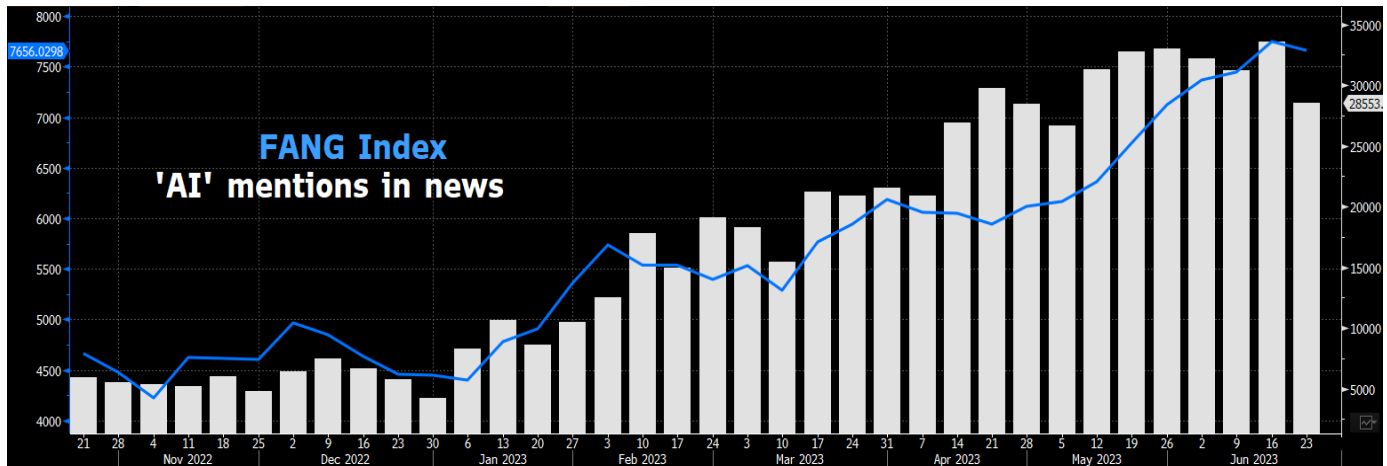


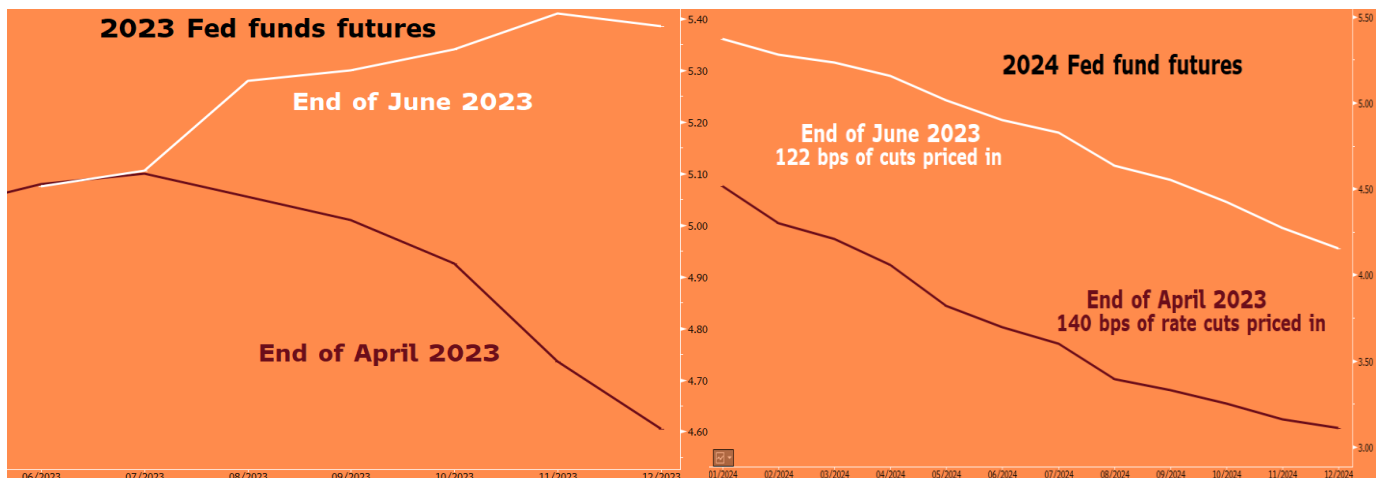
June 2023 Commentary

The 493 'other' stocks in the S&P 500 gained +3.7% during the first half of 2023, a gain that if predicted six months ago, would have seemed reasonable given the mix of macro variables at the start of January. Instead, the S&P 500 (SPX) generated a total return of +16.9%, fuelled by the 70% expansion in the P:E multiple accorded those other '7 macro cap tech' stocks, with the first US\$2T market company, Apple Inc., accounting for ~20% of the total gain in the index. Pundits attribute much of the recent five-week ramp in equities to investors' thirst to be invested when the Fed is done hiking rates and the excitement radiating from artificial intelligence ("AI").



