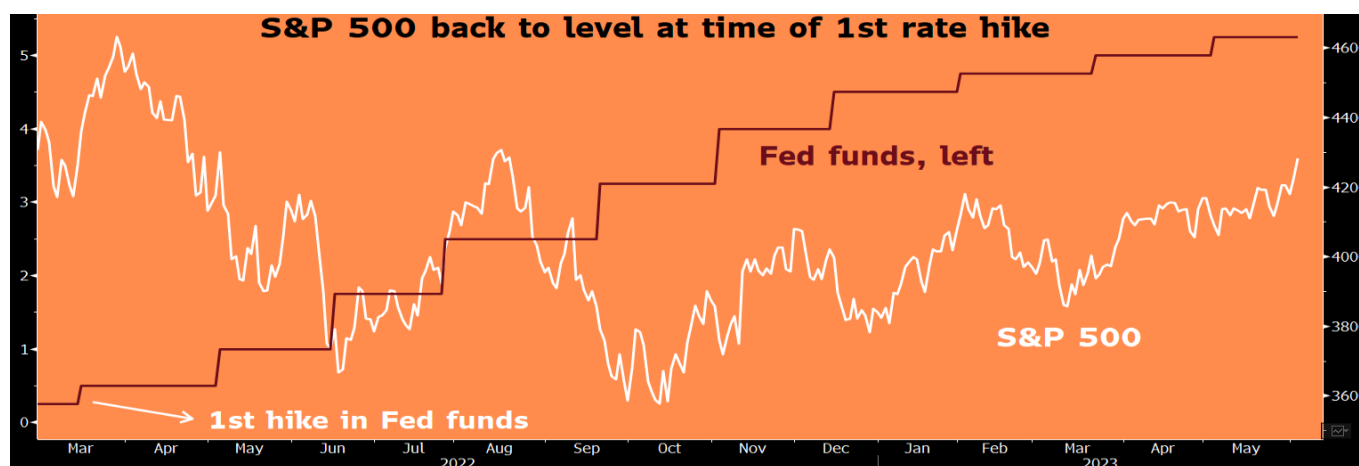


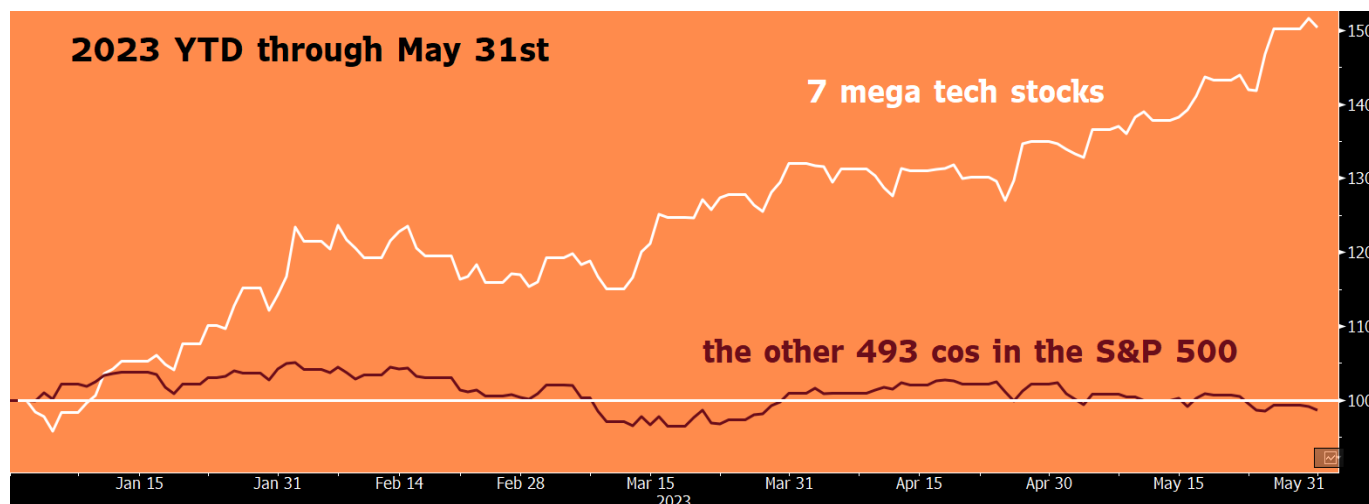
## May 2023 Commentary

While the story line for equities evolved during May 2023, the bottom line remained the same, as despite deteriorating market breadth, a handful of macro cap tech stocks enabled U.S. indices to close higher on the month. Hence, the S&P 500 (white line, right axis) exited May matching the price levels of mid-March 2022, back when the Fed initiated its series of rate hikes (red line, left axis). Washington's end of month debt ceiling and spending agreement, plus the growing belief that a 'not too hot, not too cold Goldilocks' economic environment may be unfolding in the U.S. (jobs data last week), undoubtedly played roles in the positive outcome. However, it strikes us that the role of large systematic buy programs should not be underestimated.



