VALUEWORKS
QUALITY ASSETS COMPELLING VALUATIONS

VOLUME 20,3 THIRD QUARTER 2022

Our portfolios continued to perform quite solidly in the face of what has developed into a harsh market sell-off. Importantly, I see us as increasingly well positioned to generate meaningful upside once these powerful market headwinds subside in the months and quarters ahead.

While I consider the near-term outlook for the markets – meaning the next two or three quarters– to have the potential for meaningful challenges, I view policy makers' current actions as setting us up positively for the next several years after that.

Monetary policy tightening from the Fed is having a very powerful impact on the financial markets. It makes sense to us that that impact will continue and could credibly culminate in a full-blown liquidity crunch in something like three to nine months from now. On the other hand, the "damage" to the real economy – especially as measured by employment and overall output -- may remain quite modest even as the Fed achieves its inflation-containing objectives. Beyond that, the fact that the Fed has "re-loaded" and firmly moved us away from the "zero-rate bound" is an important positive development and another factor that creates the conditions for a very positive economic and investment set-up for a multi-year period.

The market sell-off in the third quarter was exceedingly broad and deep. The worst performing major average was the Dow Transport which shed 8.0%; the best was the Nasdaq Composite which lost 3.9% and is now down 32.0% for the year. The S&P 500, the Nasdaq 100, the Russell Large Value, Russell Large Growth, and Russell Small Value all posted declines in that range. For the Year-to-date, the laggard in that group was the Nasdaq 100 with a decline of 32.3%, and the best was the Russell Large Value with a decline of 17.7%. Adding injury to injury, fixed income investments saw comparable damage, with the total return loss on holding a 20-year treasury bond from the beginning of the year to September 30th being 26%, with 8.5% of that loss being incurred in the third quarter.

The primary reason these losses are occurring is because the Federal Reserve is being quite aggressive in curtailing liquidity in order to tame inflation. In fact, they are being much more aggressive than we have seen before, and more aggressive than I projected in my letter at the beginning of the year. I expected the Fed to be only by degrees more aggressive in this cycle than they were the last time they began raising rates in 2016. In that cycle they raised rates from basically 0.25% to 2.50% from March of 2016 to March 2019. This time they raised them from basically the same starting place to 3.25% in six months, not three years, and they are saying they are going much higher over a period of months.

We do expect higher rates to dampen demand, especially for the classically rate-sensitive parts of the economy like real estate. Raise mortgage rates from 2 ½ percent to 6 ½% and home buyers will be less inclined to pay millions of dollars for an apartment, and on down the line. But until recently, demand across the board has been way too high for what businesses can deliver. As less liquidity (in higher rates and shrinking money supply), dampens demand, price increases should moderate. But it is not obvious to me why demand needs to drop to the point of being lower than what businesses can deliver today in order for price levels to stop going up. Businesses are de-bottlenecking from supply chain problems and output is going up. Pre-pandemic, auto makers were able to produce close to 20 million cars per year. Our current run rate is closer to 14 million. But demand has been so high

that dealer lots have been empty, and prices for both new and used cars have ramped higher. We can see how production could grow 15% or more, excess demand can moderate, and prices for both new and used cars come down.

Part of why I see this as credible is what I see in the margins that companies are generating and the rates of return they are earning on invested capital. For bread-andbutter parts of the economy, on an anecdotal basis, profit margins across the board are much wider than at any time in the past 35 years that I have been reading financial statements. That is true of steel producers like Cleveland Cliffs, US Steel and Nucor, to trucking and shipping companies, to chip companies ranging from Broadcom to Micron, to Auto Dealers and Auto Makers, and of course to energy and commodity companies broadly. Conditions are such that I expect almost all these companies to grow output in the quarters ahead, but likely to also be lowering prices, as the mismatch between demand and supply moderates and profitability remains high. In truth, this is exactly what seems to already be playing out in several specific industries that we have exposure to.

That is an argument for why both output and employment could credibly continue to grow in the months ahead even as price levels moderate or, in many sectors and maybe overall, actually decline as this plays out. There is nothing about this recipe that smells of 1970's stagflation. It is a case why the real economy – Main Street – may continue to perform well.

If we do go into a full-blown liquidity crunch, there will be a short moment – measured in days and weeks – when asset prices will simply not matter. Almost all financial securities will become quite cheap. The strategy we will try to execute in that moment will be to upgrade the quality of our portfolio and control even higher quality assets at very distressed prices. In the past, those types of adjustments, and the opportunities created in those moments have allowed for very compelling returns over multi-year periods.

Beyond this focus on near term challenges, current Fed tightening should put us in a position to adjust rates and liquidity in the years ahead to "fine tune" monetary policy through the rest of the decade, providing a backdrop conducive to a multi-year period of economic growth and healthy investor returns. After twelve years, we are once again off of the zero-rate bound, and – after a two-year Covid detour -- perhaps have finally fully recovered from the crisis of the late 2000's.

