MIDWAY CAPITAL RESEARCH & MANAGEMENT LLC
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Dear Fellow Investors,

We hope that 2010 has been a good year for you and that 2011 is off to an auspicious start as well. As you can see from your statements and the results below, 2010 has been an exceptionally good year for us as investors. We don't expect to report 18.8% returns every year, and we have grown a bit more cautious as markets have heated up. However, we do feel confident that the long-term returns of the companies we own will continue to be exceptional.

Midway Capital Value Portfolio Returns

	Midway Composite (net of fees)	S&P 500 TR Index	Difference
Q4 2010	10.95%	10.76%	+0.19
2010 Full Year	18.81%	15.06%	+3.75
Annualized Return Since Inception	10.01%	1.60%	+8.41
Total Return Since Inception	26.93%	4.05%	+22.89

Data reflect total returns (including dividends) net of fees as of 12/31/2010. 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.

A few words on the investing climate

We had several very good buying opportunities in 2010, a year with significant stock market volatility. We like to take advantage of these pockets of pessimism to expand our holdings of superior companies. However, the optimism of the past quarter, coupled with a large run-up in stock prices, has left us with less enthusiasm for the way our favorite firms are now priced. We have a large and growing bench -- our "watchlist" -- of stocks we would love to own when the prices are more reasonable. In these times we think cash retains a large option value in case we get a market correction. We do still have some firms on

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our buy list, but since we started Midway Capital, there have never been so few. It's no coincidence that this corresponds to a 2-year stock market high.

As we've said many times, we don't make macroeconomic predictions. We have no special insight into where the economy is headed, what inflation rates will be in China, or whether the Euro will collapse. However, we do have to think about how the broad economic landscape will affect the companies we own and predict how much each firm can grow over a long cycle (usually 10 years, give or take). If the price of a stock implies more growth than we think possible, we'd consider selling and vice versa. Right now, we think the price of stocks implies very robust near-term growth – the kind we have seen in good economic conditions in the past. However, we see the world economy as still shaky, not justifying the kind of growth investors seem to be expecting given the prices they are paying.

There are a number of threats to economic stability that could easily roil markets or even trigger a new recession. Unemployment in the United States is stubbornly high and shows little sign of improvement. House prices remain low. The picture in Europe ranges from dicey to dire depending on whose analysis you read. *The Wall Street Journal*[1] reports today that the cost of insurance on several European countries' debt reached an historical record yesterday. This means that more and more bond investors believe that these countries will default on their debts. The countries most in the limelight are Greece, Portugal, Ireland, and Spain. The price of insurance against default (credit default swaps) for these countries implies that they are considered "junk" bonds by investors. Whether or not a default happens, the whole Euro-Zone is on the hook for much of the debt from member nations. The European Union has floated the idea of making bondholders pay for some of the bank bailouts, which is rather like defaulting, whether you call it restructuring or anything else. This is not the picture of a healthy market, and we could easily see repercussions around the world if Europe falters.

It's hard to say why markets have been so strong during the past quarter. Certainly the consumer spending numbers are good and the U.S. economy is growing again. But we also suspect that investors have been forced into stocks by the low yields on other investments and the current bond bubble. That money could come pouring out if there is a large market correction. Before we become too optimistic, we'd like to see the global recovery on a firmer foundation. If there is a correction in the market, we will be glad to use some of our cash to pick up our favorite stocks at good prices.

Changes in tax lot accounting – how it affects us

A long-standing headache for investors has been keeping track of the cost basis for the investments we own. Particularly with investments that have merged, split, or gone through divestitures, this can be a real chore. Midway Capital tracks all this information for our investors and it is included in all your quarterly statements. However, many firms do not track this and were not required to – until now. Beginning in 2011, the IRS has mandated that brokerage firms report cost basis for stocks and ETFs to the government as well as to investors. The purpose is twofold: it discloses gains to the IRS, making it more difficult to

[1] Gongloff, Mark. "In Europe, Angst Fills Sovereign Bond Gap." January 7, 2011.

underreport income; it also presents investors with their gains and losses in an easy-to-understand format. In subsequent years, cost basis reporting will be required on mutual funds and other securities.

