VALUEWORKS
QUALITY ASSETS COMPELLING VALUATIONS

VOLUME 18,3 THIRD QUARTER 2020

The turmoil of the past year has been historic. After a dramatic swoon and sharp rebound, our portfolios are valued very nearly where they were a year ago. The Capital Appreciation portfolio added 9.2% for the quarter (gross of fees – see p. 4 for additional performance information); the S&P500 was up 8.9% for this same period. That is not to say that our holdings are unchanged through this period. Rather we have been quite active, upgrading the opportunities within the portfolios with the intention of positioning them for a powerful advance over the next several years.

At ValueWorks we've had the advantage of managing through several periods of similar turmoil over the past 25 years. It is particularly helpful to recognize that the pattern of our portfolio performance has been consistent through each of these periods.

We entered those windows with diversified portfolios that we considered prudently invested. There were short periods – measured in months or quarters – of radical price contraction during which market values declined significantly. We were quite active through those periods, upgrading the opportunities within the portfolio. Each time the rebound from the low was stunning. During this initial spike we typically recouped the initial loss with advances in the order of magnitude of 30-60% – again in the space of months or quarters. In the past, that initial recovery was followed by powerful, steady advances that roughly doubled the portfolio values over the following several years.

We see ourselves in an analogous position today. We have been quite active in the past nine months, upgrading the opportunities among our holdings, buying investments where we see the opportunity for 2-5 fold advances playing out over 2-10 years. If that seems overly optimistic, we do have the advantage of having experience through similar turmoil and you can still find among our current holdings several investments where we had that very experience emerging from past implosions.

Casual observers will not see it that way. They will view these investments as part of the carnage and wreck of the past year. Our skill set is in sifting through this carnage and identifying the roughed-up diamonds, having the conviction and confidence to place them in the portfolio and then giving them the time and room to shine. We have the holdings we have today because in the past we have had a good success rate working that process.

Through these cycles, it is never unequivocal that the bottom is behind us – that there will not be another shoe to drop. Frankly, the change of direction often depends on factors that are ultimately impossible to know. Today, there are two primary concerns raising fear and uncertainty: the outcome of the election and the course

of the virus. I consider the most likely outcome to be that the incremental risk from each continues to decline and that the worst is behind us. If that plays out, those underinvested today will likely not participate in a very streaky 10-30% advance in the quarters ahead. But it also seems irresponsible not to recognize that it may not play out that way; we could be in for some consequential bumps ahead if bad case developments play out.
We are prepared to navigate either outcome.

In terms of the election, I have been making the case for some time that the headwind of an election is not in the risk that the wrong party wins; it is that there is certitude of economic damage if "the bad guys" win. The salient detail is the conviction is equally strong on both sides of the political divide. Once the winner is clear, half the population breathes a sigh of relief, puts money to work, and the indexes move higher. The other side remains frozen. But if everyone is scared before a winner is known, and only half are scared once we know the winner, you add a lot of buying power and remove none.

From that perspective, we can expect a huge sigh of relief once investors gain confidence that a winner is known. That may be happening right now as one side may be seen as having an unassailable lead. Of course that could change on any given day and we may have real edginess right through November 3rd. That would be fine and expected. The bad case though is that we have a contested outcome after November 3rd. I do not expect that to happen, but if it does, we need to be prepared to manage through another powerful market contraction.

We know we may get a great buying opportunity if that bad case plays out, and we have some room to become more aggressive in that event. But my expectation is that a more normal scenario will unfold. We are not willing to miss a very significant move to the upside in that more likely case. Those who moved to the sidelines ahead of the last election were not well served by that decision.

As for the virus, I am in the camp that believes this challenge will likely be with us for the better part of another year, but that the greatest economic and market damage is nevertheless behind us. But I also recognize the real chance that things play out either better or worse than my base case expectation. In the weeks and months ahead, we may see real progress containing the virus' spread, managing the severity when people get sick and making progress on vaccines. On the other hand, when we all were first hearing of this virus there was

TOP 10 HOLDINGS

1. Qualcomm
2. Whiting Petroleum
3. Amgen
4. Comcast
5. United Natural Foods
6. Goldman Sachs
7. Cliffs Natural Res 6.25% Due 10-01-40
8. Apple
9. New York Times
10. Corning

—As of 9/30/20—

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consistent talk of how it – like the Spanish flu 100 years ago – would travel around the world in waves, slowing in the summer and re-accelerating into the winter flu season, when we really get walloped. Events since then have been remarkably consistent with that early projection and it seems reckless to rule it out at this point. I consider my base case expectation to be somewhat balanced between these two credible possibilities.

