VALUEWORKS
QUALITY ASSETS COMPELLING VALUATIONS

VOLUME 14,3 THIRD QUARTER 2016

The market dynamics that drove our portfolio's outperformance in the first half of the year clearly remain intact. We are in an environment where underlying asset values are increasingly being reflected in securities' prices. This is a reversal of the type of market action we saw through the middle of the first quarter. Up to that point momentum was driving security prices further and further from underlying asset values. Current valuations suggest to me that this process may still have a long way to go.

The S&P 500 added 3.8% for the quarter and is now up 7.8% for the year. The Dow Industrials added 2.8% for the quarter and 5.1% for the year, and the Nasdaq Composite added 10.1% for the quarter, making up for its earlier losses and giving it a gain of 7.1% for the year. As you can see from the table on page 4, our Capital Appreciation accounts added 7.48% for the quarter, bringing the composite to 20.68% for the year (gross of fees)--outperforming those indexes handily.

For the next six weeks the presidential election will dominate investors' thoughts and behavior. We are in the midst of a particularly transfixing election cycle and it seems almost irresponsible to manage a portfolio without considering the risks and ramifications of that election.

Our bottom-up approach provides a framework to manage through this very unpredictable process. It also offers an insight into a macro conclusion that deserves careful consideration. Specifically: all the focus on downside risk stemming from the flaws of each candidate has, paradoxically, led us to a place where a near term rally is possible, regardless of who wins.

In our bottom-up process, we have sought to own investments with any of the following characteristics: 1) Issues that stand to benefit from either of the new administrations, but whose share prices do not already reflect that benefit. Boeing is a good example with its large defense business and a valuation of 13 times earnings. 2) Companies that would likely see little direct impact, but are trading at valuations consistent with an imminent economic slowdown. I would put Cisco Systems, Corning Glass, and Xerox into that category. 3) Companies that might have negative business risk if one party wins and upside if the other wins, but are already pricing in a very bad case outcome. Gilead, currently trading at 7x earnings is a perfect example.

In going through that evaluative process, it is striking how few companies' share prices reflect the possibility of a good case outcome and how many reflect the possibility of a bad outcome. We see more companies' shares priced for a negative outcome relative to the election, and few pricing in any upside should the perceived less-damaging candidate come out on top.

That makes sense. Investors on both sides of the political spectrum are genuinely concerned about the possibility of the wrong candidate winning and the damage they would cause to the economy. I speak to investors on both sides of the divide. Both sides speak with passion and conviction about the damage that will be done if the wrong candidate wins. Ahead of that risk and uncertainty both sides want to be protected from that bad case outcome. They would prefer to wait to see that the more harmful candidate does not win, and make investment decisions once they have that comfort.

That is a dominant mindset on both sides of the political spectrum. So there is a degree to which 80% of the populace is scared onto the sidelines. Both sides seem convinced that "if that one wins, we are going to be in for some very difficult times."

In the near term, it doesn't matter if either or both of those sides are right (i.e., that the new

TOP 10 HOLDINGS

1. **Cliffs Natural Res.** 6.25% Due 10-01-40
2. **Boeing Company**
3. **Boston Scientific Corp**
4. **Eli Lilly & Co.**
5. **Corning Inc.**
6. **Comcast CL A**
7. **Cisco Systems Inc.**
8. **Xerox Corporation.**
9. **Chesapeake En.** 5.75% Due 3-15-23
10. **American Express Co.**

—As of 9/30/16—

*see notes on pg 4 for additional details

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President will usher in a period of great economic distress). Once the election is over, a minority of us will remain scared. But the majority (because, elections) will breathe a sigh of relief. Half of us will be sure the more dangerous, harmful candidate did not win. And at least that half can be expected to act with more confidence. Not only will a major uncertainty be removed, but it will be removed in a way that the majority are comfortable with.

