VENATOR
CAPITAL MANAGEMENT LTD.

STAY LOCAL, OR GO LOCO/LOUCO/PASSESCO/τρελός/FOU/CRAZY

December was a fairly quiet month and all of our Funds were able to put up some modest gains. This left both the Income and Catalyst Funds with what we would characterize as solid gains in an otherwise difficult 2011, while the Founders Fund completed what I would call its first truly disappointing year since its launch (while we weren't happy with being down 20% in 2008, that tumultuous year had the potential to be much worse than it was for us). Hopefully, we can recapture the Founders Fund's 2011 decline this year in what we think has the potential to be an exciting near future for our investments.

Instrument	December's Return	2011 Full-Year Return	Since Inception[3]
Venator Founders Fund[1]	**1.0%**	**-14.0%**	**72.9%**
Venator Income Fund[2]	**1.4%**	**4.2%**	**59.3%**
Venator Catalyst Fund	**0.8%**	**11.3%**	**54.7%**
TSX Composite	-1.7%	-8.7%	20.4%
Russell 2000	0.7%	-4.2%	9.8%
S&P Toronto Small Cap	-2.1%	-16.4%	7.0%
S&P 500	1.0%	2.1%	11.1%

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 Income Fund and the Venator Catalyst Fund have no benchmarks.*

We don't really have a lot to report on in terms of new insights for the New Year. Our investment themes remain fairly similar and our portfolios have generally had little turnover. Despite some declines in asset values last year, our companies have generally remained on the paths that we believed were set for investment gains, even if those gains have been slower to materialize than we had originally hoped.

Our hedge funds (Founders and Catalyst) continue to favor domestic businesses and eschew companies with substantial foreign operations. We remain concerned with both a slowdown in Asia and Europe in general. We also like companies that are somewhat in control of their own destiny rather than being dependent on broader economic trends.

Our big caution flag for the markets continues to be the Euro. We have shorts and some put options on the vulnerable currency. The short represents our fundamental call for a declining/collapsing Euro, while the Puts represent insurance against a potential material shorter-term decline. Fortunately for the global economy, currencies don't tend to move very quickly and trade 24 hours a day. If the Euro were a stock, it would get halted on bad news and open for trading down 10% the next day, like any other stock that delivers bad news. Alas, as a currency it will likely be a slower, longer-term bleed that lasts for several years before eventually settling around par with the US dollar (a 25% decline from here).

Frankly, we really don't spend much time doing macro work. The vast majority of our time is spent seeking out and researching individual stocks. We keep track of macro data because we need to in a market where 90% of all stocks move in the same direction every day based on macro data.

That being said, we have spent more time researching the current European situation than we care to admit, and I firmly believe that this situation represents the single biggest risk to "the system" that we have seen in the past 30 years. The financial crisis always had a way out in the form of controlled bankruptcies (General Motors), letting investors lose all their money while preserving corporate operations and non-investment related payables (AIG, Countrywide, Merrill Lynch, Fannie and Freddie), or money-printing stimulus spending. But that was contained in the US, with no one to answer to but their own citizens. That situation was *manageable and containable.*

The European situation is not. Italy's debt becomes Germany's burden. Citizens of one country become responsible for another. We didn't hear too many complaints out of Texans about being responsible for Californians. But we Canadians would not take too kindly to a federal policy designed to bail out the debt addicted United States, which is what Germany is being asked to do. And like any prudent lender, they are asking for certain *covenants* which, if broken, will result in some form of trustee-type action and possible asset security.

This is what makes the situation *unmanageable*. Italian citizens are not about to allow Germany to oversee their tax collection (hell, they don't even allow the Italian government to collect taxes!). Nor are Greeks about to allow Germany to audit their fiscal budget to ensure that the deficit-to-GDP ratio remains below 3% (they are rightly afraid that Germany would come out with an accurate number that is far worse than anyone imagines). Nor do I see Portugal allowing Germany to raise the official retirement age. The worst part of it all is that everyone needs Germany to bail them out and yet no one trusts Germany. The EU is staring down some form of economic warfare that would result in Germany controlling the entire region in some non-violent replay of WWII. To make the parallels even more ominous, France appears ready to walk right into this situation as a German "ally" (France is currently in violation of their agreed 3% deficit-to-GDP ratio, projected to exit 2011 somewhere between 5.5% - 5.7%), the UK is refusing to join this "forced union of continental Europe" and Russia's quasi-dictatorship stands on the outside looking in. You really couldn't have made this stuff up pre-unification.

But that scenario will not happen, which is what makes the situation unmanageable. No one is willing to give up their sovereignty, as it would be too devastating politically, and represents the stock market equivalent of selling at the bottom. No one wants to go bankrupt and leave the Union because this would be domestically devastating in the short term and painfully expensive over the long term. No one wants anyone else to go bankrupt because they would lose all the money they have already thrown at the problem.

Like I said before, there don't appear to be any answers – easy or hard. Put another way, there are no practical, politically acceptable solutions. The US government was willing to lend *domestically* to bail *themselves* out with little in the way of security; such is not the case in Europe. When American institutions failed, resulting in federal bailout, their assets and equity were effectively transferred to the US Government (i.e. GM, Citi, AIG), and their crushing debt was extinguished leaving leaner, viable operations. When Spain gets bailed out by Germany, they will not allow Germany to own their coastlines; the crushing debt will still be there, which prevents the bailout process from working.

Perhaps the one comforting sign is that domestic markets have recently been shrugging off bad news from Europe in the midst of decent numbers out of the US. A rising North American market coupled with a rapidly declining Eurozone is the dream scenario for how our Funds are currently positioned. With a little luck we can get back to good old fashioned stock-picking and get back to making the kind of market-beating returns our investors had become accustomed to before last summer.

Thank you again for your continued support,

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.

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