FORGEFIRST
ASSET MANAGEMENT INC

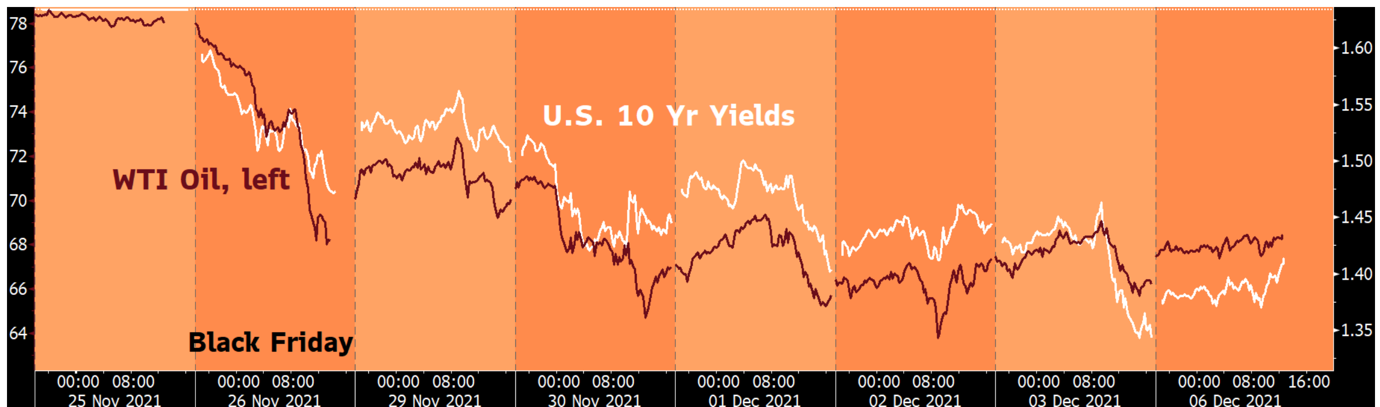
December 8, 2021

November 2021 Commentary

Usually it's March, but this year, thanks to Fed Chair Powell and Omicron, it was November that came in like a lamb and went out like a lion. Powell's 'broken record' denial that inflation could become problematic, combined with the Fed's ongoing printing of money, U.S. M2, up +37% since February 2020, a further +13% year-over-year in October, kept investors dancing into the 3rd week of November. As shown by the one-year indexed graph below, the big winners during this latest leg of the rally were the 'macro cap' tech stocks (white line). In fact, at the November peak in the S&P 500, the six stocks highlighted below accounted for 26.4% of the SPX and 50.7% of the NASDAQ-100.

Source: Bloomberg

Then a one-two punch hit the markets! On November 26th a.k.a. 'Black Friday', news of a new COVID variant, Omicron, made headlines, causing fear as its mutations changed a staggering 35 amino acids, with 10 of the mutations previously unseen in other variants. The following Tuesday, November 30th, Fed Chair Powell "threw in the towel" (swept it under the rug is a more apt description) on the Fed's view that the recent rise in inflation was merely transient. The results were either interesting or painful, depending upon your positioning. For example, one might be excused if surprised that Powell's admission caused bond yields to decline not rise, but the eight-day intra-day graph below suggests the decline in oil prices was the key reason driving the fall in yields. This view is backed up by the fact real yields or TIPs have trended flat during this time frame, while breakeven yields accounted for the full decline in headline yields.



Source: Bloomberg

While we didn't predict the plunge in oil, we have assumed that tightening monetary policy would inevitably be most damaging to speculative 'bubbles' in unprofitable stocks and other speculative securities. The white line in the graph at the top of the next page illustrates the relative strength of mega cap tech stocks to a basket of unprofitable tech stocks, while the red line represents the cumulative interest rate hikes through the end of 2023 in basis points that are priced into Fed Futures. It is, of course, no surprise to anyone that the biggest pain was seen in the price of companies euphemistically

