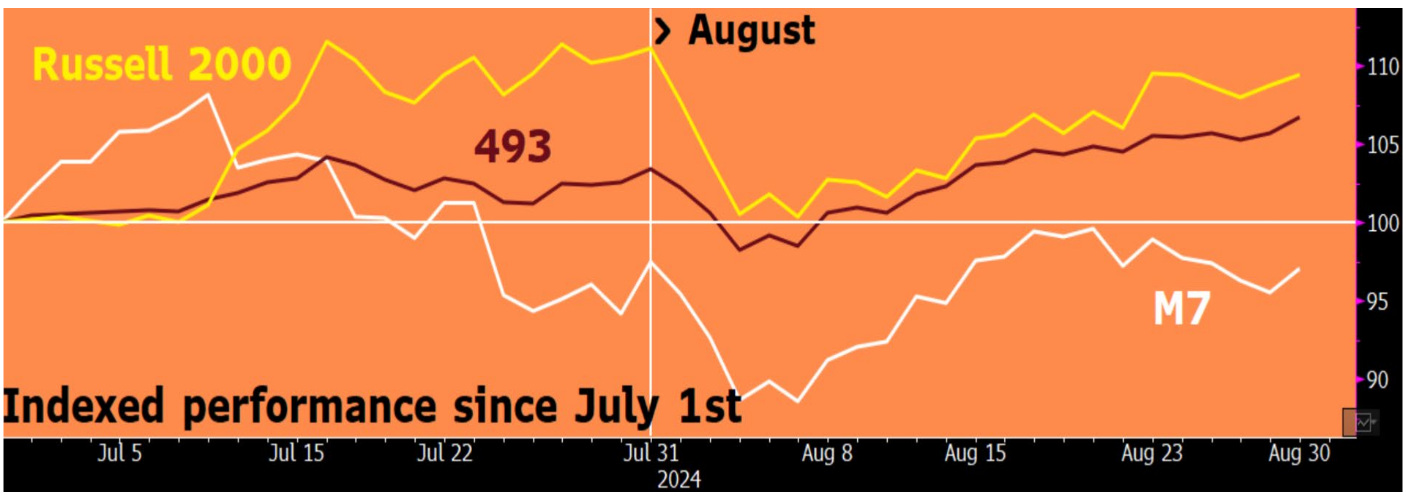
September 10, 2024

August 2024 Commentary

While several variables drove markets down then up during August, the seminal event was the more dovish than expected interest rate guidance provided by Fed Chair Powell at Jackson Hole (JH) on August 23rd. Making it clear the Fed intends to initiate rate cuts on September 18th, Powell enunciated the FOMC is now focused on the employment side of their dual mandate. His language implied the Fed will now be proactive in its attempt to prevent further weakness in the labour market. This was an important pivot in the Fed's messaging and directionally supportive of a soft-landing economic environment.

