MEET THE NEW BOSS, SAME AS THE OLD BOSS (HINT: REDMOND)

HEDGE FUNDS (Inception)	MAY 2023	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund (March 2006)**	**-2.7%**	**4.1%**	**7.7%**
Venator Select Fund (September 2013)	**-4.3%**	**7.2%**	**5.0%**
S&P/TSX Total Return (March 2006)	-4.9%	2.3%	6.1%
Russell 2000 (March 2006)	-0.9%	0.0%	6.6%
S&P Toronto Small Cap (March 2006)	-4.1%	-0.9%	2.6%
S&P 500 (March 2006)	0.4%	9.6%	9.3%

ALTERNATIVE MUTUAL FUNDS (Inception)	MAY 2023	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund* (January 2020)**	**0.7%**	**4.1%**	**-2.1%**	**5.0%**	**2.1%**	**4.1%**
Venator Founders Alternative Fund (July 2021)**	**-2.7%**	**3.5%**	**-19.7%**	**-**	**-**	**-**
B of A Merrill Lynch High Yield Index (August 2008)	-0.9%	3.7%	-0.2%	3.0%	2.9%	3.9%

** As of May 31, 2023*

*** 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*

Times remain volatile from a macro perspective, which makes for a continued tough environment for single company picking vs macro themes. This makes sense in some realms, such as resources, where a rising commodity lifts all boats regardless of individual fundamentals (if anything, it’s the riskiest marginal companies which benefit the most), and some sectors, like homebuilding, where reinvigorated new home buying and relative price stability benefit all in some capacity. Electrical infrastructure companies, another favorite theme of ours, can benefit everyone as the buildout continues with an added push on the previously stagnant data center market as AI has created renewed interest; companies may make differentiated products, but all projects need wiring and transformers. This contrasts with retail, for example, where rising and sinking tides don’t lift and sink all boats (The Gap vs Lululemon, for example).

The two dominant themes for May were Artificial Intelligence, punctuated by Nvidia’s stellar outlook (the quarter itself was nothing special at negative 13% revenue growth), and “The Debt Ceiling”, which has become a near annual event for the past ten years. The Debt Ceiling really isn’t worth the press it gets since it always gets resolved and there is always more money. To our knowledge, no one is forecasting a US budget surplus in the next ten years, so we can expect this to continue to be a recurring semi-annual theme for the next decade.

One theme that has started to get more press is the overall weakness of markets outside of the dominant top six technology stocks in the S&P 500, referred to in the financial community as a lack of market breadth. These stocks, representing about 1% of the index, are approximately 30% of the market value of the index, and some are the only members of the ultra-exclusive “four-comma-club”. The contrast becomes apparent when comparing the S&P 500 (up 9%) to the NASDAQ (up 24%) where these stocks represent close to 50% of the index, the Dow (which is flat), the Russell 2000 (which is flat) and the Equally Weighted S&P 500 (which is flat).

We try to be more focused on individual companies than themes. This means differentiating products, growth rates and valuations. This is also why more diversified indexes, such as the Equal Weighted S&P 500 and Russell 2000/3000, are more indicative of “stock picking” than the standard S&P500 and NASDAQ. It’s quite a bit of work to find the Homebuilders that trade at the lowest valuations and build in the better locations, and it can seem a bit fruitless to do this work in return for a little outperformance when you could just buy the whole sector and not worry about individual characteristics (our attraction to the sector was due to most of them trading below book value nine months ago). Likewise, there is a lot of filtering involved in finding those promising companies tied to the “electrification of everything theme” that have promising prospects but trade at extremely discounted valuations, in part because they aren’t in any of the main indexes.

While investing in Artificial Intelligence should carry differentiation, this hasn’t been the case, as investors take a shotgun approach and, as usual, can’t bother to note differences in approach in the early days. Firstly, what sparked the excitement is “generative AI”, which is largely language learning but can also encompass Images and coding as well as other applications. Most other forms of AI, such as vision technology, machine learning, and logistics routing have been around for quite some time. Apple’s Siri has been allowing natural language queries/instructions for years (“Hey Siri, wake me up at 7am!”). We like and own Uber which has been using AI for years, but we fail to see how generative AI is going to enhance its business prospects. Likewise, just saying you are going to use an OpenAI plug-in to allow natural language queries of an existing product dataset isn’t really “your AI technology”, nor is it likely to be materially impactful to those companies. For most companies, simply putting AI in their press release seven times when their product is essentially unchanged isn’t worth much from a value perspective; the easy analogy is adding a “dot-com” to your name 25 years ago in hopes of a valuation boost.

