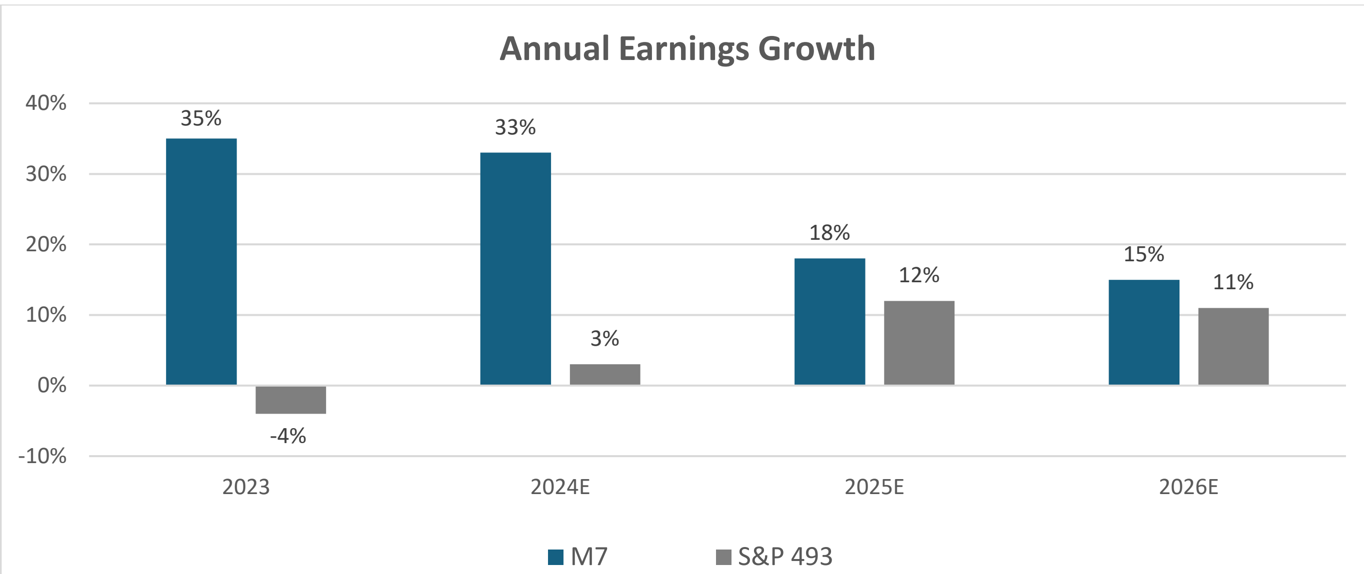
FORGEFIRST
ASSET MANAGEMENT INC

December 9, 2024

# November 2024 Commentary

Without doubt, the U.S. Presidential election was the catalyst for strong equity prices last month. Predictive polls were wrong once again as the race was called in President-Elect Trump's favour early the morning after the election (Nov. 6th), and the expected too-close-to-call results became a clear Trump victory. The initial market reaction to the results featured a broad market advance lead by high beta factors and cyclical sectors, ones expected to benefit from the presumed stronger economic growth catalyzed by a Trump Presidency. The list of winners included Financials and small cap stocks while the losing side of the ledger included solar power companies, issuers dependent upon imports from China, including dollar stores, along with some housing and real estate issues.

After the election-driven pop, equity performance shifted towards asset and issue reallocation trades as markets digested the impact of potential future government policies, regulations, and spending. Meanwhile, equities maintained an eye on earnings as investors expected Q3 results to mark a new record (up 2% from the prior record, Q2 of 2024) in earnings and sales, with S&P 500 margins remaining high at 11.9%. Looking ahead, while sequentially down from last quarter, forward profit estimates are forecasted to successfully set new records during the next five quarters, leaving 2025 EPS sitting up roughly +15% to $271. As is evident from the bar chart below, a key feature of this expectation is a notable narrowing in the rates of EPS growth between the M7 and the S&P 493.

