

## PROVE IT!!!

The Venator family of funds finished the year like everything else...on a high note. We saw increases in all of our Funds, and all were up comfortably over the 2008-2009 timeframe, while markets were generally down. But this monthly commentary isn't about last year, it's about next year.

Instrument	December's Return	Year-to-Date	Jan 1, 2008 to Dec 31, 2009	Since Inception (March 1, 2006)
Venator Founders Fund <sup>1</sup>	3.2%	40.3%	12.4%	71.9%
Venator Income Fund <sup>2</sup>	5.4%	42.6%	30.1%*	N/A
Venator Catalyst Fund <sup>3</sup>	0.9%	12.6%	17.7%	N/A
TSX Composite	3.0%	31.3%	-14.7%	0.9%
Russell 2000	9.5%	27.2%	-17.0%	-11.6%
S&P Toronto Small Cap	9.3%	60.8%	-16.0%	-16.4%
S&P 500	1.8%	23.5%	-24.1%	-12.9%

1. The performance of the Venator Investment Trust approximates the performance of the Venator Founders Fund.
2. YTD of Fund is net of distributions reinvested. The benchmark of S&P/TSX Income Trust is no longer relevant as the Fund is now comprised of a high proportion of bonds. \*30.1% refers to the since inception (August 2008) return of the Fund.
3. The Venator Catalyst Fund has no benchmarks.

Those of you that have been with us from inception are aware of our inability to embrace panic and euphoria, and our tendency to remain somewhat sanguine in the face of even the most unprecedented volatility. Indeed, we are a hedge fund, and our active hedging program affords us the luxury of avoiding the gut-wrenching swings some investors have experienced in the past two years. In mid-2008, we were warning that prevailing market conditions (specifically commodities, emerging markets, private equity and valuations) were not as rosy as people believed. In our March review last year we were quite clear that valuations were too low, and that things weren't as bad they seemed.

That being said, we haven't been the greatest economic forecasters. While we thought things weren't so rosy back in mid-2008, we never said that we thought the economy was going to collapse. Conversely, while we didn't believe that the world was coming an end in 2009, we never suggested that a pronounced, rapid and extended economic rebound was in the offing either (this has yet to play out, but it is what the market is expecting). If we are to believe that 2010 is still an ongoing process/story that began in 2008, and that continued volatility is suggestive of uncertainty rather than momentum, then we can assume that the market is not its traditional "discounting mechanism", as it has been a somewhat incorrect forecaster of events for the past several years; that's what continually reversing volatility means. So, as it was in mid-2008, and early-2009, we will not be using the current direction or level of the market to develop our views. That being said, *we do believe that the economy is stable as a worst-case/base-case scenario, so the question becomes: "Will we grow, and if so by how much?"*

In our opinion, the market is currently forecasting an aggressive rebound and long-lived economic expansion. To arrive at this conclusion, we are looking mainly at cyclical investments. While less cyclical companies are trading inexpensively relative to the market in general (i.e. IBM's near historic multiple discount relative to the S&P500), many cyclical companies are trading rather expensively, even for cyclicals coming out of a recession. One of the reasons why these stocks seem so expensive to us is that operating margins didn't collapse during this recession, as is typical. Costs were cut quickly to adjust to the lower revenue levels, which suggests to us that expenses will likely rise quickly if these companies start growing again. Therefore, many of the expectations we are seeing of 5%-10% annual revenue growth resulting in 15%-20% annual earnings growth for the next several years may prove optimistic on at least one of these measures. Furthermore, even if these predictions come true, many stocks still appear expensive on this basis. Finally, while no one wants systematic deflation, prices of cyclical products have remained quite high in the face of low capacity utilization levels, indicating an expectation of rapid demand growth of 15% per year for the next two years.

Put another way, this is going to be a year of proving out the 2009 rally. We believe there is the potential for a lot of disappointment, particularly towards the end of the year. While first half of 2010's numbers will look good relative to the disaster that was the first half of 2009, the second half of the year will be the true test of whether there is any real growth in the economy. With supply capacity still high, growth will have to come through or prices could start to collapse -- and stocks with them. While we are not necessarily saying that the back half of the year will disappoint, we are saying that expectations are running high, and that a strong 2010 cyclical recovery is already priced into market.

So how do we see 2010 unfolding?

We think 2010 can start well but end poorly. We recognize that this is the consensus view, but we think it's right. There are a few reasons why we believe this. The first quarter of the year should look pretty good when compared with the first quarter of last year, which could sustain the possible mirage of an economic rebound. Also, the bulk of the government economic stimulus plans are expected to be spent in the first half of the year, which can keep numbers strong through Q2. As the back half of the year descends upon us, governments should start looking to raise rates back up to a more normalized level of 2%-3%, most commodities will likely still be in an oversupplied situation, and the expectations of real growth will be put to the test in Q4 when the year-over-year comparisons get tougher.

Last March we suggested a rally might be in the offing as the market gradually realized that, come December, things would not look so bad relative to Q4 2008. March of this year (when everyone finishes their quarterly models for 2010) analysts may start to realize that December 2010 results aren't quite set to show a return to growth versus December 2009. *One word of warning though:* the one thing that could screw everything up for the year is full-year guidance given early in the New Year. When the Street is expecting 7% revenue growth and 15% earnings growth, but corporations have yet to see the rebound in the economy, it could be difficult for them to guide to the Street's satisfaction.

To this end, we believe that there are enough pushes and pulls to suggest a US market in a -5% to +10% range, but weakness in commodities towards the end of the year could hurt the Toronto Exchange so we see a little more risk there, putting it in a range of -10% to +10%. These are admittedly fairly wide ranges, but we believe we can make money, and market-beating money, under these scenarios (but as always, we aren't going to guarantee it!). With regard to our Income Fund, our expectation of modestly rising interest rates combined with our assessment of a stable economy puts us pretty much where we are invested. Namely, in short term (1-5 year maturity) bonds of strong and stable, but not blue-chip, companies. On the equity side, we are invested in high yielding, but non-cyclical companies.

We are looking forward to the year ahead. We would like to remind our investors that the RSP contribution deadline for our Funds is February 28<sup>th</sup> and that both the Venator Income Fund and the Venator Investment Trust are RSP-eligible. Please contact JoAnne if you would like more information.

Thanks for your continued support,



Brandon Osten CFA  
President, Venator Capital Management Ltd.

*This is intended for informational purposes and should not be construed as a solicitation for investment in any of Venator's Funds. The Funds may only be purchased by Accredited investors with a medium-to-high risk tolerance seeking long-term capital gains. Read the Offering Memoranda in full before making any investment decisions. Prospective investors should inform themselves as to the legal requirements for the purchase of shares. All stated Venator returns are net of fees. It is important to note that past performance should not be taken as an indicator of future performance.*