THE BEST LAID PLANS . . . SOMETIMES DON'T GO AS PLANNED

Instrument (Inception)*	October 2018 Return	Year-to-Date Return	Compound Growth
Venator Founders Fund (March 2006)	**-7.0%**	**11.8%**	**11.9%**
Venator Investment Trust (September 2007)	**-7.0%**	**11.9%**	**8.7%**
Venator Income Fund (August 2008)	**-1.4%**	**1.0%**	**10.9%**
Venator Select Fund (September 2013)	**-9.6%**	**14.4%**	**16.2%**
S&P/TSX Total Return (March 2006)	-6.3%	-5.0%	5.0%
Russell 2000 (March 2006)	-10.9%	-0.6%	7.4%
S&P Toronto Small Cap (March 2006)	-7.6%	-11.7%	1.4%
S&P 500 (March 2006)	-6.8%	3.0%	8.4%
Merrill Lynch High Yield Index (August 2008)	-1.6%	0.9%	8.2%

Last month we discussed our concerns with market levels, valuations and signs of a near-term top as the market moved from bubble to bubble in growth stocks and was pricing low growth stocks at valuations that would take many years to grow into should they fall to historically reasonable levels. We also talked about how we were hedged with individual short positions, augmented with market-based put options.

At the time, we viewed our overall position as *'over-hedged'*, a situation necessitated by our view that several of our positions would exhibit out-sized volatility in a correcting market. While this proved to be the case, we were still surprised by the magnitude of some of the downward moves that several of our positions experienced despite statistically lower measured beta. While our hedges did offer some protection to the tune of a 4% positive impact in the long/short strategy, we still had a rough month.

That said, we were able to take advantage of the volatility in October, buying back into stocks we had previously sold at substantially higher prices, as they corrected to reasonable valuations relative to their prospects. We were also able to profitably buy back into Tesla convertible bonds which we have talked about in the past.

The fact of the matter is that we believe that we own great businesses at value prices and, as such, it's difficult for us to simply go to cash when we get fearful of overall market levels. Even when the market looks expensive, our positions tend to look cheap on a relative basis. If this wasn't the case, we wouldn't own them no matter how positive our market view might be. This is the main reason why we choose to increase our hedges rather than liquidate positions; we wouldn't want to forego potential profits due to short-term market timing, which has never proven to be a reliable strategy.

Our biggest addition to the portfolio last month was an arbitrage situation in Red Hat Inc. (RHT), which recently agreed to be taken over by IBM. We did not own the stock prior to the news as the fundamentals of the company were deteriorating rapidly (the stock was down 35% prior to the takeover due to two badly missed quarters in a row). This is a somewhat desperate acquisition for struggling Big Blue in that it paid way too much for a business that will not be terribly material to them, and they took on a ton of debt to do it. However, financing has been secured, and the deal closing within nine months is only contingent on US trade approval, which will likely be easy to achieve since there is not a lot of product overlap between the two businesses. Overall, a high degree of certainty for a deal with an 11% spread-to-takeout price. As a result, we hold the position across each of our strategies.

So how do we see the year finishing out? The mid-term elections will keep things volatile until their conclusion, but ultimately represent a win-win scenario from a narrative standpoint. Either the Republicans win out and the pro-business policies continue, or the Democrats win out and keep the unpredictable Trump in check but are still unable to reverse any pro-business policies already in place. Furthermore, the labour situation is so strong right now that we would expect early retail numbers out of Thanksgiving weekend to be strong.

The big macro overhang of rising interest rates should be relatively quiet around mid-terms and Christmas, and we don't expect any more negative news on that front until the New Year. The only wild card is the current trade hostilities with China; but Trump likes to play the hero and partly measures his success on the strength of the stock market, so we would expect that situation to be eventually resolved. In the end, we remain optimistic about a profitable resolution to 2018.

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

Brandon Osten, CFA
CEO, Venator Capital Management Ltd.