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ValueWorks:

Redefining wealth management through critical thinking and independent research

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The Paradox of Investing . . .

The market decline seemed to reach a crescendo in the third quarter. The S&P 500 declined 17.2% for the quarter and 28.2% for the year. The Nasdaq composite shed 19.8% for the quarter and 39.7% for the year. At its nadir, the S&P was down 50% from its high; the Nasdaq was down 78%. Over the past five years the S&P has produced an annual return of -1.62% while the ValueWorks Capital Appreciation composite has produced trailing annual returns of 2.97%--a difference of almost 5%.*

We have been through a once-in-a-generation bear market. This downturn will rank high in the history books. Less disciplined investors are abandoning their investment programs, fearful of further declines. But the paradox in investing is that the greatest risk exists when conditions and recent performance are most positive, while the greatest upside with least risk tends to be when conditions seem most uncertain and recent performance is most depressed. The key to managing through these uncertain times is to stay prudently consistent to an investment strategy that largely protects on the downside, but is positioned to benefit from an eventual stabilization. In the past, the greatest market opportunities have been presented after a period that is arguably like the one we have just been through.

Those who try to time the general markets, and invest according to their sense of market direction, are at a big disadvantage to those who focus on the merits of individual securities: timing this market's bottom will prove as elusive and emotionally trying as did timing the top in '99.

ValueWorks' Top 10 holdings:

1. **Pfizer inc.**
2. **Fidelity National Financial**
3. **Level 3 9.125% bonds**
4. **Cablevision 11.75% pfd**
5. **Rowan Companies**
6. **Stewart Information Services**
7. **Apple Computer**
8. **General Motors**
9. **American Greetings**
10. **Washington Mutual**

as of 9/30/02 (see notes)

By way of contrast, at ValueWorks, our day-to-day job is identifying places where there is a mismatch between what the underlying assets are worth, and what we are paying to get them through particular securities. And there are more of those mismatches today at greater discrepancies than there have been in quite some time. On a dispassionate basis that simply creates opportunity. Unarguably, that opportunity has been created by a massive, prolonged market decline that has been very difficult to work through, and has had a meaningful impact on our portfolios. But again, the contradiction of investing is that the darkest times provide the greatest opportunities, and the brightest times the greatest risk.

On a macro-economic basis I believe that the pessimism and fear that increasingly dominate market outlooks actually argue strongly that this downturn has mostly run its course. And although—as I said above—we are not trying to time the bottom, the model offered by the dramatic market decline of the 1970's offers another 'big picture' basis for optimism.

*These figures are gross of fees: for additional information on returns, including net performance, see the chart at the bottom of page 4 and the accompanying footote.

Presently, this downturn has proven every bit as severe as the bear-market of 1973-1974. Early in 2000, I argued that this was an unlikely development as global and fundamental conditions were nowhere near as challenging as they were in the 1970's. But with the events of the past year (which I admittedly would have considered far-fetched) that has changed. So a comparison may be quite relevant. While superficially, one might find a comparison disheartening, a closer look actually suggests significant opportunity.

"We control quality assets at compelling valuations"

In that instance the S&P 500 declined 48% from a high of 120 in January of 1973 to a low of 62 in October of 1974, bounced by 21%, then retreated to 65 before the end of 1974. Over the ensuing two years it surprised investors with 65% gain to end 1976 at 107. This time the S&P declined by 50% from a high of 1552 in March 2000 to 775 in mid-July, bounced by 24% and now three months later is again very close to the lows. A 60+ percent advance over the next two years would come as a very pleasant surprise to most of us, but is consistent with what happened then, and in my view, is consistent with the type of upside being offered by many individual issues.

This last point—the upside offered by individual securities—is in my mind where the strongest investment argument lies. If one looks at individual issues rather than the overall averages, valuations range from the fair to the exceedingly attractive. Consider some of the reasoning behind these few of our current investments:

JP Morgan Chase's market capitalization of $31 billion is a 25% discount to book value and only nine times very depressed current-year estimated earnings. At this valuation it is priced at only a modest premium to my estimate of the value of its asset management and custody business—one of only 4 of its business units.