Source: Bloomberg

The year-to-date indexed graph below compares the performance of the seven mega cap tech stocks (white line) against the remaining 493 companies in the S&P 500 (red line). Rarely has a graph so obviously not needed an explanation. During May, only the three sectors (of a total of 11) of the S&P 500 that contain "tech" stocks saw gains, down from eight in April and seven in March, as the Consumer Discretionary (includes Amazon.com Inc. and Tesla Inc.) and Communication Services (includes Meta Platforms Inc. and Alphabet Inc.) indices joined the Info Tech sector 'in the green'.



Source: Bloomberg

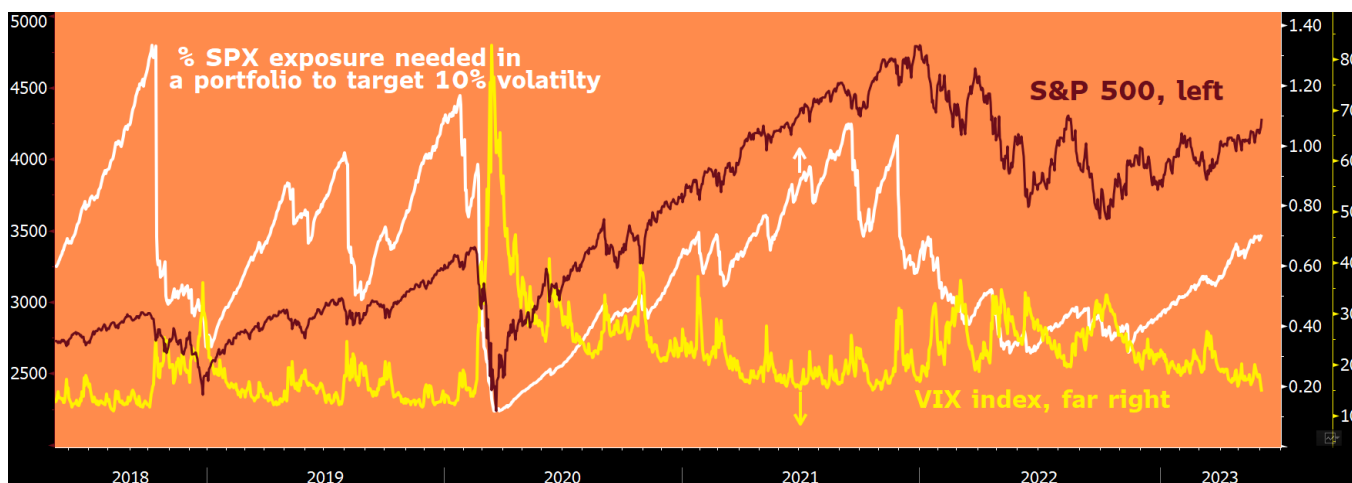
Market breadth was negative as 124 issues saw their prices rise, down from 266 in April and 263 during March, while 379 declined (235 in April, 240 during March) with 91 declining at least 10% (28 in April, 53 in March) and 11 falling greater than 20% (4 in April, 14 in March).

| 2023 Market Breadth for S&P 500 |     |       |       |
|---------------------------------|-----|-------|-------|
|                                 | May | April | March |
| Number of winning sectors       | 3   | 8     | 7     |
| Issues up                       | 124 | 266   | 263   |
| Issues down                     | 379 | 235   | 240   |
| Down >10%                       | 91  | 28    | 53    |
| Down >20%                       | 11  | 4     | 14    |

Source: Bloomberg

In chatting with U.S. trading desks, our team heard a common theme that the trading share of systematic (algorithmic or automated) traders had increased from the usual 15%-ish level to closer to 50% during the month of May. Understandably biased towards the most liquid securities, systematic traders undoubtedly played a role in the continuing rally of the mega caps, especially in light of the mini-AI craze catalyzed by the recent revenue guidance provided by Nvidia Corp. (NVDA.US).

The five-year graph below explains one reason for the significant increased participation by these 'quant funds'. The price of the S&P 500 (red line, left axis) is displayed against the VIX Index (yellow line, far right) and the net long exposure to the S&P 500 a portfolio would need to have so as to exhibit a volatility of 10% (white line, near right axis). Note on the far right of the graph, the marked increase in requisite net exposure from late 2022 through the end of May 2023. This obligatory higher net exposure is attributable to the decline in the VIX, which in turn we attribute to numerous factors including broadly lower net exposure among investors, the reduced rate of change in Fed tightening, the absence of price shocks in the commodities space and the Fed's backstopping of regional banks.



