AMERICA PLAYS THE TRUMP CARD

VENATOR'S YEAR IN REVIEW

Instrument (Inception)*	November 2016 Return	Year-to-Date Return	Compound Growth
Venator Founders Fund (March 2006)	**-0.5%**	**-2.3%**	**12.3%**
Venator Partners Fund (July 2014)	**-1.4%**	**-5.0%**	**-0.7%**
Venator Investment Trust (September 2007)	**-1.0%**	**-3.8%**	**8.5%**
Venator Income Fund (August 2008)	**0.2%**	**12.4%**	**12.2%**
Venator Select Fund (September 2013)	**0.9%**	**3.2%**	**16.4%**
S&P/TSX Total Return (March 2006)	2.2%	19.1%	5.4%
Russell 2000 (March 2006)	11.2%	18.0%	7.1%
S&P Toronto Small Cap (March 2006)	2.0%	33.3%	2.3%
S&P 500 (March 2006)	3.7%	9.8%	7.4%
Merrill Lynch High Yield Index (August 2008)	-0.4%	15.2%	8.8%

In keeping with tradition, we do our "Year in Review" as part of our November letter so that we can come out with our more relevant "Year in Preview" in early January. We do so because our positioning for the future is more important than the past, even if the two often bear a significant resemblance, thematically. Format-wise, we had a significant market event - the US election - and we are going to briefly address the relevance of what happened there, as well as our view of the implications for the future (including what is and is not materially important). We'll follow that up with a review of what went right, and what went wrong at Venator this year (short story: the Income Fund went right, our Long/Short strategy not so much).

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Let's first talk about the US election and then, what happened in the aftermath of the election to the market and to our funds. As everyone is aware, successful self-promoter Donald Trump defeated sort-of incumbent Hillary Clinton to win the US election. More importantly, the Republican Party took control of Congress as well so we can definitively say that some changes will be made over the next two years.

In terms of what will and what will not get done, there is a lot of speculation in the press. It looks like Hillary will not be going to jail, there will not be mass deportations, the "wall" sounds more like a chain-link fence, the United States will not turn into a racial profiling police-state, and, by January, everyone will realize that it's largely going to be business-as-usual to either their relief or to their disappointment.

Economically speaking, there are a few material issues, and a few cases of mistaken materiality, to keep an eye on. Included among election promises that are unlikely to result in anything material would be changes to employment/wages, and infrastructure spending. The bottom line on employment is that it's really tight in the US; all of the "America needs to bring jobs back" rhetoric is out of sync with the current state of the job market. Regarding wages, we don't see a lot that the government can do here from a practical perspective as individual states are driving minimum wage, as is the aforementioned tight labour market. With respect to infrastructure spending, the projected increase won't make a dent relative to the current level of spending. As a corollary, the Canadian government is currently running up taxes and deficits in the name of infrastructure spending, while public Canadian infrastructure companies have been absolute disasters over the last six months.

However, one area that stands to benefit from the Republican sweep will likely be material tax reform. Trump, in his campaigning state of exaggeration, articulated that he wants to see a 15% corporate tax rate, but the Republicans want to see a reduction down to 25%. A move to 25% would potentially goose corporate earnings by over 10%, especially for more domestic-facing firms. Corporations may also get a window to pull overseas money back to America at a reduced tax rate. If there was a bona-fide reason for the market rally, tax reform was the cause.

The wild card will be international trade, and no one knows what to expect here. Trump has appeared antagonistic towards current trade partners and the protectionist rhetoric has been a concern. This has extended beyond goods and into labour issues such as foreign workers in the technology space. Canada appears safe for now, but I am unsure of the outcome in leaving Justin Trudeau alone in a room with "The Donald" for any serious negotiations.

THE MARKET RESPONSE

There was a little irony in the way the aftermath of the election played out. The consensus view was that a Trump victory would send the market tumbling roughly 10%. Indeed, as the election results came rolling in, the futures market was indicating a drop in excess of 6%, and gold was skyrocketing. But a strange thing happened on the way to Trumpaggedon: the market experienced a strong rally. The strongest rallies were in reversals of previously weak sectors such as retail, restaurants and manufacturing; while areas of previous strength such as REITs, staples, utilities and golds turned for the worse. To be sure, it is difficult to separate the market's reaction to the Trump victory vs. the Republican sweep, the latter of which would have been widely viewed as positive prior to the election. However, if we were to sum up the election aftermath with the bottom line it would be this: <u>you would have been better off being positioned for a Clinton victory than a Trump victory</u> (unhedged, long and more aggressive than defensive).

The Venator Income Fund was always positioned conservatively in terms of both yield and duration, as we were prepared for the Fed to start raising rates by March of next year regardless of which way the election went. In large part, this explains why the Fund managed to increase by roughly its monthly yield in November, despite the negative move in the bond market.

Our long/short equity strategy was positioned for the 'expected adverse reaction' to a Trump victory. Our market-based, short-dated, protective Put options effectively went to zero. Meanwhile, our more defensive long positions did not generally participate in the market rally. Furthermore, a good subsection of our short book over-participated in the market rally; specifically, our more consumer-facing short positions, such as our basket of restaurant stocks, which went from a materially profitable position to a material loss in the 48 hours post-election.

The fact of the matter is that even if we had known with complete certainty that Trump would win the election beforehand, our portfolio positioning would have been the same, with the possible addition of some gold exposure. To be sure, we were never convinced that a Trump victory would be a long-term negative to the market, but we were fairly certain that it would garner a short-term, negative reaction - and it did . . . for about four hours.