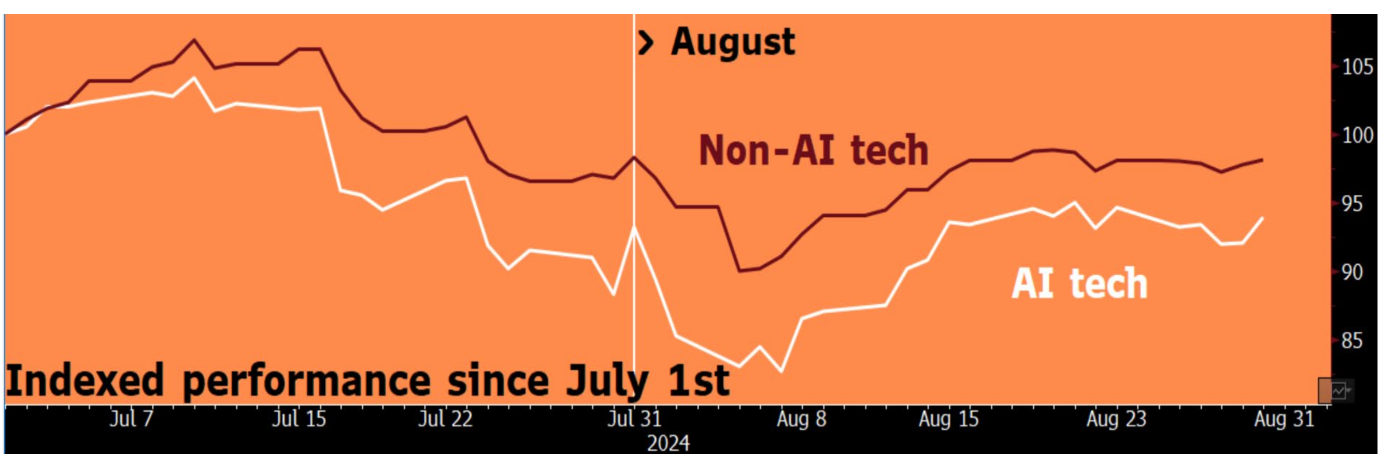
Equities rejoiced, no longer fretting that July's weaker than expected employment report was predictive of a recession, as investors became convinced the Fed would acquiesce to the timely delivery of the multiple rate cuts markets have long presumed would occur by the end of 2024.

At the start of August, the jobs data had caused U.S. 2-year yields to plunge from 4.39% to 3.65% by the mid-point of the 3rd trading day of the month while the S&P 500 had declined -6.08%. As pundits explained why they expect jobs data to bounce back to a greater than 150,000 a month net add rate with August's data, dispelling fears of a recession, yields shifted higher, and stocks began to recover from their plunge at the beginning of the month. Then Powell stepped up at JH enabling the S&P 500 to motor up +8.91% off the beginning of the month bottom, including a greater than 1% climb during the last ten minutes of trading for the month. While the trip was bumpy, August was a good month for both stocks and bonds. Our funds delivered a mixed performance with our Long Short LP making money while our Multi Strategy LP lost money.



Source: Bloomberg

While all equities ended up having a solid month, nascent shifts in factor rotation continued during August. The above graph, indexed as of July 1st, indicates that post the start of the month downdraft, the Russell 2000 (proxy for small cap stocks, yellow line) delivered steadier and better performance than the M7 (white line) or even the S&P 493 (red line). Further, and using the same timeframe as the first graph, within the Technology sector, the next graph suggests that 'non-AI' tech (red line) has outperformed the 'AI' tech space (white line) as of late. This explains why the current $64,000 question among investors is whether the reaction by the market to NVIDIA Corp's latest quarterly results marks a true regime shift or it's just a pause.



Source: Bloomberg

While NVIDIA Corp's 122% year-over-year revenue growth sounds amazing, that rate of growth was less than half the 262% year-over-year growth reported for the prior quarter. Also, forward quarters are expected to merely report 'double digit' year-over-year gains in sales. Hence, the 'law of large numbers' could be catching up to the poster child company for AI-mania. That's undoubtedly what is driving a large degree of the current rotation within equity markets, along with the historical evidence that rate cutting cycles typically generate a new round of equity market leadership.

As for our funds, the Class F Lead Series of our Long Short LP posted a net gain of +0.53% for August, boosting its year-to-date net return to +10.68%. Winning sectors included Financials, Technology, Real Estate, and market hedges while Consumer Cyclical and Industrials were the source of the majority of losses. Within Financials, iA Financial Corp. (IAG.CA), Element Fleet Management Corp. (EFN.CA), and Cboe Global Markets, Inc. (CBOE.US) were the largest contributors to the performance within this sector. The fund continues to own the two former holdings but has exited the latter position.

Further within Financials, the fund has initiated short positions in several North American P&C Insurance companies based on the belief extreme events will cause Q3 results to be especially challenging. Market hedges also contributed positively during the month as the structure of our Russell 2000 index hedges made money despite the increase in the Russell 2000 and this exposure outperformed other market hedges we had on the books. On the losing side of the ledger, shares in Pet Valu Holdings Ltd. (PET.CA) fell on a toughening consumer outlook here in Canada while several positions in our Industrials sleeve each suffered minor leaks in their share prices. The fund exited August with delta-adjusted gross and net exposure of 126% and 34% respectively.

