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ValueWorks
quality assets. compelling valuations.

Volume 7,1 **January 2008**

Once again, equity markets are in the midst of a sharp correction. Experienced investors will use this as an opportunity to build positions in better valued securities. Inevitably, those with less confidence in their approach will step to the sidelines, selling securities at a significant discount to recent prices. In our portfolios, we have continued to put money to work through this downturn.

The sell-off has now exceeded the level of a typical correction. After peaking at 1570 in October, the S&P 500 declined by nearly 20% through lows this month. The other major indices are down similar amounts. While last year there was a very large disparity between sectors, the movement this year has been much more uniform.

For the record, the markets posted modest but highly divergent returns for 2007. Small cap and value indices performed least well, and larger cap and growth indices performed best. Specifically, the Russell 2000 small cap index lost 1.6% for the year, while the Russell 1000 large cap index gained 5.8% for the year. The Russell large cap value index shed 0.2%, while the large cap growth index added 11.8%. The S&P 500 gave up 3.3% in the fourth quarter, trimming its gain to 5.4% for the year. The Dow shed 3.9% in the quarter, ending the year with a gain of 8.8%. The wide range was primarily driven, in my opinion, by the divergent performance of industry groups. Financial companies and real estate related companies (which are major components of the value indices but lightly weighted in the growth indices) declined meaningfully while both defensive plays and companies exposed to basic materials/commodities did much better. However, that seems like a long time ago. In sharp contrast to this large divergence in returns amongst sectors in 2007, the market decline of 10-14% over the first weeks of 2008 has been remarkably uniform.

ValueWorks' Top 10 holdings**:

1. Cypress Semiconductor
2. Chesapeake Energy
3. Rowan Companies Inc
4. Boeing Company
5. Schering-Plough
6. 3m Company
7. Sony Corp Adr New
8. Questar Corp
9. Dow Chemical Company
10. Pfizer Inc

—as of 12/31/07—
**see notes on p4 for additional information

We have weathered many market dislocations in the past quite similar to this one. Experience has shown that the greatest investment opportunities are offered in periods of dislocation and crisis. A key component of our investment strategy is ensuring our portfolios are invested into the decline in order to benefit from the rebound. Accordingly, we are creating portfolios that are on the one hand soundly diversified in order to ride out the storm and, on the other hand, adequately exposed to the areas in most turmoil in order to benefit from the sharp rebound often experienced.

Of course the market downturn is occurring in the context of an economy that has clearly decelerated. There may be increasing discussion of whether or not the economy entered into a recession in the beginning of the fourth quarter. I would land in the camp that suggests a recession -- by some measure or definition -- likely began in the late fall. Undoubtedly, the pace of growth has been negligible since November. Housing starts and permits are at multi-decade lows and are unlikely to rebound before mid-summer at the earliest. A negative wealth effect from both real estate values and stock prices is weighing down consumer spending and the contraction in credit has a tangible effect on both businesses and consumers' ability to invest and spend.

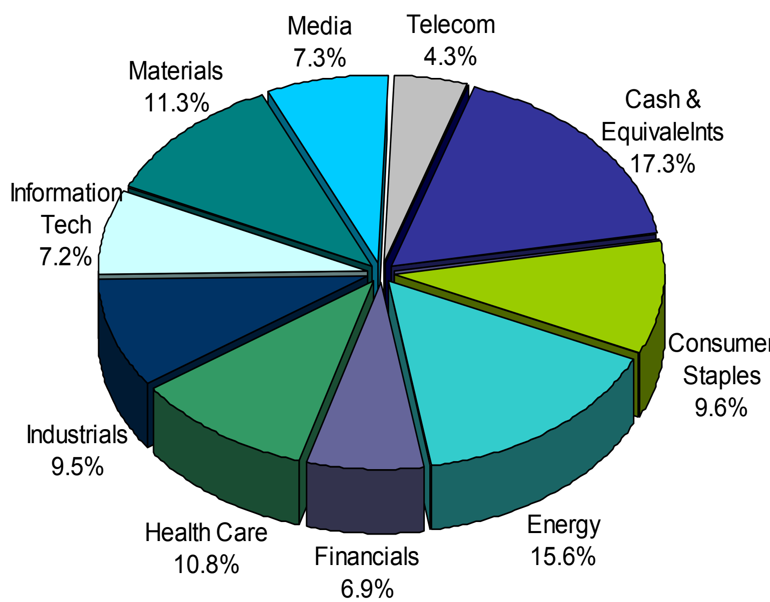
Given the current economic situation, the proper policy response is to provide liquidity to the financial sector in order to spur lending and economic activity. As of this morning, the Fed Funds rate was cut .75% to 3.5%. The cut coincided with a global equity sell-off. As such, the cut could be viewed as a response to the financial markets. However, in my opinion, economic conditions warranted such a cut independent of the sell-off. Previous high interest rates served to deflate the credit and real estate bubbles that drove economic activity through the mid-2000's. However, at this point, that excess has been wrung out of the system, and more stimulus is needed to break the logjam that has developed in the financial markets. Such cuts will not re-inflate real estate prices or lead to increased construction spending. But they will (1) moderate the pace of mortgage payment increases on adjustable rate mortgages, lowering the number of people who are expected to default as their mortgage payments reset higher, thereby moderating real estate price declines, [this represents a much more sensible strategy, in my view, than the plan to freeze resets through some government led plan] and (2) allow the banks to earn healthier returns as their cost of borrowing goes down, thus allowing them to earn back some of the money they lost.

