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ValueWorks
quality assets. compelling valuations.

Volume 7,2 **July 2008**

The pace of the global market sell-off moderated in the second quarter. Nevertheless, the overall extent of the decline, coupled with its intensity and duration in select sectors, is creating significant investment opportunity.

The S&P 500 posted a 3.2% decline for the quarter; the Dow Jones Industrial Index dropped 7.4%; while the NASDAQ gained a meager 0.6%. Year-to-date, this puts the S&P at -11.9%, with the Dow and NASDAQ close behind at -13.3% and -13.1% respectively. There are two important elements behind the second quarter numbers that should be high-lighted. First, if the decline this past quarter had occurred as an isolated event, it might be construed as mixed market activity. But coming on the back of the sell-off that began late last year, the perception is one of overall decline; and the reality is that the cumulative impact on valuations is now quite large.

Second, the market environment last quarter, like much of the last year, was characterized by an increasing divergence between investment winners and losers. Investors' focus on momentum and direction at the expense of underlying merit is fueling an increasingly large disconnect between valuations and underlying asset values. As a result, the current environment presents significant opportunities for those with both clear investment perspective and the confidence to execute that discipline during tumultuous periods.

As valuations amongst industries further polarized this quarter, it became increasingly apparent that momentum and emotion are driving market action, with little emphasis being placed on valuations. Prices of commodity-related and capital intensive names continued to inflate, while the performance of most other sectors languished. As such, the current environment is reminiscent of the 1998-1999 and 2002-2003 periods in that we are again seeing an increasing divergence in valuations between securities that fall into the investment "winners" or "losers" categories. In all these periods, price direction is used to justify any given price level – i.e. securities that are already deemed "winners" can become overvalued, reaching eventually unsustainable prices, while those issues that are out of favor can fall to improbably low valuations. In the short run, direction and outlook matter, while valuation does not. If history is a guide, the recent move towards extreme divergence in valuations will prove to be a pattern that will run its course and then reverse.

ValueWorks' Top 10 holdings**:

1. Chesapeake Energy
2. Rowan Companies Inc
3. Cypress Semiconductor
4. Questar Corp
5. Dow Chemical Company
6. Legg Mason Inc
7. Boeing Company
8. 3m Company
9. Schering-Plough Corp
10. Boston Scientific Group

—as of 06/30/08—

**see notes on p4 for additional information

When viewed from an historical perspective, the recent decline is less remarkable in that it represents normal levels of market volatility. In the 4½ years from March 2003 to September 2007, the S&P 500 gained 95%, with the Dow Industrials advancing 92% for the same period. During the past nine months, the S&P has declined by 15%, with 3% of that decline occurring within the last quarter. Likewise, the Dow saw a 17% decline, of which 6.9% occurred in the second quarter. Taking into account a near 100% gain in less than five years, a 20% decline since September should not be considered anomalous.

Part of the market decline can be explained in terms of the US economy's current stage in the business cycle. After years of economic expansion, certain sectors of the economy became overheated. Specifically, excess liquidity from 2003 to mid-2006 fueled an unsustainable run-up in real estate prices and home building activity. That cycle reversed in 2007 as the Fed drained liquidity from the system. The bust has had a ripple effect on the overall economy, which is now skirting recession.

The current sell-off is more than a US phenomenon. Indices in Europe are generally down 20-30% since last fall. Asian indices are down a bit more, with emerging markets down by 30-50% from recent highs. As global growth appears to remain strong – as evidenced by higher commodity demand and prices – the recent decline may represent nothing more than a classic market correction within the context of a longer advance. If, on the other hand, it is a problem tied to global fund flows and disintermediation, central bankers may need to be more proactive in re-energizing capital markets.

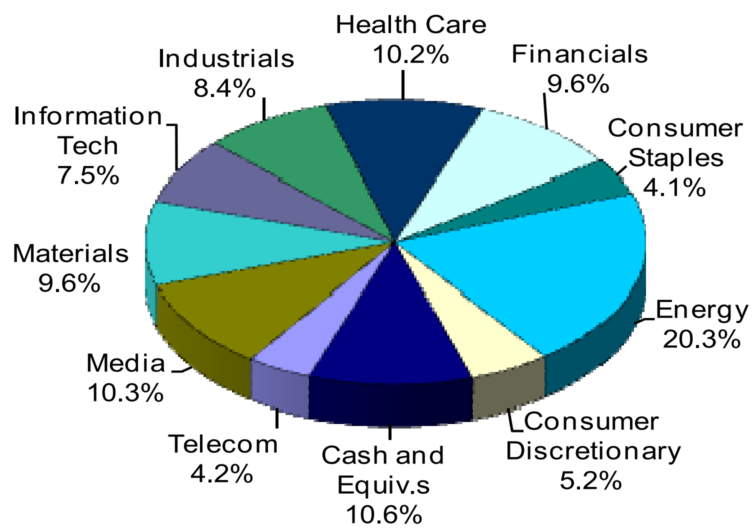
I am confident that our portfolio is well positioned to navigate these volatile conditions. Our energy exposure has held us in good stead during this period. We will continue to use price strength to decrease our exposure to companies such as in Chesapeake, Rowan, and Questar. We will also look for opportunities to invest in more attractively priced energy and commodity-related names.

