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ValueWorks:

Redefining wealth management through critical thinking and independent research

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Volume 5,1 **February, 2006**

10 Years

In the financial markets, the lackluster environment we have been writing about for almost two years remained intact through 2005. This "range-bound" period may not be quite over, but there is reason to believe we are closer to the end of these doldrums than the beginning.

Our performance in 2005's uninspired environment mirrored the overall market. Our Capital Appreciation Composite posted a return for the year of 1.83%. This compares to the one year return on the Dow of 1.70%, the S&P 500's returns for 2005 of 4.91% while the Nasdaq Composite posted returns of 2.12% for the period. However, in part because our relatively modest performance, I consider the portfolios particularly well positioned. In the past such periods have often set the stage for our earning quite robust returns.

2006 marks ten years of ValueWorks' published track record. Over that entire period our results are as follows: our Capital Appreciation composite is up 14.0% per year since year-end 1995; our Balanced composite is up 14.2% per year. $1,000,000 compounded at 14% per year grows to $3,707,221. The S&P 500 over that same time returned 9.0% per year, the Dow 9.7%, and the Nasdaq 8.1%. These results place us among the very best performing managers for the decade. Moreover, returns of 50% over the index (14% versus 9%) over an extended period are in line with those achieved historically by the very best performing managers. Surely, we do not know that we can repeat this performance — as they say, "past performance may not be indicative of future results" — but I am confident we can continue to employ the same philosophy, ply the same craft, and maintain the same discipline that has been responsible for our results in the past.

ValueWorks' Top 10 holdings:**

1. Chesapeake Energy Corp
2. Sony Corp
3. Wachovia Corp
4. Rowan Companies
5. Boeing Company
6. Pfizer Inc.
7. Sun Microsystems
8. Freddie Mac
9. Schering-Plough
10. Questar Corp

—as of 12/31/05—

**see notes on p4 for additional

Over the years there have been periods that seemed better than others and there are always investments that seemed to be working better than others. Not every security choice has worked (or will work) well; and our results have rarely been extraordinary in any given period. Steadfastly though, we have been willing to maintain an independent view, sometimes agreeing with the consensus, and sometimes not. A key to our performance over those ten years has been our willingness to remain committed to our views (and our investments) even when near term market action indicated we shouldn't – when it looked like we had made a mistake. We have taken long-term views and been willing to work through setbacks when we were confident in our underlying analysis. And because our conclusions were based on our own independent research and a critical eye towards appraising value, we have tended to remain confident in our initial conclusions.

The bulk of the return from the indexes last year consisted of dividend yield. Excluding dividends, the Dow was down 0.8%, the Nasdaq was up 1.3% and the S&P was up 3.0%. This underscores the modest level of overall market movement. Furthermore, the volatility within the year was also modest, as was the level of daily volatility. The number of days in which the markets advanced or declined by more than

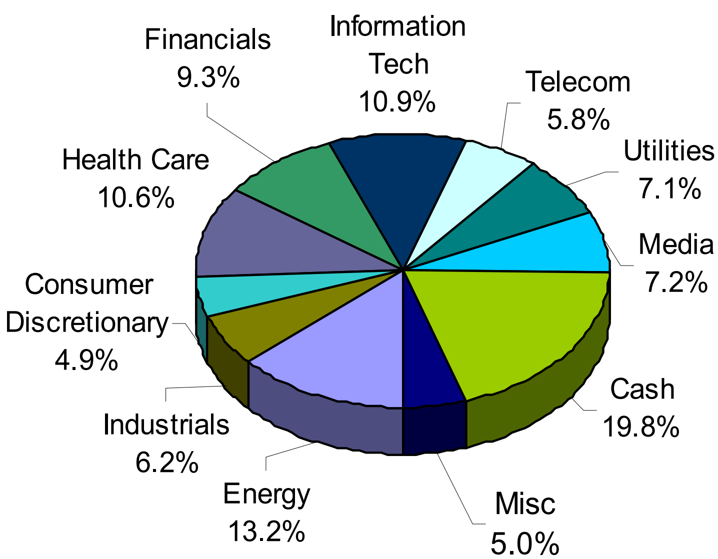
*All ValueWorks' figures are Gross of Fees. For additional information on returns, including net performance, see page 4.

one percent has been in a steady decline throughout the decade. This reflects the speculative extremes of the last decade being gradually removed from the financial markets. As the volatility and excitement of the markets decline, a more somber, business-like demeanor seems to dominate. One does expect such a period of quiescence to follow the end of major bull and bear markets, and perhaps to be a necessary precursor to any further important advances.

I construe us as basically two years into such a period of relative quiescence. At 2,205 as of year-end, the Nasdaq index is barely 50 points higher than its high in January 2004, the S&P 500 is up a scant 10% over the two years since its high that month, and at 10,717 the Dow is up a nearly imperceptible 15 points from its closing high of 10,702 reached in January 2004. (The indexes basically first reached those levels in the summer of 1998. However, the period until January 2004 represented tremendous volatility, while the past two years offered a very modest range from high-to-low.)

