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ValueWorks:

Redefining wealth management through critical thinking and independent research

1450 Broadway 42nd fl NY NY 10018 212 819 1818

Volume 4,3 **August 1, 2005**

A Sober Marketplace . . .

Through the first half of the year the equity markets have drifted lower. For the half the S&P 500 declined by 0.9%, the Dow Industrials declined by 3.6%, and the Nasdaq Composite declined by 5.1%. In the context of general market erosion, I consider our results in the period to be unexciting but satisfactory. Specifically, the Capital Appreciation Composite is up 1.8% YTD and 14.78% over the trailing one year period.

After a decade of fantastic volatility, the equity indexes have been historically stable since the end of 2003. The Dow Industrials ended 2003 at 10,453 and closed the last quarter at 10,274 for a 1.7% decline over eighteen months; the S&P 500 ended 2003 at 1,112 and ended the last quarter at 1,191, for 7.1% advance. Smack between those two, the Nasdaq added 3.5% over the year-and-a-half. This year, not only has the net change been modest, but the range over the period has been particularly narrow. There also appears to be a high level to which the performance of different market sectors and investment styles has converged around these middling returns. Valuations also have become more homogenous.

ValueWorks' Top 10 holdings:**

1. **Calpine bonds: 8 ½ of 2011**
2. **Pfizer Inc.**
3. **Wachovia Corp**
4. **Rowan Companies**
5. **Freddie Mac**
6. **Delphi Pfd**
7. **Sprint Corp**
8. **Sun Microsystems**
9. **Sony Corp ADV**
10. **General Motors**

—as of 6/30/05—

****see notes on p4 for additional information**

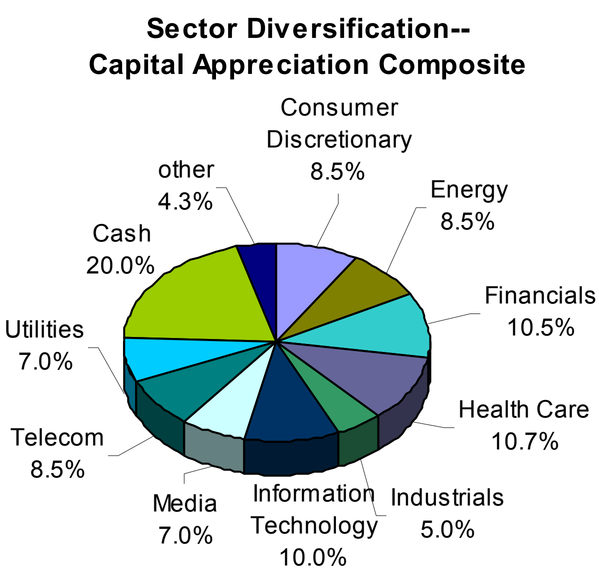
Fundamentally, I believe this stability and quiescence makes sense given the status of the overall economy paired with the general level of the financial markets. We appear to be in a gestation period between major market moves. It is a fairly sober investment environment. Investors are not generally caught up in great "investment stories." Corporate developments are, for the most part, met with measured stock price changes. And overall there has been a great convergence of valuations (admittedly the bulk of which took place in 2004). To a degree, many investment ideas appear quite bland. The froth and enthusiasm has been taken out of the system and the panic and hysteria has also run its course. Those looking for excitement and "easy money" are somewhere else.

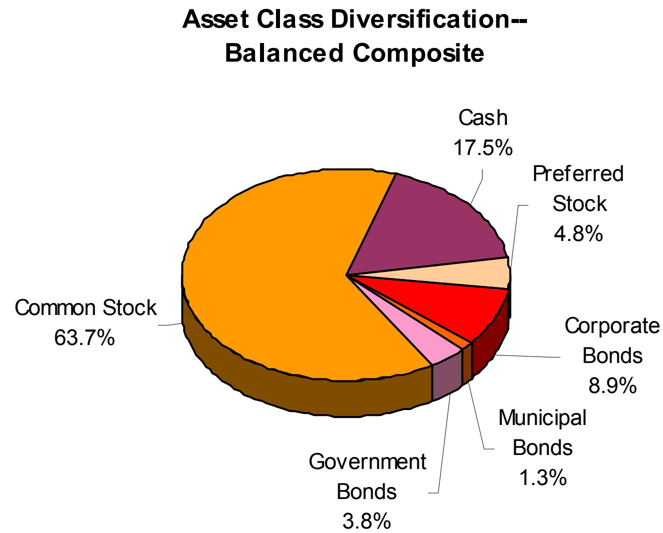
I consider this a healthy, positive turn of events. The steady growth of the economy and the associated increase in underlying values are factors that rightly take time before being reflected in share prices. The tug-of-war between the

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

negative impact of higher interest rates and the positive impact of economic growth and higher corporate profits has resulted in a near dead tie. But that does not mean that nothing is changing. To the contrary, the economy is, in dollar terms, nearly 10% larger than it was when the markets stalled. The economy is unequivocally expanding. So is the cumulative size of the businesses that make up that economy. As the businesses grow, and the share prices remain the same, the valuations get more and more compelling.