VENATOR'S YEAR IN REVIEW

	MULTI-YEAR RETURNS			
Investment	**2016 YTD**	**2-Year**	**3-Year**	**5-Year**
Venator Founders Fund LP	**-2.5%**	**-0.7%**	**24.9%**	**102.3%**
Venator Partners Fund LP	**-5.2%**	**-6.5%**	**-**	**-**
Venator Investment Trust	**-4.2%**	**-2.9%**	**20.8%**	**95.6%**
Venator Select Fund LP	**3.0%**	**3.5%**	**46.0%**	**-**
Venator Income Fund	**12.5%**	**6.2%**	**19.6%**	**65.4%**
S&P/TSX Total Return	19.1%	8.7%	23.1%	43.8%
S&P 500 Total Return	9.8%	11.1%	29.8%	96.4%
Russell 2000 Total Return	18.0%	16.0%	20.6%	92.3%
S&P Toronto Small Cap Total Return	33.3%	15.2%	15.9%	16.2%
Merrill Lynch High Yield Total Return	15.2%	8.4%	14.0%	44.0%

2016 YTD Fund returns are estimated as of November 30th
2-Year, 3-Year & 5-Year returns are cumulative; and net of fees in the case of the Venator Funds

Beginning with the Venator Income Fund's 2016 performance, the strategy did what it’s supposed to do, and in precisely the way it is supposed to do it. Essentially, we got the yield we bargained for plus some additional capital gains. Next month, we will get into the outlook for the Fund, but, at this point, we see more of the same: a 5%-8% annual yield boosted by the occasional opportunistic situation that seems to present itself every now and then with surprising regularity. Over time, this Fund's formula for success has become clear; healthy yields, enhanced by the occasional special situation. It has basically become a 5%-8% base yield return fund with the occasional "plus". We see no reason why this can't continue going forward.

As previously mentioned, our equity funds positioning for a possible Trump victory backfired. As such, we missed most of the powerful two-week rally in years. In the past, we have written that you can miss a whole year in week (we usually put this contrarian view to work with increasingly aggressive positioning in declining markets) which was clearly the case this year as the two weeks following the election amounted to 80%+ of the year's gains in the US stock market (US markets were only up about 2% on the year heading into the election).

We would also note that the current earnings season just didn't help our cause. Half of our long investments beat their quarters, while 75% of our short investments missed their quarters (we measure this on the basis of reported numbers and guidance confirmed by the stocks' immediate subsequent move). Normally, we would have expected those results to yield positive returns overall for the portfolio. But, as mentioned above, our sector allocations were off the mark, and our shorts rebounded to levels above where they missed their earnings, while our more defensive and lower beta longs got left behind, leaving us with breakeven results in the strongest month of 2016.

The chart above has multiple investment horizons not just to keep perspective over our longer-term track record, but also to highlight the three-year number as it encompasses the round-trip adventure of Concordia Healthcare, our most profitable position in 2014 and our biggest loser in 2016; we would note overall that this was ultimately a profitable holding start to finish.

Looking back over the one, two, and three year periods, we can tell you that our long positions have contributed to solid gains for the Fund; we can still find great investments. But the big difference between our disappointing 2016 performance and the solid three-year number displayed in the chart above has been the short sales. Over three years, we broke even on our short sales while the market rallied 20%, an admirable result and what fund analysts would call significant alpha. In 2015 our profitable short selling offset our long losses leading us to breakeven results in a rough year for the markets. But this year our shorts have had the opposite effect, cancelling our 9% long gains and causing the Fund to miss a significant market rally.

While these underlying attribution numbers tell us that we can do better, it's also important to remember that our first 10 years of solid, market-beating returns were no fluke. The fact is that our recent relative and absolute performance boils down to us basically missing a two-week post-election rally due to defensive positioning through protective short sales. While you might ask in a year like this why we bother shorting at all, historical analysis shows that we are quite good at it and that, historically, we have been able to mitigate market risk while putting up market beating returns. We continue to find attractive investment opportunities, at good valuations, for the long side of the portfolio; and attractive short sale candidates that can reduce the overall risk of the portfolio over time. In conclusion, we look forward to returning to our usual selves in 2017, thereby rewarding the patience of our loyal investors.

WE ARE RE-OPENING VENATOR FOUNDERS FUND

Many of you have probably noticed that the Venator Partners Fund, which doesn't invest in companies with less than $100 million in market value, has underperformed Venator Founders Fund since its inception 2 ½ years ago. Naturally, this performance discrepancy was unintended as our historical analysis suggested that the two Funds would have had a negligible performance differential based on our 10+ year history and the 90%+ overlap in positions. The reality is that there have been no significant positions in the Founders Fund that couldn't have been executed with the combined assets of the two funds; and nearly all the sub-$100 million market cap positions eventually ended up in the Partners Fund portfolio as they crossed the $100 million market cap level.

As a result, we plan on merging the Partners Fund into the Founders Fund and re-opening the Founders Fund to new capital in 2017. We do not anticipate that the proposed merger will have any adverse effect on the liquidity of the Founders Fund (there is a 90%+ position overlap between the Funds currently), and it will lower the overall expense ratio through greater scale.

We will monitor the liquidity of the Founders Fund portfolio as the strategy grows over time. While a larger Fund may allow us to exert more influence on some of the junior issues in the portfolio, we will not allow the Fund to reach a size that prevents it from investing in earlier stage companies.

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

Brandon Osten, CFA
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