

LOONIE TUNES

May was a flat month for the Founders Fund, which experienced a gain of 0.6%. This puts our year-to-date return at 15.5%, our twelve month return at 46.7% and our NAV at \$15.38 per unit. May was a very strong month for the markets in general. However, it wasn't the broadest rally as big caps were noticeably favoured over small caps. As such we managed to lose a bit of money on our longs, while making some money on our shorts despite strong 3%+ upward moves in the core indices we track. This market rally (our comparative indices are up anywhere from 7%-9% YTD) continues to be one fueled by liquidity, be it private equity takeovers, mega-mergers, the continued proliferation of the mis-named Exchange Traded Funds (most of the new ones aren't actually based on any known exchange), and foreign government (or government sponsored companies) investments. We are having an increasingly difficult time finding "value" in this market (are screens are yielding fewer names that fit our valuation criteria) which is clearly in a "momentum" phase. However, it appears that rising bond yields (the result of too much debt issuance to purchase equity in the form of takeovers and leveraged investment) could have a dampening effect on the current market rally given some more time.

The Canadian dollar's aggressive appreciation seems to be very topical, so we are going to disclose how the Venator Founders Fund deals with this issue. Firstly, from an investment standpoint, the Fund maintains a U.S. dollar denominated margin account through which we purchase our U.S. equities. This means that every time we purchase U.S. securities, we borrow (short) U.S. dollars. This "insurance" costs us approximately 2% on an annualized basis (or less than 1% since less than 50% of our money is invested south of the border). However, the Canadian dollar's appreciation can wreck havoc for some Canadian companies (exporters) as well, although some sectors can benefit from the stronger loonie (importers). Finally, some "Canadians" do all of their business in the U.S. which subjects us to translation risk. Here are examples of how we are managing our currency exposure:

- **Exporters:** We have two ways of dealing with these companies. The first one is that we sold the stocks of several companies that we believed were operating near peak efficiency and, in our estimation, did not have room for further operational efficiency gains to offset the rising loonie. In other cases, we have bought the Canadian manufacturers using U.S. dollars, effectively shorting the greenback as a hedge. **Importers:** We have been buying up shares in several selected Canadian retailers and wholesalers who buy U.S. and sell Canadian. From our readings of analyst reports, we do not believe that the potential gross profit gains are being properly accounted for in forward estimates.
- **U.S. companies in Canadian clothing:** Similar to what we have done with some of our exporters, we have been moving these companies into our U.S. dollar denominated accounts in order to avoid translation risk of their financial results into Canadian dollars.

We don't really have a view on where the Canadian dollar is headed other than to say we want to make sure the Fund is hedged either way. However, we can see long-term problems arising from an increasing dollar. Much of the loonie's rise is due to strong commodity markets (or at least that's what the economists are attributing it to). Lest we forget, commodity pricing can be wildly cyclical (remember oil prices used to cycle in an "up 200%, down 65%" range in seven year cycles) as can the hyper-growth economies that are providing the fuel for these commodity rallies (wasn't there a Russian AND Asian crisis within the last 10 years? On second thought ignore that, after all "it is different this time!"). The big concern here is that the longer commodity prices stay at record levels, the longer the loonie stays as record levels (modern records anyways) the more devastated the Canadian manufacturing/exporting business. Somehow, I don't see these exporters coming back to life at a later date; once decimated they will become extinct as there are too many global low income jurisdictions waiting in line for jobs. It's only because the start-up costs of domestic manufacturers are already sunk (and high international freight costs to a lesser degree) that the overseas competition hasn't put all North American exporters out of business. In a worst-case scenario, commodity

prices stay high for ten years, pushing the loonie above parity and sending the manufacturing industry the way of the dodo. Eventually these commodity prices will come down to the marginal cost of production (\$30.00 oil, \$3.00 gas, \$1.10 copper, \$7.00 nickel, \$35.00 uranium etc.) at which point the Canadian economy could be in a bit of trouble without anything to fall back on. Maybe the banks can provide some stability, although I would imagine that quite a bit of their business is tied to the commodity cycle, and what's left of manufacturing, as well.

Then again, maybe the Canadian dollar stays under \$0.95, commodity prices check back to more sustainable levels (i.e. levels that don't encourage too many new capital projects and too much new production), and our manufacturing industry lives to see another day. Unfortunately the Bank of Canada has little ability to control the outcome in these matters so we will all have to wait and see what happens.

We are pleased to announce that Venator Capital Management Ltd. has received final approval to launch the Venator RSP Trust. This Fund will be structured as a "Fund of Funds" that will invest in the Founders Fund initially, and have the ability to invest in other Funds run by Venator once the Founders Fund closes. It is important to note that the Venator RSP Trust will not be able to accept RRSP money until we are assured of having 150 investors at a minimum of \$500.00 each. Therefore, we would appreciate any \$500.00 (non-RSP) "token" investments we can get in order to get to our 150 investor goal. Once we are assured of reaching our goal we will begin to take RSP investments.

As Always, Thank you for your support,



Brandon Osten, CFA
President, Venator Capital Management Ltd.