VENATOR
CAPITAL MANAGEMENT LTD.

THE YEAR IN PREVIEW
(Because the Year in Review is too Painful)

December finally showed some signs of life for Venator Funds as tax-loss selling abated and market volatility slowed going into the holiday season. As the table below indicates, our Hedge Fund gained 4.8% while the Income Fund managed to gain 2.9%.

Instrument	Monthly Return	Year-to-Date Return	Return Since Inception
Venator Founders Fund[1]	**4.8%**	**-19.9%**	**22.5%**
Venator Income Fund[2]	**2.9%**	**-8.8%**	**-8.8%**
Venator Catalyst Fund[3]	**3.3%**	**4.6%**	**4.6%**
TSX Composite	-3.1%	-35.0%	-23.1%
Russell 2000	5.6%	-34.8%	-31.6%
S&P Toronto Small Cap	5.7%	-47.8%	-48.4%
S&P 500	0.8%	-38.5%	-29.4%

1. *The performance of the Venator Investment Trust approximates the performance of the Venator Founders Fund.*
2. *As the Venator Income Fund was launched in August, 2008, YTD represents five months of performance, as well as return since inception. Benchmark results for the S&P/TSX Income Trust: Monthly Return -9.9%, YTD -39.5% (since inception of the Venator Income Fund).*
3. *The Venator Catalyst Fund launched January 2008. Therefore return since inception is the YTD return. There are no benchmarks for this Fund.*

Venator Founders Fund: The Founders Fund showed a relieving 4.8% gain in the month. We managed to take advantage of a few opportunities such as companies trading below the value of cash on the balance sheet, and at the same time we lowered our short positions and were less hedged than usual in month. Much of our time was spent researching our existing companies Q4 performance and we remain confident that our companies had solid quarters and should have better than expected 2009's.

Venator Income Fund: The Income Fund experienced a 2.9% gain in the month. The Fund is down 8.8% since its August launch despite being fully invested and unhedged during one of the worst five month stretches in market history. At the end of the year, the Fund was still fully invested and carried a better than 10% yield on its expected dividend/interest payments. The Fund has also recently been buying several debt issues due to the attractiveness of yields on certain shorter-term and safer opportunities.

Venator Catalyst Fund: We are taking this opportunity to introduce this fund to our investors, which was in limited distribution last year (less than 10 investors). As its name suggests, this Fund takes shorter term positions in strategic and technical trading opportunities. The Fund is

typically 50% in cash (for shorter term trades executed sporadically), 25% in longer-term investments, and 25% in intermediate term investments. This strategy was able to provide 4.6% returns in a difficult 2008, and is a good option for investors that believe the market volatility will continue and that "trading-oriented" strategies will outperform in the coming year.

Quick Review of 2008:

While Venator's Funds had performed well in a flat to down market from inception through August, we were simply unprepared for the events that unfolded and led to the worst market environment in 80 years. Our strategy has been, and continues to be, finding great growing companies trading at inexpensive valuations, which is largely a function of getting to them before the rest of the market discovers them. We also hedge by shorting against positions that we believe carry market or valuation risk (generally anything trading above 15x earnings, cyclicals and resources). Unfortunately, we had not counted on great growing companies trading down in valuation from 8-10x earnings to 5-6x earnings, and this resulted in the unhedged portion of the portfolio experiencing some surprising declines despite significant operational strength displayed in better-than-expected Q3 financial results and Q4 guidance.

The old adage that there is always a bull market somewhere didn't apply to the stock market in 2008 as money moved out, rather than around. Like others in this business, we saw a few disasters on the horizon (in our case we had previously written our warnings on commodities, financials, emerging markets and private equity), but missed out on a few others (aversion to any company with any debt, unemployment). For quite some time we had fervently believed that avoiding the resource, emerging market and financial bubbles, and focusing on the more neglected small-cap stocks outside of these sectors would result in similar returns that being invested in "anything but technology" gave investors earlier in the decade (indeed we believed a fall in commodity prices would help the rest of the economy). While we made some money shorting the resource and financial sectors, the volatility had us covering many of these shorts before we should have.

With all that has happened we don't believe that the full story has played out for our portfolio, and that three months of horrid losses (September-November), after two-and-one-half years of solid returns in a flat-to-down market, is not enough time for us to give up on our companies or strategy yet.

