BREXIT / GERMEXIT?

Instrument (Inception)*	June 2016 Return	Year-to-Date Return	Compound Growth
Venator Founders Fund (March 2006)	**0.2%**	**-4.2%**	**12.6%**
Venator Partners Fund (July 2014)	**0.7%**	**-4.3%**	**-0.5%**
Venator Investment Trust (September 2007)	**0.5%**	**-4.3%**	**8.9%**
Venator Income Fund (August 2008)	**1.3%**	**9.6%**	**12.6%**
Venator Select Fund (September 2013)	**-0.5%**	**3.7%**	**19.1%**
S&P/TSX Total Return (March 2006)	0.3%	9.8%	4.8%
Russell 2000 (March 2006)	-0.1%	2.2%	6.0%
S&P Toronto Small Cap (March 2006)	5.3%	28.0%	1.9%
S&P 500 (March 2006)	0.3%	3.9%	7.2%
Merrill Lynch High Yield Index (August 2008)	1.1%	9.3%	8.6%

BREXIT (I'll be brief)

I think enough has been written on this subject so there is no sense in giving out a long-winded copycat opinion on the matter. But there are a few things to keep in mind:

- **The Pound gets pounded:** The pound is hitting 30-year lows. I sincerely wonder if it would be hitting 30-year lows if the UK hadn't entered the Eurozone in the first place; my guess is that it would not be and that at current levels the pound is likely undervalued.
- **Two more years!:** The UK has two years to exit the Eurozone. In that time, and in the face of potential 5%+ inflation and a 10%+ drop in housing prices, UK citizenry may want a re-vote, some other form of negotiation with the EU, or may choose not to exit at all (apparently they have not yet "officially" requested the exit). I am not saying this is likely but it is definitely a "non-zero" probability (despite all the articles claiming that the referendum is binding).
- **Ripples through the Continent:** Will the UK break up even further? Will Germany not want to support the lesser countries without the UK? Will the other countries want to be tied that closely to an economic powerhouse like Germany without the UK as a check/balance? Basically, will the whole Eurozone experiment just break apart? Again, not likely, but a greater than non-zero probability.

The bottom line is that Brexit may end up bringing about serious global socio-economic change, or it may end up being nothing, even if it comes into effect in two years (it's not like there won't be any international commerce with the UK). I might be a bit more concerned if I was living in the UK or Europe, and had all of our money invested there, but this is hardly the case (as we will get to below).

OUR EUROPEAN EXPOSURE

The several days that followed Brexit weren't fun for investors (unless you were invested in gold, which outpaced the US dollar rally). Unfortunately, when events like this occur you invariably need to decide whether or not to hedge into the event prior to the outcome. Hedging costs money either through actual costs, like buying put options, or opportunity costs, like going market neutral for a few days.

Frankly we were surprised at the outcome, as many Brits oddly enough seemed surprised by the aftermath. Nevertheless, our funds were minimally exposed to Europe going into the vote. In fact, we only owned a few stocks across the portfolios that had material exposure (over 20%) to Europe: Concordia, Magna, Spectrum Brands and Granite REIT (we have since exited our Granite position). On the short side of our portfolios, we had eight positions with material European exposure, three of which we would consider substantial (CNH Industrial, Borg Warner and Enghouse Systems). We also had some index shorts and we recently reinitiated our short position in oil.

That being said, in the short-term everything was going to follow the indexes down to some extent and nothing is immune. Even Entercom Communications, a broadcast radio business and our largest position, with zero exposure to Europe and a customer base focused on local advertising, still saw weakness in sympathy with the market. Fundamentally and logically this makes no sense, but we weren't surprised to see it happen. Other companies that fell in a similar vein but with 0% of their business exposed to Europe on even a first or second derivative basis included Kirkland's, Lithia Motors, Superior Uniform and Hanger among others.

SIX MONTHS IN

While our Income Fund is off to a solid start, and our Select Fund is slightly positive on the year, this hasn't been the easiest first half of the year for our hedge strategy (Founders Fund, Partners Fund and Investment Trust). The hedge strategies' short portfolio has not helped us so far (our lack of long exposure to resources hasn't helped either). Thus far, the strategies' short positions have contributed the entire loss on the year. This can be largely traced to the first quarter when our short sales did not decline as much as the market during its January/February swoon, but they did largely participate in the ensuing rally. This has resulted in some shifts in the short portfolio, namely after a period of time where we had no ETFs in the short book, we have increased our weight to make sure we are "guaranteed insulated" from at least some volatility until this uncertainty is in the rear view mirror.

We have also seen some turnover in our portfolio and at this time approximately 50% of our long positions have been in the strategy for less than twelve months. This is largely a function of us finding new names during some of the recent weak periods in the market, and selling some positions which have reached our price objectives, or selling some investments that have disappointed us with their financial results.

Our ability to refresh the portfolio leaves us in our normally cautiously optimistic mood. The outlook for our portfolio positions makes us optimistic, but the market environment in light of these geopolitical events makes us cautious. Over time we expect the fundamentals of our largely North American contained investments to prevail.

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

Brandon Osten, CFA

CEO, Venator Capital Management Ltd.