

## WHY WORRY? LET ME COUNT THE WAYS!

We are approaching a pretty murky point in the market cycle. All the great things that were expected to happen simply aren't happening. After a consecutive five year run in the S&P 500 we are seeing a lot of broken promises on growth, lost emerging market momentum, and an end game on the capital allocation shifts that have served this market so well. In short, we are investing your money cautiously over the near term despite the run of good fortune we have had year-to-date.

Instrument (Inception)*	August 2013 Return	Year-to-Date Return	Compound Growth
<b>Venator Founders Fund (March 2006)</b>	<b>-0.3%</b>	<b>20.1%</b>	<b>13.5%</b>
<b>Venator Income Fund (August 2008)</b>	<b>0.5%</b>	<b>10.0%</b>	<b>16.0%</b>
S&P/TSX Total Return (March 2006)	1.6%	3.9%	4.0%
Russell 2000 (March 2006)	-3.2%	20.0%	5.9%
S&P Toronto Small Cap (March 2006)	2.1%	-1.0%	0.5%
S&P 500 (March 2006)	-2.9%	16.2%	5.5%

\*Estimated Performance

The first issue we mentioned above was that the growth that everyone has been expecting never materialized. North American companies, for the most part, have experienced great profit margin growth but not much top line growth. With profit margins pushing all-time highs, that game is coming to an end. IBM, Oracle, Macys, every teen retailer, sporting goods retailers, Caterpillar, Cummins, and Walmart have recently reported very disappointing revenue trends. Best Buy may be one of the great turnarounds of the year, but last quarter's sales were still down 10% versus last year. Even the new (there is always growth in the new) seems to be experiencing decelerating growth lately, with Amazon and Google reporting multi-year lows in terms of quarterly growth rates. Industrial distributors, a barometer for construction and manufacturing activity are experiencing negligible same store growth. Sure, there are some bright spots, like home appliances and automobiles, but this is largely a function of replacement demand for bulk items at record high ages rather than discretionary demand.

Basically, we aren't seeing the growth out there. We have seen a lot of "pretend" growth, whereby companies become serial acquirers to cover up their own lack of growth, but we aren't inclined to pay up for that. The past several years have been a golden era in surfacing shareholder value. Activism (i.e. buying a stake in a company and telling them to put themselves up for sale), spin-offs, "exploring options", closing non-performing divisions, converting to tax efficient structures, creating REIT subsidiaries or other dividend increasing measures, and debt refinancing seem to happen on a daily basis. This game can probably continue, but with diminishing returns as these value-surfacing activities are being increasingly built into expectations (note these activities aren't necessarily value creating as the value was always there). Basically, we see this game as getting close to being tapped out.

We also aren't seeing a lot of value, especially in the growth companies. Everyone knows what the great companies are. In a recent interview, Carl Icahn acknowledged that he doesn't buy great companies, he buys value (I am paraphrasing here); but to give you an actual quote Warren Buffet is fond of saying "Price is what you pay; value is what you get", a piece of advice he got from Ben Graham. We know that Michael Kors, Tesla, Salesforce.com and Restoration Hardware are great companies, but so were Cisco, Callaway and Coach at the height of their powers; we just don't generally invest in the arena of high expectations. That being said, we recognize that there is value in growth and look to buy these top of mind companies from time to time as evidenced by our 2009-2012 position in Apple.

Finally, a word on capital allocation, interest rates and the end of increasingly accommodative central bankers. The issue of central bank policy on interest rates has been cited as a major factor in the five year run in the stock market. By holding rates near zero, they have effectively forced fearful investors first into the corporate debt markets and finally into stock markets. The move out of debt and into stocks has been particularly pronounced this year, but that game also seems to be ending. We continue to read a lot about "tapering" easy money policies with the analogy of taking the punch bowl away from financial markets. I personally don't see them taking the punch bowl away, but they aren't going to be refilling it anymore. As 10-year government rates head towards 3%, that will probably be seen as good enough by cautious investors to slow the money flow switching into equities.

We fully realize that the stock market appears strong, and that much of the positive commentary we hear on the economy seems based on the stock market's positive run this year. But our view is that it has been based on money flows and corporate banking activities rather than actual organic growth. To the extent that the stock market is a market of stocks, we just aren't seeing a lot of good news to justify the year to date run we have seen in the US. So as you might have guessed, we are positioned quite cautiously heading into the school year. We have scaled our Income Funds use of leverage back and pared some of our higher risk positions. In the Founders Fund we are still fully invested, but have taken up our short positions in order to mitigate any near-term volatility. Why not just go all cash? Because we really think our long positions will go higher at some point in the next year and trying to time these moves could cause us to miss the opportunity completely.

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



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