MOVING DECADE

HEDGE FUNDS (Inception)	JULY 2020	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund (March 2006)**	**5.1%**	**10.4%**	**10.7%**
Venator Select Fund (September 2013)	**6.2%**	**9.2%**	**14.5%**
S&P/TSX Total Return (March 2006)	4.5%	-3.3%	5.3%
Russell 2000 (March 2006)	2.8%	-10.6%	6.5%
S&P Toronto Small Cap (March 2006)	7.4%	-8.0%	1.2%
S&P 500 (March 2006)	5.6%	2.4%	9.0%

ALTERNATIVE MUTUAL FUNDS (Inception)	JUL 2020	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund* (January 2020)**	**3.7%**	**-5.9%**	**-4.8%**	**2.1%**	**3.7%**	**7.5%**
B of A Merrill Lynch High Yield Index (August 2008)	4.8%	-0.3%	3.0%	4.1%	5.7%	6.6%

**As of July 31, 2020*
***Venator Investment Trust is 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*
****Performance data prior to January 24, 2020 relates to Class F Units of Venator Income Fund, which was distributed to investors on a prospectus-exempt basis in accordance with National Instrument 45-106*

The ‘more buyers than sellers’ bull market continued in July and we were fortunate to participate despite our larger hedge book. Even though the S&P 500 is up on the year, the average stock is still down about 7% year-to-date. It’s a point worth noting because there are still many overlooked investment opportunities if you believe in a recovery. You can find both cheap stocks and shorter-term high yield bonds (along with the occasional positive yielding convertible bond). These have been unprecedented times and we have been laser focused on being nimble and looking for secular changes and oversold opportunities in the current environment.

COVID-19 has brought some interesting changes to the economy, to say the least. Some, such as hand sanitizers, facemasks, respirators, and, eventually, vaccine production are going to be very short lived. We don’t advise paying-up for such short-lived trends. The most obvious trend to come out of COVID-19 is technology in the form of cloud computing/work-from-anywhere (Zoom, RingCentral, Microsoft, Amazon, Teledoc) and e-commerce enablement/shop from home (Shopify, Amazon, Square, PayPal, Twilio, Wayfair). These companies were already winners prior to the COVID-19 outbreak, but recent events have accelerated their adoption, as economic dislocations tend to do. That said, because they were well known secular winners going into this, they already carried high valuations pre-COVID. Now aggressive money flows into these beneficiaries have supercharged valuations far beyond what we saw in the 2000 tech bubble. Lest we forget, Cisco was a $19 billion in sales, 65% gross margin, 60% grower and had a near monopoly in selling the networking equipment that made the internet run and that stock is still down 40% from its 2000 peak. This is an important point to note when Shopify currently trades at 45x revenues, despite a similar margin profile and expected forward growth rate off of a base of only $3 billion in revenues (similar observations could be made about other great technology companies you may have heard of such as Zoom, Datadog, Coupa, or DocuSign).

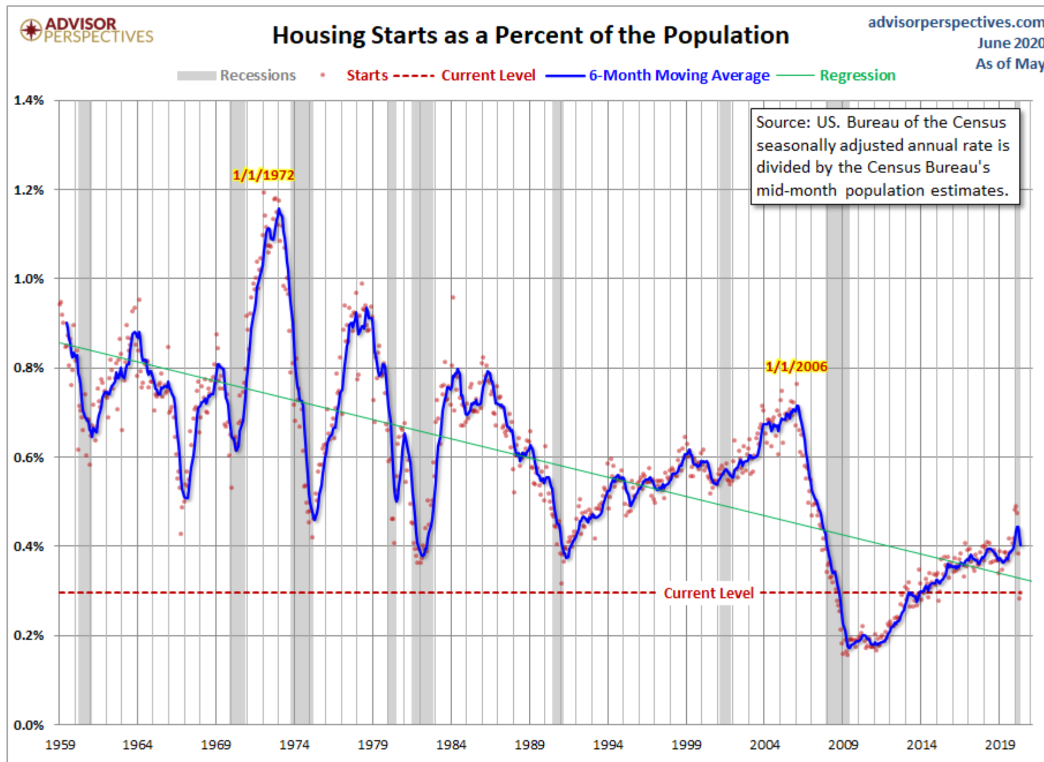
In our opinion, the more interesting investable opportunities are not in the acceleration of pre-existing secular growth themes, but completely new secular trends that didn’t exist (or were even going in the wrong direction) prior to COVID-19. Part of this is that growth outlooks need to be recalibrated materially higher, and the other part is that valuations are far less demanding, and you can invest in many of these new secular winners at valuations substantially below 20x revenues (which historically is never sustained), and quite often below 20x earnings.

