VENATOR
CAPITAL MANAGEMENT LTD.

2013: LET ME GAZE INTO MY BOWLING BALL

November continued to allow our Funds to modestly add to their gains for the year. With just over two weeks to go until 2013, we think everyone will be pleased with their 2012 investments in Venator come the New Year. Thank-you very much for your support over the years. We fully recognize that you have a lot of options with regard to where you invest your savings, and we appreciate the trust you have placed with the team at Venator.

Instrument (Inception)	**November's Return**	**Year-to-Date**	**Compound Growth**
Venator Founders Fund (March 2006)	**0.3%**	**25.4%**	**12.2%**
Venator Income Fund (August 2008)	**0.8%**	**19.4%**	**16.2%**
TSX Composite (March 2006)	-1.3%	5.1%	3.6%
Russell 2000 (March 2006)	0.5%	12.4%	3.2%
S&P Toronto Small Cap (March 2006)	-3.9%	-4.5%	0.3%
S&P 500 (March 2006)	0.6%	15.0%	3.7%

As we wind up the current year, we are giving a lot of thought to how we want to position ourselves for 2013. While we have some ideas of what to expect for the market as a whole, we are having a difficult time calling for any particular direction in the markets at this time. While stocks remain inexpensive relative to long-term government bonds, the issues holding them back are significant and generally well advertised. Most of the bigger issues may result in multi-year overhangs to the market in general.

- **The Fiscal Cliff:** The so-called Fiscal Cliff will get resolved in some form. The most likely scenario is more tax revenue from the wealthy and a spending freeze at current levels. My own expectation is that these will provide an almost meaningless deficit reduction in the US of far less than the targeted $400BB per year, leaving deficits at around $1 trillion and putting the US on pace for $20 trillion in debt by the time President Obama leaves office. As interest rates rise back to the 4-5% range over the next 10 years, the interest expense to service this debt will rise by about $500BB, which will offset the savings from the pending resolution and result in more pain down the road. Once the current stand-off is resolved, I would imagine a very short term pop in the market of less than 7% with a quick retraction as we shift our concerns back to the "debt ceiling", which will need to be raised by mid-year.
- **Europe:** It's pretty well established that the EU is staring down a multi-year recession due to poor government balance sheets, forced spending cuts in government jobs, higher taxes, aging demographics, and high unemployment. This could last years. We don't disagree with this view.
- **China:** Many of our long-time followers will recall that we have been bearish on China for years, and will be bearish for many more due largely to demographics (roughly equivalent to that of Florida within 10 years) and a "phoney" balance sheet where state and municipal debt is kept off the federal ledger to make things look far better than they are. We don't invest in China and only mention it as a bearish factor because without the China bull story, we think all commodities suffer (think oil below $50.00 and copper below $2.00) which is bad for Canadian markets.

To be fair, things aren't all bad. There appear to be some opportunities in the US housing market (building products, appliances, lumber), automotive markets (dealers and suppliers) and Natural Gas (producers and energy services companies trading around book value). It's just that the positives seem rather narrow relative to the negatives which appear broader and long-lived. Furthermore, despite what feels like a tough market, the US market (which is still the barometer for global markets) is up 15% this year after posting a 2% gain last year, as well as gains for 2010 (+15%) and 2009 (+26%) before that. After a four-year winning streak, a breather in 2013 wouldn't be out of the ordinary should it come to pass.

SO WHAT'S OUR PLAN FOR 2013?

In our Founders Fund/Investment Trust, we are left with pure, old-fashioned stock picking. For reasons stated above, "macro" strategies will probably be unreliable so we are looking hard for company-specific opportunities. That's pretty much what drove our returns in 2012 so hopefully we can achieve more of the same. It also means that we will continue to be more hedged than in the past with some strategically timed directional trades.

Our Income Fund is a much simpler vehicle for us to run in times of uncertainty. Recall our strategy is to simply find good companies with attractive yielding bonds and hold them to maturity. If we are right (meaning that the companies don't go bankrupt), when the bonds come due we get our yield returns (typically 7%+). By keeping our bonds relatively short-term, we don't need to worry about interest rate movements relative to a 3-4 year time horizon. We will continue to be very selective on the stock portion of the portfolio, which remains a minority of the portfolio and largely hedged.

More so than ever, we reserve the right to change our mind!

HAPPY HOLIDAYS

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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