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ValueWorks:
Redefining wealth management through critical thinking and independent research

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What a difference a year makes . . .

2003 was quite a full year. From mid-January through early March, we saw a return of the brutal erosion that characterized the first years of the decade. In very sharp contrast, from that point to year-end we experienced a very potent rally.

Throughout this period we were well positioned to protect against the erosion and to benefit from the subsequent rally. Our Capital Appreciation composite gained 42.27% for the year*. That compares to a 28.7% on the S&P 500, 28.3% on the Dow, and 50.8% on the Nasdaq composite.

I am always impressed by how sentiment changes so fully over such short time spans. The depths of investor despair occurred in March of 2003 and October of 2002. At the time, it felt like it would take years for confidence to return. But markets and sentiment change much faster than seems credible at any given point. While intellectually we have seen this pattern time and again, emotionally it nevertheless impresses me each time.

To me, the key to managing these changes is to maintain a steady, disciplined course through the cycle, making only modest adjustments on the margin for varying conditions. That means constructing portfolios that can weather the downturns reasonably, and participate well on the upside. The modest adjustments we made were to put money to work incrementally through the market decline, becoming increasingly well positioned for returned investor confidence, and upgrading the quality of our portfolio along the way. Our performance for the year is largely a result of the work we did through the downturn, as our holdings have been fairly consistent since the market bottom.

ValueWorks' Top 10 holdings*:

1. **Calpine Cap Tr III pfd**
2. **Sony Corp. ADR**
3. **Pfizer Inc.**
4. **Freddie Mac**
5. **Conexant Systems 4% bonds due '07**
6. **Cablevision 11.75% pfd**
7. **Apple Computer**
8. **Chesapeake Energy**
9. **Fidelity Nat. Financial**
10. **General Motors**

—as of 12/31/03—

*see notes on p4 for additional information

I anticipate a more gradual market advance to continue for the foreseeable future. This advance should reflect an ongoing improvement in the underlying economy. I have steadily attributed the bulk of the market gyrations to a classic business cycle. The Federal Reserve Bank raised interest rates to slow growth through 1999, and has lowered them through 2003 in order to restore it. In my view, unexpected shocks to the system made the downturn deeper than what would have otherwise occurred.

Unequivocally, I expected the economic cycle to be managed with less volatility, and did not expect the degree of financial-markets implosion we did experience. Presently, the consensus view has coalesced around the notion that the economic contraction and the magnitude of the market decline were inextricably linked to the robust economy of the late 1990's, and as such were somewhat inevitable.

I am hardly convinced. I believe unexpected events, and policy makers' reactions to them, deflated confidence. In the process, what should have been a modest deceleration of growth became an extended economic contraction, and what could have been a rotation between sectors became a wholesale market meltdown.

Economic activity is a function of both liquidity and confidence; in the words of economists, GDP equals the "money supply" multiplied by "velocity". In the words

*ValueWorks figures are gross of fees. For additional information on returns, including net performance, see page 4.

of the rest of us, it depends upon how much money we have and how quickly we are willing to spend it. Changes in confidence alter how quickly we are willing to spend our money – in other words, declines in confidence mean slower velocity (when we're nervous, we hold on to our money a bit longer). In order for economic activity to stay the same while confidence declines, the money supply has to go up to compensate. The degree to which the money supply rose and economic activity declined from the end of 2000 through the first quarter of 2003 speaks very loudly about how much confidence collapsed over the period. I believe such a decline in confidence had everything to do with what happened over the past three years, and much less to do with the robust economy of the late 1990's.

That said, the overall pattern is nevertheless consistent with a classic business cycle. There are clear signs that we have passed through the stage of contraction and that we are in the early stages of a classic recovery. Low interest rates and ample liquidity are offsetting dampened confidence, fueling an economic expansion. These conditions can lead to sustained economic growth for quite some time.

Our portfolios are constructed to benefit from such a sustained advance. On the other hand, we are by degrees less aggressively positioned than we were at this time last year, reflecting the less extreme valuations offered in the current environment.

-Charles Lemonides CFA

fig 1. Sector Diversification (Capital Appreciation)