Source: Bloomberg

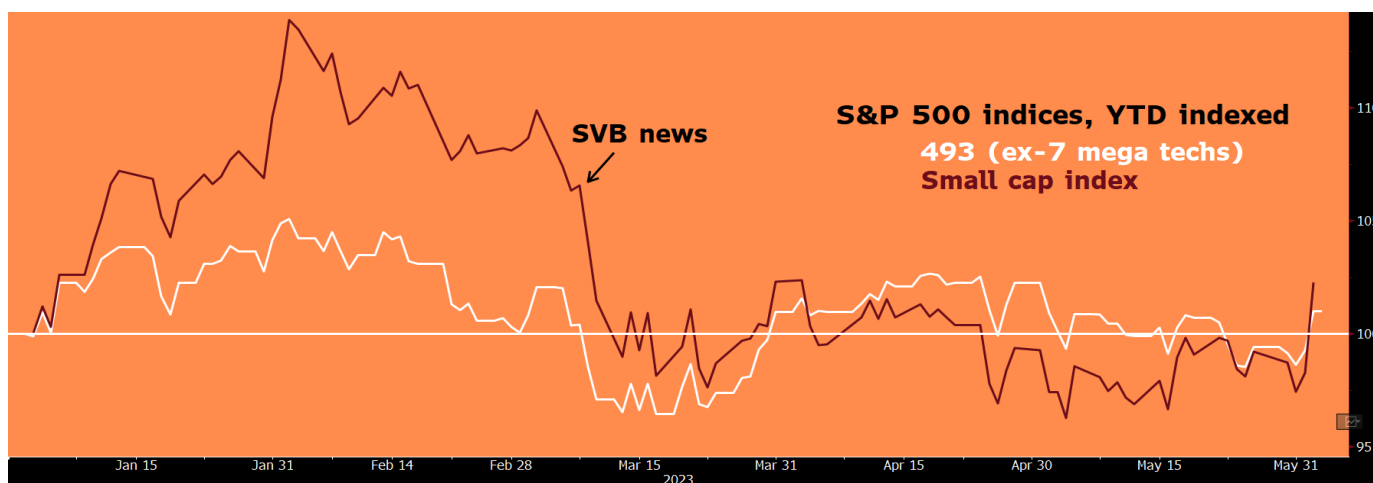
Here at home, investors were not so lucky, as soft bank earnings (19.7% index weight), falling commodity prices (28.9%) and the low exposure to technology stocks (7.6%) caused the total return index of the S&P TSX to fall by -4.95% during May. At Forge First, we had one fund that gained and one fund that suffered a modest decline. The Class F Lead Series our Long Short LP fell -0.39% net of fees due to losses principally in the Energy, Consumer Cyclical and Technology sectors while positions in Financials, Materials and Industrials accounted for the majority of the gains. Losing positions included hedges on our Technology exposure, Pet Valu Holdings Ltd. (PET.CA), and the net long exposure to Energy, given that WTI oil and natural gas fell 11.5% and 6.0% respectively. In contrast, weakness in our Gold exposure was more than offset by profits from our basket of shorts within the Base Metals and Materials complex, especially copper and iron ore. The fund also generated gains from short positions in Caterpillar Inc. (CAT.US), Deere & Co. (DE.US), and Bombardier Inc. (BBD/B.CA). Year to date, the net performance of the Class F Lead Series of the Long Short LP sits at +1.51%. The fund exited the month of May with delta-adjusted gross exposure of 107% and net exposure of 1%.

| As of May 31, 2023                                     | -----Annualized----- |        |        |        |        |         |        |         |           |
|--------------------------------------------------------|----------------------|--------|--------|--------|--------|---------|--------|---------|-----------|
|                                                        | YTD                  | 1-mo   | 3-mo   | 6-mo   | 1-year | 3-year  | 5-year | 10-year | Inception |
| Forge First Long Short LP<br>(Class F Lead Series)     | 1.51%                | -0.39% | 1.38%  | -1.38% | -6.93% | 10.17%  | 8.79%  | 11.81%  | 13.18%    |
| Forge First Multi Strategy LP<br>(Class F Lead Series) | 0.98%                | 0.42%  | 0.23%  | 0.66%  | 0.37%  | 10.62 % | 8.20%  | 9.13%   | 10.42%    |
| S&P/TSX Composite Total<br>Return Index                | 2.27%                | -4.95% | -2.40% | -2.74% | -2.46% | 12.10%  | 7.27%  | 7.66%   | 8.11%     |
| S&P 500 Total Return Index<br>(C\$)                    | 10.25%               | 0.82%  | 5.65%  | 3.87%  | 10.83% | 12.36 % | 12.10% | 15.09%  | 16.18%    |

**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 low volatility Multi Strategy LP generated a net gain of +0.42% for the month, boosting its year-to-date net return to +0.98%. May performance benefited from gains in the multi-asset and capital growth sleeves, offset by modest losses in the asset protection portion of the portfolio. Securities in the Financials and Technology sectors provided the greatest profits to the book, while the Consumer Cyclical sector generated the biggest loss.

