WHEN THE CURE IS THE DISEASE

HEDGE FUNDS (Inception)	SEPTEMBER 2023	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund (March 2006)**	**-6.5%**	**9.8%**	**7.9%**
Venator Select Fund (September 2013)	**-9.5%**	**11.6%**	**5.3%**
S&P/TSX Total Return (March 2006)	-3.3%	3.4%	6.1%
Russell 2000 (March 2006)	-5.9%	2.5%	6.7%
S&P Toronto Small Cap (March 2006)	-5.2%	-1.1%	2.6%
S&P 500 (March 2006)	-4.8%	13.1%	9.3%

ALTERNATIVE MUTUAL FUNDS (Inception)	SEP 2023	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund* (January 2020)**	**-0.6%**	**6.2%**	**5.2%**	**2.5%**	**2.0%**	**4.1%**
Venator Founders Alternative Fund (July 2021)**	**-6.7%**	**8.5%**	**-1.6%**	**-**	**-**	**-**
B of A Merrill Lynch High Yield Index (August 2008)	-1.2%	6.0%	10.2%	1.8%	2.8%	4.2%

** As of September 30, 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*
***** Venator Offshore Fund is available as the US dollar version of Founders Fund strategy*

With scarce corporate news in the month of September (few companies report in the third calendar month of the quarter), the Fed got the spotlight and filled the vacuum with inflation jawboning. The higher forever narrative sent broad markets tumbling, even though they did not raise rates. The shifting to the “dot plots”, a measure not many had heard of until six months ago, and an ever-shifting and unreliable narrator of Fed rate expectations going out over a year, did all the talking in the absence of actual action. If future moves are going to be “data dependent”, then why are we paying attention to loose 18-month rate projections without any data related to the future (yes, that doesn’t make any sense, neither do dot-plots)? Markets were broadly down on the hawkish narrative, with the equally weighted S&P500, Russell 2000, and Toronto exchange all threatening negative territory year-to-date. The “magnificent seven” is about the only thing holding up the more publicized cap weighted S&P500 at this point.

In the Spring of 2021, we wrote about the coming bout of inflation. Our primary source: corporate earnings conference calls. At the time, the Fed didn’t see any, perhaps because they focus on hard data, which is trailing data in that it reflects things that have already happened (even the “leading indicators” are trailing data). Corporate conference calls contain true leading data. When a company says that they expect to raise or lower prices, or they expect their suppliers to do so, that is a true “leading” indicator that will not show up in the data until the prices are adjusted and the products are purchased; only then does it go into the economic record.

Now we are hearing the opposite. Input costs are down: copper, lumber, lithium, transportation, natural gas, solar panels, rent, steel, semiconductors (except Nvidia GPUs), fasteners, and agricultural products to name a few. Supply chains have a lot of excess capacity. The only “shortages” we hear about nowadays are labor, GPUs and transformers. Even house prices are down a bit on the surface, although they are up a bit on an apples-to-apples basis as

homebuilders have been lowering costs to help affordability (think 2” baseboards vs 4”, lower price base countertop materials and hollow doors as examples).

Indeed, the only two real inflationary factors left are labor costs (which have flattened out in non-union environments) and interest rates. In Canada, our “hot” inflation number, which for some reason the US markets paid attention to on release (slow news day), was almost entirely a function of mortgage rate resets, which isn’t a problem in the US due to their 30-year mortgages vs our 5-year mortgages. In other words, central banks are now the main creators of inflation, which seems counterintuitive given that they are trying to bring inflation down. What’s more, they seem completely oblivious to their role in propping up the last remnants of inflation – borrowing costs in a levered society. We do understand higher for longer – 5% is not a particularly restrictive interest rate level (see the 1990s). But raising rates beyond current levels would be counterproductive to bringing down inflation. Whether all the Fed members are reading off the same “hawkish” script for rhetoric, or whether they are serious about another hike, we do not know.

It is also worth noting how corporate growth has slowed. “Defensive” companies in the food sector are largely looking at volume declines, even if their total revenues are showing some slow growth owing largely to “mix” (pricing up due to packaging where you get a little less in the box). Indeed food, telcos, healthcare, pets, and utilities have been among the worst sectors to own this year. Delayed construction, due to increased finance costs, has slowed the materials sector. Even within software, which has leaned into AI-hype, growth is way down across the board, with self-proclaimed AI “leader” Palantir looking at sub-20% growth; self-proclaimed AI play Oracle looking at sub-10% growth (largely thanks to a large healthcare acquisition last year); perpetual 20% grower Salesforce.com seeing its growth cut in half to 10% among other notable names. Even Tesla’s growth has been halved while earnings will be down this year vs 2022.

Last month was a broad challenge. With the exception of energy, nearly every sector sold off in lockstep. We are a bit surprised by some of the values being presented out there, although perhaps we shouldn’t be as your average stock is down between 10% (large cap) and 20% (small cap) since the beginning of last year. There are opportunities in these markets. There are homebuilders that have retreated below book value with no debt, earnings, and a low likelihood of land impairments given shorter term inventories. There are secularly attractive infrastructure companies trading below 10x earnings. There are great multi-year compounding growth companies trading below 15x earnings.

The majority of our losses amidst this recent market selloff are stocks giving back gains, rather than outright losses. MI Homes going from $100 to $84 in the month is not a small move after more than doubling to its high. Meritage Homes was up 60%, now it’s up 30% and trading below book value. Hammond Power, another double-plus performer this year, has retreated a similar 15%. Skechers is only up 17% after being up 34%. These are good companies with bright prospects facing market turbulence.

In some cases, we have gotten “stopped out” of winners and are sidelined until they show some stability. In the case of Beazer Homes, we were “stopped out” of the name at a 30% gain after being up 65% earlier in the year; Beazer is the most discounted homebuilder to book value and we look forward to buying back into this stock in the future. Wesco was up 50% on the year, but we got stopped out after a retracement that left us with only a 20% gain; another stock we look forward to re-engaging as we see substantial multi-year upside in this pre-eminent supplier to the electrical industry. This selloff has brought up a very rich “roster” of companies we want to own with substantial upside should the stocks show some stability.

On the bond side, short term government bonds may look attractive at 5%, but short-term corporates look really good at 8%-plus. The negative narrative is largely on longer term bonds over 10 years. It has been a long time since people have been able to get equity like returns with bonds over shorter-term horizons as we can today. Plus, there is the added benefit of many of these bonds trading below par which gives them a capital gain component that you don't get in government bonds.

The market works in cycles. The inflation cycle appears largely over. We would assume at some point that means that the rate hike cycle will end with it (the Fed still has the shrinking of its balance sheet as a tool they are using). Infrastructure has to be refurbished and built. New homes need to be built, and existing homes need to be repaired or torn down. PCs and phones need to be updated. Copper supplies need to be replenished. Clothes, shoes and sports equipment get worn out and need to be replaced. Cars need to be replaced. Energy has to be replenished. Companies need to restructure into a stronger position. People retire and need to be replaced. Some companies are priced as though this won't be the case. Those are the ones we have our screens on.

We reserve the right to change our mind!

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