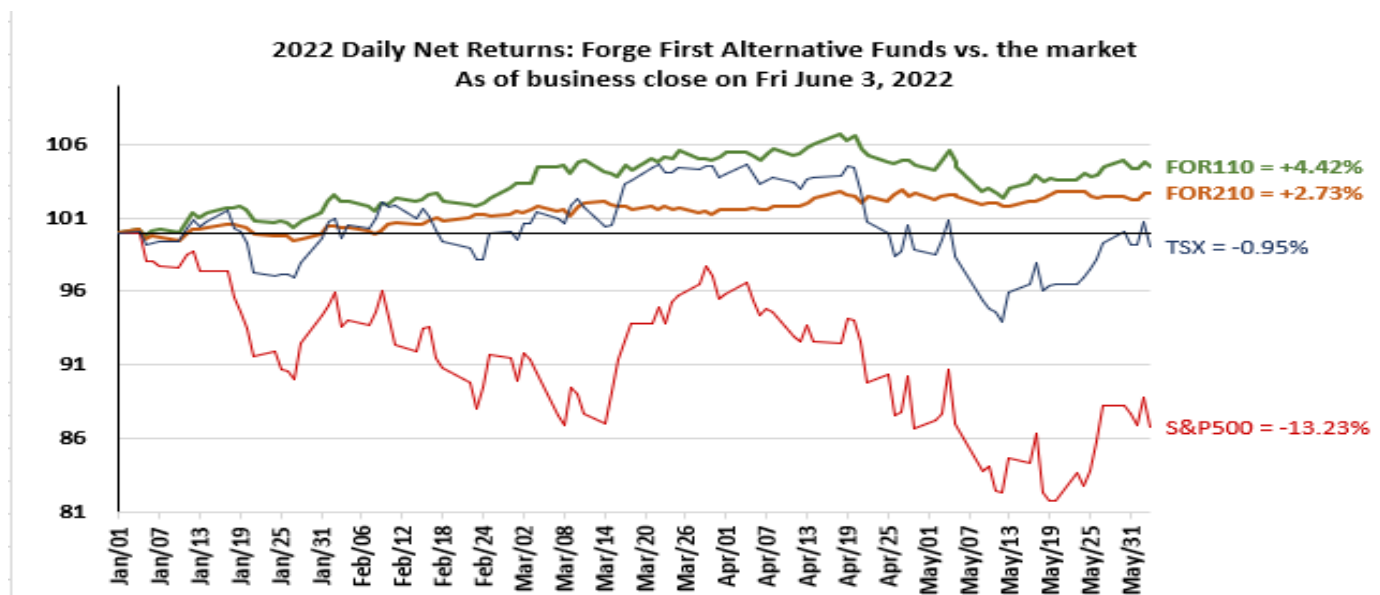


May 2022 Commentary

One of the well-known quips about investing is that there are fewer things more humbling than markets. In last month's commentary, we mused that by Labour Day markets would sense a pending shift by the Fed, be it dovish or hawkish. Then, lo and behold, near the end of April, in light of weakening Chinese data and plummeting U.S. housing data, market psychology assertively pivoted towards growth fears from concerns about inflation. The impact of this shift dominated market action during May, especially after Target Corp. (TGT.US) and Walmart Inc. (WMT.US) tabled sizable overhangs in their inventory positions and the latter joined Amazon.com Inc. (AMZN.US) in announcing a hiring freeze; two companies that employ three million people. As a result, markets exited May amidst a "perfect storm" of P/E multiple compression, profit margins that are rolling over and the rising prospect that revenue growth will roll over thanks to supply issues and the growing prospect of an economic slowdown.

The graph below highlights the performance of our alternative mutual funds which utilize similar investment strategies to our two LPs, the Series F of the Forge First Long Short Alternative Fund and Series F of the Conservative Alternative Fund. Year to date, through the close of business on Friday, June 3rd, each of our two funds have exhibited stability and positive net returns.



