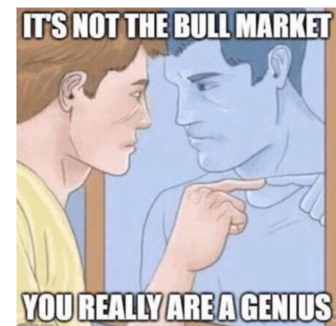
TWO BIG BRICKS IN THE WALL OF WORRY

HEDGE FUNDS (Inception)	OCTOBER 2021	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund (March 2006)**	**5.7%**	**11.5%**	**12.7%**
Venator Select Fund (September 2013)	**9.3%**	**21.7%**	**18.2%**
S&P/TSX Total Return (March 2006)	5.0%	23.4%	6.9%
Russell 2000 (March 2006)	4.3%	17.2%	9.0%
S&P Toronto Small Cap (March 2006)	5.6%	23.3%	3.8%
S&P 500 (March 2006)	7.0%	24.0%	10.8%

ALTERNATIVE MUTUAL FUNDS (Inception)	OCT 2021	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund* (January 2020)**	**1.4%**	**9.8%**	**22.1%**	**7.9%**	**6.8%**	**8.6%**
B of A Merrill Lynch High Yield Index (August 2008)	-0.2%	4.5%	10.7%	7.1%	6.2%	6.7%

**As of October 31, 2021*
***Venator Founders Alternative Fund, which holds the same securities as Venator Founders Fund, is now available as a Liquid Alternative Mutual Fund; 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*

North American markets kept moving higher in October and are now up over 20% on the year, on top of a 15% gain last year. Since the NBA shut down on March 11, 2020, the S&P 500 equal weight index is up 65%. Our Founders Fund has more than doubled since the end of March as well, while our safer income strategy has posted a 45% gain versus a high yield index that has gone up 30%. Clearly the road to retirement for all is to have a global pandemic for every generation! It has been a great run for blue chip stocks and pump-and-dump promotes, investment grade bonds and bonds in default, established private companies and “cloud diagrams on a chalkboard” startups, established cryptocurrencies like Bitcoin and zero-utility meme-coins like Dogecoin, commodities with bright futures like copper and secularly challenged ones like thermal coal.



Investing legend Jeremy Grantham recently said: “Nothing is more supremely irritating than watching your neighbors get rich”. When combined with JP Morgan’s famous quote: “Nothing so undermines your financial judgement as the sight of your neighbor getting rich”, you have the conditions to set up a bubble. When everyone around you is getting rich, you start to feel the FOMO (Fear of Missing Out). Everyone is an investment genius and it’s hard to stay rational with the mention of every new opportunity that has doubled in the last month. We forget that people don’t tell you about their losers, we only talk about the winner; every big winner you hear about isn’t the whole portfolio, just one position of many. Everything is seemingly going higher and every 10% drop (for no reason) after a 200% gain (also for no reason) is a buying opportunity.

It seems nearly everyone knows someone who had the not-so-elusive “10+ Bagger” over the last eighteen months. Maybe it was a private company that went public, or a private company that just did a higher round (otherwise known as getting rich “on paper”), maybe it was a cryptocurrency that went from 0.2c to 24c like Dogecoin, maybe it was a recently near bankrupt but now resurgent oil producer that had been sitting in their portfolio for six years (that might still not be back at their cost), maybe it was just Tesla (which people thought was a fraud only two years ago – we actually had redemptions because of how irresponsible we were for owning the convertible bonds in our Income Fund!), maybe it was a mundane couch manufacturer we own called LoveSac that went from $5 to $75, or maybe Donald Trump decided to fold The Apprentice and Miss America brand names into the blank check company and that company went up 1000% in two days to a valuation in excess of $8BB!!! Maybe your neighbor was really smart and leveraged up to make this amazingly fortuitous investment or better yet – maybe they used options!

It would appear that the time of steadily compounding returns strategy is over. Some great quotes that will have to be banished to the dustbin of investing history include:

- *"The joys of compounding are there if you keep your stake growing, but all you need to have is one year in which you give back half, and your program, at the same growth rate, must stretch out years and years longer" – Adam Smith*
- *"Compounding is the magic of investing" – Jim Rogers*
- *"The effects of compounding even moderate returns over many years are compelling, if not downright mind boggling" – Seth Klarman*
- *"Over the years, a lot of very smart people have learned the hard way that a long string of impressive numbers multiplied by a single zero always equals zero." – Warren Buffett*
- *"Good investing isn't necessarily about earning the highest return. It's about earning pretty good returns that you can stick with for a long period of time. That's when compounding runs wild" – Morgan Housel*
- *"Financial markets suffer from a deep inability to price patience and compounding because of their dominant short-termism" – James Anderson*

Dinosaurs all! The new mantra of investing was coined by Russ Hanneman, the fictional "three comma club" billionaire from the show Silicon Valley, who said:

This brings us to our biggest concern where we currently see two aspects that led to the biggest crashes in the last 25 years. Rampant speculation/valuations that accompanied the 2000 technology crash, and the easy credit that led to the 2008 crash. In 25 years, we have never seen valuation count for so little a factor in the investment process, including the technology bubble. Being unprofitable, once the exclusive realm of private companies, early stage biotechs and mineral explorers, is now acceptable for scaled companies with sub 50% growth rates (for example, software company Asana is going to lose $185MM on $500MM in revenues off a merely decent 35% growth rate; with a market value of $25 billion, that growth rate is worth 50x 2022 *revenues,* so we are clearly out of touch). With leverage more accessible than ever, it is easy to see how valuations got so pumped up. Remember that the financial markets are the only markets in the world where buyers prefer paying for items that are more expensive than they were yesterday; fortunately for those buyers, the sellers will take the higher price in all situations.

