

ValueWorks:

Redefining wealth management through critical thinking and independent research

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The Classic: A Slowly Unfolding Business Cycle . . .

2004 proved productive for the ValueWorks group of accounts. As of December 31st our Capital Appreciation Composite was up 20.1% for the year, inclusive of a 11.9% gain for the last quarter. This compares to a yearly advance of 10.8% for the S&P 500, 5.3% for the Dow Jones, and 9.1% for the Nasdaq composite. The Merrill Lynch Domestic Master Bond index offered a total return of 4.0% for the year.

Pleasantly, the financial markets lacked the drama that characterized the better part of the previous decade. Not only was the overall advance for the year modest, but also the gyrations during the year were among the smallest we have seen in quite some time. Moreover, the performance of different investment styles, sectors and asset classes largely converged around the range of plus 4-14%. It was a year where stock selection proved to be the driving factor in earning returns outside this range. As the calendar turns, I see few reasons to expect this to change through 2005.

In the financial markets the theme for '04 was the shift in focus to capital intensive/ commodity industries from intellectual property/technology industries. Steel and energy companies hit new highs while software and pharmaceutical shares lagged. This makes sense in the context of a business cycle where the downturn was driven by a contraction in access to capital. As such, heavily capital-intensive industries curtailed spending. As the recovery has extended, these industries are seeing capacity constraints related to their under-investment during the downturn.

ValueWorks' Top 10 holdings**:

1. Wachovia Corp
2. Pfizer Inc.
3. Sun Microsystems
4. Sprint Corp
5. Calpine bonds:
8 1/2 of 2011
6. Freddie Mac
7. Sony Corp. ADR
8. Rowan Companies
9. Baxter International
10. Walt Disney Co

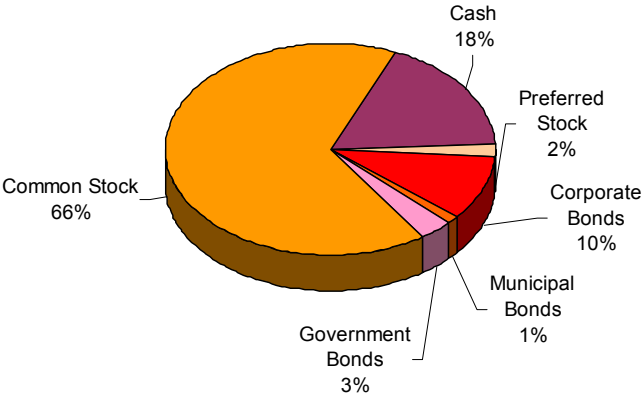
—as of 12/31/04—

**see notes on p4 for additional

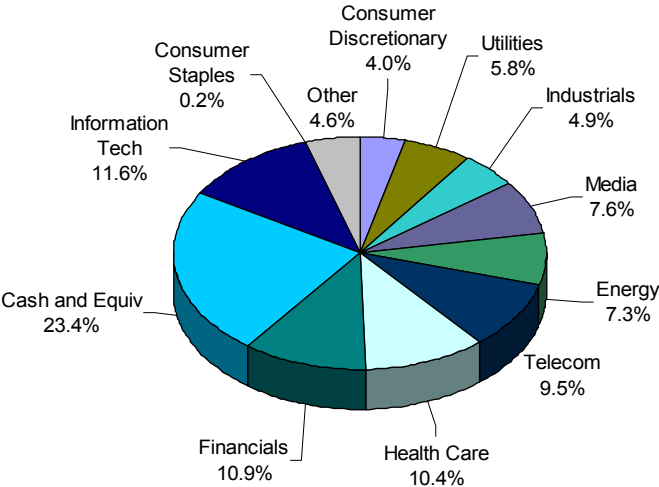
*All ValueWorks' figures are Gross of Fees. For additional information on returns, including net performance, see page 4.

As one would expect, higher demand with steady supply is now leading to higher prices; and this seems to be leading to increased capital spending, thereby fostering an extended economic upturn. This scenario is consistent with a slowly unfolding business cycle and I would view it as healthy and normal, if a bit unexciting.

**Asset Class Diversification--
Balanced Composite**



**Sector Diversification--
Capital Appreciation Composite**



I believe stable and steady financial markets should provide a positive backdrop for this activity to continue. There are many factors that would argue for such a continuation; valuations are more-or-less fair, economic activity is neither exceedingly robust nor anemic, liquidity is ample in the system but inflation seems tame, interest rate changes should be modest and are well anticipated, etc. I believe our portfolios are generally well positioned (if slightly cash-heavy), to benefit from such an environment.

