VENATOR
CAPITAL MANAGEMENT LTD.

RULE #7: THE STOCK MARKET ISN'T FAIR (although the bond market is)

Instrument (Inception)*	July 2014 Return	Year-to-Date Return	Compound Growth
Venator Founders Fund (March 2006)	**2.3%**	**15.6%**	**15.2%**
Venator Partners Fund (July 2014)	**1.5%**	**1.5%**	**-**
Venator Income Fund (August 2008)	**1.2%**	**9.5%**	**16.3%**
Venator Select Fund (September 2013)	**-4.7%**	**20.1%**	**-**
S&P/TSX Total Return (March 2006)	1.4%	14.5%	6.3%
Russell 2000 (March 2006)	-6.1%	-3.1%	6.6%
S&P Toronto Small Cap (March 2006)	-2.5%	15.0%	3.1%
S&P 500 (March 2006)	-1.4%	5.7%	7.3%
Merrill Lynch High Yield Index (August 2008)	-0.7%	4.9%	11.0%

Our Funds performed in-line-to-better than expectations in July and we were quite pleased with the performance given the general weakness in the market. The Founders Fund/Partners Fund experienced gains on the back of its short positions which generated 4% of positive returns against 2% losses on the long side of the portfolio, leaving this strategy with a healthy 2% gain on the month. The Income Fund also experienced a healthy positive return on the back of some strong performances in the stock portfolio and rock solid stability in the shorter-duration bond portfolio. The higher-risk Select Fund lost 4.5% as it is currently a fully invested long-only portfolio and didn't have the benefit of any of the short sales experienced in the Founders/Partners strategy; but at a positive 20% year-to-date (and up 40% in its first 11 months), we can't say we are disappointed with the overall performance of this Fund.

When you are feeling the world is against you; that you have done everything right yet it has come out so wrong, it is important to remember that the stock market isn't fair. Too many things get in the way of fairness. We experience this all the time. There are so many things that can turn a good call into a bad call (and the other way around, but human beings tend to recall losers being the result of bad luck and winners the result of skill). Bad luck comes in many forms and can hit you in numerous ways. We have provided several situations we have observed in recent years, some of which we experienced first hand. A couple notable and consistent categories of bad luck include:

- ***The short sale takeover:*** This is the worst! I remember being short Equinox when it was taken over by Barrick at a 30% premium. Our theory at the time was that it was in an unstable geography (the Congo), was experiencing significant cost overruns, had infrastructure challenges and that copper prices wouldn't hold record levels. Were we right on every single point? Yes we were! Did Barrick eventually realize that our thesis was correct and write-off the majority of its investment in Equinox? Yes they did! Did we lose over 30% on our short despite being absolutely correct on our outlook for Equinox? Yes we did. That feels pretty "unfair".
- ***Companies that keep beating their numbers but won't go up:*** I can't even count the amount of times this has happened. We see companies miss their numbers and go up, so imagine how frustrating it is when your investment beats and goes down. Portfolio holding Callidus Software almost always beats their numbers and raises their guidance, yet the stock seems go nowhere when these earnings come out. The

best solution to this problem seems to be buying and holding; however nearly all companies eventually miss expectations and there is nothing worse than not getting the benefits of three consecutive beats only to feel the full brunt of an eventual miss. This also works in the other direction, illustrated by short position Fastenal, which has experienced all the adverse issues we predicted two years ago but continues to trade at an elevated multiple (although it has not participated in the recent market rally, so at least it has been a relative winner, even if not an absolute one).

- ***Financings (longs):*** Financings have a way of messing things up on both the long and the short side of the ledger. On the long side, they have a way of both diluting your holding in the stock while at the same time using up a considerable amount of demand for prospective buyers. This happened last year with core holding Superior Plus when they issued stock to lower debt levels. The better alternative would have been to cancel their dividend for 12-18 months to pay down the same amount of debt and then reinstate the dividend; instead the dilution from the financing lowered our long term target for the company to account for the added shares outstanding. We are willing to take some well thought out short term pains (the stock likely would have declined had they cut their dividend) for longer term gains.
- ***Financing (shorts):*** We talked about portfolio short Redknee recently. Despite significant reported EBITDA and little CAPEX they have been hemorrhaging cash and were pretty close to "cash less debt" breakeven/negative at the end of Q3. This would have negatively surprised the Street given the declining cash was the result of what appear to be extended payment terms offered to its customers. But thankfully (if you are long) or regretfully (if you are me) they managed to do a financing and raise a substantial amount of cash right before the disappointing March quarter ended, pre-empting a likely material slide in the stock. Our call was right, for the right reasons; but analysts didn't see it coming and as a result the market was accommodative to the financing. This trade has yet to reach its final result, but that sure felt unfair to us.

Corporate finance transactions aside, **Rule #27:** ***"The Market (usually) Eventually Gets It Right"*** applies. You just need patience. Timing is impossible. And you can't complain about how long a stock stays stagnant because if the stock was more fairly valued you wouldn't have made the trade in the first place. Hopefully, the good luck you didn't deserve (yes, we get lucky sometimes too) offsets the bad luck over time.

Now the bond market is perfectly fair if you invest along the lines of our Income Fund. Our long time investors will recall that our Income Fund applies a KISS (Keep It Simple Stupid) strategy when it comes to our bond holdings. Namely, we buy a bond at a targeted annual return to maturity, and between the purchase date and the maturity date we expect to realize that annual return. If the underlying company is still in business when the bond matures, we get that return - *guaranteed.* If the company goes out of business, we will get none, some, or all of our expected return, depending on the asset or liquidation value of the business and the priority standing of the bond. This is incredibly fair.

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

Brandon Osten, CFA
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This is intended for informational purposes and should not be construed as a solicitation for investment in any of the Venator 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.