FORGEFIRST
ASSET MANAGEMENT INC

February 10, 2025

January 2025 Commentary

What a crazy last couple of weeks in the markets! First, it was DeepSeek, then it was tariffs. Yet despite DeepSeek's blind-siding of AI-related stocks and a worse-than-expected (at least for a few hours) scenario tabled on tariffs, at the time of writing, U.S. markets are flat year-to-date while the decline in the TSX isn't even 1%. In last month's year ahead commentary we suggested 2025 would be a year of higher volatility and we've sure started the year with some big bangs. After discussing January's performance in the funds, this commentary will focus on the two topics clients have been asking about: tariffs and DeepSeek.

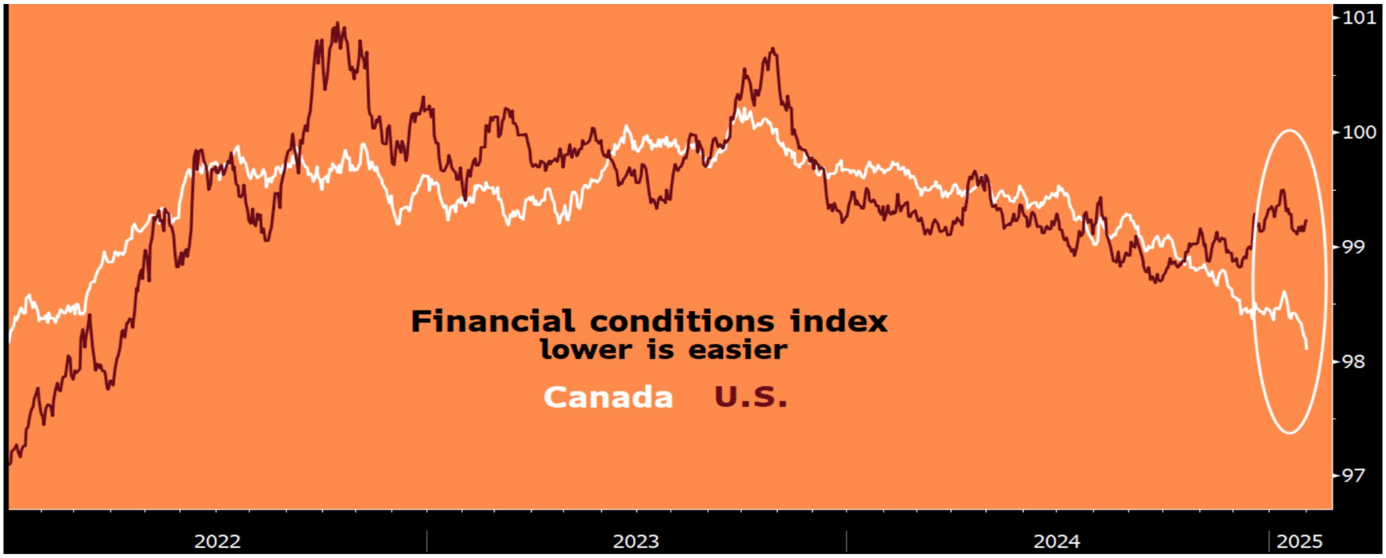
						----------------Annualized----------------			
As of January 31, 2025	**YTD**	**1-mo**	**3-mo**	**6-mo**	**1-year**	**3-year**	**5-year**	**10-year**	**Inception**
Forge First Long Short LP (Class F Lead Series)	-0.24%	-0.24%	2.21%	4.25%	13.08%	5.59%	10.24%	8.84%	13.13%
Forge First Multi Strategy LP (Class F Lead Series)	-0.03%	-0.03%	6.84%	5.30%	18.51%	9.25%	11.51%	8.04%	11.08%
S&P/TSX Composite Total Return Index	3.48%	3.48%	6.47%	12.11%	25.19%	9.97%	11.45%	8.96%	9.75%
S&P 500 Total Return Index (C$)	2.86%	2.86%	9.87%	14.84%	35.88%	16.70%	17.13%	15.18%	18.05%

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.

After a solid risk-adjusted net return profile during 2024, we were disappointed with our first month of 2025. The Class F Lead Series of our Multi Strategy LP fell -0.03% net of fees. Gains were led by credit on the positive side of the ledger, hedges being a flat performer, and equities exhibiting a modest drag. The credit book benefited from Canadian 5-year government yields reaching 2.5-year lows driven by ongoing concerns about the Canadian economy. Positioned mostly in Canadian bank paper, with these credits hedged by the ownership of listed puts on Canadian bank stocks, we continue to see high single digit yield to maturities in these instruments.