On the leverage side, "Fintech" is also having its moment, where abundant financing coupled with easy credit is adding fuel to the fire. The brokerage Robinhood, combined with Reddit, is the gamification of day trading with the volume pumped up to eleven through easy leverage and option trading that a traditional bank would never allow on their balance sheets until FOMO forced their hands. Buy Now Pay Later used to be called 'factoring their receivables' (the retailer offloads account receivables to a third party in exchange for 10% of the sale price) – something that used to be a red flag that attracted short selling! Lending Fintech is just shaving 25bps of off rates because machine learning algorithms that have never seen a credit cycle say the *aggregate* book of loans will be ok; this isn't too far off from slicing up mortgage tranches in 2008 (the calling card in Fintech companies is that credit

scores don't matter…but we securitize 90% of our originated loans just in case). We agree that the lowest credit scores currently don't matter when those with them are getting government COVID cheques while living expenses are down 25% from not going to work. But that's not why default rates are down, according to the fintech lenders…it's the magic of the artificial intelligence/machine learning algorithms!!!

Unfortunately, the popular financial press can't help itself from promoting some of the most speculative investment "opportunities" out there. Unregulated Crypto-exchanges (DeFi exchanges, or decentralized finance) that get most of their revenues from trading sub-$1.00 altcoins (over 10,000 of these exist). Dogecoin, Shibu Inu, and Squid (game) coin (up 2,500% in one day!) are basically Leonardo DiCaprio making solicitation calls on Pink Sheet stocks at the beginning of *Wolf of Wall Street* (Defi exchanges, or DEXs, have no regulations or money laundering/know-your-client verifications yet trade billions of dollars worth of these coins per day)! I don't think CNBC ever covered the Pink Sheet winners (some of which are real businesses) as enthusiastically as they follow these crypto exchanges and altcoins, some of which are created for the sole purpose of being promoted within moments of launch for pumping and dumping. Perhaps you are at the cutting edge of the collectibles/art market and would like to purchase the non-fungible token CryptoPunk for $11.75MM (that's not a painting, it's a perfect digital image replica of the "original" that no doubt took the artist 45 seconds to create).

Fear Of Missing Out of 2000 marries the easy money credit cycle of 2008 is Halloween scary. Famed Investor Howard Marks is a noted watcher of cycles, and as a bond guy, he is particularly focused on credit cycles. He once pointed out that a major feature of modern finance is that no one expects/intends to pay off their debts in the future; they expect to roll them over. Governments might talk about lowering their debt/GDP, homeowners look at the loan-to-value on their appreciating house, companies talk about lowering their debt/EBITDA; but borrowers don't generally expect their absolute amounts of debt to come down in the future – they plan to grow into lower leverage *ratios*. But when lending standards go down (lower interest rates and less assets or earnings backing these loans, otherwise known as leverage) in order to buy lower quality investments, look out below. Levered up investors may not intend to have to pay off that loan (as their houses or stocks or bitcoins go up), but that money is still owed, and that loan can still be called! The more stretched borrowers are, the smaller the downturn in increasingly speculative investments that is required to "call" those loans and wreak havoc on financial markets.

The wall of worry contains many bricks, some larger than others. It gets built up over time and it can get built up high. Asset prices can't inflate beyond fundamental growth forever. At some point, there are limiting factors. Greed builds up gradually, while fear manifests all at once – building up vs tumbling down. There is a saying that markets don't correct sideways. We have sacrificed some returns hedging our portfolio over the last several years. We have always viewed our best long-term hedge as being invested in reasonable value and avoiding unchecked high-priced momentum. That said, history says that when things go down, everything goes down together over the short term, so we can't make any short-term promises, even as we remain cautious. Matters of degree is what separates the temporary losers that come back from the unrecoverable losers (think about blue chips in this category including Cisco and Citibank), but waiting for the 'crash' results in lost opportunities. This is why we have never been market timers. The corrections we have witnessed over the years, we have never seen coming in a tight enough timeframe to qualify as a market call; we only know cheap vs expensive in both valuation and expectation terms. For this reason, we remain near fully invested on the long side of our Founders Fund, but with some hedging on the other side to avoid greater than market volatility.

Our Income Fund continues to focus on high credit quality convertible bonds. While this strategy carries higher short-term risk (convertible bonds move with stocks to a greater extent than other bonds), the long-term risk is generally lower since they are for the most part incredibly high-quality credits, often with more cash than debt and huge market caps underlying relatively small debt balances. These instruments currently make up over 50% of the portfolio.

Two more beauties to leave you with (why make my own quotes when the great ones said it so well already):

> *"The line separating investment and speculation, which is never bright and clear, becomes blurred still further when most market participants have recently enjoyed triumphs. Nothing sedates rationality like large doses of effortless money. After a heady experience of that kind, normally sensible people drift into behavior akin to that of Cinderella at the ball. They know that overstaying the festivities - that is, continuing to speculate in companies that have gigantic valuations relative to the cash they are likely to generate in the future - will eventually bring on pumpkins and mice. But they nevertheless hate to miss a single minute of what is one helluva party. Therefore, the giddy participants all plan to leave just seconds before midnight. There's a problem, though: They are dancing in a room in which the clocks have no hands." – Warren Buffett*

> *"…when the same or closely similar circumstances occur again, sometimes in only a few years, they are hailed by a new, often youthful, and always supremely self-confident generation as a brilliantly innovative discovery in the financial and larger economic world. There can be few fields of human endeavor in which history counts for so little as in the world of finance. Past experience, to the extent that it is part of memory at all, is dismissed as the primitive refuge of those who do not have the insight to appreciate the incredible wonders of the present." -John Kenneth Galbraith*

We reserve the right to change our mind!

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