While we believe the lagged impacts of tight monetary policy will continue to challenge forward growth, the positioning of this fund now includes a lower allocation to cyclical factors for the near term, replacing that short exposure with longer-dated index hedges at two-year lows in implied volatility. The fund has also increased its exposure to service-oriented cyclicals that continue to be relative winners in a bifurcated economy. Selections include Air Canada (AC.CA) and Starbucks Corp. (SBUX.US). The fund exited May with delta-adjusted gross and net exposure of 106% and 23% respectively, with the net exposure split between common equities (4%) and multi-assets (19%).

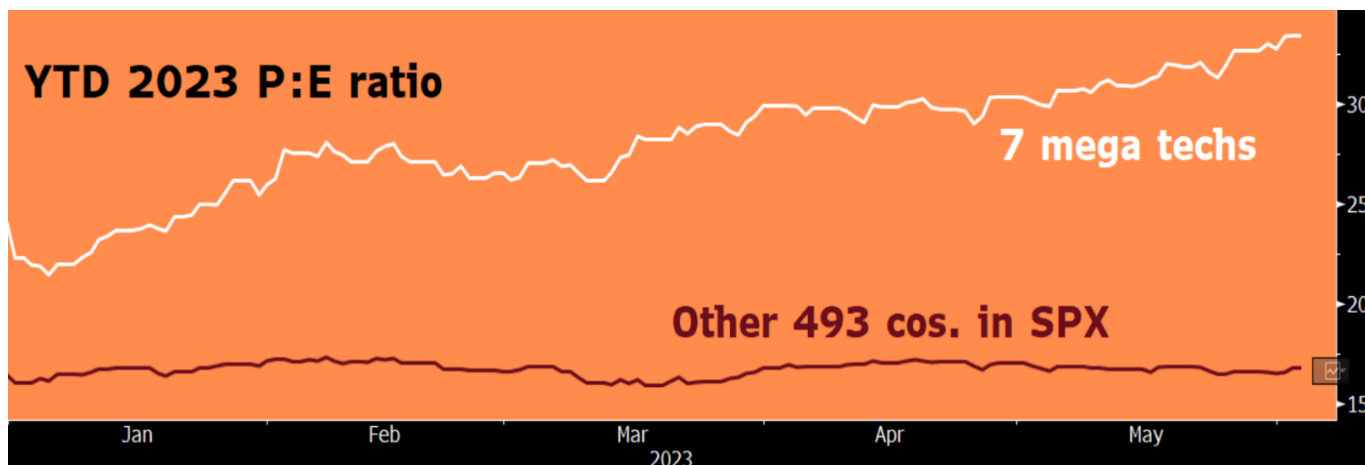


Source: Bloomberg

Aside from the gains in the seven macro tech stocks, the above year-to-date indexed graph indicates that the remaining 493 issues in the S&P 500 (white line) have performed as poorly as small cap stocks (red line). If you haven't owned any of the big 7, it's been a pretty tough year. After having owned Microsoft Corp. (MSFT.US) and Alphabet Inc. (GOOG.US) for more than five years, we sold these two positions early in 2023, after forming the view that the material job layoffs in the tech sector would disrupt the cloud and seat licensing business.

Overall corporate revenue growth has slowed markedly at these seven tech giants, with various units at the different companies actually printing year-over-year declines in revenues. However, the almost instantaneous income statement benefit from the aggressive cost-cutting programs that companies including Microsoft and Alphabet embarked upon, mitigated potential margin erosion. In addition, general skittishness towards most sectors of the market (especially since the regional banking crisis) caused investors to seek safety in these securities. These two facts have enabled this handful of stocks to see huge gains this year. Having said that, as can be gleaned from the year-to-date graph below, the gains have been strictly on the back of valuation expansion as the P:E multiple for these seven stocks (white line) has advanced more than 50%, now sitting at >33X EPS versus 21X times in early January; but of course, gains are gains! In contrast, note how the multiple accorded to the remaining 493 stocks in the S&P 500 hasn't budged. When combined with the (to-date) modest decline in year-over-year

earnings, it is no surprise the indexed price of this group sat on the negative side of flat at the end of May relative to the end of 2022.