Within the equity sleeve of the fund, Industrials, with winners on each of the long and short side of the book, led the charge. Towards the latter part of the month, presuming tariff-related weakness could be forthcoming, we reduced our exposure to Canadian Pacific Kansas City Ltd. (CP.CA) and Canadian National Railway Co. (CNR.CA), only to add back shares, particularly in CP, post the tariff news from early last week. Consumer Cyclical stocks were another source of strength last month, with U.S. housing exposure and Amazon.com Inc. (AMZN.US) leading the way. Losing equity sectors included Technology and Energy. Lumine Group Inc. (LMN.CA) a core holding since it was spun-off from Constellation Software Inc. (CSU.CA) just shy of two years ago, saw its shares decline due to the announced short-term medical leave of its CEO and the robust levels of M&A at its sister spin-off company Topicus.com Inc. (TOI.CA). We've been buyers of Lumine Group on this weakness. The delta-adjusted gross and net exposure of this fund ended the month at +265% and +69% respectively, with the net exposure split between common equities at +26% and fixed income including preferred shares sitting at +33%.

The Class F Lead Series of our Long Short LP fell -0.24% including fees during the month of January, driven by equity losses in Energy, Utilities and Financials. Winners included large cap Technology, and the same U.S. homebuilders trade referenced above for the Multi Strategy LP. Losing positions included Helix Energy Group Solutions Inc. (HLX.US), an offshore energy service company and Trisura Group Ltd. (TSU.CA), an insurance company. Despite the fact Helix has 65% of its forward 3-year business contracted with the '25 components priced up by 20% to 40% from last year, and spot rates up 20%, negative sentiment towards offshore oil has pushed the shares lower. Helix shares trade at 3.5X EBITDA, offer a 17% free cash flow yield, and we expect management will be active in their authorized US$200M buyback (versus $1.25B market cap) this year.



Source: Bloomberg

Trisura shares have been weak due to expected reserve charges surrounding their exit from their U.S. business despite having been well telegraphed by management. Now trading at levels below the value of their Canadian business, we believe the market has "more than thrown out the baby with the bath water". Looking ahead, despite the pressures facing the Canadian economy, we foresee opportunities in the historic spreads between the yields on rate sensitive securities and government bonds. Of course, the magnitude of these differentials has been driven by the distinct loosening of financial conditions in Canada by the Bank of Canada that is confirmed within the white oval on the far right side of the above three-year graph. The fund exited the month of January with delta-adjusted gross and net exposure of +153% and +59% respectively.

Shifting to markets, we believe respectable rates of U.S. economic growth, driven largely by the ongoing impact of Biden's fiscal stimulus complemented by the wealth effect kicking in as of 9+ months ago, combined with still ample liquidity should enable equities to remain generally okay for the near term. We don't believe there is an imminent bursting of a bubble and hasten to remind investors that markets break from a reduction in earnings growth (cyclical) or an exogenous event (COVID, 9/11) versus a popping of valuations. True, markets are expensive hence President Trump's frenetic energy will likely translate into sideways markets for the near term, and the risk remains he does something that disrupts said markets. Short of such an action we believe the setback in stocks will await a reversal in liquidity conditions beginning during late '25 and into '26 and/or an economic slowdown. Of course, rarely do things go according to plan, hence with that outlook summary, let's shift to tariffs.

