VALUEWORKS
QUALITY ASSETS COMPELLING VALUATIONS

VOLUME 16,3 THIRD QUARTER 2018

2018 is shaping up to be another solid year for our portfolios and the economy. Investors though, are experiencing a wide range of results. Fixed income investors are broadly realizing losses with, for example, the ICE 20 year US government bond index losing 5.9%. On the opposite extreme, the Nasdaq 100 posted a total return of 20.2%. Within the equity markets, the results were also quite wide, with the Russell Large Value index adding 3.9% for the nine months, the Dow and the S&P 500 adding 8.8% and 9.0%, and the Nasdaq Composite adding 17.4%.

In this context, our portfolios continued to post solid results. Our Capital Appreciation group of accounts was up 9.7% for those same nine months (gross – see details on page 4). Importantly, those results build on extended gains to generate quite meaningful growth over longer periods. In the enclosed tables we have included performance over the past three years to provide some longer perspective.

The US economy is clearly on a growth trajectory. We are adding 200,000 jobs month in and month out. Business and consumer confidence are high. Incomes are rising. Unemployment is low and capital is plentiful. These conditions create a momentum that builds on itself and trivial changes and events will not knock this economy off this growth path. What we expect to eventually cool the economy is higher interest rates and curtailed liquidity. The first stages of this have clearly begun, but it is a process that is almost impossible to complete in quarters; it typically plays out over multiple years.

As the economy continues to grow and confidence continues to broaden out, we can expect what we have been seeing in the markets over the past eighteen months to only become more pronounced. Specifically, we have been seeing excitement re-enter the financial markets. Enthusiasm is driving securities prices. As a result, investment darlings are rocketing higher while more staid investments are left behind. Bonds are down, the Russell Large value Index is up 3.9%, and the Nasdaq is up 20%! Amazon has added $400 billion in market capitalization this year and a "pot stock" with $10 million in quarterly sales touched an equity capitalization of $20 billion.

This is consistent with the last upward leg of a long bull market. This stage typically lasts years and generates meaningful wealth. If your investment approach is to look for diamonds in the rough, it is the best possible world.

For many investors, it is quite a tricky period. For those who have been on the sidelines in cash and bonds for the past decade, the frustration only builds. The economy continues to grow for longer than they thought possible, people around them become more and more prosperous, and they are begrudgingly drawn into stocks as the indexes grind higher, fueling further advances. Those in more defensive, reasonably priced equities watch as their portfolios underperform; the investments that go higher in exciting, prosperous times are exciting companies doing exciting things.

We are still early in this process, so it is impossible to know exactly what those industries and companies will be. But they will create excitement because they will be at the forefront of real change. And it will go on until it reaches a mania. As that plays out, those who invest right into the heart of that mania get positive reinforcement all the way up. They become increasingly successful, they get more investor attention, and become increasingly confident. On paper, they are incredibly successful on the way up. But even for those investors, such an environment is tricky. Because there is a time they should get out, and only a very small number of them do.

In that heady environment, the difference in price between exciting companies and boring companies just gets bigger. We have been seeing the start of that for the past 18 months. While there will be short periods where that trend reverses, those reversals will be fleeting until we reach the ultimate top.

We consider this part of the economic and market cycle to be the sweet spot for our investment style.

These conditions create a good environment for us in two ways. First, the emotional element of the excitement and the concept-centric thought process results in a very large universe of investments that are left out and become objectively cheaply priced. That gives us a lot of opportunities where we can look for that true diamond in the rough. As a result, we end up with a fully stocked portfolio of those diamonds. Second, when investor excitement finds any one or two of these hidden gems, the upside is dramatic because in this environment the difference in price between investment winners and also-rans is not 20-30%; it is 200-400%.

These large, impactful moves in just a few investments is what drove our results in the last quarter. Qualcomm, Eli Lilly, and Corning Glass each advanced 30% in the quarter. We are in an environment where investor perceptions can change easily and when they do the moves are dramatic. This is good for us because we do not try to buy mediocre assets at below average prices, we try to buy truly good assets that are misperceived at a moment in time. In this environment, when the perception changes, the moves are very large, but this dynamic carries one important note of caution: these results can be spotty and streaky. There will inevitably be periods where we need to be patient as that spotlight does not turn to our names at predictable or regular intervals.

Of course, things on the big stage may play out differently than we expect. Macro conditions may advance along alternate pathways because of bad policy decisions that get made along the way. However, the impact from the big picture on how we manage the portfolio will be modest and on the margin. Ten years ago, at the end of the third quarter of 2008, my expectation was that policy makers would stop worrying about "moral hazard," would stop seizing weak institutions, would restore confidence and would not stoke a further 40% drop from September 30, 2008 to the market trough. It played out very differently than that expectation. Nevertheless, we did the same thing then that we are doing now: we stayed focused on fundamentals with a straight-forward value investment discipline; we put capital to work in specific securities where we were confident we were creating a claim against quality assets at an attractive price. From that point to now, our portfolios have grown substantially and we are confident that the same thoughtful and disciplined approach that worked then will continue to be effective in the months and quarters ahead.

