ValueWorks
quality assets. compelling valuations.

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Current market volatility is enormous. The S&P 500 lost over 45% from the highs in 2007 through the close on Mon, Oct 27. More than half the plunge occurred within weeks. One jump, from Fri, Oct 10th to Tues the 13th, was nearly 25%. A 25% move within a day and a half. With swings of this order of magnitude, it is reasonable to question how much import should be put on share prices at any given moment in time. Prices that are so different week-to-week may not be indicative of where prices will be six months from now, let alone within the next two to five years. Because valuations are so compelling for the securities in our portfolio, and for the reasons laid out below, a strong case can be made that we should see a strong rebound in share prices in the not too distant future.

That's the easy part. I would expect such a rebound in the best likely-case outcome: modest further financial melt-down and a continued garden variety recession that ends by the early part of 2009. Below I have focused on how we are positioning the portfolio to manage the complex risks that are present in this period. (We have addressed the overall market and the economic climate in two recent Market Bulletins published separately.)

During previous downturns I emphasized the opportunity such gyrations create. The highest returns are typically earned after periods of sharp correction. As in other periods, some investments in our portfolio will not recover from the current turmoil. But the greatest valuation-compression we have seen in the portfolio is in well capitalized, very stable, solid companies.

ValueWorks' Top 10 holdings*:

1. Constellation Energy Pfd
2. Rowan Companies Inc
3. Chesapeake Energy Corp
4. 3m Company
5. Boston Scientific Group
6. Dow Chemical Company
7. New York Times
8. Sunpower Corp
9. Legg Mason Inc
10. Boeing Company

—as of 09/30/08—

*see notes on p4 for additional information

Among these are Boeing, 3M, Pfizer, Schering Plough, Dow Chemical, McGraw Hill, etc - these shares are trading at tremendous discounts from recent levels and at valuations last seen in the late 1970's. Such compression occurs in periods of market panic. But it does not typically last long. And the rebound can be stunningly sharp.

But given the erratic actions of policy makers, and the uncertainty of future policy choices, real risks persist for investors. As a result, we have made specific decisions within our holdings to protect investors in each of the less favorable scenarios, knowing that we forego some upside in any individual outcome in order to maintain a degree of protection in each.

There are no simple strategies that protect against both inflation and deflation. Inflation can devastate the purchasing power of cash and erode the value of fixed income holdings. Deflation poses its own risks. Moreover, because the ultimate outcome likely depends upon policy decisions that are in flux, relying upon the certainty of any one of these outcomes seems naive.

The risk of higher inflation levels is clearly real. The amount of money being pumped out by central banks is unprecedented. We are very much in uncharted waters in this respect. It is credible that this action triggers inflation levels like those seen in the US from 1974-1982. Less likely but surely possible are the much higher levels experienced in countries such as Argentina, Mexico, Russia, and many other economies over the past twenty years. In the U.S. example, investors holding cash lost over 60% of their purchasing power. In the other (perhaps more far-fetched and less comparable) examples, the devastation that resulted from holding cash was much worse.

Owning well priced, high quality, well capitalized corporate assets is a sound strategy in such environments. Moreover, we have several specific holdings in the portfolio that could benefit from a touch of inflation. Surely Pfizer, Schering Plough and Boston Scientific should deliver stable profits and be able to pass along price-increases. Our modest real estate-related holdings should also benefit. Commodity companies should do well, benefiting natural gas companies Chesapeake, Questar and Rowan. Teco Energy, which has both a stable electric utility business and a large coal operation, should benefit on the coal side. 3M, McGraw Hill and Boeing are very well capitalized and should be able to pass along price increases. Meanwhile, almost all these companies are trading at under 10 times earnings.

Deflation offers different – but equally pernicious – consequences. Policy makers are clearly concerned about deflation being unleashed as a result of the financial disintermediation occurring in the banking system. As some measures of interest rates approach zero, stimulating economic activity through the classic response of lowering rates clearly becomes problematic. The downside in such a period is that earning positive nominal returns becomes increasingly difficult. If such a climate develops, rates on bank deposits and money funds could be under 1% for a decade. Corporate assets generally depreciate and finding investments that generate decent yields becomes increasingly challenging.

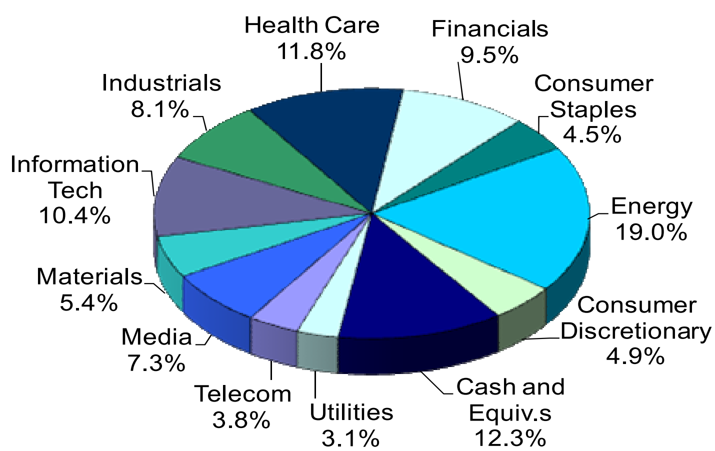
We expect investments offering high yields backed by stable and well capitalized businesses to appreciate meaningfully if a deflationary climate develops. This is part of the reasoning behind our purchase of issues like Teco Energy and Constellation Energy preferred shares. Teco's 6% dividend yield should support a higher share price. Constellation is a somewhat more aggressively capitalized utility that has agreed to be bought by a company controlled by Warren Buffet. The preferred trades at $22 per share and has a current yield of almost 10%.