Source: Bloomberg

Typically, when growth is scarce, investors bid up the price of growth stocks; the mirror image to the rationale for the outperformance of value stocks at the start of an economic cycle. The relative strength graph below, which begins in January 2022 on the left of the horizontal axis, indicates that value stocks have materially underperformed growth stocks, in each of the S&P 500 (red line) and the Russell 2000 (white line), from the start of 2023. Interestingly, note that the relative underperformance of value to growth in the S&P 500 is less severe than for the Russell 2000, even though the big 7 'tech' stocks are in the S&P 500 and not the Russell 2000.



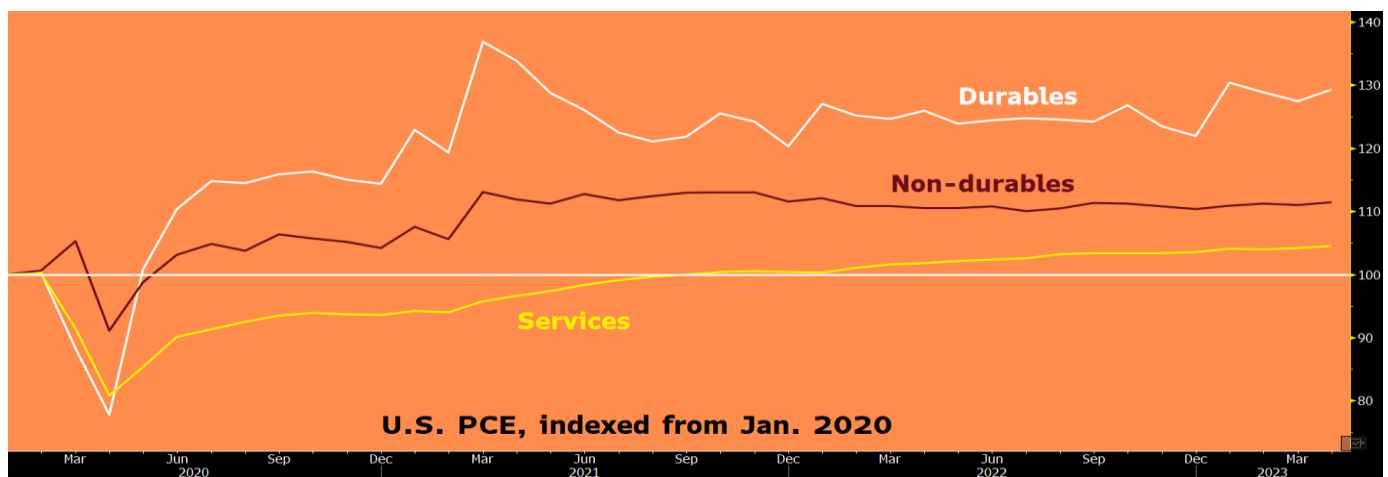
Source: Bloomberg

Assessing U.S. equity markets from the lens of a different factor pair, the 7+ year graph below compares the relative strength of cyclical versus defensive stocks (white line) against the U.S. 10-year nominal yield (red line, left axis). While value and cyclical stocks are not synonymous, shares in the Industrials and Banking sectors often exhibit a degree of overlap between these two factors. Assuming interest rates are rising due to inflation, cyclical stocks (companies which generally don't have pricing power) tend to benefit relative to defensive stocks, especially ones characterized as 'bond proxies', think Telcos, REITs and Utilities. With that in mind, please look at the right-hand side of this graph. Note how cyclical stocks markedly underperformed defensive stocks when markets became fearful of a recession (first arrow, on the left) during mid-2022, then outperformed when growth fears abated, taking a backseat to rising bond yields (second arrow, on the right), as this 2nd leg higher in yields was triggered by inflation versus a 'normalization' of monetary policy.