It's also worth noting that generative language models might be commoditized very soon. OpenAI and Google Bard are already nearly indistinguishable from each other and have the same strengths and weaknesses. Data walls are starting to go up for companies that have proprietary information (such as images that might have copyrights, or Twitter that is cutting off its feeds to these language learning models). We have yet to see what Meta/Facebook is planning which should be impactful given that they likely possess the richest store of conversational language (Facebook, Messenger, WhatsApp) and imagery/videos (Instagram, Reels) in the data universe.

Rapid developments are also possibly making previous slow-moving attempts at AI obsolete. We are seeing this with chatbot technology that has been widely used in customer service but is now considered out of date. Salesforce has had trouble getting their ten-year-old AI technology “Einstein” to reach broader acceptance within its customer base. Google has something to lose in search, even if they have been working hard on generative AI for over a decade; they are just trying to defend their turf. Adobe has something to lose since photo/video editing upstart generative AI competition is popping up everywhere.

Picking amongst the giants, portfolio holding Microsoft likely has the most to gain from the proliferation of AI, but at 30x earnings you do need to pay up for it. They have been early and have a lot of ways to win here. It can be through automated collaboration, through Microsoft Teams, better productivity though Office, coding productivity through GitHub, gaming through Xbox, or selling workload capacity/infrastructure for other businesses using Azure. Maybe Bing picks up, maybe it doesn’t. The point is that Microsoft has everything to gain, nothing to lose, and they are early; generative AI is additive to nearly everything they do, and it is not cannibalistic to anything they do.

This brings us to the "belle" of the ball: Nvidia. We don't own Nvidia. We flirted with owning it last year in the low-$200s but got out before it plummeted to $120 (this seemed like a good idea at the time). Nvidia has been unbelievable at transitioning to the next thing forever - from PC gaming chips, to cloud servers, to automotive electronics, back to console gaming chips and, recently, to crypto. Just as all these markets start to fall apart (sales were down 20% two quarters ago and getting worse), along came generative AI and the massive orders from already large and established cashed up software tech giants. Nvidia's power is analogous to Cisco in the late 1990s. Internet infrastructure build out was different back then in that everyone needed Cisco products. Now startups outsource computational power to Microsoft, Amazon and Google through the cloud, so we suspect 90% of the buying will be done by a handful of companies, and the "overbuying" of the late 1990s will not recur as capacity is rented from the cloud providers rather than bought by well financed startups. It will be a lot of buying and it will be fast and furious. Once the buildout is complete, these cloud "hyperscalers" will reap annuity/utility-like benefits for the next decade. This puts Nvidia in the catbird seat for a few years but leaves the big cloud services providers in the captain's chair for much longer. We would rather pay up for the longer tail opportunity vs the shorter-term supernova, which is why we favor Microsoft over Nvidia here. That said, Nvidia always finds the next new new thing!!!

From a more "third derivative" perspective, we are excited about the prospects for electrical infrastructure. There are probably about twenty good investible companies in this space from a direct perspective, but we have been focused on a handful of well run and cheap stocks (most companies trade between 15-20x earnings while our companies all trade at 10x or less). Recently, the slowdown in datacenter build outs has been a fly in an otherwise attractive ointment which included onshoring, infrastructure refreshing/hardening, renewable energy infrastructure and EVs. We have two particular companies that we are excited about. Wesco is the largest distributor of electrical products in North America. Because they aren't product specific and rather sell everything to everyone, they are a pure play on the market dynamics. While we are not about to buy into management's views that "what were once cyclical markets are now secular markets" we do believe that the build out cycle is likely to be an extended one that could last for a decade.

The other interesting opportunity is right up the 401 in Waterloo. We owned Hammond Power years ago and only re-entered the stock in the back half of last year. They are the leader in dry-type transformers and everything electrical needs a transformer. It's a tight market, which is why margins have been moving up lately. The company is currently going through an expansion to handle what it thinks is a bright outlook through the end of the decade. While it is difficult to handicap future margins in what has historically been a volatile margin industry, we suspect that current margins in the low 30% range could hold for longer than in the past. This is from analysis of other companies in the same universe that do a lot of custom/made to order products, and because there just aren't many reliable transformer manufacturers around.

We reserve the right to change our mind!

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