ValueWorks
quality assets. compelling valuations.

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Our portfolios navigated the summertime stock market gyrations handily. As you can see from the enclosed tables, we generally held on to the gains earned through the first half, and are earning fair returns thus far into 2007.

The third quarter very much resembled the first quarter in terms of overall market action. Both quarters started with a rally, followed by a sharp correction, and then bounced back to finish near starting levels. The pace was a bit more dramatic in the third quarter, as the sell-off was in the range of 10-12%, compared to 4-7% in the first quarter. The first quarter's rollercoaster ride was followed by a solid rally in the second quarter. I think conditions argue for the same pattern to hold though year-end and into 2008.

The big news for the quarter was the continued weakness in the residential real estate market and the associated volatility in the financial markets. The accepted shorthand for this whole chain of events is "sub-prime lending". The reality is both broader and more specific than that label implies. The following elements of that phenomenon impact how we position our portfolios. Clearly our primary concern is the implication for economic growth (and the subsidiary issues of interest rates, the dollar, and then equity valuations). Second, it is important to put the volatility and financial market gyrations in context – specifically how real estate related stocks drove that volatility and what can consequently be expected in terms of market direction. Lastly, I think investors are well served to consider the role real estate has played as an alternative investment class, and how the changes in the way investors view that asset class may impact investment choices.

The impact of the real estate downturn on the economy is primarily driven through three channels: directly through lower economic activity in real estate related industries (i.e., construction spending and mortgage loan production jobs, etc.), secondarily through a negative wealth effect as consumers stop tapping into the higher value of their homes to fund their current spending, and lastly through a general credit contraction as banks are less willing to extend credit generally because of the losses they face on their real estate loans.

We experienced a period of over-investment in residential real estate that went along with unsustainable advances in housing prices. A correction of that excess has been unfolding for almost two years. The downturn was triggered by high interest rates. Such a correction is healthy and appropriate and, if properly managed, need not translate into an overall economic contraction. This contention is supported by recent experience; the bulk of the actual decrease in construction and related jobs and spending has already taken place, yet the economy generally has continued to expand, although at a slower pace. The slowdown is clearly significant and has represented a material drag on economic activity. However, as new home construction has petered out over the past 18 months, the incremental jobs to be lost as construction crews (and loan production personnel at mortgage banks, etc.) are dismissed, is not as large as the losses incurred to date. There is a glut of new homes on the market, so we should expect very little new home building for some time. However, the job losses in construction and the drag on the economy after this quarter should be modest compared to the losses sustained up to this point. Moreover, I think the appropriate policy response is monetary easing though lower interest rates in order to offset the negative impact of declining housing activity with sustained growth in other areas. I see that as occurring. I consider it positive.

I would employ a similar line of reasoning vis-à-vis both the reversal in the real estate wealth effect and the contraction in credit. Regarding the wealth effect: (a) the pattern of using higher home prices to fund spending went too far and is a good pattern to have broken. Regarding the credit crunch: (a) the overextension of lending against homes went way too far. In both cases, (b) the biggest negative impact has already been realized as lending against residential real estate has slowed to trickle, and: (c) the proper tonic to ensure conditions stabilize is a more accommodative monetary policy.

ValueWorks' Top 10 holdings**:

1. Cypress Semiconductor
2. Boeing Company
3. Schering-Plough Corp
4. Bausch & Lomb Inc
5. Chesapeake Energy Corp
6. General Motors Corp
7. 3m Company
8. Wachovia Corp (2nd New)
9. Dow Chemical Company
10. Rowan Companies Inc

—as of 09/30/07—

**see notes on p4 for additional information

In summary, the deceleration in the real estate market will put a damper on economic growth, but this is a condition that has been playing out for some time. Moreover, the fact that the Fed can now be accommodative -- because it has succeeded in cooling an overheated real estate market -- itself represents a positive for the rest of the economy. The lower dollar that is coming with those lower interest rates is also providing a slew of investment benefits.

