

2021: YEAR IN PREVIEW

HEDGE FUNDS (Inception)	NOVEMBER 2020	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund** (March 2006)	12.1%	44.7%	12.5%
Venator Select Fund (September 2013)	11.9%	35.2%	17.2%
S&P/TSX Total Return (March 2006)	10.6%	3.8%	5.7%
Russell 2000 (March 2006)	18.4%	10.4%	7.8%
S&P Toronto Small Cap (March 2006)	17.6%	6.7%	2.2%
S&P 500 (March 2006)	11.0%	14.0%	9.6%

ALTERNATIVE MUTUAL FUNDS (Inception)	NOV 2020	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund*** (January 2020)	7.3%	2.6%	3.6%	3.8%	6.1%	7.7%
B of A Merrill Lynch High Yield Index (August 2008)	4.0%	4.1%	6.3%	5.3%	7.4%	6.6%

*As of November 30, 2020

**Venator Investment Trust is available as an extension of the Founders Fund strategy, its monthly performance mirrors the Founders Fund, and it is eligible to be held in both registered & non-registered accounts

***Performance data prior to January 24, 2020 relates to Class F Units of Venator Income Fund, which was distributed to investors on a prospectus-exempt basis in accordance with National Instrument 45-106

The US election was indeed a ‘clearing event’ with financial markets seemingly unconcerned with the prospect of a turnover in the Presidency, a Senate that is still undecided until January 5th, and rising COVID-19 cases worldwide. All these issues have been usurped by not just one, but two, 95% effective vaccines, providing light at the end of the volatility tunnel. Here at Venator, our equity strategies performed nobly during November considering that they were *market neutral* for the month. Venator Alternative Income Fund also had a nice rebound last month and completed its comeback from the depths of the March lows. While not quite on par with our equity-linked performance, we are optimistic that the Alternative Income Fund will finish the year having fulfilled its primary ‘capital preservation’ mandate.

Looking forward, we imagine that 2021 will not be as eventful as 2020 has been, although that’s not to say it won’t be interesting. With low rates and a stable political environment, the determining ‘Factor of the Year’ will be growth as the global economy continues to rebound from the pandemic. Is the economy growing enough off from an all-time trough? Is employment rebounding enough in terms of both levels and wages? Are epicenter stocks (hotels, movies, theme parks, restaurants) growing enough to justify their respective stock price rebounds? Are the high-flying, secular growth companies still growing fast enough vs 2020 to justify their sky-high valuations? Can the stay-at-home beneficiaries (home reno/fitness/streaming) grow fast enough to lap strong 2020 financial results? What 2020 changes will prove to be temporary, permanent and/or enhanced? In a year where Nordstrom, Inc.; The Cheesecake Factory, Inc.; Ford Motor Company; and Denny’s Corporation are all *expected* to grow faster than Amazon.com, Inc.; Alphabet, Inc.; Salesforce.com, Inc.; and Microsoft Corporation, closer analysis of *growth vs expectations* will carry enhanced importance. With that in mind, below are a few topics/themes guiding our investment principals as we position for 2021.

Easy Comps (comparables), Hard Comps and Comping the Comp: In retail investing, comparable same store sales are a key measure of company health. When the prior year was exceptionally bad, it sets up easy year-over-year comparisons – or ‘easy comps’. ‘Comping the comp’ refers to the ability of a company to report strong growth, despite a good prior year. 2021 is going to be a strange year for comparables; what constitutes a good year-over-year number when the prior year was down 50%? We believe that the two-year comp will become the key metric of growth health; was 2021 better than 2019? That door swings both ways for companies like The Gap, Inc. (which had

a tough 2020) and for companies like The Home Depot, Inc. (where same store sales were up 20%+ in this year's third quarter). It can also have implications for industrial companies (easy comparables), technology companies (Zoom Video Communications, Inc., for example, will likely experience a material growth slowdown from this year's telework growth boost), and homebuilding stocks, where orders/backlog grew significantly this year even though the revenues will come over the next two years. As a point of reference, The Gap, Inc. is expected to grow by 60% in the early summer quarter (easy comps), while Shopify, Inc. is expected to be growing by approximately 25% at the same time (hard comps); under that scenario, The Gap, Inc. is trading at 15x earnings with twice the growth rate of Shopify, Inc., which is trading at 30x revenues for that given point in time.

Reopening stocks, mis-characterized as value stocks, have taken over from technology since the vaccines were announced. Since the beginning of the month retail, restaurants, theaters, and airplanes have been winners while the pandemic beneficiaries have started to lag. These are the companies with the 'easy comps' we previously outlined and will likely continue to be the focus of the markets for the next several quarters. With the strong rebound that these reopening stocks have enjoyed also comes the expectations of a return to 2019+ financial results, that could potentially disappoint as the world has shifted to greater acceptance of e-commerce, video conferences and sunk costs in home theatres.