GM's market value of $17.5 billion is only a modest premium to the $15 billion in cash on its balance sheet. At this price it costs less than my appraisal of its GMAC finance arm—which I value at $20 billion based on 12 times run-rate earnings of $1.7 billion and 1.2 times book value of $17 billion.

Pfizer's market value is 15 times estimated 2003 earnings, a multiple we have rarely seen in the past decade.

Sprint, with 892 million shares outstanding and trading at under 9, this security represents a $7.8 billion equity capitalization. This represents a 50% discount to the value of their 8.2 million local access lines, which I consider conservatively valued at $1,500 per line, or $12.3 billion. (I note Verizon recently sold 800,000 lines for $2.4 billion, or $3,000 per line.) This is also the company that owns Sprint's long distance and internet backbone business, the value of which is higher (by my estimation) than the value of its local phone operations.

I see similar opportunities in name after name within our portfolios.

Of course it only makes sense that there are more cases of underpriced issues now that we have been through a 50% decline in the S&P and a 75+% decline in the Nasdaq. This is the type of market turmoil that leaves many issues undervalued. Clearly, there are more such cases today than there were three years ago, following a multi-year bull market. We have taken advantage of these market conditions to exercise our investment discipline and I believe we are properly positioned to take advantage of a market stabilization and eventual rebound. Given our experience coming out of similar but less severe downturns, I expect the next several years to be among our most fruitful investment periods.

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controlling quality assets at compelling valuations

Defining our Philosophy:

At ValueWorks we define value investing as buying the best-quality assets at the best possible prices. We like to think of ourselves as bargain hunters: it is our goal to pay only $0.50 to $0.75 for $1.00 worth of assets. We evaluate the component parts of a company, assigning each of its assets a dollar value that, when added together, comprises the underlying value of the company; if this is higher than the company's stock price, we consider it an investment opportunity.

Defining our Process:

1) Identification. We monitor the financial markets to identify securities that match our investment criteria—focusing on opportunities that appear misunderstood by the general market.

2) Appraisal. First we identify the assets; then we appraise them. This allows us to determine the company's *underlying value*. We then decide whether the assets are of high quality and therefore likely to appreciate over time.

3) Assessment. Here we assess any claims against a company's assets; we then compare the market price of the claims to the company's *underlying value*. If a particular security trades at a discount, we identify factors that could eliminate the valuation gap and increase its price. We then make a decision on the purchase of the security.

4) Re-Evaluation. We continuously monitor our positions to determine if our original investment thesis still applies, taking necessary action to optimize our portfolio.

5) Exit. We exit a position when a security either reaches full valuation or changes in its outlook invalidate part of our original thesis.

Our objective is uncomplicated, but achieving it requires a high level of research, expertise, discipline and independent judgment. By applying this framework consistently we remove emotion from the investment decision making process, enabling us to capitalize on inefficiencies built into the market.

About our Portfolio Structure:

We believe risk can be better contained through educated security selection than through over-diversification. Consequently, our position sizes range between 3 – 5 %of the overall portfolio value. Fully invested portfolios tend to hold 25 – 35 individual investments.

We enter investments that we view as 25 – 50% undervalued and sell them when we see them as fairly priced. Our anticipated holding period tends to be one to two years which results in only modest portfolio turnover.

Because our decisions are based on research and sound fundamentals we view depressed price action on our securities as buying opportunities rather than sell signals.

We use senior debt and preferred instruments—offerings that can be easily misunderstood by traditional equity or fixed income investors—to gain equity type returns on safer vehicles.

About our Client Services:

ValueWorks provides independent investment management on an individual account basis. Our clients receive the benefits of owning securities directly, coupled with the advantages of having a dedicated portfolio manager.

Working directly with your financial consultant, we evaluate your investment profile and build a plan designed to meet your specific goals.

