MIDWAY CAPITAL RESEARCH & MANAGEMENT LLC
150 N. MICHIGAN AVENUE, SUITE 800, CHICAGO, ILLINOIS 60601

April 11, 2012

Dear Fellow Investors,

We're always more excited to write to you about an outstanding quarter for our investments, and this past quarter was one of our best. We spent last year navigating a volatile market and making opportunistic investments when stocks were cheapest, so it is good to see some of that work start to pay off. Ironically, it is the difficult quarters, when investors are most skittish, that the best opportunities arise.

Midway Capital Value Portfolio Returns

	Midway Composite (net of fees)	S&P 500 TR Index	Difference
Q1 2012	16.81%	12.59%	+4.22
Annualized Return Since Inception	7.75 %	4.89%	+2.86
Total Return Since Inception	32.32%	19.63%	+12.69

Data reflect total returns (including dividends) net of fees as of 3/31/2012. Inception date is 7/1/2008. Returns are unaudited. Your individual returns reported on your statements may vary from the composite depending on when you invested and upon any special instructions or restrictions applicable to your account. The composite return is the time-weighted return of all our accounts added together into one big pool. We believe it is the best indication of how the average client fared during these time periods.

Does the Presidential election affect the financial markets?

It's impossible to miss the fact that the US will be electing a President in November. During all the media coverage of the pre-election posturing, all the candidates, including the President himself, have had a lot to say about how they will help our economy. Amid this rhetoric we at Midway Capital have been asking ourselves whether the outcome of the presidential election will really have any tangible effect on financial markets. If so, we want to prepare for it and if not, we can safely ignore it. This turns out to be a complicated question to answer but the data are interesting. The team behind *Freakonomics*[1], Steven Levitt and Stephen

[1] Levitt, Steven D and Stephen J. Dubner. *Freakonomics: A Rogue Economist Explores the Hidden Side of Everything.* (New York: Harper Perennial, 2009)

TELEPHONE 312.445.8562 ✣ FAX 773.345.3637 ✣ WWW.MIDWAYMGT.COM

Dubner, have done an investigation of this issue and turned up some fascinating expert opinions. We'll be quoting material from the Freakonomics Radio podcast and blog entitled "How Much Does the President of the U.S. Really Matter?"[2] The upshot, when you talk to a variety of economists, politicians, and constitutional scholars, is that the President actually matters a whole lot less than people think, particularly regarding the economy.

J.C. Bradbury is an economist and an expert in baseball statistics. He has found little impact of baseball club mangers on team performance and he see the same pattern with the President. He says, "I think people think the President is almost like a benevolent despot, determining our fortunes, when in reality I think the President is really just someone who's sitting in the co-pilot's seat in a plane that's already on auto-pilot."

Constitutional scholar Bernadette Meyler of Cornell University agrees:

> Well, I really believe that the President isn't as significant as we imagine him or her to be. We think of the President as having great power to fix the economy for example, or fix international conflicts. And to some extent the President has persuasive authority to do things like that. But the President really can't just turn around and fix the economy within two years, for example. It really depends a lot more on Congress, because Congress has the power to – under the spending clause – to decide how to…raise revenue, and also to allocate those funds. And most federal statutes actually are passed now using the spending power, so that's a really important power. I think we think the President can do more with regard to that than he can.

When asked if the President is more like a "puppet master pulling every string" or more like the Wizard of Oz, "this very mortal man behind the curtain", she responds: "I do see it, in a way, as the Wizard of Oz, partly because I think so much of what is important about the President is an image. And I actually think that is why the President is so important in the foreign affairs context, because the President ... is the figurehead for the US abroad and the figure that galvanizes public support or public disapproval." And what would happen if the US didn't have a president for some reason? Meyler surmises: "I think we would continue functioning in almost the same way. I don't think that, actually, the day to day experience would change all that much."

So we have several expert opinions about the limited power of the President, but what about some actual data? Justin Wolfers, an economist from the Wharton School, studied the election eight years ago between George W. Bush and John Kerry and its effect on stock markets. Here is what he says:

> 2004 was a social scientist's dream. If you want to try and study the effects of the Presidency on anything – in my case on the economy – then if you're a doctor, what you'd do is you'd run a big randomized trial. Half the time you'd randomly make it a republican President, half the time you'd randomly make it a democrat[ic] President and you'd see how those two treatments did in terms of effects on the economy. The problem is we're not allowed to do that in the social sciences. I can't randomly make someone President.
>
> But if you remember the 2004 race, around about 3:00 on Election Day the exit polls got leaked and the exit polls said that John Kerry had won in a landslide. Now, around about 7:00 at night they counted enough votes that it had become quite clear that, in fact, Bush was going to win. But what

---

[2] http://www.freakonomics.com/2010/11/04/freakonomics-radio-how-much-does-the-president-really-matter/

TELEPHONE 312.445.8562 ⁜ FAX 773.345.3637 ⁜ WWW.MIDWAYMGT.COM

> you have in this 4 hours …is a Kerry Presidency...And so what we can do, is look at how the financial markets performed during those four hours of the Kerry Presidency and compare that to either the four hours prior, when it was clearly a Bush Presidency, or the four hours after when we learned it was actually going to be the second George W. Bush Presidency. So when we do that, you see, in fact, that stocks fell a little bit during the four hours of the Kerry Presidency and then they rose a bit when it became the Bush Presidency. So that tells us that the stock market preferred George Bush to John Kerry.
>
> It sounds like good news for republicans. Now let me give the democrats' response, which is in fact - it didn't move very much. It looks like the difference between having a Bush Presidency and a Kerry Presidency for the value of US stocks was maybe 1 ½ or 2% which is really a pretty small thing.