This is the situation that has emerged in both home and car ownership, both secularly challenged for years, and now set to be secular winners for the next decade. The thesis against home ownership has been that millennials wanted to live in the big city in rented condos, eat at restaurants and order in, commute via uber and public transit, and spend their all their money on vacations rather than furniture or children, well into their 30’s. Thanks to COVID-19, this narrative has been

flipped on its head. Today, people don't want to live in large dense cities; they are moving to the suburbs or smaller '3-sport' cities (think Charlotte, Minneapolis, and Denver). People want houses with backyards and, more importantly, home offices. Furthermore, if you are going to live in the suburbs, you are going to need a car.

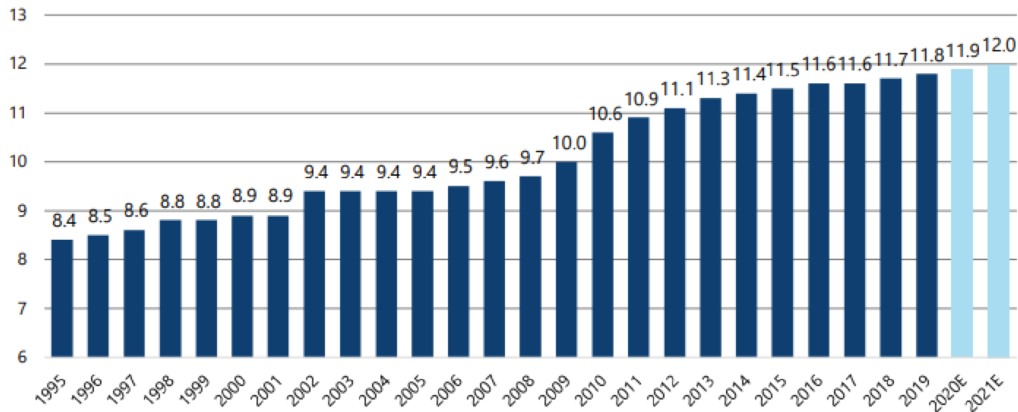
Since this represents a stark trend reversal, shortages are fast becoming an issue in these sectors. There is a notable shortage in houses for sale and a marked increase in demand among the homebuilders. This, in turn, is also affecting demand for building products, although this is on a bit of a lag given their installation months after land is developed. On a further lag will be furniture purchases. The good news is that, for whatever reason, these markets are not terribly competitive and are dominated by oligopolies (except furniture which has many competitors). You don't even need to be creative to take advantage of these trends. Skyline-Champion Corporation and DR Horton, Inc. are the leaders in entry-level homes (May and June orders up 50%); while Masonite International Corporation is the leader in residential doors, which every house needs.

Masonite is particularly illustrative of the changes that we are talking about. Aside from the slowdown in new homebuilding we have seen in the last decade, the market also saw a move to smaller homes and open concepts which dropped the average number of doors per house by 20%. Now, with the work-from-home phenomenon, house sizes are back on the rise, leading to more doors per house, and you are starting to see a move back to 'rooms' as well as more expensive, sound barrier, solid core doors. That's a lot of positives on top of a pre-COVID 15% price increase across the board (it turns out people aren't very price sensitive when it comes to doors).