Source: Forge First

During May 2022, each of our two funds suffered modest losses. The Class F Lead Series of our Long Short LP fell -0.37% net of fees, pushing its year-to-date net return to +4.96%. Energy, Financials, Consumer and Industrial sectors all contributed positively to performance during the month, while our positions in Technology, Materials, Real Estate and Utilities posted negative performance. Our Long Short LP exited May with delta-adjusted gross and net exposure of 121% and 40%, respectively. Net exposure remains oriented to cyclical sectors, specifically Energy, Materials and Industrials.

The Class F Lead Series of our lower volatility, multi-asset Multi Strategy LP lost -0.52% net of fees during May. This decline shaved the year-to-date net return to +1.96%. In addition to option-based hedging, the Multi Strategy LP suffered modest losses in its yield-enhancing alternative strategy sleeve. These losses offset gains in the capital growth sleeve. This fund closed the month with delta-adjusted gross and net exposure of 111% and 19%, respectively, having increased the net long exposure of common equities by the end of the month to 13%. Directionally, the fund owns shares in service companies that benefit from the reopening trade, energy equities and high-quality GARP stocks, while remaining short housing, unprofitable tech (GAAP) and discretionary consumer stocks.

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	YTD	1 mo	3 mo	6 mo	1 year	----- Annualized -----		
Forge First Long Short LP (Class F Lead Series)	4.96%	-0.37%	1.42%	4.20%	6.30%	15.02%	12.25%	15.45%
Forge First Multi Strategy LP (Class F Lead Series)	1.96%	-0.52%	0.77%	1.06%	3.06%	11.23%	8.80%	11.50%
TSX Total Return	-1.28%	0.06%	-1.15%	1.74%	7.91%	12.23%	9.43%	9.24%
S&P 500 Total Return (US\$)	-12.76%	0.18%	-5.16%	-8.85%	-0.30%	16.44%	13.38%	14.03%

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.

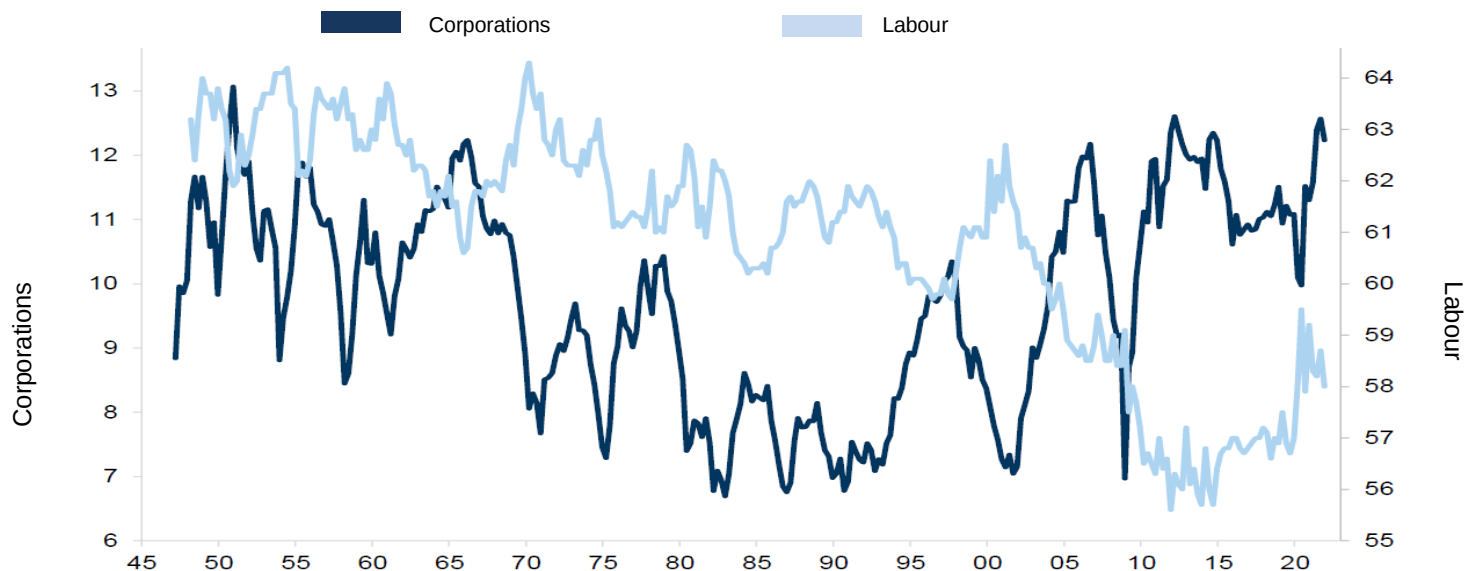
The goal of our funds is to generate a competitive net return, while protecting capital when markets get rougher. One component of our disciplined approach to constructing these portfolios, is to always include a book of listed options, roughly 90% of which protect individual positions or hedge broad market risk. Sometimes, falling volatility and flat to higher markets, combine to create a nasty cocktail for this component of our portfolios. That's exactly what happened during the latter part of May, causing our listed options book to be the largest detractor of fund performance for each of our funds.

