2023 YEAR IN REVIEW

HEDGE FUNDS (Inception)	DECEMBER 2023	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund (March 2006)**	**10.5%**	**32.8%**	**8.9%**
Venator Select Fund (September 2013)	**13.1%**	**40.0%**	**7.5%**
S&P/TSX Total Return (March 2006)	3.9%	11.8%	6.4%
Russell 2000 (March 2006)	12.2%	16.9%	7.3%
S&P Toronto Small Cap (March 2006)	3.8%	4.8%	2.9%
S&P 500 (March 2006)	4.5%	26.3%	9.8%

ALTERNATIVE MUTUAL FUNDS (Inception)	DEC 2023	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund* (January 2020)**	**3.4%**	**12.1%**	**12.1%**	**1.1%**	**3.5%**	**4.3%**
Venator Founders Alternative Fund (July 2021)**	**10.5%**	**31.5%**	**31.5%**	**-**	**-**	**-**
B of A Merrill Lynch High Yield Index (August 2008)	3.7%	13.5%	13.5%	2.0%	5.2%	4.5%

** As of December 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*
***** Venator Offshore Fund is available as the US dollar version of Founders Fund strategy*

What a wild finish to a wild year. Your average stock was up 10% by February, down on the year by March, up 10% by July, down 5% by October, before finishing the year up just over 12%. That's five full year-type moves in one year. The Fed sure kept this market on a string with inflation talk, "higher for longer", ever changing unreliable "dot plots", and finally an unambiguous commentary about the end of rate hikes and a hope for cuts in 2024. Rate narrative was the largest factor driving the broader markets, with impacts on financials, housing, bonds and consumer spending. While artificial intelligence, spurred by the emergence of ChatGPT (which no one talks about anymore), inspired a narrower subset of stocks, dubbed "the magnificent seven", are so big, they had massively outsized impacts on the prominent indices. Finally, with market seers deciding they wanted to look at perpetually underperforming "small caps" in November without doing actual company research, small caps ripped off a furious and highly correlated two-month 25% rally with nearly all stocks participating (it's too bad mid-caps don't have such a prominent ETF as they got left in the dust this year). Let's look at some of the factors that influenced 2023 and extrapolate the implications for 2024.

The Magnificent Seven: You can't talk about 2023 without talking about the Magnificent Seven Stocks (the successor to FAANG), six of which are the largest six market caps in the S&P500 (Facebook/Meta is still under $1 trillion). Don't buy tech in 2022 turned into only buy tech in 2023. They all benefitted in lockstep as the Magnificent Seven turned into a "sector". This despite massively missed expectations by Tesla as EV slowed down dramatically, Apple turning into a slow/no-growth company without a "one more thing" growth prospect, and Google having more to lose than to gain from AI. The Magnificent Seven represents 50% of the NASDAQ (up 45% on the year), 30% of the S&P500 (up 25% on the year), and 1.5% of the equal weight S&P500 (up 12% on the year), just to give you a sense of their influence by virtue of market cap. We think this group will be fractured in 2024, leaving the market searching for a new acronym. Google must prove its ability to hold market share in the face of AI search and ad spending. Meta must prove it can do more than cut costs. NVIDIA needs to hold off price competition from "good enough" tighter smaller generative AI model semiconductors (vs ultra-large language models). Tesla needs to reinvigorate its growth rate in a slowing EV market where it needs its "next big thing". Apple must hope that the market maintains its patience with GDP growth while it searches for its next leg of growth. Microsoft and Amazon would be the two companies we see continuing to push forward in 2024 as they have longer tail "nothing to lose" opportunities in AI.

The Rise of AI: Every company jumped on the AI train by mid-year. Our personal favorite was the golf industry where TaylorMade had AI developed irons and Callaway had an AI putter (we doubt they were thinking about the AI marketing angle when they were developing these products in 2022). Financial products became AI enabled credit check algos, streaming services became AI in content (AI is usually the villain), and some software products were rebranded as AI without any discernable changes to the products. Company descriptions on screening databases were changed to incorporate AI and conference call transcripts were inundated with AI mentions in hopes of getting attention, but most of these companies' prospects were not impacted by the AI messaging. Salesforce.com, probably the most aggressive AI marketers outside of Microsoft, saw its growth rate cut in half. Another early AI marketing software vendor was Oracle, reinvigorated early in the year with aggressive AI messaging, but ultimately missed its last two quarters in 2023 after failing to live up to its early year self-promotion. We think in 2024, many companies, especially in technology, are going to have to turn the AI messaging into financial reality which could prove a difficult task given how myopically they have set up expectations for accelerating AI fueled growth in the back half of 2024. Among the household names, again Microsoft, whose growth rate has accelerated for the last several quarters, seems best suited to fulfill market views of better growth ahead.

