# LABOUR DAY R & R (Rates and Recession)

| Instrument (Inception) | August 2019 Return | Year-to-Date Return | Compound Growth |
|---|---|---|---|
| **Venator Founders Fund* (March 2006)** | **-4.6%** | **5.4%** | **10.8%** |
| **Venator Income Fund (August 2008)** | **-1.0%** | **5.7%** | **10.6%** |
| **Venator Select Fund (September 2013)** | **-1.8%** | **17.8%** | **15.1%** |
| S&P/TSX Total Return (March 2006) | 0.4% | 17.1% | 5.6% |
| Russell 2000 (March 2006) | -4.9% | 11.9% | 6.9% |
| S&P Toronto Small Cap (March 2006) | -1.5% | 12.2% | 1.6% |
| S&P 500 (March 2006) | -1.6% | 18.4% | 8.6% |
| Merrill Lynch High Yield Index (August 2008) | 0.4% | 11.6% | 8.1% |

***** *Venator Investment Trust is also available as an extension of the Founders Fund strategy; its monthly performance mirrors the Founders Fund, and it is eligible to be held in both registered & non-registered accounts***

August was a volatile month for capital markets with yield curves, trade wars and recession fears dominating the discussion. To be clear, it's the first two topics that bring on fear of the third. Inverted yield curves are supposedly a 'leading indicator' of recession (I say *'supposedly'* because while they have historically been a precursor to recession, their ability to time one is far more suspect). The current trade war between the US and China is also believed to be a potential trigger factor for recession, although this is also speculative with little basis in the factors driving the current economy.

Last month we talked about the current contentious move to lower rates in the US. With the Fed reaching a split decision on the side of cutting, it is obvious that the rest of the world is moving to zero/negative interest rates, if they aren't already there. While interest rates have been negative in certain parts of the world for several years, this has also recently expanded into certain high yield issues and mortgages (!) in Europe.

In the investment business, it's said that sometimes you see something so stupid or obvious that you can't believe it's happening. Tulips trading at $75,000 per bulb (inflation adjusted); technology stocks trading at over 20x revenues in 2000; or what happened in the mortgage space in 2008, are excellent examples. Oddly enough, technology stocks are once again trading at 20x revenues (with nowhere near the growths rates of 2000), and lending standards have again fallen dramatically, even if it isn't within the North American mortgage space. A couple of old adages come to mind: 'financial markets can remain irrational longer than one can remain solvent'; and 'being too early is indistinguishable from being wrong'. The point being that short selling tulips at $20,000 per bulb would have been a bankrupting trade on the way up, and *eventually* being able to say 'I told you so' would be small consolation after losing all your money to a margin call!

That said, for a lender to pay a borrower to take risks with no upside (we don't count getting your money back as upside) is sheer financial insanity. I'm sure that there are technical computer models out there saying that a bond is 'going higher', with no idea that said bond, held to maturity, is a 100% guaranteed money loser (to quote Danny DeVito in War of the Roses: *'there is no winning, only degrees of losing'*). Is there not a vault somewhere that makes more sense?

It appears that a market-based move to zero interest rates in government bonds is likely given the US status as the reserve currency of the global economy. The impact is already being felt, with the utility and REIT sectors leading US markets; money continuing to flow into private lending on both sides of the border; and real estate industry 'veterans' pulling back, while newcomers are pressing in. The primary risk to all of this might not be the negative interest rates themselves, but the collateral bubble being formed among yield alternatives as a result. Easy money creates more borrowers and reduced lending standards which, when coupled with increased leverage designed to make a mediocre

3% return look like a more acceptable 10%+, can lead to some devastating mark-to-market losses, margin calls and liquidations.

Without question, financial market risks are the worst kind of risk, as we all discovered back in 2008. Sector and valuation risks can be identified and contained (think tech in 2000), however, financial ecosystem risks can kill the credit cycle which, in turn, leads to financial market freezes, capital spending freezes, and more scrutiny of investment standards (which were likely loosened during the bull phase). It seems clear to us that there is probably another leg down in interest rates, but we are staying vigilant in our risk awareness.

We are doing our best to navigate this current environment within Venator Income Fund (where investment horizons are finite due to bond maturities), while working to avoid them across our equity strategies (where time horizons are infinite). As far as fixed income investments are concerned, we continue to keep maturities short which, when coupled with very modest use of leverage, should allow us to achieve our target returns without any global yield-shenanigan-related risk. Within our equity strategies, we continue to favour more non-cyclical and value-oriented investments. We do own a number of *'growthier'* companies, however, it's important to always keep in mind that while the growth of even the strongest growth companies might be secular, the growth *rates* can still be affected by cyclical factors (a growth rate falling from 40% to 15% is likely more devastating to a stock than a 6% growth rate falling to 2% during an economic slowdown).

Are we being too cautious? Perhaps. Last year we 'upped the down year', with each of the Venator Funds posting positive calendar year results, while North American markets finished down 5%-10% on average. However, this same cautious approach has resulted in our Funds missing a decent chunk of the 2019 'bounce back'. Overall, the key for us continues to revolve around finding investments that should do well in any given 18-month period, where secular trends or growth is strong enough to overcome mild recession fears. Additionally, finding longer-term, well-researched investment opportunities that can take advantage of current trends remains a focus – with NorthWest Healthcare's undiscovered potential in a zero-rate environment being a prime example.

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

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*This commentary is intended for informational purposes only and should not be construed as a solicitation for investment in any of the Venator Funds. The Funds may only be purchased by accredited investors with a medium-to-high risk tolerance seeking long-term capital gains. Read the Offering Memoranda in full before making any investment decisions. Prospective investors should inform themselves as to the legal requirements for the purchase of shares. All stated Venator returns are net of fees. It is important to note that past performance should not be taken as an indicator of future performance.*