VENATOR CAPITAL MANAGEMENT LTD.

POUNDS, OUNCES AND BARRELS

April brought flowers for Venator, even though it brought heavy showers for Canadian markets in general. As the (non-resource) markets continue to move higher, we are getting a little more cautious as financial results don't look so hot to us. As a result, we are seeing our funds exhibit less correlation with the market than usual, which may or may not be a good thing depending on how streaky the market ends up being over the next six months. That being said, we are pretty happy with how things have gone so far this year, and remain optimistic with regard to our current positioning.

Instrument (Inception)*	April 2013 Return	Year-to-Date	Compound Growth
Venator Founders Fund (March 2006)	**2.0%**	**12.8%**	**13.2%**
Venator Income Fund (August 2008)	**2.8%**	**8.8%**	**17.0%**
TSX Composite (March 2006)	-2.1%	1.2%	3.8%
Russell 2000 (March 2006)	-0.4%	12.0%	5.1%
S&P Toronto Small Cap (March 2006)	-4.6%	-4.0%	0.1%
S&P 500 (March 2006)	1.9%	12.7%	5.4%

*Estimated Performance

Long time followers will know that we have been at best neutral, and generally bearish on commodities since our 2006 launch. The following is a collection of some of the more memorable quotes that have appeared in our monthly commentaries.

"we believe a commodity 'bubble' is forming, which carries ominous parallels to the tech bubble" *April 2006*

<u>Natural Gas</u>

"Natural Gas could realistically fall from a current level of over $11.00 to $5.00" *May 2008*

We note that we went positive on natural gas last spring, several months before prices bottomed.

"We can be no more than 18 months away from a march into the $4.00-$5.00 range" *April 2012*

<u>What we think now:</u> Still bullish; natural gas is looking at a secular increase in demand for the foreseeable future, and increased exports will likely move prices higher as natural gas fetches over twice the price overseas.

<u>Oil (North American pricing):</u>

"People think we are at 'peak oil' production . . . we don't subscribe to this theory . . . supply could coincide with 'peak oil' demand" *August 2006*

"US oil imports peaked three years ago, and demand is expected to decline for the foreseeable future" *May 2008*

"We are quite bearish on oil; shale oil appears to be on track to mirror the experience of natural gas" *June 2012*

What we think now: Still bearish as North American demand appears to be in secular decline for the foreseeable future, while supply is going up. We believe that North America is on the path to not needing imported oil in the future. We believe that OPEC is in no position to stop this process without driving oil down to $40.00. Oil bulls need to ask whether or not the WTI/Brent spread can't get as wide as the domestic/overseas gas spread (in percentage terms), which could put oil as low as $30.00!

Gold:

"gold is the 'buggy whip' of the commodity markets" *May 2008*

"lower copper prices are very bad for gold producers" *June 2012*

What we think now: We stand by each of the previous comments. But with gold down at its marginal cost of production, we wouldn't be short below $1400; gold is all about emotion, which makes it tough to call the commodity.

That being said, we still don't like gold companies in general. They issue too many shares, are more levered to the price of copper and other by-products than they generally let on, and they are spending too much developing new mines rather than trying to maximize cash flow from existing built-out mines. Furthermore, their incestuous Boards generally lead to an abnormal amount of value destroying consolidation activities. Generally speaking, gold company Boards are shareholder value destroyers of the highest order.

Copper:

"bears look at nickel and zinc price collapses and wonder what makes copper so special that it won't suffer the same fate" *August 2008*

"copper is in a fair bit of trouble" *June 2012*

What we think now: Copper has a long way to fall. We continue to believe that infrastructure spending in China will grind to a halt in 2016 when its demographic chart reflects the inevitable inversion created by its one-child policy. We forget that copper used to regularly trade below $2.00 not long ago. With demand collapsing, and enough current supply to adequately handle demand as China slows down for the next twenty years, we can see copper dropping over 30% from here.

Bonus Quote:

"generally speaking, the only thing resource companies produce that shows up on a financial statement is more shares outstanding" *October 2012*

In case you haven't noticed, the US markets have significantly outperformed their Canadian counterparts since 2011. Since the beginning of 2011, the TSX is down about 3% (small caps down over 20%), while the S&P 500 has gained over 30% (small caps up over 20%). The problem is obvious and two fold. We have two major components of our market: resources and financials. As everyone knows, resources have been pretty poor over the past several years. But what people fail to grasp is that our financials have ties to resources, and are not terribly sensitive to the machinations of other more volatile economies providing solidity in bad times, but not enough benefit in the good times. Of course the real issue is that low commodity prices are only bad for commodity companies. Everyone else would rather see them go lower, thank-you very much.

So when you are rooting for a resource comeback, remember that it's you against the world, which would rather pay less to fill up their cars (oil), heat their homes (gas), build their infrastructure (copper, iron ore), power their cities (coal, uranium), eat their food (potash and other agricultural commodities), keep inflation down and generally avoid economic collapse (gold). So remember when you bet on a commodity, everyone else is betting against you!

To be fair to other longer-running funds that have been hurt in this commodity meltdown, we started running this fund in 2006, well after the bull market in resources had started. Generally speaking, I find that funds that launched post-2006 were not as long resources as their pre-2006 counterparts, just as: funds that launched in 1999 generally were not starting overweight technology; funds that launched in late 2008 were slow to get fully invested; and "hedge" funds that launched in 2009 were generally not hedging long positions in a meaningful way (i.e. much more economic sensitivity and beta on the long-side of the portfolio).

That being said, we continue to like our current positioning of underweight resources/financials, and overweight neglected Canadian industrials and US stocks.

We reserve the right to change our mind,

Brandon Osten, CFA
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