VENATOR CAPITAL MANAGEMENT LTD.

NOT WORRIED...BUT NOT HAPPY

There was a significant divergence between our Funds last month. Our Catalyst Fund performed well through some skillful trading of some recent hot IPOs. The Income Fund suffered a small loss but remains up over seven percent on the year. Finally, the Founders Fund suffered a significant loss in excess of six percent, which we will discuss in more detail below.

Instrument	May's Return	Year-to-Date
Venator Founders Fund[1]	**-6.2%**	**-3.1%**
Venator Income Fund[2]	**-1.4%**	**7.4%**
Venator Catalyst Fund	**2.0%**	**5.0%**
TSX Composite	-0.9%	3.6%
Russell 2000	-1.9%	8.7%
S&P Toronto Small Cap	-1.9%	1.6%
S&P 500	-1.1%	7.8%

1. *The performance of the Venator Investment Trust approximates the performance of the Venator Founders Fund. Return is for Class "A" units.*
2. *YTD of Fund is for Class "F" units net of distributions reinvested.*

When you have a month like this, you do a lot of statistical soul searching (the professional term is performance attribution analysis). For example, we knew that we were net 65% invested in equities (110% long, 45% short) plus another 10%+ in convertible positive-yielding convertible bonds, plus another 30% in non-convertible bonds. Therefore, we should expect to capture roughly two-thirds of any equity market moves, plus or minus any stock-specific outperformance (technically known as alpha).

One frustrating point on the month was that we didn't make any money on our shorts – which really hurts in a down month in the markets. We also noted that we lost two percent on closed-out positions (where fundamentals went against our original thesis on the stocks – this is not unusual for earnings season). Furthermore, we didn't suffer any disproportionate losses on any single security, meaning our losses were widespread among 15 different positions. Finally, we didn't have any big winners (this was unusual for earnings season) to offset our losers; heck we didn't even have any small winners – it was that bad!

As it turns out, most of our losses came from positions that we have bought and held to some significant unrealized profits. Buying and holding is different than higher-turnover trading and derivatives-based strategies. In fast trading strategies you are closing out positions all the time. When you buy and hold stocks you sometimes accept volatility as part of the deal. Over the last 10 years, Apple Corp., one of the great growth stories of the past decade, has dropped in excess of 20% six times on its run from $8.00 to $330.00. Nearly every great stock I have ever seen has had multiple 20%, if not 30%, pullbacks on its way to 200%+ gains.

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We aren't about to panic because we have seen drops like this before and have always bounced back without making wholesale changes to the portfolio. We don't view this current correction as potentially severe or completely unexpected. We don't think this correction will be particularly severe because it is more about disappointment in the rate of growth during the recovery than the direction of the economy. Everything is getting better, just much more slowly than the optimists anticipated. Capital markets are very receptive to equity, debt and acquisitions, while monetary policy remains accommodative. The jobs picture is slowly getting better, tax receipts are up, and corporate as well as consumer outlooks are fairly stable.

For our part, this correction isn't totally surprising as our long-term readers will know that we have been saying for quite some time that the rebound would disappoint the market in terms of the rate of recovery. This is why we have placed our money largely in defensive/non-cyclical businesses that performed exceptionally well during the 2008-2009 period.

Where we have been surprised, in a repeat performance of what always seems to surprise us in market corrections, is how easily cheap stocks can get cheaper. On some of our smaller-cap, relatively unknown names, the bottom has simply fallen out from beneath the bid. More expensive, but non-economically sensitive, growth stocks have not sold off enough to merit our attention yet. We have a sub-10% net weighting in commodities because disappointing economic growth will likely hit commodity prices, so explosive asset base growth is the only viable strategy here. Finally, we are hedged down to around 50% net equity exposure. This isn't so much a function of caution toward the overall market, as it is determining an appropriate hedge relative to the increased volatility the Founders Fund is experiencing.

We are spending most of our days burning up the phone lines, focused more on researching the current conditions of our holdings than looking for new names. We have our shopping list of companies we would look to buy at lower prices should this correction get more severe. And we have a keen eye on levels where we would look at taking off some of our hedges.

As we approach the mid-point of the year, the markets aren't looking so hot. But lest anyone forget the broader markets were negative last year as late as the end of August before finishing the year with returns between 15%-35%, depending on what market you we looking at. It's also worth noting amid all the gloom out there that both our bond-focused Income Fund, and our more actively-traded Catalyst Fund, have performed exceptionally well this year providing consistent returns with a relative lack of volatility.

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 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.