With the move to home ownership in areas that are less accessible via public transit, you will also see a renewed interest in car ownership. People will still use Uber for weekend dinners out so that they can drink, but the five-day a week Uber population will likely decline as people choose to work from home more often or simply opt out of shared vehicles. Also, $20 round-trip intra-city rides are easier to swallow than $50 round-trip suburb-to-city rides. Like housing, car demand has gone through the roof at the same time production has ground to a halt. This has caused significant used inventory drawdowns and car retailers/resellers have experienced unprecedented strength. Now, they are starting to experience used car shortages and new car production is going to have to pick up the slack, especially given the record age of existing vehicles.

Chart 22 - Historical & JEFE Average Vehicle Age (Yrs)



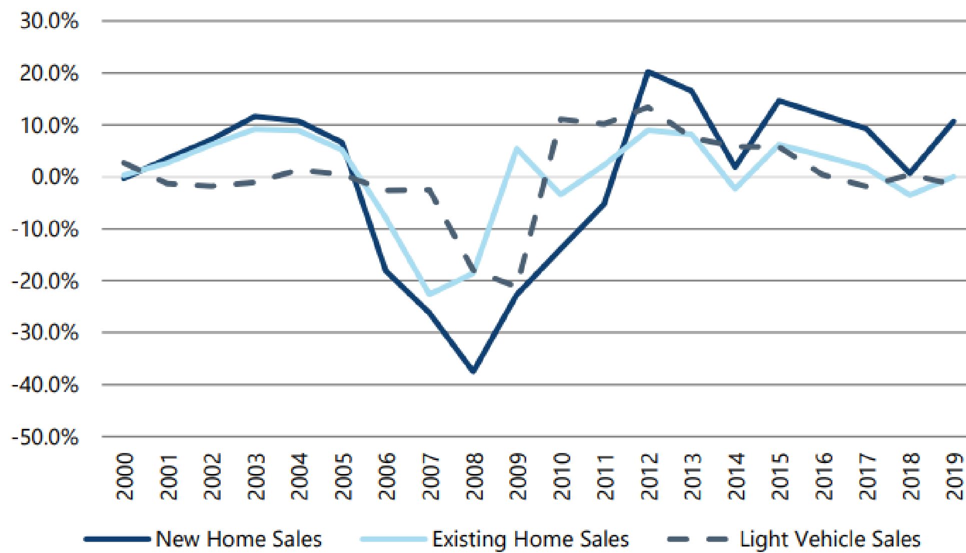
Source: Jefferies estimates, Auto Care Association

Unlike housing, the auto industry is experiencing a massive upheaval thanks to Elon Musk, who, over the last several years, has gone from mad scientist to an unfiltered-Steve Jobs. Historically, you had to figure out who was winning what programs for next-gen models; today, you have to discount companies making drivetrains for internal combustion vehicles and sideview mirrors. These market share and technological shifts have kept valuations low, and pensioners have kept debt levels high. Rather than research/guess who is going to win next-gen programs, it might be better to bet on Lear Corporation (because everyone needs seats), or Magna International Inc. here in Canada, which has managed its exposure to internal combustion components down to a small minority of revenues. Both companies currently trade at exceedingly cheap multiples of earnings despite what we see as a strong multi-year macro outlook.

For those who really feel compelled to have a technology angle, Wayfair, Inc. and Tesla, Inc. - both of which have had massive moves post the Mid-March market bottom - represent near perfect intersections of the future of technology and these strong secular trends we are expecting. Wayfair experienced a true reversal of fortune going into COVID-19 with a growth rate that had deteriorated significantly in the past year and mounting losses as its higher cost structure did not contemplate the deteriorating growth rate. However, with the current pandemic sales growth rocketed to 90%, which seems to be sustaining itself, and recent cost cuts are resulting in scaling profitability. Home improvement meets pure play ecommerce is about as perfect a narrative as one can find.

Of course, Tesla is leading the charge into consumer vehicle electrification. They have proven the doubters wrong with the highest growth rates and highest operating margins in the business. They have also proven the bear thesis of 'just wait for the competition' false as other market participants have barely showed up to the game. In a twist of fate, it was the established industrial leaders that promoted 'vaporware' while the technology company released actual working products to promised specs. Moreover, with more vehicles coming out that target more use cases and price points, Tesla should lead the auto industry in growth for years to come.

Houses and automobiles, they go hand in hand like peanut butter and jam. You can't have one move without the other. These are 8-10-year secular COVID-19 winners. Beyond being big sectors of the economy, they trade at inexpensive valuations due to a history of low multiples in automobiles, and book value standard in homebuilding.



Stay bullish, stay hedged, and stay safe - and, as always, we reserve the right to change our mind!

Brandon Osten, CFA
CEO, Venator Capital Management Ltd.

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