MIDWAY CAPITAL RESEARCH & MANAGEMENT LLC
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January 7, 2010

Dear Fellow Investors,

From an investing perspective, 2009 was an exceptionally good year.

	Midway Composite (net of fees)	S&P 500 TR Index	Difference
Q4 2009	4.89%	6.04%	-1.15
2009	35.40%	26.45%	+8.95
Annual Return Since Inception (7/1/08)	4.48%	-6.47%	+10.95

Data reflect total returns (including dividends) net of fees as of 12/31/2009. 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.

Investment performance – knowing the unknowable

This past year was a very good year to be in the stock market. But none of us would have guessed that last January. The reader of our letter from last year wouldn't have known that our clients' portfolios would be up 35% in a year. We didn't anticipate that either. As usual, we bought good companies at cheap prices – and there was an abundance of cheap prices! We doubt we will see another opportunity on this scale anytime soon. If we do, however, you can be certain we will take full advantage of it. In the meantime, we are holding our portfolio of high-quality companies and buying opportunistically as prices allow.

Hindsight is an interesting phenomenon. Consider these data: in 2009 the S&P 500 Total Return Index increased in price by 26.45% and U.S. Treasuries declined in price by 3.3%. It would be tough to surmise from these figures the extraordinary events of 2009. Yet this was a year when the government felt compelled to take large stakes in banks (at times against the will of the banks' managers). Two of the world's largest car makers, GM and Chrysler, collapsed in bankruptcies wrapped in political favoritism. The official unemployment rate still stands at 10% and some statisticians calculate the unemployment rate to be nearly 20%. It has been an unusual year to say the least, and unusual circumstances for a major stock market rally.

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Needless to say, we won't even try to predict the events of 2010 and beyond. As Warren Buffett noted in an op-ed in August, the fiscal deficit of the US government and the consequent money printing could provoke significant, but unknowable results, in the next decade and beyond. In Buffett's words, "we are in uncharted territory."[1] We have a good idea of what could be possible, but we cannot know the timing and we cannot predict what further interventions could occur. The only advice we can give with a high probability of being correct is the same as last year: avoid long-term fixed income instruments like Treasuries.

With respect to our approach to investing in stocks, the only method that we can use to plan for the unknowable is to be sure we buy decent businesses for less than they are worth. This process will help us avoid investing in GM-like situations. GM was, and is, a dreadful business. It does not make an economic profit. Because the business had consistently been so poor, we have never attempted to try to value the shares. But there are numerous businesses that we think would be worth owning at the right price. Because prices, on average, have increased in the past few months, the number of stocks we'd consider buying has declined throughout 2009. If the prices of these stocks decline in 2010, we might be buyers. If the prices do not decline, we will sit and wait. Waiting for a better price may be the toughest investing task of all. John Milton said "They also serve who only stand and wait."[2] If buying low and selling high is the goal of investing, then there will always be a time when the most profitable service we perform for our investors is waiting. In either case, we're prepared to invest judiciously, no matter what 2010 sends our way.

Portfolio update

In our first quarterly letter, dated July 7, 2008, we talked about two "gems" that we were buying. They were **East West Bancorp (EWBC)** and **Sotheby's (BID).** We would like to take this opportunity to circle back and update you on those two businesses. We still hold positions in both of them and we still think they are great firms. Naturally, things are different than they were a year and a half ago, however, so this is a good time to discuss what has changed and what hasn't.

East West, as you may recall, is a small bank that serves the Chinese-American community in California. It's not such a small bank anymore. East West is now the second largest bank headquartered in California. It bought the assets of another struggling institution, United Commercial Bank (UCB) in an FDIC-assisted sale in November. If that doesn't sound exciting, think of it this way: the FDIC asked East West to take the loans and deposits of UCB and manage them, bringing stability to former UCB customers. In return, the FDIC will absorb a portion of the losses on any bad loans. We expect East West to book an immediate gain on the transaction and additional gains as it works out the loan portfolio. The bank also gets access to cheap funds (deposits) from UCB customers, most of whom are likely to stay with East West. We think of it as a win-win for East West. Consequently, we think the bank is worth more than it was before the deal and we are hanging onto the shares.

