ValueWorks:
Redefining wealth management through critical thinking and independent research

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Discipline and Patience

The financial markets remained relatively calm through the third quarter as they have through 2005 generally. Our Capital Appreciation Portfolios have posted a year to date return of 3.1%, with 1.3% of that coming from the third quarter.* In comparison, the Dow Industrials have declined 0.3% on the year with a third quarter advance of 3.4%. The S&P 500 is up 2.8% since year-end, advancing 3.6% for the quarter; the Nasdaq Composite is now down 0.6% on the year — its advance of 4.8% this quarter almost erasing earlier declines.

Our outlook for the equity markets at the end of last quarter was mixed for the near term. We noted a stand-off between the positive impact of a growing economy and higher corporate profits against the negative impact of higher interest rates and an up tick in inflation. To this picture the last quarter added hurricanes and a sharp run-up in energy prices. These do not add clarity to the likely pace of economic activity or the direction of equity markets from here. However, they do create some specific areas of opportunity and some specific risks that warrant even closer attention.

ValueWorks' Top 10 holdings:**

1. **Rowan Companies**
2. **Pfizer Inc.**
3. **Wachovia Corp**
4. **Boeing Company**
5. **Sony Corp**
6. **Questar Corp**
7. **Sun Microsystems**
8. **Schering-Plough**
9. **Chesapeake Energy**
10. **Freddie Mac**

—as of 9/30/05—

**see notes on p4 for additional information

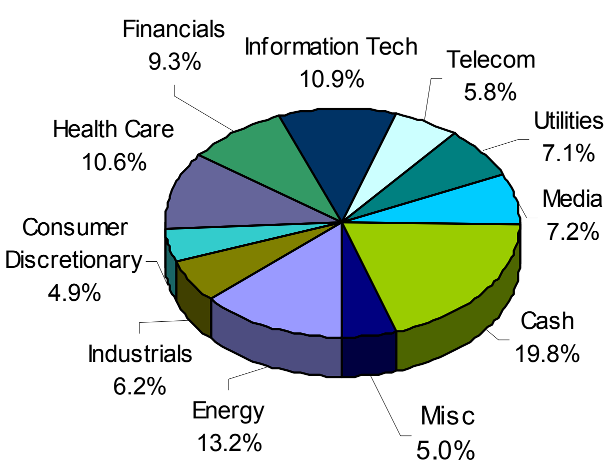
On one side, the physical devastation will result in economic stimulus. Emergency efforts and clean-up and restoration efforts will eventually morph into rebuilding efforts. Money will exit the coffers of insurance companies, the government, and savings accounts and be put to physical use. A mini-boom and gold-rush mentality is already taking shape. This will extend into a long-lived process. The other side of this argument is that the financial burden entailed drains resources and has negative impacts for the financial system. Specifically, the government deficit will be higher as a result, insurance companies' balance sheets will be weakened, individual's savings balances will be lower and businesses' ability to invest for growth rather than repair will be impacted. That said, near term the simulative impact dominates. And, from a larger perspective, the dollar amounts involved are not large relative to a twelve trillion dollar GDP. The negative impact should be easily absorbed by the overall system.

The impact of higher energy prices also cuts both ways, but I believe presents greater risk over the near term. On the positive side, activity in the oil patch continues to accelerate, enhancing economic growth. And as for the impact on corporate profits, the benefit to the profitability of energy companies goes a long way to offset the negative impact on everyone else. But higher energy prices have the negative effects of both fueling inflation and cutting into consumers' purchasing power. I consider the second impact the greater near term

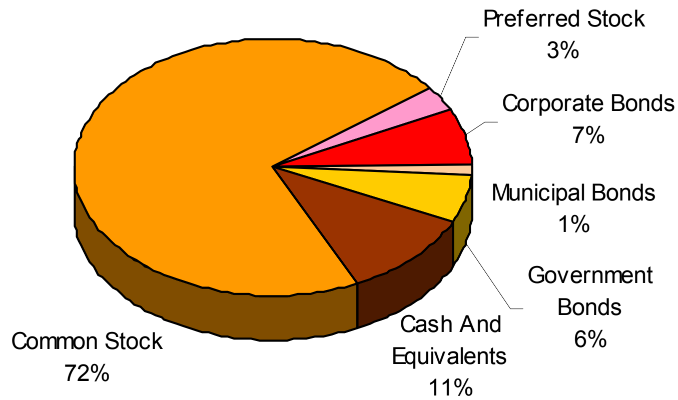
*All ValueWorks' figures are Gross of Fees. For additional information on returns, including net performance, see page 4.

Home heating and gasoline bills will be importantly higher this winter given current oil and natural gas prices. The impact on consumers of current prices is not trivial. I expect it to have a measurable impact on spending and economic growth. If energy prices remain at current levels, I would expect enough of an economic impact to offset some of the existing momentum in the economy and translate to very modest growth rates over the next three to six months. I see too many similarities to the period of the mid-to-late 1970's to discount the risk of extended stagnation. Some may argue that energy is not as large an issue in today's economy because it represents 6% of GDP down from 12% of GDP in the late 1970's. However, doubling the price of all energy products (which is not currently the case, but not that far removed), would double energy's share of GDP and quickly remove that distinction.

