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

April 16, 2016

Dear Fellow Investors,

This year started out as a continuation of 2015. Oil prices plunged in tandem with emerging markets, and value stocks were still taking it on the chin. But somewhere amid the speculation about a recession, that trend reversed. March and April (thus far) have been excellent months for the type of value-oriented investments that we favor, and the dip in January gave us the opportunity to go bargain hunting. Our returns still reflect the difficult environment that prevailed last year and in January. While we know that our investments won't always perform above the average, we are still disappointed when they don't. So it was gratifying to have some of our convictions vindicated in the recent rally. Specifically, emerging markets are finally gaining some traction after almost six years of underperformance. Financials and energy have also shown recent strength as oil prices have rebounded and investors have figured out that trouble in the oil patch will not bankrupt our lenders. We still expect markets to be choppy in the near term, but at the same time we hope that the nearsighted oil and commodity-driven markets are now in the rear view mirror.

Midway Capital Value Portfolio Returns

	Midway Composite (net of fees)	S&P 500 TR Index	Difference
Q1 2016	-0.68%	1.35%	-2.03
Annualized Return Since Inception	8.61%	8.68%	-0.07
Total Return Since Inception	89.7%	90.6%	-0.90

Data reflect total returns (including dividends) net of fees as of 3/31/2016. 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.

Making Sense of a Volatile Quarter

As we said above, the first quarter was dominated by volatility. Leading this volatility was the price of oil, which fell to $26 per barrel in February. You may be tired of hearing about oil prices by now, but it's important for investors to consider the shocking magnitude of this change – the price of the world's most sought-after commodity dropped by three fourths over the course of two years. Imagine if coffee did the

TELEPHONE 312.445.8562 ⁘ FAX 773.345.3637 ⁘ WWW.MIDWAYMGT.COM

same – a $2 cup of Joe would fall to a mere 50 cents. Imagine if homes were suddenly worth 25 cents on the dollar. That would make the recent housing crisis look tame by comparison.

Perhaps not surprisingly – given the magnitude of disruption to global markets – the stock market started moving in absolute lockstep with the price of oil during the first quarter. If crude rose by 10%, the stock market moved up by 2%. If oil fell, so did the market. This was true for both American and foreign markets, and it crossed all sectors from banks to pharmaceuticals, from manufacturing to the service sector. For a while, one could tell what the stock market was doing by watching numbers change at the gas station.

Why did this happen? Frankly, we think investors were just scared. Low oil prices lead to financial difficulties for many oil producers. When that happens, oil companies struggle to pay their loans. Next, banks don't have enough money to lend to other businesses, and so on. However, if you dive into the actual numbers in a rational way, this doesn't make much sense. By and large, one could write off every dollar lent to an energy firm, and U.S. banks would still be on solid footing.

But consider an economy like Saudi Arabia's or Venezuela's which are totally dependent on oil exports. The effects there could be more than just economic. As Jeremy Grantham says,

> I consider that Saudi Arabia, if it has been driven by commercial as opposed to political reasons, has made perhaps the biggest economic error in the history of oil. If their main motive is political, on the other hand, it better be an extremely important one for they themselves are quite likely to pay a very high political as well as financial price. An oil price change of this magnitude and speed is very destabilizing to economies, politics, and social cohesion. It makes for dangerous times and the market does not like it. The psychological response is understandable.[1]

While the big move in crude oil led many to believe a recession was just around the corner, things haven't panned out that way. First, oil has stabilized since February, rising to around $35 per barrel as of this writing. This leads us to believe much of the deepest drop in oil prices was speculative in nature. Second, there's no logical reason that the *every* company around the globe should be negatively affected by cheap oil. Take our newest holding, Apple, as an example. Apple is selling to a consumer who's paying less at the pump. Low oil prices mean consumers have more discretionary income to spend on their iPhones and Apple Music library. We have long believed, and we continue to believe, that low oil prices will be a net positive for the U.S.

While we're discussing the defiance of logic (and perhaps too, defiance of federal law), the U.S. Treasury issued new guidelines regarding corporate inversions. This affected two of our holdings, Allergan and Pfizer. They had planned to merge later this year, with Pfizer adopting Allergan's Irish headquarters and their Irish tax rate along with it. The Treasury's regulations put the merger's tax benefits in serious doubt, and rather than fighting the Treasury, Pfizer and Allergan decided to go their separate ways. We had planned for such a contingency when we bought Allergan last year. While we believed the merger would likely be completed, we knew at the time that we'd be happy to own Allergan regardless of the outcome of the merger. It would appear others don't share our sentiment.

---

[1] Grantham, Jeremy. *GMO Quarterly Letter Q4 2015*. p. 15. www.gmo.com

TELEPHONE 312.445.8562 ⁘ FAX 773.345.3637 ⁘ WWW.MIDWAYMGT.COM

Shares of Allergan have fallen considerably since the break-up was announced, while Pfizer's have climbed. That would seem completely illogical. Isn't Pfizer the company who's losing out on the low tax rate? Isn't Allergan the company who received a $150 million breakup fee? In fact, we think Allergan is worth at least as much, if not more, without Pfizer.