Source: Bloomberg

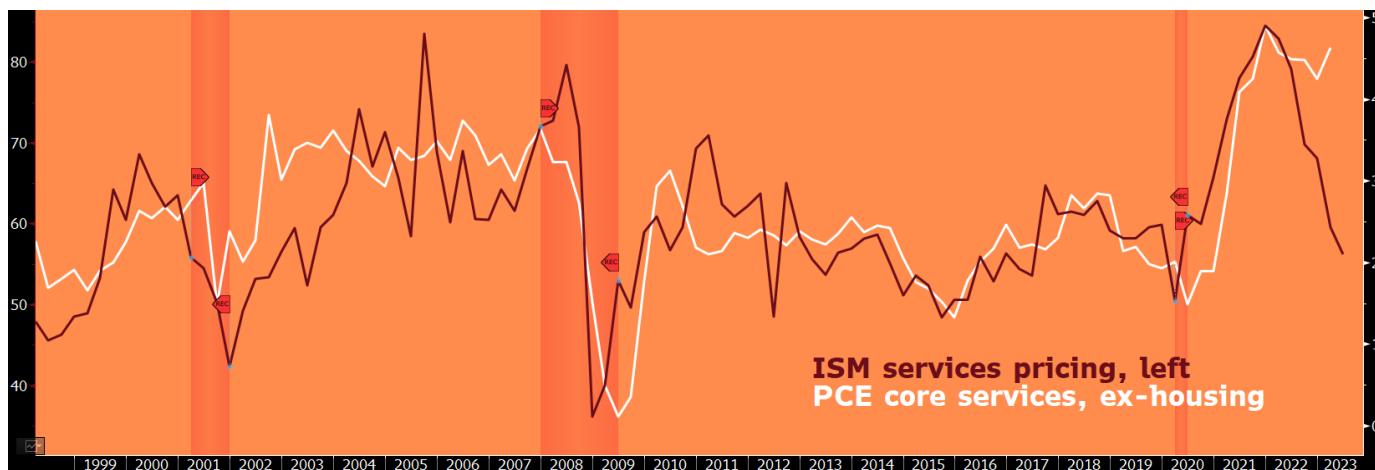
With that backdrop, let's shift to our current thinking towards growth and inflation, and hence markets. While the U.S. economy has proven more resilient than expected, growth has begun to slow with GDP currently trending around 1%. Yet, job markets remain strong. Sure, leading indicators suggest a weakening employment environment including household employment and slowing temp jobs, yet wage growth remains well above levels aligned with 2% inflation. In addition, the 'quits' rate and the NFIB wage intention surveys imply the Fed still has work to do. It's true, quarterly commentary from the likes of Wal-Mart, Home Depot and Target confirm consumer spending is slowing, yet the indexed graph below implies spending on services continues to lag that of durables and non-durables. Meanwhile, leading indicators infer that the ISM Manufacturing Index has further to fall, plus the new budget deal in America will, at the margin, serve to tighten the fiscal belt. While delayed, the slowdown is coming.



Source: Bloomberg

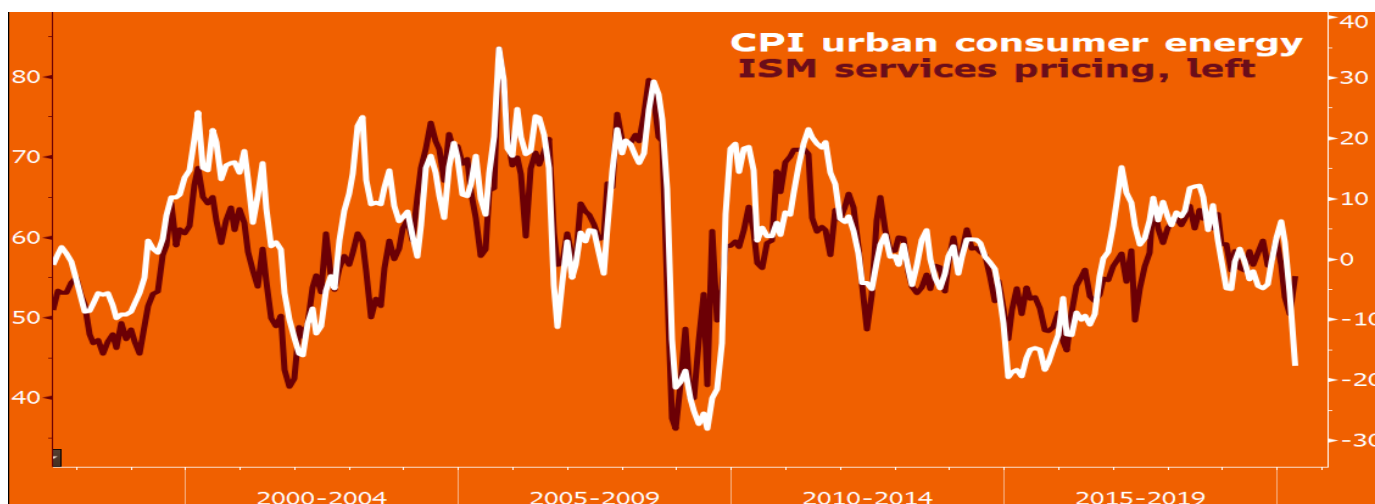
Historically, inflation falls commensurately with growth, and the harder growth falls, the more rapidly inflation will fall. As we wrote months ago, the road to 3.5% PCE Core is highly believable, and the data implies inflation is inching in that direction, but the move towards the low 2s will be tough. We maintain that service sector inflation will remain sticky due to employment costs and weak productivity. The next two graphs will address these factors.