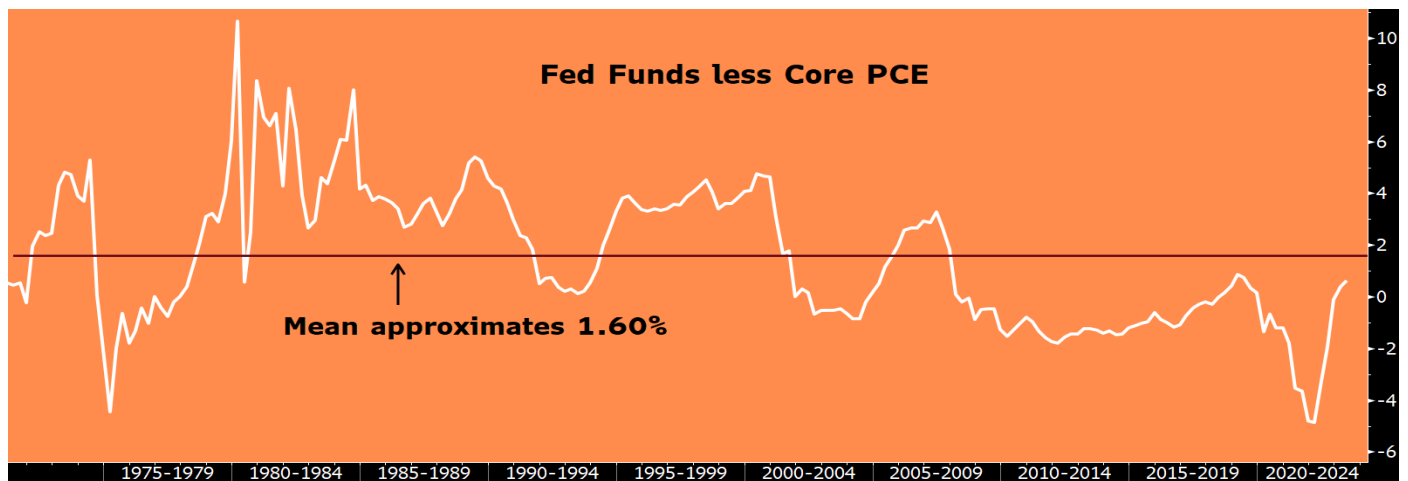
Source: Bloomberg

Investor anticipation towards the potential productivity benefits emanating from the use of AI is palpable as validated by the correlation evident in the above graph between the frequency of 'AI mentions' in news items and the performance of the 'magnificent 7' (M7) as many folks have coined the basket of AAPL.US, AMZN.US, GOOG.US, META.US, MSFT.US, NVDA.US and TSLA.US. There's little question that AI offers opportunities to replace personnel in the fields of legal and administration, and productivity enhancements in many other fields; however, AI is likely to offer little benefit to manual and outdoor jobs.



Source: Bloomberg

Investors buying stocks so as to be long when Chair Powell utters the words "I'm finished hiking rates" is a tougher sell to us. We're baffled at the resilience of equities given our longstanding belief of rates being higher for much longer. The two side-by-side graphs directly above highlight the Fed Funds futures curve for the remainder of 2023 (left) and 2024 (right) as of the end of April (red) and June (white). Cognizant of the small print on the vertical axes, at the time of writing, markets were pricing the Fed Funds to close 2023 at 5.40%, then fall 125 bps during 2024 to close next year at 4.15%. Based on the long-term mean of 1.60% for Fed Funds less Core PCE shown in the graph below, a 4.15% Fed Funds Rate implies Core PCE will fall to 2.55% by the end of 2024.



Source: Bloomberg

Prior to delving deeper into the recent performance of equity markets, let's first recap the results of our two funds. The Class F Lead Series of our LPs generated positive, albeit modest net returns during the first half of 2023. The Class F Lead Series of our Multi Strategy LP gained +0.59% net during the month of June, boosting its H1 2023 net gain to +1.58%.

June performance benefited from gains in the capital growth and multi-asset sleeves of the portfolio, offset by modest losses in the asset protection segment of the portfolio. Securities in the Consumer Cyclical and Industrials sectors led performance, while market hedges and the Technology sector were the biggest drags on performance. Winning positions included Air Canada (AC.CA), Installed Building Products Inc. (IBP.US), GFL Environmental Inc. (GFL.CA), and MYR Group Inc. (MYRG.US). Leading losers included market hedges (XLI.US and SPY.US) and CP Rail beta hedge Norfolk Southern Corp. (NSC.US). The fund exited June with delta-adjusted gross and net exposure of 112% and 30% respectively, with the net exposure split between common equities 15% and multi-assets 15%.