We would also expect Pfizer to perform well given its 7.5% yield and very stable business. Boeing's defense business should continue to support the company's 3.5% dividend, driving the shares higher as income becomes harder to generate in a deflationary setting.

In summary, we are cognizant of the particular risks embodied in the current climate and are positioning the portfolio accordingly. Such positioning does not prevent against short term price declines in a period of significant turmoil. However, longer term such positioning does represent a well-thought out plan to protect against various potential adverse scenarios while providing the foundation for significant gains as better conditions develop.

—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:

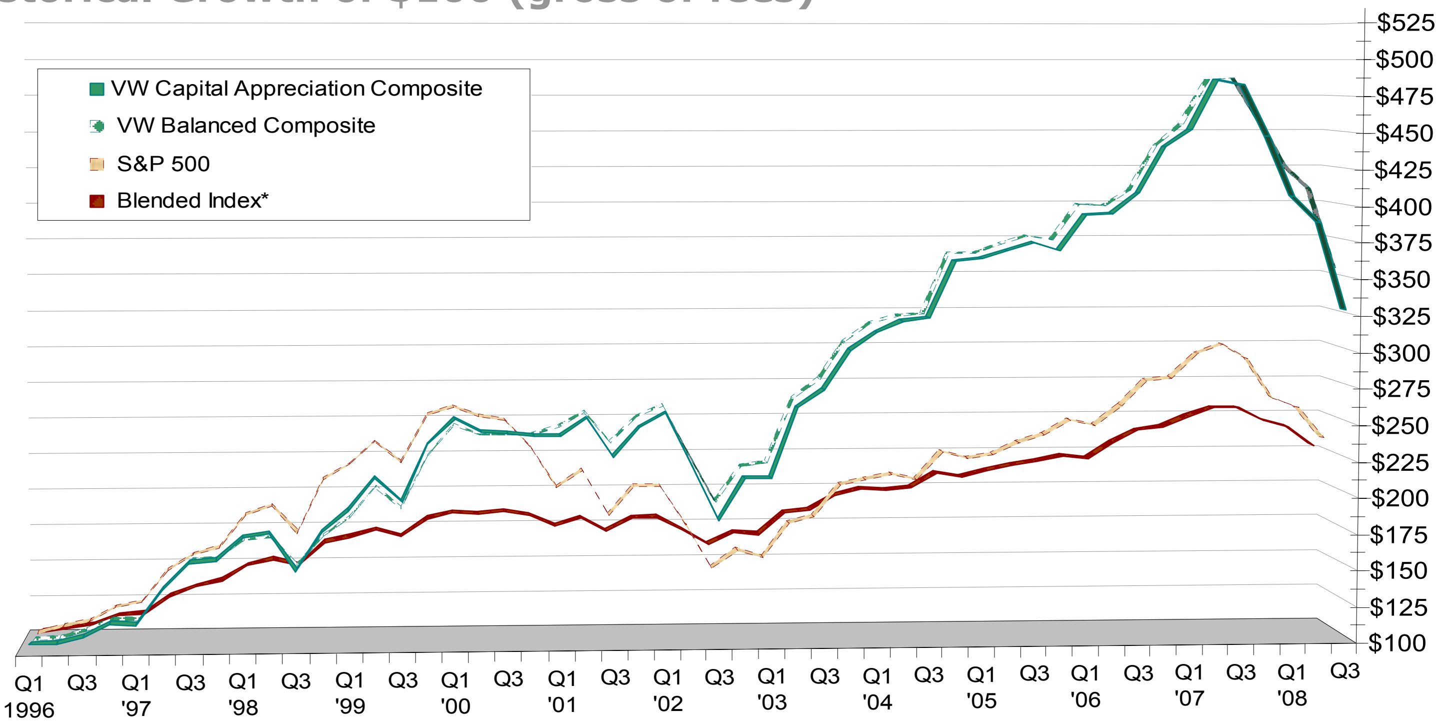
- Individual review of your portfolio requirements
- A separately tailored portfolio created and maintained to your investment objectives and risk tolerance
- Access to the Portfolio Manager on an ongoing basis with timely and responsive communication
- Flexibility to meet your changing tax requirements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

3rd Quarter: June 30, 2008 —September 30, 2008

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	7.81	6.26	3.08	8.70	6.93	4.41
7 year	5.17	3.70	3.52	5.91	4.25	4.21
5 year	3.56	2.13	5.19	4.87	3.30	4.31
3 year	-4.34	-5.64	0.23	-2.06	-3.53	1.95
1 year	-31.93	-32.84	-21.93	-26.94	-28.04	-10.76

*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 avail-

As of 9/30/2008 the Capital Appreciation Composite consisted of 399 accounts and $95,992,895 in assets; while the Balanced Composite consisted of 108 accounts and $49,638,023 in assets. Together this represents 99.22% of total accounts and 83.06% of total assets.

Past performance is not a guarantee of future results.