THE POST COVID MARKET HAS ARRIVED; WILL DELTA RUIN THE PARTY?

HEDGE FUNDS (Inception)	JULY 2021	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund (March 2006)**	**-5.3%**	**5.7%**	**12.6%**
Venator Select Fund (September 2013)	**-5.8%**	**9.8%**	**17.3%**
S&P/TSX Total Return (March 2006)	0.8%	18.2%	6.7%
Russell 2000 (March 2006)	-3.6%	13.3%	9.0%
S&P Toronto Small Cap (March 2006)	-2.7%	16.6%	3.5%
S&P 500 (March 2006)	2.4%	18.0%	10.6%

ALTERNATIVE MUTUAL FUNDS (Inception)	JU 2021	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund* (January 2020)**	**-0.8%**	**7.8%**	**21.8%**	**7.3%**	**6.6%**	**7.8%**
B of A Merrill Lynch High Yield Index (August 2008)	0.4%	4.1%	10.7%	6.9%	6.8%	6.4%

**As of July 31, 2021*
***Venator Founders Alternative Fund, which holds the same securities as Venator Founders Fund, is now available as a Mutual Fund; 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*

July was largely a tale of two markets, and small cap was the one you didn't want. Unfortunately, Venator equity funds have always been weighted towards small caps and this largely led to a poor showing absent much news flow as we await second quarter earnings results (the earnings results we did get we were quite happy with as they soundly beat expectations). While the S&P 500 and TSX moved higher, small caps on both sides of the border moved lower as small caps are back on pace to underperform large caps for the fourth time in five years. Our Income Fund also had a small check back owing to its convertible bond positions but remains ahead of its targeted returns.

After watching a good sample of companies report second quarter results over the last two weeks, it is clear that the market is struggling to decipher what "normal" looks like post the reopen. Airlines and hotels, primary beneficiaries of the reopen, are failing to impress anyone with their bounce-backs. Big tech's "monster beats" against easier 2020 comparisons were shrugged off. Furniture stocks have collapsed despite continued revenue beats, record margins and six-month backlogs as the street looks to both 300% increases in shipping container costs, several month delays for the containers getting through ports putting Q3 in danger, and finally, unguided post-pandemic 2022 earnings. Apparel stocks also petered out after 50%+ growth against easy comps elicited "of course you did" yawns (despite showing solid growth against 2019 numbers as well). Housing stocks have held in surprisingly well despite higher prices starting to put a dent in demand – we think price loses this war even though supply is still low. Compounding the housing issue is final sale lumber prices still reflecting pricing peaks from six months ago (how do you sell profitably based on your January peak price cost of inventory when everyone knows those prices are coming down 50% in the next six months?).

Finally, the resurgent Delta variant is the cloud that hangs over everything. Here in North America, particularly in the United States, where large portions of the population refuse to get vaccinated, cases are surging. Domestically, I see little chance of lockdowns or even material restrictions. Frankly, it's just too politically unpalatable and unpopular. You don't win votes by putting people under house arrest; you win them by dropping money from helicopters. States/Provinces won't play the "bad guy" while letting the Federal government play the "good guy" this time around. Mask mandates are as bad as its likely to get this time around.

That being said, the one area where Federal governments around the world have been willing to step in aggressively is international travel, which is already a mess based on differing vaccination standards. This should bode better for domestic businesses of all sorts as money stays in-country. This could keep the COVID beneficiaries like cars, boats, outdoor activities and renovation markets stronger for longer. It will also put a clear view of “normal” off until Spring 2022, which we take to mean that investing strategies will need to be very short term (trade the volatility and call the quarters like last year) or very long-term (looking to late 2022 for your secular winners). Intermediate outlooks will be of little use today.

Last month the winners that held up the market were of the “flight to safety” variety. Utilities, healthcare, REITs and mega-cap tech took the spotlight. Of course, the most telling divergence was the rare and massive 6% spread between large caps (up 2.4%) and small caps (down 3.6%). I think this defensive retreat by the markets is the result of confusing and conflicting data, whether it is year over year or month over month. Inflation will be high this year but will likely be low next year as everyone raised prices all at once in 2021. Housing is slowing in part because prices are high, but supply is low (industry leaders are not even taking orders in some areas because they can’t ensure on time delivery). There are shortages in home goods but buying intentions are falling. Used car sales are strong, largely because the semiconductor shortages are holding back new car production, which should reverse next year. Shipping and logistics are at capacity, but UPS warned of a slowdown as people are lowering their online intake. For every give, there appears to be a take right now.

Our Income Fund has taken advantage of some of the recent volatility and has been in “buy mode”. Unfortunately, some of our companies have also been in “buy mode” and several bonds have been called from us recently (Tesla finally called the bonds that we bought when everyone still thought they were going bankrupt). That said we have managed to maintain a yield of 5% despite a significant weighting towards lower yielding convertible bonds. We can debate the growth outlook of companies like Peloton in a post-COVID world, but we think we are pretty safe buying their debt at 90c on the dollar in what we see as a low likelihood of insolvency in the next several years. Overall, we have been very happy with the positioning and the results of this Fund considering the overall poor risk-reward being offered in the bond world right now. Leverage is low and credit quality is high and this fund will continue to be defensively positioned until better opportunities open up in high yield.

We expanded our fund offerings on June 30, 2021, with the launch of Venator Founders Alternative Fund as a liquid alternative mutual fund. The Fund will mirror our index beating, founding strategy, the Venator Founders Fund, which has been offered for over 15 years and remains available to accredited investors by way of Offering Memorandum. For additional details on the fund, visit our website at https://venator.ca/funds-profile/founders-alternative-fund.

We reserve the right to change our mind!

Brandon Osten, CFA
CEO, Venator Capital Management Ltd.

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 Venator Hedge Funds may only be purchased by accredited investors with a medium-to-high risk tolerance seeking long-term capital gains. Please read the Offering Memorandum for each Hedge Fund in full before making any investment decisions. Prospective investors should inform themselves as to the legal requirements for the purchase of securities. All stated Venator Hedge Fund returns are net of fees. It is important to note that past performance should not be taken as an indicator of future performance. Commissions, trailing commissions, management fees and other expenses all may be associated with investing in any of the Venator Alternative Mutual Funds. Please read the prospectus and Fund Facts relating to each Alternative Mutual Fund before investing. The indicated rates of return of the Venator Alternative Mutual Funds are the historical annual compounded total returns, including changes in share or unit value and the reinvestment of all dividends or distributions, and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently, and past performance may not be repeated.