Looking ahead, the fact that one-month implied volatility on the S&P 500 sits at pre-COVID-19 lows, affords the fund the opportunity to add systemic protection to the book and increase the allocation of capital to high conviction long positions without having to markedly change the net exposure of the fund.

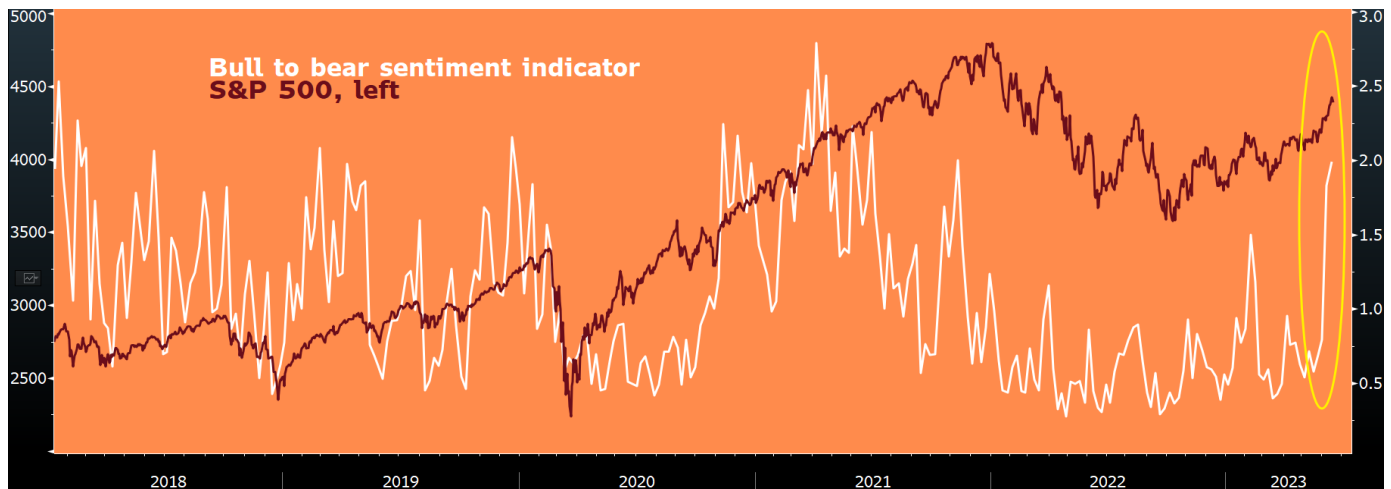
As of June 30, 2023	-----Annualized-----								
	YTD	1-mo	3-mo	6-mo	1-year	3-year	5-year	10-year	Inception
Forge First Long Short LP (Class F Lead Series)	0.43%	-1.06%	0.29%	0.43%	-3.98%	9.19%	8.64%	11.43%	12.96%
Forge First Multi Strategy LP (Class F Lead Series)	1.58%	0.59%	1.09%	1.58%	2.08%	10.53%	8.43%	8.87%	10.40%
S&P/TSX Composite Total Return Index	5.70%	3.35%	1.10%	5.70%	10.43%	12.42%	7.62%	8.43%	8.37%
S&P 500 Total Return Index (C\$)	14.29%	3.67%	6.38%	14.29%	22.91%	13.50%	12.45%	15.47%	16.43%

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 Long Short LP declined -1.06% net of fees for the month, cutting its year-to-date net profit to +0.43%. Materials combined with hedging losses and net exposures in the Consumer, Technology and Energy sectors to overwhelm gains in the Financials, Industrials, Real Estate and Utility sectors. Consumer shorts including Whirlpool Corp. (WHR.US) and Carnival Corp. (CCL.US) hurt performance; frankly all shorts did, given the rip higher in stocks, as did long positions in securities including private equity firm Brookfield Business Partners LP (BBU-U.CA) and net long exposure to Materials including Gold and Energy (during the front half of the month). The delta-adjusted gross and net exposure of this fund exited the first half of the year at 107% and 13% respectively.