Either way, something like 50% of the electorate will be very relieved on the evening of November 8th. Fear will subside for a bit more than half of us. And that majority — whether you or I are in it or not and whether that majority is eventually right or wrong -- will breathe a sigh of relief, engage in the investment process, and put money to work. It would hardly be unrealistic to expect that "relief rally" to lift equities 5-15% higher between now and the day the new President is inaugurated. Whether that near term rally is ultimately justified, it is just too early to tell. I would note a couple of things. First, that any certainty of how the election will play out seems absurd. Yes, after the fact, it will have been obvious. But up to this point both the things we all knew would happen have happened (Hillary is the nominee). And the things we all knew could not happen, have also happened (Jeb is not the nominee, and Donald Trump is). We have never seen an election like this before and we cannot know how it will play out. But even beyond that, the certainty of what actions will be taken by either candidate is just not supported by history. Politicians have surprised us before both to the good and the bad.

Nixon went to China. Reagan oversaw a massive fiscal deficit and a huge market advance. And Bill Clinton inherited a deficit, left with a surplus and oversaw a huge market advance. In each of those cases, one can identify a slew of specific reasons why original expectations were confounded. So those of us that find ourselves on the wrong side of that 51% come November 8th, even if we cannot acknowledge that the majority's choice is a decent one, should at least allow for the possibility that some other factors prevent that "wrong" candidate from doing the all damage we have been trained for years to be terribly afraid of.

That is not to understate the degree to which we have made and will continue to make adjustments to reflect changed macro and political realities. I would expect that a 5-15% rally would bring a handful of the issues in our portfolio to a more fully priced level leading us to be sellers of those issues. The point is that our tools for making these adjustments are more nuanced than a simple broad political or market call. In short, the portfolio is constructed to perform well through this election cycle without relying on placing a bet on who will win. As the election plays out and conditions change, we will continue to make adjustments to take advantage of the opportunities that are created.

-Charles Lemonides, CFA

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.

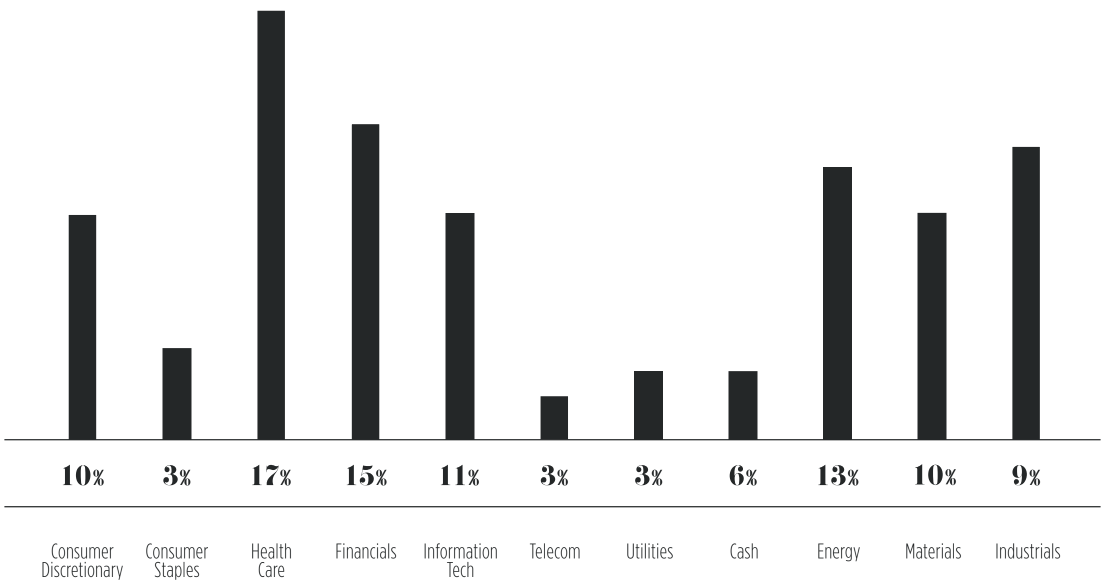
5 *Exit*

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.