For most clients of Midway Capital, this law won't have much practical significance and it certainly won't change the way we invest at all. However, there are a few things you should be aware of.

1. Whenever we sell a security for your account, we will be required to select a specific tax lot to sell. In cases where we sell only a portion of your holdings, we will select HIGH COST by default.

We have always done this in order to minimize your taxable gains. When making a sale, we identify the specific shares of stock we are selling. This allows us to sell the shares with the highest purchase price first, thereby minimizing gains that must be recognized immediately. For instance, we may have bought shares of XYX corporation at two different times: 100 shares at $50 per share and another 100 shares at $30 per share. The average cost for all 200 shares is $40 per share. However, they are technically two different lots for tax purposes. Say that XYZ stock rises to $75 per share and we want to trim our holdings by selling 100 shares. We'll sell the lot we bought at $50 per share first, thereby realizing a gain of $25 per share. (Compare this to a gain of $45 per share if we sold the low cost lot). This minimizes the current gain and results in the lowest tax bill.

2. Once a tax lot is selected and the trade settles, it cannot be changed.

For most of you, this won't be relevant. But if you have a tax strategy that involves selecting lots at the end of the year depending on your tax liability, then you won't be able to do this much longer. Keep in mind that the new rules only apply to securities *bought* in 2011 and beyond. If you sell something you bought earlier, your brokerage won't be required to report it. However, if you have specific tax strategy you'd like us to execute in a given year (other than just minimizing taxes, which we already do) you need to let us know.

3. This has no practical effect on non-taxable accounts like IRAs or 401(k)s.

Brokerages are not required to keep this information for qualified accounts. However, we still keep track of the cost basis for these accounts and our bank, SSG, will track these as well.

There will be an insert in your December statement from SSG explaining the details of the new law. And we'll be talking to you individually about this during the year. To sum up: if you want us to select tax lots in a way other than "high cost," please let us know. Otherwise, this is just for your information.

Tax strategy

Since we're on the subject of tax management, we'll say a little more about the strategies we use to minimize taxes for our clients. When dealing with taxable accounts, we seek to defer gains until they can be realized without paying taxes. There are a few ways to do this. (We’ve deliberately simplified some of the following examples. Consider them a rough outline of a more comprehensive strategy.)

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First, gains and losses can be counted against one another. Thus, a $5,000 gain from selling stock A can be erased if we sell stock B at a $5,000 loss. Second, long-term capital gains are generally taxed at a lower rate then short-term gains. As long-term investors, we seek to have multi-year holding periods for the investments we buy. As such we anticipate very few realized short-term gains. Third, there are occasional situations where a taxpayer may find him or herself in a low tax bracket. One of these situations exists now: until 2012, married taxpayers reporting less than $68,000 in taxable income per year pay no tax on long-term capital gains. For such taxpayers, it is a good time to take gains without paying taxes. Fourth, estates all have a step-up in basis. The heir who inherits securities gets them at a new cost basis. This is equal to the fair market value of the securities on the date of the decedent's demise. And finally, because we hold all securities in individual separate accounts, not in one big fund, any realized gains and losses are particular to your account. This makes our accounts much more tax efficient than a mutual fund, where one investor cashing out can trigger gains in other investors' accounts.

Given the many ways taxable gains can be avoided, it is often possible to delay gains until they can be realized tax-free. We try to take advantage of every bit of flexibility given to us in this matter. We think this is the best approach under the vast majority of circumstances. But there are exceptions, which we can't always be aware of. If you hold assets with us in a taxable account, and find yourself in a situation where your taxable income will be either unusually low or high in a given year, please notify us as soon as possible so we can work out a more appropriate strategy.

By the same token, there are a myriad of choices concerning your retirement accounts. If you have questions about whether to convert an IRA to a ROTH, whether to open a 401(k) for your business, or anything else in that vein, we are always more than happy to help you think through your options and the tax consequences that go with them.

Yours,

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