

WHAT'S WORSE? COMPANIES vs. COUNTRIES.

Getting the bad news out of the way, all of our funds were down on the month. The good news is that they are all still up decently on the year. As we noted last month, our net equity exposure was at a historical low going into May. While we have used the market selloff to strategically add to a few of our “absolute return” return positions, we are still avoiding many areas that we perceive to be particularly risky, as we will outline below.

Instrument	May's Return	Year-to-Date
Venator Founders Fund¹	-4.1%	8.5%
Venator Income Fund²	-2.6%	5.0%
Venator Catalyst Fund³	-1.0%	6.4%
TSX Composite	-3.5%	1.2%
Russell 2000	-7.6%	6.3%
S&P Toronto Small Cap	-5.2%	2.8%
S&P 500	-8.0%	-1.5%

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.

This Euro crisis is a real mess. It's something we have talked about in the past, and it is driving more money towards the *international reserve currency for the foreseeable future*-US dollar (recall our October 2009 review). Even we were shocked by how fast a currency could drop 20%. We did make some money shorting some Euro-exposed companies, but not nearly enough. But what's important to note is that we have *several* significant countries in trouble (let's not forget that Dubai isn't exactly in great shape either). So it would appear that Greece, Spain and Portugal are in trouble, and Germany, France and England could get themselves into trouble bailing out the former. China, who is potentially staring down a real estate crisis of its own amid a horrible six month stretch in its stock market, could get left holding the bag on its foreign currency reserves. Canada and Australia's resource-heavy economies can't really handle a slowdown in China. I guess that makes your safest bet...wait for it...the US dollar!!! Granted it's the best of a bad lot, but we are playing a relative game to some extent. I suppose you could make an argument for gold under this scenario, but subdued commodity demand and robust supply, coupled with a still very slack labour market and an oversupply of foreclosed houses, is not a very good recipe for inflation. Therefore, interest rates can remain low, making gold something of a crapshoot, subject to the whims of the gold bugs (we would note that gold is exhibiting some anecdotal bubble-like characteristics; anyone notice any new “Cash for Gold” stores popping up in their local markets?).

So you could say that we are of the mind that investors should remain contained within the Americas for now. Even there caution is warranted. From the weak industrial sector of Canada, the drug cartels of Mexico, the political instability of Colombia, and the increasing taxation of the United States, we see reasons to be concerned everywhere we look. Great opportunity never carried so much risk! And it's not like you are being rewarded for this risk with low valuations promising doubles and triples either. If you are going to buy commodities, you'd better count on prices staying well above the cost of production despite oversupply. If you want cyclicals, be aware that much of a potential cyclical rebound is built into the stocks.

It sure makes me long for the bull markets of the last thirty years. In the 1980s we only needed to worry about interest rates. In the 1990s we only needed to worry about valuations (in a very specific sector). In the 2000s we really didn't worry at all did we? Yeah, there were some big, short lived market drops, but the crash of 1987 (short lived), the early 1990s recession (fairly low-key), the Asian Crisis (China wasn't the global phenomenon back then that it has become today), Long-term Capital Management (quick resolution) and the tech wreck (you still could have made money almost anywhere else) all seemed quite contained within their specific regions/sectors compared to what we have witnessed in the past few years. The current situation is just so much more far reaching and pervasive; and despite what the bulls might say, it still feels very much unresolved. The whole bull case rests on the government(s) having successfully bailed out the global economy with borrowed money as well as the resilience of China and their ability to bail everyone else (and their own foreign currency reserves) out.

If there is one positive we can glean from all this caution, it's that corporations are as fearful as we are. Debt maturities have been pushed up, cash balances are very high, and operating margins are still pushing all time highs. Even as acquisitions are heating up, buying is prudent, with debt levels staying relatively low.

So what are we doing? We are hedging a lot for one. We are hiding away in select consumer product stocks, where earnings and cashflows have proven remarkably resilient, and growth can be found, and where foreign market risk is immaterial at best. We are hiding away in US healthcare, where the fallout from health reform can now be measured. We are hiding away in select technology stocks, where cashflows remain strong and revenues are recurring. We are hiding in cost-plus food distribution models, again where cashflows remain strong. Lastly, we are hiding in bonds, where regardless of how the next six months go, we fully expect our capital to be returned to us in the next several years with a decent return over that period.

Yours Truly,



Brandon Osten, CFA
President, Venator Capital Management Ltd.

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