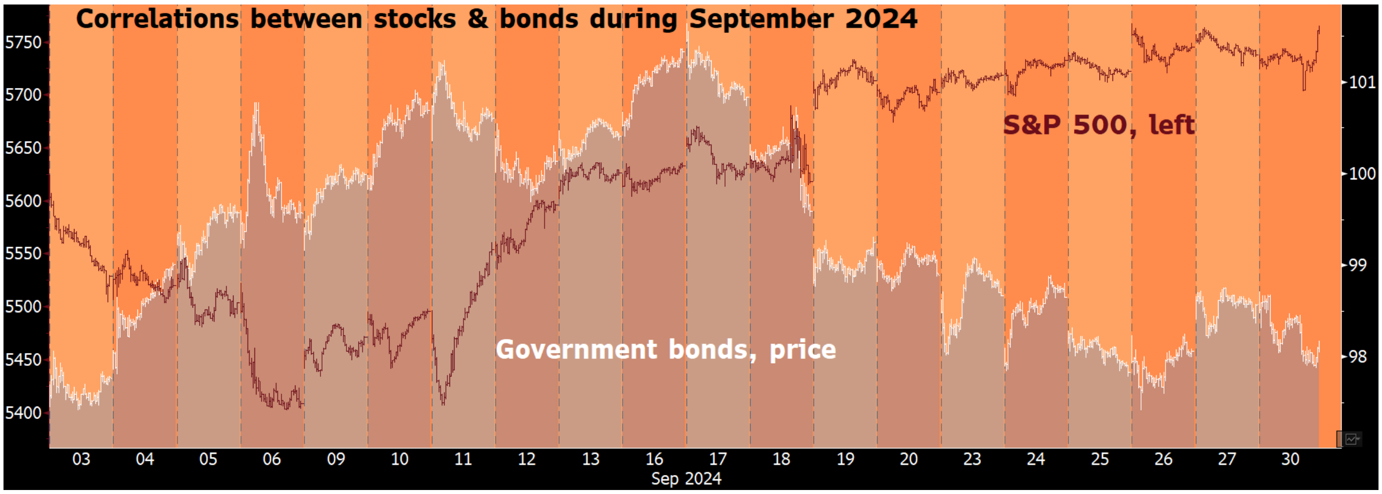
FORGEFIRST
ASSET MANAGEMENT INC

October 8, 2024

September 2024 Commentary

While the historically challenging month of September (average decline for S&P 500 of -1.2% since 1926) started on the wrong foot (down -4.25%), the trend turned quickly enabling stocks (and bonds) to post another winning month. The intra-day graph below of the S&P 500 (red line, left axis) and long term U.S. bonds (white line, right axis) highlights their flip-flopping correlation, from negative to positive to negative. After the fourth trading day of the month, several items catalyzed the change in investor sentiment.



Source: Bloomberg

Constructive comments about the consumer from Visa Inc. (V.US), AI-supportive words from NVIDIA Corp. (NVDA.US), hotter but not too hot PPI & CPI prints, and the debate victory by Kamala Harris all served to reverse the trend in stocks. Shortly thereafter, Fed insider (presumably in the true sense of the word!) and Wall Street Journal reporter Nick Timiraos floated the notion of a 50 bps cut by the Fed at the FOMC meeting scheduled for the following week. That 'story' fueled stocks until the Fed meeting. Then Powell's 'dovish 50 bps cut' versus an expected 'dovish 25 or hawkish 50' enabled equities to print five all-time closing highs (now 43 YTD). Long bonds on the other hand, and in contrast to the short end of the curve, proceeded to retrace much of their advance earlier in the month on worries about the longer term inflationary impact of accelerated rate cuts today.

Small and mid cap stocks underperformed large cap equities, especially the M7 which materially outperformed. In fact, the price of the M7 advanced +6.45% versus +2.15% for the equal weight SPX, and +0.55% for the Russell 2000 (small caps). Each of our two funds generated solid net returns with little of the volatility that marked the past few weeks for equity indices. After discussing the monthly performance of our two funds, this note will briefly assess the recent news from China and the outlook for interest rates in Japan.

The Class F Lead Series of our Long Short LP posted a net gain of +1.35% for September, boosting its year-to-date net return to +12.17%. Winning sectors included Industrials, Financials, and Utilities while Energy was the principal source of losses. Argan Inc. (AGX.US) has been a winning position that we sold after it gapped markedly higher post its latest earnings beat. The company designs and builds traditional and alternative energy plants. We view this company as being a 20+% forward earnings grower, but the stock became too expensive post its recent move higher. It's a company we would welcome another opportunity to repurchase in our portfolios. On the other side of the ledger, Global Payments Inc. (GPN.US) held an analyst day during which management maintained its guidance for 2024, pleased investors with their buyback plans, but disappointed with its guidance for 2025. The latter point dictated late September tape action in the stock costing the fund some basis points during September. The fund exited September with delta-adjusted gross and net exposure of 113% and 22% respectively.

