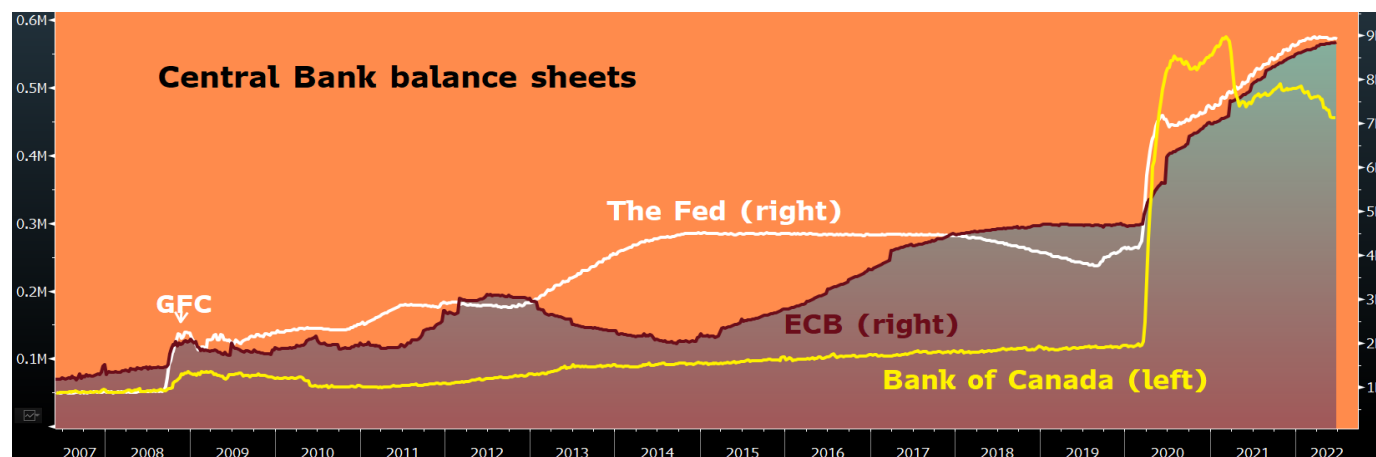


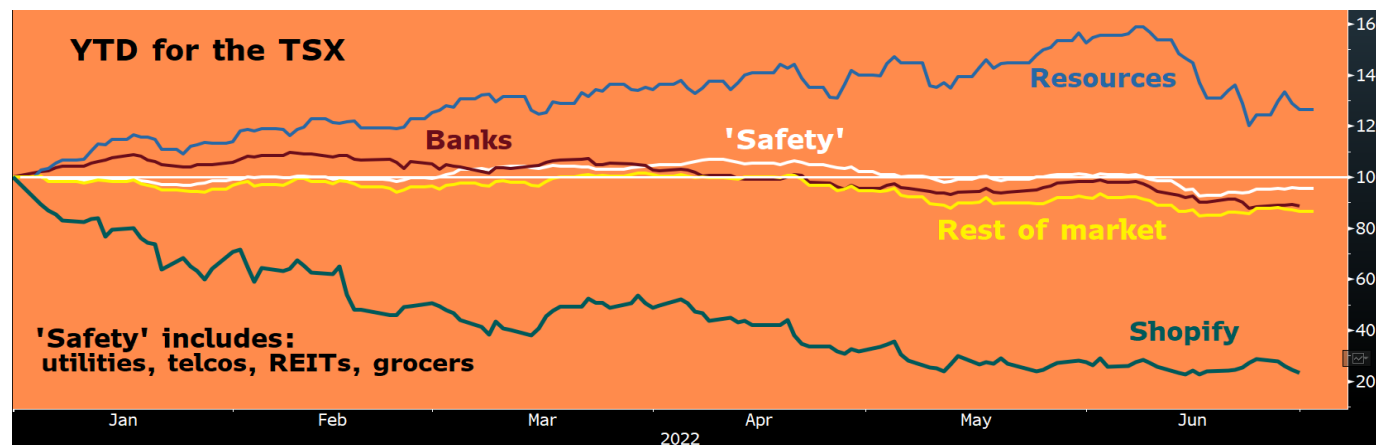
June 2022 Commentary

While we all knew the party was going to end at some point, few expected such a reckoning to begin during the first half of 2022. In our year-ahead commentary, published in early January, we cautioned investors that 2022 could be a down year for markets based on the impact of sticky supply chains and weakening economic growth. However, we saw market weakness in H2, not H1. The principal reason for the earlier-than-expected shellacking of all things financial was clearly the Fed. The central bank of the U.S. waited far too long to admit inflation wasn't 'transitory' and then shocked the market with a 180-degree turn during the 2nd week of January. Yet, talk is cheap (except for the negative wealth effect on investors) because, as you can see from the white line on the 15-year graph below, as of June 30th, the Fed has yet to begin to shrink the size of its balance sheet. But let's not get ahead of ourselves, and prior to reviewing the second half outlook for markets, let's recap H1 and discuss why June was so ugly.



