

EATING GREENS(HOOTS) MAY NOT BE GOOD FOR YOUR (FINANCIAL) HEALTH

Firstly, we are happy to report that all of Venator's Funds were up in the month of May, although none were able to keep up with the torrid pace of the Canadian markets' 10%+ increases. This is largely due to several factors, including low net equity market exposure, a lack of focus on natural resources, and a large weighting in US stocks (the US market significantly underperformed Canada in May).

Instrument	May's Return	Year-to-Date
Venator Founders Fund ¹	5.3%	26.6%
Venator Income Fund ²	3.8%	12.1%
Venator Catalyst Fund ³	1.5%	5.4%
TSX Composite	11.2%	15.4%
Russell 2000	2.9%	0.5%
S&P Toronto Small Cap	12.1%	16.9%
S&P 500	5.3%	1.8%

- 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.*
- 3. The Venator Catalyst Fund has no benchmarks.*

The sheer magnitude of change we have seen in market sentiment over the past eight months is truly mindboggling. Almost everyone reading this update can remember the tech bubble/burst, the Asian/Russian/Long-Term Capital collapse, the early nineties recession and the crash of 1987. Some (admittedly not us) can even remember the early eighties. But no one I know vividly remembers the late 1920s-early 1930s period in North America. Reading the statistics and stories is one thing, but nothing you can read will give you a true gauge of sentiment.

Consensus opinion has been shattered time and time again over the past several years. Real Estate appreciation, private equity, cheap debt, commodity shortages, increasing agriculture prices and emerging markets have all proven poor theses in the tradition of "it's not different this time". Markets barely hit new all-time highs in the "goldilocks economy" before heading into the worst decline since the great depression. Then just as the doomsayers started calling for nearly every major financial institution to go bankrupt and the consumer to be shut down for the next decade, the market tore off a 40% gain led by financial, cyclical and consumer discretionary stocks.

Our readers will know that we are the "goldilocks investors". We never believe that things are as good, or as bad as consensus would suggest. We are always partially hedged and long biased (we have never been net short). We believe good companies will always trade in excess of 10x earnings as long as interest rates remain below that level. We generally try to figure out where consensus is and then try to figure out if that consensus is justified, because a correct consensus can be a very powerful thing. That being said we think the current consensus is dead wrong.

The current consensus revolves around "green shoots". What passes as a green shoot is not positive news, but a *deceleration in the negativity of bad news* (if that doesn't make sense to you, don't worry, it doesn't make much sense to us either). Mr. Market is happy that new jobless claims are coming in at "only" 600,000 because it could have been worse, yet ignoring the consensus view that the unemployment rate is still expected to increase to over 10% by the end of next year. So we are marching more slowly than expected to what we still believe is the ultimate conclusion, and this passes as good news (like a car wreck at 60mph is better than one at 100mph when both result in death).

Consensus went from the second coming of the great depression, to bear market rally, to wait for the check-back, to full blown recovery, to rampaging bull market complete with renewed growth expectations. All that institutional money sitting on the sidelines has been sopped up by near-record equity and debt issues over the past six weeks. Short interest

is now at multi-year lows. The market's P/E ratio is above its historical median despite a subdued outlook for growth and historically high corporate operating margins. The amount of press dedicated to rampant pessimism versus guarded pessimism versus unbridled optimism has definitely migrated to the latter as of late. Just to drive our point home we note:

- The 52-week high list is really bulking up lately, despite the better financial results and rosier outlooks of stocks a year ago.
- The S&P500 crossed its 200-day moving average meaning that the market is higher than its average over the past 10 months (since August).
- Industrial capacity is running very low and sales are falling, yet companies are still pumping out record profit margins, a condition that has been historically impossible to maintain.
- Unemployment is expected to rise, but the slower pace of getting there seems to make people think the employment picture is actually improving.
- Improving sentiment towards home buying intentions and builders' inventories is obfuscating increasing prime mortgage delinquencies and still lower home prices.
- Oil prices are higher than they have been at any point prior to 2005 despite near record storage, a poor growth outlook for the economy, OPEC producing at only 80% capacity, and a socialist US government that is going to push through some very aggressive fuel efficiency standards in the next several years (since the government is going to own the auto companies, there won't be much of a lobby to oppose them this time).
- Potash of Saskatchewan is trading near where it started 2008, despite some massive profit drops in recent quarters (remember that in 2008 Potash was supposedly no longer cyclical).
- The US Government has unilaterally decided that the legally binding capital structure hierarchy in a bond indenture no longer matters relative to the needs of employee pension plans in a bankrupt company, therefore eliminating much of the security inherent in bond ownership.
- Money is just flying out of treasuries, as people pull out of money market funds to get into ETFs, brokerage accounts or mutual funds.

Given our economic outlook for stable low growth going forward, the unrealistic growth outlook that the market appears to be discounting cannot be a good thing for the next move in this straight up/down 40% market. Like some other increasingly rare skeptical market participants, we are finding it harder to find companies we like, but are also somewhat fearful of shorting new stocks (the stuff you want to short is the stuff going up the most right now). Therefore, our hedge funds are largely invested in defensive stocks at cheap multiples, pair trades, and a few high growth and turnaround stocks that are offset with ETF hedges to hedge out short-term market volatility. The Founders Fund is 105% long and 45% short for net exposure of 60%, while the Catalyst Fund is approximately 50% long and 50% cash. The Income Fund is 100% long with a bond/equity split of roughly 50/50.

Thanks for your support,



Brandon Osten, CFA
President, Venator Capital Management Ltd.

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