As of September 30, 2024	YTD	1-mo	3-mo	6-mo	1-year	3-year	5-year	10-year	Inception
						----------------Annualized----------------			
Forge First Long Short LP (Class F Lead Series)	12.17%	1.35%	3.34%	7.45%	17.68%	5.07%	10.83%	9.38%	13.30%
Forge First Multi Strategy LP (Class F Lead Series)	10.50%	1.31%	0.96%	5.34%	13.88%	5.72%	10.25%	7.79%	10.65%
S&P/TSX Composite Total Return Index	17.23%	3.15%	10.54%	9.95%	26.73%	9.51%	10.95%	8.09%	9.39%
S&P 500 Total Return Index (C$)	24.85%	2.17%	4.58%	10.17%	35.96%	14.27%	16.44%	15.51%	17.46%

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 added +1.31% net for September increasing its year-to-date net return to +10.50%. Similar to our Long Short LP, Industrials and Financials drove the positive performance for the month while market hedges and Energy hurt the performance of the fund. Towards the end of the month, the fund shifted to a neutral net exposure on both Utilities and Real Estate and modestly net short several sectors. Industrials and Technology remain the highest net long exposures within the equity sleeve of the fund.

Within the credit sleeve of this fund, exposure continues to be focused on the institutional preferred shares and LRCN paper of the Canadian banks. While duration averaged 2.5 years during the majority of the month, the fund has recently shorted long-dated U.S. treasury bonds to shorten the overall duration of this sleeve. The combination of U.S. government debt levels and our view that the Bank of Canada will be more aggressive on rate cuts accounts for the described cross-border positioning. The fund exited September with delta-adjusted gross and net exposure of 179% and 53%, respectively. This net equity exposure is split between fixed income securities (+28% net long) and common equities (+25%).

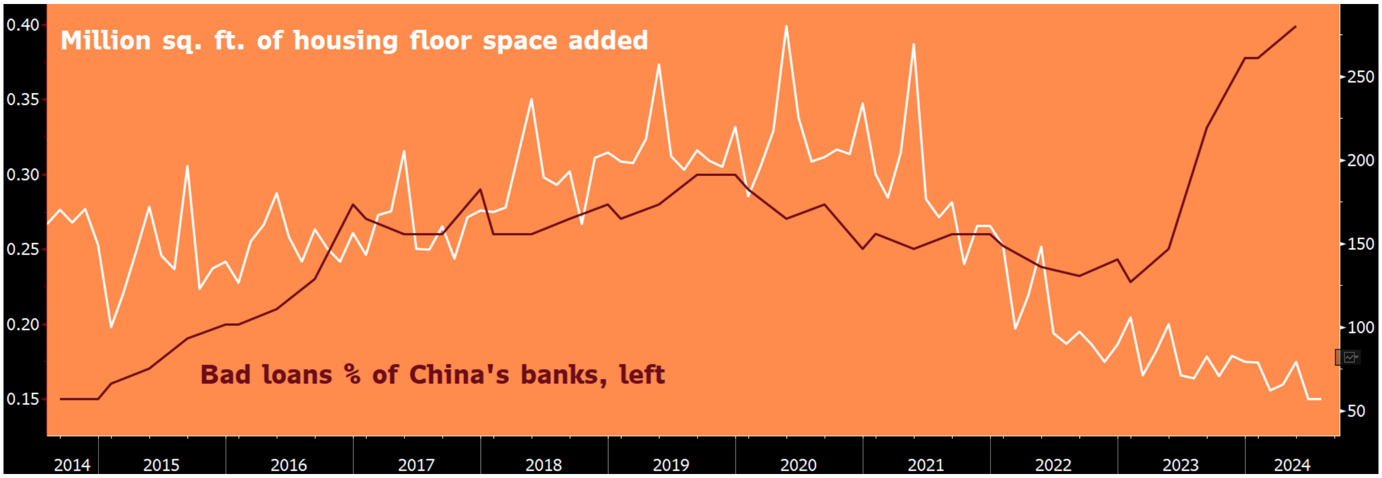
Equity markets remain in 'goldilocks' mode forecasting more than seven additional rate cuts from the Fed over the next 12 months and 2025 EPS growth for the S&P 500 of 18%, quite a powerful combination! In addition, despite the Fed's QT program, we estimate liquidity in U.S. financial markets remains 66% above pre-COVID levels, which when combined with 7% fiscal deficits, explains why the historic pace of rate hikes did little to dent the price of risk assets. We believe the supply of liquidity will begin to shift next year, a topic we'll discuss in a future commentary, but for now it's tough to fight the Fed, although we'll continue to focus on our conviction long positions and hold high degrees of protection, especially in the run up to the U.S. presidential election.

Shifting to China, there's no doubt folks had pretty much given up on the likelihood of China 'bringing out their bazookas' again, as they had so frequently done during the past 20 years in their attempts to attain their targeted rates of economic growth. In recent times, government priorities appeared to have shifted towards upgrading technology and building a fortress-like economy, insulated from the ROW. But in a haphazard way the government finally acted, first with monetary policy, then with fiscal policy. Little question the stimulus was needed as literally every graphed metric on the Chinese economy (ex-exports) continues to slide down and to the right. For example, as shown in the graph below Chinese money supply growth is now shrinking at the annualized rate of -7.5%.