-Charles Lemonides, CFA

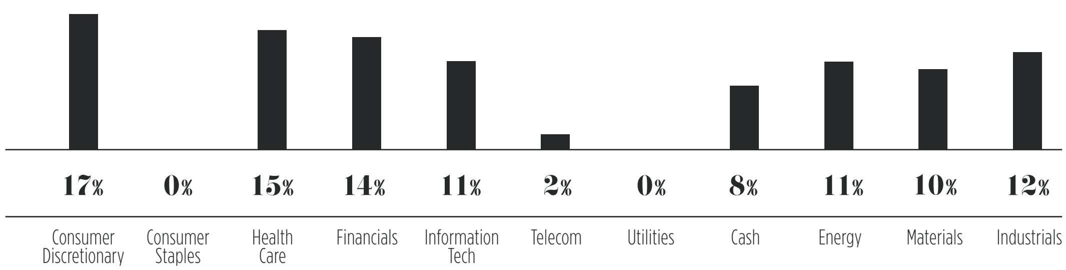
TOP 10 HOLDINGS

1. Qualcomm Inc.
2. Cliffs Natural Res 6.25% Due 10-01-40
3. Transocean Ltd.
4. Eli Lilly & Co.
5. Corning Inc.
6. Brunswick Corporation
7. Amgen Inc.
8. Boston Scientific Corp.
9. American Express Co.
10. Live Nation Entertainment, Inc.

—As of 9/30/18—

*see notes on pg 4 for additional details

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.

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.

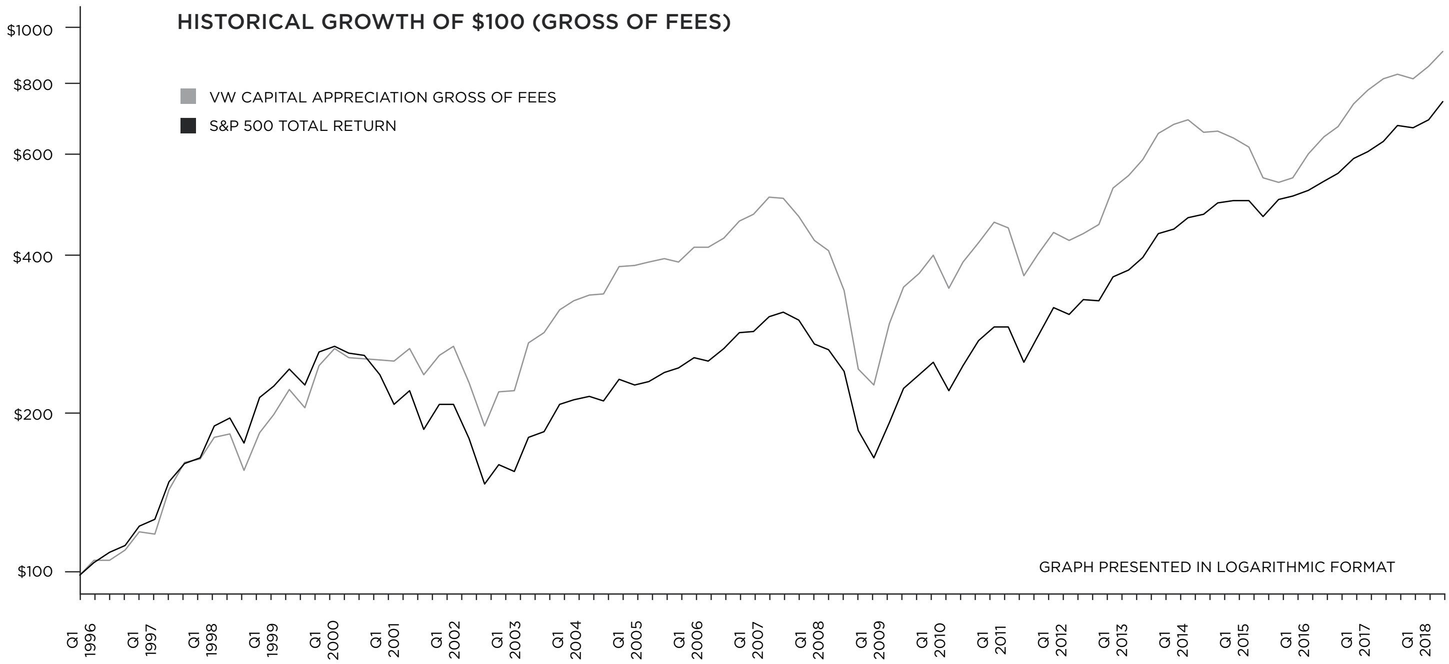
Objective

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.

VALUEWORKS

PERFORMANCE REVIEW

THIRD QUARTER 2018 JULY 31, 2018—SEPTEMBER 30, 2018



TRAILING PERFORMANCE DATA

VALUEWORKS' CAPITAL APPRECIATION COMPOSITE

	GROSS OF FEES	NET OF FEES	S&P 500 TR
2018 Q3	6.25	5.96	7.71
2018 YTD	9.65	8.74	10.28
1 year	12.22	10.96	17.61
3 years	19.24	17.87	17.22
5 years	9.42	8.12	13.90
10 years	10.50	9.13	11.91
Life*	10.10	8.54	9.09

*Life is 22.75 years (inception 1/1/1996)

VALUEWORKS' BALANCED COMPOSITE

	GROSS OF FEES	NET OF FEES	BLENDED INDEX*
2018 Q3	5.14	4.80	3.86
2018 YTD	7.68	6.63	4.25
1 year	9.93	8.50	7.92
3 years	16.05	14.52	9.10
5 years	8.71	7.24	7.79
10 years	10.08	8.56	8.13
Life*	10.30	8.61	7.38

*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.

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