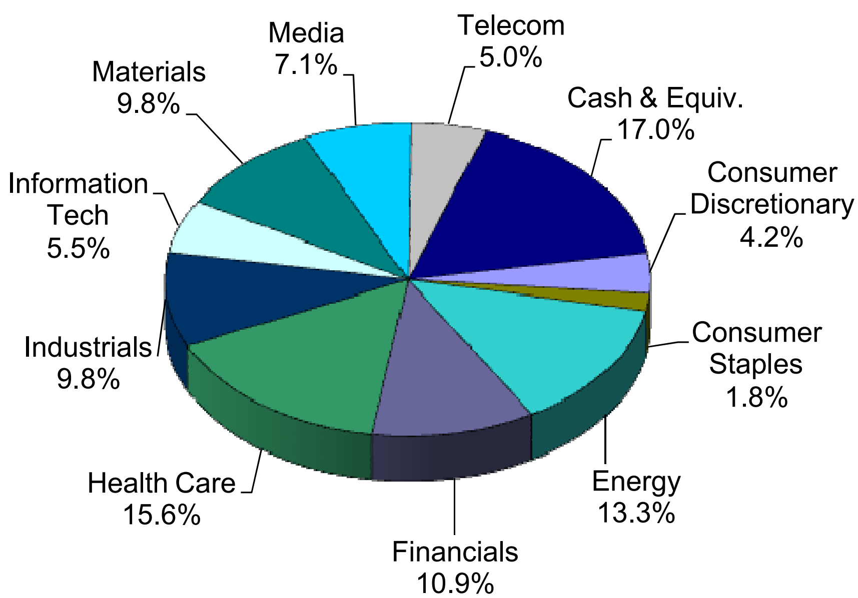
The stock market activity over the summer can be understood in the context of a prolonged downturn in the "real estate-related" sector that culminated in a classic "bear-market climax" and a group rotation. While the broad indexes remained relatively unchanged after some sharp movement, there were significant investment winners and losers within those indexes. In stark contrast to the past several years, there was a wide divergence of investment returns. I would argue that the real estate sector (as a sector within the stock market), provided market leadership into 2005, but that it has been in a bear market since then. My point in the earlier arguments is that the real estate downturn has been playing out for an extended period of time, and the bulk of the actual downturn has by now already occurred. To a large extent, the downturn in share prices has also been playing out over a long period. Homebuilders share prices peaked in August 2005, and registered a classic bear market trading pattern. Lenders peaked shortly thereafter and have been in a similar long-term decline through August. Bear markets are characterized by long gradual declines interrupted by sharp and short advances. They culminate in a capitulation sell-off. I would view this summer's activity as that capitulation sell-off characterized by fear and a general consensus that conditions are doomed to get much, much worse. The climactic sell-off in the July-August time frame is a fairly classic element of this type correction – it is a type of market action we have seen innumerable times in the past 20 years. While such sell-offs create overall market volatility, they tend to do little long-term damage as other investment sectors gain increased investor attention and provide leadership for the next leg of a market advance. Unless something is deeply wrong, investors come out of that sector and go into something else, and the markets advance to new highs.

Finally, there is the question of how this shake-up changes investor's views of real estate as an investment alternative to equities and other investments. It is likely something we all intuit, but it deserves being said. Following the market sell-off of 2000-2002, real estate seemed a very safe alternative to equity investing. For investors burned by stocks, using real estate as an alternative to putting money in the equity market seemed like a very low risk, sensible investment choice. Put money in the stock market or put that money in a bigger-house-or-a-second home? Well, real estate only goes up, and stocks can lose a lot, so…. the house? And as housing prices did nothing but climb year after year, the comfort levels only got greater and the prices higher. It was in part this sense of security and comfort that led to the dramatic over-extension of real estate prices.

I suspect those perceptions are just beginning to change. Investors in real estate are much slower to realize how much values have declined, and to what extent they cannot sell their investments for the amount they presently think they are worth. Today houses are on the market at modest discounts to last year's prices. Some are selling, and some are not. As those houses sit for an extended period (because sellers do not recognize how much lower they need to be priced to attract buyers), investors are likely to be less and less convinced of real estate's safety. The resulting change in investor perceptions and behavior is likely to be important. Investors will increasingly look to other investment choices rather than the "low risk" that was perceived in residential real estate. Equities may well be one of several asset classes that benefit from this change.

—Charles Lemonides, CFA

Sector Diversification--
Capital Appreciation Composite*



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ValueWorks
critical thinking. independent research.

