SUPERSTOCKS!

HEDGE FUNDS (Inception)	MARCH 2024	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund (March 2006)**	**8.9%**	**11.0%**	**9.4%**
Venator Select Fund (September 2013)	**13.0%**	**16.0%**	**8.8%**
S&P/TSX Total Return (March 2006)	4.1%	6.6%	6.7%
Russell 2000 (March 2006)	3.6%	5.2%	7.5%
S&P Toronto Small Cap (March 2006)	7.5%	7.9%	3.3%
S&P 500 (March 2006)	3.2%	10.6%	10.3%

ALTERNATIVE MUTUAL FUNDS (Inception)	MAR 2024	YTD	1-YR	3-YR	5-YR	10-YR
Venator Founders Alternative Fund (July 2021)**	**8.9%**	**10.6%**	**34.2%**	**-**	**-**	**-**
Venator Alternative Income Fund* (January 2020)**	**1.9%**	**3.3%**	**10.9%**	**0.4%**	**3.4%**	**4.1%**
B of A Merrill Lynch High Yield Index (August 2008)	1.2%	1.5%	11.0%	2.2%	4.0%	4.4%

** As of March 31, 2024*
*** 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*

The first quarter of 2024 was indeed a strong one. The bears are in hibernation and the recession hawks are questioning whether the economic cycle matters for investment returns. The wall of worry has crumbled as no one wants to miss the party. It’s an election year and “the bottom of the cycle”, which are twin towers of bullishness. In a world dominated by price momentum, nothing is ever “built into expectations” – the market just follows the news flow like never before. We are neither bullish nor bearish, but valuations look a little stretched across the board as growth rates look weak relative to the hype cycle. It is difficult to reconcile market strength with financial results as we are not bouncing off a bottom, we are extending tops.

The S&P 500 has been the king of “diversified” indexes, up 180% over the past 10 years. It has blown away the returns of the small cap Russell 2000 (up 84%) and the “equally weighted” S&P 500 (up 135%). It has done this largely on the back of “SUPERSTOCKS!” (a term apparently coined by financial historian William Bernstein), once the FANGS, then the FAANGS, then the Magnificent Seven and soon to be the Elite Eight (Berkshire and Eli Lilly in, Tesla out; although pharma companies should probably never be in this category as their competitive advantages are never sustainable beyond their patents). The S&P 500’s “secret” lies in the top 10 stocks representing over one-third of the value of the index, while the other indices remain “diversified”. This is perhaps the most important distinction for portfolio managers, or simply those that manage a portfolio. This is not about concentration per se, or conviction regarding your favorite investments. Nor is it about anti-diversification, for no manager marketing a diversified 500 stock portfolio would ever be putting 33% of it in 2% of the holdings. This is about SUPERSTOCKS!.

We all know what a SUPERSTOCK! is. It’s basically a 100-bagger, “once in a lifetime” opportunity that seems to come about more often than you might think. It’s Apple, Microsoft, Amazon, Nvidia, Tesla, Cisco (circa 2000), Fastenal, DR Horton, Netflix, Monster Beverage, Nike, Starbucks, Home Depot and Berkshire. In Canada, it can be Constellation Software (up 14,000% from its IPO) or Boyd Group (up 11,500% from its IPO), or current holding Hammond Power Solutions (up 13,000% from its IPO).

SUPERSTOCKS! don't go up in a straight line either. People tend to forget that Apple almost went bankrupt and needed a bailout from Microsoft, Amazon suffered major 50%+ declines on three occasions, Nvidia dropped 60% a few years ago, DR Horton had to go through the housing crisis, while Netflix and Meta both took 65%+ hits several years ago. This is why active managers of portfolios "trim" their winners – because if you are fortunate to own one of these SUPERSTOCKS!, they can become a disproportionate part of your portfolio.

But you know who doesn't trim their winners in the interest of not over–concentrating the portfolio? The S&P 500 (historically this group has also included venture capital as they were fortunately "stuck" in their biggest winners until a liquidity event)! The equally weighted S&P 500 trims through rebalancing and the Russell 2000 "graduates" stock out of the index like a high school, for nearly all SUPERSTOCKS! only became one because they started small with a ton of runway (going from a $20B IPO valuation to a $500B valuation is great – but not a SUPERSTOCK! ($20B is what it takes to get you into the S&P500 nowadays). Because we live in an age of SUPERSTOCK! domination of indices, and passive investing throwing increasing amounts of money at the same companies (fun fact, the two largest shareholders of Nvidia, Blackrock and Vanguard ETFs, don't know or care what Nvidia does), SUPERSTOCKS! have allowed the two market-weighted indices (the other being the NASDAQ 100 where the top 10 holdings represent nearly half of the portfolio) to completely dominate the rest of the financial markets.

