Taylor Investment Services LLC
2009 Q1 Letter

INTRODUCTION

The stock market gyrated wildly in the quarter before ending lower, with large company indexes outperforming small. TIS LLC (TIS) consolidated performance was better than our large company benchmark. As noted previously, consolidated performance represents a blended fee rate and individual accounts, especially those under $100,000, may differ significantly.

TECH LIQUIDATIONS

During the quarter I liquidated major positions in Cisco (CSCO) and Intel (INTC) along with small positions in Hewlett-Packard (HPQ) and Oracle (ORCL). I also decided to stop following the companies entirely (for now). This section explains why.

Very simply, I did not feel comfortable in this area.

There are several reasons why, including 1) an inability on my part to judge the appropriateness of acquisition activity, 2) a preponderance of jargon-laden commentary in the conference calls which was difficult to understand, and 3) a convention in this industry to, in my opinion, arbitrarily exclude certain recurring expenses (option related expenses in particular).

To assist in understanding these companies, I also found myself relying heavily on outside research, to the point where I was no longer sure if my opinion was my own or a result of what I'd read. Granted, some analysts do fine work, and outside analysis can be extremely helpful in developing a story, but relying exclusively on these opinions leads one open to an investment philosophy and approach which may have little resemblance to one's own.

This all leads to a basic question – did I understand the business model or not? Now, a business does not require my understanding to go up or down but without that understanding I am often constrained and confused on both how much to invest and what to do when the stock moves up or down. Ultimately, I was also unprepared for the cyclicality of earnings in these businesses too. Because of this uncertainty I found myself spending an inordinate amount of time trying to figure out what to do with these positions which limited my ability to follow other stocks where my understanding was superior.

This feeling of unease came into sharper focus one day when I was reviewing the latest earnings call for Dollar Tree (DLTR), a business I've followed for many years. As a shopper, I was intimately familiar with the business, having been in the stores numerous times. As an investor, the earnings calls were straight-forward and easy to understand and this familiarity rendered the need to consult with secondary sources redundant. Of course, just because I feel comfortable and familiar with stocks like DLTR doesn't mean we will achieve success in the portfolios but I believe it certainly increases the odds.

Of course, my timing on those tech sales doesn't look so wonderful in hindsight (several have move sharply higher since), but ultimately I feel that my time is better spent elsewhere in places where, as Peter Lynch writes, I have an 'edge'.

Note: I can't end this section without noting that I would never say never as far as revisiting this area. We still own our Microsoft shares and I still plan on reading, for example, the quarterly Value Line updates, on these businesses.

POSITION SIZES

During the latest market declines position sizes have, for the most part, been getting smaller. In hindsight, they might have gotten <u>too</u> small, and thus you should expect a bit more uniformity in our allocations in the future. Specifically, I will begin to favor an allocation system which uses the same position size on every transaction. On rare occasions, I may also use outsized position allocations when circumstances warrant.

MAJOR ADDITIONS

This section provides of list of the major additions to the portfolios, though not all trades appeared in every account.

Becton Dickinson (BDX - stalwart). As noted in the Q4 report, my past sale of medical devices company BDX looked premature in hindsight and a lower price enabled us to reestablish the holding.

Dollar Tree (DLTR – fast grower/asset play). **I** continue to be enamored with dollar store retailer DLTR which is generating huge amounts of free cash flow and is enjoying solid sales.

Global Deal Fund preferred A share (GDL-A – fixed income). Essentially a fixed income substitute for our cash holdings, unlike like most closed end preferred shares this one has a set termination date. Also, the underlying fund is a merger arbitrage vehicle which has, in the past at least, been uncorrelated with the market. I am trying to increase this position.

Kirkland's (KIRK – asset play). Brought to my attention by a top-notch stock analyst, retailer KIRK generates significant free cash flow in a difficult business area – home furnishings. The company is currently closing stores and hoarding cash and recent sales trends have been surprisingly strong, especially compared to others in the space.

Laboratory Corporation of America (LH – stalwart). I was attracted to testing laboratory LH's business model which generates significant free cash flow which should be somewhat recession resistant, though the balance sheet contains higher debt levels than a typical holding.

McDonald's (MCD – stalwart). Restaurant company MCD pays a significant dividend and offers a steady business model which has shown considerable resilience during difficult times. Currency pressures and slowing sales represent potential negatives and as with most stalwarts we will vary this position size epending on valuation.

Nike (NKE – stalwart). Like MCD, shoe manufacturer NKE reappears in the portfolios as the stock price fell again though the company faces slowing sales in Europe and the United States.

Thermo Fisher Scientific (TMO – stalwart). After completing the first iteration of my research on the laboratory consumable and equipment company TMO I decided to make this stock a more substantial holding.

MAJOR SALES

This section groups transactions by major themes and contains brief commentary where warranted. Not all trades appeared in every client account. Technology trades were discussed previously.

*sold/reduced based on lowered opinion of shares (**Ark Restaurants** (ARKR), **Chicago Mercantile Exchange** (CME), **IntercontinentalExchange** (ICE))

ARKR – Same store sales, which measure sales after one year compared to the same sales the year before, continue to trend negative on a double digit basis.

CME & ICE – I had become wary of owning companies whose stock price is ultimately tied to monthly trading volumes which are by nature unpredictable, though you should expect to see CME and ICE appear in the accounts at a future time.

*short holding periods (**Costco** – COST, **Citi-Trends** – CTRN, **Coca-Cola** - KO))

COST – Margin pressures impacted earnings in the recent quarter for this warehouse club retailer and I exited to try to buy the shares at a better entry point.

CTRN – the shares of this urban retailer moved sharply higher from my buying price (and I had trouble picking up shares in all accounts) though subsequent price appreciation after our sale indicates I could have been more patient with this position.

KO – the stock price of the well-known beverage company traded at an attractive valuation and rapidly moved higher in tandem with the market.

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