VENATOR
CAPITAL MANAGEMENT LTD.

RULE #3: THE MARKET IS STUPID

Instrument (Inception)*	January 2014 Return	Year-to-Date Return	Compound Growth
Venator Founders Fund (March 2006)	**-0.7%**	**-0.7%**	**14.1%**
Venator Income Fund (August 2008)	**1.8%**	**1.8%**	**16.3%**
Venator Select Fund (September 2013)	**-4.1%**	**-4.1%**	**-**
S&P/TSX Total Return (March 2006)	0.8%	0.8%	5.0%
Russell 2000 (March 2006)	-2.8%	-2.8%	7.1%
S&P Toronto Small Cap (March 2006)	1.7%	1.7%	1.7%
S&P 500 (March 2006)	-3.5%	-3.5%	6.5%
Merrill Lynch High Yield Index (August 2008)	0.7%	0.7%	11.3%

*Estimated Performance

We are going to go with a new format this year for our monthly letters. I have compiled a list of over 200 investment "rules" over the last 15+ years in this industry that I go back to for guidance every several months. While I am not about to publish a book or anything, I thought that maybe we would share some of these rules with you as they become relevant to our investment process either from a macro standpoint or from a company specific standpoint. Just to be clear, many of my rules have been compiled from observations and readings of other market-guru rules and guidelines so I wouldn't presume to give myself credit for any brilliant insights you might gather from these letters. Give credit to Buffet, Marks, Klarman, Graham, Dodd, Fisher and others.

So 2014 is not off to the greatest start, and an NFC Super Bowl win doesn't help. Market gyrations have been fairly streaky since the fall of 2008. By streaky I am referring to significant market moves that in hindsight appear to have happened based on what people thought would happen, but no regard to what actually happened. For example, 2009 and 2013 were huge years in the S&P500 despite final earnings numbers ending those years materially below the beginning of year estimates. Recently we saw markets rally because the Fed said that they had decided not to taper their quantitative easing program, then rally again weeks later when the Fed announced that it would be tapering its quantitative easing program.

These are extreme examples, but we have seen numerous corrections which appeared to happen with no apparent reason, either by speculation or in hindsight. Basically, the market gyrates, and people try, in retrospect, to figure out a reason why; often times the "news" that "caused" the market to move isn't a cause at all, just a coincidentally coinciding press release. Although this will never stop us from being amused when CNBC claims that the market dropped 4% after monthly auto sales came in 15.5MM when the street was expecting 15.5MM but had a whisper number of 15.6MM. If all else fails there is the mythological technical reasons the market is down (i.e. it went through its 52-week moving average) which basically amounts to "the market is down because it is down". So in the midst of this recent bout of turmoil we are bringing out Rule #3:

THE MARKET IS STUPID: do not look for market fluctuations to give you direction, look for market fluctuations to create opportunities! Most macro research is not in fact valuable insight, it consists largely of hindsight explanations of sentiment. These fluctuations may not cause the market to overshoot to the downside all the time (as it did in the spring of 2009) but can cause various individual high-beta (volatility) stocks to move to ridiculously low levels, or cause overvalued but great businesses to fall to reasonable prices (great businesses

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rarely trade at reasonable prices in a stable market). The key to taking advantage of these moves is preparation, or the building of a shopping list. At the outset, you need to know that not everything will go into the bargain bin, but that in a portfolio of only 20-30 names you only need a few to hit your levels to make an impact. Here are a few examples of stocks we are watching right now:

- **Move Inc.:** We actually own this one already but as it declines lower we take note of the value of its business as a long-term viable enterprise, and couple this with tax losses in excess of $1.2 billion. That $1.2 billion is worth close to $400MM to a shareholder who believes that the business will one day be sufficiently profitable as to take advantage of them, or to an acquirer that we think could reap $75MM in annual pre-tax profits if a deal was structured properly. In other words, over $9.00 of Move's $13.00 stock price can be considered an off-balance sheet asset. This would be a nice stock to own more of if it continued its decline to $10.00. We don't think it will happen, but we are ready to take advantage if it does.

- **Macy's:** We sold this stock in high $40s, only to watch it fall, and then subsequently rebound into the mid-$50s as one of the only retailers to have a strong holiday season. But that news (which came out a few weeks ago) is ancient history and, with a high degree of correlation to the market, this stock is now threatening $50.00 again. If it were to come back down below $45.00 I would feel very comfortable getting back in as I believe that once the market starts to better appreciate how good this management team really is, the stock could eventually see $70.00. A 50% return for a blue chip stock is something I am always interested in.

- **Precision Drilling:** We have been trading in and out of Canada's leading contract driller for years. The key to our range is our internal valuation of their assets of $12.00/share. Precision has spent the last several years building a top-tier fleet, and while there is always a little controversy surrounding the value of the older components of its fleet, we are pretty comfortable in our assessment of the company's value. This is a volatile stock and at $8.00, or two-thirds of our assessment of its asset value, we are very comfortable owning a stock that we think one day will be north of $16.00.

The key benefit of using market fluctuations to your benefit is that you gain an opportunity to make substantial gains on the back of high quality companies you are familiar with. This is a little different, and safer, than what you are doing in a bull market, when you are looking for newer names that you are less familiar with. The higher the market goes, the more you need to either go out on the risk/valuation curve, or invest in companies with lower valuations but possibly lower potential returns while still increasing risk through higher market exposure. There is a saying that no one sits there with an open bag collecting all the broken stocks in a market correction. But if you know what you want to buy going into it, you might bag a few 3-baggers.

As always, we reserve the right to change our mind.

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