

MIDWAY CAPITAL RESEARCH & MANAGEMENT LLC

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Dear Fellow Investors,

I am sure that there will be quarters when things are so dull that there will be hardly anything to say in these letters. The third quarter of 2008 was not one of those. And the fourth quarter has started with a bang as well.

The good news is that your portfolios managed by Midway Capital performed relatively well during the third quarter. Although we target higher long-term returns, we are pleased with the results in the third quarter against the backdrop of a falling stock market. As shown below, Midway's composite portfolio returned 4.63% during the quarter compared with -8.37% for the S&P 500 Index, meaning that we outperformed this index by 13 percentage points. The average stock mutual fund (according to Lipper data) lost 10.3% during this past quarter, so we are pleased to report better results than many investors are getting in the stock market.

	Q3 2008	Total Return Since Inception (7/1/08)
Midway Composite (net of fees)	4.63%	4.63%
S&P 500 Index	-8.37%	-8.37%
Difference	13.00%	13.00%

Data reflect total returns (including dividends) net of fees as of 9/30/2008. Returns are unaudited. Your individual returns reported on your statements may vary from the composite depending on when you invested and upon any special restrictions applicable to your account. Returns for each month have been different and the longer you've been with Midway, the more invested your portfolio is. 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 over the past quarter.

I have compared our returns to the S&P 500 index. I picked that benchmark because it is the best proxy I can find for the opportunity cost of investing your portfolio with Midway Capital. Essentially, I want to give you a sense of what you are giving up by investing with us. Funds that track the S&P 500 are widely-held and easily accessible to any investor. This quarter, it was a good trade-off since our returns beat the benchmark by a wide margin. We won't necessarily be able to do this every quarter, or even every year. So while we're pleased with these results to date, we remain focused on long-term returns.

To that end, we continue judicious buying of high-quality companies with strong competitive positions. We still hold a sizable amount of cash overall as we await more bargains down the road. We don't know where the market is headed, but with all the recent volatility and extreme pessimism, we expect that there

will be some buying opportunities worth waiting for. In the meantime, we couldn't be more pleased by the group of high-quality firms which we own.

News this quarter

I said last quarter that we weren't investing in oil or commodities. That served us well in the third quarter when many of these stocks posted big declines and oil prices fell dramatically. We also did well with our financial holdings, buying superior businesses and steering clear of the riskier names that lost most or all of their value. Volatility has been our friend this quarter, allowing us to invest on some very significant dips in price. But all this doesn't amount to a hill of beans compared to the appreciation potential we see in the stocks we own. So the biggest news from the quarter is really the burgeoning group of excellent companies we are acquiring at bargain-basement prices.

The other good news is that Midway Capital now has a dedicated research specialist. Matt Nellans joined us this quarter as Associate Director of Research and has been digging into new ideas as well as vetting ideas that I have. Matt and I worked together as colleagues at Morningstar for many years and he is one of the best analysts I have had the pleasure of working with. We look forward to many years of collaboration in creating portfolios that meet your long-term goals and high expectations.

Stock focus

In this section, we'll discuss two of our current holdings to give you some color on how we think about investing. I'll kick it off with a company that Matt knows particularly well as a long-time insurance analyst. We bought shares of an insurance company in Chicago called **Old Republic (ORI)** because we can understand the business, the business produces good returns for equity owners over time and the managers have a track record of running the business like it was their own.

We have a good understanding of the insurance business - which is why we usually avoid insurers even if they appear to be cheap. Insurance companies, on average, do not produce good returns and the business is replete with the risk of permanent capital loss. Old Republic, however, is different. Old Republic uses very little debt and does not use derivatives at all. Managers prefer to pay out its profits as dividends or re-invest in the businesses it knows best. This is reflected in its superior long-term track record.

