FORGE FIRST
ASSET MANAGEMENT INC

April 12, 2022

March 2022 Commentary

Driven largely by an influx of systematic capital flows during the back half of the month and a belief the Omicron-related Q1 economic dip was transitory, equities had a strong March. Markets appeared to be unfazed by higher interest rates and inflation, with limited impact from the Ukrainian situation. Despite the continuing conservative positioning held by each of our two funds, the table below highlights that each fund generated a positive net return. While we can identify catalysts that could cause equities to move higher, the combination of rising rates and slowing economic growth causes our bias to remain towards protection. The Energy sector continues to offer the best opportunity for offence.

	YTD	1 mo	3 mo	6 mo	1 year	2 year*	Since Inception*
Forge First Long Short Alternative Fund Series A	5.05%	2.08%	5.05%	4.30%	11.01%	21.74%	11.39%
Forge First Long Short Alternative Fund Series F	5.27%	2.15%	5.27%	4.74%	11.97%	22.81%	12.37%
Forge First Conservative Alternative Fund Series A	1.38%	0.32%	1.38%	0.04%	3.96%	17.18%	8.87%
Forge First Conservative Alternative Fund Series F	1.61%	0.39%	1.61%	0.49%	4.92%	18.22%	9.84%
TSX Total Return	3.82%	3.96%	3.82%	10.54%	20.19%	31.67%	12.79%
S&P 500 Total Return (US$)	-4.60%	3.71%	-4.60%	5.92%	15.65%	34.47%	17.53%

*Annualized | Inception date: April 24, 2019

The Series F of the Forge First Long Short Alternative Fund gained +2.15% net of fees during March, boosting its year-to-date post-fee return to +5.27%. The Materials sector was a major source of gains, led by holdings in the Agricultural sector, specifically Nutrien Ltd. (NTR.CA). Given the substantive move higher shares in this leading fertilizer company have enjoyed, it's important to add that we have been diligent in rolling up the strike price on listed put options held by the funds, to protect the position. Other significant wins were generated by Agnico-Eagle Minds Ltd. (AEM.CA), Royal Gold Inc. (RGLD.US) and Major Drilling Group International Inc. (MDI.CA).

Once again, Energy and Technology also made positive contributions to the performance of the fund, led by Tourmaline Oil Corp. (TOU.CA) and Canadian Natural Resources Ltd. (CNQ.CA). Within Tech, our position in cyber security operator, Crowdstrike Holdings Inc. (CRWD.US), was the largest positive contributor. Besides a modest loss from Real Estate hedges or protection, both listed put options and ETFs were the other and largest losing sector. The Long Short Alternative Fund exited March with delta-adjusted gross and net exposure of 129% and 31% respectively.

The Series F of our lower volatility, multi-asset Forge First Conservative Alternative Fund gained +0.39% net during the month, fuelled by gains in the capital growth and alternative strategies sleeves of the portfolio, and losses in asset protection. Industrials, Utilities and Energy drove the gains in the capital growth or common equity sleeve of this fund. The alternative strategy portion of this portfolio benefited from both convertible and straight bonds, including a short position in government bonds. Losses in the asset protection sleeve arose from increased equity index ETF short exposure and increased equity hedges on long positions. This fund exited March with delta-adjusted gross and net exposure of 125% and 9% respectively. The 9% net long exposure was split between equities (+3%) and alternative strategies (+6%).

We're not enamoured by the forward risk/reward opportunity in equity markets. While it is likely that Q2 will mark the peak in hawkishness by the Fed and inflation statistics, perhaps catalyzing a trading rally at >20X 2022 EPS, we don't view the S&P 500 as attractive. Q1 earnings season, which starts this week, will be very telling. Excluding significant positive revisions in the Energy sector, year-over-year earnings are expected to be flat with the first signs of margin pressure. We will be listening to management commentary on demand, margins and supply chain issues. It's true that tight labour markets should enable the consumer to keep spending money, but as we move into H2 of 2022, we expect the cumulative impact of rising mortgage rates, food prices, gasoline and rent will begin to take a bite out of the consumer. The graph below highlights the variables that are increasingly pressuring the U.S. consumer.