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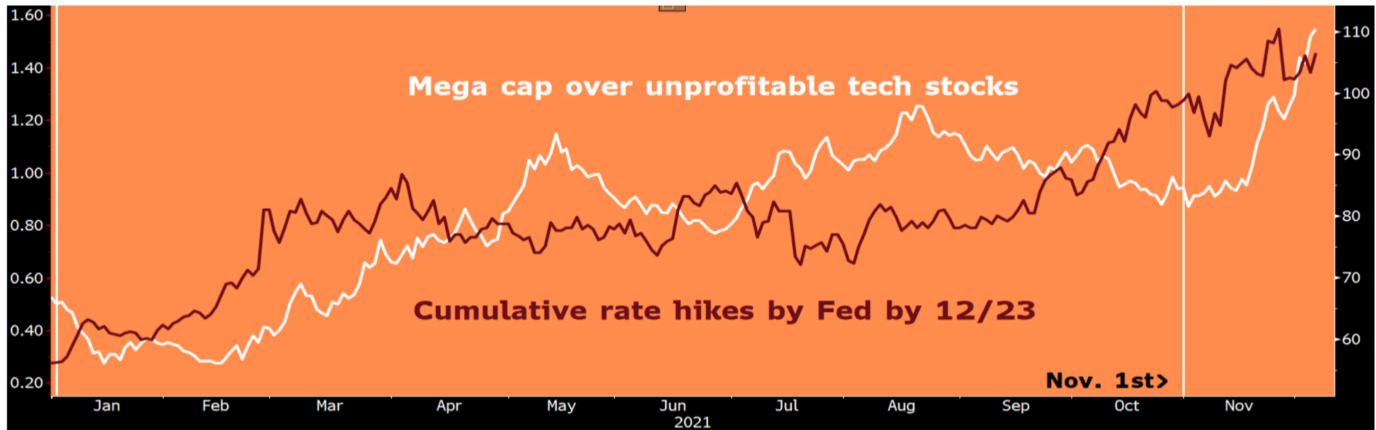
referred to featuring the longest duration profile of earnings. Note how their underperformance accelerated during November.



Source: Bloomberg

Overall for the month of November, the price of bonds rose, commodities and stocks fell and each of our funds suffered mild losses. Similar to markets, November was a month of two tales for our funds. We entered November with a defensive posture, holding hedges on our major holdings, including positions in the Technology and Energy sectors. With many of the tech stocks performing strongly during the first part of the month, these hedges acted as a drag on performance. Subsequently, during the latter part of the month, the cyclicals in our portfolios, including energy stocks, suffered losses, while those same hedges on our tech book served to soften the impact of the declines.

With respect to Energy, early in the month, we had reduced the net exposure of the fund to both oil and gas producers given our belief that the upside/downside risk of oil at US$85 and natural gas at US$6 was negatively skewed. While we did maintain a net long position in Energy, we were able to structure this exposure such that Energy delivered a positive contribution of 18 basis points to performance despite energy indices on both sides of the border declining almost 6%. Similarly in our tech book, put option protection on several stocks buffered the declines in long-held positions including Meta Platforms, Inc. (FB.US), Microsoft Corp. (MSFT.US) and Visa Inc. (V.US). Similarly, our listed put position in the Ark Innovation ETF (ARKK.US) offset some of the losses in the remainder of our tech book. In aggregate, our tech book lost 15 basis points during the month. In a review of other sectors, Utilities made a positive contribution, while securities in the Industrials and Materials sectors cost the fund money.

Overall, while our short book generated gains of 150 gross basis points, this contribution was dwarfed by 221 gross basis points of losses from the long positions in the fund. As a result, the Series F of our Long Short Alternative Fund declined -0.63% net last month, cutting its full year-to-date net return to +12.88%. The fund exited November with gross and net exposures of 121% and 30%, respectively.

	YTD	1 mo	3 mo	6 mo	1 year	2 year*	Since Inception*
Forge First Long Short Alternative Fund Series A	11.99%	-0.70%	1.27%	1.46%	15.00%	15.08%	11.13%
Forge First Long Short Alternative Fund Series F	12.88%	-0.63%	1.49%	1.90%	16.00%	16.14%	12.11%
Forge First Conservative Alternative Fund Series A	9.10%	-0.86%	0.62%	1.59%	13.05%	13.49%	9.85%
Forge First Conservative Alternative Fund Series F	10.03%	-0.78%	0.85%	2.06%	14.09%	14.52%	10.82%
TSX Total Return	21.38%	-1.62%	1.01%	6.06%	23.47%	13.47%	11.64%
S&P 500 Total Return (US$)	23.18%	-0.69%	1.32%	9.38%	27.92%	22.58%	20.07%