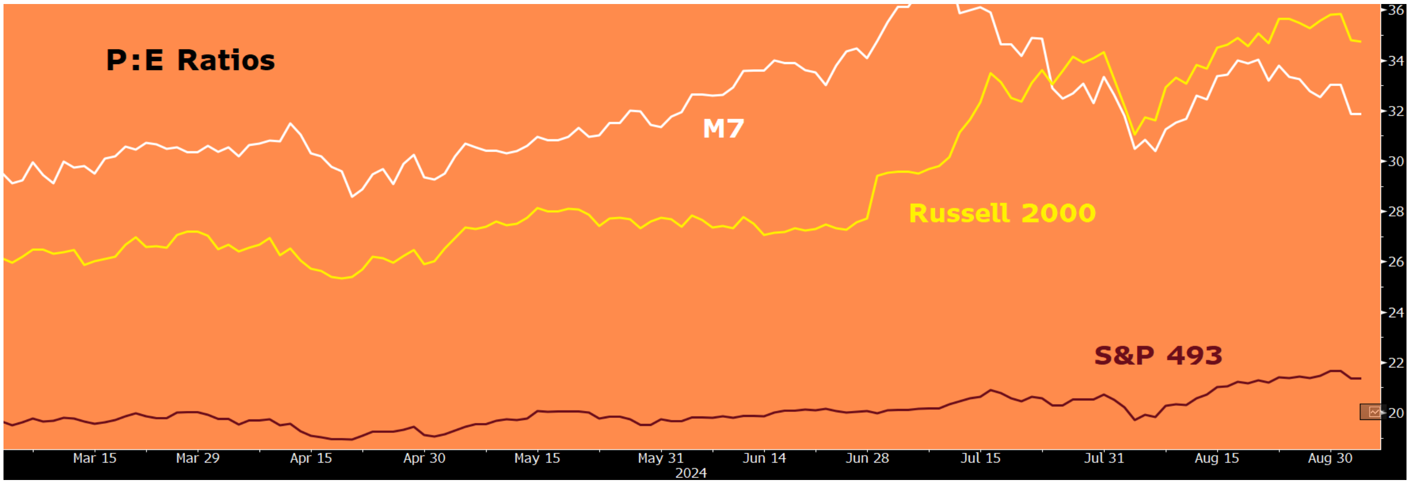
						-----------------Annualized-----------------			
As of August 31, 2024	**YTD**	**1-mo**	**3-mo**	**6-mo**	**1-year**	**3-year**	**5-year**	**10-year**	**Inception**
Forge First Long Short LP (Class F Lead Series)	10.68%	0.53%	6.15%	8.16%	16.41%	5.15%	10.60%	9.08%	13.27%
Forge First Multi Strategy LP (Class F Lead Series)	9.08%	-4.24%	3.86%	5.95%	14.00%	5.70%	9.91%	7.57%	10.61%
S&P/TSX Composite Total Return Index	13.65%	1.22%	5.65%	11.01%	18.77%	7.58%	10.63%	7.32%	9.18%
S&P 500 Total Return Index (C$)	22.20%	0.16%	6.28%	10.97%	26.72%	11.85%	16.27%	15.46%	17.39%

Note: Returns for the Forge First funds are based on the August 2012 Class F Lead Series and are net of all fees and expenses. In a year, up to 12 series can be created within a Class of units. Unitholders are advised to refer to their monthly statement for the net return of their respective Class and Series. All returns are in local currencies.