There are two difficulties in winning with SUPERSTOCKS!. The first one is finding them. The second is holding them. The first part isn't as hard as one might think, despite the "needle in the haystack" analogy. Sure, the S&P500 has a bit of an advantage in that it owns all 500 of the largest stocks in the US so it doesn't need to "discover" the SUPERSTOCK!; it just lets the market gods sort them out. But market enthusiasts have heard of most SUPERSTOCKS! early enough in their emergence to benefit. At various times in our own history, we have been "early" investors in Tesla (at the bottom of COVID when no one thought they would turn a profit), Boyd Group (coming out of the 2009 financial crisis) and Apple (when the iPhone 3 was released).

It's the second part, the holding of the SUPERSTOCK!, that is the tougher part. How often do we hear some commentator in the financial media talking about their winners and say that after a big run they are "trimming their position" or "taking a little off the table"? This is often done at a recent high. The question is, why? What are these advisors afraid of? Making too much money? We suppose there is a fear of giving back your gains, but generally speaking, people buy stocks that are doing well, so selling a strong stock chart to buy another strong stock chart, doesn't make a lot of sense unless you have reason to believe your current winning holding is going to falter.

You have likely heard the saying "you don't lose money by turning a profit"; we have always thought the rebuttal should be: it depends on how you redeploy those profits. When it comes to SUPERSTOCKS!, it is worth noting two of our rules of investing: We have never seen a stock go from $10 to $100 without passing through $30 first; you don't own a 10-bagger if your post-trimming averaged out price is less than 10x, even if your last share is sold at 10x. It is worth noting that Warren Buffet has allowed his Apple holding to rise to 50% of his public portfolio (it is up 600% since he first bought it).

From a portfolio diversification perspective, it's difficult to avoid the tendency to "manage weights", which brings another rule to mind: not everything is going to go up at the same pace. Basically, we are saying not to be afraid of overweight positions that became overweight through appreciation. This is the mistake we made with Boyd Group, a stock we initially bought at $3.50 (spring 2009) and trimmed and trimmed and trimmed before eventually selling our last share at $100 (early 2018). While we haven't quite done the full accounting, we would imagine our average selling price per share was probably below $50.00.

This is a mistake we have not repeated with Hammond Power, the bulk of our position which was purchased less than two years ago at $12.00 (in fact we originally bought Hammond Power way back in 2006 at $4.00 and sold at $10.00 but re-entered the position two years ago on our electrification of everything thesis). Last Friday, Hammond reported a great quarter and went up by $18.00, more than our original cost base, and solidifying its fully owned and held 10-bagger status in the portfolio. As a result, Hammond is approaching a 20% weight in the portfolio which seems large but selling half at $40.00 and half of the remainder at $80.00 doesn't seem like it would have worked out for the better. Even if the stock missed a quarter or the narrative changed, and it dropped 20%, we would still be better off for having held every share until then vs trimming for the sake of diversification.

Granted, you can't always hold forever. No one is regretting selling their Cannabis stocks (Canopy Growth was briefly a SUPERSTOCK!) after achieving some fantastic gains. Facebook/Meta reached SUPERSTOCK! status briefly before dropping 75% and subsequently rebounding. Nvidia didn't lose its SUPERSTOCK! status in 2022 but it did drop over 60% that year. Cisco is a SUPERSTOCK!, up 60,000% in 35 years but still 25% below its 2000 peak. We believe fundamental analysis and our internally developed technical models can help mitigate these inevitable setbacks, but it's still worth noting that there is more to SUPERSTOCKS! than blindly buying and holding your winners.

Obviously, it takes a lot of time and luck to turn a great stock (10-bagger) into a SUPERSTOCK!. It probably starts with a cheap valuation, which can often give a stock a 200% head start. You probably also need a business that is resistant to change (the world will always need transformers, home repair retailers, like Home Depot, and shoes, like Nike and hopefully portfolio holding Skechers). Either that or you need a business that can adapt to change (Microsoft and Apple vs Cisco and Research in Motion/Blackberry). Maybe you find a management team that is a great capital allocator, as is the case with Boyd Group and Constellation Software.

The point is that the SUPERSTOCK! can come from anywhere. It starts with a double, then becomes a 10-bagger, and then another 10-bags and you have a SUPERSTOCK!. Just don't fear the winner. Every SUPERSTOCK! had to start at $10.00 and found its way through $20.00 and $100.00 on its way $1000!

We reserve the right to change our mind!

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