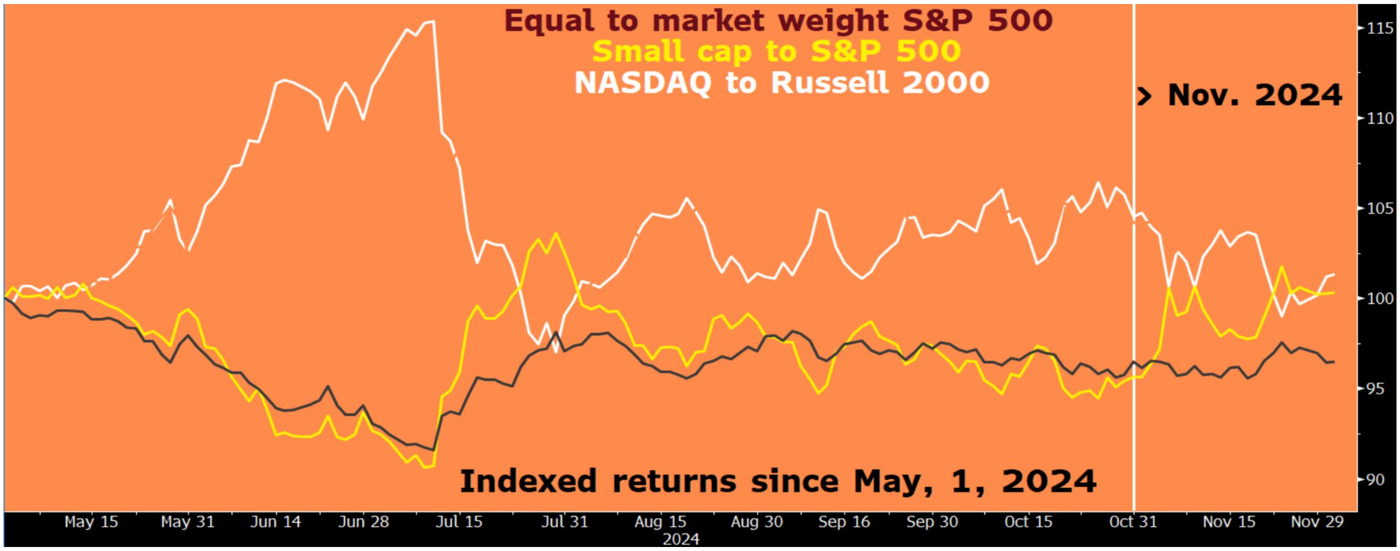



Source: Goldman Sachs

Valuation-wise, there's little question stocks aren't cheap, with the S&P 500 now trading at 23X forward earnings, ranking in the high 90s historical percentile against expected mid-teens EPS growth next year. Disaggregating this top line multiple shows the M7 trading at 30X profits for +18% profit growth next year compared to 19x for +12% growth for the remaining S&P 493. While not outrageously expensive, clearly these levels imply elevated risk to any negative shocks.

In light of the potential impact of policies from the White House and the narrowing growth gap discussed above, in thinking towards 2025, our investment team has been debating the prospects of the equal weighted S&P 500 outperforming the M7, including the set-up for AI beta and momentum versus other segments of the market. As a result, equity positioning in our Multi Strategy LP, for example, has been broadened across sectors, with a concomitant reduction to the emphasis of AI infrastructure. Having said that, the fund still holds a +22.1% net long exposure to the Technology sector including long positions in Taiwan Semiconductor Manufacturing Co. Ltd. (TSM.US), Meta Platforms Inc., CL. A (META.US), Marvell Technology Inc. (MRVL.US), Broadcom Inc. (AVGO.US), Apple Inc. (AAPL.US), and long-held Lumine Group Inc. (LMN.CA).

Factor-wise, the seven-month, indexed graph below compares the relative strength performance of small cap stocks (based on the Russell 2000) to the S&P 500 (yellow line) and NASDAQ (white line), in addition to the equal-weight to market-weight of the S&P 500 (blue line). The white vertical line denotes November 1st of this year. Hence post election, small caps notably outperformed, with the equal-weighted S&P 500 beating its market-weighted benchmark by a lesser magnitude.



