

## GROWTH IS ALWAYS IN STYLE

| HEDGE FUNDS (Inception)                     | FEBRUARY 2022 | YEAR-TO-DATE  | ANNUALIZED   |
|---|---------------|---------------|--------------|
| <b>Venator Founders Fund**</b> (March 2006) | <b>-5.0%</b>  | <b>-14.8%</b> | <b>11.0%</b> |
| <b>Venator Select Fund</b> (September 2013) | <b>-8.7%</b>  | <b>-22.3%</b> | <b>13.4%</b> |
| S&P/TSX Total Return (March 2006)           | 0.3%          | -0.1%         | 6.8%         |
| Russell 2000 (March 2006)                   | 1.1%          | -8.7%         | 8.1%         |
| S&P Toronto Small Cap (March 2006)          | 5.5%          | 4.4%          | 3.8%         |
| S&P 500 (March 2006)                        | -3.0%         | -8.0%         | 10.2%        |

| ALTERNATIVE MUTUAL FUNDS (Inception)                     | FEB 2022     | YTD          | 1-YR         | 3-YR        | 5-YR        | 10-YR       |
|--|--------------|--------------|--------------|-------------|-------------|-------------|
| <b>Venator Alternative Income Fund***</b> (January 2020) | <b>-0.8%</b> | <b>-4.2%</b> | <b>-0.5%</b> | <b>5.0%</b> | <b>5.2%</b> | <b>7.2%</b> |
| B of A Merrill Lynch High Yield Index (August 2008)      | -0.9%        | -3.6%        | 0.8%         | 5.1%        | 4.7%        | 5.8%        |

\* As of February 28, 2022

\*\* 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

February was an eventful month for the markets. Already worried about inflation (which we still believe to be transitory) and the ensuing Central Bank responses (namely “higher” interest rates vs what we view as a less intimidating prospect of restoring interest rates to more normal levels of around 1.50%-2.5%), we now have 24-hour news cycle geopolitical events. After a few weeks of worrying about the fate of the Ukraine, should Russia invade its neighbour, the market rebounded on both days of initial incursion into the country (first into “separatist” regions, and then into the heart of the country towards the capital).

The biggest positive response by the markets was the revelation that crippling sanctions would not include energy and would have a limited financial impact outside of Russia. It’s worth noting that not disrupting energy flows have more to do with natural gas than oil, which is more easily diverted – Russia can ship more to China so the Middle East can ship more to Europe. Russia makes almost \$200 billion a year on oil and only about \$50 billion from natural gas. The humanitarian and political cost of Europe cutting off their own gas supply is too much of a sacrifice relative to the minor financial impact to Russia of doing so.

Our own funds have, admittedly, not fared well to start the year. We have been holding our positions rather than cycling into more favored areas of the market, such as the current event affected resources. We remain largely overweight small cap US growth (still down 20% from Spring and Fall highs). Because we are largely bottom-up investors, rather than top-down macro investors, we haven’t made major changes to the portfolios’ larger weightings this year as we believe their prospects remain undiminished in a 2% interest rate environment, and we believe we own them at attractive valuations. This has led us to owning several large positions in companies that could be characterized as great houses in bad neighborhoods, and it may take a few quarters for markets to see things our way.

We are, first and foremost, growth investors with an eye to value. When we do buy “value” stocks, which we do all the time, it is because we expect earnings growth that will exceed revenue growth. Furthermore, there is value in growth, which is where you get valuation expansion on top of the benefit of compounding growth. Growth can turn expensive stocks into inexpensive stocks in time. Growth can repair broken balance sheets. Growth covers up a lot of small problems in the business (Amazon is notorious for trying out a lot of eventual “Fire Phone” type failures, as is Google’s “other bets” business) while low growth businesses don’t have that luxury. Growth attracts acquisitions.

A combination of overestimating the durability of growth and how growth attracts fast money and promoters means the market often overpays for growth, which is why growth companies can go out of favor like it is today. But it is important to note that it is not the growth that goes out of favor – even if that growth is slowing – it is the valuations that got extended and those valuations go out of favor, as we are seeing today.

