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# ValueWorks

quality assets. compelling valuations.

**Volume 12,1** **Q1 2014**

After a torrid advance last year, the markets generally took a breather in the past quarter. The Dow gave back -0.72%, the S&P 500 added 1.80%, and the Nasdaq tacked on 0.54%. As you can see in the enclosed tables, on page 4 our portfolios continued to perform well both absolutely and relative to those benchmarks; our Capital Appreciation group advanced 3.53% (gross) for the period.

The past quarter marked five years since the nadir of the financial panic. Much progress has been made since '08: the economy has seen large improvements in both efficiency and productivity; and the S&P has rebounded 160.25%. In that same period our Capital Appreciation group advanced 197.08% (Cumulative; Gross).

But while the past five years have been quite good for those with the confidence to be invested, there remains just as much room for further improvement. This is a long, slow process that plays out over years, not quarters.

## Top 10 holdings*:

1 American Express Co.
2 Xerox Corporation
3 Boeing Company
4 Paccar Inc.
5 Nokia Corp. 6.625% Due 05-15-39
6 Calpine Corp.
7 Bombardier Inc.
8 Dow Chemical Company
9 Cliffs Natural Rescources
10 Pfizer Inc.

—as of 03/31/14—

*see notes on p4 for additional Information

In my estimation we are probably not even half-way to a really robust, prosperous environment.

That estimation is based in part on the ample increase in the labor participation rate, and a decrease in the unemployment rate, we could see an increase in employment in the range of 25 million people before we get to that peak level of prosperity and economic output. Coupled with the potential for productivity growth, that would represent a very significant increase in economic output.

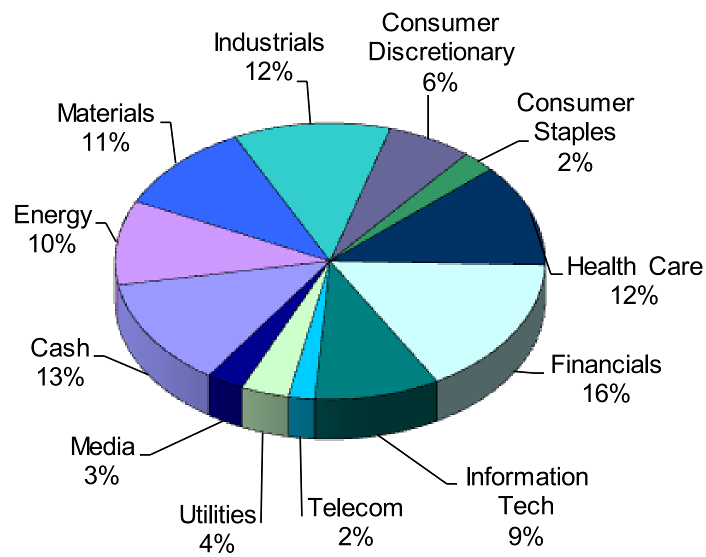
There is an analogous amount of excess potential investment capital parked in cash on the economic sidelines. That cash is currently earning negative real returns. While the Fed may slow its pace of QE, the prospect of earning compelling returns on fixed income investments does not appear to be on the horizon. So that cash should gradually move into productive assets, providing the fuel for economic growth.

The perennial challenge though is to know what new industries will emerge to drive this growth. There are some that seem easy and obvious. New pharmaceutical products (Pfizer and Lilly) are quite likely to play a role, as are new medical devices and procedures (Boston Scientific and Zimmer). Computing and telecom technologies (Hewlett, Cisco, Corning, and Sprint) will continue to advance, making today's generation of products obsolete. Transportation needs will grow, as more efficient trucks (Paccar), planes and trains (Boeing and Bombardier) serve a growing global population. But the really transformative drivers of innovation and growth are those that are so nascent as to not yet have come fully into focus. Trusting that they will emerge does require a leap of faith; but that has historically been a good bet to make.

With the broad market bouncing around all time highs, investors with inadequate equity exposure remain in a tough emotional box. They may intellectually accept: that equities earn positive returns over time; that they have earned below average returns for almost fifteen years; and that fixed income investments are not meeting their needs. So intellectually they may conclude that they need to increase their equity exposure. But there is a fear and hesitancy that comes with buying equities into record high territories. So that money will only get put to work gradually, begrudgingly, and slowly over time.