The Class F Lead Series of our Multi Strategy LP declined in value by -4.24% such that its year-to-date net performance fell to +9.08%. This decline was largely attributable to three factors. First, cognizant of how rich the valuation of the semiconductor stocks had become amidst the AI-euphoria, an item we flagged in last month's commentary, and concerned about an accelerated deleveraging event post the 3-day plunge in markets at the start of August, we opted to cover the lower strike on a one-by-two put spread. Such an action would have further improved the profitability of that trade had the chip stocks continued to decline. Lo and behold they proceeded to more than fully retrace their roughly 20% rapid decline over the next ten trading days. Second, core holding Lumine Group Inc. (LMN.CA) fell on what was deemed to be weak quarterly results. We remain very constructive on the outlook for this software consolidator. Finally, while our multi-security U.S. housing trade has been a solid contributor to the fund this year, it definitely wasn't last month. On the other side of the ledger, Financials and Utilities delivered solid contributions.

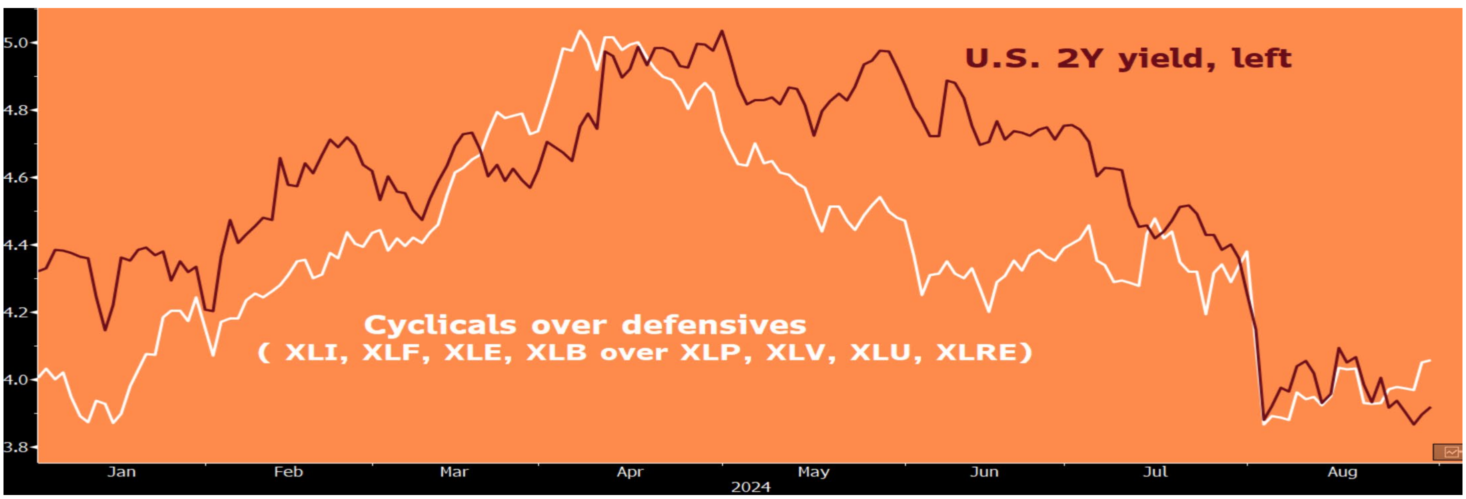
The fund exited August with delta-adjusted gross and net exposure of 198% and 74%, respectively. This net equity exposure is split between fixed income securities (+30% net long) and common equities (+44%). In the near term, we expect to modestly increase our net length to credit, including a modest extension of duration, and will maintain a now reduced net equity exposure.

While there are many solid, liquid North American securities trading at very undemanding valuations overall, at 23X forward EPS, the S&P 500 is not cheap while the graph below confirms the S&P 493 (red line) is trading at >21X and >35X for the Russell 2000 (yellow line). In addition, while there's no recession pending in the U.S., there's little question the economy is slowing, a fact that presumably will have an impact on earnings, as will the decline in interest rates. Remember net interest expense as a percent of sales actually declined for all but small cap stocks during the period of high interest rates as Corporate America had raised money on the cheap (2020 through 2022) and invested those dollars in higher yielding government debt. Finally, it is prudent to note the magnitude of the cash Warren Buffett is continuing to raise, while shifting to Washington we believe the U.S. Presidential election, which is just two months away, represents a risk for markets (tonight's debate should be interesting!).



