IT'S A BUBBLE, BUT NOT NECESSARILY A TOP

HEDGE FUNDS (Inception)	FEBRUARY 2021	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund (March 2006)**	**5.5%**	**8.4%**	**13.1%**
Venator Select Fund (September 2013)	**4.8%**	**10.2%**	**18.4%**
S&P/TSX Total Return (March 2006)	4.4%	4.0%	6.0%
Russell 2000 (March 2006)	6.2%	11.6%	9.1%
S&P Toronto Small Cap (March 2006)	9.5%	10.0%	3.2%
S&P 500 (March 2006)	2.8%	1.7%	9.8%

ALTERNATIVE MUTUAL FUNDS (Inception)	FEB 2021	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund* (January 2020)**	**1.7%**	**4.9%**	**12.0%**	**7.0%**	**8.6%**	**7.9%**
B of A Merrill Lynch High Yield Index (August 2008)	0.3%	0.7%	8.6%	6.2%	8.8%	6.3%

**As of February 26, 2021*
***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*

Each of the Venator Funds finished at record highs for the fourth consecutive month. Granted, it is a bull market in pretty much everything (including nearly all commodities and made-up from scratch currencies) but having each of our three strategies close at all-time highs never gets old. March is an anniversary month for quite a few events since the turn of the century. It is when the bubble burst for the NASDAQ in 2000 (final tally was a 78% drop!!!); when the market bottomed in 2009 amidst the financial crisis; and it is when the market crashed over 35% in just a few weeks last year due to COVID-19. It also marks the 15-year anniversary of the launch of our Founders Fund, our flagship long-short strategy that has returned over 500% for investors, better than the total return of 310% for the S&P 500 and the 150% return of the TSX. In fact, based on a quick look through the comprehensive database *FundLibrary.com*, in the "Alternative Equity Class" category, the Venator Founders Fund "A" Class units rank in the first quartile in the most recent 1-year, 3-year, 5-year, 7-year and 10-year periods for annualized returns! All while remaining well-hedged throughout our history.

Back to that NASDAQ bubble reference, which we touched on last month, but remains a timely discussion because we firmly believe the ominous parallels are there and building by the week. Like in 2000, it is not the whole market that is in a bubble despite all major indices hitting all-time highs. But it is an increasingly large portion of the market as valuation inflation and speculative fervor has resulted in hundreds of billions of dollars of market cap in both great high growth companies and outright speculative start-ups. In addition, we have seen SPACs merging into fundamentally questionable opportunities at multi-billion-dollar valuations (this is not a commentary on investing in SPACs on the initial listing but is a critical commentary on holding those SPACs post-merger, as well as many trading above the cash value of $10.00). Nearly 300 SPACs are currently looking for over $450 billion in deals. For reference, the bottom 200 of the S&P 400 Midcap Index is around $700 billion, so the SPACs need to effectively find enough market value to replace 25% of the largest 1000 listed companies in the United States – not an easy task when a substantial chunk of the companies merging into SPACs have revenues of less than $1 billion, are not growing particularly fast, and are largely unprofitable!

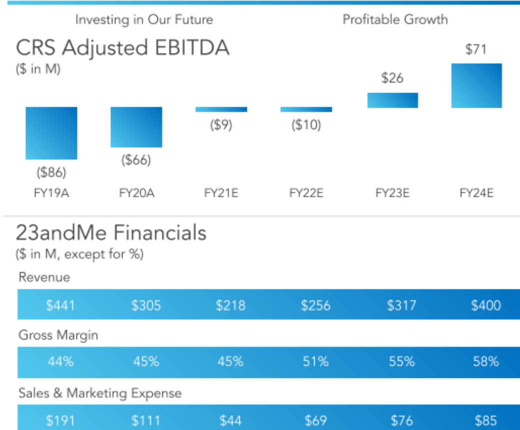
SPACs PLAYING THE PART OF THE 1999 IPO BUBBLE

Twenty years ago, there was a “first mover” company out there with good brand recognition that was annualizing $50 million in revenues on 2000% revenue growth (!) and was going after an easily definable total addressable market (TAM) of $30 billion. This company was losing money to the tune of $80 million per year because it costs money to manage a 2000% growth rate and maintain your first mover advantage. But Amazon owned over 30% of the company and management estimated that the business was “only” $200 million away from breakeven (for reference Amazon.com lost $900 million in 2000). The company was Pets.com; a paragon of all that was wrong and unholy about the tech bubble. Pets.com was basically Chewy ($40 billion market cap and was losing $250 million per year as recently as two years ago at scale) but way ahead of its time. By today’s standards, I would guess that Pets.com would achieve a market value as a SPAC takeover in the range of $2-3 billion. In 2000, Pets.com, the poster child of excess in the tech bubble, peaked at a paltry “bubble” value of less than $400 million, rather quaint by today’s standards.

