Taylor Investment Services LLC
2008 Q3 Letter

INTRODUCTION

The stock market finished lower at the end of Q3, with smaller-cap companies significantly outperforming large-cap companies. TIS LLC (TIS)'s consolidated performance was better than our large-cap company index benchmark mainly due to our large cash allocation. Consolidated performance represents a blended fee rate. Returns for individual portfolios, especially for accounts below $100,000, may differ significantly.

OUR LARGE CASH ALLOCATION

Cash levels in our accounts are very high. This is a result of day by day decisions and in accord with one of the tenets of my investment philosophy (see the website www.taylorinv.com:

"**Evaluate and scale according to the risk/reward scenario of a business and value**".

TIS tries to be optimistic about our holdings, subject to verification, but also with the view that it is only what we own that can hurt us. This has often led to rapid portfolio turnover, especially when our positions are undergoing substantial volatility. In part this is a function of the type of stocks we follow. Retailers in particular undergo wide price swings, as their progress is usually updated monthly. You might think that having more information available would increase the patience and intelligence that investors possess but the opposite is often true. In essence, it appears that more information on a short-term basis results in a short-term viewpoint. Since this leads to substantial changes in valuation, we will buy and sell as circumstances dictate.

Lately, I've been selling more than buying, and higher cash levels have resulted. As noted in previous letters, I've also shrunk my universe which means that fewer stocks are coming up on my radar screen. In essence, I'm focusing more on stocks we already follow than trying to find brand new opportunities. Lastly, note that we currently have very little invested in asset managers and retailers, two areas which historically comprise big parts of our portfolios.

Our cash levels have been a plus during a lower market, though any upward reversal could change this quickly. Yet, my daily routine remains unchanged - each day I generally look at 3 to 4 companies and decide what, if any, action is warranted. Given the right opportunities, cash levels could drop rapidly. In the final analysis, I am investing your total portfolio with at least a 5 year time horizon and am looking for companies with strong balance sheets, understandable business models, and attractive valuations – as usual.

NEW ADDITIONS

There were two major additions in the quarter as I added/initiated positions in two technology stalwarts Cisco (CSCO) and Intel (INTC). Both companies have cash-heavy balance sheets, generate significant free cash flow (net cash available after working capital changes and capital expenditures), buy their own shares, and enjoy market leading positions in their respective business areas. Both stocks also seem to gyrate far more significantly than their business progress would appear to warrant, and thus I will add and subtract in these stocks as the above investment principle would suggest – according to the risk/reward scenario of the business and assigned value.

MAJOR SALES

Here is a selected listing of sales (grouped by themes) with commentary as warranted:

***sold/reduced based on valuation**
Barnes and Noble (BKS), Dollar Tree (DLTR), Pet-Meds (PETS), Proctor and Gamble (PG)

BKS – in hindsight, I should have made this bookseller a larger position when it fell earlier in the quarter and we sold when the price rebounded strongly.

DLTR – like BKS, this dollar store retailer is a position that should have been much larger earlier in the year but the current price seems to adequately reflect the company's prospects for now.

PETS – the internet pet supplies retailer reached my target prices and we continue to reduce the position in stages.

PG – similar to PETS, my strategy is to sell this consumer products stalwart in stages as it reaches various target prices.

***sold/reduced based on lowered opinion of shares**
Automated Data Processing (ADP), Chicago Mercantile Exchange (CME), Diamond Hill (DHIL), MarketAxxess (MKTX), Nasdaq (NDAQ), Robert Half International (RHI)

ADP – I really like this payroll processor's business model but felt the stock would remain range-bound for now due to slowing employment.

CME – I decided to sharply reduce this exchange stock when volume trends year over year trended significantly lower.

DHIL – I reduced this asset manager as the company closed its largest fund which was attracting most of investment inflows and the price moved higher. Like all these names, this position could be larger in the near future.

MKTX – I liquidated this exchange stock when August volume trading numbers were sharply lower than the previous year's muted levels.

NDAQ – I decided to liquidate this exchange stock (and a smaller position in NYX) because despite further study I was unsure about the company's business position and competitive strengths. I continue to research this business model.

RHI – Finance oriented temporary employment company RHI is very well managed but faces weakening employment trends and possibly slowing business tone in Europe.

***short holding periods**
Abbot Labs (ABT), Zumiez (ZUMZ)

ABT – I took a small profit in this medical company mainly because the company's history of serial charges ("one-time" expenses) made me uncomfortable, though depending on price ABT could appear in accounts at a later time.

ZUMZ – I initiated a small starter position in this teen retailer but liquidated the position after a quick run-up. Long-term, ZUMZ has solid potential and I would like to buy back the stock at a lower valuation.

AUCTION NOTE UPDATE

Auction notes continue to be redeemed in a slow and steady process, with more than half now complete, and the notes continue to pay a distribution each week. Mentioned last letter, Cohen and Steers' Q3 redemptions were actually postponed until October.

Please note that contrary to my statement in the 2008 Q1 letter, closed end preferred stocks are <u>not</u> required to be redeemed if the fund falls under 200% coverage (e.g., in a $1.5 billion fund with $500 million in the preferred). Rather, a fund is constrained from making distributions as detailed in government regulations. In reality, this can lead to partial redemptions but this is not assured.

CONCLUSION

I hope this review has given you a better understanding of my investment philosophy and your portfolio composition. I appreciate the trust you have placed in my firm to manage your assets. If you have any questions or comments, please don't hesitate to contact me.

Paul Taylor