— 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:

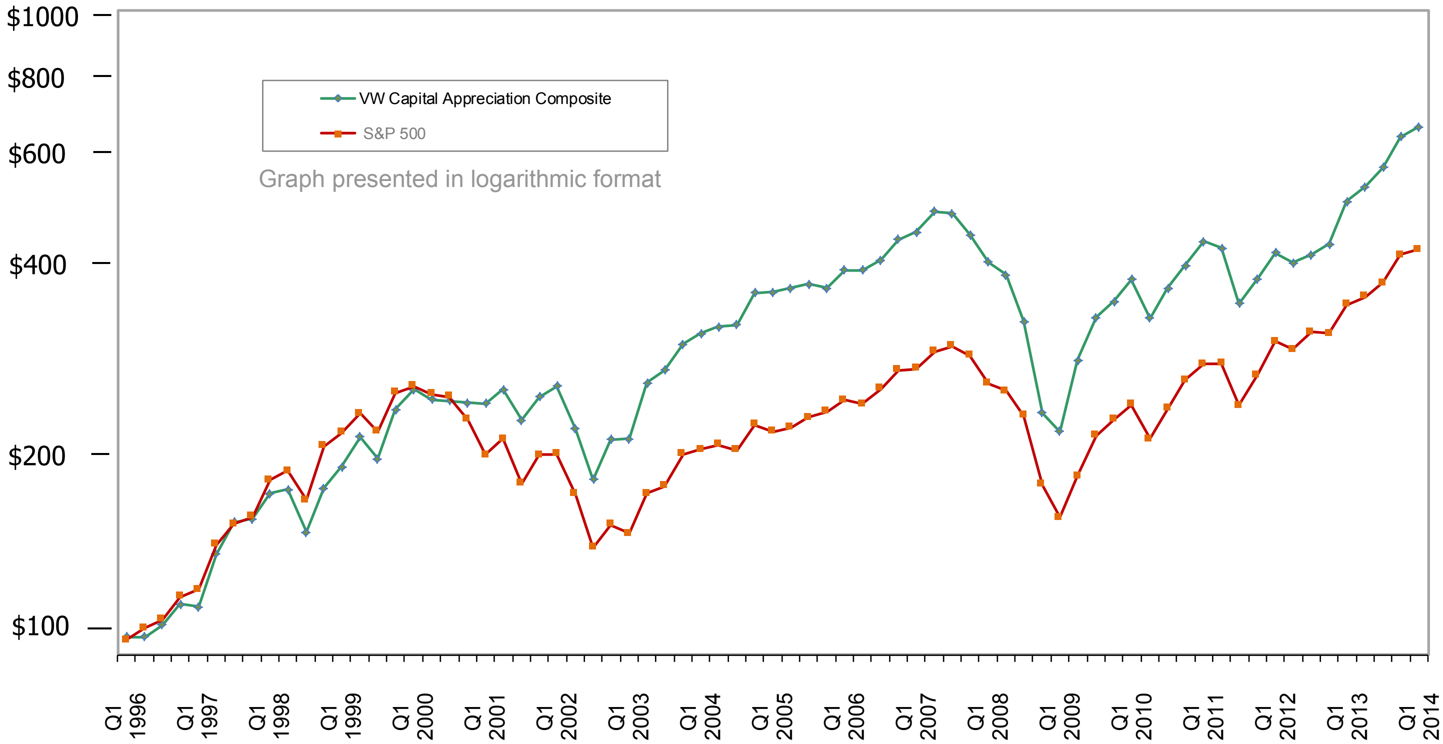
- Individual review of your portfolio requirements
- A separately tailored portfolio created and maintained to your investment objectives and risk tolerance
- Access to the Portfolio Manager on an ongoing basis with timely and responsive communication
- Flexibility to meet your changing tax requirements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

**1st Quarter: December 31st, 2013 -- March 31st, 2014**

## 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* |
| 2014 Q1 | 3.53 | 3.21 | 1.80 | 4.84 | 4.49 | 1.88 |
| 1 year | 30.62 | 29.01 | 21.85 | 26.88 | 25.18 | 10.44 |
| 3 year | 14.61 | 13.18 | 14.55 | 13.36 | 11.80 | 9.49 |
| 5 year | 24.33 | 22.74 | 21.08 | 22.61 | 20.90 | 13.17 |
| 10 year | 7.65 | 6.22 | 7.39 | 8.25 | 6.69 | 6.43 |
| LIFE* | 10.88 | 9.24 | 8.25 | 11.30 | 9.54 | 7.46 |

*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 availa-

As of 3/31/2014 the Capital Appreciation Composite consisted of 131 accounts and $96,809,585 in assets; while the Balanced Composite consisted of 55 accounts and $49,176,635 in assets. Together this represents 98.41% of total accounts and 55.51% of total assets.

