VALUEWORKS

QUALITY ASSETS COMPELLING VALUATIONS

VOLUME 14,1 FIRST QUARTER 2016

Once again the major indices ended the quarter nearly unchanged, while during the quarter both the broad market and individual sectors swung wildly. The Dow added 2.1%, the S&P 500 1.3%, and the NASDAQ composite lost 2.4%. Within the quarter those gauges declined by 11%, 11% and 17%, respectively before rebounding through quarter end. For the second consecutive quarter our portfolios performed in line with those broad market measures with our Capital Appreciation accounts up 1.9% for the quarter (Gross of Fees).

The selling in the energy/commodity space reached a crescendo in early February. As that played out, the strength of fully priced shares that were being pushed ahead largely by their own momentum (like Amazon and Netflix) gave out, translating to a sharp, broad sell-off. Taken together these events appear very consistent with the last stages of a sectoral/rolling bear market. Such action can allow for new market leadership to take hold which is needed to provide "fresh legs" to extend the market advance. By the end of the quarter the energy and commodity sectors bounced sharply off the bottom, allowing the overall indices to recoup their losses. However no sector has emerged during this brief period as clearly positioned to provide leadership for that next leg.

As is inherent with these sell-offs, many investors "throw out the babies with the bathwater". We have historically entered some of our best investments at such times. I expect this one to be no different. During the quarter we bought Rowan Companies bonds and Cheniere Energy Holdings common shares. Rowan is a company I am quite familiar with, as it was one of the first companies I recommended as an analyst in the 1980s. The company's debt sold off from the mid-eighties last summer to our entry price of 50% of par. The balance sheet is very solid and the company has revenue base of accepted contracts that locks in earnings for the next three years. Over that period they should generate more in net cash flow than the entire market value of the debt outstanding. I expect those bonds to trade north of 80% of par within the next year for well over a 50% gain.

Cheniere Energy is similar in that the company owns a large fixed asset – in this case a facility designed to load natural gas onto tankers for export – and has entered into multiyear contracts for its use. Specifically, large creditworthy companies have entered into 20 year contracts for 87% of the capacity of that facility. Over the next 18 months as incremental phases of the facility are brought on line, cash flow should allow over $2.00 per share in annual dividends. At that point I see the shares trading at a 6.5% yield, suggesting a price target of $30. That was a reasonable supposition last summer when the shares were trading in the mid-twenties. The energy melt-down gave us a chance to buy the shares closer to $15. Sifting through the wreckage of such sell-offs creates dramatic opportunities. We now have great exposure to instruments that are backed by meaningful cash generating capacity in the energy space. Our focus on companies that have protected cash flows and/or on debt trading at meaningful discounts and paying out high cash flows, should provide a degree of stability if negative developments trigger a renewed market selloff.

We are also positioned with quite a number of very well-valued issues that are in very different sectors, any one of which could provide leadership for a renewed market advance. After all, it is rarely the sector that just went through a huge decline that leads the economy in its next phase of expansion.

TOP 10 HOLDINGS

1. Boeing Company
2. Xerox Corporation
3. Boston Scientific Corp
4. Cisco Systems
5. Corning Inc.
6. Eli Lilly & Co.
7. Gilead Sciences Inc.
8. American Express Co.
9. Calpine Corp.
10. Paccar Inc.

—As of 3/31/16—

*see notes on pg 4 for additional details

"Our focus on companies that have protected cash flows and/or on debt trading at meaningful discounts and paying out high cash flows, should provide a degree of stability if negative developments trigger a renewed market selloff."

With that as context, I can't help but wonder if I am just getting caught up in the typical hysteria when I look around and ask if this time really might be different with potentially meaningful uncertainty and risk. Maybe I am. But the range of uncertainty generated by the leading candidates just does not seem normal. There are moments when I am comfortable that it will all work out seamlessly – clearly a meaningful percentage of the population is optimistic about each of the major candidates. Perhaps anyone of those groups could be right. But there are also moments when I really wonder. And my concerns are not limited to either side of the political spectrum or to just one or two of the candidates. So I think a "set-it-and-forget-it" approach is particularly risky at this moment in time. As the situation unfolds we are prepared to manage the portfolio quite actively.

If over the next three months or nine months we go through a tumultuous period as a result of quirky events that develop, there will be a lot of work to do managing the portfolio. We have a clear bottom-up oriented strategy that has been battle tested. We expect that if it happens, we are likely to see near term valuation declines. But there are solid reasons to expect those moments to be short lived, and once behind us, our portfolios may even benefit as a result of the opportunities created.