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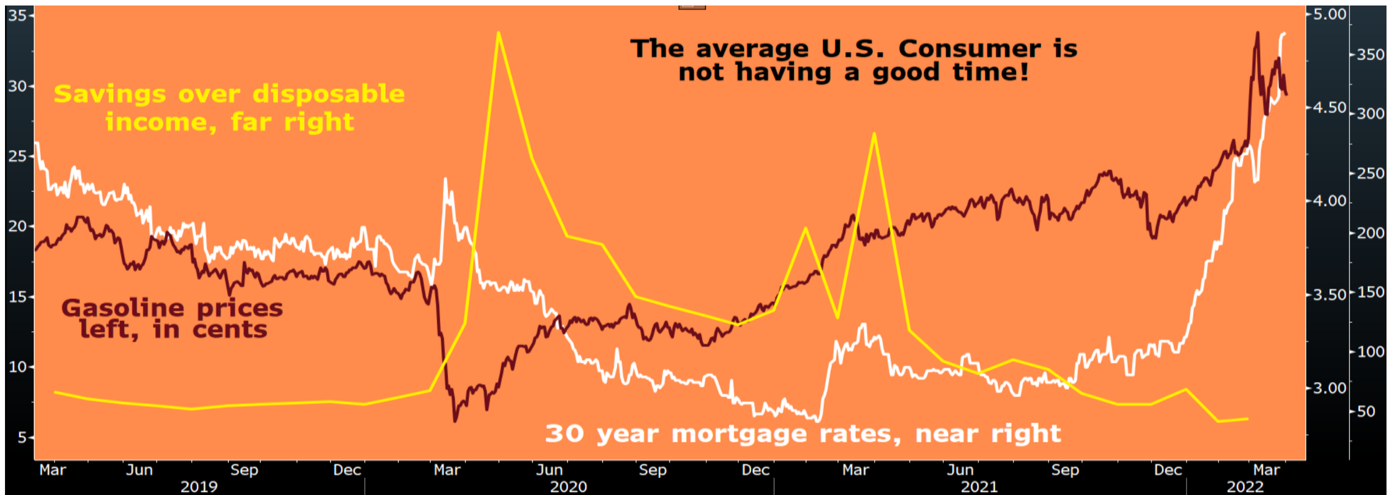

Source: Bloomberg

Shifting to manufacturing, last week's ISM data was very disappointing. Sure, we're likely to see a post-Omicron bounce, but the trends seen in the graph below are troubling. The headline index fell 1.5 points month over month to 57.1, the lowest print since September 2020, while new orders (white line, right axis) witnessed the steepest decline since April 2020, falling 7.9 points from the previous month, to 53.8. In contrast, prices paid (red line, left axis) exhibited a huge month-over-month gain. History suggests that high oil prices and rising interest rates will cause a further fall in the ISM manufacturing index.

Source Bloomberg

As for interest rates, we're not overly fussed by the extent of the yield curve inversion to date, given the outsized impact on long-term interest rates of years of quantitative easing. However, we do note from the graph directly below that rarely has the market viewed the Fed as being as far behind the tightening curve as the Fed is at this point in time. The white line on the 25-year graph illustrates the yield spread between a 10-year bond and a 90-day note. The red line being the well known 10 minus 2-year curve. The uncommon and exaggerated spread on the far right of the graph implies markets view the Fed as being way behind the curve. That's why Fed members, even uber-dove Brainard, have been as hawkish as they've been of late, trying to placate markets that all will be okay.

