IS THE RALLY FOR REAL?

HEDGE FUNDS (Inception)	JULY 2022	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund (March 2006)**	**13.1%**	**-32.2%**	**9.2%**
Venator Select Fund (September 2013)	**18.5%**	**-47.1%**	**8.0%**
S&P/TSX Total Return (March 2006)	4.7%	-5.7%	6.3%
Russell 2000 (March 2006)	10.4%	-15.4%	7.4%
S&P Toronto Small Cap (March 2006)	7.7%	-7.6%	3.0%
S&P 500 (March 2006)	9.2%	-12.6%	9.6%

ALTERNATIVE MUTUAL FUNDS (Inception)	JUL 2022	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund* (January 2020)**	**4.5%**	**-10.9%**	**-9.9%**	**1.5%**	**3.1%**	**5.8%**
B of A Merrill Lynch High Yield Index (August 2008)	6.0%	-8.9%	-7.7%	1.8%	2.9%	4.8%

** As of July 31, 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*

We got a little relief last month, but our funds seem to remain macro/beta dependent during these times of violent market swing which is frustrating for “bottom-up” investors. As we talked about last month, broadly lower input costs are resulting in a relief narrative on the inflation outlook, even though the monthly numbers still appear high (we continue expect that September vs August numbers will show a dramatic slowdown in inflation). The final week rally was largely in response to Chairman Powell uttering the magic words: “depend on the data”. This is in contrast to the previous narrative of guaranteed rate hikes only being a question of “how much, how fast”. Market-based rates (treasuries, corporates and mortgages) have already started dropping as the market adjusts to a 2.5%-3.0% Fed Funds finish line.

Earnings season is off to a mixed start in general. Only a handful of our companies have reported, nearly all beating their expectations but refusing to increase guidance. Second half concerns include currency fluctuations or supply chain issues. It is worth noting that, except for our one homebuilder, our companies have not been reporting issues with demand. That being said, there are definitely pockets of expected weakness that have become apparent such as furniture sales, online advertising and ecommerce in general. There have also been a few negative surprises (such as “defensive” Walmart and Proctor and Gamble and “reopening” stocks such as travel agencies, restaurants and theme parks). And finally, there remain supply chain issues holding back companies such as auto manufacturers and parts as well as construction materials. We are seeing a lot of variability in commentary from management teams. While the stocks may be moving in tandem, the fundamentals are widely divergent.

It is also worth noting that the reactions to earnings reports can be equally surprising. Watching Bath and Body Works miss expectations by 40%(!) we were not expecting a 20% rally in the stock, but that’s what happened (we keep track because we own the bond). We have seen similar reactions among home furnishings, homebuilders, retail, autos and restaurants. This signals that we could be in the “it's not as bad as we thought” phase of the market cycle. Not great, but “good enough” earnings have complicated the art of forecasting quarterly releases.

While the recent rally could still prove to be a bear market bounce, we remain optimistic for the balance of the year for several reasons:

- Forward earnings expectation will have been substantially de-risked by the end of the current earnings season. Management teams read the same bearish press as everyone else, no one is guiding more aggressively than their most conservative outlook. Management likes to beat earnings and, if they have the opportunity to lower the bar without penalty (as they do now), that is what they are doing.

- If the Fed isn't done for now, it is almost done. We have been saying for some time that the supply chain fueled inflation will end soon and, with commodity prices broadly down (metals, lumber) or stabilized (energy), we should see a data-led pausing of rate hikes.

- US mid-term elections are going to be a contest of who can spend the most money, while saying they won't raise taxes or increase deficits. We would guess that the Fed will be less prominent as not to interfere with the outcome, and that a business-friendly "Red Wave" should carry the market into year end.

We still see geopolitical reasons to be cautious. The news cycle appears to have moved on from the Ukraine situation, largely because there is an apparent limit in terms of how much help the West is looking to provide and, as such, newsworthy progress has been slow on both sides. Europe has shown a general unwillingness to push Putin too hard because they still need the resources, and Putin has focused on natural gas since it's the one crucial resource that can't be globally substituted or rerouted (unlike oil or grains). If Putin decides to freeze out Europe going into the winter, this could result in a major disruption to Western European economies. They will have to decide if they are going to cave on sanctions or risk their populations freezing when gas storage volumes run out in February (the current forecast assuming a normal winter). Our guess is that they cave on sanctions; they don't have the moral luxury that we do 6,000 km away in energy independent North America. Over a longer period of time, enough LNG capacity should be built up to alleviate these issues while Russia builds out its pipeline capacity to the Far East, but this rerouting of resources will take 5-7 years, leaving Europe at least partially dependent on Russian natural gas for the next half decade.

Unlike a growing chorus of market watchers, we do not think we should be expecting any rate cuts on the horizon. Our own belief is that the recent supply-driven inflation has scarred the Fed for the intermediate term. Just as we needed 20 years for tech stocks to see 20x sales again, or how mortgage lending standards are considerably tighter than they were 15 years ago, we think the Fed will be loath to lower rates below 2.50% for the next ten years, barring a 9/11/Great Financial Crisis/COVID-type scenario.

We reserve the right to change our mind!

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