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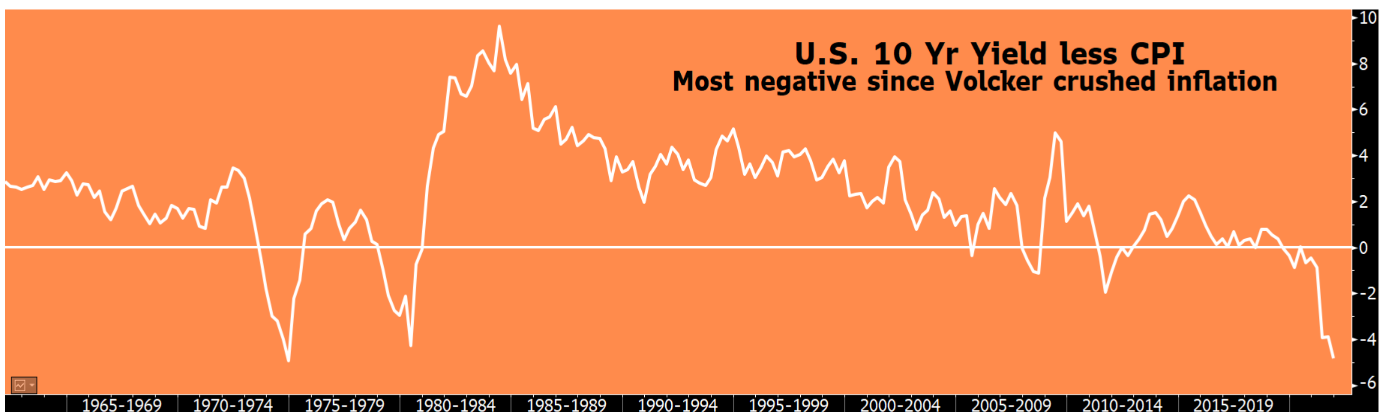
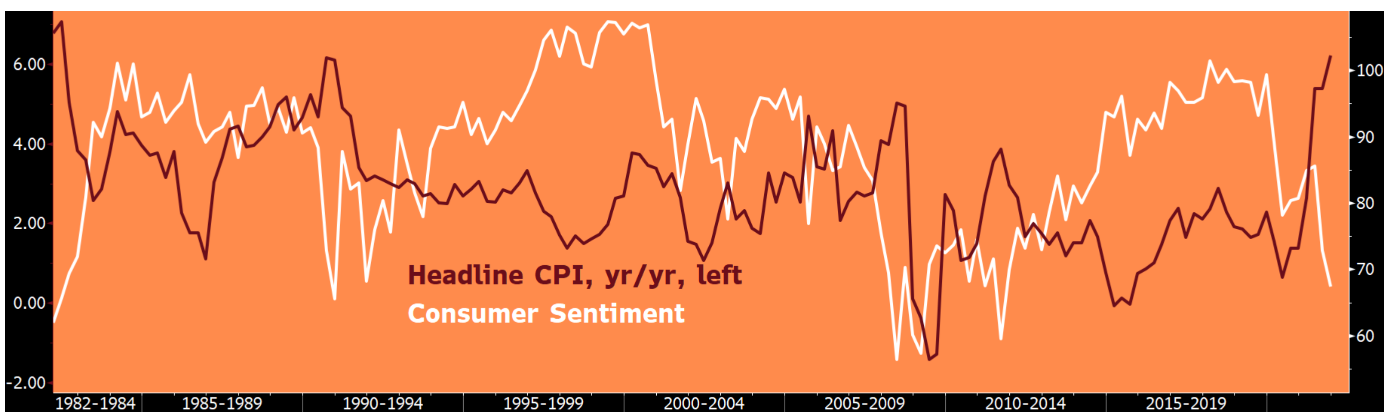
The Series F of our multi-asset Conservative Alternative Fund declined -0.78% for the month of November, reducing its year-to-date net gain to +10.03%. Declines in the capital growth sleeve of the fund were only partially offset by gains in each of the asset protection and multi-asset sleeves. Within the capital growth portion of the portfolio, the largest declines were experienced from positions in Industrials, Real Estate and the Consumer sectors. Positions in Financials and Utilities provided some offset. This fund ended the month with gross and net exposures of 123% and 19%, respectively.

In assessing the near-term outlook for markets, a few comments merit consideration. One key question is whether the factor and style volatility will continue to the degree they exhibited during November. For example, the Russell 2000 index, a broad index of small and mid-cap U.S. stocks that tends to be correlated with the value and cyclical factors, rose more than 6% during the first half of November, before declining 10% peak-to-trough by the end of the month. Two important determinants to this answer will be the outlook for inflation and Omicron.