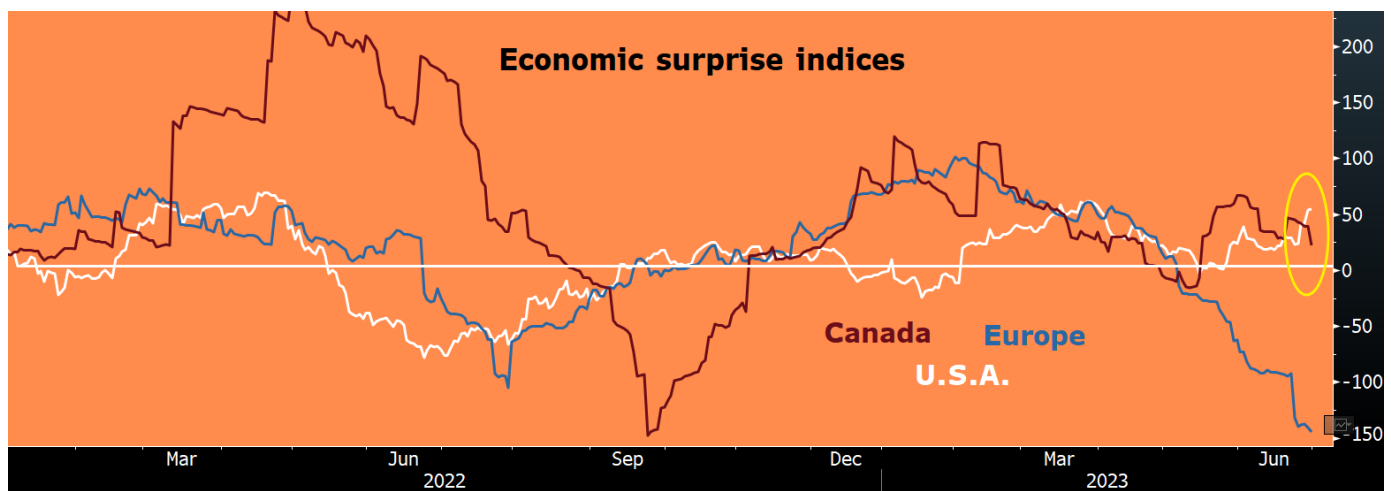
While it's true market breadth for the SPX has improved, with 28 issues now accounting for all the YTD gains versus just eight at the end of May, let's not lose sight of the fact that if you haven't owned M7, it's been a gruelling year. Yet, seeking hope, investor sentiment has recently improved markedly due to fading sources of left tail risk from the resolution of the debt ceiling negotiations, the regional banking crisis and the belief that falling commodity prices will help the Fed win its battle against inflation. As highlighted in the yellow oval (far right) on the five-year graph below, one could wonder if sentiment, as shown by

the bull to bear ratio (white line) is getting a tad too enthusiastic given it has now been more than three months since the SPX has suffered a correction of 3%.



Source: Bloomberg

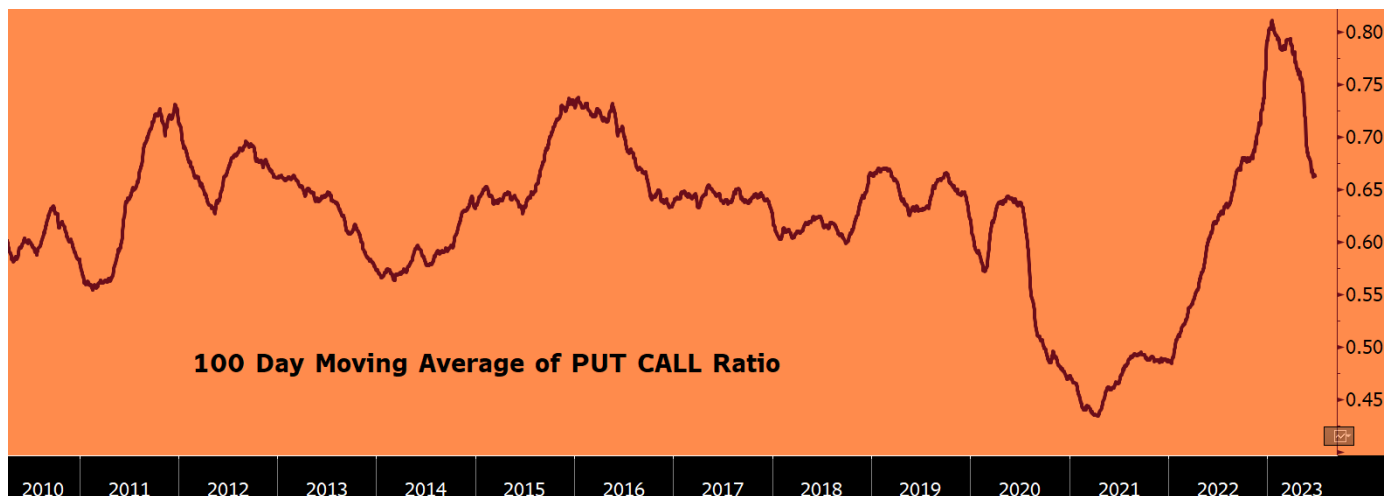
Stronger-than-expected recent economic data from the U.S. has also served to boost investor enthusiasm towards stocks. The three-year graph below of the Citigroup Economic Surprise Index suggests a) the U.S. economy continues to exhibit higher trends off of its 2022 lows, b) Canada, while still positive, has turned downwards, while c) the Eurozone has plunged over the past five months and now sits at its lowest level since the days of COVID-19. While we're cognizant of the missteps Powell's Fed has taken during the past couple of years, we believe the apparent resilience of the U.S. economy is the key reason why the Fed means business when it says "higher for longer", a phrase that formerly rattled investors.