Source: Bloomberg

When the Fed became hawkish during January, realizing how far behind the curve they were, they took a very aggressive stance. As is often the case, bonds discounted the shift before stocks, with yields on UST2s moving from 0.73% at year-end 2021 to 2.50% by March 31st, while UST10s saw their yields almost double by mid-April to 2.94%. The impact on stocks was predictable. Defensive or 'safety' stocks (white line on YTD indexed graph below) began to outperform, risky &/or speculative stocks, think Shopify Inc. (SHOP.CA, green line below) underperformed while the rest of the non-resource sector parts of the market (banks in red, 'rest of market' in yellow) moved in step with the declining indices. The one outlier was resource stocks, as the bull market, partially catalyzed by the supply shock from COVID-19, continued to have legs.



Source: Bloomberg

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The YTD tallies were ugly, as excluding dividends, the SPX and NASDAQ fell 20.6% and 29.5% respectively while a U.S. long government bond ETF (TLT.US) plunged 20.8% (Canadian equivalent XRB.CA fell 13.8%), the 10-2 yield curve flattened by 79 basis points (“bps”) and there was a marked widening in credit spreads (IG by 69 bps and HY by 265 bps). As of July 1st, only 32% of the S&P 500 companies showed positive y/y stock price comparisons. Here at home, the numbers weren’t pretty, but not nearly as bad as in the U.S., thanks to the much heavier energy weighting in the TSX (18.4% vs. 4.4% in the SPX) and the fact that the price of the heavily weighted Canadian bank index fell ‘only’ 11.5% vs. the 25.4% thrashing seen for U.S. bank stocks. Note we mentioned energy not resources in that last sentence because, while the energy index was up 23.5% (34.3% for the E&P sub-index), gold stocks fell 10% and base metals experienced a round trip, up 37% by mid-April, yet negative for the half year. Overall, the YTD price of the TSX fell 11.1% through June 30th, including a 9% decline during June, yet when dividends were added, the YTD total return loss stood at 9.8%.

	YTD	1 mo	3 mo	6 mo	1 year	----- Annualized -----		
						3 year	5 year	Inception
Forge First Long Short LP (Class F Lead Series)	0.67%	-4.09%	-5.16%	0.67%	0.39%	13.40%	11.15%	14.83%
Forge First Multi Strategy LP (Class F Lead Series)	0.85%	-1.09%	-0.63%	0.85%	0.46%	11.01%	8.49%	11.27%
TSX Total Return	-9.87%	-8.71%	-13.19%	-9.87%	-3.87%	7.97%	7.62%	8.16%
S&P 500 Total Return (US\$)	-19.96%	-8.25%	-16.10%	-19.96%	-10.62%	10.60%	11.31%	12.92%

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.

At Forge First, we’re pleased that each of our two funds ended the first half with positive year-to-date net returns. Broadly speaking, we attribute this performance to our disciplined approach to managing client capital; a recipe that always includes a diversified short book, listed put options and for the past two years, our constructive stance towards energy stocks.

