THE YEAR IN REVIEW

Instrument (Inception)	December 2019 Return	Year-to-Date Return	Compound Growth
Venator Founders Fund* (March 2006)	**0.4%**	**4.7%**	**10.4%**
Venator Income Fund (August 2008)	**0.9%**	**8.1%**	**10.4%**
Venator Select Fund (September 2013)	**-1.6%**	**18.6%**	**14.3%**
S&P/TSX Total Return (March 2006)	0.5%	22.9%	5.8%
Russell 2000 (March 2006)	2.9%	25.5%	7.6%
S&P Toronto Small Cap (March 2006)	5.4%	15.9%	1.8%
S&P 500 (March 2006)	3.0%	31.5%	9.2%
Merrill Lynch High Yield Index (August 2008)	2.1%	14.4%	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***

December capped a strong 2019 for North American markets, as they enjoyed a prolonged winning streak, almost determined to finish at a high, as compared to last year's worst finish in 100 years. Despite the 30%+ return by the S&P 500, it's *'only'* up 10% vs the end of Q3 last year, such was the extent of the 2018 Q4 collapse. Capital continues to search for attractive opportunities in a low rate environment and investors have, perhaps, become a bit too comfortable with the longest bull run in recent history.

Our equity funds both struggled to gain ground last month in large part due to a single shared position that went south faster than anything I have experienced in the 14 years since founding the firm. KEW Media Group, Inc. (KEW), a former SPAC we began investing into several years ago, had built a decent portfolio of production content and distribution in the hot market for TV/Streaming content. However, it recently came to light that the now-former CFO had been misrepresenting the 'asset collateral' classification to its lenders, which triggered an event of default, sending the stock plummeting as the company scrambled to replace or renegotiate its debt arrangements. KEW was one of our larger positions and single-handedly caused the Venator equity mandates to miss out on a strong rally into year end. The company is currently reviewing 'strategic alternatives' which will likely include anything from a full sale (positive) to a dilutive financing (negative).

On a much more positive note, HemaCare Corporation (HEMA) agreed to be acquired for a reasonable premium last month, resulting in a gain of over 300% from our initial purchase price several years ago. HemaCare represents a recent example of what we do well at Venator; namely, finding unknown, small-cap stories with multi-year growth potential, ahead of the market. As we begin 2020, we're optimistic that our portfolios contain a few more of these similar opportunities, which are potentially poised to unfold during the year.

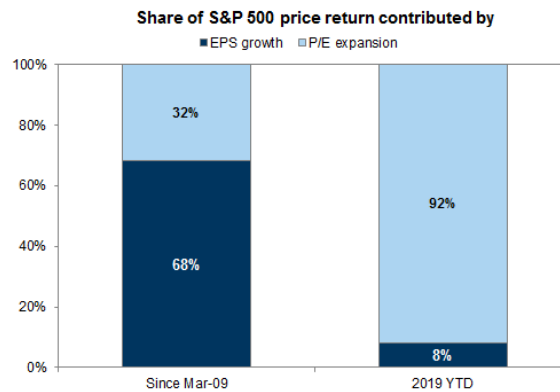
2019 NORTH AMERICAN MARKET REVIEW

2019 can probably be best described as the most 'macro market' and/or least 'stock picking market' in recent memory. Coming out of last year, the biggest concern was a trade war with China and a neutral Federal Reserve. Without any settlement of a trade deal with China (even the recent 'deal' is only a take back on mid-year threats) and only a mildly more accommodative Fed, low interest rates seemed enough to push markets to big gains despite a sluggish economy and a discernable lack of earnings growth.

The S&P 500 was the champ in 2019 and has really held that title over the last five years. While there is no definitive explanation for this large cap outperformance (usually small caps have more 'torque' in bull markets), our belief is that this is largely a function of ETF flows, with the SPY's being more broadly known than the small-cap IWM's (in Canada, the small-cap XCS's have virtually no following). To drive home the point, the Russell 2000 is still below where it was

in October 2018, while its Canadian counterpart is still below where it was in 2007, 2011, 2014, and 2018!!! The belief in the continued low interest environment has created a flight to safer businesses with 'utility-like' features. In Canada, this has meant strength in the domestic REIT space (an area we have been unfortunately under-invested in). In the US, it has meant larger, low-growth, and perceived 'defensive' stocks well represented in ETFs like Proctor & Gamble, Wal-Mart, Nike, Apple and McDonalds - where stock price performance has vastly outpaced underlying business growth, despite no major upside surprises in fundamentals (Apple's 80%+ stock rally in the face of trailing twelve month revenue growth of *negative* 2% and EBITDA growth of *negative* 5% is particularly instructive). Many have characterized 2019 as a beta-timing market whereby your ability to outperform is about timing market swings with stocks exhibiting both high correlation and volatility vs security or sector selection.

