FORSTRONG GLOBAL

Strategy Dashboard:
Q1 - January 2025

DeepSeek & Destroy

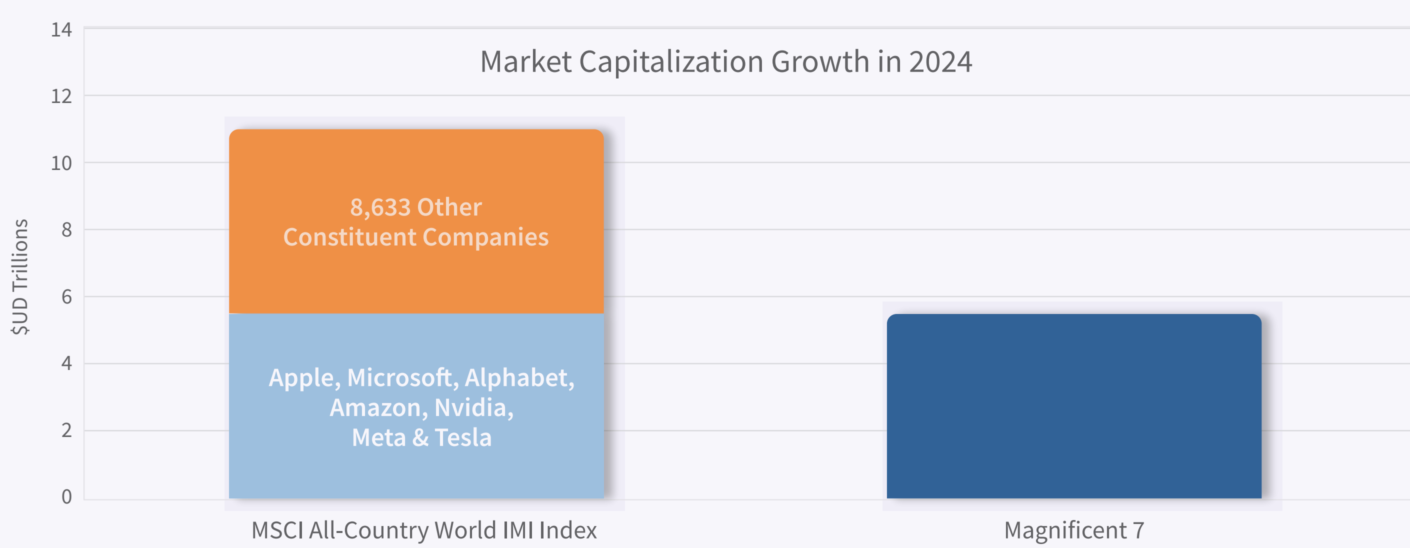
In the 2025 iteration of our annual Super Trends outlook, our investment team forecast an increasingly competitive landscape for today's leaders in artificial intelligence (AI). While this prediction was meant to play out over the course of 2025 and beyond, the recent release of DeepSeek's R1 model has heightened global AI competition and we're not even one full month into the year! With a significant market reaction, we explore why the DeepSeek news is an important milestone and how it will impact the AI landscape.

Almost everything about DeepSeek's model is disruptive. The "Chat GPT-like" large language model (LLM) is robust, open source, created by a Chinese startup and cost a fraction of what its US competitors spent to develop (the company claims it spent only $USD5.6 million on its base model). This challenges numerous well-entrenched assumptions about the AI field. Investors must reassess the US' perceived dominance in AI, the efficacy of the massive AI-related investments US companies made in recent years, and the need for cutting edge AI chips (as sales of such chips to China have effectively been prohibited in recent years). On the last point, one must also question whether Chinese companies have been able to skirt US sanctions and acquire state of the art semiconductors.

Comparisons are being drawn to the launch of the Sputnik 1 satellite by the Soviet Union in 1957, in which the assumed technological and scientific gap between the US and the Soviets was flipped on its head. This may be a bit hyperbolic, particularly as the output and performance of the R1 model is comparable to its US LLM peers, not ahead by leaps and bounds. But the efficiency gains, both in development and ongoing operation, appear to be significant.