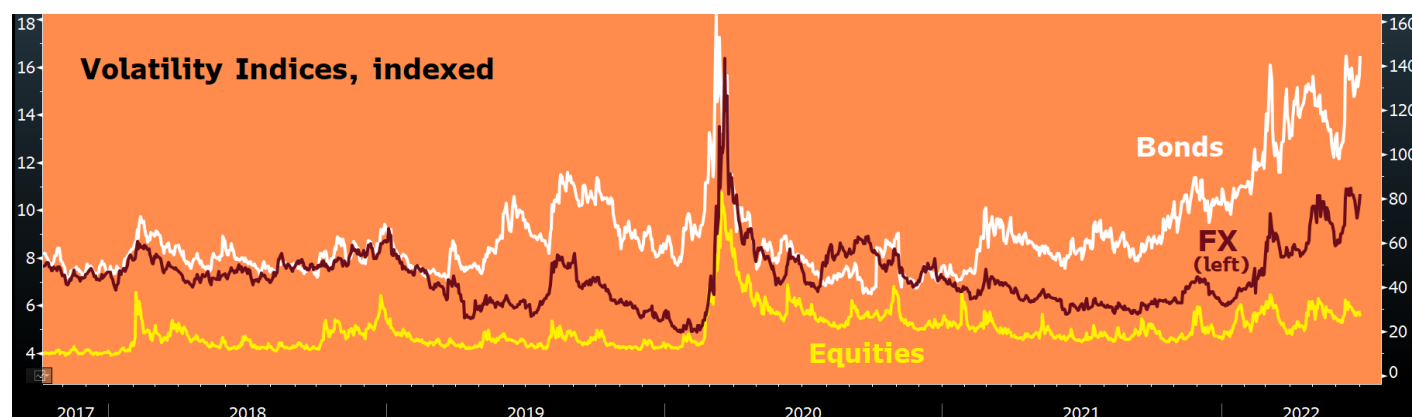
This positive YTD net performance includes the month of June, a period during which each of our two funds succumbed to market pressures and suffered losses. The Class F Lead Series of our Long Short LP fell 4.09% including fees during June, such that its year-to-date net gain sat at +0.67% at the mid-point of 2022. The extreme mid-month rotation after the June Fed meeting yielded material weakness in the energy sector, a sector important to the positioning of our funds given our continued constructive outlook for oil and natural gas. Weakness was pervasive across this sector; hence, the impact of our mid-teens net long exposure was painful. Most other sectors also suffered losses, while the largest positive contributor to the fund was its short book and listed index put options. Biggest single name losers were long-held Enviva Inc. (EVA.US) and Tourmaline Oil Corp. (TOU.CA). The Long Short LP exited the month with delta-adjusted gross and net exposures of 119% and 5%.

The Class F Lead Series of our multi-asset Multi Strategy LP fell 1.09% including fees during the month of June, as losses in its capital growth or common equity sleeve and a modest decline in the value of its yield-enhancing strategies bucket, more than offset solid gains in the asset protection section of the portfolio. Within the common equity portion of the portfolio, similar to our Long Short LP, sector-wise Energy dominated the losses, while Air Canada Inc. (AC.CA) and Enviva Corp. (EVA.US) stood out as single name losing positions. The fund exited the month with delta-adjusted gross and net exposure of 106% and 4% respectively. This net short position of the fund was composed of approximately +9% in the multi-asset sleeve, +7% in common equities, and a -12% position in the asset protection section of the book. Year to date through June 30th, the Class F Lead Series of our Multi Strategy LP gained 0.85% net of fees.

So, what’s the outlook for H2 of 2022? Exclusive of the potential impact of exogenous events, the storyline for stocks will continue to be driven by the outlook for inflation and economic growth. Key questions include whether the rate of core inflation starts to decline at a pace supportive of a dovish Fed pivot six to 12 months from now; an event that would be

helpful for stocks? Conversely, one of the nastiest of outcomes for stocks would occur if ongoing supply chain challenges, continuing high energy prices and further gains in rental prices causes inflation to persist at elevated levels for longer, regardless as to whether the economy is falling into a recession. Do the November U.S. mid-term elections play into this calculus? While only time will tell on these points/questions, let's review a few items.