Fast forward to 2021, when Rover is in the process of going public via a SPAC merger. I chose Rover because of the parallels with Pets.com and as a typical example of what is being promoted today as hundreds of SPACs are looking for quasi-IPOs to fulfil several hundred billion dollars of needed transactions. Rover, if you have not heard of it, is a dog walking service. Pre-COVID, it had a mere 35% growth rate (vs Pets.com’s 2000%) and lost $35 million on $95 million in revenues. Last year, sales fell 50% to $48 million; meanwhile, Rover is currently being valued at over $1.5 billion!!!

Part of what makes SPACs special as a liquidity event for private companies is that they are not IPOs and are not subject to SEC rules against making projections in their “coming out” presentations. In the case of Rover, they are projecting 70% growth in 2021 (recovery post COVID) plus an additional 100% growth in 2022 based on management estimates only. In a traditional IPO process, you are not allowed to make forward projections, and instead, must rely on your audited historical financials and allow investors to make those assumptions for themselves. That said, even Amazon and Apple will not go out on a limb with a 2022 revenue guide and I would guess they have more insight into 2022 than Rover does. Forward projections based on nothing substantive seems to be the norm for SPAC go public transactions, on opportunities that would get laughed off the calendar in a traditional IPO process where projections are not allowed.

Take 23andMe, another multi-billion SPAC merger. To your right is a slide from the presentation where the projections appear to be purposefully more legible than the history, and with good reason. I will note that 2020 revenues were down 30% and that the 2021 “rebound year” revenues are expected to shrink *another* 35%, effectively a two year –50% revenue cut; but do not worry because it will return to 30% growth in 2024! The slide deck also includes references to companies like Virgin, Amazon, and Airbnb (with logos) even though they do not appear to be listed as customers. This is quite common in SPAC presentations. One deal, Artius Acquisition/Origin Materials, an eco-plastics company, lists in its slide deck non-customers committed to decarbonization including Ikea, Microsoft, Unilever, Best Buy, Amazon, Walmart, Nike, and Ford, alongside a picture of a Model 3, which would seem to imply that these companies are actual customers if one did not see the small font “fine print” saying that the companies in the slide deck are not all customers.



Finally, there is Tesla lookalike (but not really) Lucid Motors, known by Redditors as SPAC CCIV, one of several early-stage electric vehicle vehicles coming public via SPAC on the back of Tesla's 8 year "overnight" success. Lucid has some good pedigree being founded by an ex-Tesla engineer but they have not sold a single car yet. Lucid cars do not appear to carry any advantages over the Tesla Model S refresh, do not have the teraflops of historical driving data, do not have the charging network, do not have the lower cost variants that are now most Tesla sales, and, frankly, aren't as good looking as the Model S (subjective, but not really). Yet Lucid's SPAC market cap which peaked at $60 billion, and currently sits at $30 billion, is pretty much where Tesla's was in 2019 when Tesla already had $25 billion in revenue!

These are not isolated incidents. From looking at SPAC mergers daily, we estimate that over two-thirds of them would fail to find an audience as traditional IPOs. SPACs, which are often seeing as much as 10 new IPOs per day, are a new outlet in bubble investing as they are easy to take public and easy to close mergers due to some recent structural innovations. The hundreds of quasi-tech companies that will be coming public over the next year using this format will come to dominate small and midcap markets by the end of 2021 and we predict will become a wasteland of broken former multi-billion dollar value companies once actual financial reporting fails to achieve fantasyland accelerating growth rate projections, which rarely has happened in my 25 years of experience in growth and tech investing (COVID-19 aside, which is why we often look at pre-pandemic growth). In the litigious United States, these SPAC PowerPoints with projections are no doubt being collected by Class Action shareholder lawsuit specialists, who are probably the only ones who could credibly put out some aggressive five-year growth projections that will probably come true.

