

GROWTH (?) vs. VALUE (!)

January was a good month for all the Venator Funds, which were all solidly profitable despite weak markets (the S&P 500 had its worst January EVER):

Instrument	Monthly Return	Return Since Inception
Venator Founders Fund ¹	6.5%	30.5%
Venator Income Fund ²	6.5%	-2.9%
Venator Catalyst Fund ³	3.3%	8.1%
TSX Composite	-3.3%	-25.6%
Russell 2000	-11.2%	-39.2%
S&P Toronto Small Cap	-0.3%	-48.5%
S&P 500	-8.6%	-35.5%

1. The performance of the Venator Investment Trust approximates the performance of the Venator Founders Fund.
2. The Venator Income Fund was launched in August, 2008. Benchmark results for the S&P/TSX Income Trust: Monthly Return -2.1%, Return Since Inception of the Venator Income Fund -40.8%.
3. The Venator Catalyst Fund was launched January 2008. There are no benchmarks for this Fund.

One of the questions perpetually asked by market watchers is whether you would be better off investing in growth stocks or value stocks. Statistically speaking, growth stocks tend to outperform when markets are strong (they go up more) while value stocks tend to outperform while stocks are going down (they go down less). This is partly why being a growth manager is more profitable than being a value manager, in that growth managers outperform during a bull market when people are in an investing mood.

That being said, we are in tough economic times right now, and views are polarized into those that believe we are in for a significant rebound, and those who believe that the current economic situation will persist for longer than anyone realizes and hold markets down for quite some time. The first scenario suggests jumping into this market with both feet, while the latter screams “stay away” and stuff it all in your mattress. Here at Venator, we are taking our usual sanguine middle view. Our position is that the global economy will bottom this year, but after bottoming will experience a prolonged period of very low growth.

By and large, our investments are situated on the premise that if you can't count on growth, you had better be sure you are getting value. Unlike the last 10 years when fortunes were temporarily made off the front pages of the newspaper (i.e. front page headlines regarding the internet, peak oil, and the food crisis), you will need to be selective to make money in the next several years. While this sounds easy in practice, it is trickier than it sounds because you need to consider how bad things can get before you can determine what constitutes value. In that sense, we continue to avoid “value traps” such as:

- Infrastructure/Cyclicals: While people are generally excited by the various stimulus plans initiated throughout the world, we are far more cautious. First, these projects are going to take at least several quarters before they even get awarded, never mind showing up on the income statements of these companies. Second, they only fill part of a gap left by the private sector, meaning there will still likely be overcapacity in these industries, and pricing may be incredibly competitive. For the winners, flat revenues and lower operating margins could mean 50% earnings shortfalls even after the stimulus kicks-in.
- Selected commodities: Contrary to popular belief, oil, gas, gold, silver and copper are well above their marginal costs of production. While new projects and some existing ones are being shut down, what is left is a lower marginal cost of current production, and production levels which are higher than what the economy needs (still too many BOE's/Pounds/MCF's for the current environment). OPEC is now at 80% capacity, with an average cost below \$10.00 per barrel, and the highest cost oil found in our tar sands at

about \$20.00 per barrel (assuming natural gas gets to its marginal cost of \$3.00/mcf). Freeport McMoran suggested that after shutting down its higher cost copper projects, it will eventually be profitable at \$0.80 per pound. Commodity stocks typically bottom with the underlying commodity, so in our view, you are not getting value until the commodity hits the traditional cycle low at the marginal cost.

You can hope for a boost from government stimulus, you can hope for the consumer to spend their mortgage rate and gasoline savings, and you can hope that tax incentives spur capital spending, *but you can't count on it*. In this environment, we believe that visible growth is the only growth that matters, no matter how low it might seem. Good value is always good value, as long as you have a realistic outlook for fundamentals. Our largest investment, Futuremed Healthcare, is the leading supplier of disposables to nursing homes in Canada. With a virtually guaranteed 10 year compound annual growth rate of 3%-8%, a multiple of less than 10x earnings, and a dividend in excess of 10%, this is where you want to be. A mundane, but highly visible 5% growth rate qualifies as "hyper-growth" in this economy. An example of a cyclical we own is Hammond Power Solutions, an infrastructure play. We think Hammond could earn as much as \$1.50 this year putting the stock at 5x earnings. But if we assume a 20% drop in sales and a 30% fall in operating margins we could see a fall to \$0.75 in 2010. At \$7.50 per share we believe the stock is already pricing this in; and after going through our analysis with management, we believe that they are of the mind that levers can be pulled to keep earnings above \$1.00 in the event of a 20% revenue drop, which would be fine by us.

The point we are making is that you should not build any economic optimism into your forward thinking right now when selecting stocks, BUT there are gains to be made even in a deteriorating economy. Building Armageddon into your estimates, rather than an economic rebound, is how you find value. This defensive view, coupled with a net 50% long asset allocation in our hedge funds, means that we could underperform the market (but likely still make money) if the economy were to snap back quickly, because we are not positioned for a strong economy. We are looking to make gains in a volatile, but relatively stagnant economy and market.

Our Offer Reiterated:

Last month we outlined an offer we were making to our investors, whereby we are willing to forgo performance fees on any new money invested with us that was previously invested elsewhere, until we get you back to where that investment was on January 1, 2008 (for details see our December newsletter).

At Venator, all of our funds carry perpetual "high watermarks", meaning we do not collect performance fees until we surpass our previous record highs. Some investors are surprised to learn that many other funds, including those you may be invested in, have "resets", which means that if they don't get you back to a record high within one or two years, you will start paying performance fees even though you are still below where you were on January 1, 2008 (in theory you could end up paying performance fees even though you are below your initial invested capital, or paying performance fees twice as previous gains are recouped).

If you are invested in other performance-fee structured investments with high watermark resets, and are as comfortable with us as you are with your other money manager, this offer may be right for you.

Yours Truly,



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 who are seeking long-term capital gains. Read the Offering Memorandum 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.