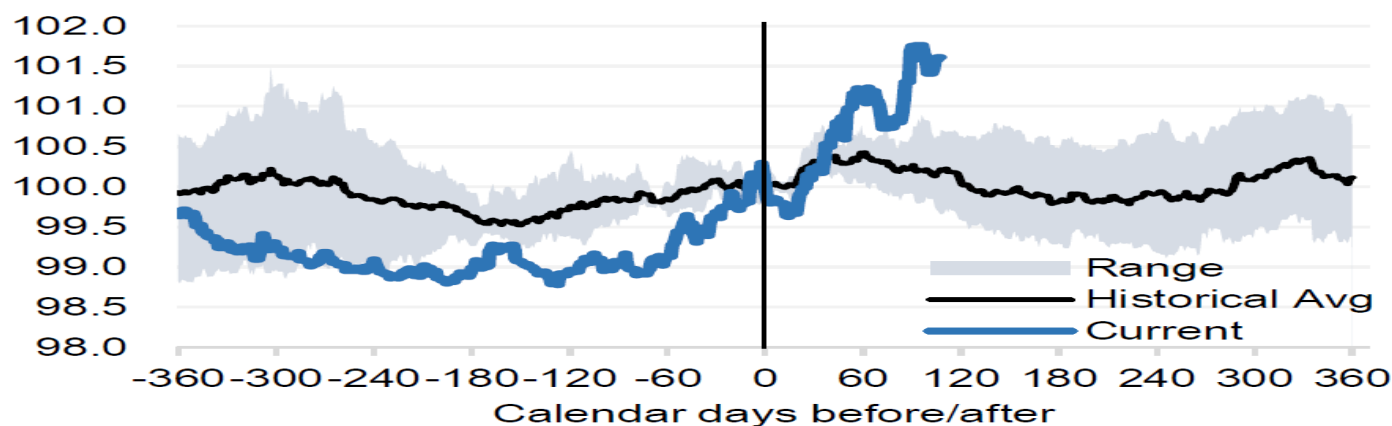
Year to date, the market drop has been solely attributable to a decline in the valuation multiple for stocks. Higher than forecast inflation readings catalyzed a faster-than-expected pace of Fed tightening, triggering a back-up in nominal yields, led by real yields, serving to compress the P/E multiple for the SPX by 24%, from 21X to 16X. If this fact didn't make markets challenging enough, increasing volatility has exacerbated the stress on investors. YTD, the SPX has registered a daily move of greater than 2% on more than 20% of trading days, 2.5X the average frequency during the past 20 years. To top it off, the four bear market rallies (of greater than 6% each) have added to this tension. Perhaps ominously, note in the 5-year graph below, the rising volatility being exhibited in bond and currency markets, often a precursor to heightened volatility in equity markets.



Source: Bloomberg

As a result of rising yields, credit spreads, falling stock prices and the fact the U.S. dollar index is up 10% YTD, the Goldman Sachs Financial Conditions Index (please see graph below) sits at its tightest level at the start of a rate-hiking cycle since 1994. Yet, while financial conditions have tightened markedly and we hear many anecdotal stories of less trading liquidity (driven mostly by regulation), available capital remains ample, as evidenced by the NY Fed's daily reverse repo operations that regularly exceed US\$2T.

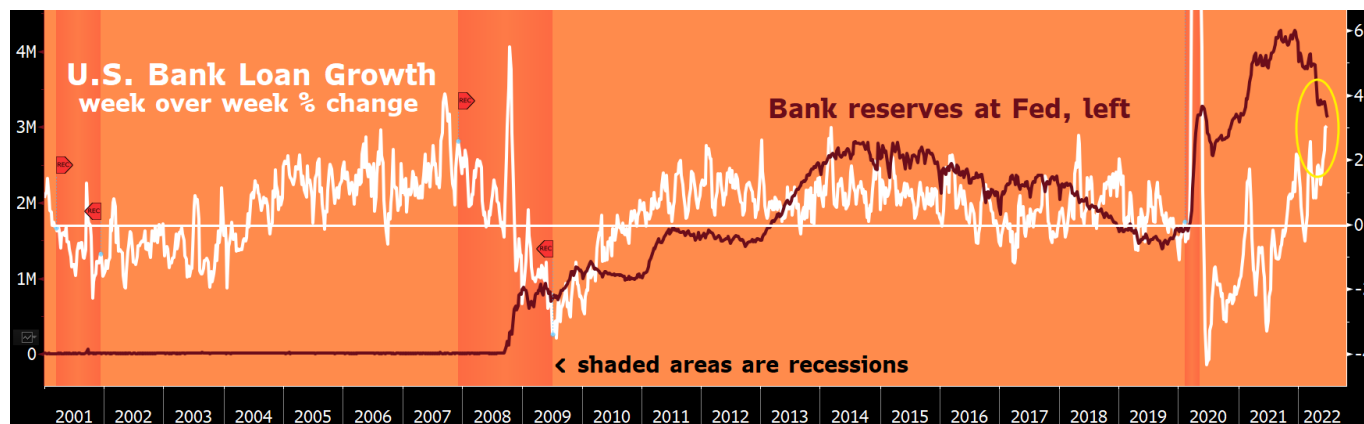
GS U.S. Financial conditions around start of rate hike cycle



Source: Evercore

Looking at this liquidity from a different angle, while U.S. commercial bank reserves have declined 25% from their November 2021 peak, the red line in the 20-year graph below highlights that private-sector banks remain awash in the