Source: Bloomberg

The result appears to be that bankers will keep hiking rates until labour markets soften meaningfully, with any attempts at a "soft landing" (lowering rates before labour market softens) being non-existent at this point. This causes us to wonder whether the driver for markets to expect 125 bps of rate cuts next year is because the economy will finally experience the much discussed (by us too!), much delayed recession. In turn, what such a downturn could mean for profit forecasts, hence markets, with the SPX now trading at around 20X forward earnings remains open for debate.

But for now, to paraphrase singer Pink, the "party has started". The plunge in the 100-day moving average of the put-call ratio in U.S. markets on the far right of the 12-year graph below supports a report from the CBOE that more call options (on the VIX) have changed hands on the average day in June than any other month on record.



Source: Bloomberg

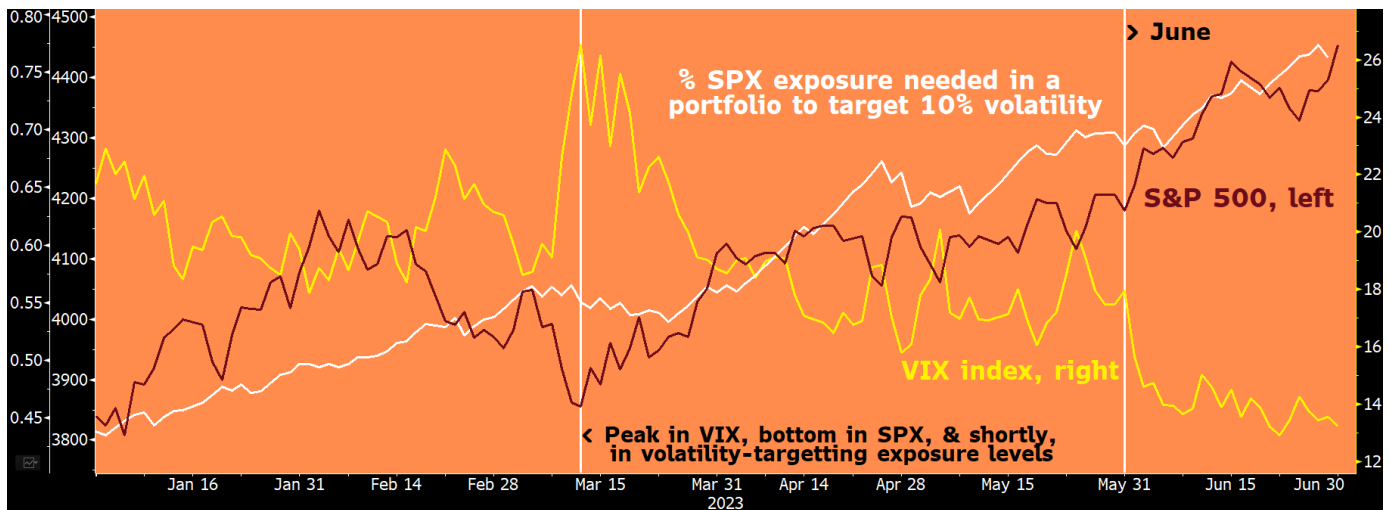
In addition, the directions of the two lines inside the yellow oval (far right) on the following one-year graph suggests investors witnessed a major short squeeze during the month of June. Speculators entered June with a sizable, short position on the SPX (white line, right axis) and these folks were forced to cover as stocks squeezed higher, likely exacerbating the extent and rapidity of the move higher in stocks.



Source: Bloomberg

At the same time, as discussed in [last month's commentary](#), with net exposures generally low amongst the traditional long/short hedge fund community and cash positions high in the retail and institutional investment community, the demand for put protection remains low. At the same time, record amounts of call buying forces dealers to hedge their gamma exposure (the rate of change between an option's delta and the underlying asset's price), serving to push stocks higher in rising markets.

The year-to-date graph below compares the level of the VIX Index (yellow line, right axis) against the S&P 500 (red line, left axis) and the percentage net exposure to the SPX required by a 'volatility targeting' fund (one type of systematic trading strategy) so as to ensure that their fund exhibits volatility equal to 10% (white line, far left axis). The two white vertical lines mark March 13th (line on the left) and the end of May 2023 respectively.



Source: Bloomberg

After market close on March 12th, the Federal Reserve issued the tweet shown below. In effect, with this announcement, the Fed launched ‘yield curve control’, as its Bank Term Funding Program (BTFP) allowed commercial banks to receive 100% collateral coverage (until maturity) for government bonds held on their balance sheet. While we presumed this declaration would reduce the already low likelihood of the regional banking problems becoming systemic, we did not envision this news would be the catalyst to trigger the raging ‘short-term bull’ market of the past 3+ months.