Source: Bloomberg

As shown by the 60-year graph above, real yields have not been this negative since Paul Volcker crushed inflation in 1980. With President Biden poised to announce three additional appointments to the Fed's seven-seat board, a key question will be whether the reconstituted FOMC will have the gumption to 'giddy up' if inflation refuses to fade. We all know that supply chain challenges continue to pressure the prices paid for manufacturing inputs and transportation. More recently, we've seen signs of accelerating wage growth in labour contracts. Finally, it's probable that continuing hot home prices (on both sides of the border) will ensure that the housing/rental costs in both CPI and PCE inflation metrics will stay uncomfortably high for at least several more months.



Source: Bloomberg

As can be seen from the above 40-year graph, rising headline CPI (red line) is not good for consumer sentiment (white line) and we all know it is not possible to overstate the importance of the U.S. consumer to the American economy (16% of global GDP!). For example, while sales for the start of this year's U.S. holiday shopping season were still down 28% from the comparable levels of 2019, sales were up 48% from the levels of 2020.

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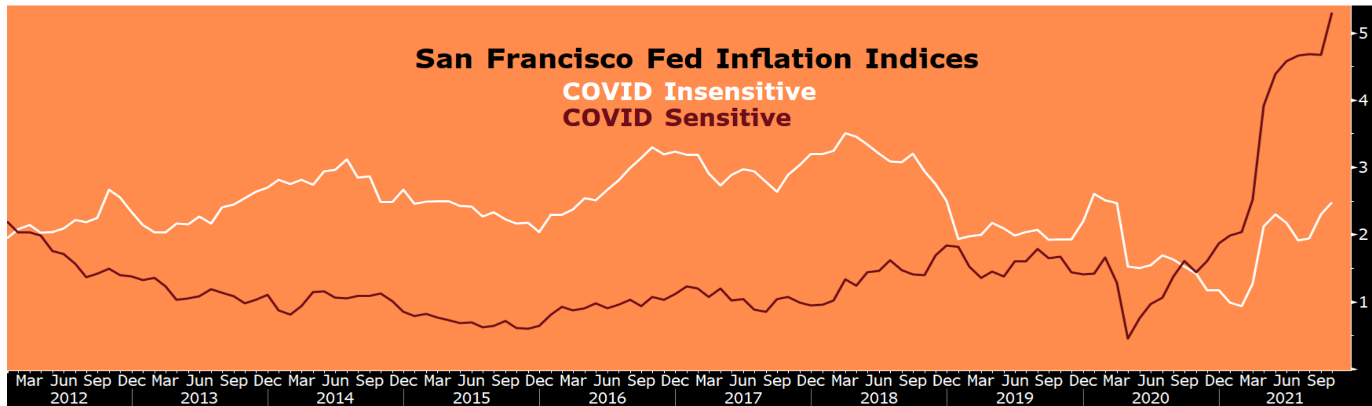
While the markets appear to be more concerned about inflation than COVID, even Omicron, it is too early to be confident towards Omicron or the ability of our various communities from making it through winter without a resurgence in case counts. mRNA vaccine manufacturers have spoken optimistically towards the speed with which something specific to Omicron can be integrated into their vaccines. Unfortunately, the time taken to change production procedures would make it unlikely that substantial quantities of an Omicron-targeting vaccine could be produced before the middle of 2022. However, on the positive side of the ledger, according to The Economist, it is estimated that 97% of Omicron sequences are identical to the original virus found in Wuhan which suggests existing vaccines should enable T-cells to preserve 93%-97% of their targeting capacity when faced with the new variant.



Source: Bloomberg

Putting COVID and inflation together, the 10-year graph above from the San Francisco Fed tracks inflation for COVID-sensitive (red line) and insensitive (white line) indices. The spike in the COVID-sensitive index is supportive of the inflation being along the lines of the word that Powell erased from his dictionary late last month.

For the near-term, our funds will maintain their conservative positioning, given the twin risks of the Fed and COVID and of course, stick to our discipline of owning shares in companies that generate lots of free cash, are reasonably priced relative to their respective rates of growth, and are complemented with shorts and listed put options to hedge single stock and broad market risk.

Thank you for your business and interest in our funds. The team at Forge First hopes that you and your loved ones share a healthy and happy holiday season. 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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