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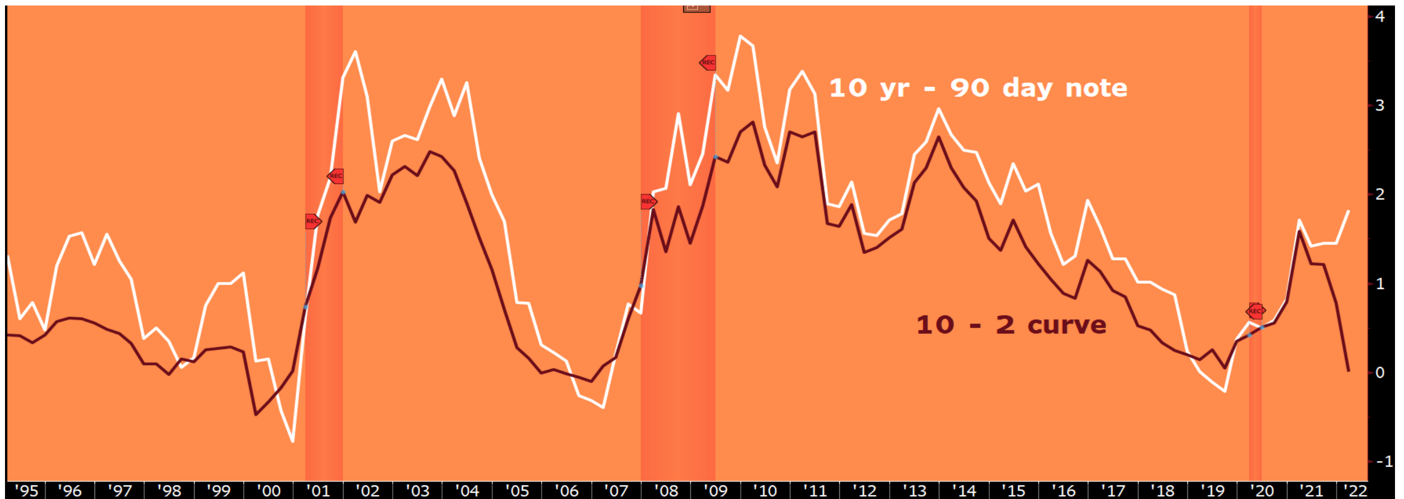
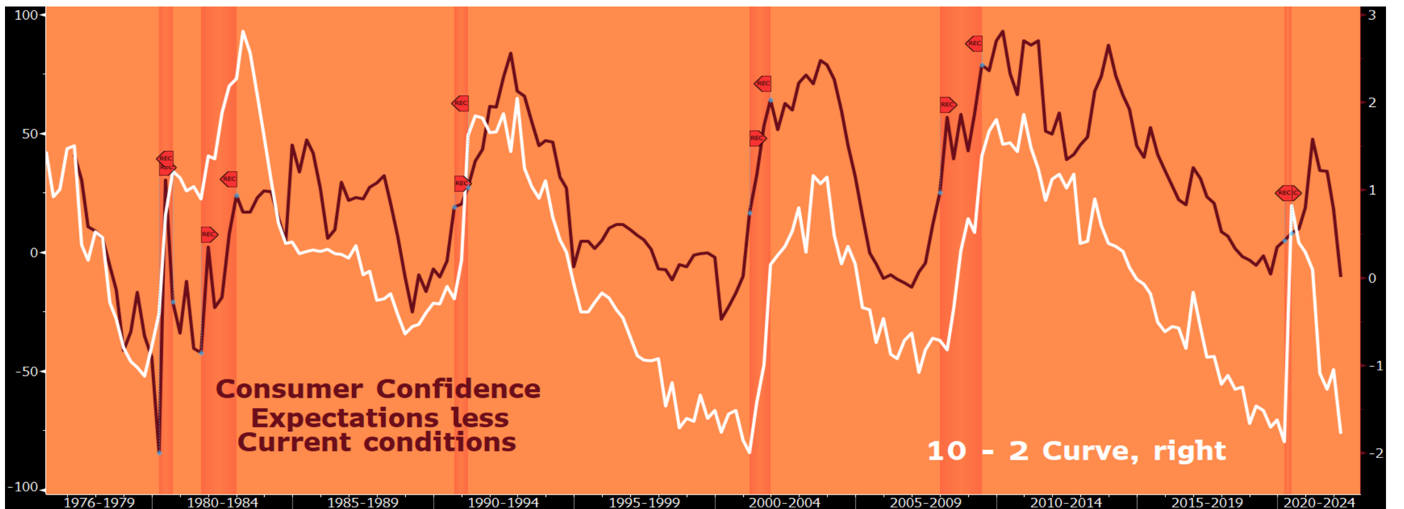


