IT'S ALL ABOUT THE EURO

After suffering a drop of 7% last month before rebounding, markets finished with a slight loss. Our Funds finished the month with modest profits. As the market stumbles towards year end, it is looking like 2011 is going to be a down year for the global investment landscape. At Venator we are hoping that two of our Funds can hang on for a positive 2011, while our Founders Fund will likely finish the year with a loss. About the only things you could count on in 2011 were IBM, the US dollar and Tim Tebow. Hopefully, there are more places to find wins in 2012.

Instrument	November's Return	Year-to-Date	Since Inception[3]
Venator Founders Fund[1]	**0.3%**	**-14.8%**	**71.3%**
Venator Income Fund[2]	**0.3%**	**2.7%**	**59.1%**
Venator Catalyst Fund	**2.1%**	**10.4%**	**53.5%**
TSX Composite	-0.2%	-7.1%	22.5%
Russell 2000	-0.4%	-4.8%	9.0%
S&P Toronto Small Cap	-1.5%	-14.6%	9.3%
S&P 500	-0.2%	1.1%	10.0%

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.*
3. *The Venator Income Fund and the Venator Catalyst Fund have no benchmarks.*

Last month we wrote about how little we cared about the peripheral European economies' effect on our companies. We still couldn't care less about what happens in Greece or Portugal (although Italy is a little worrisome). We have made adjustments to ensure that our companies have as little exposure to Europe except in some circumstances. That being said, we have been keeping a watchful eye on the Euro, and have been learning just how subjectively valued currencies are in the process.

As it turns out, currency markets are dominated by two parties: hedgers and traders. Hedgers don't have a particularly useful view of the fundamentals of currencies because they are just hedging future obligations; they are not speculating on future direction. Traders, on the other hand, are generally reacting to the news of the day (or anticipating the news of tomorrow); they are more concerned with short-term direction than longer-term targets. There are a few currency analysts out there, but they seem to enjoy writing research reports without targets.

In short, everyone in the currency game speaks a different language than those in the stock and bond game, where we are looking for fundamental information (i.e. earnings, shares outstanding, cash flows, growth) to give us an idea of eventual targets on securities (i.e. maturity at par in bonds, $500 on Apple). Even commodity analysts look at supply and demand in order to determine whether gold should go to $2000 or oil should go to $120.

For currencies it is just a different market. Targets are rare, and when they exist they are rarely backed up by any quantitative explanation. When we ask around on where the Euro is headed, people say "down". When we ask how far down most don't know but many say mid-$1.20s. All direction, no targets. Furthermore, we don't really hear much about second derivatives in currencies. For example, I don't think it would surprise anyone to know that the Euro has weakened relative to the US dollar recently (about 7%). But hasn't the Canadian dollar dropped from 105c to 98c? Isn't that also about 7%? Has the Canadian dollar really gained nothing relative to the troubled Euro over the past few months? Shocking!

On a day to day basis, watching the volatility of the Euro is somewhat comical. There is no question that the general direction is down, and that every day seems like it should be a down day. But it seems that every day that the Euro appears ready to crack by a penny or more we get some ridiculous ambiguous headline about how France and Germany support the Euro, or how Greece or Italy approved some immaterial austerity measures. Most of these headlines have no concrete hard numbers or legal commitments attached to them. Nearly all of the multi-hundred-billion dollar bailouts supported by the IMF that are announced during market hours seemed to be denied after-hours. None of the half-dozen per week back-of-a-napkin "agreements" will ever become "law", in part because no country will legally allow Germany to oversee their lax tax collection processes, and Germany doesn't want to keep funding other countries. It really is something of a running joke.

At this time, we simply expect the Euro to continue its steady March to 1.00 vs. the US dollar. After all, it was below that less than 10 years ago. When I asked a currency veteran why that was, he said because US growth was expected to be superior to that of Europe at the time. Well if that's the case again, why aren't we there again? I think currency experts just can't fathom 25% currency drops. But we think it can happen, and this isn't even an extreme view. The extreme views include Germany convincing all the weaker countries to leave (since they can't technically kick them out), resulting in a sharp Euro rally ($1.60+?), or Germany deciding that maybe the Brits were right to stay out and exiting the Euro ($0.70?).

Both the Founders Fund and Income Fund are positioned to mitigate the impact of a sharp and quick Euro drop via a small nominal position in out-of-money Put options. Basically, this means we can potentially make a little money in the event of a swift Euro decline (after accounting for a broad market drop), but that we shouldn't experience any severe losses in the event of a Euro rally (we wouldn't lose too much on the Puts, and the market would likely rally with the Euro). But without question, we view a potential collapse of the Euro as the greatest single risk facing investors today, which is why we are hedged for a variety of circumstances.

With that said, we are quite disappointed with the performance of the Founders Fund this year. While the Income Fund has done its job as a defensive investment in a tough year, and our Catalyst Fund has put up some impressive returns through skilled trading, the Founders Fund just wasn't able to gather any momentum this year. This was a good year for large caps and a poor year for small caps, which is historically where we have gravitated. The Fund continues to be defensively positioned with a low relative equity weighting, and most investments are in non-cyclical businesses with limited international exposure. We believe that this will serve us better in 2012 than it did in 2011.

Thank you for your continued support,

Brandon Osten, CFA
President, Venator Capital Management Ltd.

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