In looking ahead at markets, one ever-present challenge in writing these commentaries is the timing of their publication. This month's note was written ahead of this week's U.S. CPI print. With a Fed meeting next week, it's an understatement to say this week's inflation print is potentially market moving. However, even if it's lower than expected, for several reasons, we remain in the camp that inflation is likely to stay stickier at higher levels for longer, and hence be problematic for Central Bankers.

First, we expect many of the existing supply chain issues to persist into 2023 and that's prior to the incremental challenges caused by the war in Ukraine. Further, we believe energy prices will remain "higher for longer". Eight out of the 10 largest OPEC producers are not even producing up to their quotas, defying the usual pattern when crude is above US\$100/barrel of countries producing more, not less, than their allocation. In addition, US producers are pumping 1M fewer barrels a day than in 2019, and Russia 1M fewer barrels a day than it did three months ago. Finally, as shown by the light blue line on the right vertical axis on the graph below, labour's share of the economic pie has been increasing during the majority of the past 10 years. The continuance of this trend should serve to further boost pricing pressures.

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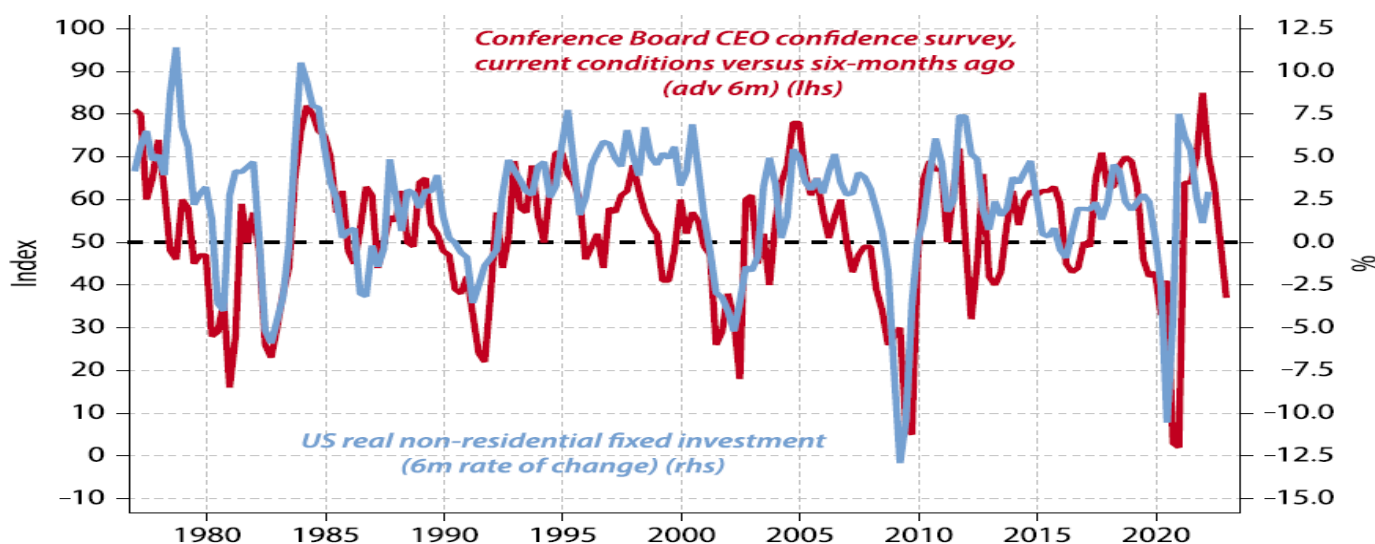
Profit shares as a % of GDP – fell in the 1970s and 1980s and should fall as inflation picks up



