

RULE #33: MAKE YOUR OWN MISTAKES

| Instrument (Inception)* | November 2014 Return | Year-to-Date Return | Compound Growth |
|--|----------------------|---------------------|-----------------|
| Venator Founders Fund (March 2006) | -0.5% | 22.5% | 15.3% |
| Venator Partners Fund (July 2014) | -0.3% | 5.0% | - |
| Venator Investment Trust (September 2007) | -0.5% | 22.3% | 11.5% |
| Venator Income Fund (August 2008) | -0.3% | 9.3% | 15.3% |
| Venator Select Fund (September 2013) | 0.7% | 34.8% | 44.0% |
| S&P/TSX Total Return (March 2006) | 1.1% | 11.0% | 5.7% |
| Russell 2000 (March 2006) | 0.1% | 2.0% | 7.0% |
| S&P Toronto Small Cap (March 2006) | -0.1% | -2.0% | 1.1% |
| S&P 500 (March 2006) | 2.7% | 14.0% | 7.9% |
| Merrill Lynch High Yield Index (August 2008) | -0.8% | 4.0% | 10.4% |

This is one of my favourite rules. Really, there are so many different types of mistakes you can make in this business (some of which we touch on below) that the last thing you want to do is compound your problems with other people's mistakes. This generally comes from “hot trades” piled on by the fast money crowd and early-stage companies making improbable assumptions; who hasn't seen the zero revenue company with 5-year “projections” showing an exponential ramp to \$100MM in revenue – because it's just that easy!

The bottom line is that there are so many mistakes to be made in a given year. Likely hundreds. Most of these mistakes are made by virtue of investing style or past experience. Most mistakes aren't even mistakes; technically they are just missed opportunities being the result of our investing style.

We see hundreds of opportunities per year and only invest in about fifty. So we are going to miss a lot of them. Some of these will be mistakes, but the vast majority are going to be situations where we simply didn't feel the risk-reward was there and something we viewed as improbable happened, or the street incorrectly bought into a thesis that didn't ultimately come true but sent the stock up on the “story” in the interim. Some of these mistakes will be our inherent biases which we need to get over. I believe Warren Buffet once said that his biggest investment mistakes were not generally the ones he invested in, they were the ones he didn't invest in. With over 20,000 investable companies errors of omission are always going to be the most prevalent – the ones that got away. That being said, don't forget Rule #6: You Don't Have To Own 'Em All (June 2014).

In terms of the mistakes we do make, here is a short list of the ones we have a tough time avoiding:

The right horses in the wrong stables: We own a lot of great companies. Our greatest hits list includes big gainers like Spectrum Brands, Lithia Motors, Boyd Group and Concordia Healthcare. Owning these stocks, and owning them early, was a rewarding experience. But we probably didn't make as much money on some of these as we should have. This is because sometimes the big winners are only 2% weights in the portfolio, while one of your losers might be a 5% weight. Shorting oil has been our big macro call for several years now, but our risk tolerances are such that an abnormally large short position is between 5-10%. So as prescient as our short call was, our own risk tolerances didn't allow us to make more than several percent on this position. Our portfolio can vastly outperform or under-perform our average investment's gains based on how we divide your money amongst our investments.



Selling too early: We don't tend to sell out too early, but we do have a bad habit of selling down too early. Concordia, our biggest winner on the year, never exceeded 10% of the total portfolio, had we simply held our initial position in both our hedge and income strategy it would currently be a 20% weight. We could say the same thing about Boyd Group, which has never been above a 12% weight, but would be north of a 30% weight had we simply let our initial 3% weight accumulate (actually, when the stock was at \$10.00 it was a 10% weight; if we had ridden that weight it would be 50% of the portfolio today). In the interest of keeping the Fund diversified we have managed weights often to our detriment. Of course sometimes this works out in our favour, like when we sold two-thirds of our Badger Daylighting shares north of \$40.00. That being said, this is part of the reason we opened the Select Fund; to enjoy the full benefit of the next 10-bagger, without any pesky urge to diversify getting in the way.

Underestimating potential: This is the classic mistake of a value investor. We can see what is, and what can be based on what is, but can't see the potential beyond that. For example, I can see a company with no earnings, but a realistic chance to increase margins to the point where it is earning \$50MM, and based on this information can speculate that the company with a current market value of \$250MM can double to \$500MM. But what to do when the market value reaches \$500MM? Does the street now view the CEO as a turnaround genius and afford the company a higher multiple of 15x earnings, or \$750MM? Does this higher valuation give the CEO the currency to make a few accretive tuck-in acquisitions sending both the earnings to \$60MM and the multiple to 17x earnings and sending the stock to a \$1BB? Can the R&D department tweak the product so it can attack a whole new market? As mentioned above we don't tend to sell out at the \$500MM level, but we probably lighten up. It is said that stocks get sold from value investors to momentum investors. Hopefully, while getting to know the company as a value investment you are better positioned informationally to take advantage of its transition to a momentum investment. But it's tough to see this potential when you were always looking at the value characteristics. This means that you may have owned too little in the first place or sold way too early.

These are common mistakes that we make. But again the bigger issues lie in making other people's mistakes. You really don't want to go around cursing the investment gods because someone else had a numerical mistake in their financial projections, or some market expert thought Blackberry had a better phone than Apple, or thought there was "news" coming, or built a nonsensical comparable investment chart to make their case. You don't want to buy the "hot deal" if you know nothing about the company or haven't done any of your own research. You never want to say "I never should have listened to that guy" or "I feel stupid for buying that one". With a well thought out thesis and a well-researched idea your losses will be a function of probable and improbable outcomes based on well understood odds of success, and not the result of wild guesses, hype and intentional or unintentional mistakes made by someone who's primary motivation is to sell you a block of shares or a hot IPO/financing (yeah, all else being equal they want you to make money because win-win is the best outcome, but most of the trades we get "pitched" on are not owned in the personal portfolios of people pitching them).

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

A handwritten signature in dark ink, appearing to read "Brandon Osten".

Brandon Osten, CFA
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