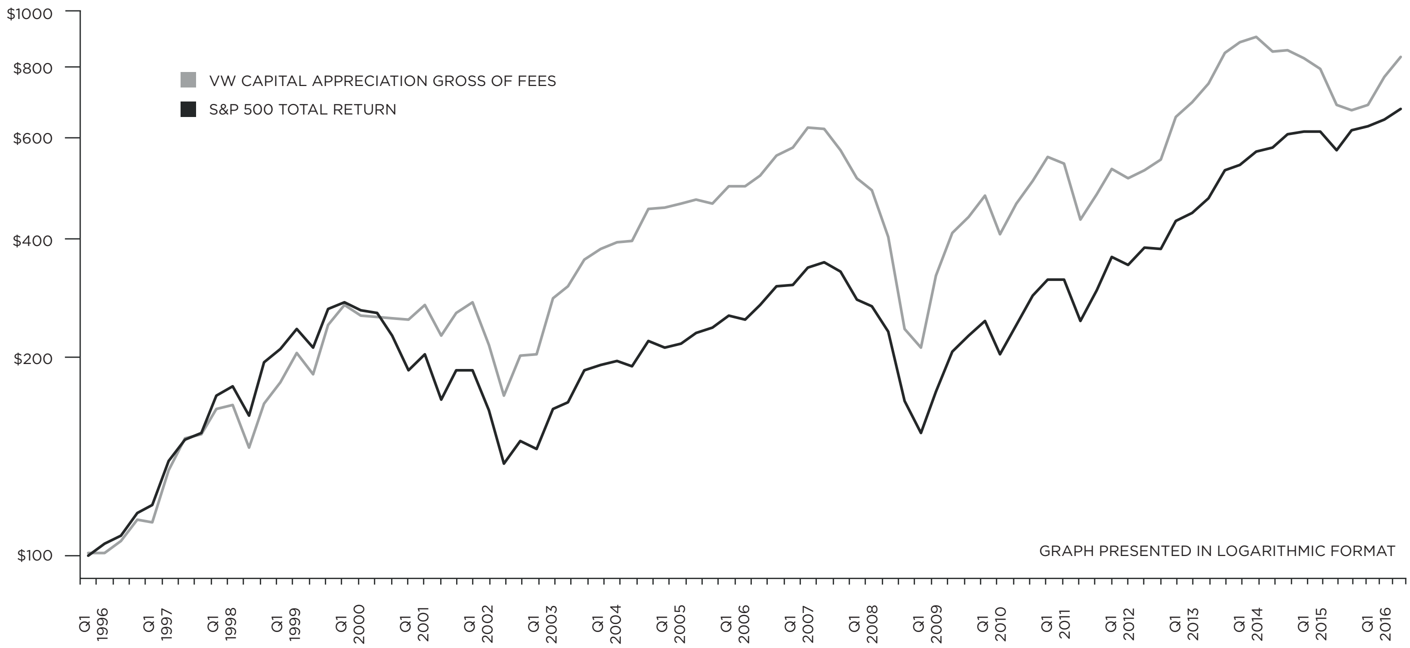
Because our decisions are based on research and sound fundamentals we view depressed price action on our securities as buying opportunities rather than sell signals.

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

THIRD QUARTER JUNE 30, 2016 – SEPTEMBER 30, 2016



TRAILING PERFORMANCE DATA

VALUEWORKS' CAPITAL APPRECIATION COMPOSITE

	GROSS OF FEES	NET OF FEES	S&P 500 TR
2016 Q3	7.48	7.16	3.86
YTD	20.68	19.60	7.85
1 year	18.66	17.25	15.45
3 years	3.15	1.89	11.17
5 years	12.27	10.88	16.34
10 years	4.33	2.99	7.20
Life*	9.24	7.65	8.26

*Life is 20.75 years (inception 1/1/1996)

VALUEWORKS' BALANCED COMPOSITE

	GROSS OF FEES	NET OF FEES	BLENDED INDEX*
2016 Q3	7.20	6.85	2.14
YTD	20.01	18.62	6.90
1 year	18.08	16.52	10.36
3 years	4.67	3.23	7.34
5 years	11.91	10.36	9.54
10 years	5.54	4.04	6.40
Life*	9.85	8.14	7.28

*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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