Note in the graph above how the VIX index peaked, and the price of the SPX bottomed at this time (left vertical line). Then days later, the net exposure vol-targeting funds began to steadily increase their net exposure, taking it from less than 55% to recent levels of almost 80%. The combination of this relentless buying by these algorithmic trading funds, blended with the above-mentioned short squeeze and the material shift in the put-call ratio, appears to have fuelled the surge in stock prices during June.



6:23 PM · Mar 12, 2023 · 604.8K Views

Source: Twitter

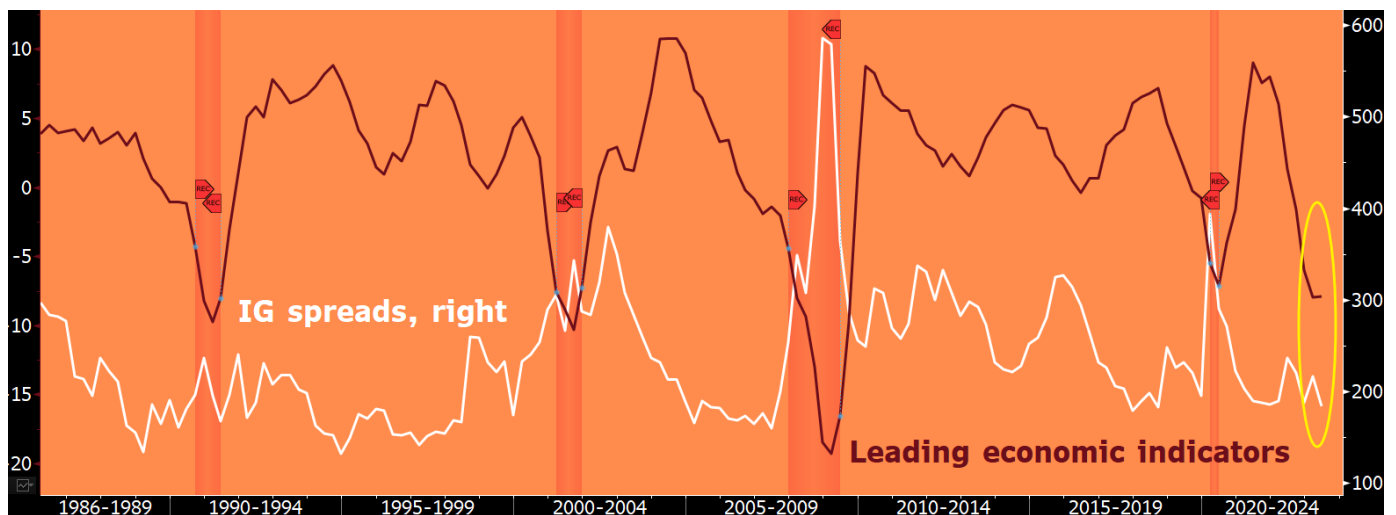
As a result, the SPX now trades at 20X forward earnings (red line, left axis, inverted) and appears to have decoupled from its historical valuation relationship with 10-year ‘real’ yields (white line, right axis). This breakdown implies investors either expect rapid rate cuts or that their expectations for long-term growth have moved higher, or a combination of these two variables. Speaking to growth, after strong U.S. consumer spending during this year’s first quarter, April but especially May data, exhibited a material slowdown in consumer spending. As we move towards 2024, we foresee a further tightening of wallet books by consumers, thanks to the elimination of their excess savings (which peaked at \$2.2T, now sitting at \$500B) by year-end and the impact of the restart of student loan payments this fall season. In addition, fixed equipment spending appears on track for its third consecutive quarterly decline, a variable that’s unlikely to reverse given the increasingly tough pricing environment, rising interest expense burdens and falling corporate profit margins. Throw in the drags from restrictive monetary policy, tightening credit availability and lousy final domestic demand in China, and it’s tough to be bullish on the outlook for growth as we move towards 2024.



