A HAWKISH CUT RUINS DECEMBER

HEDGE FUNDS (Inception)	DECEMBER 2024	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund (March 2006)**	**-5.6%**	**9.7%**	**9.0%**
Venator Select Fund (September 2013)	**-7.9%**	**20.4%**	**8.6%**
S&P/TSX Total Return (March 2006)	-3.3%	21.6%	7.2%
Russell 2000 (March 2006)	-8.3%	11.5%	7.6%
S&P Toronto Small Cap (March 2006)	-3.3%	18.8%	3.7%
S&P 500 (March 2006)	-2.4%	25.0%	10.6%

ALTERNATIVE MUTUAL FUNDS (Inception)	DEC 2024	YTD	1-YR	3-YR	5-YR	10-YR
Venator Founders Alternative Fund (July 2021)**	**-5.8%**	**7.9%**	**7.9%**	**-8.2%**	**-**	**-**
Venator Alternative Income Fund* (January 2020)**	**0.8%**	**11.2%**	**11.2%**	**1.8%**	**4.1%**	**4.4%**
B of A Merrill Lynch High Yield Index (August 2008)	-0.3%	8.2%	8.2%	2.9%	4.0%	5.1%

** As of December 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*

The market threw a bit of a tantrum in mid-December in reaction to the “hawkish rate cut”. Angry algos caused some record and near record negative responses to an announcement that was largely expected. This move largely erased the “Trump Bump” from November, creating a top-of-the-market debate among the media pundits who are focused on the sustained run of narratives from the last two years. A two-year 50% run in the S&P500, fueled by mega-cap tech, which represents a disproportionate weighting in the index, will call sustainability into question, but it's worth noting that most stocks have not experienced such benefit, and the equally weighted indices have experienced half of this performance, while small caps remain below 2021 levels. In other words, you can call into question the sustainability of the rally in the largest companies that drive the largest indices, but for the vast majority of stocks there has been no such historical strength to make the same argument.

Getting the Fed statement that caused the recent sell-off out of the way, we didn’t really understand the big deal. A neutral rate goal of 3.5% in two years may have been mildly disappointing, but it seems like a reasonable target that we have been predicting for two years. This seems to be a good level to keep inflation under 3%, employment steady, growth manageable, bond yields worth investing in, and just enough to move mortgage rates into the mid-5%s to improve housing affordability and allow for some turnover in the frozen existing homes market. It also gives the Fed some leeway to lower rates further if something unforeseen really bad happens like a war or private credit collapse. If the market does sell off in 2025, we don’t see interest rates as being the culprit.

The new year will not come without risk, but no year ever does. Consensus was incredibly positive on everything going into the Fed decision and 30x EPS multiples were being handed out like candy for many low growth (and in many cases low quality) companies. The US government transition will likely dominate the first quarter and set the tone for the year. The "mass deportation" threats, which may prove more rhetoric than action, holds the risk of being massively inflationary, especially in construction and hospitality services as it pertains to private companies (public companies generally can't hire immigrants without documentation). The government efficiency mandate could have broad implications as much of the private sector depends on public sector funding including healthcare, defense and infrastructure.

One development to watch is the continued development of the Artificial Intelligence narrative, which has been driving markets, and needs to find its way into the mainstream. Thus far, nearly all the value has accrued to the infrastructure buildout. Few of the hyperscaler software vendors have experienced any material economic return on their investments thus far on the income statement (Salesforce can make fun of Microsoft CoPilot not taking off, but its own ten-year-old Einstein AI offering has been just as much of a disappointment, if not more so). Back in the heady days of the internet expansion era of the late 1990s, end product businesses were growing in excess of 100% and pulling demand for hardware (Cicso routers and Sun Micro servers) with them. This time, the hyperscalers and software companies are building the infrastructure ahead of demand as search, media, chatbots and coding are the killer apps that are getting good take up but have yet to break through financially as they mostly look like evolution rather than revolution of existing products. In short, AI needs to be a new product, not just a feature or improvement, to justify the investment. While the hyperscalers have bottomless bank accounts, without sufficient return on investment in the next few years, the infrastructure build growth rate could grind to a halt, and possibly even decline within a few years.

As mentioned above, while the largest companies have experienced phenomenal returns driven in the past two years, the majority of the market has experienced decent, but not spectacular returns. This leaves a wide ocean of relatively neglected opportunities that can't grab the market's attention thematically. By way of example, we remain baffled by the markets neglect of Skechers, a company we have owned at various times dating back nearly twenty years. It just keeps growing and yet the market treats it as a low/no growth business with a heavily discounted multiple relative to all other public companies in the sneaker industry. Its growth rate is superior to Nike and rivals Deckers (Hoka/Uggs), yet it trades at half the valuation of its higher marketing profile competitors while the market ignores its growing stature. Skechers shoes are not "in style" or "sexy", but that is a strength that has allowed it to sneakily become the clear number three shoe company globally without anyone noticing as they aren't subject to either fashion risk or saturation. Most analysts would agree that the hottest shoe innovations of the past five years are Hoka and On Running, both of which are running at about $2.5B in revenues this year. Only that isn't the whole story. Skechers Slip-In technology, which has only been around for three years, should exceed $3B in revenue this year (according to one recent broker report as the company doesn't break out product sales) making it bigger and faster growing than the other two hot brands, which trade at three times the valuation. As a bonus, Skechers is the number one brand in difficult to penetrate India, probably the best international growth story for the next ten years. Overall, our watchlist continues to expand as we do further research on a broad set of neglected opportunities in a diverse set of industries.

Our Income strategy is in a very good position right now. The yield is a very healthy 8%, while nearly all bonds mature before 2030. All bonds are backed by public companies, making both transparency and access to capital easier than with private equity/credit. Also, the weaker credit markets of the past several years have surfaced more “senior secured” opportunities, adding to our confidence in the portfolio. Admittedly, it is getting difficult to find good 8%+ opportunities in today’s environment, which is why we are happy to say we took advantage of those opportunities when they presented themselves two years ago.

We reserve the right to change our mind!

On behalf of the entire team at Venator Capital Management Ltd., we wish you a happy, healthy, and prosperous 2025!

Brandon Osten, CFA
CEO, Venator Capital Management Ltd.