Still, our starting place remains; the more likely scenario is that a year from now we look back and view this moment of uncertainty as an excellent time to have been building investment exposure.

All that said, I finished writing this latest instalment on the second day in our new office on the 84th floor of One World Trade Center. We are structuring our portfolios and our business based upon a long time horizon, not the next quarter or two; the lease here is for ten years. Our track record goes back twenty years, and as of yesterday Valerie and I have been working together for thirty years. On a related note, it was fifteen years ago we moved up to midtown from here. We take great satisfaction in contributing to the rebuilding of lower Manhattan. As our clients and stakeholders you should too, because ultimately it is your support that make this endeavor possible. In that regard, please think of this newsletter as an open invitation. We consider this space yours as much as ours and we look forward to seeing you here.

-Charles Lemonides, CFA

Our ability to build and manage the portfolio from a bottom-up perspective, focusing on a solidly positioned group of individually well positioned investments, is particularly helpful at this moment in time. I say that because the view from a top-down, macro perspective seems to offer an unusually uncertain array of potential outcomes.

Yes, low interest rates, low inflation and low commodity prices are helping the economy consistently add 200,000 jobs per month. There is a solid case to be made that these conditions continue and that the market resumes a general advance following the eighteen month pause we have just been through. And as we have just seen in the period between early February and late March the advance can be remarkably sharp and sudden. On the other hand, the Federal Reserve is just starting to raise interest rates; if that is mishandled, it is hard to know how damaging such a mistake could be.

Then there is the matter of the election. In each election cycle we hear the cliché that the current cycle is different and special, and we are poised for very stark risks if the wrong candidate is elected. But I do not think that has generally been true, and I do not think in the past I have generally thought it was true in the moment. Yes, there are always differences on the margin; but most economic decisions are made in New York and Cleveland and Houston (for example), and not in Washington. As a consequence, the impact of one potential president or another has rarely caused me near-term concern relative to our overall portfolios.

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.

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*

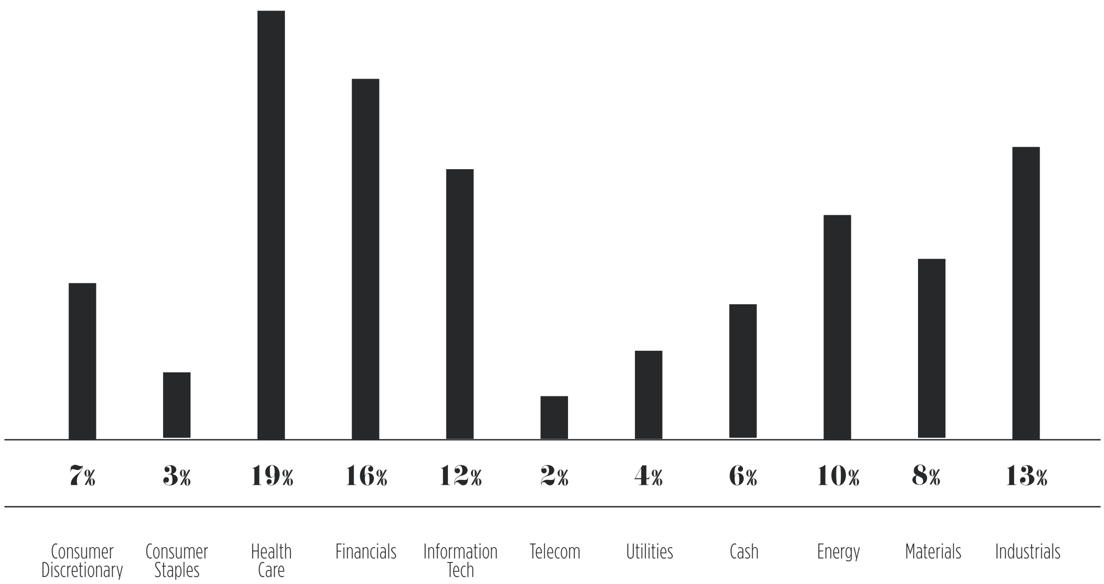
We exit a position when a security either reaches full valuation or changes in its outlook invalidate part of our original thesis.

Objective

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.

SECTOR DIVERSIFICATION

CAPITAL APPRECIATION COMPOSITE



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.

OUR PORTFOLIO STRUCTURE

We believe risk can be better contained through educated security selection than through over-diversification. 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.