-Charles Lemonides CFA

Contact us:

ValueWorks LLC
1450 Broadway, 42nd floor
New York, NY 10018

email:
info@valueworksllc.com

Call us:

866 567 4523 (toll free)
212 819 1818 (ny)
212 819 1463 (fax)

Visit us on the web:
www.valueworksllc.com



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 overdiversifica-

tion. 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:

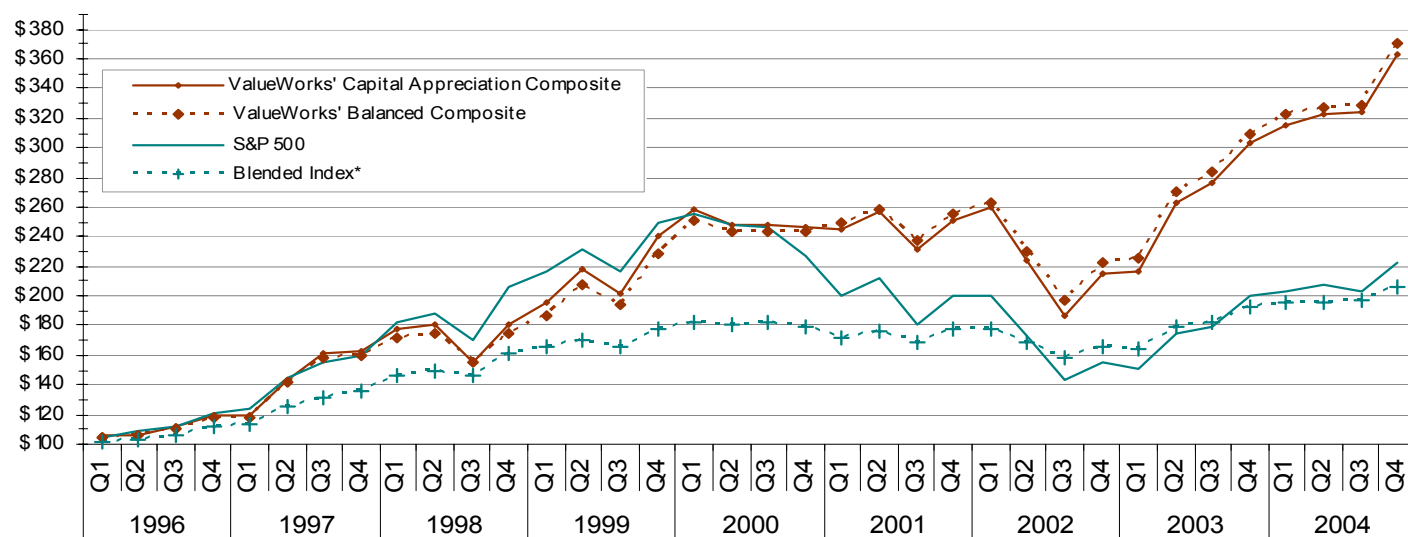
- Individual review of your portfolio requirements
- A separately tailored portfolio created and maintained to your investment objectives and risk tolerance
- Access to the Portfolio Manager on an ongoing basis with timely and responsive communication
- Flexibility to meet your changing tax requirements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

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

ValueWorks: Performance Review

4th Quarter: September 30th—December 31st, 2004

Historical Growth of \$100 (gross of fees)



Trailing 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*
1996-Present	15.43	13.56	9.28	15.68	13.70	8.41
7 year	12.21	10.54	4.78	12.76	10.85	6.24
5 year	8.64	7.11	-2.28	10.10	8.29	3.08
3 year	13.18	11.64	3.60	13.22	11.45	5.29
1 year	20.14	18.68	10.87	19.64	18.09	7.70

*The "Blended Index" is a calculation comprised of 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. Results were generated at other firms prior to 9/30/01. Information on other composites is available on request.

As of 12/31/2004 the Capital Appreciation composite consisted of 159 accounts and \$78,397,185 in assets; while the Balanced Composite consisted of 104 accounts and \$64,994,671 in assets. Together this represents 99.25% of total accounts and 89.59% of total assets.

Past performance is not a guarantee of future results.