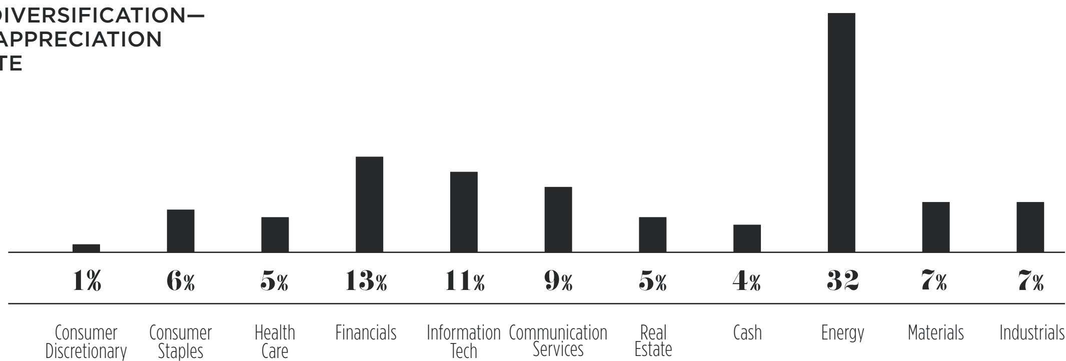
-Charles Lemonides, CFA

TOP 10 HOLDINGS

1. Chord Energy Corp.
2. Cheniere Energy Inc
3. United Natural Foods Inc.
4. Netflix, Inc.
5. Qualcomm Inc.
6. Goldman Sachs Group Inc
7. Mesabi Trust
8. Micron Technology Inc
9. Apple Inc.
10. Air Lease Corporation

—As of 9/30/22—

*see notes on pg 4 for additional details



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.

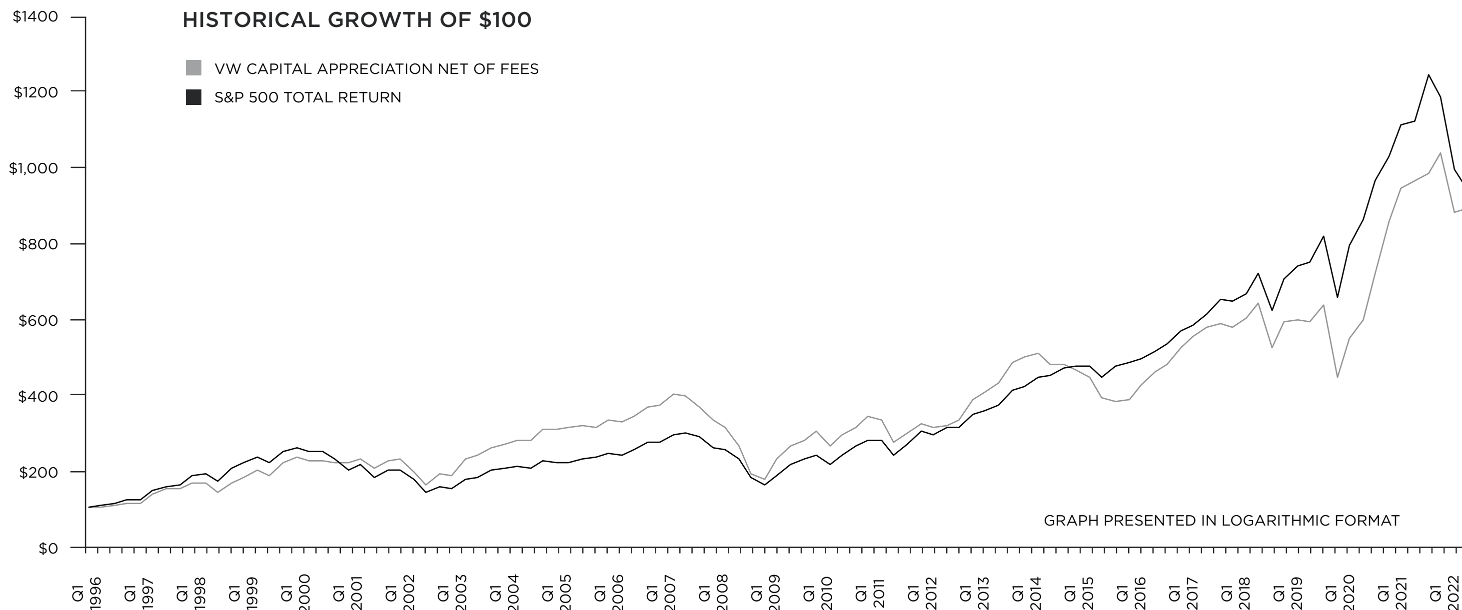
Objective

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 2022 JULY 1, 2022 - SEPTEMBER 30, 2022



TRAILING PERFORMANCE DATA

VALUEWORKS' CAPITAL APPRECIATION COMPOSITE

	GROSS OF FEES	NET OF FEES	S&P 500 TR
2022 Q3	1.42	1.15	-4.88
2022 YTD	-8.42	-9.23	-23.86
1 year	-6.38	-7.47	-15.47
3 years	16.00	14.66	8.05
5 years	10.33	9.08	9.12
10 years	12.07	10.75	11.65
Life*	10.07	8.55	8.79

VALUEWORKS' BALANCED COMPOSITE

	GROSS OF FEES	NET OF FEES	BLENDED INDEX*
2022 Q3	1.48	1.05	-4.90
2022 YTD	-8.29	-9.30	-19.31
1 year	-7.84	-9.16	-14.82
3 years	16.80	15.38	2.85
5 years	10.90	9.48	4.84
10 years	11.74	10.26	6.36
Life*	10.43	8.77	6.88

*Life is 26.25 years (inception 1/1/1996)

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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