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:

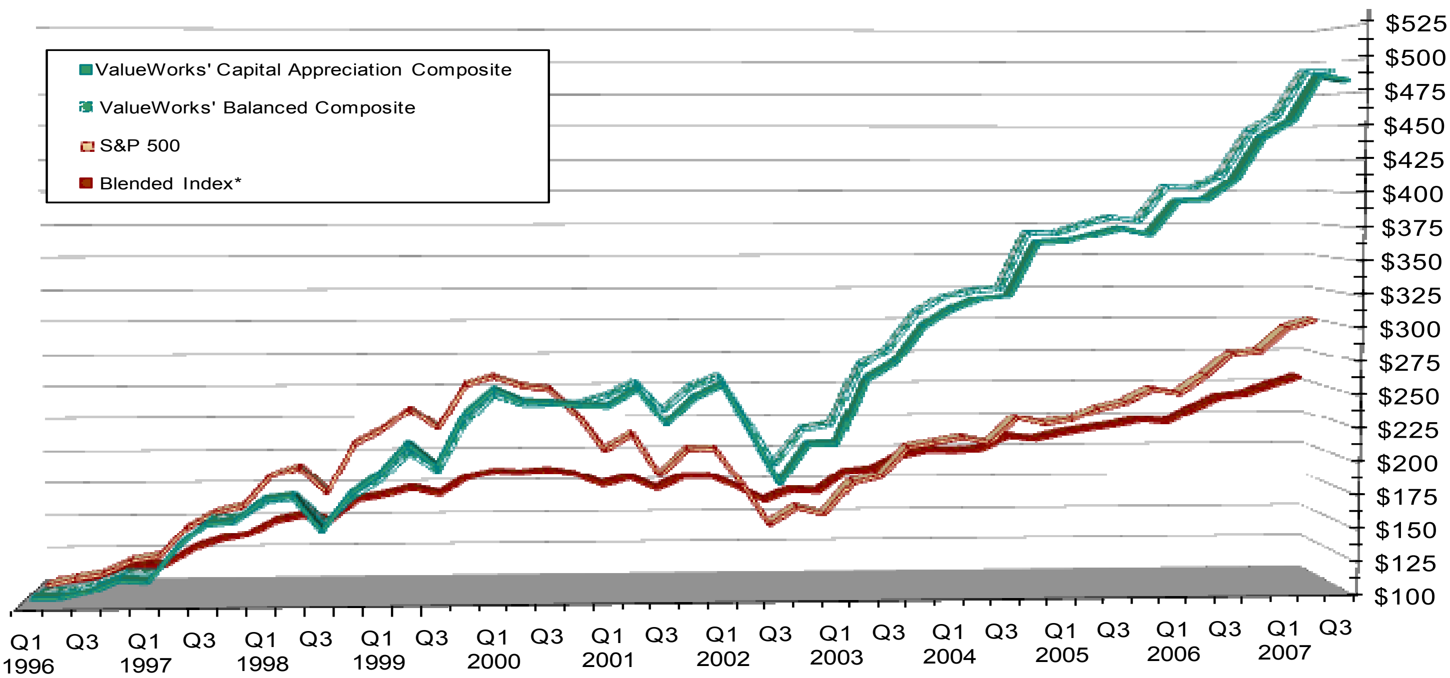
- Individual review of your portfolio requirements
- A separately tailored portfolio created and maintained to your investment objectives and risk tolerance
- Access to the Portfolio Manager on an ongoing basis with timely and responsive communication
- Flexibility to meet your changing tax requirements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

3rd Quarter: June 30th— September 30th, 2007

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	11.65	10.01	6.58	11.97	10.13	6.69
7 year	10.02	8.50	2.62	10.54	8.82	4.68
5 year	20.98	19.34	15.46	20.08	18.31	9.70
3 year	14.17	12.65	13.16	14.33	12.72	8.53
1 year	18.03	16.44	16.43	18.80	17.02	10.78
2007 YTD	9.52	8.44	9.13	10.45	9.21	6.56
Q3 2007	-0.74	-1.06	2.03	0.17	-0.22	2.49

*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 pe-

As of 9/30/2007 the Capital Appreciation Composite consisted of 497 accounts and $191,280,467 in assets; while the Balanced Composite consisted of 121 accounts and $79,521,292 in assets. Together this represents 99.36% of total accounts and 86.44% of total assets.

Past performance is not a guarantee of future results.