The read-through of what we can expect in the markets and the economy is complex. There are myriad cross currents, some of which get unendingly rehashed in the financial media and some that do not get as much attention as they deserve. The potential impact of low interest rates and fiscal stimulus are quite aggressively discussed. These are important offsets to the real damage this pandemic is causing. These are very real and powerful forces and could be laying the foundation for a multi-year economic advance. No matter the ultimate outcome of the election, I expect meaningful monetary and fiscal stimulus to create a very favorable look-term outlook for equities. If that support is not provided, we can expect a much bumpier ride.

When considering where stock prices are today relative to where they were a year ago, there are two other concepts that deserve more attention than they are getting.

The first is that when measuring how things are going, our primary measurement tool is economic activity as opposed to economic wealth. GDP, a measure of economic activity, is published every quarter and estimated constantly. Measures of our actual resources – what we have – are not focused on in the same way. Our reactions to this virus have decreased economic activity dramatically, but the resources we have available to us have not changed nearly as much. Slamming the brakes on economic activity the way we have in the past year is massively disruptive and creates real challenges and turmoil. But our economic resources do not evaporate when we do that. The read-through to how impactful this moment is therefore gets confused. Yes, it is very disruptive to close thousands of movie theaters, restaurants and bars, sending employees home a matter of months. It is not seamless to re-open them, and it will not happen in weeks, but perhaps over quarters. Still, once the crisis subsides, the assets that made those businesses run are mostly still there. My point is simply that we tend to look at the damage in terms of activity stopping, which has been exceedingly dramatic. When we look at the impact in terms of our ability to resume activity, the opportunity for recovery is also dramatic, because our basic economic resources have not been impaired in the same way our activity has been halted.

Secondly, the degree to which we have had winners as well as losers through this turmoil has been remarkable. There has been a positive side as well as a negative side to many of the adjustments we have made. That has been one of the biggest eye openers for me. It turns out that when people can't go out to bars, commute to work, spend time watching sports on TV or get on endless airplanes, they spend more time gardening and redecorating their homes, buying electronic bikes or boats, upgrading their computer systems, and baking sourdough bread. Those have been the specific tradeoffs made in my immediate family. And they are similar to the tradeoffs that the vast majority of us are making.

Each of these observations contribute to my sense of how strong a recovery we could have from this moment of extreme disruption. I also see opportunity created by the bifurcation we have seen within equity returns. Equity indexes are near their highs because a select group of high-quality global technology companies have been accepted as fixed-income alternatives and have become increasingly fully priced. Most other equities have contracted significantly. Our portfolios are within striking distance of the broad indexes over the past twelve months because we have had select exposure to those high-quality investments including Apple and Qualcomm. But most of our portfolio remains invested in the names that have become ever more compellingly priced. It is in those names that the opportunity lies going forward. It also appears increasingly likely that those high-flying names will at some point pose significant risk to investors. The lessons of 1999-2000 when high flying tech stocks propelled the indexes ever higher only to end in 80% declines are increasingly being forgotten or dismissed.

In summary, this is a complicated moment in which to manage portfolios. Our effort has been to build diversified portfolios of well valued assets that offer significant upside in the months, quarters and years ahead.

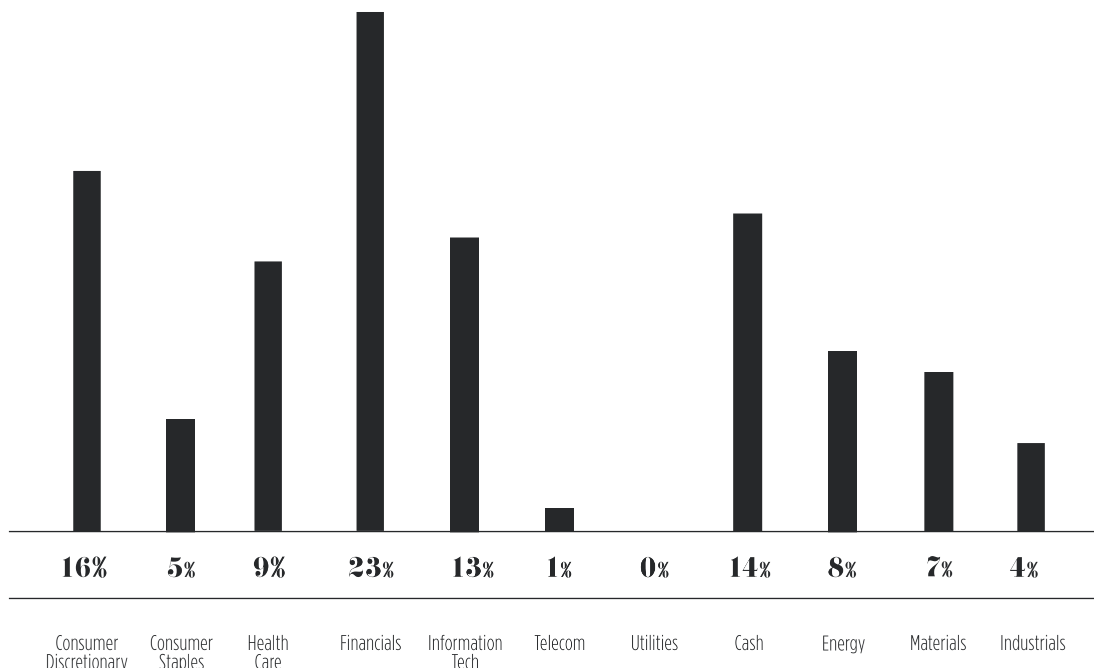
We hope you are staying healthy and making the most of this very unusual moment.