We have endeavored to position our portfolios to earn a fair return in this generally uneventful environment, and to participate nicely if an overall advance begins sooner than we expect.





I anticipate a tipping point where valuations and share prices will expand to catch-up to underlying growth. And while there are few signs that such a point is imminent, it is important to remember that the markets have a tendency to move in advance of the actual events or news, pricing-in future developments well in advance.

Either way, for me, the right strategy is to maintain a disciplined approach through these less exciting times. Building exposure when others are less interested is the only strategy that allows one to sell quality investments at higher levels when everyone else is clamoring to buy them. We may not be in a period where we see immediate gratification, but that does not diminish the importance of this positioning.

-Charles Lemonides CFA

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ValueWorks: 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 overdiversification. 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

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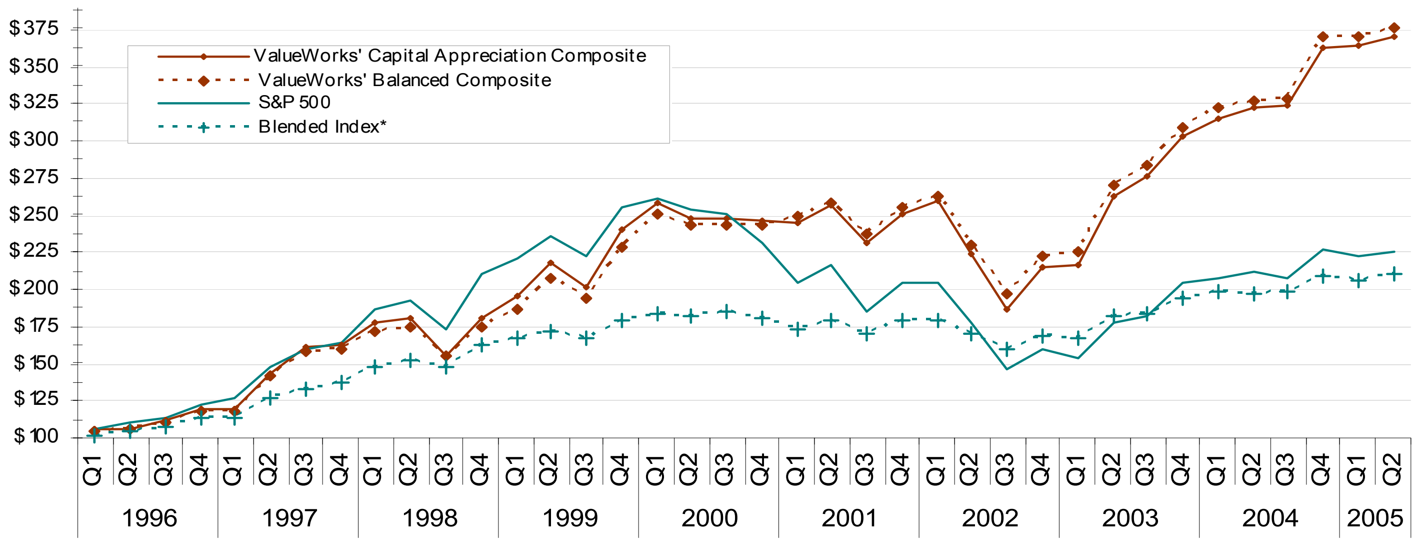
2nd Quarter: March 31st, 2005—June 30th, 2005

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	14.78	12.93	8.93	14.99	13.04	8.18
7 year	10.83	9.20	2.25	11.65	9.79	4.82
5 year	8.29	6.77	-2.36	9.12	7.38	2.91
3 year	18.18	16.56	8.28	17.83	16.06	7.33
1 year	14.78	13.31	6.31	15.17	13.76	6.76
2005 YTD	1.80	1.04	-0.81	1.62	0.91	0.92

*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 period under management. From 1996—Q1 1998 exiting accounts are included through the period in which they left. Starting in Q2 1998 exiting accounts are included through the last full period under management. Results were generated at other firms prior to 9/30/01. Information on other composites is available on request.

As of 6/30/2005 the Capital Appreciation Composite consisted of 259 accounts and $103,394,228 in assets; while the Balanced Composite consisted of 127 accounts and $72,145,303 in assets. Together this represents 99.48% of total accounts and 90.75% of total assets.

Past performance is not a guarantee of future results.