Source: Bloomberg

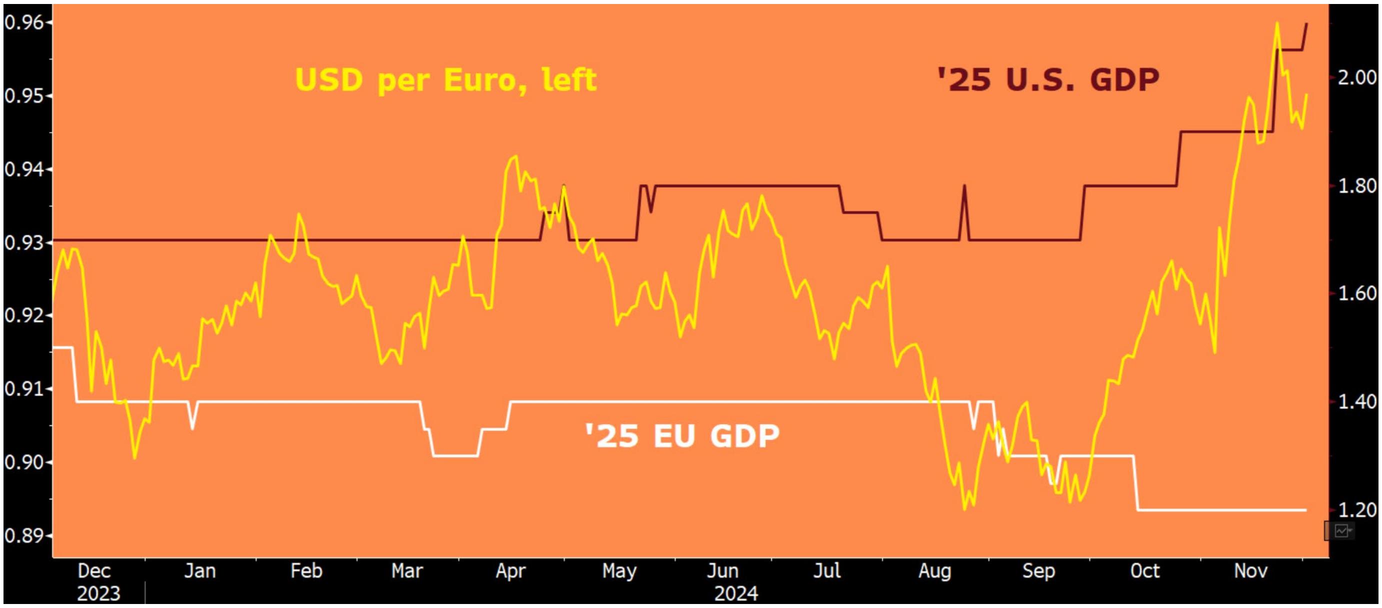
Speaking of our Multi Strategy LP, the Class F Lead Series advanced +4.67% net of fees during the month of November, boosting its year-to-date net return to +17.51%. Performance was led by Technology, Financials and Industrials and contribution breadth was strong. Performance headwinds occurred within our exposure to Consumer Non-Cyclicals, Energy, and market hedges. The fund exited the month with delta-adjusted gross and net exposure of 222% and 72% respectively, with the net exposure split between multi-assets (27%) and common equities (45%).

| | | | | | | ----------------Annualized---------------- | | | |
|---|---|---|---|---|---|---|---|---|---|
| **As of November 30, 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) | 13.77% | 1.32% | 2.79% | 9.11% | 16.94% | 5.54% | 10.80% | 9.39% | 13.24% |
| Forge First Multi Strategy LP (Class F Lead Series) | 17.51% | 4.67% | 7.73% | 11.89% | 21.47% | 8.08% | 11.49% | 8.33% | 11.05% |
| S&P/TSX Composite Total Return Index | 25.76% | 6.37% | 10.65% | 16.90% | 30.68% | 10.90% | 11.92% | 8.96% | 9.88% |
| S&P 500 Total Return Index (C$) | 35.75% | 6.45% | 11.09% | 18.07% | 37.97% | 14.76% | 16.99% | 15.66% | 18.01% |

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 advanced +1.32 % net of fees such that its year-to-date net return at month end was +13.77%. Exiting the U.S. election, the performance of the fund was constrained by the impact of the “red sweep”, however, as the month progressed idiosyncratic stock picking improved the performance of the fund. Financials, Technology, Consumer Cyclical and Industrials were the key sources of profits while Energy, market hedges, and exposure to rate sensitive securities were the principal sources of losses. As of November 29th, the fund held a delta-adjusted gross and net exposure of 136% and 48% respectively with Technology having net exposures in the low double-digits. The largest net exposures in the fund are Technology (+15%), Financials (+9%), and Industrials (+6%).