Source: Bloomberg

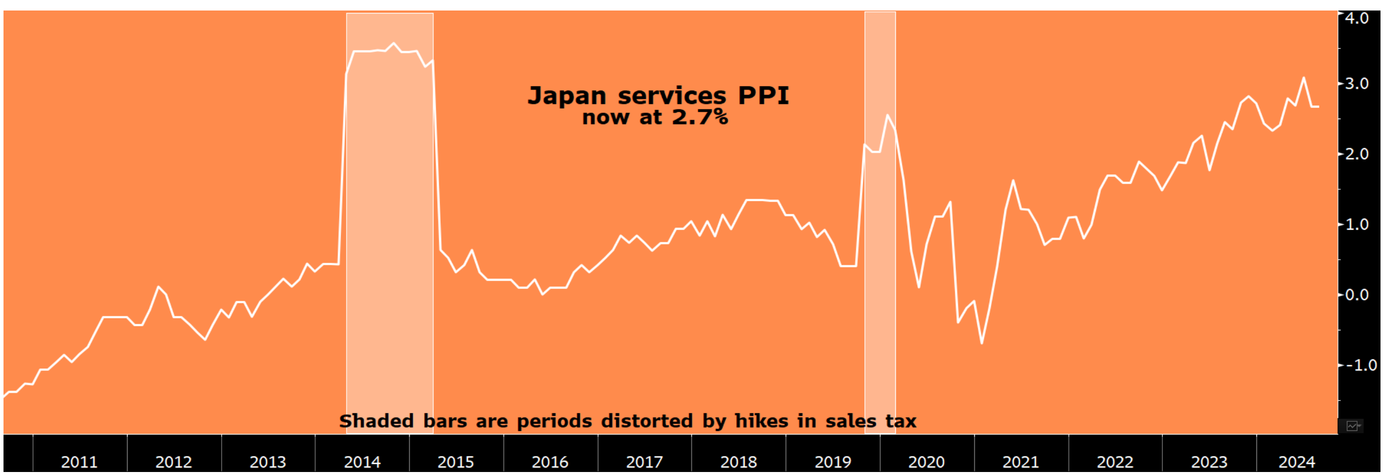
In fact, some economists including Richard Koo of the Nomura Institute have suggested China is showing signs of entering a balance sheet recession, the same nasty downward spiral haunting Japan since 1990. This type of recession occurs when a debt-financed asset bubble collapses, causing asset prices to fall markedly but leaving liabilities intact, forcing the private sector to retrench by engaging in collective deleveraging. The 'poster child' for this phenomenon in China is real estate.

Nationwide, residential floor space sold declined by 20.4% yr/yr in the first eight months of this year, though the implied monthly data shows that the decline has moderated from 25% yr/yr in April. Further, the graph below compares the amount of new housing floor space built (white line, right axis) against the percentage of bank loans that are bad (red line, left axis). Both trends are obvious, and both are bad. The one variable that remains ok relative to how things were in Japan 30 years ago is that certain sectors of the Chinese economy are still borrowing money, specifically the Industrial sector, where loans grew +17.4% during Q2 of 2024, albeit down from 32.3% a year ago.



Source: Bloomberg

We doubt this round of stimulus will provide enough momentum to sustain the desired rate of growth throughout 2025. The key to regaining consumer confidence will be a recovery in the housing market and while the declines have been lessening, it seems a historic assumption to believe recent actions in and of themselves will facilitate a recovery. In addition, we hold a healthy degree of skepticism that Chinese fiscal stimulus will be strong enough to spark a dramatic commodity rally. At this juncture we won't be making changes in the portfolios to gain significant exposure to China.



Source: Bloomberg

Meanwhile, we understand the 'yen-carry trade' is back to the 'all-in' levels of just prior to the early August 'hissy fit' markets had before quickly forgetting about it. Hence, it's prudent for investors to maintain an eye on the potential for future rate hikes by the BoJ. Shigeru Ishiba, the new leader of Japan's Liberal Democratic Party and hence the country's new Prime Minister, has stated his preference for the BoJ to hike interest rates to control inflation and boost the yen. While futures pricing implies no forthcoming rate hikes, we note the graph above highlights that service PPI sits at its highest level in years.

In the U.S., inflation trends continue to be directionally positive as core inflation, excluding all food and energy, has decelerated to 1.7% yr/yr in August, making it four consecutive months of less than 2%. By contrast, core CPI, excluding only fresh food, rose from 2.2% yr/yr in April to 2.8% yr/yr in August. A bigger economic surprise was last week's revision in the personal savings rate from 2.9% to nearly 5%. Clearly, this data suggests consumer spending will persist for longer than previously thought.

Source: Bloomberg

Hence if the Fed is going to keep cutting rates, history suggests it's highly probable the yield curve (above graph) will steepen. Our funds are positioned accordingly. Please let us know if you have any questions and thank you for your business.

Andrew McCreath
CEO

Keenan Murray
CIO, Portfolio Manager

Richard Roth
Associate Portfolio Manager