Source: Bloomberg

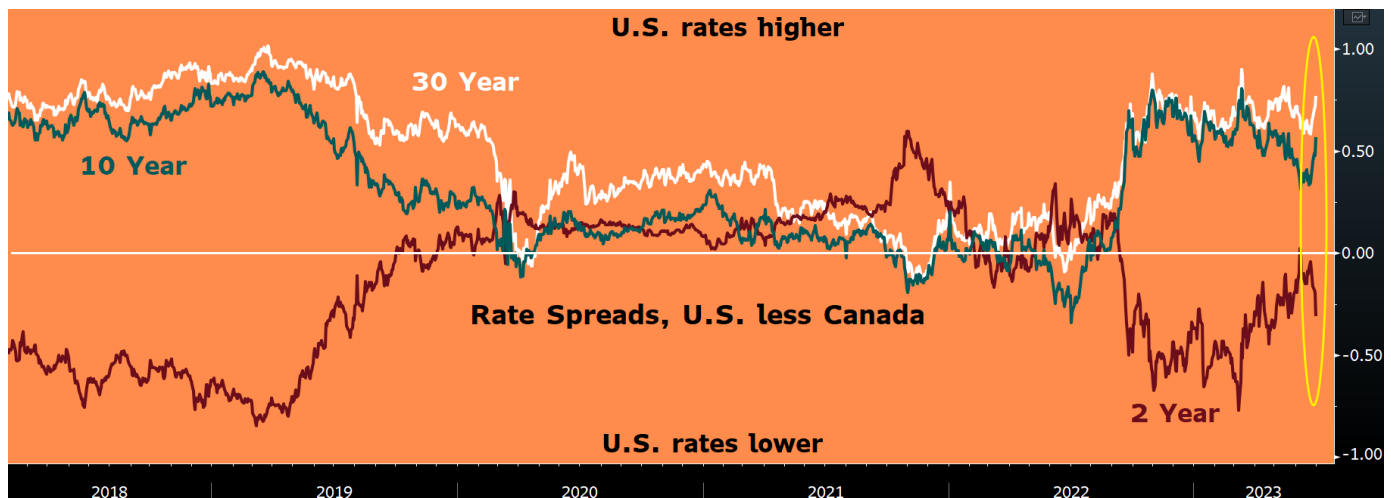
Shifting to inflation, we stick by the view we expressed at the start of 2023: that the road to 3.5% was easy, but the path towards the Fed's target in the low 2s will be tougher to achieve. In the near term, favourable year-over-year comparatives will combine with (finally) falling rental costs to push the key metrics watched by the Fed lower. However, sticky insurance premiums, especially auto and, shortly, a return to modest increases in health care costs, is likely to stall the advance to lower inflation entering the fall of 2023, serving to keep core statistics sticky in the low to mid 3s.

Consequently, while our lower volatility Multi Strategy LP will maintain and gradually increase its net long exposure to credit (especially the high-reset, short-duration institutional preferreds issued by Canadian banks), the almost 40-year graph below demonstrates why we will manage our exposure to credit on a single name versus 'across the board' basis. Note how ahead of each recession (the four shaded vertical bars), credit spreads widen (white line, right axis) while the index of leading indicators (LEIs are the red line, left axis) plunge, yet on the far-right side (inside the yellow oval), you can see that spreads sit near all-time lows despite the LEI suggesting a recession is forthcoming. Given current spreads, whether we experience a recession or not, it's tough to believe spreads have further room to narrow.



Source: Bloomberg

Speaking of interest rates, the five-year graph below compares sovereign rate spreads between the U.S. and Canada (U.S. minus Canada) at the two-year (red line), 10-year (green line), and 30-year (white line) duration. Note that inside the yellow oval (far right), two-year spreads have recently narrowed, while the gap on 10s and 30s has widened. On a relative basis, these shifts are likely attributable to the modestly softer inflation data recently printed in Canada, combined with Powell's reiteration that additional hikes are forthcoming in the U.S.; whereas, on an absolute basis, as the yield on the U.S. two-year keeps rising while the 10-year remains stable, the bond market is pricing in a more severe disinflation/recession assumption the higher short-term rates go.