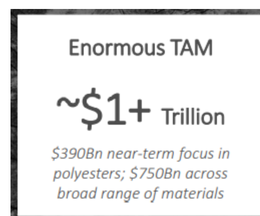
BUBBLES ARE ABOUT VALUATION MORE THAN FUNDAMENTALS

The beauty of bubbles is that the highest-flying beneficiaries of them have a narrative justification for the outsized valuations (remember the "early innings" internet crowd of 2000, the real estate is always secure crowd of 2006, and the "peak oil" crowd of 2011). Note that we are solely focused on valuations vs fundamentals because a great fundamental backdrop among bellwether sector leaders is a given and necessary precursor to a bubble; the macro fundamentals are strong, the cyclical factors are in your favour, but it is the valuation that makes it a bubble. Over the last year, the macro justification for growth stocks valuation inflation has been twofold: low interest rates and 10-year secular trends. We would note that neither of these things really matters beyond the narrative when valuations are this extended. Interest rates at 1% or 3% is not the reason why Snowflake ($1 billion in revenues) traded at a $100 billion valuation or Shopify ($5.5 billion in revenues) traded at a $150 billion valuation. The pre-revenue Lucid Motors did not get a $60 billion valuation because of low interest rates, nor do any of its multi-billion-dollar early-stage science projects in the acronym-laced AI/EV/ESG narrative; I am looking at you Plug Power ($400 million in revenues, $20 billion market value). I could say the same thing for bubble valuation household names like Peloton or Zoom. Beyond 30x two-year forward *earnings* (or some reasonable proxy like 10x gross profit if a fast growth company is currently unprofitable) interest rates have nothing to do with it.

Ten-year projections will not stop a bubble from bursting either because a bubble valuation's optimistic ten-year projections are already factored into the expectations. Almost anyone who puts up outsized buy-and-hold valuation expansion-based gains in a bubble (think Tesla doubling since November without any commensurate increase in forward expectations) cites a longer-term secular outlook and refuses to acknowledge that valuation played a larger role than fundamentals in the final parabolic runup. One wonders what the ten-year outlook would have looked like for Cisco, Sun Microsystems, Intel, EMC, Dell, Yahoo or even Microsoft in 2000! How about the ten-year outlook for oil in 2011? Ten-year outlooks are going to be notoriously unreliable, *especially in the "defined by change" field of technology*. Investors in a bubble will tend to severely miscalculate the odds of very optimistic forecasts coming to fruition whether it be the degree or duration of an already existing strong

trend. The only reason for being forced into an unpredictable 10-year outlook is that the value does not make any sense based on a more visible five-year outlook.

In a bubble, the fundamentals are not enough, because the later stage entrants do not have strong enough fundamentals to justify the valuations; we need a bigger number. Enter the Total Addressable Market of hundreds of billions and ignore company revenue of hundreds of millions (or less). The company is small, and the opportunity is big; you don't have to be good; you just have to be "there". We do not need to see $1 trillion TAMs in investor presentations for companies with less than $200 million in revenues. Growth and profits impress us while competition concerns us, not addressable markets. Before anyone gets too excited over SPAC merger Origin Materials' eco-plastics TAM of $1 TRILLION (screenshot right; no revenue expected until 2023), we would note that Microsoft's total revenues are only $150 billion, Disney's are only $75 billion, and Proctor & Gamble's only $75 billion – some very established companies in some very large markets. Ten-year TAMs did not save Pets.com and it will not save electric vehicle battery startup investors either.



We are not calling the top now, as bubbles have no theoretical limits, which is what makes them bubbles. The stocks that go down 80% in the aftermath likely went up hundreds of percent during the euphoria. That is what makes calling a top a futile exercise. That last big move in a short period of time is perfectly normal and an ominous sign. If Tesla were to fall 50% from a recent high of over $800 to $400 it would seem like a big deal; however, that $500 billion vaporization of market value would only represent a three-month correction to November's stock price. Extreme valuations do not tend to correct "sideways"; and overvalued growth stocks do not simply stay at the same price while they grow into the valuations. For reference, the NASDAQ doubled from August 1999 to its peak in March 2000, and then retraced all those gains to a 50% loss by year-end 2000.

Given our recent performance, we obviously have not been sitting out this recent rally despite our concerns. Aggressive money flows like the ones we are currently experiencing have a way of lifting all boats to varying degrees. When the music stops, it is likely that Nike and Disney will follow Netflix and Shopify down as correlations are always higher than expected in the short term. Therefore, we remain "over hedged" relative to what I estimate to be only 15% exposure to high torque stocks. While Venator Alternative Income Fund is possibly exposed to some market volatility owing to its high weight in convertible bonds, we note that we view these securities as principal protected long term call options and would gladly add to these positions should they offer higher yields in a market correction.

In the meantime, stay safe, stay hedged – and, as always, we reserve the right to change our mind!

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