VENATOR
CAPITAL MANAGEMENT LTD.

MOVING LIQUIDITY FROM ONE BUCKET TO THE OTHER

HEDGE FUNDS (Inception)	JULY 2024	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund (March 2006)**	**4.2%**	**5.0%**	**8.9%**
Venator Select Fund (September 2013)	**5.3%**	**7.8%**	**7.8%**
S&P/TSX Total Return (March 2006)	5.9%	12.3%	6.9%
Russell 2000 (March 2006)	10.2%	12.1%	7.8%
S&P Toronto Small Cap (March 2006)	5.8%	15.1%	3.6%
S&P 500 (March 2006)	1.2%	16.7%	10.4%

ALTERNATIVE MUTUAL FUNDS (Inception)	JUL 2024	YTD	1-YR	3-YR	5-YR	10-YR
Venator Founders Alternative Fund (July 2021)**	**4.0%**	**3.8%**	**6.8%**	**-9.2%**	**-**	**-**
Venator Alternative Income Fund* (January 2020)**	**1.0%**	**4.1%**	**9.7%**	**-0.1%**	**3.0%**	**3.7%**
B of A Merrill Lynch High Yield Index (August 2008)	2.0%	4.6%	11.3%	2.2%	4.0%	4.6%

** As of July 31, 2024*
*** 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*
***** Venator Offshore Fund is available as the US dollar version of Founders Fund strategy*

July was one of those rare months when small caps actually outperformed large caps. This was spurred on by a number of inflation data releases showing deflation is the new concern, which has led to a high confidence outlook for rate cuts (Canada got a head start with two cuts in the bag already). The three-day jump in small caps and “interest sensitive names” was furious while mega cap names moved in the opposite direction even though lower rates should be beneficial to them as well.

The financial press tried to find fundamental explanations for the moves in opposite directions. Soft landings are good for small caps? Lower rates should get the economy humming next year? Is AI spending in a bubble because we haven’t found the killer app to justify $500B in data center buildout over the next several years? These are explanations and not predictions. In time, we are going to be writing about weight loss drug patents expiring in 2033 when those stocks start correcting as though that's new information.

But, if we are looking for explanations rather than predictions, there is only one explanation for the small caps up/mega caps down that makes sense, and it's not fundamental. The bottom line is that two weeks ago, the aggregate market value of the Magnificent Seven was $15 trillion, and the aggregate market value of the Russell 2000 was $3 trillion. And if the algos and ETFs that control 90% of daily trading want to move just 10% of their cash from one bucket to the other, it's going to mean a 50% bump in demand for small caps. That’s all the explanation you need for the “first move”. This theory can be readily observed by a low Russell 2000 to Nasdaq 100 beta of 0.3 last month.

This would be just the beginning, however. The "knee-jerk" reaction to buying small caps in the face of limited available liquidity is to go after the most liquid companies and the Russell 2000/S&P Small Cap ETFs. Only if this desire to broaden out the investment allocation continues can fundamental stock analysis come back into vogue (when company specific factors and valuation play a role, as opposed to broad narratives that have allowed mediocre businesses to flourish by virtue of being in the right sector).

Most of our investments would still be characterized as small cap, given that a decade of neglect has resulted in very cheap values in high quality companies to be found in the sub-$10 billion market, where most companies are. Although, we acknowledge that the overall quality of small cap markets has declined significantly over the years. Nearly half of all small caps lose money, and far too many are either cyclical or just don't grow at all. That shrinks the pool of companies that we are interested in, it also makes the better investment opportunities stand out among the crowd.

With rate cuts on the horizon, we expect the Income Fund, currently yielding over 9%, to perform well for the remainder of the year. We recently added a few names to get in under the wire of probably the last good opportunity to grab some yield before rates started coming down. It has definitely become more difficult to find sellers of high yielding bonds as of late as liquidity has dried up for performing debt yielding more than 7%. Fortunately, we are set up well as fully invested and don't need to buy anything in the near term.

We reserve the right to change our mind!

Brandon Osten, CFA
CEO, Venator Capital Management Ltd.