As a high-end investment alternative, you receive:

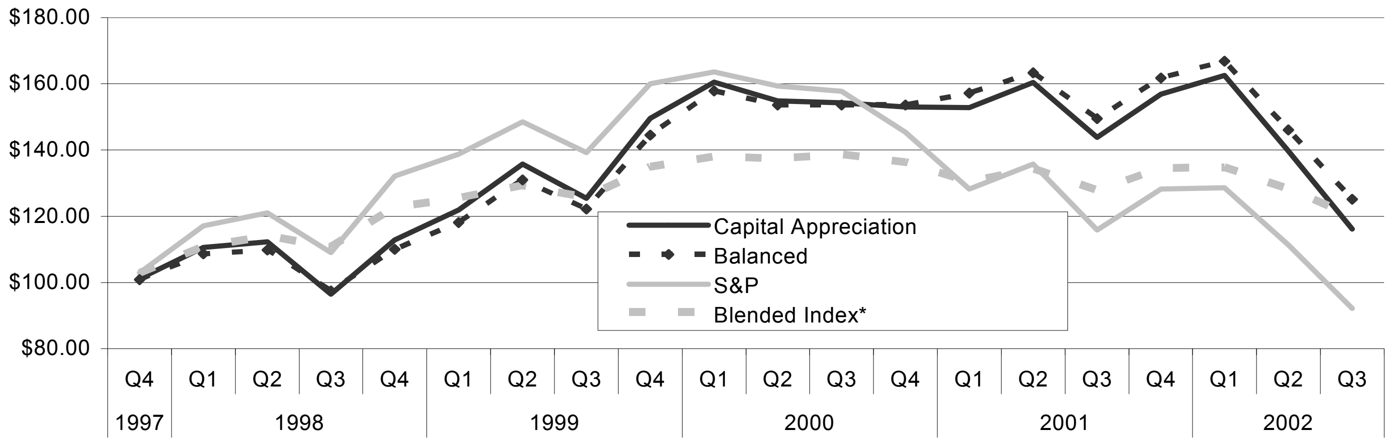
- Individual review of your portfolio requirements
- A separately tailored portfolio created and maintained to your investment objectives and risk tolerance
- Access to the Portfolio Manager on an ongoing basis with timely and responsive communication
- Flexibility to meet your changing tax requirements and investment needs
- Comprehensive quarterly performance reporting

Working within the framework of our value investment discipline, we build portfolio's that cover a wide spectrum of risk-tolerance, from aggressive to much more conservative and income oriented.

ValueWorks: Performance Review

3rd Quarter—September 30, 2002

Growth of $100 over 5 years (gross of fees)



Performance Data

	ValueWorks' Capital Appreciation Composite			ValueWorks' Balanced Composite		
	Gross of fees	Net of fees	S&P 500	Gross of fees	Net of fees	Blended index*
YTD Through Q3 2002	-25.94%	-26.72%	-28.14%	-22.69%	-23.71%	-10.65%
Rolling 1 Year Return	-19.23%	-20.36%	-20.47%	-16.33%	-17.78%	-5.90%
Rolling 3 Year Return	-2.52%	-3.95%	-12.85%	0.94%	-0.84%	-1.47%
Rolling 5 Year Return	3.05%	1.44%	-1.62%	4.67%	2.80%	3.76%

*The 'blended index' is 50% S&P 500 and 50% Merrill Lynch Domestic Master Bond index.

The above benchmark indices are unmanaged indices. The benchmark performance numbers reflect the reinvestment of dividends and interest but do not reflect the deduction of any fees or expenses. ValueWorks' value investing style is not limited to the securities in any of the above indices and utilizes specific investment techniques which are not utilized in the above indices and which may or may not increase volatility. Returns include all dividends, interest, accrued interest and other cash flows received as they may result from the implementation of a particular investment strategy. Trade date accounting has been used. Results for the full period are time weighted. Accounts are included in composite at the start of the first full quarter under management. Exiting accounts are included through the last full quarter under management.

"Top 10 Holdings" are complied from the aggregate holdings of the ValueWorks' Capital Appreciation Composite. Niether this or any other reference to specific securities in this publication is intended to be a recommendation to purchase or sell these or any other securities.

The Capital Appreciation Composite consisted of 51 accounts and $26,075,864 in assets as of 09/30/02: the Balanced Composite consisted of 64 accounts and $29,075,648 in assets as of 09/30/02. Combined, these represent 99% of the accounts, and approximately 85% of the assets managed by ValueWorks LLC. These results were generated at other firms prior to the fourth quarter of 2001. Results for other composites are available upon request.

Past performance is not a guarantee of future results.