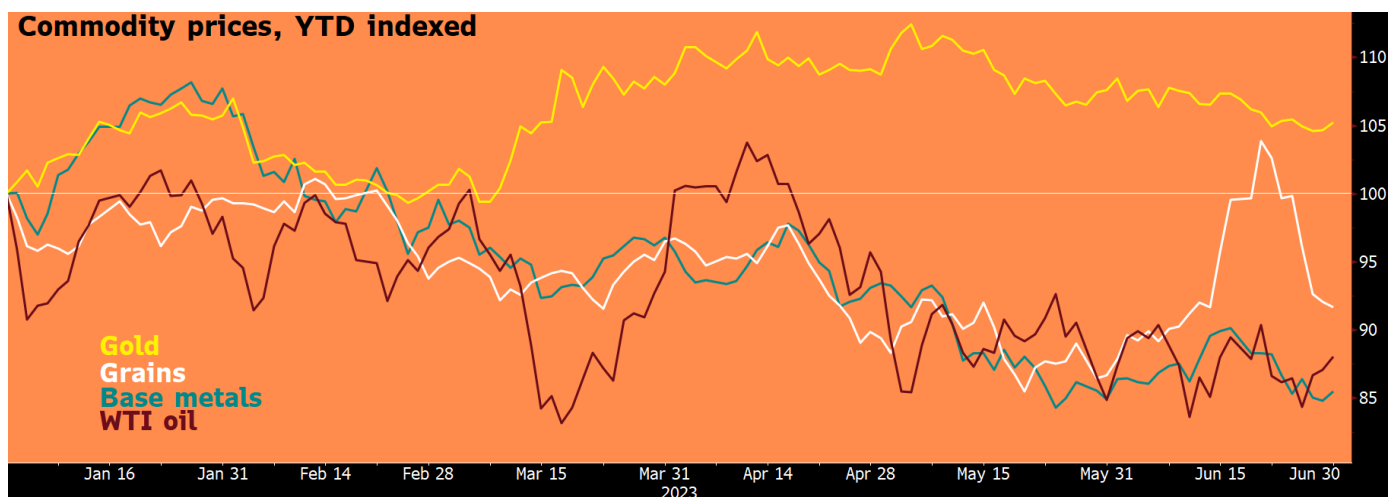
Source: Bloomberg

The table below displays the numbers driving the change in year-to-date spreads between the two countries, as the 2-10-year U.S. curve now sits at its deepest inversion in 42 years. Given the pressure of higher consumer debt to income levels and the greater likelihood of a negative impact of higher rates on housing prices in Canada (notwithstanding immigration) in 2024, we would expect the Canadian dollar to move lower versus the U.S. dollar from its current level of \$0.7547 over the next six to nine months. As it pertains to our funds, it is important for investors to know that we hedge our net U.S. dollar exposure on a weekly basis, as we do not speculate on currencies in our funds.

YTD Change in Bond Yields (Bps)			
	2-year	10-year	30-year
Canada	53	-3.2	-10.3
United States of America	47	-3.8	-18.7

Source: Bloomberg

In reviewing the year-to-date performance of commodities, 'disappointing' is the single word that comes to mind. The indexed graph below indicates that grains, base metals and oil have all fallen roughly 10%-15% while gold has held its gain from mid-March; that point in time when the Fed launched its BTFF. We've left natural gas off this graph, as including its eye-popping 45% decline eradicated the visual utility of the rest of the graph 😊!



Source: Bloomberg

Looking at equities, all 11 sectors in the S&P 500 exhibited gains during the month of June whereas here at home, Utilities, Health Care, Real Estate, Materials and Communication Services suffered price declines. Year-to-date, those same sectors in Canada remained in the red. Clearly the 'goldilocks' path for markets implies a 'soft landing' in which inflation recedes into the comfort zone of Central Banks, setting the stage for a long expansion phase. It's definitely possible, but not our 'most likely'

scenario. We believe it is more likely that the economy slows, partially because the Fed keeps rates “too high for too long”, hence forcing the U.S. into a mild recession, which in turn ultimately triggers rate cuts. Yet at 20X forward earnings and given the leverage in the system, it’s tough to get excited about the future trajectory of corporate profits relative to the valuation of the market. Remember, when the S&P 500 touched an earlier peak in 2021, a period of higher volatility, the Federal Funds Rate sat at zero (it is now 5%) and 10-year Treasury yields at 1.5% (now 3.7%).

As our team strives to be pragmatic when managing client capital, each of our two funds has recently increased the gross long exposure to equities and used ever cheapening index put options to manage net exposure levels. Recent equity additions include Intel Corp. (INTC.US), Granite REIT (GRT-U.CA), Air Canada (AC.CA) and Starbucks Corp. (SBUX.US). Out of principle, regardless of what the market is doing, we won’t ‘chase the market’ nor ‘drift from our value-oriented style’ or the inclusion of a diversified short book in our funds.

In assessing the outlook for stocks during the remainder of 2023, below please find a few positive and negative drivers that we’ve taken into consideration in determining our targeted overall exposure levels and positioning amongst and within sectors.

- On the positive side:
 - The TGA rebuilt by US\$300B+ the decline in the RRP did not negatively impact liquidity in the marketplace, while further reductions in bank reserve balances were kicked down the road.
 - April/May Core Services Ex-Housing CPI was benign and recent Core CPI driven by housing/used cars and weakness ahead could cause Core CPI to print low, in turn potentially fuelling the bull case, something that would likely be supportive of cyclical-driven equities versus the M7.
 - Powell’s ability to surprise with hawkish messaging is limited as (1) Fed nears peak rates and (2) if inflation continues to decline.
- On the negative side of the ledger:
 - In the short term, each of the SPX and QQQ are extremely overbought based on RSI, % from 50-day moving averages and the Fear and Greed Index.
 - June 15th saw record SPX call buying -> clearly a sign of speculation and chasing.
 - The ‘systematic’ equity community is very net long.
 - SPX valuations are not appealing on absolute yield basis or relative yield basis. 20X full year 2024 EPS of \$240 = \$4800 and it is difficult to see SPX exceeding this level during 2023.
 - We are a long way from any Fed easing.
 - Recent price action appears to be driving the narrative, i.e., feeding on itself.

Despite being well aware that market breadth was very narrow up until the last few weeks, of course we wish our funds had generated stronger net returns during the first half of the year. Yet, almost finishing our 11th year of managing client capital, with both funds exhibiting strong risk-adjusted net returns, we remain highly confident in our ability to generate competitive net returns while protecting investor capital.

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.

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Portfolio Manager

Keenan Murray
Portfolio Manager