It's also important to note that growth can come from anywhere, even in out-of-favor or staid sectors of the economy. When energy is in favor, as it is today, it is because the market expects earnings growth (and balance sheet repair) due to higher energy prices. When financials are in favor, it is because the market expects earnings growth in a rising interest rate environment. When defense stocks are going up, it is because the government defense budgets are expected to rise. Growth can come from innovation in an otherwise stagnant sector, as it did with Tesla in the low growth automotive sector, or Peloton in the exercise bike category, or Lululemon in the workout gear category. Emerging technology always lends itself to growth because it is usually replacing an existing market with a better product (electronic medical records, video/music streaming, electric vehicles, smartphones, robotics) or creating a new business category altogether.

A good house in a mediocre neighborhood is fine (Lululemon in a stagnant retail market, Tesla in automotive), but even a great house in a bad neighborhood creates a lot of frustration for “bottom-up” investors and great opportunities for those that look past the neighborhood and investigate what makes these companies uniquely great. We have remained invested in several names in these categories, some of which have experienced declines in excess of 30% this year alone.

One such company we have owned since its IPO: The Lovesac Company. Lovesac is a classic case of a great house in a bad neighborhood. It sells furniture, specifically sectional couches. But it does so in a very innovative and unique way. Its “Sactionals” sell as unassembled components in boxes. The customer receives a bunch of rectangular boxes and puts the sectional together, including the clamps/feet that hold the “sactions” and sides together and then slips on upholstery fabric themselves (see below). This carries some advantages over traditional sectional couches. Firstly, they are “designed for life” business model, meaning, that the couch is infinitely re-configurable; you can add and subtract sections, or turn one large configuration into two smaller couches, if you move. Also, because the fabric can be replaced by the customer quite easily, the product is repairable, and you can change the fabric later without buying a new couch. Finally, because the product comes in rectangular boxes, the company is able to store a lot of inventory, and the couches can be shipped easily in all configurations without the help of furniture delivery services. Because of this unique model, Lovesac is probably the only place one could order a custom high-end sectional and get delivery inside of two weeks, which no doubt has led to some temporary enhanced growth. But, unlike the competition, Lovesac didn't go from being a 7% grower to a 30% grower, like Restoration Hardware, Williams Sonoma, Ethan Allen, etc; Lovesac went from being a 40% grower to a 40% grower (in units, pass through shipping pricing made them a 50% grower last year) – it was a high growth business in a static market for sofas pre-COVID. Lovesac was already Tesla to Restoration Hardware's BMW and Pottery Barn's GM/Ford. Disclaimer: While we are confident that Lovesac had an outstanding yet-to-be-reported fourth quarter, that doesn't mean that the markets will reward the company, given its current bias against the entire home furnishings sector. The Website is Lovesac.com (check out the Stealthtech built in speaker section, if you visit).



We fully acknowledge that our start to the year has been frustrating as large macro headwinds bring 2008-09 and 2020 to mind. This time feels a bit worse owing the relative strength in Canada (fueled by the resource trade), where we are underinvested. While we had been pleased with the business performance of our companies during earnings season thus far, positive initial reactions to strong earnings reports have been short lived. With nearly half of the NASDAQ down over 40% from their 52-week highs, it has been astonishing how quickly highs have turned into 52-week lows. We believe that this situation has created some great investment opportunities. While we recognize that broader market indices don't reflect the carnage in small and growth stocks, and that many of these more speculative and bubble-valuation stocks will never come back to former highs, we believe there are outsized gains to be made once current events are either resolved or better understood by the financial markets.

We are all transfixed with what is happening in the Ukraine right now. We should all be impressed with the resolve of the Ukrainian people in the face of an unprovoked attack by a stronger adversary. We should be particularly impressed with the actions of its leader Volodymyr Zelensky, who chose to stay and fight rather than accept an offer by the US to be airlifted to safety ("I need ammunition, not a ride"). While I am not optimistic the situation will be resolved to the satisfaction of the Ukrainian people without compromise to their independence, I would hope that it can be resolved in a manner that ensures the safety of the 40MM civilians in the country.

We reserve the right to change our mind!



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