

ValueWorks

quality assets. compelling valuations.

Volume 6,1

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Steady As We Go

2006 proved to be a solid year for the financial markets and quite productive for the ValueWorks group of portfolios. The steady, workman-like conditions put in place in 2006 seem largely intact and may remain in place into 2007. The mid-part of this decade has thus far lacked the high drama that characterized the end of the 1990's and the first several years of the 2000's. In place of that drama, we have experienced a solid, relatively stable environment in which investors can earn fair returns in a more evenly paced manner.

The ValueWorks Capital Appreciation Composite returned a solid 19.2% for the year and a respectable 7.8% increase for the quarter. Our Balanced Composite was up 17.3% and 7.6% for the year and for the quarter respectively. By way of comparison the S&P 500 returned 15.8% and 6.7% for the two periods, while the Dow increased 19.0% and 7.4%. The Nasdaq again lagged the other indices and returned 10.4% for the whole year, most of the gain being in the fourth quarter, which added 7.1%.

ValueWorks' Top 10 holdings**:

- 1 . Wachovia Corp
- 2 . Boeing Company
- 3 . Walt Disney Co
- 4 . Sun Microsystems
- 5 . Bausch & Lomb
- 6 . Calpine Bonds
8.5% of 2011
- 7 . Boston Scientific
- 8 . Pfizer Inc
- 9 . Schering-Plough
- 10 . Rowan Companies

—as of 12/31/06—

**see notes on p4 for additional information

Overall, I believe we are on sound economic footing as we begin 2007. The Fed's orchestration of higher interest rates has had the expected effect of tempering economic growth, thereby cooling commodity prices and the real estate market. As a result, inflation concerns have moderated.

Throughout the year, with the head-winds of higher energy and commodity prices and rising interest rates both removed, equity prices moved higher with conviction—especially through the second half. This positive backdrop (admittedly with short and sharp corrections along the way) could stay in place for some time. The conditions remain favorable for continued solid, if unspectacular, economic growth driven by gains in capital spending. As this develops, prices levels should remain constrained, creating increased consumer spending power, thereby extending the economic advance.

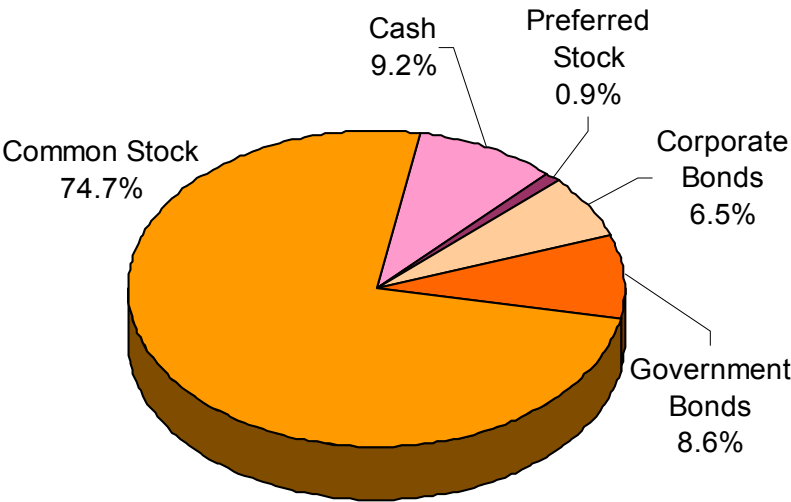
Investment gains in the equity markets have been driven by fundamentals. The most attractively priced securities have paced the advance. This is evidenced by the out-performance of "value" versus "growth" indexes. And the move higher has

been helped along the way by a healthy dose of private equity buyers. These buyers are making the calculation that the businesses they are bidding for are worth more in their hands than the price at which they are trading in the public equity markets. While there is of course always some level of this activity, the pace of buyouts has clearly accelerated over the past six months. Because valuations and the overall economics justify it, I expect this activity to continue and, if anything, accelerate over the next several years. Whether or not we see a buyout craze like we did in the late 1980's remains to be seen, but I would not be surprised.

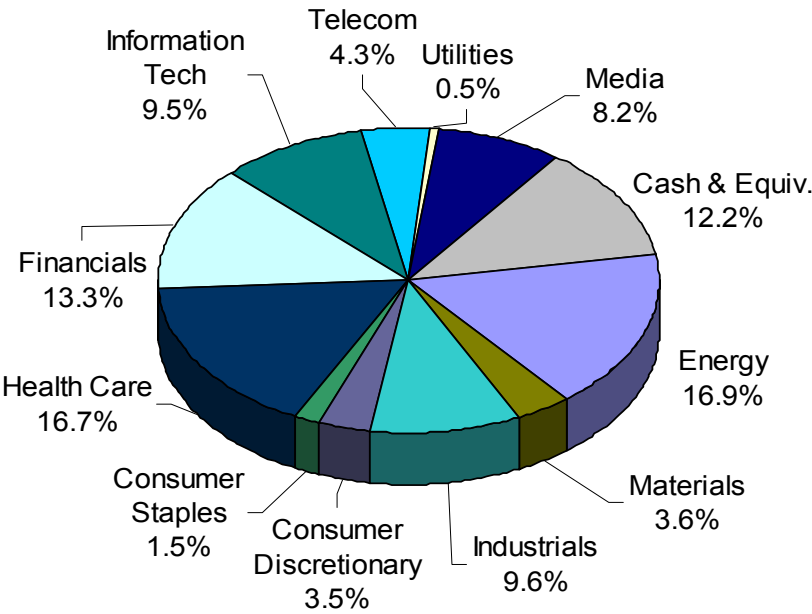
I consider these to be quite good investment conditions overall. Valuations are, in my opinion, generally quite attractive. And the macro-economic conditions should remain relatively stable. This should prove a good environment for us to ply our craft: buying good quality assets when they are reasonably priced.