Noting the chart below, the market experienced a huge rally without any meaningful commensurate increase in earnings. This is commonly referred to as multiple expansion, and in the absence of fundamental change, it's just another way of saying that the market represents less value than it did twelve months ago. It's like walking into/logging onto your favorite store and finding out that the same stuff just got marked up 30% in price. That said, one rule of financial markets that is consistent throughout history is that they are the only markets in the world where higher prices attract more buyers!!! Therefore, timing the end of this bull market is a futile endeavor. One can only be prepared.



Many market watchers are calling for a catch-up trade for small-cap stocks in the coming year. They also seem to think that the best way to participate would be through the small-cap ETF IWM, believing that the move will be very broad-based. The lamenting of a multi-year, underperforming small-cap trade could just be sour grapes for active manager underperformance - the punitive consequence of going off the beaten path, as opposed to just following the money into large caps. It could also be wishful thinking that could lead to more disappointment, as money flows will likely continue into that which people know best or in which they feel safest, namely the S&P 500.

Bond markets were also strong in 2019, and particularly high yield, as low interest rates pushed bond traders 'down market'. Our belief is that the quality of new issues continues to deteriorate; new bond issuance is being made largely to roll over existing maturities or for collateral destroying capital market activities such as stock buybacks. We are also seeing shenanigans such as 'below par' offers, whereby bonds are being offered at discounts in order to make the coupon rate look artificially low. These new issues are happening at rates that are both too low, and maturities that are too long, and therefore we see better opportunities in the secondary markets.

2019 EQUITY STRATEGY REVIEW

Our equity strategies reflected what we discussed above, with our largely *unhedged* Select Fund materially outperforming our *hedged* Founders Fund/Investment Trust. The sobering fact is that the hedging cost the Founders Fund/Investment Trust portfolio close to 15% in 2019, the largest loss we have ever suffered in a single year (including 2009). Over the course of fourteen years running the long/short strategy, our short book has lost money in seven of

them. That said, prior to 2016, our long book outperformed by such a wide margin that our shorts never cost more than 25% of gains in any given year. However, in both 2016 and 2019, the shorts were far more punitive.

This is largely why we see our best hedging strategy being in options going forward, with a few individual alpha shorts. The market has changed, and we need to change with it, to the extent that passive investing keeps correlations high in between news events. While this hedging strategy was not in place for the full year (which is unfortunate, since January/February would have likely been the best time for this options strategy to be in place), it has been beneficial when utilized, resulting in a 20% outperformance in up markets vs being short the market. We anticipate that it helps even more in down markets, due to the nature of the strategy.

While hedging was a big part of our underperformance last year, we would note that our longs did gain over 20% during the year. While most of our larger gains stemmed from non-household names such as HemaCare Corporation (HEMA), Skyline Champion Corporation (SKY), and RingCentral, Inc. (RNG), we did rack up some nice profits in Disney (DIS) and Alphabet/Google (GOOG), as well as some well-timed trading in the IPO of Beyond Meat (BYND). The aforementioned KEW Media (KEW), as well as Entercom Communications (ETM), cost the strategy a combined 5%.

Heading into 2020, our largest long positions include:

- **Northwest Healthcare Properties REIT (NWH.UN)**: It was a transformational year for NorthWest Healthcare as they made good on their promise to become an asset manager though a multi-billion joint venture in Australia. Unfortunately, the complexity of the business has held it back in our estimation (currently 1 Buy and 4 Holds from the analyst community), and its low valuation has hindered the financial metrics of its transactions. However, the pieces are now firmly in place, and the balance sheet has become more *in-line* with other REITs. This is a globally unique asset, with an equally unique management team and skill set, and we believe that there will be more international joint ventures formed in the coming year. With healthcare REIT valuations pushing 20x AFFO (along with apartment and industrial REITs) there is a good argument to be made for Northwest Healthcare at $20 (even its 25% owned subsidiary in Australia was up 40% last year, and trades at over 25x AFFO). The business appears to be a laggard from any objective angle.