Sincerely,

-Charles Lemonides, CFA

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.

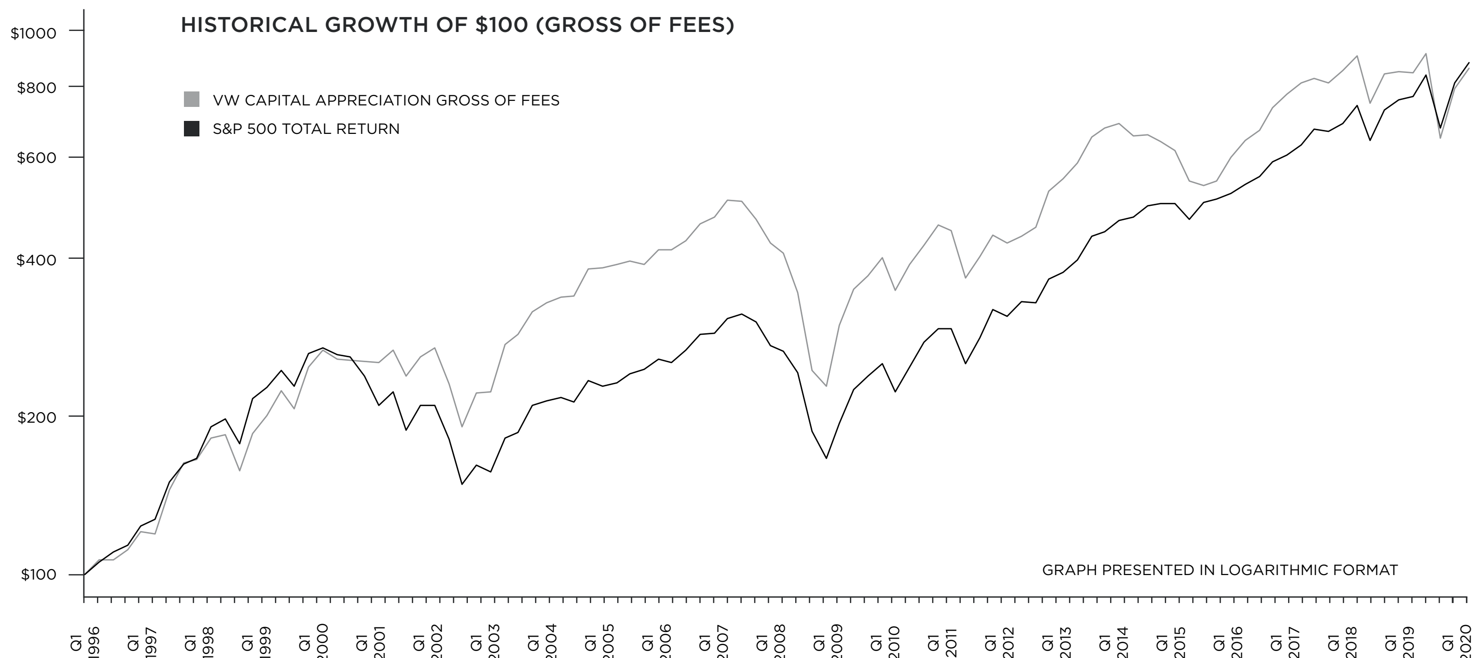
Objective

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 2020 JUNE 30, 2020 – SEPTEMBER 30, 2020



TRAILING PERFORMANCE DATA

VALUEWORKS' CAPITAL APPRECIATION COMPOSITE

	GROSS OF FEES	NET OF FEES	S&P 500 TR
2020 Q3	9.21	8.89	8.93
2020 YTD	-5.68	-6.47	5.42
1 year	1.89	0.75	14.99
3 years	2.20	1.05	12.13
5 years	10.03	8.77	14.07
10 years	8.65	7.35	13.67
Life*	9.03	7.51	9.12

*Life is 24.75 years (inception 1/1/1996)

VALUEWORKS' BALANCED COMPOSITE

	GROSS OF FEES	NET OF FEES	BLENDED INDEX*
2020 Q3	9.62	9.34	4.80
2020 YTD	-2.19	-2.94	7.48
1 year	6.48	5.34	12.42
3 years	3.88	2.55	9.39
5 years	9.77	8.34	9.51
10 years	8.45	6.99	8.89
Life*	9.52	7.86	7.60

*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.
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