Source: Goldman Sachs

At the same time, economic growth is clearly slowing down; in fact, the magnitude of the recent rate of change has been stunning. This economic softness began with the COVID-related lockdowns in China, followed by the impact of supply chain issues and high energy and food prices in Europe, then the combination of a plunge in housing data and rising non-automotive inventories in the U.S. Up next, expect a retreat in consumer spending.

While the savings rate in Canada remains at the lofty level of 8%, at 4% it's below pre-COVID levels in the U.S. Add negative real hourly earnings to high food, rent and gasoline, it's clear consumer spending will slow. However, that's all known. We'd say the big risk to the economy in N.A. is capital spending by businesses, as it's been running at a healthy low double-digit rate of growth. Unfortunately, as can be seen in the graph below, all the above listed negative issues are beginning to negatively impact the confidence of corporate CEOs (red line, left axis, advanced six months). Slowing CAPEX (blue line, right axis, six-month rate of change) could push N.A. into a recession.

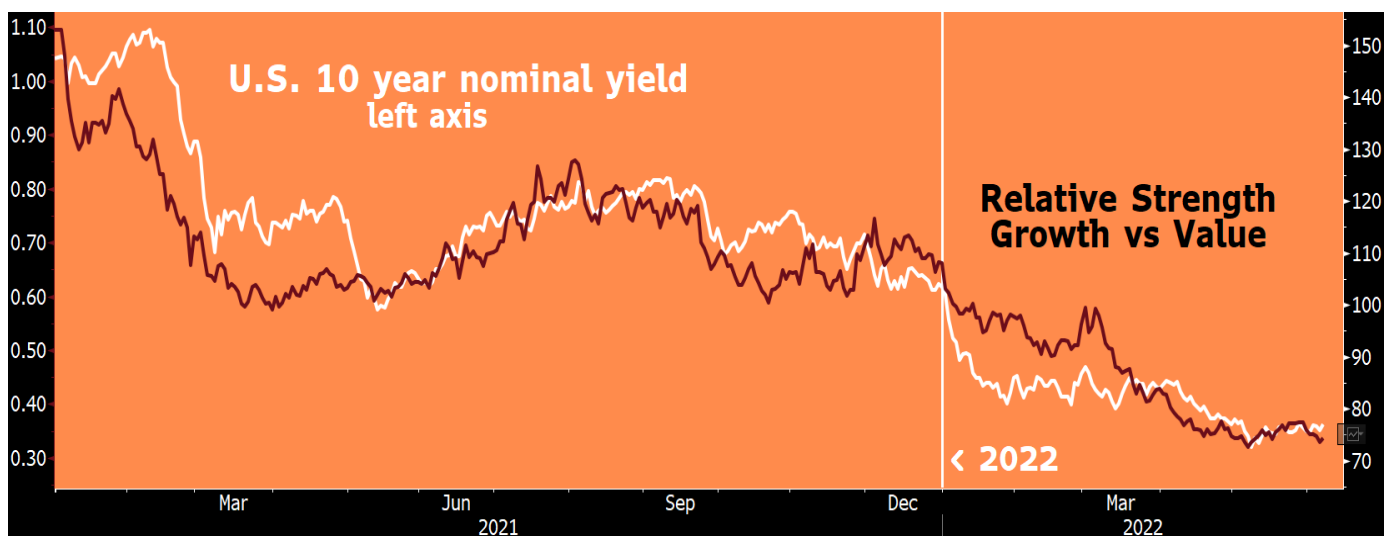


Source: Gavekal Research

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Of course, the above is the recipe for stagflation, so the question becomes “What will be the reaction of Central Banks and the impact on financial markets?”. In Canada, both growth and inflation are running hotter than in the U.S., validating the continuing more hawkish stance of the BoC's Governor Macklem. Hence, a 75 basis point hike is definitely on the BoC's table in July. Combined with continuing high commodity prices, it's possible that our loonie may finally trade higher versus the U.S. dollar. South of the border, 50 basis point hikes by the Fed in each of June and July appear to be done deals, leaving the key question being whether Fed speakers begin to waiver on a further hike in September.

We expect year-over-year inflation comps will begin to roll over this summer. Combined with tightened financial conditions, this duo of items is likely to give the Fed cover to pause hiking rates this Fall, when it will have become obvious that the rate of economic growth is slowing. If at this time investors perceive inflation is moving towards the 2% target of the Fed, the price of financial assets could enjoy a strong rally, with bond yields falling and growth stocks outperforming value and cyclical stocks. Such an outcome should enable U.S. indices to outperform Canada's TSX Index. The challenge for central bankers would be if year-over-year rates of inflation remain elevated. Besides the conundrum for the bankers, investors could be in for a rough ride.



Source: Bloomberg

