VENATOR
CAPITAL MANAGEMENT LTD.

Year In Review

The month of November was not kind to our Funds, which all underperformed a fairly strong month for the markets overall. The Founders Fund was particularly disappointing as it generated a loss of nearly 4%, the Catalyst Fund broke even and the Income Fund generated a modest 2% gain. The underperformance of the Funds was due to slight losses on our long equity positions across the Funds (despite nearly 5% gains for the markets overall). The difference between the Funds' performances was due to income (which is why the Income Fund posted a modest gain), and shorting (the Founders Fund tends to short more than the Catalyst Fund which holds a lot of cash).

Instrument	November's Return	Year-to-Date	Since January 1, 2008
Venator Founders Fund[1]	**-3.7%**	**36.0%**	**8.9%**
Venator Income Fund[2]	**2.2%**	**35.4%**	**23.4%***
Venator Catalyst Fund[3]	**-0.2%**	**11.6%**	**16.7%**
TSX Composite	4.9%	27.4%	-17.1%
Russell 2000	3.0%	16.1%	-22.0%
S&P Toronto Small Cap	5.8%	47.2%	-22.2%
S&P 500	5.7%	21.3%	-24.6%

1. *The performance of the Venator Investment Trust approximates the performance of the Venator Founders Fund.*
2. *YTD of Fund is for Class "F" units net of distributions reinvested. There are no benchmarks for this Fund. *23.4% return is since inception of August 2008 and not since January 1, 2008.*
3. *The Venator Catalyst Fund has no benchmarks.*

2009 was one hell of a follow-up to 2008. While the market seemed to not know what was going on in late 2008, as it dropped and then reversed by over 15% several times in the last four months, by early 2009 the market had positively made up its mind and concluded that the world was definitively coming to an end.

At that point some stocks and many bonds had become extraordinarily cheap. In our March review we predicted quite specifically that good companies would trade for 10x earnings again and that debt would again be considered a viable financing tool for businesses. At the time, we believed that fourth quarter 2009 financial results would be fairly flat with those of 2008, and the rest of the world would conclude that life would go on for planet finance. We believed that there was a very easy 20% to be made in the market, buying stable defensive companies at 7-8x earnings and positive earnings companies trading below book value. What we didn't count on was that by the time the world figured out that the fourth quarter financials would be flat with the prior year, the investment community would not simply take this as a sign of stabilization, but that they would extrapolate it into an expectation of a ripping 8-year, 5% per year economic profit expansion, which is what we believe the market is currently forecasting with cyclical companies.

Perhaps the most amazing aspect of the market was that it saved itself with some fortuitous timing (something we have read very little about over the course of the rebound). The reality was that the market desperately needed a rebound in early March to prevent a wave of creditor forced bankruptcy restructurings. If Bank of America had to raise their $12 billion three weeks earlier when the stock was at $3.00 (as opposed to the $12.00 they actually raised it at) the shareholders would have been wiped out; alternatively if the market didn't start rebounding until June, you would have seen the same result, as they still needed to raise that money by mid-April. The same can be said of Teck or any other company that was allowed to refinance its debt just before they ran afoul of their creditors and were forced into creditor protection. In other words, if the rebound had started in June instead of March, 2009 would have had a very different outcome. We still believe that nice gains would have been made, but the speculative fervor would have been somewhat subdued without some of the high profile doubles and triples that came with the recapitalizations.

Another interesting aspect of the market in 2009 was that it was a world where everything went up together. Stocks, bonds, commodities and gold all skyrocketed. Paradoxes were seemingly aplenty. If you were looking through to 2011, oil futures were high but it made no sense that spot oil would be high in a clearly oversupplied market. The same could be

said of copper. Interestingly, natural gas, uranium and agricultural commodities weren't up, but that didn't prevent the stocks from rising.

The common theme for this high correlation between all asset classes for the year was low interest rates and the resulting low dollar. Low rates allowed companies to recapitalize their balance sheets and as corporate junk rates kept coming down, investors kept getting forced further into equities. This definitely supports the idea that a big part of this rally was moneyflow-based rather than fundamentally-based, which explains a lot of the skepticism we saw throughout the rally (ourselves included). Furthermore, the weak dollar and speculation of further weakness pushed the commodities further than supply and demand would dictate. Finally, the weak dollar enhances the offshore earnings of many multinationals which also helped stocks.

We had a pretty good year at Venator all things considered. The Funds were all fairly cautious, if not too cautious, through this big year for the markets. The Funds had slight gains and low net market exposure at the end of February, but got much more aggressive in terms of asset allocation as March saw a reversal of the bear market. In fact, our moves in March were very telling of how we manage risk:

- Founders Fund: We went from 35% net long to 65% net long. This was not necessarily a directional bet on the market. It was more because we believed that the more defensive names that we were holding did not need to be hedged at the prevailing valuations.
- Income Fund: We shifted our weights more towards bonds. This was largely because we could get better and safer yields in corporate bonds than we could get in dividend stocks at the time.
- Catalyst Fund: Gradually went from 10% invested to 60% invested. This was largely a directional investment after successfully “hiding” mostly in cash for the previous 12 months.

However, while we got more aggressive in asset allocation, we stayed defensive in terms of the individual securities we owned, given that we believed:

- The end of deterioration in financial results was not necessarily the same as a return to growth,
- The US consumer would remain weak,
- Unemployment would remain high, and
- Commodities would remain in an oversupplied situation.

All of these conditions remain in place today, so our guiding views for the year were correct. But as we stated above, we did not fully appreciate the market’s desire to take our “easy Q4 2009 comparison” thesis and extrapolate a full-blown growth recovery in 2010-2012. Clearly, 2009 rewarded risk-taking, and while we always could have done better, we are quite happy with our various Funds’ abilities to navigate through the entire 2008-2009 period with gains across the board and considerably less volatility than the market.

Next month we will be talking about our outlook for 2010.

Happy Holidays,

Brandon Osten CFA
President, Venator Capital Management Ltd.

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