Source: Goldman Sachs, Bloomberg

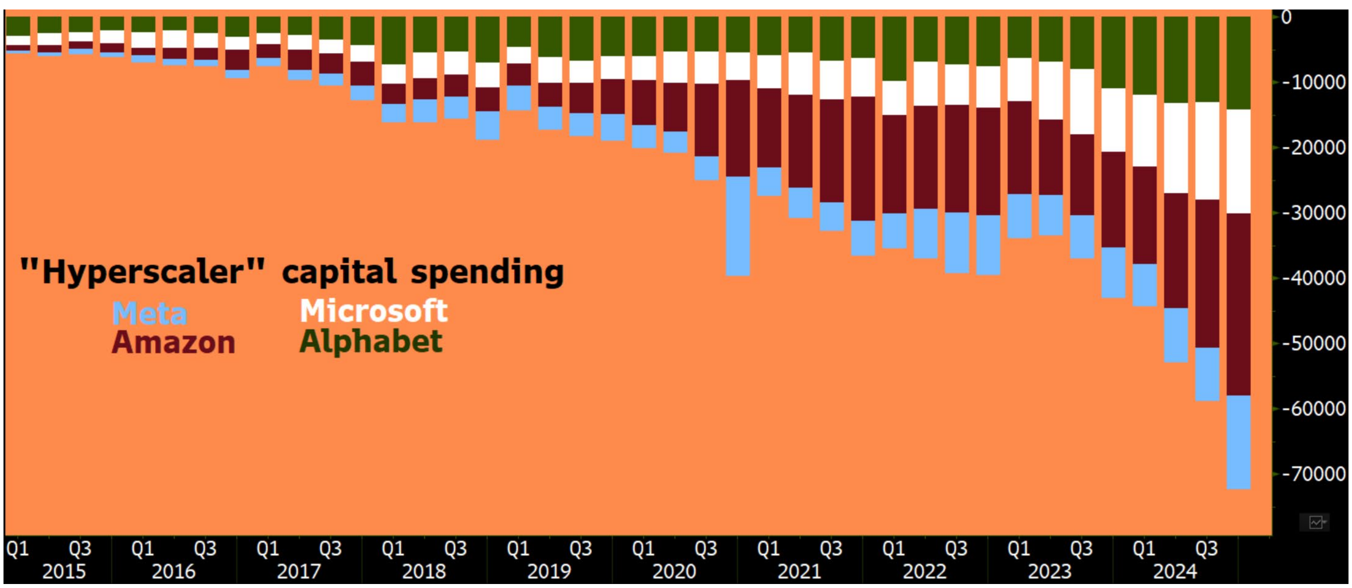
Tariff headlines from the Trump administration increased in both frequency and severity during the month of January, culminating with the announced, then delayed for one month, 25% across the board tariffs on products imported from Canada and Mexico, with a lesser 10% tariff on Canadian energy products. Trump also introduced an incremental 10% tariff on imports from China. As you can see from the above indexed graph of tariff baskets created by Goldman Sachs, Canadian-listed, exposed companies (white line) significantly underperformed U.S.-listed, exposed companies (dark red line) and U.S. consumer companies (yellow line), beginning in early December.

Then in front of a U.S. Senate Commerce Committee session, Commerce Secretary Howard Lutnick referred to the news against Canada as "an action of domestic policy versus a tariff action", a tactic meant to catalyze Canada to "fix its border". Lutnick went on to say that given border actions deemed appropriate by the President these incremental 30% tariffs won't happen and Canada may only be vulnerable to decisions on trade emanating from studies expected to commence during April pertaining to ordinary tariff cases. Frankly, it's tough not to wonder whether the "stick and the carrot" will ever stop moving, which of course equates to uncertainty, a variable nobody nor markets like!

A sustained North American trade war would be stagflationary, sinking both growth and profits, raising the risk of higher inflation, and pushing the Canadian economy into a recession. Tariffs are taxes, and when you tax something you get less of it. Who pays the tariff depends on the elasticity of supply and demand for the goods. To quote BMO Economics, such tariffs could reduce real Canadian GDP by 2% during '25, boost unemployment to 8%, and cause the BoC to cut its overnight rate by an additional 100 bps, ending at 1.50%. Goldman Sachs estimates that ceteris paribus every 5-point increase in the U.S. tariff would shrink S&P 500 EPS by 1%-2%.

Currently, we presume the financial professionals in Trump's cabinet, such as Treasury Secretary Bessent, will limit the scale and severity of long-term trade implications. The macro views and positioning levels that we discussed in our year ahead commentary have not changed in any substantive fashion. If we derive strong conviction, plus note actual developments that suggest a prolonged and sizeable impact to U.S. growth and inflation, we will adopt a macro positioning viewpoint that would reduce equity exposure below long-term averages and rotate equity exposure within the portfolio. Such a shift would be similar to the positioning we successfully adopted during the 2022 inflationary cycle.

Shifting to DeepSeek, the key question becomes whether the hyperscalers will continue to require as many chips to train their large language models (LLMs) at the front end and as many chips for inference (use of the LLMs) at the back end. Based on Q4 earnings releases and conference calls from the four companies shown in the quarterly capital spending bar chart below, the answer is a resounding no! Q4 capex increased to more than US$70B and guidance for group capex during 2025 sits at US$320B, a 32% increase from their spend during 2024. Having said that, we acknowledge a gap will exist between the innovations discussed and the timing of this future demand, hence we have adjusted our positioning to leave room for potential near term weakness in the ASIC and GPU segments of the chip industry.



Source: Bloomberg

Looking at a more general impact of DeepSeek, losing companies will include those business models dependent on training LLMs as those revenue lines could decline precipitously. Alternatively, winners could include companies that benefit from a greater adoption of inference with this growth occurring at an accelerated pace. During our [On Demand Insights webinar] on the outlook for AI we expressed a desire for increased exposure to software and Edge AI. The introduction of DeepSeek further increases our appetite to hold exposure to these segments.

The world appears to have many crazy and disturbing events going on right now, but one dependable constant is the team at Forge First who will stick to our discipline and execute on our mandate. You can count on us to always include 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 and please let us know if you have any questions.

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