What we are Thinking for 2009:

There are a wide range of views out there in terms of what 2009 will bring. We are somewhat neutral on the prospects for the economy overall (expected first half weakness, followed by later year stability), which is probably good for the stock market. To be sure, the world still needs to deleverage which will provide ready and willing sellers for all that money supposedly

waiting on the sidelines to be invested, which will probably prevent a huge rebound in 2009, but a more gradual market recovery could be in the offing.

We continue to believe that the commodity markets, specifically oil and gas, are finished for at least the next several years. The last bubble is rarely the next market leader and frankly there are too many people that still believe in oil for us to believe the market has capitulated yet. After a very quick fall from $140.00 to $40.00, we believe that there is a longer 12 to 24 month drop to below $25.00 ahead (the marginal cost of current production). With OPEC now at less than 80% utilization, and the global economy staring down less than 2% annual growth, we are looking at 5-7 years before anyone starts talking about supply constraints in the oil markets, which was necessary for the previous excitement.

Furthermore, we are not worried about the specter of some short-lived deflation. *The commodity bulls are having a tougher time letting go of their bubble than the techies did in 2000.* They want to believe that this short period of deflation is horrendous for the economy while a return to $100 oil, $10 gas, $3.00 copper and a $6.00 box of cereal is what this economy needs to get going. The current mostly non-core deflation, spurred on by lower commodity prices, will roll over by next fall and likely result in a return to benign inflation which is where you want to be.

We think the Fed is actually doing the right things here. In a deflationary environment you can, and are supposed to, print money. In fact, with 20-year treasuries yielding less than 3%, we are surprised the U.S. isn't issuing more debt. Assuming that they can stop the presses by mid-summer, and that sequential GDP growth/shrinkage can flatten out by the summer, we can see a return to normalcy by the fall, without dramatic re-inflation. If the market holds true to form by rebounding six months before the actual economic rebound we could get a sustained market uptrend starting in the spring.

Our above views suggest that we see the US markets outpacing the Canadian markets for the next several years. To the extent that Canadian investors want to invest in Canada, we believe we are in the right place outside the resource market, where "anything but resources" has experienced a solid five years of neglect. This means that most Canadian money managers and brokers are going to have a tough time investing if they can't let go of their easy-money macro-economic trades.

10 Reasons to be Hopeful for 2009:

We are not necessarily saying we are bullish on the market; we are always bullish on our individual positions, not on the market in general. But we realize everyone is down in the dumps after the worst stock market performance in 80 years so we thought we would give you a few reasons why the market could stage a partial rebound in the coming year.

1. **Oil is down**: Bush's little $600 rebate checks are nothing compared to the likely $2,500 that families are saving on gasoline and heating, not to mention business savings on transportation costs.
2. **Low Mortgage Rates**: As with the oil price declines, mortgage rate declines will put more money into the hands of consumers (regardless of whether it helps actual home prices) to the tune of $1,000-$4,000 per year.
3. **Low Interest Rates**: This should eventually prove to be beneficial if interest rate spreads narrow over time. Good companies can still get debt financing, while poor companies will likely go under (but will likely continue operating as someone acquires them for 50¢ on the debt-dollar). The world still needs to deleverage a bit from here, but we think that these lower rates will prove beneficial towards the latter half of the year.
4. **Consumer Spending/Savings**: The above factors are going to go a long way towards giving Americans more money to spend (as much as a 10% drop in expenses per household, partially offset by a further 4% increase in unemployment). But the concern is that people are simply going to hoard their cash. We surmise that consumer spending is unlikely to drop another 10% with all these stimuli put in place, and we think this is already built into market expectations. If the excess money goes to savings, is that so bad? Personal and corporate balance sheets will improve and get less risky/more attractive when government bonds are yielding next to nothing. How can less mortgage and corporate debt delinquencies not ultimately be a good thing?
5. **The Fed Model**: The so-called Fed Model stipulates that the P/E ratio of the market should be the inverse of the yield on the 10-year Treasury note. The 10 year treasury yield is comfortably below 2.5%, suggesting that the P/E of the market should be around 40x earnings. Depending on whether you are looking the P/E multiple from a bottom up (11x) or top down (15x) perspective, you could expect the market to either rise by 100%-200%+ or treasuries to drop significantly from current levels (we have positions in on both sides of this trade).
6. **Valuations**: There are a lot of inexpensive companies out there. You can likely buy the market for short spurts, but will need to be more selective to make sustained gains. We have bought companies with no operations that trade at less than 70% of cash on the balance sheet (truly buying $1.00 for 70¢). You can buy defensive, growing heathcare companies for less than 8x earnings. If you are comfortable with a company's forward prospects, then it is probably a cheap stock.
7. **BAILOUTS!**: We like the way the government is ensuring that no major company goes under (after the initial Lehman screw-up), which can provide some confidence in companies in terms of counterparties' willingness to do business with them. Having the shareholders get diluted to nothing is actually not a big deal as long as the debt holders can take the operations, and the companies can retain most of their employees.
8. **"Hope and Change"**: Its sounds like a great plan even though it is devoid of specifics. It was enough of a message to get a relative political newcomer selected as the Democratic Nominee and subsequently elected as the next President of the United