The fit between ISM Services pricing (red line, left axis) and the Fed's 'go-to' PCE Core Services, Ex-Housing (white line, right axis) is obvious in the 25-year graph below, except for today! Note the recent divergence. We attribute this divergence to at least two influences.



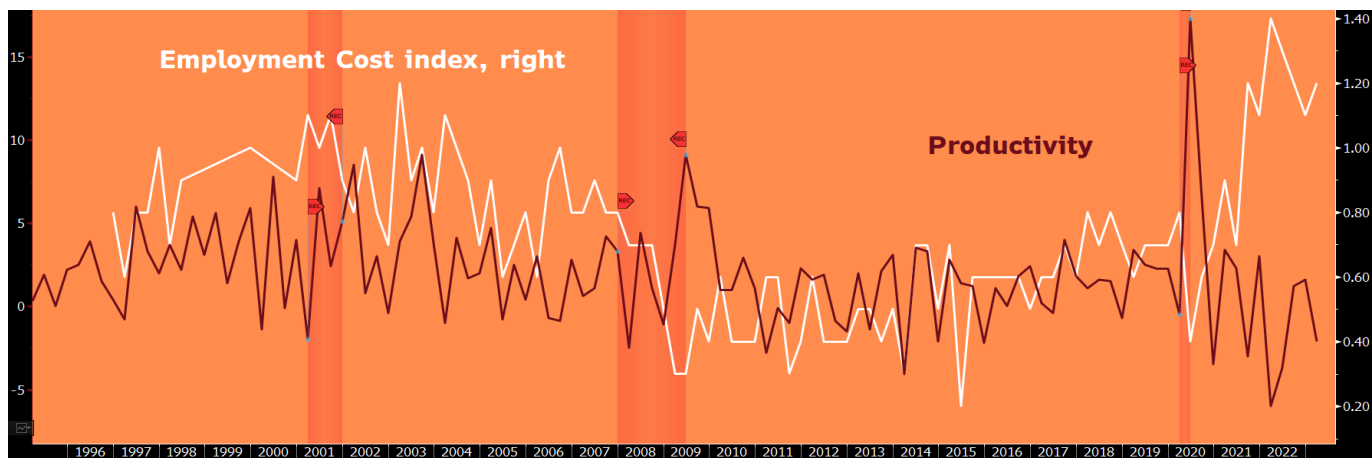
Source: Bloomberg

First, the ISM Service Pricing Index includes the prices of both goods and services purchased by service sector companies including energy (transportation costs), a variable with a lower impact on the PCE Core Services, Ex-Housing data point. With respect to energy, notice the precipitous fall in the CPI Urban Consumer Energy Index (white line, right axis) that has undoubtedly helped to drag down the ISM. In contrast, employment cost pressures are expected to continue to have a substantial upward impact on PCE Core Services, Ex-Housing.