Banking "crisis": Remember the banking crisis in the wake of Silicon Valley Banks' failure? Neither does anyone else. Higher rates are supposed to be good for banks, but proved anything but as the market's learned, thanks to Silicon Valley Bank, that assets do have market value even if you don't need to show it as such on your financial statements. Several other large regional banks nearly went under or were bailed out. We don't generally invest in US regional banks, but it was a dominant theme for about six weeks last year and worth mentioning.

Homebuilders: This sector was sneaky good and the second-best performing space behind semiconductors last year. It just doesn't get the hype and the financial media seems confounded by moves in the sector beyond economic data narratives, such as mortgage rates and monthly home sales. No one ever talked about book values, cheap earnings ratios, material business model shifts, and a long-term housing shortage; although they are talking about these factors now as they brush up on their knowledge of a hot sector. The revelation for the market in the face of higher mortgage rates was that when it comes to home purchases, you "Marry the House but Rent the Rate"; the house is yours, but you can refinance the rate lower if rates come down (you can't do this in Canada). With the existing home sales market frozen, pricing is about the same for new vs existing homes (average age 40 years and in need of post-purchase renovations), and homebuilders can "buy down" rates for buyers, a double whammy competitive advantage of new over existing homes. This led to a really strong year for homebuilders despite miscalculating their 2023 plans by scaling back coming out of 2022. For 2024, these companies are facing strong prospects, easy comparable results in Q2/Q3, and still reasonable valuations. We remain quite bullish on the sector in 2024 but are getting more selective as valuations have risen vs where they exited 2022.

Energy Never Changes: Remember last year when oil was over $100 and natural gas was over $9.00 and all the producers told us that they will maintain "capital discipline" in order to help keep prices propped up. One year later, North American capital budgets are again on the rise despite lower prices, OPEC has spare capacity, and it appears that there is enough floating LNG capacity to handle all of Europe's needs without Russia, a bearish sign given all the scheduled LNG capacity scheduled to come online in the next five years. Oil and gas producers simply can't help themselves from increasing production, except perhaps Saudi Arabia. Barring an escalation in Middle East tensions, we imagine energy will be "stuck" in 2024 without a plausible shortage narrative and a possible multi-year surplus narrative as new production needs to get absorbed.

Crypto is back?: Bitcoin was up 150% this year. We found this a bit surprising given that the narrative of "the future of money" no longer exists. No one thinks crypto will replace money in the future. The media has stopped writing about it fundamentally (they only write about it in the sense of "it's up/down"). Many of the most prominent crypto organizations have been discredited in very public ways. It is impractical and unnecessary as a product/commodity/currency/sector. That being said, if there is enough liquidity and float (as measured in dollars) to trade it, it will be traded. And therein lies the "value" of cryptocurrencies. It's in charts and cost of mining and the occasional self-contained story such as a "fork" or an ETF. But at this point, moves seem to be determined by randomness and chart-following algos rather than any fundamental developments. Frankly, we would sooner own gold, the OG non-fiat alternative, which has had a nice but quieter run of its own.

Still waiting on that recession?: Two years of recession calling and we're still waiting to see it. Did the Fed actually pull this "soft landing" off? It's probably too early to tell given lagging policy effects, but it does appear that any recession will likely be mild, and it also appears possible that waiting on it was financially costly, at least for this year. Unemployment remains low and inflation appears largely tamed. Furthermore, we are heading into a "good news" election year, which is not an unimportant consideration. Employment remained strong and the consumer showed up for Christmas, as they are known to do (there's an old investment saying: never bet against the US consumer). Finally, three-month-old, pre-Fed pivot expectations from the last two quarters have kept 2024 expectations subdued and beatable. As we noted last year, and as 2009, 2020 and now 2023 have shown, the fear of recession is often worse than the recession itself when it comes to stock market performance. Historically, the stock market "calls" more recessions than actually happen. It's best to keep that in mind when listening to financial media. Not that we don't appreciate the efforts of economists, it is just that there have been so few recessions in the past 50 years that the sample size is too small as to draw any reliable conclusions from the analysis.

