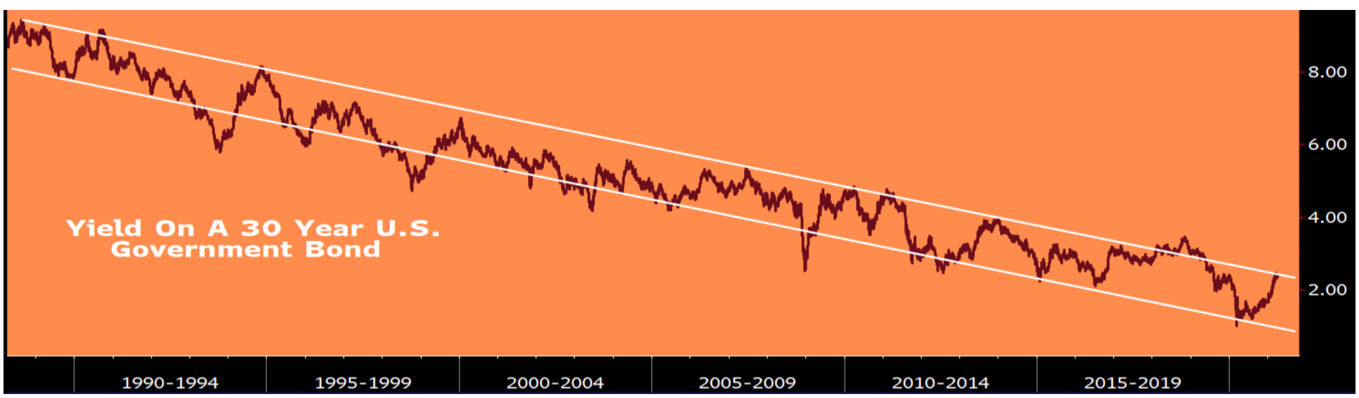
The 10-year graph above indicates that prices for HRC Steel are also at record highs, despite the semiconductor-driven disruption in the key auto market. In fact, our research suggests steel prices will remain comfortably above historic averages well into 2022. We estimate Stelco is currently generating pre-tax free cash flow of as much as C$1,000 per tonne.

In contrast, while our Conservative Fund holds positions in Stelco and the aforementioned energy companies, its cyclical bias is weighted more towards free cash flow generating, compound growth-oriented U.S. Industrials including API Group (APG.US) and IES Holdings (IESC.US). However, while the 'music is playing' and it's important to keep dancing, prudence suggests it is also imperative to consider what conditions could be 6-9 months later on this year. While we pick stocks at Forge First versus watch index levels, let's presume the S&P 500 reaches the consensus target of 4,350 during the next several months. At that level, its valuation would be 21.8X 2022 EPS or one multiple point higher if a portion of Biden's corporate tax hikes (such as Manchin's suggested 25%) impact next year's numbers. Not an outlandish valuation, but remember that the rates of economic and earnings growth will fade during H2 of 2022 while the graph below suggests the Fed will have started its rate-hiking cycle with one hike in 2022 and an additional three hikes during 2023.



Source: Bloomberg

It's the Fed that has brought us to this dance and it's the Fed that's likely to 'stop the music'. While Chair Powell keeps reiterating his intent to let the economy (and hence markets) 'run hot', history suggests that markets have a canny knack at forcing Central Bankers to take action. Also, while we expect trend inflation to revert from its expected 'hot levels' during the summertime of 2021, the 35-year graph below of 30-year bond yields certainly gives one pause for consideration.



Source: Bloomberg

And when it comes to managing other people's money, sticking to a discipline and being pragmatic are two rules that we are strict adherents to at Forge First. In turn, being pragmatic requires much thought and vigorous debate. Each of these items is a prerequisite to succeed at protecting client capital from market downdrafts, while still offering a competitive net return. It's hard work, but the team loves it. We thank you for your business and remind readers that our alternative mutual funds are rated as having medium risk and feature daily liquidity.

Thank you for the 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	Daniel Lloyd	Keenan Murray
President and CEO	Portfolio Manager	Portfolio Manager