For 2021, year-over-year growth and the acceleration/deceleration of growth for 2020-2021 will not be a good determinant of a company's true go forward growth rate and overall value. Will 60% growth be enough for The Gap, Inc. to hold 15x earnings? Will 30% growth be enough for Zoom Video Communications, Inc. to hold 40x revenues? Air Canada is expected to grow by 66%, still lose money, and still lag 2019 revenue levels by 50% - how will the market look on that situation (Cineplex, Inc. faces a similar scenario)? The period from 2019-2022 is going to be a wacky time in financial history in terms of growth vs expectations, and realizing this as we head into 2021 can be a source of informational advantage in what is shaping up to be an uncertain year for the perception of growth.

Mature Bubbles: Before I take any criticism for being out of touch with the wondrous technological environment of the day, allow me to explain the evolution of stock market bubbles, from the perspective of someone who has witnessed several first-hand over the past 25 years. First, bubbles start with strong and credible secular growth trends, evidenced by high quality early movers that deserve the attention and stock performance they get. Examples include Tesla, Inc. in electric vehicles; Amazon/Cisco/Siebel in the 1990s tech boom; and Bitcoin in the cryptocurrency boom. Once these high-quality early movers have established a strong secular outlook for others, we get the second tier quality companies, and eventually the third tier 'ideas on a chalkboard looking for billion-dollar valuations' that base their valuations on TAM (Total Addressable Market opportunity) rather than the fundamentals of the company itself. Before you know it, there are more low-quality, \$1 billion+ pretenders than legitimate contenders, as the market evolves into a mix of unsustainable valuations among the best of the best (think Amazon and Siebel Systems in 2000) and companies that should never have been allowed to go public in the first place (think Pets.com). That's when *everything* drops 70%-100% before the eventual winners, usually the original quality companies and a few others that sparked all the hype in the first place, stage their comeback.

The Big Bubble today is 'all things tech', with the notable exception of crypto currencies which saw its bubble several years ago resulting in everything functionally going to zero other than eventual (and original) winners Bitcoin and Ethereum. The Electric Vehicle ecosystem, spurred by the success of high-quality long-term winner Tesla, has seen several questionable companies achieve multi-billion-dollar valuations, largely through reverse mergers with SPACs; the so-called 'unicorns' have now become commonplace. Meanwhile, the SPAC market itself has shifted from quality mature company transactions several years ago to speculative technology start-ups currently, in a sense mirroring the made-in-Canada shell company phenomenon we experienced in cannabis, but on a much greater scale. We also believe that there are mature bubbles in other areas such as telehealth, work from home, shop from home, and software-as-a-service.

As a former software analyst covering the sector back in 2000 when the bubble burst, I can say with firsthand experience that the ominous parallels are there. The *'it's different this time crowd'* will protest, but 2000 was all about Pets.com, while today's companies are higher quality vs the speculative garbage of yesteryear (ignoring the fact that 2020 Rockstar Chewy.com is basically pets.com, only financially breaking even due to scale). My response is that 2000, like all bubbles, started with quality companies like Cisco, EMC, Microsoft, Oracle, SAP, Siebel, and eBay. Even software company earnings were *'recurring'* since annual maintenance renewals is where all the earnings stemmed from.

As a starting point, I would note that *nothing* today looks as good as Cisco Systems, Inc. did in 2000. Cisco sported a 66% growth rate in October 2000 (after the bubble bust), with 28% EBITDA margins, and arguably a monopoly on the 20-year buildout of the internet which was in only its *'third inning'* at the time. The only problem is that it traded at 25x forward twelve-month revenues at the time, which was just too high a number to grow into. The result is that despite per share revenue growth of close to 400% in the last 20 years, the stock is still down about 50%. To use a *'Made in Canada'* example, Descartes Systems Group, Inc. is a recurring revenue rock star; it was considered so in 2000, and it is considered so today. Its sales, on a per share basis, are up 300% over 20 years, but the stock is down 40%, even though it currently trades at an elevated 12x revenues. Today, other quality technology names trading in excess of 30x 2021 revenues include Snowflake, Inc. (80x), Zoom Video communications, Inc. (40x), Unity Software, Inc. (39x), Coupa Software, Inc. (37x), Palantir Technologies, Inc. (35x), Bill.com Holdings, Inc. (35x), Datadog, Inc. (35x), Shopify, Inc. (33x), and Jfrog Limited (31x). These are quality names, with great prospects and secular growth rates; but *we would note that while their growth is secular, their growth rates likely have cyclical elements that can disappoint*. Our approach is that if we cannot see 10x revenues within three years, we will usually cross it off our list.

As a second major point, I would call out is the less than proven fundamental value of many of the highfliers of today. In 2000, we were valuing *'eyeballs'*, or potential revenues from *existing* users, which led to outsized valuations for companies like Yahoo! and American Online. Today, ascribing value using *Total Addressable Market* (known as TAM) is in vogue which, in other words, equates to customers we don't have yet, but believe we will get, because we have a product (if only in beta) that we think they might want. This *'future growth potential'* metric that is completely decoupled from financial performance is another sign of a bubble. So, where people say "2000 was all about Pets.com", I would counter that today's market is pumping up equally dubious businesses like Virgin Galactic Holdings, Inc.; Nikola Corporation; Plug Power, Inc.; Fisker, Inc.; Quantumscap Corporation; and Arrival to multi-billion-dollar valuations.