States. Confidence is important when it comes to the general public spending and investing, and the American people believe in Obama.

9. **You are still "in the Game"**: As mentioned above, we just weren't hedged enough for the second worst year ever in the stock market. That being said, the Founders Fund is down "only" 20% from January 2008. However, if the market is cheap and our companies' prospects remain bright, there is a real chance for quick and impressive gains in the Fund as positions move from amazingly cheap valuations of 6x earnings to still cheap valuations of 9x earnings (or 50% gains from here in some cases).
10. **2008 is OVER!!!**: GOOD RIDDANCE!!!

Aggressive Asset Allocation, Defensive Positions:

Without a doubt, it's still worth being cautious. For one thing, there is no rule that recessions can't last more than one year, and Q1 is going to be tricky. Quarterly results appear likely to make the low-bar expectations that have been set. However, we are not yet sure where the 2009 annual guidance is going to come in on the conference calls, but it will not be pretty.

That being said, we think we can still make money in really cheap stocks coupled with really low expectations. When we say cheap, we mean that on the basis of prior and expected earnings and cash flow rather than growth potential, tough to value assets or turnaround prospects. When we say low expectations, we mean growing companies where the market has no expectations of growth going forward. When everything is down so much in such a short period of time, you don't need to get especially creative or take outsized risks to find value and hopefully make outsized gains.

Almost all of our largest positions have four defining characteristics: they trade at less than 8x earnings, they are expected to increase their earnings next year, they beat Q3 expectations and are expected to "meet or beat Q4", and they are all the market leaders in their industries. Hammond Power Solutions, Futuremed Income Fund, Pet Valu, Allion Healthcare, and Glentel all qualify on these fronts. Other large positions are in the three-out-of-four category (New Flyer Income Fund missed their Q3, Hanger Orthopedic trades at 15x earnings), or are experiencing extreme growth (Zynex Inc.'s Q4 should show over 100% revenue growth), or represent extreme value (Cenveo trades at less than 2x free cash flow).

A Small Token of Our Appreciation :

We at Venator were disappointed with the performance of our funds in 2008. As a small firm, we don't really have a lot to offer back to investors, so we have opted to offer our existing investors a bit of a break on our fees for any new money that you may choose to invest with us.

Specifically, for any new money invested we will not take any performance fees until we reach our January 2008 high watermark. For example, the Founders Fund will have to gain

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approximately 20% before we take any performance fees on new money. This offer will remain open until we get back to our Jan 2008 high watermark.

We also realize that we are not the only investment that you may have in your portfolio, and that potentially worse losses may have been suffered elsewhere. Therefore, we will allow existing investors to invest new money in any of our funds at the January 2008 high watermark from any previous fund you may have redeemed from last year (with a limit of a 100% high watermark return from our Jan 2009 level). For example, if you redeemed money from a fund that was down over 50% last year and reinvest that money with us, we will not charge any performance fees until we double your money. The table below provides additional examples:

Loss from Prior Investment	Threshold for Performance Fees
-20%	25%
-30%	42.9%
-40%	66.7%
-50% +	100%

This offer will remain open through the end of April. We reserve the right to restrict the amount of money we accept under these terms.

The net effect of this offer is that we are effectively allowing existing investors to invest additional money at fee schedules below that of a typical active mutual fund (2% management fee for the hedge funds, and 1% for the income fund).

Thank you for your continued support,

Brandon Osten, CFA
President, Venator Capital Management

This is intended for informational purposes and should not be construed as a solicitation for investment in any of Venator's Funds. The Funds may only be purchased by Accredited investors with a medium-to-high risk tolerance who are seeking long-term capital gains. Read the Offering Memorandum in full before making any investment decisions. Prospective investors should inform themselves as to the legal requirements for the purchase of shares. All stated Venator returns are net of fees. It is important to note that past performance should not be taken as an indicator of future performance.

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