

THEY ARE ALL BEAR MARKET RALLIES, UNTIL THE LAST ONE

HEDGE FUNDS (Inception)	OCTOBER 2022	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund** (March 2006)	0.9%	-38.7%	8.4%
Venator Select Fund (September 2013)	6.0%	-50.6%	7.0%
S&P/TSX Total Return (March 2006)	5.6%	-6.2%	6.2%
Russell 2000 (March 2006)	11.0%	-16.9%	7.2%
S&P Toronto Small Cap (March 2006)	3.7%	-13.2%	2.5%
S&P 500 (March 2006)	8.1%	-17.7%	9.0%

ALTERNATIVE MUTUAL FUNDS (Inception)	OCT 2022	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund*** (January 2020)	0.6%	-14.1%	-14.8%	0.5%	1.9%	5.0%
B of A Merrill Lynch High Yield Index (August 2008)	2.8%	-12.2%	-11.4%	0.2%	1.9%	4.1%

* As of October 31, 2022

** Venator Founders Alternative Fund, which holds the same securities as Venator Founders Fund, is available as a Liquid Alternative 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

The markets rallied strongly last month outside of the growth heavy NASDAQ. Earnings haven't been nearly as bad as expected. The market remains hopeful that interest rate increases are nearing an end. If this is "as bad as it gets", it's time to start figuring out which growth companies have held up financially through the growth recession and still have bright futures. Apparently, this does not include big tech, where cloud services (Amazon, Microsoft) have slowed from mid-thirties hyper-growth to mid-twenties solid growth, and where the online ad giants have maxed out their share of ad budgets for now.

Everyone is very focused on a Fed pivot, while the Fed governors have succumbed to celebrity culture. Every week there are several Fed governors doing interviews or speeches and getting unprecedented media attention on whether rate increases are almost finished, or whether rates will stay high forever, or whether rates could come down in the next two years. We personally can't remember a time when Fed governors who weren't the Chair were ever interviewed, quoted or followed on a regular basis. This includes 2008/9 when the Fed was tasked with bailing out the economy from systemic collapse. The Fed should be like a referee; they should be managing the game without having an obvious influence on the outcome. But this officiating crew seems to be enjoying their celebrity status a bit too much.

The Fed pivot is believed to be in the cards because most measures of inflation appear to be headed in reverse. It has been generally recognized that the outsized "shelter" component of the CPI is the last pillar standing in the fight against inflation, and that this number is the most trailing of the trailing indicators. The reason for this is because September rent, in aggregate, would be higher than August rent, as they might only represent six months of renewal increases with another six months of renewals to go at current higher rates. So, while rental renewal levels might be flat month over month, aggregate twelve month blended rental rates will likely increase at a slowing pace until the twelfth anniversary of rent increases.

The other not-directly-CPI related item that continues to hold up is employment. It is generally believed that the Fed wants employment to drop, but we personally think that if the inflation monster can be slain while employment holds up, this would be an ideal outcome. The one major area seeing employment surpluses appears to be technology, with numerous hiring freezes getting media attention owing the media attention generally bestowed on big tech. It is worth noting that when Microsoft says it is laying off 1,000 people, that they probably hire over 20,000 people per year (10% growth, maximum efficiency, and attrition replacements). We would expect that technology will see a rise in total employees, even if the growth is subdued. That said, we would imagine residential construction employment is likely to check back next year.

Earnings season is off to an interesting start, as the gives and takes of the last year start to find their way into financial results and forecasts. Some early observations:

- Price increases, implemented early in the year, are meeting cost deflation being seen today, resulting in some outsized earnings beats, even if unit volumes are relatively flat. This is causing some strong earnings reports among larger cyclical businesses, such as consumer staples despite flattish sales volumes.
- The strong US dollar is having an impact on earnings reports. For Canadian companies, this is a positive translation. For American companies with significant international exposure, this has caused some reported weakness, even if the “constant currency” numbers have been good.
- The supply chain is easing up quickly, but there are some lingering effects. Shipping costs are way down, and shortages are turning into surpluses. But seasonal products have arrived late owing to problems earlier in the year, which will lead to severe discounting on late arrival seasonal items.
- On these last two points, if you are an importer with overseas costs and shipping, your profit margins could rise substantially next year. Cost deflation could be a major theme going forward. This doesn’t appear to be factored into earnings forecasts yet and could be a big positive to profitability in 2023.
- Infrastructure and non-residential construction spending is booming. The few companies that have reported have seen virtually no signs of weakness and have been fearless in their outlooks.

We have had very few companies report earnings so far. Skechers reported better than expected revenues and demand, despite weakness in China owing to COVID lockdowns, but missed earnings due to inventory logistics hangover issues from earlier in the summer. General Motors beat expectations, although we are more interested in the launch of their EV platform next year than anything they are doing in the next six months. MI Homes, like a lot of homebuilders, put up huge numbers while warning about a slowdown next year, but the stock remained firm owing to a valuation of 50% of tangible book value. Finally, Hammond Power Solutions beat projected revenues by 30% and earnings by 100% as electrical infrastructure remains a source of strength in the economy.

On the Income front, yields remain incredibly attractive. We acknowledge that 4% two-year government bond yields have taken the shine off of the corporate bond market but being able to achieve 8-10% returns with modest risks over a sub-5-year horizon is the most attractive we have seen since 2008/9. We continue to find good high yield bonds, but it is challenging to find sellers of these bonds as other holders have taken a similar view of preferring to hold to maturity than trading.

We reserve the right to change our mind!



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