Here is one final chart to drive home the ominous parallels between the 2000 technology bubble and what we're witnessing today (noting that the technology number will go up by another 3% once Tesla gets added to the index):



The lingering effects of COVID-19: With the release of the vaccine(s), COVID-19 will clearly be a temporary phenomenon, but its effects will linger. Work-from-home will turn into work from anywhere, but will still influence office space and home design going forward (think bigger homes, which begets more furniture, more doors and windows, more landscaping, more lumber, more drywall, more paint, etc.). E-commerce may slow a bit, but multi-channel capabilities have become permanently more important (multi-channel sales are lower margin for retailers, and less points of presence and more points of distribution favors warehouses and parcel delivery at the expense of mall owners). Most importantly, the altered *'way we work'* is going to cause real upheaval in the job market. While broad economic data might not cover the minutiae, we can anecdotally say that companies by and large are telling investors that some of their COVID-19 cost cuts are permanent. In other words, not all the jobs are coming back, and we believe that that pre-COVID strong employment and wage inflation will take several years to be repaired.

This employment situation is key for our macro thinking going forward, and basically means that we are looking at a multi-year recovery. It also means that the Fed is unlikely to raise rates materially for the next several years and that governments will be accommodative and running outsized deficits through the current election cycle. In other words, we expect things to get directionally better for several years in terms of the business climate versus current levels, but don't expect a return to 2019 levels so quickly.

Venator equity mandates positioning for the best of all worlds (*while staying hedged*): With all the aforementioned factors taken into consideration, we are trying to position for the best of all worlds. That means re-openers with *'easy comps'*, reasonable valuations, and well away from bubble land (we sold our Tesla as we do not think it will escape the gravitational pull of the EV bubble bursting despite its entrenched market leadership). This does not mean that we are looking for decimated stocks or avoiding the 52-week high list. For example, Facebook is near an all-time high, but is also a re-opening trade owing to the poor small business advertising environment of 2020 (which sets up easy comps), and trades near the market multiple of 20x earnings, despite a growth rate considerably above that of the broader economy.

Our big investment theme remains *'nesting'*, which translates into housing and automobiles. We believe that the real *'work from anywhere'* opportunity is in the physical home. This is likely a five-to-seven-year secular theme characterized by continuing shortages and/or capacity constraints. Homebuilders remain inexpensive as backlogs build. Building products can be even more interesting as some leaders screen cheap, have *'easy comps'* due to building restrictions this year, and strong secular outlooks. For example, Masonite International Corp., a door manufacturer, operates at capacity, is increasing prices, and is witnessing both an increase in doors per home and more expensive solid core doors (bigger homes and more privacy in the home); a great setup for a stock that currently trades at only 13x 2021 EPS expectations. Lear Corporation, the leader in car seats and an emerging leader in vehicle electrification (30% of revenues), also has *'easy comps'* owing to automotive manufacturer shutdowns, and can be had for 13x 2021 earnings too (a number that we think will prove to be conservative), as people buy cars to travel from the suburbs.

Other areas of interest include special situations which are largely still *"easy comp"* reopening trades, that are somewhat company specific. A prime example would be Skechers U.S.A., Inc., the third largest shoe company in the world. Skechers is a secular grower trading at 15x earnings with *"easy comps"*, which is the same multiple afforded to other more growth challenged retailers like The Gap and Macy's. Meanwhile, Skechers two largest competitors trade in excess of 30x earnings, despite inferior growth rates (although admittedly stronger brands). We also have a large position in an industrial distributor facing *"easy comps"* but trading at only 10x earnings, despite its position as the largest distributor of electrical maintenance/repair/operating products in North America.

While we remain over-hedged, likely through year end, many of the opportunities we currently invest in appear to represent obvious and objective value as opposed to questionable relative value. We therefore remain bullish on our prospects heading into next year despite the strong returns generated during 2020.

Venator Alternative Income Fund positioning for tactical advantages in a low-rate environment: Interest rates remain artificially low and, in our opinion, it is not advisable to reach up the risk spectrum in hopes of achieving mediocre returns. For this reason, we remain cautious on both the quality and duration of debt opportunities within the high yield market. While the Fund's current yield is slightly above 6.5%, this number is subdued by a healthy allocation to lower yielding convertible bonds, that are functionally investment grade but with optionality related to the stock price. We believe that convertible bonds offer extremely compelling risk-reward in a market where quality issues yielding over 6% are difficult to find. As a capital preservation strategy, we would rather wait for opportunities to come to us than push for risk through either increased leverage or lower quality. That said, despite our more conservative positioning, we believe that we should be able to achieve returns within our historical 5%-10% target range.

In the meantime, stay safe, stay hedged – and, as always, we reserve the right to change our mind!

On behalf of the entire team at Venator Capital Management Ltd., wishing you a happy holiday season, and a healthy and prosperous 2021!



Brandon Osten, CFA
CEO, Venator Capital Management Ltd.

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