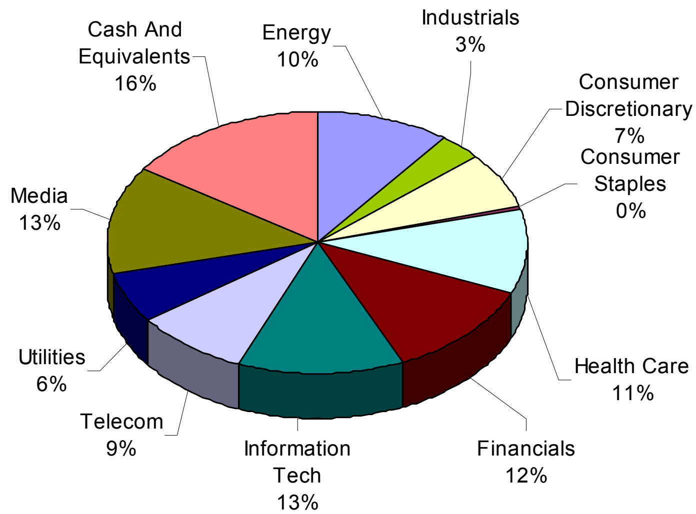


fig 2a. Asset Class Diversification--Capital Appreciation

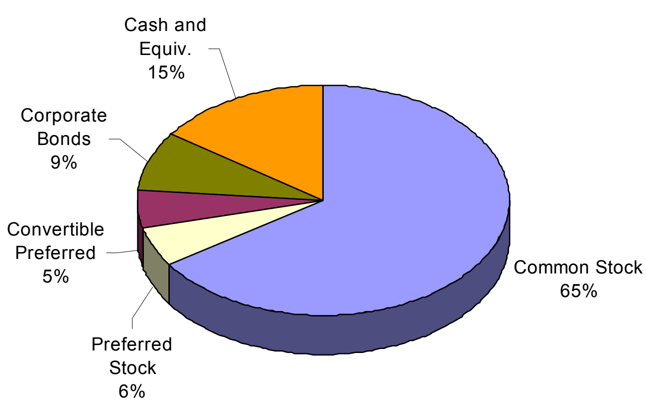
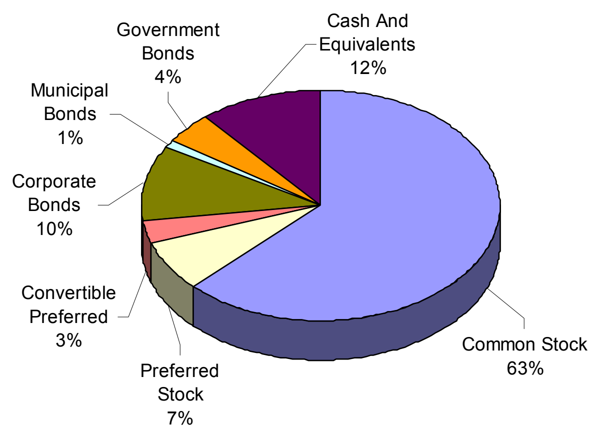


fig 2b. Asset Class Diversification--Balanced



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ValueWorks:

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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:

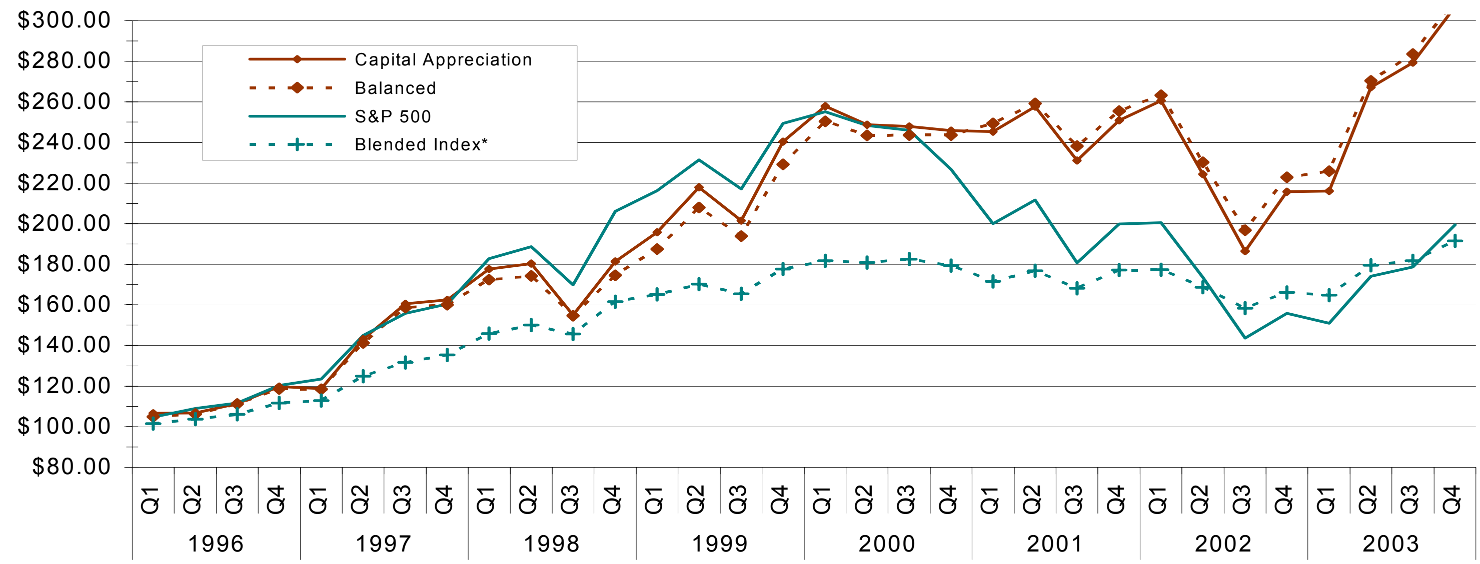
- Individual review of your portfolio requirements
- A separately tailored portfolio created and maintained to your investment objectives and risk tolerance
- Access to the Portfolio Manager on an ongoing basis with timely and responsive communication
- Flexibility to meet your changing tax requirements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

4th Quarter—December 31, 2004

Historical Growth of $100 (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*
Return 1996-2003	**15.57**	**13.57**	**9.32**	**15.72**	**13.62**	8.75
Rolling 5 Year Return	11.10	9.44	-0.64	12.17	10.20	3.46
Rolling 3 Year Return	7.67	6.13	-4.16	8.35	6.52	2.20
Rolling 1 Year Return	42.27	40.24	28.05	39.08	36.88	15.22
Q4 Return	9.82	9.42	11.64	9.32	8.89	5.35

*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 month under management. Exiting accounts are included through the last full month under management.

“Top 10 Holdings” are complied from the aggregate holdings of the ValueWorks’ Capital Appreciation Composite. Neither this nor 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 93 accounts and $49,480,316 in assets as of 12/31/03: the Balanced Composite consisted of 84 accounts and $51,781,385 in assets as of 12/31/03. Combined, these represent over 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.