Source: Bloomberg

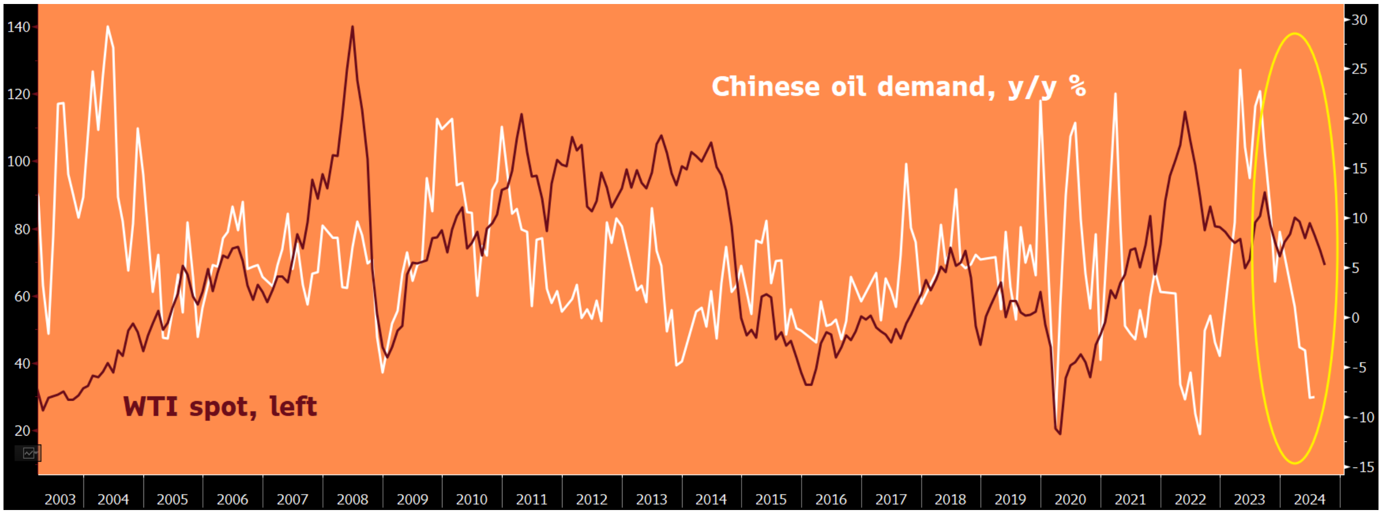
Parts of the American economy are soft, including housing, manufacturing and (low and middle income) retail spending, while government spending, defense, high-end retail and capital spending (for AI) remain relative healthy. While the labour market is slowing, it remains okay for now. Yet from here, further softening should be expected to drag wage growth and consumer spending with it, since the 2.9% savings rate is at its lowest level in 17 years and corporate bankruptcies, up 40% year-over-year, sit at a 12-year high.



Source: Bloomberg

The previous paragraph likely explains why stocks considered to be 'defensive' (Consumer Staples, Healthcare, Utilities, and Real Estate) have materially outperformed 'cyclicals' during the past 3 to 4 months. Note in the above graph how this relative strength (white line) has been highly correlated with the decline in the yields of U.S. 2-year government bonds.

While the U.S. economy is slowing, the Chinese economy is completely stuck in the mud. Hence, it's tough to be optimistic on the outlook for resources. Despite all the talk out of OPEC, given near record oil production in the U.S. and the year-over-year decline in oil demand in China (white line, right axis) shown in the following graph, it's tough to envision oil being anything but rangebound for the foreseeable future.



Source: Bloomberg

Amidst all the ‘noise’ impacting markets, our team will remain focused on continuing to generate a competitive net return and, perhaps more importantly during the historically tough Fall, protect your hard-earned dollars when markets get rockier. Thank you for your business and please don’t hesitate to reach out if you have questions.

Andrew McCreath	Keenan Murray	Richard Roth
CEO	CIO, Portfolio Manager	Associate Portfolio Manager