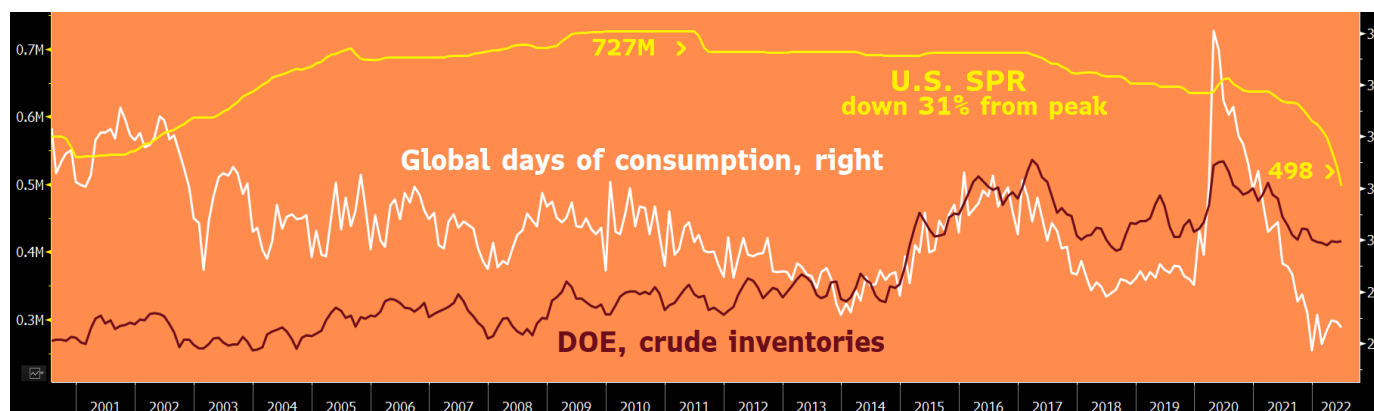
reserves (US\$3.13T as of June 29th) supplied under QE. Further note, inside the yellow oval on the right of the graph, bank lending (white line) is accelerating, recently running at a 7.9% annualized clip (all commercial loans, as consumer lending has dried up). Hence, hiking rates won't be enough to ensure the credit side of the economy plays its role in dampening inflation. The Fed's QT program, which only began last month, is needed, but at its current pace, would take the Fed at least three years to mop up these excess reserves. This elongated unwind offers one reason why there's no "Fed put" for equity investors just yet, as it is likely that Powell and company are hoping a reverse wealth effect will do much of their work for them.



Source: Bloomberg

We don't believe energy markets will help the Fed either in its fight to reduce inflation, as we continue to expect both oil and natural gas prices to stay higher for longer. Sure, the rate of change will cut headline inflation since oil doubling from \$50 to \$100 is a 100% increase, whereas an additional \$10-gain is only 10%. However, we view energy prices as 'ground zero' for inflation and don't believe the full extent of the existing rise in energy prices has yet to have been passed through to end users.

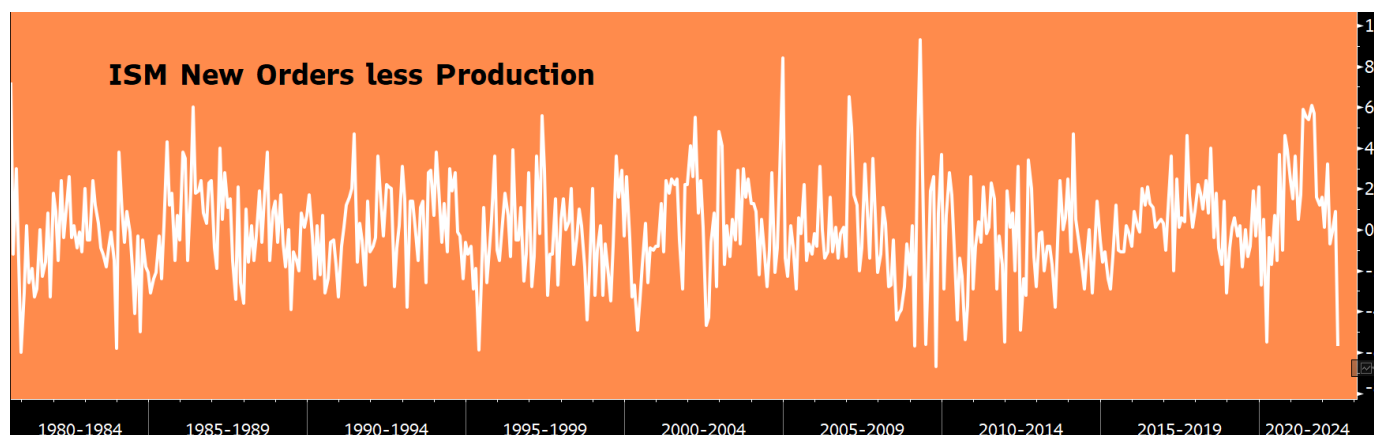
Further, the 20+ year graph below compares global days of consumption of oil in inventory (white line, right axis) to the U.S. Strategic Petroleum Reserve (SPR, yellow line, left axis) and the private sector U.S. Department of Energy ("DOE") oil inventories (red line, left axis). Notice how days of consumption is hovering near its lows, while the SPR is at its lowest level since the turn of the century and DOE inventories are at their lowest level since 2015. In addition, last month, 20 OPEC countries failed to produce their allowable quotas. Meanwhile, China's official Composite Purchasing Managers Index (PMI) rebounded to expansion territory and more recently, COVID lockdowns have been relaxed, likely serving to boost domestic consumption. The world continues to be short oil, a view supported by the continuing steep backwardation in the quote.



