ValueWorks
quality assets. compelling valuations.

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## Round and round we go

The equity markets saw more volatility in the latest quarter than they have in some time. But through the period, the overall impact was nearly imperceptible. For example, the Dow advanced to a new high on February 20th, declined by almost seven percent over the next three weeks, then rallied back and ended the quarter with a 0.3% loss. The other major indexes experienced similar movements; the S&P 500 remains well under its high of eight years ago, and posted a 0.6% gain for the quarter, while the Nasdaq Composite posted a 0.4% advance. Overall, a fair degree of volatility, but little change.

The ValueWorks accounts on the other hand, bumped along to again end the period on an up-note advancing 2.6% for the quarter.

Bull markets can be said to be characterized by slow advances with sharp and steep corrections. The decline in the first quarter was surely sharp and steep. And it was in many respects similar to the corrections in May-June of last year and October of 2005. In each case, significant economic or geopolitical concerns dominated investor thinking for a period. However, as these specific issues were resolved, investors returned to the basic task of putting capital to work, and equity levels moved higher.

I expect a similar pattern to emerge through the next several months, and to be repeated over the next several years. Presently, investors are focused on weakness in real estate generally, the housing market specifically, and more precisely, the sub-prime lending market. Those concerns are well placed to the extent that the housing market was clearly getting over-extended, and the explosion of sub-prime lending was overdone. Those paces of advance could not be sustained, and a retrenchment was surely in the cards. However, this is not a question of all-or-none, and much of the decline may already be over. The housing market can cool, and sub-prime lending can be curtailed, without a massive real estate melt-down. Pundits are now predicting a 5% decline in median home sales prices for 2007, which would represent the biggest decline since the great depression. The possibility is credible, but on the other hand, I am not convinced these are the worst conditions for housing prices in over 70 years. No doubt default rates will go higher over the next several months, and real estate will not provide a growth engine for the economy over the next six months.

However, we may well be quite far along in this correction already, with modest further contraction ahead of us. The slow-down

**ValueWorks' Top 10 holdings**:**

1. **Calpine Bonds 8.5% due 02-15- 2011**
2. **Sun Microsystems**
3. **Chesapeake Energy**
4. **Wachovia Corp**
5. **Boeing Company**
6. **Bausch & Lomb Inc**
7. **Walt Disney Co**
8. **Sony Corp**
9. **Cypress Semiconductor**
10. **Schering-Plough Corp**

**—as of 03/31/07—**

**see notes on p4 for additional information

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

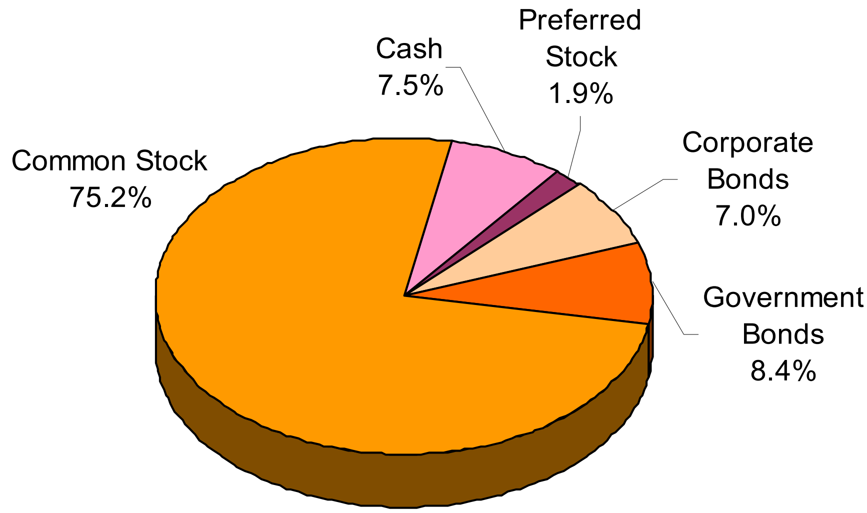
started quite some time ago. Stocks of homebuilders peaked in July of 2005, almost two years ago.

Home prices slowed their advance over a year ago; buyers were being offered hearty discounts on homes since at least last summer. And sub-prime lending, which was clearly being curtailed from four to six months ago, is now virtually halted. In my mind, being concerned about a pending downturn at this point is quite a bit late. The time to be concerned about sub-prime lenders was last summer, not now. At this point, there may be quite a bit more pessimism priced into the markets than reality warrants. That is not to say that more opportunities will not be created over the next few months. They may well be. However, the bulk of the decline in prices – in both the securities and the actual homes – may already be reflected in current levels.

