VENATOR CAPITAL MANAGEMENT: Keeping You in the Game

Getting to the point, the Founders Fund dropped 2.7% in July, better than Canadian markets, which were off over 6%, but lagging the US half of our benchmarks, where the Russell 2000 gained 3.6%. As the Bear gathers steam it's worth noting that all four of our benchmarks are now negative on the year while we hold onto our 8.4% gain. Clearly, a weaker global economy is getting to the commodity bulls, and unfortunately the US has spent their rebate checks and China is effectively shut down for a month, leading us to believe that Q3 numbers will be uninspiring and that we could see continued weakness in the markets until Q4s are reported in January.

It's August 4th and I am sitting in the office on this beautiful Monday catching up on a few things and thinking if the Toronto Stock Exchange were open today, it would be down about 5%. We find it ironic that the market would choose a Canadian holiday to absolutely decimate oil and gas stocks (down about 7%), agriculture stocks (down 7%), gold stocks (down 5%), copper stocks (down 9%), and the once mighty Loonie (below $0.965). Of course last month we saw broken and more-or-less insolvent US financial institutions jump over 50% in a week (Bank of America added over $50 Billion to its market value that week). *The volatility is shocking*. At end of the day you can sit on the sidelines, try to trade it, try to hedge it, or simply "ride it out".

We are not advocates of the first two strategies. We have never been big advocates of holding cash. Inflation is just eating away at your purchasing power (as is a now declining Canadian dollar) and it's difficult to "time the turn". Generally speaking, the first move up tends to be big and those sitting on the sidelines usually don't know it has happened until it's too late. Markets can move 8-12% a week in this market; in other words, you can miss the whole year in one week. Trading this volatility could drive you insane. This market has no qualms about 2% intraday moves with several changes in direction. If you don't mind staring at a computer all day and flinching every 15 minutes, this might be the guessing game for you. But it's worth noting that with the market moving 1% intraday on a daily basis (that's 20% a month in aggregate), US markets finished relatively flat. Volatility can be fun to trade if you have some direction but it can be a fast money losing exercise without direction.

We are advocates of the last two strategies mentioned above. If you have a good degree of conviction towards your investments, and are willing to give yourself a few years for an extended bear market to pass, then by all means go long. However, if you like to sleep better at night, it might be worthwhile to hedge your bets, which is what we do here at Venator. It has allowed us to be patient with the names we like, while riding out the volatility shorting names we don't. *The key is to make sure you are still in the game when things do eventually go our way.* Numbers work in funny ways: if you lose 20%, you need to make 25% to get back to even, if you lose 50%, you need to double your money to come back. In other words, once you have lost money, it becomes proportionately harder to get it back. This is where not hedging can really hurt you, while instruments such as leverage can really kill your financial aspirations. The goal behind capital preservation (the first and most important investment goal here at Venator) is to keep you in the investment game while things are going in the wrong direction. We are not trying to time the markets, but we hedge our market risks so that when our investee companies fulfill our hopes and dreams for them, it will result in profits for our unitholders, and not just a recovery of losses.

Thank you for your support,

Brandon Osten, CFA
President, Venator Capital Management

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