Source: Bloomberg

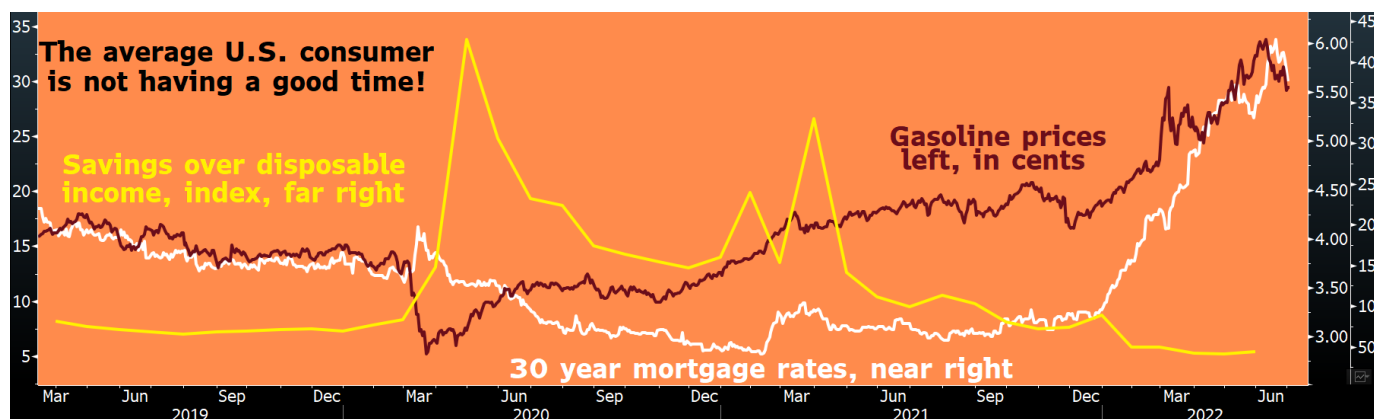
We believe sticky inflation (energy, rising prices for rent and strong credit demand) and a hawkish Fed (tough talk, rate hikes and QT) will continue to pressure the P/E multiple for stocks. Having said that, we acknowledge the potential for a multiple-driven countertrend rally in and around the July 27th Fed meeting, in case Powell communicates, with intent or not, the potential for a capitulation by the Fed. Such a short-term trading window would favour growth stocks over value stocks, several names of the former style we have home-worked and parked on the bench waiting for action. However, as discussed in our last commentary, in the medium-term, it is our view that bond yields move higher, and P/E multiples lower, due to the bigger picture changes in the supply vs. demand metrics of the sovereign bond market.

Shifting to growth, it is obvious the global economy is slowing markedly, and we stick to our beginning of year call that the U.S. will enter a recession by 2023. Having said that, it's worth noting that post the -1.6% annualized Q1 GDP print and the Atlanta Fed's forecast for Q2 GDP of -2.1%, it's possible a technical recession is already upon us. Regardless, the 40+ year graph below of ISM new orders less production illustrates how manufacturing has slowed markedly.