Remember at 17X forward earnings, the S&P 500 is merely pricing in a growth slowdown, not a recession. Regardless, in the near-term, it's likely this latest pivot by Powell and company would be short term bullish for financial assets. The problem could occur next year when inflation remains sticky, growth is slowing further, and the withdrawal of liquidity finally begins to bite. The Fed's QT program only began on June 1st and, while we're referring to two separate buckets of liquidity, the fact that reverse repos regularly top US\$2T a day implies the first six-nine months of QT does not need to be deleterious to markets.

If we do have a recession next year, we buy the pitch that the downturn can be shallow for a few reasons. First, corporate balance sheets are strong. Cash levels are high and the majority of debt doesn't mature for five to 10 years, including less than 5% of high-yield debt maturing before 2024. In addition, the job market remains tight and high energy prices provide capital surplus countries with funds to lend to countries such as the U.S. that continue to run huge trade deficits. However, as discussed in our commentary last month, according to Goldman Sachs, on average since World War II, earnings have declined roughly 15% during a recession. In addition, a change in the supply and demand for bonds should push interest rates higher over the medium term.

After the Great Financial Crisis of 2008, Central Banks and U.S. commercial banks were each sizable buyers of government bonds, while there was little demand for credit; a great environment for a bull market in bonds. However, now Central Banks, ex-Japan (for now), have finished buying bonds and according to J.P. Morgan, there will be an estimated US\$4T per year of credit demand to finance the fight against climate change. Combined with the likely medium-term inflationary impact of repatriating jobs from China and Russia, it seems probable that rates, especially real rates, will grind higher, challenging the valuation multiples accorded financial assets.

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Consequently, while the risk/reward in equities is superior to when we published our cautious full year 2022 outlook commentary in January, post-our expectation of a bump and related factor rotation from a Fed pivot, we continue to remain wary towards equities over the medium term. The bottom line is simple. Policy accommodation peaked last Fall and the stimulus that markets have become addicted to, be it monetary or fiscal, has begun to shrink. The slope of this downward curve will be highly correlated with how sticky inflation proves to be. Remember, don't fight the Fed works both ways!

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.

Andrew McCreath
President and CEO

Daniel Lloyd
Portfolio Manager

Keenan Murray
Portfolio Manager

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