We have also continued to strengthen our exposure to quality names that have reached increasingly attractive levels. No doubt our portfolios have suffered downside compression as a result of our willingness to take advantage of weakness in specific sectors. However, these opportunities were starkly compelling when purchased, and are generally more compelling now. They range from: Boeing trading at less than 10 times earnings with 10-15% earnings growth; to Legg-Mason trading at 6 times operating cash flow; to Washington Mutual trading at 1.25% of assets; to The New York Times trading at a modest premium to the value of its internet business; to Micron trading at a discount to book value, to; Pfizer trading at 8 times earnings (and a discount to its business exclusive of its Lipitor franchise); MMM at 12 times projected earnings; Dow Chemical trading at a level solely justified by its Dow Corning and Agricultural business; to the monoline insurers who stand to see ten-fold gains should the financial markets stabilize; to, lastly, General Motors, currently trading at a lower dollar amount than Mattel, maker of matchbox cars. These names should rebound dramatically as the market environment inevitably changes.

Over the past decade, we have seen valuations move to extreme levels and eventually return to more normal levels. Clearly, such reversion need not happen in any given quarter; and it is always possible for valuations to become more extreme in the short term. But clearly these price directions will reverse and we will see the same pattern play out – and investors who have the resolve to invest into the decline should see dramatic upside. During the 2002 sell-off, we experienced two quarters (back to back) of negative performance numbers. In 2003 our portfolio earned approximately 40% with the market rebound. Our portfolio is not only well positioned to weather further market volatility but, equally important, we have used this period to build our exposure to securities that will fully benefit from a market rebound.

—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:

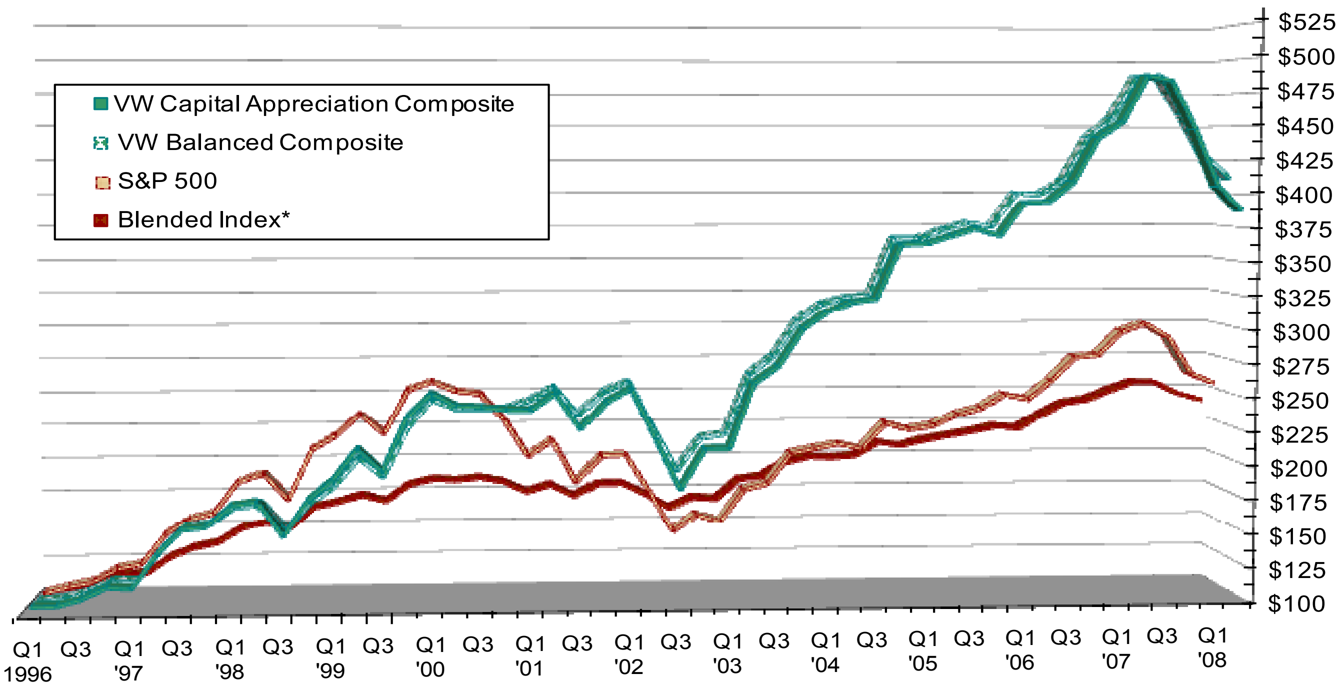
- Individual review of your portfolio requirements
- A separately tailored portfolio created and maintained to your investment objectives and risk tolerance
- Access to the Portfolio Manager on an ongoing basis with timely and responsive communication
- Flexibility to meet your changing tax requirements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

2nd Quarter: March 31, 2008 —June 30, 2008

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	7.97	6.40	2.90	8.97	7.19	4.72
7 year	6.04	4.55	2.47	6.83	5.15	4.32
5 year	8.04	6.53	7.59	8.98	7.35	5.79
3 year	1.60	0.21	4.43	3.24	1.69	4.46
1 year	-20.16	-21.22	-13.11	-15.42	-16.69	-3.08

*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 avail-

As of 6/30/2008 the Capital Appreciation Composite consisted of 473 accounts and $135,772,195 in assets; while the Balanced Composite consisted of 116 accounts and $62,738,369 in assets. Together this represents 99.49% of total accounts and 84.13% of total assets.

Past performance is not a guarantee of future results.