This situation may defy logic for long-term holders like ourselves, but it makes perfect sense in Hedge Fund Land. Before the break-up, many funds made a merger arbitrage trade that involved buying Allergan while shorting (selling borrowed shares of) Pfizer. As part of the merger, Pfizer promised to swap $359 worth of its own shares[2] for each share of Allergan, priced at $278 per share the same day. If the merger completed, each share of Allergan would have been worth $359. Thus, either Allergan's price would have gone up to equal $359, or Pfizer would have gone down to equal $278. Hedge funds placed bets to capture the gap between these prices, betting on convergence. Thus a trader would buy Allergan at the same time he sold Pfizer. Now that the deal has been called off, hedge funds are left trying to undo this trade, which entails doing just the opposite – selling Allergan and buying Pfizer. So contrary to what would seem logical based on the companies' prospects, Pfizer shares rose and Allergan shares dropped when the deal broke up. We expect this to reverse when the hedged trades are unwound.

As an interesting aside, you may be wondering how the Treasury can defy existing tax law and suddenly scuttle a tax maneuver which had been done legally by so many other companies. We haven't seen a single legal scholar opine that the new treasury regulations fall within existing law, either as written by Congress or as established by the courts. The Treasury may not have full confidence in its position, either. Referring to another inversion, the Treasury Secretary said in 2014, "We do not believe we have the authority to address this inversion question through administrative action. If we did, we would be doing more."[3]

Despite the dubious footing for Treasury's new regulations, Pfizer and Allergan were essentially trapped. They didn't have the standing to contest the mere existence of the new regulations. The Treasury taking a position doesn't cause injury to either company. Treasury is merely offering its interpretation of existing law. Were Pfizer and Allergan to merge and be assessed a tax penalty, that *would* create injury. The parties could then sue for relief. But the suit would get tied up in the courts for years, and there would be no guarantee of success. By far, the path of least resistance was just to scuttle the merger, which is what Treasury wanted.

All these machinations would be unnecessary if Congress would rationalize the tax code. The real problem here is a tax code that is outdated and out of sync with the global reality of business. With today's dysfunctional government in Washington, we don't hold out much hope for meaningful reform, but we do think that enacting a fair tax rate and eliminating corporate loopholes would be a boon for American business. As shareholders, we believe the $3 billion that American companies spend annually on lobbying could be better invested elsewhere.[4]

---

[2] Price as of late March 2016, before the deal was called off

[3] Treasury Secretary Jack Lew on CNBC. July 16, 2014. www.cnbc.com/2014/07/16/cnbc-exclusive-cnbcs-jim-cramer-interviews-treasury-secretary-jack-lew-from-cnbc-institutional-investor-delivering-alpha-conference-in-nyc-today.html

[4] Pfiasco. *The Economist*. April 9th-15th 2016. p. 63.

TELEPHONE 312.445.8562 ⁘ FAX 773.345.3637 ⁘ WWW.MIDWAYMGT.COM

What the New Fiduciary Rule Means for Investors

Today, I'm calling on the Department of Labor to update the rules and requirements that retirement advisors put the best interests of their clients above their own financial interests. It's a very simple principle: You want to give financial advice, you've got to put your client's interests first. – President Barack Obama, February 23, 2015

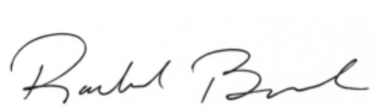
On a completely different note, we can't let April pass without mentioning the new Department of Labor rule, popularly known as the Fiduciary Rule. "Yawn", you say? Boring government regulation? In fact, this is a long-overdue step forward in helping people with retirement plans get a fairer deal. It means that anyone offering retirement advice will have to adhere to the fiduciary standard.

At Midway Capital we have always operated under the fiduciary standard (we are proud of that and we hope that is a factor in why you choose to work with us). We are required, as a Registered Investment Advisor, to put our clients' interests above our own and we always do. However many brokers and insurance salesmen aren't required to do that. I'm sure you know someone who has been given lousy financial advice. We see new clients come through the door much too frequently with investments that were clearly sold to them in the interest of the broker earning the highest commission. The new Fiduciary Rule should improve things, at least in the realm of retirement plan advice.

What does this mean for you? Many of you have retirement plans at work. When you talk to your representative about your plan and your options, you should expect them to disclose the fees you are paying and to be up front about any commissions and sales charges (loads). In fact, this rule is designed to discourage costly commissions and sales charges in favor of asset-based fees so you should be suspicious if a product has no fees or if the broker/advisor tries to tell you that it won't cost you a thing. Ask specifically how the provider gets paid. The advisor should disclose exactly how they are paid and why certain products are better for you than other choices. Beware of proprietary funds and ones with overlapping holdings, and remember that stuffing more investments into your plan is rarely better.

If you want a hand with this, we are always happy to go over your retirement plan options with you, wherever your plan may be. If you are a client, we offer this at no charge as part of your ongoing relationship (for which you pay us a quarterly asset-based fee – that's how we get paid.) For those who aren't clients, we are offering a new "Retirement Plan Check-up" service for a flat fee of $100. We'll go over your plan with you and recommend selections that fit your needs and goals while keeping fees to a minimum. And remember that we always offer a free second opinion service, so if you, or someone you know, is uncertain about any advice given by another advisor, we will give you a straight answer. Give us a call or email anytime.

Yours,



Rachel Barnard, PhD, Todd Schrade, CPA, and the Midway Capital team

TELEPHONE 312.445.8562 ✣ FAX 773.345.3637 ✣ WWW.MIDWAYMGT.COM