**Past performance is not a guarantee of future results.** This material is approved for client use.

**PROCESS:**

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**5. Exit** We exit a position when a security either reaches full valuation or changes in its outlook invalidate part of our original thesis.

| | Total Firm | Composite Assets | | Annual Performance Results | | | |
|---|---|---|---|---|---|---|---|
| Year End | Assets (in Millions) | USD (in Millions) | Number of Accounts | Composite: Gross | Composite: Net | S&P 500 | Composite Dispersion |
| 2013 | 252 | 93 | 134 | 47.03% | 45.24% | 32.40% | 2.54% |
| 2012 | 167 | 70 | 150 | 12.92% | 11.49% | 15.98% | 1.84% |
| 2011 | 160 | 75 | 193 | -4.58% | -5.80% | 1.85% | 1.64% |
| 2010 | 165 | 81 | 221 | 13.71% | 12.15% | 15.04% | 5.25% |
| 2009 | 152 | 78 | 241 | 48.83% | 46.92% | 26.48% | 7.86% |
| 2008 | 112 | 58 | 311 | -46.97% | -47.68% | -36.96% | 8.58% |
| 2007 | 295 | 178 | 515 | 1.50% | 0.14% | 5.49% | 5.93% |
| 2006 | 267 | 159 | 411 | 19.08% | 17.44% | 15.79% | 7.25% |
| 2005 | 209 | 119 | 340 | 1.81% | 0.31% | 4.91% | 3.73% |
| 2004 | 165 | 78 | 158 | 20.03% | 18.42% | 10.88% | 4.20% |
| 2003 | 121 | 49 | 93 | 40.31% | 38.29% | 28.69% | 4.71% |
| 2002 | 75 | 33 | 58 | -13.97% | -15.23% | -22.10% | 3.53% |
| 2001 | 85 | 36 | 51 | 2.05% | 0.64% | -11.88% | 8.31% |
| 2000 | 80 | 35 | 69 | 2.28% | 0.68% | -9.11% | 6.64% |
| 1999 | 81 | 36 | 79 | 32.56% | 30.46% | 21.04% | 15.60% |
| 1998 | 66 | 26 | 78 | 11.60% | 9.68% | 28.58% | 6.03% |
| 1997 | 39 | 9 | 30 | 35.65% | 32.96% | 33.36% | 3.84% |

**DISCLOSURES**

**Past performance is not indicative of future results.**

***Capital Appreciation Composite*** *contains all accounts with a Capital Appreciation mandate. For comparison purposes the composite is measured against the S&P 500 Index.*

ValueWorks has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®).

ValueWorks is a separate registered investment adviser. Prior to September 30th, 2001, ValueWorks was a subdivision of M&R Capital. The firm maintains a complete list and description of composites, which is available upon request.

*Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Past performance is not indicative of future results.*

The U.S. Dollar is the currency used to express performance. Gross returns are shown as supplemental information and are stated gross of all fees and transaction costs; net returns are reduced by all fees and transaction costs incurred. Wrap accounts pay a fee based on a percentage of assets under management. Other than brokerage commissions this fee includes investment management, portfolio monitoring, consulting services, and in some cases, custodial services. Wrap accounts make up 100% of the composite for all periods shown. Wrap fee schedules are provided by independent wrap sponsors and are available upon request from the respective wrap sponsor. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the composite the entire year beginning December 31, 2001. From January 1, 1996 to December 31, 2001 dispersion reflected an equal weighted dispersion. Additional information regarding the policies for calculating and reporting returns is available upon request.

The management fee schedule is as follows: Low and high rate for wrap sponsors: 1.25% and 2.75%, respectively. Fee schedules from individual wrap sponsors are available upon request. Actual investment advisory fees incurred by clients may vary.

The Capital Appreciation Composite was created December 31, 1995. Performance presented prior to October 1, 2001 occurred while the Portfolio Manager was affiliated with two prior firms and he was the only individual responsible for selecting the securities to buy and sell. ValueWorks' is in compliance with the GIPS standards for the period October 1, 2001 through December 31, 2007. In addition, a performance examination was conducted on the Capital Appreciation Composite beginning October 1, 2001.

**For more information about ValueWorks Capital Appreciation Composite and our other composites please visit valueworksllc.com or call 212.819.1818**
**This material is approved for client use.**