VENATOR
CAPITAL MANAGEMENT LTD.

GIVE ME ONE GOOD REASON…

Again, we are happy to report that all of Venator's Funds were up in the month of June, with the most surprising performance coming out of the Venator Income Fund which gained over 3% in a benign month for the markets. The recent market surge appears to be abating as volatility dies down (we don't see too many 3% daily moves in the market anymore) and we are seeing less day-to-day volatility across all funds as a result.

Instrument	June's Return	Year-to-Date
Venator Founders Fund[1]	**0.4%**	**27.1%**
Venator Income Fund[2]	**3.8%**	**16.4%**
Venator Catalyst Fund[3]	**1.5%**	**7.0%**
TSX Composite	0.0%	15.4%
Russell 2000	1.9%	2.4%
S&P Toronto Small Cap	-1.3%	15.3%
S&P 500	0.0%	1.8%

1. *The performance of the Venator Investment Trust approximates the performance of the Venator Founders Fund.*
2. *YTD of Fund is net of distributions reinvested. The benchmark of S&P/TSX Income Trust is no longer relevant as the Fund is now comprised of a high proportion of bonds.*
3. *The Venator Catalyst Fund has no benchmarks.*

We have been fairly upfront about our intermediate view for the economy: stable but very low growth. This will present extraordinary challenges for most individual investors, mutual funds and hedge funds for the next several years. The markets in general will, in our opinion, reach a point of stasis, which is going to make it difficult to find the macro-wave trends that have led to multi-year macro surges that investors have been able to capitalize on from simply reading the front page of the newspaper (think financials, emerging markets, technology and resources, followed by the macro-collapse). If there are a few important things that most people learned from those years it is that:

- individual investors generally live and die by macro market trends, rather than heavily researched stock picking (which makes sense given that you all have real jobs to occupy your days);
- mutual funds are nothing more than closet indexers, looking to outperform by altering their weighting while owning the same stocks as each other; and
- many hedge funds did not in fact "hedge" your money. In fact, they went the other way by making leveraged long bets on the most volatile corners of the bubble-de-jour (think pre-feasibility study junior mining) in an attempt to maximize performance fees with complete disregard for capital preservation.

Our point is that most individuals need a surging market in a surging economy to make money, and that given our economic view, this may prove to be a tall order over the next several years. The problem is that both growth and value investors need the backdrop of a growing economy in order to post outsized gains. In the conceptually simpler method, growth investing, investors count on growing companies to grow their operations, then cross their fingers and hope that the valuation multiples either hold steady or increase, so that they can ride a 20% growth rate to 20%+ gains in the stock. Value investors, on the other hand, look for undervalued operations, which is often a function of low efficiencies relative to assets and lower than optimal operating margins. In such a scenario, companies are expected to increase their efficiencies by either freezing or cutting costs. The problem is that you still need a growing economy for most value investing to work because freezing or cutting costs tends to leave some revenue

20 Eglinton Avenue West, Suite 1004, PO Box 2073 Toronto ON M4R 1K8 T 416.628.8198 F 647.477.2529 www.venator.ca

opportunities behind, and you need a growing economy to pick up the slack (i.e. stabilize revenue despite the cost cutting).

With markets seemingly settling down, it is going to get a lot harder for people to find both growth and value opportunities. Growth companies largely need growing economies to grow, and in an environment where true growth companies are scarce, multiples are likely to be high, as will be the penalties if that growth slows down. Value investments are going to have a difficult time surfacing the earnings from their assets for reasons cited above (although the downside isn't likely to be bad if the turnaround doesn't materialize). We would also note that commodities will also have a difficult time in such an environment, with easy-to-bring-online spare capacity effectively capping prices.

In order to succeed in the current environment, your investments need to have something special, or <u>one really good reason</u> to attract investor attention and sustainably outperform what could be a stagnant market for several years. We believe that our Funds, and their underlying investments, represent this philosophy:

- **VENATOR INCOME FUND**: The <u>one good reason</u> that ties all of the investments together is yield. Specifically, a 10%+ yield with the fund having 105% net market exposure (135% and 30% short with the extra 30% being in arbitrage situations). With 50% of the Fund in short term bonds, we don't see a lot of risk to the Fund's capital, but in a stagnant market, a 10% underlying yield with minimal leverage counts as <u>one big good reason</u> to invest in this fund.
- **VENATOR FOUNDERS FUND**: Nearly every name in the Fund has at least <u>one good reason</u> to own it. In some cases it is yield (where investments overlap with the Income Fund). In other cases it is a new line of business that is taking off, or contracts expected to be re-priced upwards, or earnings that are set to increase substantially due to balance sheet restructuring. The Fund remains 105% long and 40% short for 65% net market exposure.
- **VENATOR CATALYST FUND:** This fund is all about finding <u>one good reason</u> to invest in something. Searching out market inefficiencies for shorter term opportunities we continue to manage this Fund to produce consistent positive returns with minimal volatility.

We continue to search for investment opportunities as we head into earnings season. While earnings visibility appears to be less important to the market these days, we believe that our companies should get through their Q2 results with minimal surprises.

Thanks for your support,

Brandon Osten, CFA
President, Venator Capital Management Ltd.