Source: Bloomberg

The problem for the Fed is twofold. First, it doesn't know if commodity markets and supply chain issues will enable prices to revert to reasonable levels before uncomfortable levels of inflation get engrained in the minds of consumers. Second, while Fed members speak optimistically about the U.S. economy, we suspect they're well aware of the downside risks. China's economy is slowing markedly and, facing food, energy and immigration crises, the E.U. is poised to enter another recession. Hence, the Fed is likely to aggressively raise rates so as to have room to cut rates in case the economy falls into a recession. The almost 50-year graph below suggests consumer confidence (red line, left axis) is likely to keep falling.



Source: Bloomberg

Clearly, a resolution of the war in Ukraine would be a huge help to the Fed, as commodity prices would fall, plus it is possible sanctions could be lifted; both factors serving to take pressure off the Fed. However, even if that were to happen, we think commodity prices will generally remain higher than most investors expect, especially oil and natural gas.

We believe Russia's invasion of Ukraine merely hastened an inevitable energy shortage catalyzed by years of underinvestment. For the first time since the 1970s, this spike in oil prices has been induced by supply shortages, not rising demand; something monetary policy can't fix. Hence, while it may seem counterintuitive to own a traditionally cyclical asset class such as commodities into a looming recession, we believe stubborn inflation and the aforementioned underinvestment enable commodities to be an ideal hedge against stagflation.

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In addition to cyclicals, Energy and Materials (gold and agriculture), our funds continue to own long-held "GARP" type stocks including Alphabet Inc. (GOOG.US), Microsoft Corp. (MSFT.US) and Enviva Inc. (EVA.US), while being short hyper-expensive companies including Wayfair Inc. (W.US), the ARK Innovation ETF (ARKK.US) and several companies in the U.S. discretionary consumer and homebuilding sectors.

Source: Bloomberg

As you can see from the far right of the above graph, the rally during the 2nd half of March was driven by secular growth stocks over value (white line) and defensive stocks over cyclical (yellow line) securities, concurrent with a decline in breakeven yields (red line, left axis) and tape action that implies a dour outlook for economic growth.

According to Goldman Sachs, under a recession scenario the S&P 500 could fall to 3,600, or 20% below recent levels. This downside target is predicated on earnings falling 15%, a downturn of average proportion. If the economy doesn't succumb to a recession, we believe rates will rise to levels that will enable GICs to attract investor capital from equities. But for now, the capital losses investors have experienced in bonds undermine their 'risk-free' characteristic. During March, bond prices suffered their worst decline in more than 40 years. Further, stagflation increases the risk of a 'lost decade' for 60/40 portfolios, i.e., a prolonged period of poor real returns. Little diversification benefit and lower real returns from bonds point to higher equity/lower bond allocations compared with the last cycle. Given its running annualized volatility of ~4% and competitive net returns (please see table on page 1) we'd suggest our Conservative Alternative Fund merits consideration as a replacement for bonds; and remember, there's a 'Series T' version that pays a 2.5% annualized, quarterly-paid yield.

On the last page of our [February 2022 Commentary](), we tabled four possible outlook scenarios for the market. Aside from an end to the war in Ukraine, something we're not going to predict, we stick by those scenarios and their probabilities with one adjustment. Post-March, we believe the probability of scenario #4, an outcome that sees the Fed pivot, halting further rate hikes during H2 of 2022 regardless of what's going on with inflation, has risen.

Regardless of what happens with markets, the year-to-date stability and net performance of our funds speaks for itself. The investment team at Forge First is adept at short selling and using listed options for both defence and offence. At the same time, our free cash flow, large cap, high quality focused style of North American investing has stood the test of time.

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
President and CEO	Portfolio Manager	Portfolio Manager

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