Sector Diversification--
Capital Appreciation Composite



Asset Class Diversification
--Balanced Compositie



As a result, we are making a conscious effort to avoid being over-exposed to the consumer cyclical areas of the markets. We are also favoring exposure to some more defensive equities. Also, we are building on our energy exposure, looking to position our portfolios to benefit from tight end markets. Should energy prices decline, that portion of our portfolio may not perform particularly well, but the remainder of our portfolio should. Similarly, we have sought to increase our exposure to equities that are less tied to the pace of consumer spending in the US.

Overall I consider us quite well balanced. I continue to consider further economic advance coupled with advancing equity markets to be the most likely scenario to unfold over the next six months to two years. However, I expect our portfolios to perform well in a less hospitable environment as well.

—Charles Lemonides CFA

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ValueWorks:

controlling quality assets at compelling valuations

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.

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.

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.

About our Portfolio Structure:

We believe risk can be better contained through educated security selection than through overdiversification. 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.

About 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.

ValueWorks: Performance Review

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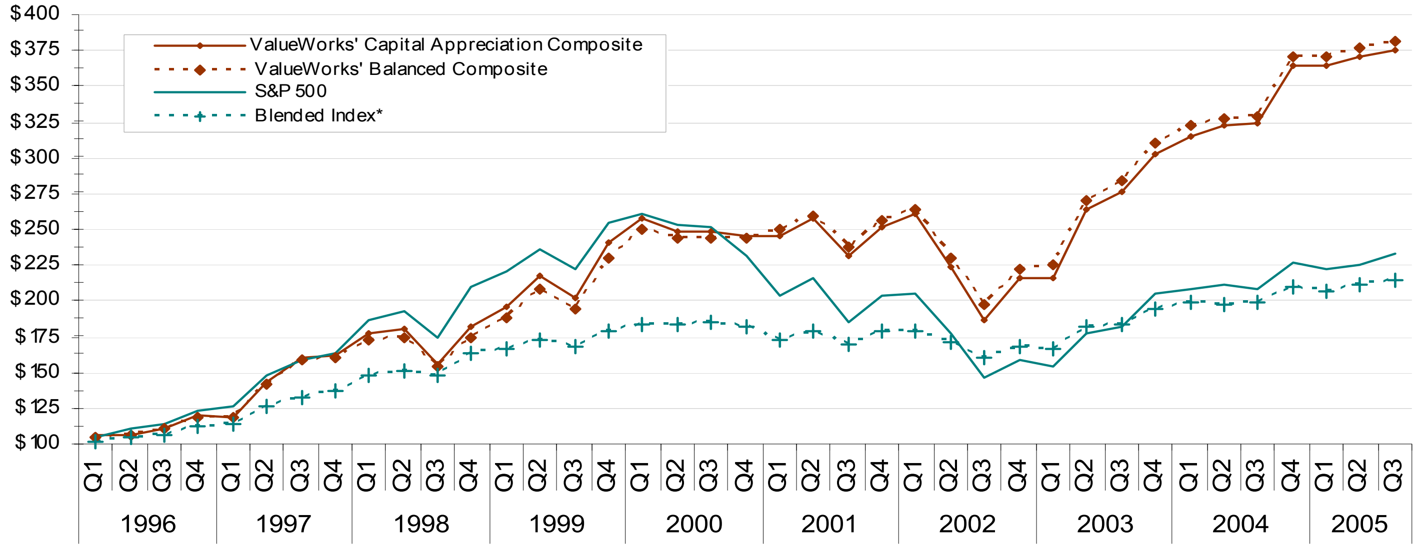
3rd Quarter: June 30th, 2005—September 30th, 2005

Historical Growth of $100 (gross of fees)



Trailing Performance Data

	ValueWorks' Capital Appreciation Composite			ValueWorks' Balanced Composite		
	Gross of fees	Net of Fees	S&P 500	Gross of fees	Net of Fees	Blended index*
1996-Present	14.52	12.68	9.09	14.74	12.81	8.12
7 year	13.46	11.81	4.33	13.81	11.92	5.48
5 year	8.65	7.13	-1.45	9.42	7.69	3.01
3 year	26.23	24.51	16.73	24.76	22.94	10.19
1 year	15.47	13.96	12.34	16.24	14.79	7.65
2005 YTD	3.11	1.96	2.85	3.06	1.95	2.43

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

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.

As of 9/30/2005 the Capital Appreciation Composite consisted of 306 accounts and $113,105,164 in assets; while the Balanced Composite consisted of 131 accounts and $74,483,994 in assets. Together this represents 99.54% of total accounts and 90.75% of total assets.

Past performance is not a guarantee of future results.