Has "stock picking" been replaced with "sector picking"?: It pains us to say this, but stock picking is still in a coma, replaced by sector picking. It's gotten so bad that we have had to make up sectors in order to keep avoiding the work of individual company, financial statement and valuation analysis. As mentioned earlier, "The Magnificent Seven" was a highly correlated sector, even though Tesla, Amazon and Meta have nothing to do with each other. Oracle had an early year run which was attributed to "AI", while no one noticed SAP having a similar run despite no real AI narrative – high correlation by virtue of being in the same sector/ETFs (both got to "coattail" their way to similar returns to enterprise software leader Microsoft). We understand that some sectors have high correlations especially when the driving factors are so similar: housing, banking, energy, metals, transportation, even retail to an extent. But ETFs and algorithms have moved these correlations to a new level. The biggest evidence of this is the rally in "small caps". For the last month, small caps are what the media has focused on. Ask which ones? No one seems to care. Small caps are a sector for now – like energy or financials or semiconductors. Investors that don't know or like the risk or work of individual companies just chase the Russell2000 ETF, some computer algos might chase the more liquid of its constituents. There have been some massive, undeserved moves in many fundamentally challenged Russell2000 constituents, in some cases 100%+ moves only weeks after massive quarterly misses. Why bother going through the hassle of "picking and choosing" when the Russell2000 jumped 25% in eight weeks. We think "stock picking" in this environment could prove more about what not to own in 2024 as the wheat gets separated from the chaff.

HOW WE ARE POSITIONED FOR 2024 IN EQUITIES

We have made no secret of our bullish outlook for US housing over 2023, and we are still bullish in 2024. We see this as a five year-plus opportunity. It is the largest sector in our portfolio at 40%, and we are always looking to add exposure should the right opportunity arise, although some of the stocks do seem poised for a pause as they reach towards relatively high valuations by historical standards. We see a robust year for units sold after a subdued 2023 as demand surprised to the upside, catching all but DR Horton off guard. We also look for better margins as lower mortgage rates will lead to less rate buydown incentives, the biggest headwind to margins in 2023. Unit growth should surprise to the upside through the summer, while margins should be the story of the back half of the year. We think Canada is headed in the opposite direction as our shorter-term mortgages are going to be refinanced at higher rates which should negatively impact consumer spending and could lead to a flood of houses for sale if people can't afford the higher mortgage rates. This is why we are more positive on the US than Canada as a general statement.

We have also been building a good position in building products and distributors. This sector carries a little more nuance than builders as they often have exposure to the repair and renovation market. Recall, the average age of a home is 40 years old, which requires a lot of this. After new project starts grounded to a halt in mid-2023 and trade backlogs started to wear off, year-over-year comparable results should start getting easy by the back half of 2024. Many distributors that trade at modest multiples should be firing on all cylinders by the time Q3 rolls around, and we imagine this will be a prosperous place to be this year.

One of the more esoteric ways to invest in homebuilding is land developers of which there are few and they are scarcely covered by the Street. Homebuilders have been focused on getting "land light" as a way of freeing up capital and untethering their valuations from book value (such is the perceived value that builders are willing to sacrifice 15% of their gross profit dollars to buy developed land rather than banking and developing themselves). This means more business, growth and margin for the land developers, and the few public ones have significant financing advantages over the private ones.

The rest of the portfolio is thematically diverse. The second largest thematic sector would be non-residential construction at about 15%. We are bullish on infrastructure spending in an election year and electric grid upgrading. Beyond that, it's largely a special situation portfolio with consumer products, technology, and medical technology. We don't currently have any resource or financial exposure and don't anticipate any long energy exposure currently. Despite the recent run up in equities, we are not finding it hard to find value and growth right now. Even our biggest winners from last year, Hammond Power (15x earnings) and MI Homes (8x earnings), don't seem particularly expensive noting neither has any net debt.

HOW WE ARE POSITIONED FOR 2024 IN DEBT

It was a good year for corporate high yield bonds, and we expect 2024 will be more of the same, assuming rates stay stable at worst and go down at best. Our own portfolio of over 30 bonds suggests 10% returns are achievable over the intermediate term, better on an after-tax equivalent basis for taxable accounts. Refinancings should be less punitive with ten-year rates down significantly, which could lead to some early "calls" resulting in acceleration of gains prior to maturity. Perhaps the only holdback to a great year is the central bank rates of 5%+, which makes leverage unnecessarily risky as the cost of leverage doesn't justify the 1-2% "spread". As a result, our use of leverage is still minimal. We would also note that currently all of our debt is backed by public equities which tend to have better refinancing options vs private debt/credit.

We reserve the right to change our mind!

On behalf of the entire team at Venator Capital Management Ltd., we wish you a happy, healthy, and prosperous 2024!

Brandon Osten, CFA
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