VENATOR CAPITAL MANAGEMENT LTD.

OUR OUTLOOK FOR THE INCOME FUND

Instrument (Inception)*	January 2017 Return	Year-to-Date Return	Compound Growth
Venator Founders Fund (March 2006)	**-3.9%**	**-3.9%**	**11.9%**
Venator Investment Trust (September 2007)	**-3.9%**	**-3.9%**	**8.1%**
Venator Income Fund (August 2008)	**1.0%**	**1.0%**	**12.3%**
Venator Select Fund (September 2013)	**-6.5%**	**-6.5%**	**14.4%**
S&P/TSX Total Return (March 2006)	0.9%	0.9%	5.6%
Russell 2000 (March 2006)	0.4%	0.4%	7.3%
S&P Toronto Small Cap (March 2006)	0.5%	0.5%	2.6%
S&P 500 (March 2006)	1.9%	1.9%	7.7%
Merrill Lynch High Yield Index (August 2008)	1.3%	1.3%	9.1%

As promised last month, we are kicking off the January letter with an overview of the current state of our Income Fund. Last year was a great year for the Fund, posting a +13.7% return (Class F Units), and finishing at an all-time high. While the Fund is off to a decent start in 2017, the current state of the bond market is tight, and has caused us to adjust the portfolio into new opportunities to find our desired 'yield-plus' returns.

'Yield-plus' is effectively how we view the portfolio, and where our excess returns have come from over the past several years. In 2016, for example, we entered the year with an expected return of only 7% based on yield-alone being generated across the portfolio. We managed, however, to exceed that by taking advantage of dislocations throughout the year; most notably, purchasing energy drilling bonds below-replacement value, near the bottom of the market. Later in the year, as the stock market rallied, the high yield bond market presented new challenges in terms of getting reasonable yields for reasonable risks which, in turn, has forced us to look elsewhere.

With the backdrop of a strong stock market, we went hunting for positive-yielding, convertible securities that could effectively give us a little yield, but also an undervalued "call option" on the underlying stock, always with an eye towards potential default risk. A prime example of this strategy was the convertible securities of Tesla Motors, whereby we had a chance to purchase 2019 convertible bonds with a 3% yield, and an attached "free" call option, at $360. Buying an early 2019, $360 call option on Tesla today would run you about $20.00, so we are effectively getting it for free (note that we also own 2021 Tesla converts, where the option would presumably be worth substantially more). Of course, the default risk of the underlying company must always be taken into consideration, but with the market value of Tesla sitting at $40 billion, and projected debt levels below $10 billion, we believe that the levels at which we bought the convertible bonds are about on par with where a non-convertible bond would trade.

The Fund went hunting for, and subsequently bought, several of these positive-yielding/low default risk, convertible securities in late 2016, and they now make up roughly 25% of the total portfolio. We believe that this allocation offers more potential upside to the Fund, without increased risk of loss. However, convertible securities tend to have lower yields than non-convertible securities, which has dragged the expected yield below historical levels. Specifically, the current yield expectation is roughly 5%, which is in-line with high-yield markets in general, despite the prevalence of the lower-yielding convertible securities in the portfolio.

It's also worth noting that the Fund is utilizing nearly no leverage, as we await better opportunities in the high yield space. We are patient, and historically, when we see interesting opportunities arise in the bond space we tend to put money to work quickly and efficiently. We have a good idea of where the next "yield-plus" opportunity is going to be, and look forward to being able to capitalize on the opportunity when it happens.

SLOW START FOR OUR LONG/SHORT EQUITY STRATEGY

We weren't initially planning on writing about the long/short strategy this month, but given the slow start, and following a flat 2016, it clearly makes sense to address what has happened. Nearly all the negative performance in January stemmed from declining prices in two of our largest long positions (both of which remain profitable overall over our involvement with the companies). Entercom Communications (ETM), our largest holding, dropped 10% in the absence of any news, to an incredibly cheap free cash flow multiple of 7x our 2017 expectation. This is now the cheapest multiple of free cash flow that we have seen the stock at in our two years of ownership, but we have made money overall as the company has increased their free cash flow per share by 60% over our holding period; the combination of which has yielded a 40% gain on our first share purchased back in late 2014.

Skyline Corporation (SKY), which we have written about in the past, had a tough month, falling roughly 30% as the company's margins were impacted by start-up cost overruns at their new plant - a situation that has since been resolved. The company's revenue growth did, however, exceed strong industry growth in the quarter. Overall, this has also been a profitable investment for the long/short strategy, and currently represents the position in the portfolio with greatest upside to our internal targets.

Historically, being able to look through short-term turbulence, on fundamentally improving situations, has yielded very profitable returns for our long/short strategy. I can remember increasing our position in Boyd Group (BYD.UN) after the stock had dropped from $12.00 to $8.00 back in 2011; today, the stock trades above $80. Even the best investments don't tend to go up in a straight line, but going sideways for two years isn't the best way to achieve intermediate returns either! That said, we remain confident that holding improving companies, at increasingly inexpensive valuations, will result in continued superior long-term returns.

As always, we reserve the right to change our mind!

Brandon Osten, CFA
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