We have used the market turmoil to build positions as prices have deteriorated. Consequently, our portfolios suffered erosion in the fourth quarter and over the past three weeks; but as a result they are better positioned to benefit from a stabilization and eventual rebound. If history is a guide, such a turnaround could happen much sooner and be much sharper than currently seems reasonable. Given that we have put significant amounts of cash to work over the past eight weeks, we are much more fully invested than we were at the market high three months ago.

Finally, ValueWorks continues to grow as an organization. We recently leased the floor below us at 1450 Broadway and will be remodeling the space over the next several months. It should provide us ample room for expansion over the next several years.

—Charles Lemonides, CFA

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:

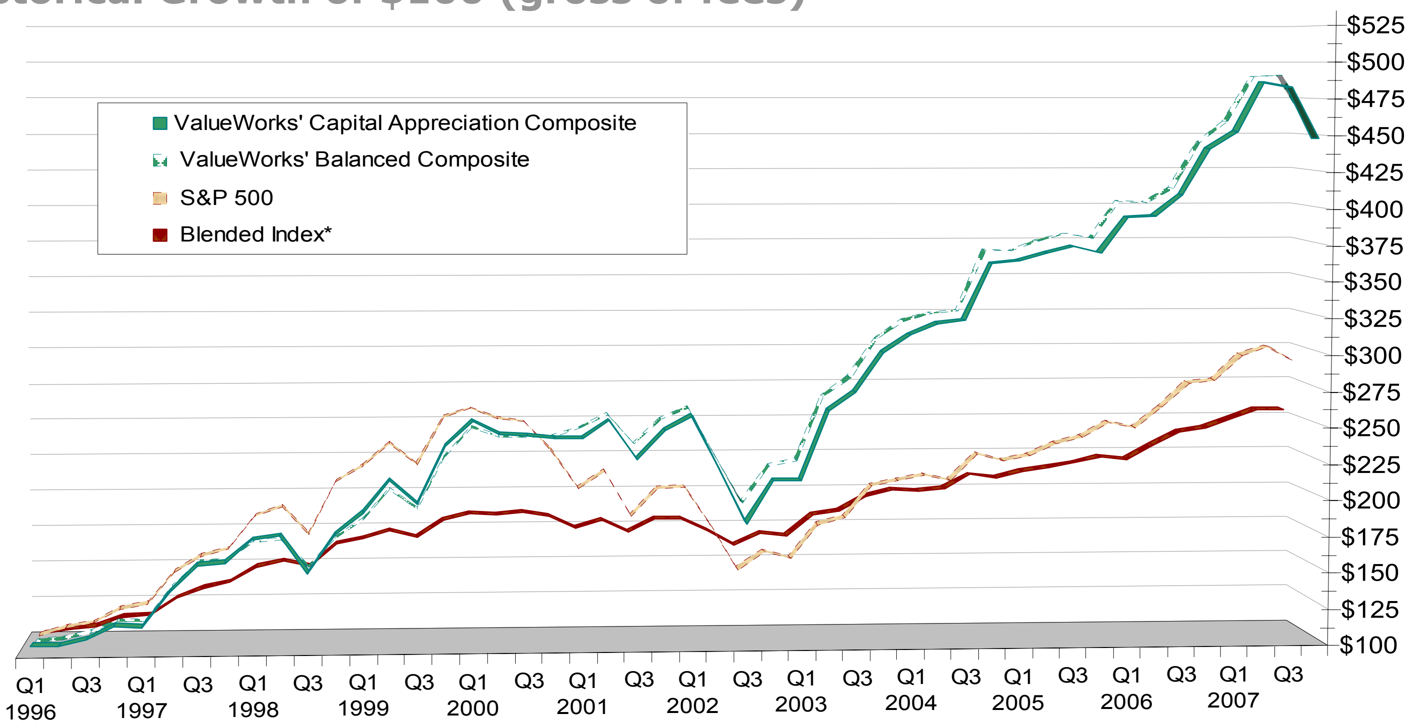
- Individual review of your portfolio requirements
- A separately tailored portfolio created and maintained to your investment objectives and risk tolerance
- Access to the Portfolio Manager on an ongoing basis with timely and responsive communication
- Flexibility to meet your changing tax requirements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

4th Quarter: September 30th—December 31, 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	10.68	9.08	5.92	11.21	9.40	6.38
7 year	8.95	7.46	3.32	9.60	7.91	4.93
5 year	15.74	14.19	12.83	15.75	14.06	8.61
3 year	7.19	5.73	8.65	7.68	6.09	6.71
1 year	1.50	0.22	5.49	4.07	2.53	6.44

*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 pe-

As of 12 31 2007 the Capital Appreciation Composite consisted of 513 accounts and $178,528,162 in assets; while the Balanced Composite consisted of 125 accounts and $75,914,615 in assets. Together this represents 99.53% of total accounts and 86.67% of total assets.

Past performance is not a guarantee of future results.