A BLACK SWAN DELIVERS THE FINAL INSULT IN A DIFFICULT YEAR

HEDGE FUNDS (Inception)	NOVEMBER 2022	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund (March 2006)**	**-4.6%**	**-41.5%**	**8.1%**
Venator Select Fund (September 2013)	**-10.5%**	**-55.8%**	**5.6%**
S&P/TSX Total Return (March 2006)	5.5%	-1.0%	6.5%
Russell 2000 (March 2006)	2.3%	-14.9%	7.3%
S&P Toronto Small Cap (March 2006)	6.4%	-7.6%	2.9%
S&P 500 (March 2006)	5.6%	-13.1%	9.3%

ALTERNATIVE MUTUAL FUNDS (Inception)	NOV 2022	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund* (January 2020)**	**0.1%**	**-14.0%**	**-12.9%**	**0.2%**	**1.7%**	**4.9%**
B of A Merrill Lynch High Yield Index (August 2008)	1.9%	-10.5%	-8.9%	0.7%	2.3%	4.2%

** As of November 30, 2022*

*** Venator Founders Alternative Fund, which holds the same securities as Venator Founders Fund, is 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*

Getting to the point, November was a gut punch in an already very disappointing year. The entirety of our losses was the result of a single position (it was a profitable position for us prior to this month), that was subject to potentially materially adverse news related to a key supplier. Compounding the issue was that a doubling of the stock over the summer (owing largely to a 100%+ earnings beat in their most recent reported quarter and new institutional analyst coverage) put the stock in a top four position in the equity Funds heading into the news. The company is a $600MM in revenue "Contract Research Outsourcer" that provides discovery and safety research services to biotech, pharmaceutical companies, academia, and government. Unfortunately, a high-ranking government wildlife official in Cambodia and several employees of the industry's largest supplier of laboratory primates in that country (they supply close to 50% of the US market) were recently indicted for selling wild macaques mixed with bred animals and forging the documentation prior to export. With the supply related to 25% of the company's revenue possibly cut off for an indeterminate period, the stock plummeted by over 2/3rds during the month, most of which was within 24 hours of the news break. While this could throw 60%+ of the entire US drug/vaccine development pipeline into chaos for 3-5 years, the potential effect on our investment was more direct.

This "black swan" development was a hard hit in a year of disappointment for us overall. We suffered a lot of losses this year but few wins (most of which were intra-year buys). Some of those losses were deserved due to deteriorating fundamentals where we sold too late (even if ahead of the "bad news"; for example, several building product distributors that are still reporting massive earnings that will likely slow next year). Some of these losses felt undeserved in the cases where earnings consistently exceeded expectations (such as Uber, which has exceeded expectations in each quarter this year). Some were more nuanced (such as Walt Disney where parks and subscriber numbers exceeded expectations in contrast to other streamers and theme park operators that missed dramatically). Finally, some were just random negative events such as the situation outlined above, or a copper company where a chunk of lead fell into the ore separator halting production for several quarters!

The one major thesis we got wrong was the interest rate ceiling. We believed that inflation would drop dramatically by year end, as measured month-over-month (this is looking to be accurate), and that the Fed would recognize this by the fall (it didn't) and that interest rates would top out in the mid-3% range (they won't). We believed the Fed would halt the interest rate hikes and use the unwinding of its balance sheet as its primary tightening measure. An interest rate ceiling of under 4% would have cushioned the blow for bonds (long term government bonds dropped over 25% this year while shorter term government bonds are down 10%). It likely also would have slowed, rather than frozen, the housing market in terms of new home sales volumes, noting that prices were due to stall/decline regardless. A more manageable ceiling would likely also not create a refinancing issue among REITs and other sectors that need to roll debt every several years. While we are not sure the Fed will go all the way to 5%, as they are threatening, we do not expect a pivot/cut for at least twelve months once they have hit their target. That said, even a pause would be constructive, allowing debt issuers, home sellers/buyers, and growth industrials (i.e., capital projects and acquisitions) to better budget/build for their futures.

Another big macro we missed out on was the energy sector rally, which has been by far the strongest sector despite oil being flat on the year. While we can appreciate the balance sheet repair that occurred during the post-Russia/Ukraine price spike to $100+, the continued strong performance of energy companies during the recent 30% retreat in oil prices is something of an historical anomaly. We would not have predicted energy stocks would be so strong in the flat commodity environment, but it was the intra-year moves and the lag on new rigs deployed that resulted in outsized balance sheet repairing free cash flow. We don't foresee supply/demand being terribly out of balance, but oil is a geopolitical game, and by the time Russia made its move, oil prices quickly peaked for the year (as is usually the case during geopolitical events).

With all that said, our most disappointing stretch in 15 years comes down to the stocks we put in the portfolio. Some of our biggest losses were among our best researched and highest conviction ideas (including last month where we thought we had proprietary information on pricing and cross-sale success; the actual financial results will be irrelevant now). There were no crypto and no "20x sales" technology companies. There were no companies that were disproportionately COVID beneficiaries in terms of growth spikes or margin benefits. There were no cash hemorrhaging start-ups or "concept" stocks, such as nascent EV Tesla wannabees. We thought we were sidestepping the worst of 2021 bubble and simply didn't feel a need for a twitchy trigger finger because we were confident our companies were fundamentally sound and valued reasonably rather than speculatively. As much as we like to think of our strategy as "buy and hold", clearly we should have adhered more closely to two of my "Rules of Investing": there are other things to own, and you don't need to make it back the same way you lost it (not necessarily out of stubbornness, but just in terms of finding something else in a more favored corner of the market). It's better to watch a stock go from 10x earnings to 6x earnings because the earnings are going up than watch it go from 10x earnings to 6x earnings because the stock is going down (even if the earnings are also going up).

The Income Fund has not been as disappointing but still has a weak year nonetheless as rising rates lowered bond prices in general. This was compounded by some of our lower coupon convertibles, which didn't have the current yield to defend them. We have shifted the portfolio more towards traditional high yield given the current attractiveness of the bond market (there are a lot of 8% credits out there). The fund is currently yielding 10%+ (with one third of that being subject to capital gains for greater tax efficiency) utilizing minimal leverage and all underlying companies are public companies, which gives them comparatively easy access to refinancing options relative to private companies.

2022 has been a difficult year for many, but especially us as guardians of your investment capital. While we may be down, we remain optimistic about our investments; we see great values and promising secular themes on the other side of this cycle. We believe we are invested in great companies, with great prospects trading at what we believe to

be attractive valuations, especially in this difficult market environment. And, most importantly, we are heavily invested in our own Funds!

We reserve the right to change our mind!

Brandon Osten, CFA
CEO, Venator Capital Management Ltd.

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