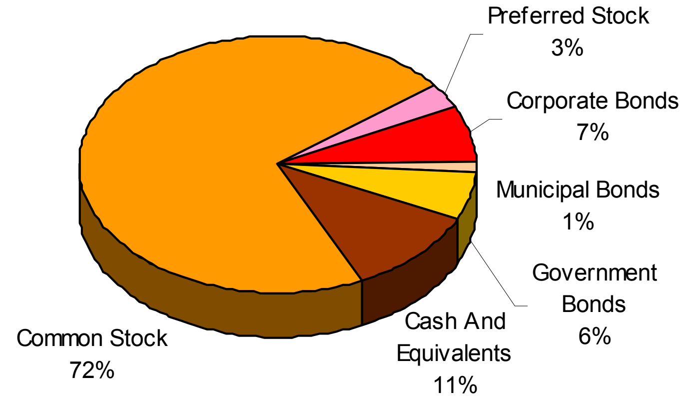
This steadiness has made sense as a respite from the previous decade's volatility. It is also consistent with the underlying fundamental conditions

Sector Diversification-- Capital Appreciation Composite*



*Graph data presented is current through 9/30/05

Asset Class Diversification --Balanced Compositie*



that prevailed through the year. As we have previously written, there has been a trade-off between advancing economic growth and the resultant growth in value of the underlying businesses – which argue for higher equity prices, offset by higher energy/commodity prices (which may be consistent with an advance in inflation) and higher interest rates – which serve to dampen valuations.

However, the constraining elements of this equation – higher commodity prices (with their tint of inflation) and higher interest rates – may not provide headwind for much longer. Fed Funds are now at 4.25% and are no longer massively stimulative. A Fed funds target of 4.5-5.0% seems appropriate to me given current conditions. If the Fed were to come to the same conclusion, we would be at the end of the rate tightening cycle for now. That would remove an important barrier to higher equity prices. On the commodity price side, we may be near a point where prices generally start to decline. Last year we wrote of modest business investment taking place to meet growing demand and tight commodity markets. That seems to have been addressed, and investment has ramped up. I would expect this to serve to moderate if not reverse commodity price increases as incremental capacity comes on line. There is little question that the pace of activity in these areas has reached a near-fevered pace. I expect the result will be a better balance between supply and demand, which should be reflected in prices.

—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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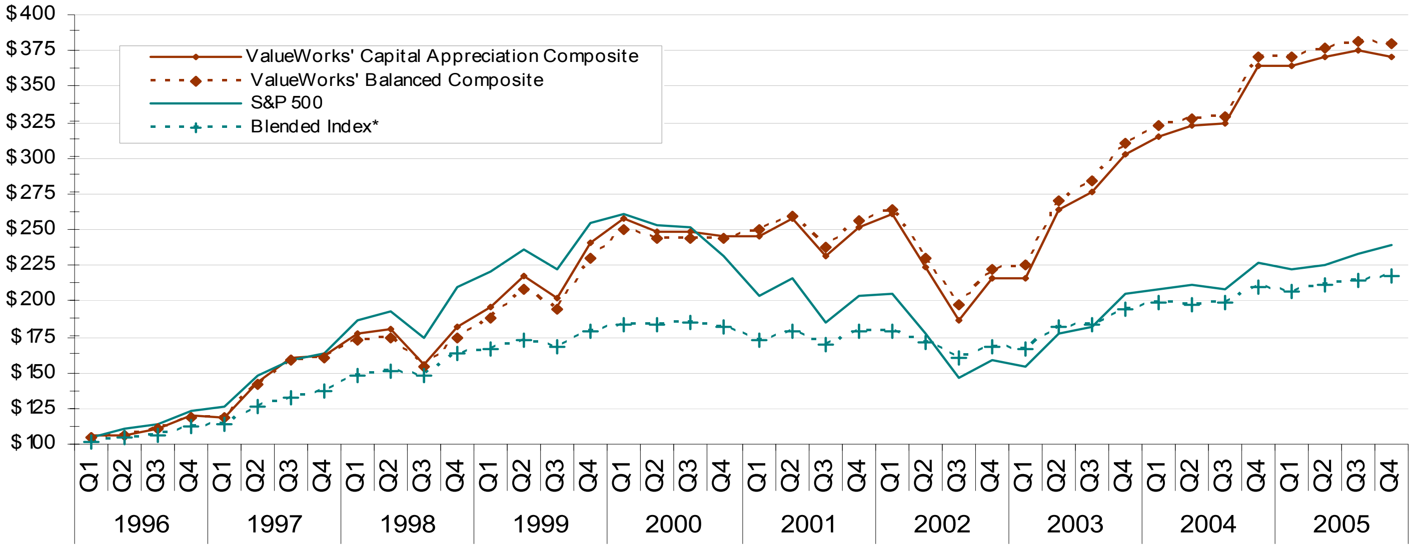
4th Quarter: September 30th, 2005—December 31, 2005

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*
10 year	13.99	12.16	9.08	14.26	12.34	8.06
7 year	10.74	9.14	1.79	11.72	9.88	4.14
5 year	8.54	7.03	0.58	9.25	7.54	3.65
3 year	19.76	18.12	14.41	19.38	17.66	8.89
1 year	1.83	0.33	5.00	2.24	0.77	3.80

*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 12/31/2005 the Capital Appreciation Composite consisted of 350 accounts and $121,368,128 in assets; while the Balanced Composite consisted of 123 accounts and $69,085,567 in assets. Together this represents 99.58% of total accounts and 91.19% of total assets.

Past performance is not a guarantee of future results.