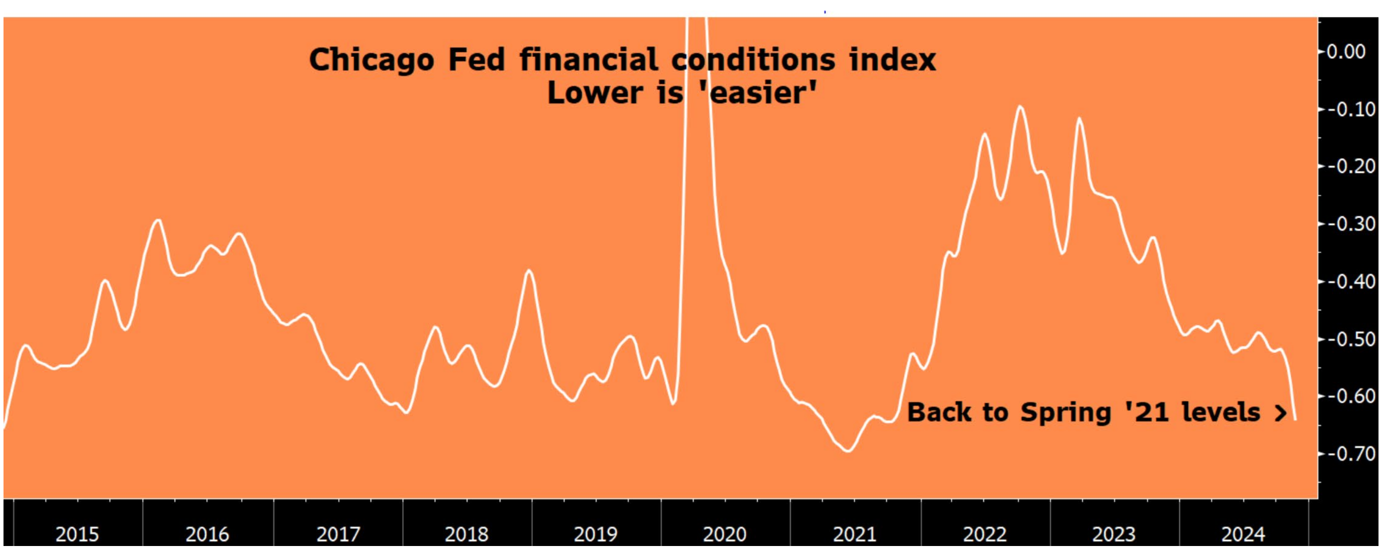
Looking ahead aside from what seems to be perpetual, though now presumably heightened, geopolitical risk, the much discussed but still unknown realities of Trump’s policy agenda will clearly be the driver of financial markets. Will Trump further “pump up the volume” of the U.S. economy, increasing the risk of a resurgence of inflation and the continued ascent of the USD? Or will apparent fiscal conservatives such as the potential Treasury Secretary Bessent catalyze the restraint that enables the trajectory of inflation to remain quiescent, albeit at above trend levels, such that the Fed can continue to take short end rates lower.



Source: Bloomberg

The right side of the graph above highlights the upward revisions to U.S. GDP growth (red line, right axis) for 2025 while that of the E.U. (white line, right axis) is grinding lower. The widening gap explains why a) the number of rate cuts by the Fed between now and the end of 2025 sits at just over three cuts versus five during mid-October and b) the USD has advanced against most currencies including a roughly 5% climb versus the Euro (yellow line, left axis) since the U.S. election.

Given the robust nature of the U.S. economy, albeit a "K-shaped" split between the winning and losing segments of the nation, there's logic to the camp that believes a rate cut by the Fed next week (Dec. 18th) could be an 'error'. The current strength in the economic headline numbers and the disinflationary trend has stalled out well above target. Trailing 3-month annualized core PCE sits at +2.9%, above the six-month trend, as persistently higher shelter pricing serves to anchor core inflation while remaining inputs continue to exhibit month-to-month volatility. In addition, the Chicago Fed's financial conditions index (10-year graph shown below) is back to the 'easy' levels it was at during the height of COVID!



Source: Bloomberg

However, with 10-year breakeven yields trading at 2.32%, comfortably below the believed to be critical 2.50% level, and the fact that Fed policy is about inflation and employment and not the level of the stock market (56 all-time highs so far during 2024), subject to Trump's policy agenda (will it prove to be as inflationary as believed?), it's probable the Fed will remain on the path of a gradual reduction in interest rates. Please make note that this commentary was written prior to last Friday's jobs report. If that jobs report turned out to have been stronger than expected, potentially triggering a pause by the Fed, it's tough not to think Fed mouthpiece Nick Timiraos of the Wall Street Journal won't give us the heads up this week. Hence our hunch would be no Timiraos article about no cut on the 18th implies another 25 bps cut is the Fed's Christmas present to markets.

As we wrote last month, the equity bull case depends on a proactive Fed, resilient tech EPS expectations, range-bound inflation, and stable growth. We continue to be in the camp these macro forces will remain risk positive in the near term such that markets will continue to offer investors the near term benefits of stimulus before the longer term hangover of deficits and/or inflation kick in. Yet, please remember that the equity set-up is not the same as the Trump-based bull market of 2016. Back then, the S&P 500 traded at 18.5-19X, yields on UST10s were below 2%, the corporate tax rate was 35%, the rate of unemployment sat at 4.7%, the fiscal deficit was a 'mere' US$600B, the debt to GDP of the U.S. was around 75%, and the Fed Funds rate was less than 1%. Markets don't go straight up forever and it's naïve not to think 2025 won't include some Trump-driven volatility. Finally, with the Bank of Canada in full speed rate-cutting mode, GICs won't be the savior for investors that they were a couple of years ago.

Meanwhile, the team at Forge First will stick to its discipline that includes market hedges, a good-sized short book, and a quality GARP/value-bias among our long positions. We believe slow and steady wins the race.

Thank you for your business! The team at Forge First wishes you and your loved ones a safe and happy holiday season.

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