The decision to keep the R1 model open source is arguably the most impactful facet of the DeepSeek story. With the ongoing TikTok banning saga playing out in the US and general distrust of Chinese technology amongst Western nations, the rise of a Chinese competitor in AI would

7 US mega-caps accounted for 50% of global market cap growth last year



Sources: Macrobond, BEA, Fostrone Global Asset Management otherwise likely be met with a healthy dose of skepticism. Open source code can be used, modified or built upon at no cost. This means that the barriers to entry industry-wide just gapped lower. This is bad news for companies that have already made considerable investments in the space and the incumbent market leaders. Conversely, this is fantastic news for new entrants and end users, as a more level playing field should drive down costs, spur innovation and allow for greater customization.

The big question for investors is whether this marks a turning point in the performance of US mega-cap stocks, which have been viewed as the AI "winners" thus far. Global equity returns have been highly concentrated in a small number of these behemoths. Per the chart below, half of the increase in global market capitalization last year was attributable to the US Magnificent 7 stocks. A disorderly unwinding of this recent performance would likely have severe consequences for global equities as a whole, considering the companies' heft in major indices and cult-like investor following.

But a more competitive AI landscape does not necessitate such a dire outcome. Major bear markets tend to coincide with economic recessions, which we view as very unlikely in the coming quarters. Instead, we believe a shift in market leadership is likely afoot, with other sectors and regions taking the baton. This would be a much healthier scenario for financial markets, as the extreme lack of market breadth witnessed in recent years exposes investors to outsized idiosyncratic risks and is unsustainable over the longer-term. Accordingly, a broadening bull market (also described in our Super Trends outlook) remains a key tenet of our investment approach.

Global Strategy Overview

Cash

Falling short-term Canadian yields continue to weigh on the attractiveness of holding excess cash. Hedges against equity risk are still well-warranted, but we have opted to initiate a position in gold bullion (see below) rather than increase cash holdings. Cash remains below benchmark in client portfolios.

Bonds

A combination of easing monetary policy from most major central banks and resilient growth should lead to a steepening yield curve for global bonds. With minimal (if any) additional yield to compensate for taking on the additional interest rate risk of longer-term bonds, we see little reason to extend duration. Overweight exposure to short-term bonds (below benchmark duration) remains a key facet of our fixed income approach this quarter.

Equities

Global equity earnings should be well supported by continued growth momentum, easing monetary policy and firming global trade. However, after a period of rapid gains since the US presidential election, a "cooling off" phase is likely as markets reduce expectations for future US Fed rate cuts. Equity exposure remains overweight but has been modestly decreased this quarter.

Opportunities

We have elected to take profits on gold miner equities, following a run of exceptionally strong performance last year. We continue to like gold as a portfolio hedge against equity and geopolitical risk. Viewed in this context, gold bullion should provide a more effective hedge than gold equities, which necessitated a switch between the two asset classes this quarter.

FORSTRONG
GLOBAL ASSET MANAGEMENT INC

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Forstrong Strategies	Inception Date	1 Month	Ytd	1 Year	3 Year	5 Year	10 Years	Since Inception
Balanced								
Global Income	30/06/08	-0.31%	10.25%	10.25%	3.88%	4.14%	5.53%	7.20%
Global Balanced	30/06/03	-1.08%	11.66%	11.66%	3.95%	5.89%	6.77%	7.01%
Global Growth	30/06/03	-1.72%	14.78%	14.78%	4.90%	7.72%	8.35%	8.25%
Canadian Income	30/06/08	-0.26%	9.52%	9.52%	3.60%	4.25%	4.85%	6.22%
Canadian Balanced	30/06/03	-1.28%	11.22%	11.22%	4.63%	6.30%	6.32%	7.07%
Canadian Growth	30/06/03	-2.02%	14.46%	14.46%	5.22%	7.88%	7.56%	8.10%
Global Equity								
Emerging Markets Equity	31/01/19	0.41%	8.26%	8.26%	1.03%	2.66%	NA	2.81%
Global Ex-North America Equity	31/12/19	-0.26%	9.46%	9.46%	3.77%	4.97%	NA	4.97%
Alternative Income								
High Income Opportunities	30/06/22	0.43%	6.98%	6.98%	NA	NA	NA	10.51%

* Performance as of December 31st, 2024
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