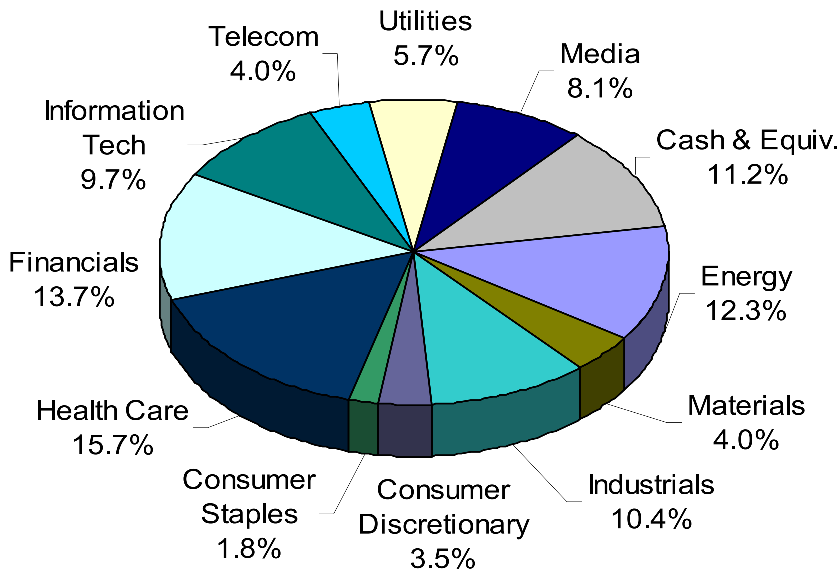
We will remain watchful to see how these issues get resolved, and look to see where opportunity gets created. Generally, our portfolios are not heavily exposed to real estate, and well under weighted in financial stocks relative to the "value" indices. Our portfolios remain well diversified, and are positioned to benefit from a renewed market advance.

—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 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:

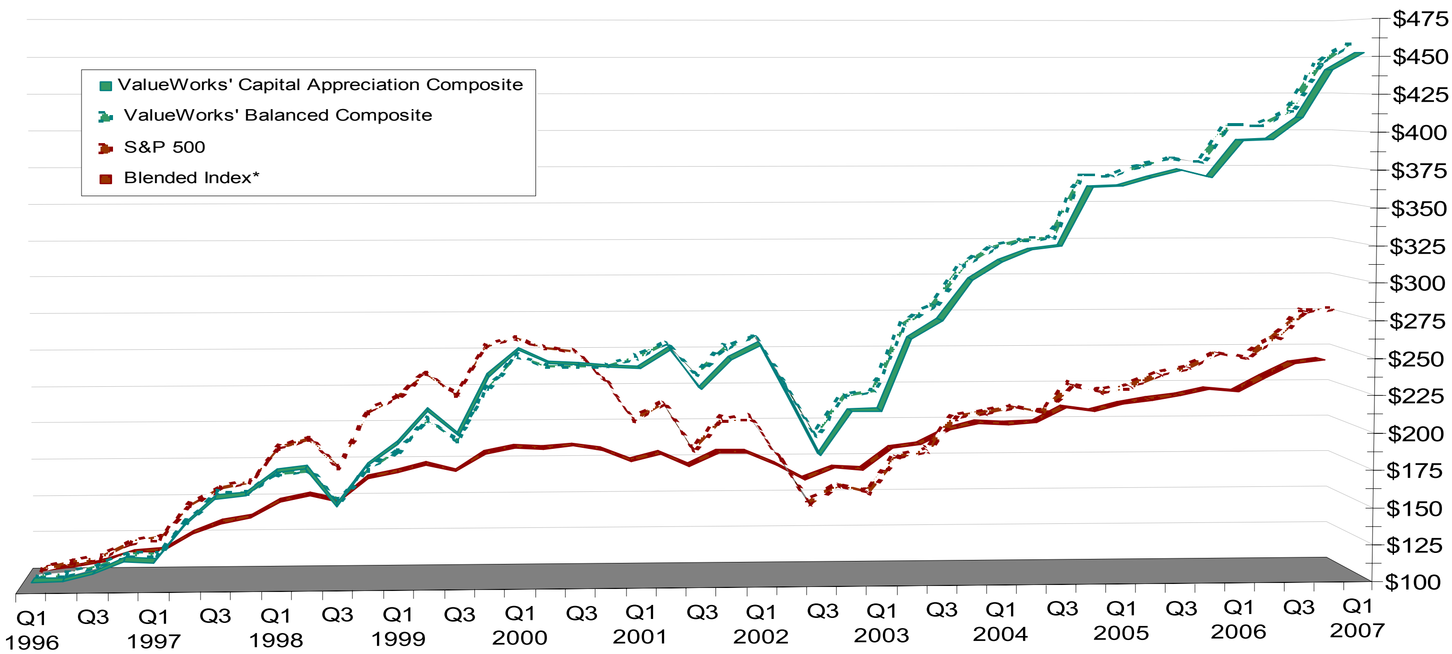
- Individual review of your portfolio requirements
- A separately tailored portfolio created and maintained to your investment objectives and risk tolerance
- Access to the Portfolio Manager on an ongoing basis with timely and responsive communication
- Flexibility to meet your changing tax requirements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

**1st Quarter: December 31st 2006 —March 31st, 2007**

## 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 | 14.33 | 12.62 | 8.21 | 14.50 | 12.62 | 7.77 |
| 7 year | 8.37 | 6.85 | 0.92 | 9.04 | 7.32 | 3.96 |
| 5 year | 11.68 | 10.15 | 6.29 | 11.76 | 10.07 | 6.11 |
| 3 year | 12.86 | 11.34 | 10.08 | 12.50 | 10.92 | 6.74 |
| 1 year | 14.68 | 13.14 | 11.82 | 13.50 | 11.81 | 9.21 |
| Q1 2007 | 2.59 | 2.25 | 0.64 | 3.17 | 2.79 | 1.07 |

*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 3/31/2007 the Capital Appreciation Composite consisted of 441 accounts and $171,469,384 in assets; while the Balanced Composite consisted of 114 accounts and $75,390,670 in assets. Together this represents 99.28% of total accounts and 86.37% of total assets.

**Past performance is not a guarantee of future results.**