Commercial property-casualty insurance and mortgage insurance are the most important businesses under the Old Republic tent. The near term fear of the mortgage insurance business allowed us to buy Old Republic shares at a discount. The market seems to be pricing in the disappearance of the mortgage insurance business. We think losses will continue in the near term, but after the firm chews through the bad business (probably into 2009) the earning power will return. Because Old Republic doesn't use a lot of debt, it can control its own destiny and survive the current turbulent market. Even better, now is a great time to be writing mortgage insurance policies. There are still plenty of good borrowers out there who need loans (94% of all mortgages today are current on their payments). Because of the large losses and increasing importance of mortgage insurance to lenders, Old Republic is now charging higher rates on new business. It is also applying tougher underwriting standards to new loans. In short, Old Republic is charging more for less risk. So the business it is writing now is the cream of the crop. And Old Republic's investors will reap the fruits of this over the next several years.

While we're talking about Chicago-based companies, we will also highlight our investment in **Jones Lang LaSalle (JLL)**. Jones Lang is a commercial real-estate services company. Instead of actually owning buildings and land, however, the firm provides services to those who do. Jones Lang can help a commercial tenant find the right building, line up financing, and manage the property on a day-to-day basis. It also provides a host of other services to firms around the globe - 50% of its business is outside the U.S. - and is one of the only major firms in this business, giving it a huge advantage over the smaller players in this fragmented industry. The jewel in the crown, however, is its investment management

business which manages \$54 billion, mostly for institutions who want to invest in real-estate. It generates annuity-like revenue every year with almost no capital investment needed.

Commercial real-estate transactions are slowing around the globe and commercial property prices may fall as well. But with very little debt and the flexibility to downsize as needed, Jones Lang can scale back its business until conditions improve. And its investment management unit will continue to generate profits throughout the cycle. But the one thing that makes Jones Lang a compelling investment now is the price. We estimate that the investment management business *alone* is worth what the stock currently trades for, and it typically generates only a third of the firm's profits. So investors are getting the other 67% of the business for free. Even in the most dire of economic situations, some property owners would need the firm's services to manage their buildings, and tenants would still need to find new (smaller?) spaces. So the services business clearly has value. And the investment management business is a gem. We love these kinds of investments – a solid company with a dominant competitive position trading at a completely irrational price.

A few words on the credit crisis and investing philosophy

There is no doubt that we are in a tough investing environment. I want to give you some color on how we approach investing during these times. Fundamentally, nothing has changed. We still seek to buy pieces of exceptional businesses at reasonable prices and hold them. We have two significant advantages over many other investors out there: we have a long time horizon and we don't invest borrowed money. That means we can ride out tough times if we need to – and there may be tougher markets ahead.

In addition, we want businesses that can withstand economic stress. We avoid risky firms that have a material chance of permanent capital impairment. Midway steered clear of Fannie Mae, Freddie Mac, Bear Sterns, Lehman Brothers, AIG and Washington Mutual. We are familiar with each of these businesses and we could run the numbers and come up with scenarios - that were not far-fetched - whereby the stocks were worth significantly more than the market price. What kept us away from these stocks was the enormous amount of debt that each firm used. The debt load and leverage inherent in derivatives meant that each firm was not able to play out its hand. Each was seized by creditors in one form or another.

Did we see it coming? The answer is both yes and no. We knew that lending standards were poor and the system had enormous leverage in it, but we did not know how unstable the US financial system would be in 2008 and we certainly did not predict the failure of several major financial institutions. We always think that any highly leveraged financial institution is on the verge of trouble, but the number of firms that are going bust is surprising to us.

We are often asked if the government bailout will work and where the market is headed. We don't know and have no control of either. But for our portfolios, it shouldn't matter. In the long run, we believe these businesses will trade at significantly higher prices. And in the near term, we believe they can withstand economic stress even without government assistance.

To end on an optimistic note, it is always possible that the markets are headed straight up from here. So while we prepare for the worst, we also need to be well-positioned when things turn around. We don't know when that will be, but it will happen. And we will be prepared for that too.

Yours,

Rachel Barnard
Manager