VENATOR
CAPITAL MANAGEMENT LTD.

DON'T FIGHT THE FED(s)???

We are happy to report that both of our funds continued their strong years (caveat: thus far). The Founders Fund increased 4.4%, while the Income Fund was up 2.6%. We believe that the Founders Fund is benefiting from its US exposure as well as a return to the old school strategy of "Buy and Hold" working, while the Income Fund continues to benefit from the bull market in yield based instruments.

Instrument (Inception)	**July's Return**	**Year-to-Date**	**Compound Growth**
Venator Founders Fund (March 2006)	**4.4%**	**16.9%**	**11.6%**
Venator Income Fund (August 2008)	**2.6%**	**12.9%**	**15.4%**
TSX Composite (March 2006)	0.8%	-0.7%	2.8%
Russell 2000 (March 2006)	-1.4%	7.0%	2.5%
S&P Toronto Small Cap (March 2006)	2.5%	-5.6%	0.2%
S&P 500 (March 2006)	1.4%	11.0%	3.3%

There used to be a well known saying in capital markets: "Don't Fight the Fed". This saying was a well known maxim of investing until early in the 2000s when, during the tech crash (and including 9/11) the Fed dropped rates to zero but the effects weren't apparent for several years, creating the bull market in the mid-2000s cumulating in the low interest rate fueled housing/banking bubble. The busting of the housing/banking bubble created the crash of August 2008-March 2009, and indeed you could again fight the Fed for about six months after it really got active, but eventually the Fed won, resulting in the massive snap back in the market from March of 2009 through to the end of 2010.

Why, in theory, shouldn't you fight the Fed? Because by lowering interest rates for the lowest risk instruments they effectively penalize the savers (as opposed to investors) by giving you nothing for your cash deposits while encouraging inflation to eat away at the purchasing power of your savings. In other words, they are trying to "force" savers to move their cash into the markets which will hopefully inflate financial assets and investment in companies, capital goods and jobs.

Right now, all the Fed-equivalents around the world are working together to force you into the investment markets. Of those that matter most, the US, China, and Europe are all forcing interest rates down, and forcing savers into the investment market. They have learnt the lesson of US financial market over the last several years: printing money works. But with investor confidence so low, yet an economy that is surprisingly stable, the most consistent gains are being found in low growth, low volatility, high (2%+) dividend companies as well as corporate bonds (3%+ yields). More volatile growth and cyclicals are consequently not getting a lot of love.

One word of caution though (isn't there always?). We are starting to see bubble like activity in the high dividend area of the Canadian stock market:

- We are seeing major spikes in stocks that initiate dividends or raise dividends; technically it shouldn't make a difference to the value of a business, and in a way shows weakness of a lack of internal investment opportunities.

- We are seeing companies getting valued based on dividend yields rather than earnings or cashflow measures; philosophically we always value the stock before considering the dividend.

- Finally, we are seeing financial engineering around dividends so that companies can attract more investors to their stocks in a yield hungry world. Always be wary of a company that pays a juicy dividend, yet issues stock: if you need to issue stock to grow or make large acquisitions, why pay such a large dividend? Issuing a dividend does not intrinsically increase the value of a business, but dilution through the issuance of shares does hurt shareholder value on a per share basis.

How are we positioning ourselves? As many of our long term investors know, we don't tend to position our funds in bullish or bearish terms (merely more or less hedged). But seeing as how the combined power of all the superpower Feds is just a little too much to fight, we think we need to be in the market. So over the last several months, we have broadened the portfolios with more names and lower weights. We have no 10% weights right now and, frankly, too many 2% weights (this creates a lot of work relative to a more concentrated portfolio). This should lower our volatility a bit, yet allow us to continue to participate in the general melt-up in financial securities.

As always, we reserve the right to change our mind,

Brandon Osten, CFA
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