- **Salesforce.com, Inc. (CRM)**: While not the most creative pick (Part I), hear me out: I have spoken to many other software companies that claim that they must work with Salesforce.com, more so than Amazon or Microsoft. Salesforce.com has been something of a laggard in the space due to controversy over its acquisition strategy, which some claim masks a growth rate that is deteriorating below 20%. That said, regardless of whether the underlying growth rate is 18% or 22%, Salesforce.com, thanks to its lagging share performance (flat over the past 15 months) represents the best value among cloud giants.

- **Alphabet, Inc. (GOOG)**: While not the most creative pick (Part II), hear me out: Alphabet has been something of a laggard (up 15% from February 2018), despite a superior growth rate to both Microsoft and Apple, and on par with Amazon. The issues are numerous including competitive encroachment from Facebook and Amazon for advertising revenues as well as increasing government scrutiny. While Apple, Microsoft and Amazon have benefited recently from emerging assets such as a 5G refresh cycle, Azure cloud computing, and Amazon Web Services - Google, on the other hand, is being perceived as a share giver in advertising. We view Google as having some submerged assets of its own including YouTube, a leadership position in artificial intelligence, its own fast-growing cloud computing platform, Google commerce, and Android which is still poorly monetized but powers 75% of mobile devices. At just over 20x earnings (net of cash), this 20% grower seems like a good bet for the next several years.

- **Upland Software, Inc. (UPLD)**: A long-time holding in our portfolios, Upland is a consolidator with a unique strategy relative to other companies with similar strategies. More specifically, Upland acquires high-growth, unprofitable companies and turns them into low-growth, very profitable companies. We would note that as of late the market has shifted its interest from the former category to the latter, and with Upland's organic growth in the mid-single digits and trending higher, it could see a 40% valuation expansion from its current undemanding P/E ratio of 14x.

One holdback last year was the Company's use of debt, combined with a lack of free cash flow related to the restructuring of subsidiaries post-acquisition, but we believe that the company has finally achieved the scale whereby cash flow should exceed these charges going forward.

- **Skyline Champion Corporation (SKY)**: We continue to believe that the low-end of the housing market will remain an incredibly strong macro environment for the next several years. Exasperated by chattel lending financing terms that have held back manufactured housing for the better part of fifteen years, Skyline is set up to be winner in this oligopoly. With a clean balance sheet and as a manufacturer (as opposed to a developer), potential multiples in manufactured housing have limited history and are not shackled by the price-to-book ratios that hold back the rest of the homebuilding sector. Expectations are low for Skyline, and we are excited to see where this stock can ultimately go in the coming years.

2019 INCOME STRATEGY REVIEW

We were quite satisfied with our returns in the Income Fund, which fell right in the middle of our target range of 7%-9%. High Yield markets were strong last year, which proved beneficial to the longer dated bonds that have been issued over the past two years; while stronger equity markets disproportionately helped lower quality issues (C-rated). Longer dated and lower quality issues aren't characteristics that we look for, and do not represent the sweet spot of the Fund. Instead, we have positioned the portfolio in shorter maturity bonds as a measure of caution, primarily due to our belief that the rates available on bonds that mature in six or seven years aren't high enough.

That said, we have adjusted for our conservative stance on high yield bonds with a larger weighting in convertible bonds that carry lower interest rates and therefore don't move in lock step with bond markets. While convertible bonds can carry an unpredictable path to maturity, they tend to undervalue the optionality embedded in the security. When bought well, they can offer either tax efficient gains to maturity or outsized gains if the underlying stock outperforms. Last year, convertible bonds were among our eight most profitable positions across all our portfolios (including those offered by Tesla and Restoration Hardware).

Heading into 2020, high yield bonds represent roughly 60% of the portfolio, while convertible bonds make up the remaining 40%. The high yield bond portion of the portfolio carries a yield of over 6%, while the convertible bond portion is yielding over 4%; with the total portfolio yield coming in at over 6%. Historically, the 'yield-plus' strategy utilized by Venator Income Fund has outperformed its underlying yield, and we don't see why 2020 should be any different.

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

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