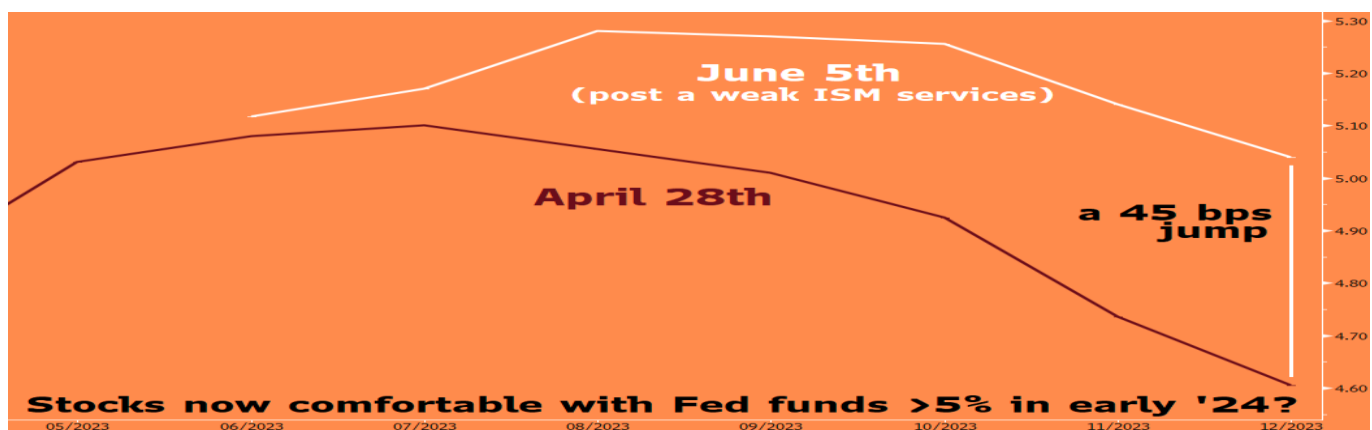
Source: Bloomberg

Lousy productivity is the second reason we believe service inflation will stay stickier, making the road below 3.5% tough for the Fed to navigate. The following long-term graph compares the U.S. Employment Cost Index (white line, right axis) against productivity (red line, left axis). Slowing economic growth and continued hiring in the labour market imply continuing weak productivity and in turn, sticky inflation. So, while a moderation in rental costs will help slow both CPI & PCE during the back half of 2023, the Fed won't consider cutting rates until well into 2024.



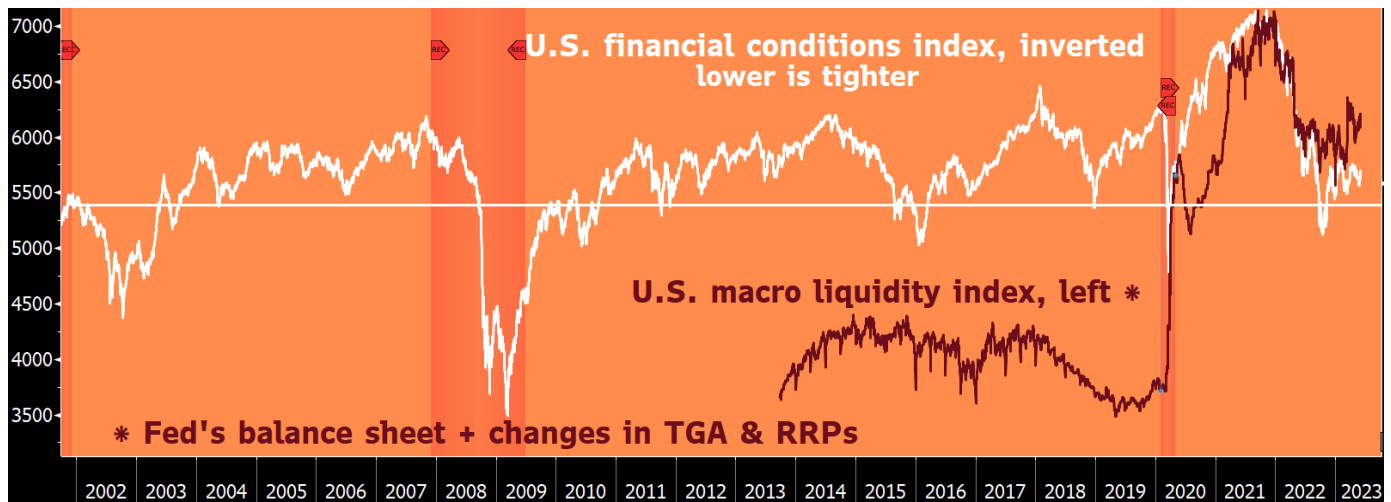
Source: Bloomberg

The graph below illustrates that investors have finally acknowledged that the Fed won't be cutting rates this year; in fact, markets have priced in one more rate hike! The horizontal axis runs from May through December of 2023. The red line was the Fed futures curve on April 28th and the white line was the Fed futures curve post Monday's weak ISM Services data. Regular readers know we've suggested since last Fall that the Fed would not be cutting rates until 2024. That was one of the reasons why our funds have remained conservatively positioned year to date. Hence, it is an understatement to say we're frustrated that markets went up when investors priced in three rate cuts for this year, and so too when instead of any cuts, investors now expect another hike! Oh, markets are a humbling experience!



Source: Bloomberg

Our team strives to constantly reassess the validity of the rationale driving the positioning of our funds; dogmatism isn't allowed. Given our outlook for weakening economic growth plus sticky inflation and higher-for-longer interest rates, we continue to believe it would be imprudent to substantially increase our net exposure. While the nirvana investing environment called 'Goldilocks' remains a possibility for the reasons discussed above, we don't believe it's the most likely outcome. In fact, we believe liquidity continues to be the biggest driver of markets. As can be seen in the graph below, the U.S. Macro Liquidity Index (red line, left axis) remains near a record high while the National Financial Conditions Index (white line, inverted) is far from restrictive. This 'free lunch' won't last forever, especially if inflation remains sticky and growth reverts towards stagnation.



Source: Bloomberg

Thank you for your business and interest in our funds. For more information, please visit our website at [www.forgefirst.com](http://www.forgefirst.com) or call us at 416-687-6771 should you have any questions.

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