—Charles Lemonides, CFA

**Asset Class Diversification--
Balanced Composite***



**Sector Diversification--
Capital Appreciation Composite***



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ValueWorks

critical thinking. independent research.

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 overdiversi-

fication. 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:

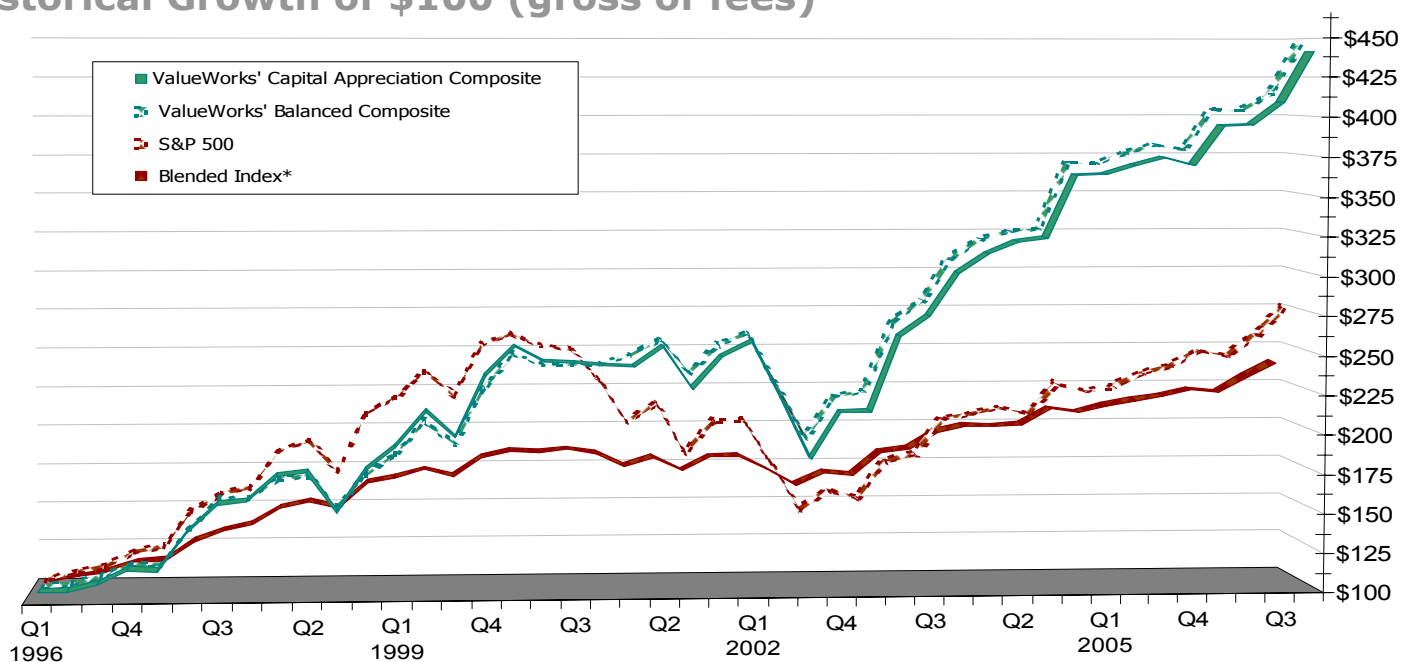
- Individual review of your portfolio requirements
- A separately tailored portfolio created and maintained to your investment objectives and risk tolerance
- Access to the Portfolio Manager on an ongoing basis with timely and responsive communication
- Flexibility to meet your changing tax requirements 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

4th Quarter: September 30th—December 31st, 2006

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*
10 year	13.93	12.20	8.43	14.13	12.24	7.77
7 year	9.07	7.53	1.15	9.93	8.19	4.15
5 year	11.96	10.41	6.21	11.73	10.02	5.91
3 year	13.38	11.87	10.46	12.80	11.21	7.13
1 year	19.15	17.56	15.78	17.34	15.59	9.98
2006	19.15	17.56	15.78	17.34	15.59	9.98

*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 12/31/2006 the Capital Appreciation Composite consisted of 409 accounts and \$156,925,043 in assets; while the Balanced Composite consisted of 113 accounts and \$73,705,995 in assets. Together this represents 99.43% of total accounts and 87.57% of total assets.

Past performance is not a guarantee of future results.