So where does this leave us on our quest for the economic impact of the Presidential election? The experts would suggest that the outcome of the election would affect the market about as much as Monday's jobs report – in other words, not much. So we'll continue to watch the election coverage with interest, but we won't make any investments based on who will be sitting in the coveted co-pilot's seat this time around. We're sure you'll be able to find plenty of lively commentary on CNBC, though!

Overconfidence

If most people overestimate the true power of the President, this is part of a wider human fallacy. We tend to give ourselves a lot of credit when it comes to evaluating our own abilities. Most people, for example, consider themselves to be above-average drivers. This is, of course, impossible, as 50% of the world must be above average, and 50% must be below average. This overconfidence is really just human nature, but inevitably leads to a degree of arrogance. (And if we're all equally arrogant, wouldn't a humble soul be unjustly labeled timid?) There are ten questions below. Take a moment to answer them by giving an estimated range. Be at least 90% certain that the true answer lies within your range. There is no limit to the size of the range you provide. Answers are on the final page of this letter[i].

1) What is the surface temperature of the sun?
2) What is the latitude of Shanghai?
3) What is the area of the Asian continent, in square miles?
4) In what year was Alexander the Great born?
5) What was the total value of U.S. currency in circulation in 2004?
6) What is the total volume of the Great Lakes, in cubic miles (1 mi^3 = 1.1 trillion gallons)?
7) What were worldwide box-office receipts for *Titanic*?
8) What is the total length of coastline touching the Pacific Ocean?
9) What is the weight, in pounds, of an empty Boeing 747-400?
10) What is the weight, in pounds, of the heaviest blue whale ever recorded?[3]

Somebody answering these 10 questions with 90% certainty should get nine answers correct. Most people get three questions right. The team at Midway Capital got, on average, 5.33 correct. This phenomenon has been repeatedly evaluated over the years with the same result. In fact, one study conducted in the 1980s determined that subjects claiming to be 100% sure of their answer were wrong 20% of the time.

---

[3] McConnell, Steve. *Software Estimation: Demystifying the Black Art.* (Redmond, WA: Microsoft Press, 2006)

TELEPHONE 312.445.8562 ✢ FAX 773.345.3637 ✢ WWW.MIDWAYMGT.COM

Part of the problem is that we're reasonably good guessers – just not as good as we like to believe. For example, when the team at Midway Capital took this quiz, we all guessed the latitude of Shanghai to within 10 degrees of its true latitude, but only one of us got the answer correct. The problem isn't that we missed the mark – after all, we were at least in the ballpark. The problem is that we were 90% sure we were right, when in actuality, we were only about 53% sure. This becomes particularly troublesome for chief executives who had to position their companies to maximize profits in 2007, and survive the Great Recession a year later. It was hard to miss the housing bubble, particularly in places like Las Vegas. However, few investors fully grasped the size of the bubble, the wide-reaching effects of its collapse, or the collateral damage wrought by lending markets that evaporated in the blink of an eye.

Recognizing our inherent weakness is the first step in overcoming it. As stock pickers, we're constantly forced to make estimates: How many iPad 3s will Apple sell? At what point do gas prices derail the recovery? We don't know the answer to either of these questions, and we'd rather not venture an estimate. This is part of our strategy: we don't make bets based on a hunch. Every guess we make is an opportunity to be wrong. We try to limit those chances, give ourselves a bigger margin of safety, and remain open to the possibility that we're still wrong.

At the same time, know thyself. Rachel studied Classics, so she was able to give the exact year in which Alexander the Great was born, but placed a comfortable range around that year just to be safe. We don't know how much oil the world will demand in the next six months. But we do know that real estate in Manhattan is expensive and always in demand. When we do make bets, we aren't afraid to be tactically aggressive, but we do choose our moves with the utmost caution. In the words of Benjamin Disraeli, "To be conscious that you are ignorant is a great step to knowledge."

Notes and Asides

In response to the suggestion from one of our clients, Midway Capital is now on Twitter. We have found it a good way to "tweet" or recommend articles that we think our clients would enjoy. We recently tweeted the *Freakonomics* story on the President that we mentioned above. We don't plan on tweeting much, probably three or four times per month. But if you enjoy our letters, you can follow us in the interim on Twitter where our handle is @MidwayCapital, or simply click the Twitter link on our website, www.midwaymgt.com.

Yours,

Rachel Barnard, PhD
and the Midway Capital team

---

[i] Answers: 1) 10,000° F; 2) 31° North; 3) 17,139,000 mi^2; 4) 356 BC; 5) $720 Billion; 6) 5,500 mi^3; 7) $1.835 Billion; 8) 84,300 mi.; 9) 393,263 lbs.; 10) 380,000 lbs.

TELEPHONE 312.445.8562 ⁘ FAX 773.345.3637 ⁘ WWW.MIDWAYMGT.COM