VENATOR
CAPITAL MANAGEMENT LTD.

REALITY SINKS IN

June was another difficult month for the markets, and our funds did not escape unscathed. However, as we cross the mid-year mark, all three funds remain up for the year and conservatively positioned. As outlined below, we are looking to get more bullish after this earnings season, but remain cautious in the near term.

Instrument	June's Return	Year-to-Date
Venator Founders Fund[1]	**-4.1%**	**4.0%**
Venator Income Fund[2]	**-0.5%**	**4.5%**
Venator Catalyst Fund[3]	**0.3%**	**6.7%**
TSX Composite	-3.7%	-2.6%
Russell 2000	-7.8%	-2.0%
S&P Toronto Small Cap	-2.7%	0.1%
S&P 500	-5.2%	-6.7%

1. *The performance of the Venator Investment Trust approximates the performance of the Venator Founders Fund. Return is for Class "A" units.*
2. *YTD of Fund is for Class "F" units net of distributions reinvested.*
3. *The Venator Catalyst Fund has no benchmarks.*

As always, we are trying to see both sides of the bull vs. bear argument. Yes, many stocks we own are so cheap that we are whining about quality companies trading at valuations of less than 10x sustainable free cash flow, but not so cheap that we think the market has lost all sense of purpose as reflected in the late 2008-early 2009 period (see our March 2009 letter). Recall that we have been saying for quite some time that the market was forecasting way too robust a recovery, and that by mid-2010 the market would put the easy economic comparisons (to early 2009) in the rear view mirror and start looking ahead to lower growth vs. the more normal economic environment of late-2009 (see our December 2009 and January 2010 letters). We are already seeing a mass lowering of expectations, although earnings estimates are still calling for optimistic high-teens earnings growth and 5%+ revenues growth for the S&P500 next year. We are also hearing many companies admit that more revenues will mean more expenses over the bare-bones cost structures of 2009, so the saleability of the earnings argument is losing steam. As a result, we are looking for another round of earnings estimate cuts this quarter.

What's important here is that we are not talking about a 2008-type scenario for the market. The difference is that we are talking about disappointing aggressive forecasts and not an outright collapse of the free-market system (yes, things were that crazy two years ago). So we need to keep our heads about

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

us because stocks are not going to get as cheap as they were in early 2009, and with cash flows strong we don't expect to see those early 2009 opportunities in the bond market either. It also means that you need to be hedged because the bottom will be tougher to spot as it will be relative to average valuation measures (i.e. P/Es) rather than absolute (i.e. profitable companies trading below the value of working capital).

In early 2009 we said that valuations were insanely low. In early 2010, we said that expectations were ridiculously high. Once the current earnings season is complete, and expectations have been brought down to more reasonable levels, I think the market will have accurate forecasts with reasonable valuations. At that point the bull/bear cases will likely be somewhat mundane. The bears will argue about government deficits and money printing inflation, while the bulls will argue that low teens P/E multiples are too low in a sub-4% interest rate environment. As a prediction, I believe we will probably fall into the bull camp at that time.

Notwithstanding our Founders Fund's last performance over the last two months, we think our funds are well positioned as we churn through this season of lowered expectations. All of our funds have very low net equity exposure (less than 50%), with the Founders Fund short a number of high-valuation cyclical companies. The Catalyst Fund continues to maintain a high cash weighting, while the Income Fund still has the vast majority of its assets invested in shorter term bonds. The market finds itself in a rare spot, with no good, discernable macro-trends (i.e. long tech in the 1990s, commodities in the 2000s, short financials in 2008), and a very highly-correlated market where all stocks seem to move in the same direction. In fact, according to Birinyi & Associates, 78% of the S&P 500 is currently moving with the market, compared to typically less than 50%, making outperformance (relative to net equity exposure) difficult. That being said, we believe the day of old-school stock-picking is close, which should be a good day for our investors.

Yours Truly,

Brandon Osten, CFA
President, Venator Capital Management Ltd.

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 seeking long-term capital gains. Read the Offering Memoranda 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.

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