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[1] Warren Buffett, "The Greenback Effect," New York Times, 19 August, 2009, p.27(A).

[2] John Milton. Sonnet "On His Blindness."

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Sotheby's has been through a very rough couple of years. This company is, by nature, pro-cyclical, meaning that when times are good they are really good and vice versa. During this global recession, sales of art have slowed and prices have fallen steeply from the lofty highs of 2007. The four "D"s still drive art sales: Death, Divorce, Discretion, and Debt. However, falling art prices have put the lid on discretionary sales, the largest part of the market. Falling global financial markets also led art buyers to keep their purses closed in 2009. We believe that the best time to buy a business like Sotheby's is at a cyclical low, when prospects look dim to other investors. Then we're content to wait for the art market to rebound – as it always has.

Signs of such a rebound are already appearing. Demand for art is on the rise again as financial markets have taken a U-turn and investors are feeling more flush. That has led to rising art prices, which in turn has attracted more sellers to the market. As we said above, when things are good in the art market, they are really good at Sotheby's. So we continue to hold Sotheby's shares and are looking forward to profiting from the good times that we believe are now on the horizon.

How we think about Cash

We always like to address common client questions in our letters. One question we've recently been peppered with is how we think about utilizing cash in your portfolios. This is a very timely question too, considering the drag cash can have on a portfolio when stock prices are rising, as they have over the last several months. The main reason we lagged the S&P 500 Index this past quarter is that we have a number of accounts with significant cash positions. The index, of course, is 100% stocks. This cash would have benefitted us if the market had fallen, arguably the most crucial time to have cash available to invest.

Generally speaking, this is how we think about investing and holding cash: purchase securities slowly when the prices are reasonable, and keep cash on hand if prices rise above the level at which we can earn a decent long-term return.

The careful reader might note that we invest more money when prices are attractive, and thereby "dollar cost average" into the businesses we like – a tried and true method of earning above-average returns. Our approach is not unlike the savvy shopper who, recognizing that toothpaste is selling for less than it normally does, spends his money on an extra tube each time he goes to the market to do his weekly grocery shopping. He keeps buying until the price goes back up – or until his pantry won't hold another tube. In investing it is even more important to come to the market only when our favorite securities are on sale.

Here's how it works in mathematical terms. Our investor has $200 to invest. She has chosen to invest in XYZ Corp, a fine company with a solid business. The stock trades at $100 per share. She invests in 2 shares for $200. Her timing is lousy, though, and the stock and goes down by 50%, to $50 per share. She now has $100 worth of stock. Despite this decline of fifty percentage points, there is no fundamental change in the business. For this investor, the price will now need to double, or increase by one hundred percent, just for her to break even.

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If, on the other hand, this same investor bought only 1 share of XYZ at $100, then she would have cash on hand to increase her investment at a better price. At $50, she could buy another share. That would give her 2 shares of XYZ at a cost of $150 or $75 average cost per share, plus $50 of cash left over. If XYZ goes back to $100, she makes $50. Or instead, following a dollar-cost-averaging discipline, she could invest her second $100 in 2 more shares of XYZ at $50 apiece, giving her 3 shares of XYX at $66.67 per share (($100+$50+$50)/3). If the stock goes back to $100, she makes $100, or a 50% return on her original $200 investment.

For this investor, having cash available reduced the risk of permanent capital loss, and increased the probability of a better return.

And in a nutshell, that is how we manage your portfolios. By slowly using cash to reduce the average price paid for certain securities we try to reduce the risk of capital loss, and to also give ourselves the flexibility to make new investments in other businesses when the price is right. We're more than happy to have a slight cash drag in up-markets, since it helps us both protect capital and plant the seeds for future performance in down markets.

Yours,

Rachel Barnard, PhD

Justin Fuller, CFA

Matt Nellans

Drew Richards