

## HIGH CORRELATION AND VOLATILITY: A TOXIC MIX

I figured with the markets continuing to run upside down we would start this letter with our closing paragraph. We are obviously dissatisfied with our Funds' performances over the past two months. It is apparent to us that the macro concerns we are constantly reading about, coupled with a stable (albeit low-growth) economy and low valuations, are creating a market fraught with top-down risks yet rife with some exceptional bottom-up opportunities. While we remain quite proud of our long term track record, we are mindful of the shorter term concerns many of you might have. We are not market timers (and have never met a good/consistent one), nor do we run any of our Funds on a market neutral basis. We simply look to invest in companies with the best long-term risk reward profiles we can find; unfortunately, the short term (which can admittedly alter some of our investment decisions) can get in the way of this master plan from time to time.

September was a difficult month for the markets and we did not escape without our share of bruises. Year-to-date both our Catalyst Fund and our Income Fund have held up quite well; however, the Founders Fund had a difficult two months (it's hard to believe that eight weeks ago the Founders Fund was even on the year, while the our other Funds were both up over 7%). Despite all the doom and gloom out there, there are reasons to maintain a degree of optimism for certain subsets of the economy, and with broad valuation measures approaching March 2009 lows, there are going to be some good opportunities to make money again.

Instrument	September's Return	Year-to-Date	Since Inception <sup>3</sup>
<b>Venator Founders Fund<sup>1</sup></b>	<b>-10.5%</b>	<b>-18.0%</b>	<b>64.9%</b>
<b>Venator Income Fund<sup>2</sup></b>	<b>-2.7%</b>	<b>0.6%</b>	<b>54.3%</b>
<b>Venator Catalyst Fund</b>	<b>0.4%</b>	<b>4.8%</b>	<b>47.7%</b>
TSX Composite	-8.7%	-11.9%	16.2%
Russell 2000	-11.2%	-17.0%	-5.0%
S&P Toronto Small Cap	-14.9%	-21.1%	1.1%
S&P 500	-7.0%	-8.7%	-0.6%

- 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.*

For those of you not spending every day in the financial markets, the really big news isn't the European Union, the slowing of China, or the collapse of commodity prices; the real story is the unusually high degree of correlation between countries, commodities, markets, and individual securities. Coupled with unusually high daily volatility, this can be an incredibly euphoric or poisonous mix. It is currently estimated that correlations are running around 90%, meaning that 90% of all stocks are moving in the

same direction on any given day. Normally this number is closer to 30%. This means that normally you can do something directionally different than the market, but not today. Our Funds have seen their fair share of companies jumping 10%+ on their Q2 earnings releases only to see their stocks fall 30%+ from those levels in the last six weeks with no subsequent news. They are simply moving with the market; company-specific fundamentals be damned.

The other big issue has been volatility. The market is hypersensitive to the most benign economic data. WE GET IT!!! - unemployment is high and growth is low - we don't need a 3% market move because employment numbers came in 10,000 people light (with a 30,000 margin for error) in a population of 300 million! When you combine extreme volatility (measured statistically by the VIX) and high correlation among nearly all assets with wild changes in direction, you need to either "buy and hold" for multiple-year returns, or try your hand at day trading and market timing, which is not our specialty. But about our Funds...

**Founders Fund:** Despite what we thought was conservative positioning, the Fund managed to only perform in line with the broader averages. The main reasons for this poor performance were that we didn't get enough added value out of our short sales, and that our bonds have been acting more like stocks as of late. Coming into the month we were roughly 66% invested in stocks and 33% in bonds. With the bond markets being as weak as they have been, we might as well have been 100% invested in the stock market. We have since rectified this situation by reducing our holdings in a number of positions in an effort to curb the volatility of the Fund.

**Income Fund:** The Fund suffered a second poor month and now stands even on the year. The main issue with bonds in general is that they tend to trade in line with their ratings, regardless of company-specific fundamentals. Our own view is that the ratings agencies and their reports are fraught with conflicts of interest and are not credible, but we need to live with this particular aspect of the bond market in the short term. Over the medium term we fully expect to be paid out on our bonds when they reach maturity. The current underlying yield of the Fund is in excess of 10% and the duration of the portfolio is less than five years, providing excellent return potential over the next several years. We would suggest that a lack of growth in the domestic economy may be tough for stocks and bond quotes, but given the cash flows of much of our holdings, we fully expect they will be able to pay their interest and principal when it comes due.

**Catalyst Fund:** Our smallest Fund managed to break even in an otherwise tough month with its very low volatility (beta) portfolio. Much of the Fund's positions are well off the radar of the market, are closely held and trade in fairly low volumes. Thus, they have been able to avoid most of the markets' turmoil. No need to make excuses for this Fund!!!

If there is one common thread among all our Funds is that the vast majority of our investments are in non-cyclical, domestic businesses. We don't believe that international markets or economically sensitive cyclical growth is reliable, and these sectors are what have been driving the market up and down since March 2009. We also continue to believe that the troubles being experienced in Europe represent the greatest macro risk out there, followed by a slowing of China (more of a Canadian issue given our resource heavy market). We do not view the domestic North American market as particularly risky at this time, it's simply stagnant which is reflected in valuations.

Now a final word about our largest position, and the passing of its founder, Steve Jobs. With the stock trading below 10x earnings we took the opportunity to buy more. While not our typical investment

given a lack of ability to get proprietary information on such a large and well covered company, if there is anything we have learned from the company's surprise earnings releases, we are not at an informational disadvantage either. The beauty of Apple's stock is that nobody knows it very well, and yet everyone knows it very well! While Jobs was the driving creative designer behind Apple's products, his real legacy to shareholders will be the iOS operating system ecosystem, the app store, iTunes and (hopefully) iCloud, which has created a customer lock-in that will likely last for years among existing users. Having the best phone and tablet out there for at least two more generations should give us at least three more years of great growth. At 10x earnings, that's a good risk reward trade-off. Steve, if you had just given us our iPhones (which effectively created the mobile computing era) - DAYENU!!!\*

Thank you for your continued support,



Brandon Osten, CFA  
President, Venator Capital Management Ltd.

\*for our non-Jewish clients *dayenu* means "it would have been enough" and it is the name of a Passover song sung at the Sedar where we tell God that had he just delivered us from Egypt "it would have been enough for us", and, to paraphrase, thanks for all the other great stuff you did for us after that. Given the otherworldly view of Steve Jobs in popular culture today, I felt the reference was respectfully and cheekily appropriate.

*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.*