

## TOO MUCH POLITICS

It's hard to believe that coming into the month the biggest concern was the raising of the US debt ceiling. This press-dominating event came and went as expected (was there ever any doubt?) resulting in a small one-day rally, followed by a two-week 13% market drop (small and large cap average), followed by an 8% rally, followed by a two-day 5% drop to open the month of September. That is some crazy volatility and let me send out my sincere congratulations to anyone who managed to time these three moves to a 5%+ gain out of the possible 25% available to the perfectly timed portfolio.

Unfortunately, our Funds didn't fare as well. While all three Funds fell materially less than the markets at the low point of the month, they all failed to move up appreciably in the late month rally resulting in the disappointing performance for August.

Instrument	August's Return	Year-to-Date
<b>Venator Founders Fund<sup>1</sup></b>	<b>-7.8%</b>	<b>-8.4%</b>
<b>Venator Income Fund<sup>2</sup></b>	<b>-5.0%</b>	<b>3.5%</b>
<b>Venator Catalyst Fund</b>	<b>-2.5%</b>	<b>4.4%</b>
TSX Composite	-1.2%	-3.5%
Russell 2000	-8.7%	-6.5%
S&P Toronto Small Cap	-3.5%	-7.2%
S&P 500	-5.4%	-1.8%

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.*

As many of our long-term readers know, we don't tend to get terribly directional in our thinking when it comes to market gyrations. Even when all seems great, valuations and expectations run too high (such as technology in 1999, or energy in 2007). Conversely, when macro-economic scenarios appear at their lowest point, expectations and valuations can be low enough to stage major market rallies (such as in March of 2009 when the market took off even as fundamentals continued to deteriorate).

The point is that there always seems to be legitimate reasons to be both bullish and bearish on sectors of the economy, as well as selective stocks. Market timing is difficult to accomplish consistently; most of the Funds that exceeded the market's 35% gain in 2009 fell by more than the market's 35% loss in 2008; and most of the Funds that broke even or slightly profited in 2008 posted poor returns in 2009 when compared to the markets 35% gain. This is why we try to hedge rather than time the market. In fact, despite all the volatility in the month, we rarely saw a 2% daily move in our portfolios.

We try to keep abreast of both sides of the market, and there are some positive points we are keeping in mind during the current volatility. Importantly, the trailing P/E of the stock market is at the same level

it was at the market bottom in March 2009. This is interesting given that corporate balance sheets are strong, as are profit margins and free cash flows, suggesting that it is unlikely that business continuity issues experienced by many companies in early 2009 will resurface.

Stocks and high-yield bonds look cheap relative to government issued alternatives on three different levels. Firstly, the aforementioned low P/E of the market is unusual when interest rates are low. Secondly, the dividend yield of the market is below long term interest rates — which is also a bullish sign for stocks. Thirdly, the interest rates on corporate bonds is very high relative to government bonds (otherwise known as the "spread"), which is unusual given the previously mentioned strong balance sheets and cash flows.

Finally, it is worth noting that the powers that be are willing to provide the tool to prevent another financial collapse. This tool is printing money, which they can afford to do in a weak economy where labour rates are going nowhere and commodities are going down. This is bullish for gold, bonds and stocks if they can manage this money printing well. Back in early 2009, we didn't know this, and therefore systemic risks are lower this time around.

So much for the positive. There are several macroeconomic and industry-specific items to be concerned about. The most obvious two items are a stagnant economy and the European financial situation. We actually don't mind a stagnant economy if we can get a stagnant stock market as well (as many of our long term investors know, stagnant market are when we perform best). We find it very frustrating that the market moves so aggressively around economic data that seems to move so narrowly around anemic, or zero growth.

The other big negative out there is that the stock market has been a gauge for the stupidity of politicians and bankers. Fund managers everywhere, including ourselves, are finding it difficult to make good investments when success or failure is dependent on short-term volatile market reactions to political rhetoric rather than fundamental stock analysis. As I write this I am wondering how the market will react to a nonsensical speech where President Obama declared, weeks after agreeing to deficit reduction measures without tax increases, a plan to reduce payroll taxes and increase infrastructure spending (which didn't work the first time) to be paid for with increased corporate and income taxes to be unveiled next month.

That being said, low valuations and low expectations are generally a good precursor for a market rally. With markets capable of moving 10% per week, we are only one good week away from major markets being up on the year, or one bad week from total panic. As always, we prefer to hedge than take sides. All of our Funds have relatively low net equity exposure relative to their recent history. Stocks are currently trading with record-high correlations (80% of stocks are moving in the same direction on any given day vs. a more typical 30%), putting a premium on market timing and macro skills and creating difficulties for long-only money managers trying to break away from the pack, or stock pickers such as ourselves. This is making things difficult for us as we don't hedge against all of our positions given our expectation that some of our positions, given time, should be higher in one year regardless of what the market does.

We believe that mitigating further negative market moves in a highly correlated market needs to take priority over missing some upside in a potentially rebounding market. Put another way, moving outside your normal risk parameters in an effort to get back to where you were is never a good (and often a

bad) market strategy. The best way to get back to where you were is to make sure you don't lose too much in the first place!!!

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.*