Source: Bloomberg

Also, given the doubling of mortgage rates (white line, near right axis) shown in the following graph, it's no surprise that trends in the housing market have plummeted. Gasoline prices (red line, left axis) remain near all-time highs and of course, recent personal spending data (especially on goods) widely missed expectations, savings as a percent of disposable income (yellow line, far right axis) are back to pre-2008 financial crisis levels and real hourly earnings remain negative. U.S. consumer spending will continue to slow.

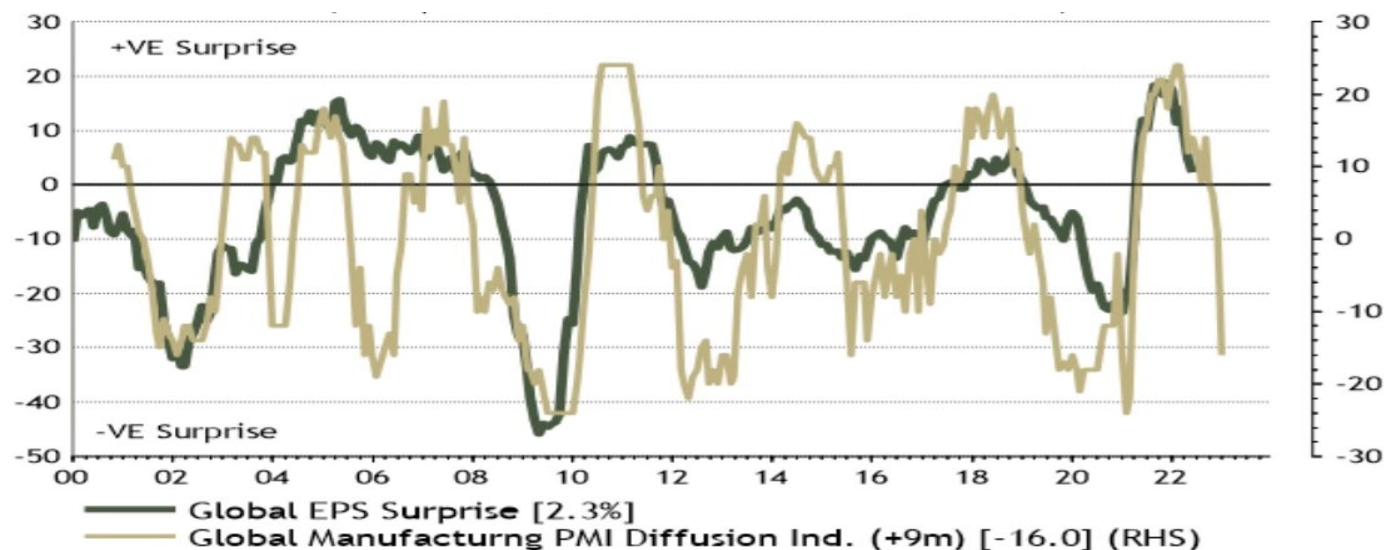


Source: Bloomberg

Finally, with fiscal stimulus in the rear-view mirror (and unlikely to be revitalized given the likely post-November 2022 D.C. gridlock), capital spending is the last standing component of final domestic demand. In last month's commentary, we highlighted the strong correlation of the CEO Confidence Index advanced six months against 3-month annualized real capital spending, and the picture wasn't pretty. There's little question CEO confidence will have soured further during the

