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ValueWorks

quality assets. compelling valuations.

Volume 11,1 **Q1 2013**

Equity markets opened 2013 with a solid advance. The Dow added 11.25%, the S&P 500 10.03%, and the Nasdaq 8.21%. Our portfolios outpaced these advances, with healthy double digit gains. Specifically, our Capital Appreciation group added 16.53% for the quarter (gross of fees).

Our outperformance was a result of solid moves by a wide number of our individual holdings – it was just a quarter where many individual securities went our way at the same time. Six months ago, my letter offered commentary about the relative underperformance of active managers, and how fundamental, bottoms-up stock selection seemed to be lagging index-based strategies. Our portfolios have seen a very solid reversal of that pattern since then. And if you look at the perform-ance security-by-security, you will see it was not a matter of sectors coming in-or-out of favor, but just solid performance from many individual holdings.

Top 10 holdings*:

1. American Express Co.
2. Calpine Corp.
3. Nokia Corp. 6.625% Due 05-15-39
4. Xerox Corporation
5. Boeing Company
6. Williams Partners
7. Pfizer Inc.
8. Paccar Inc.
9. Eli Lilly & Co.
10. 3M Company

—as of 03/31/13—

*see notes on p4 for additional Information

Meanwhile, the market continues to climb it's "wall of fear". In the face of the "fiscal cliff", sequestration, and another European banking crisis -- and an economic environment that is clearly no better than mixed -- US equity markets touched record levels. In my view, that is consistent with an economy that is expanding as monetary policy continues to have its desired impact.

The economy is adding jobs and growing even in the face of fiscal drag and political uncertainty. While markets never move in just one direction (and we have used recent advances as opportunities to take some profits and become by modest degrees more defensive), there remains much room for continued economic improvement. Auto and truck sales are not even up to replacement levels, and they will have to overshoot to make up for the under-investment of the past five years.

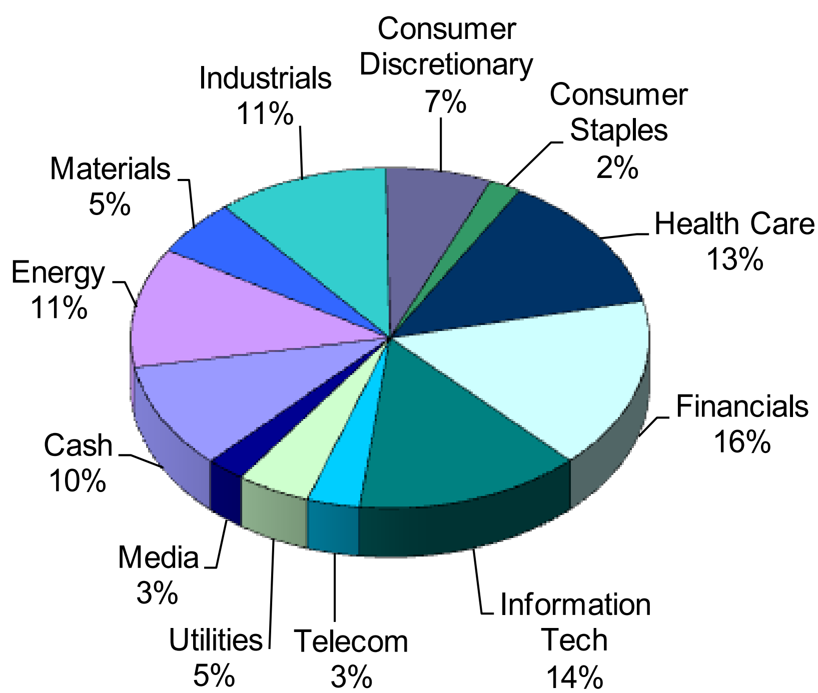
Residential real estate prices seem to have bottomed, but it will still be several years before we see boom-type levels of new home construction. And in the energy sector, the drilling activity has slowed down as the markets digest all the new natural gas supply that has been found, but the long-term shift in energy usage may provide economic opportunities in the US for quite some time. And just as has happened through history, there will likely develop some new, as yet unforeseeable driver of further economic growth.

Meanwhile, investors generally remain cautiously positioned. Cash levels are high, fixed income exposure has been increased, and there has been very little new money flowing into equities over the past five years. So as the markets regain their old highs, many who "shifted to the safety of cash" on the way down still remain on the sidelines. And even those who have remained invested have been very cautious about committing more capital to equities. This will change over time. But it will be a gradual process.

Many of the higher quality names in our portfolio are now more fairly priced. It may make sense to decrease that exposure by degrees, and seek new growth opportunities in less obvious places.

— Charles Lemonides, CFA

Sector Diversification--
Capital Appreciation Composite



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