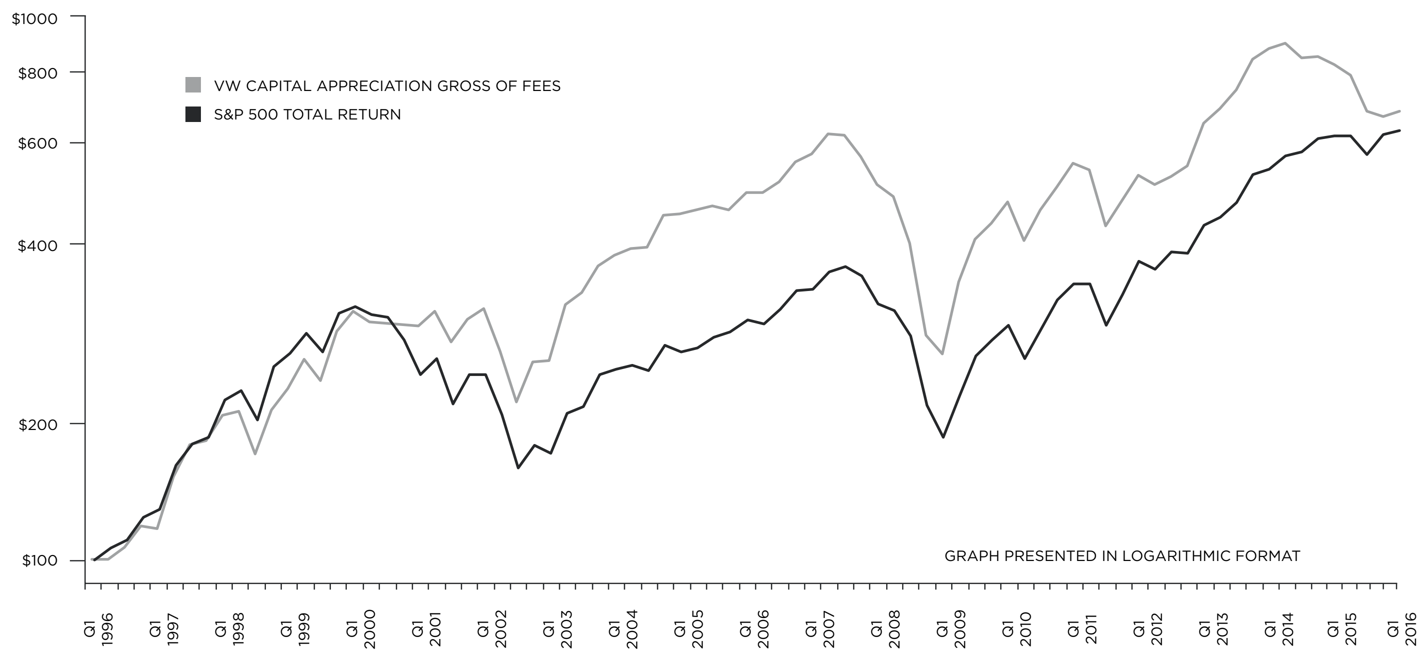
Because our decisions are based on research and sound fundamentals we view depressed price action on our securities as buying opportunities rather than sell signals.

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.

VALUEWORKS

PERFORMANCE REVIEW

FIRST QUARTER DECEMBER 31, 2015 – MARCH 31, 2016



TRAILING PERFORMANCE DATA

VALUEWORKS' CAPITAL APPRECIATION COMPOSITE

	GROSS OF FEES	NET OF FEES	S&P 500 TR
2016 Q1	1.88	1.56	1.35
1 year	-15.37	-16.42	1.80
3 years	1.53	0.27	11.83
5 years	3.82	2.53	11.52
10 years	2.95	1.62	6.97
Life*	8.56	6.98	8.14

*Life is 19.00 years (inception 1/1/1996)

VALUEWORKS' BALANCED COMPOSITE

	GROSS OF FEES	NET OF FEES	BLENDED INDEX*
2016 Q1	2.26	1.91	2.23
1 year	-13.71	-14.89	2.02
3 years	2.49	1.08	6.84
5 years	4.33	2.88	7.71
10 years	4.10	2.61	6.34
Life*	9.24	7.53	7.22

*The "Blended Index" is a calculation comprised of 50% S&P 500 and 50% Merrill Lynch Domestic Master Bond Index.

PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

This Newsletter is intended to be presented with the Capital Appreciation Fact Sheet which contains additional disclosure information.

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. Investments in this strategy may lose value.
This material is approved for client use.

ONE WORLD TRADE CENTER, SUITE 84-G NEW YORK, NY 10007 T: 212.819.1818 F: 212.819.1463 VALUEWORKSLLC.COM info@VALUEWORKSLLC.COM