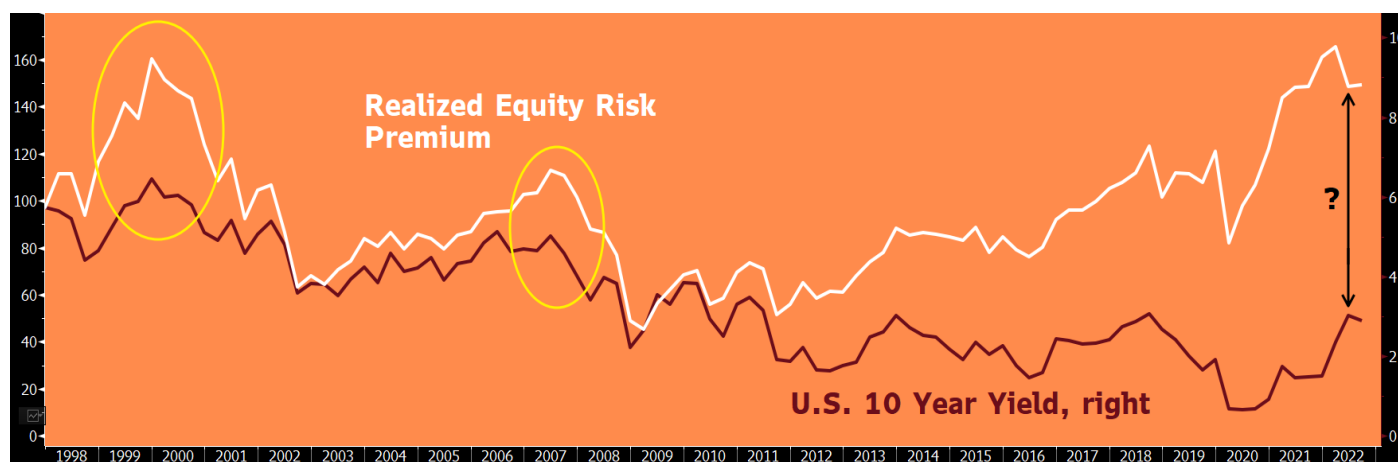
past several weeks. In addition, a recent Morgan Stanley CIO survey on tech spending highlighted that the number of CIOs expecting downward revisions to their 2022 tech budgets increased to 25% from 9% in their Q1 survey.

Slowing growth, let alone a pending recession, high energy prices, sticky inflation, and a U.S. dollar (as measured by the DYX Index) that is at its highest level since 2001, are a recipe for negative earnings revisions amongst S&P 500 companies. The 20+ year graph below advances the global manufacturing PMI diffusion index (increases less decreases, light green) against the global EPS surprise index (dark green). The logic of the fit is startlingly obvious. According to Goldman Sachs, on average since WWII, the median decline in EPS for the SPX has been 13%. In the same vein, and perhaps for the first time since the Technology sector was so important to markets, we read the following quote from a J.P. Morgan Q2 Internet preview report - "This sector continues to have secular growth, but it is far more mature than in 2008-2009, and the ability to offset broader, macro trends is more limited. As a result, all our companies are at risk in a slowing environment.". As Bob Dylan sang, "For the times they are a-changin' "!



Source: Bank of America

If as we suspect, negative EPS revisions for the SPX approximate 10%, that implies the pro-forma P/E could be considered 17.7X on forward earnings vs. the current 16.1X. That's not cheap enough for us to want to adjust anything other than tactical positioning. Prior to this year's decline, the SPX has endured 14 bear markets (declines >20%) since WWII. The average downturn lasted more than 11 months with a mean decline (pun intended) of more than 32%. Both measures imply investors could experience more pain.



Source: Bloomberg

One of the reasons why we remain cautious towards markets is illustrated by the above graph which shows the relationship between realized equity market premiums (white line, left axis) and the yield on a 10-year UST (red line, right axis). Notice how there tends to be a period of normalization subsequent to periods of substantial outperformance of equities relative to bonds. This relationship served as a strong predictor for the bear markets of 2000-2001 and 2008-2009 after the gap widened just prior to the actual market corrections. The latest gap began in 2011 and continued to widen until early 2022 when the right-hand side of the graph illustrates the first signs of a meaningful contraction. Is this instance another false positive similar to late 2018, or are we set for a further fall in realized equity returns?

That's of course the ultimate question and as discussed in this note, we believe the answer will be driven by the outlook for inflation, growth and actions taken by the Fed. While this note has enunciated our views, as is always the case, our portfolio construction will adhere to our long-held discipline of holding a diversified short book, owning listed put options plus long positions that generate lots of free cash-flow and are stylistically agnostic.

However, while policy accommodation peaked last Fall and the stimulus that markets have become addicted to, be it monetary or fiscal, has begun to shrink, we're also conscious of the previously stated potential for a countertrend rally and note the valuation for many stocks have become increasingly attractive. For example, we note several cash rich, macro cap tech stocks are now trading at 10X-12X operating cash flow, while quality industrial companies trade as low as 2X net cash positions. Hence, we expect to opportunistically increase our net exposure through the purchase of both growth and value-driven securities.

Also, despite increasing concerns about a recession, for three reasons, we will maintain our exposure to energy for three reasons. First, as discussed earlier, we remain constructive on the medium-term outlook for energy prices. Second, energy is less cyclical than other commodities such as base metals or basic materials. Finally, unlike those other resources, energy is most levered to rising geopolitical concerns.

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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