

ValueWorks

quality assets. compelling valuations.

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Q2 2009

ValueWorks' Capital Appreciation Composite more than participated in the second quarters' very sizeable advance. We have earned 29.1% returns for the quarter which puts us up 19.8% year-to-date. Advances like these reflect the opportunity that has been created by the economic and market collapse.

The average market investor also participated in sizable gains in the second quarter—even as economic conditions remained miserable. The S&P 500 advanced 15.2% in Q2. This more than offset the first quarter decline. As of the end of second quarter, the index was up 1.8% for the year. The Nasdaq Composite has been more volatile, registering a 20% gain for the quarter and 16.4% for the year. The Dow lagged, advancing 12% for the quarter and down 2% for the year.

Such gains confirm the basic paradox of investing: the best investment opportunities are created by the worst economic collapses. The worse the economic times, the bigger the opportunity is created.

Such sharp gains are rarely achievable in calmer economic periods. The economic contraction has been very sharp, and the market downturn up to this point has been very extreme. These are the very conditions that create the largest upside opportunities. The key, in my mind, is to keep managing the portfolio to realize the opportunity that has been created by this financial maelstrom.

Given how dismal the economy remains, and how close the markets are to their recent lows, I consider the recent gains – important though they are -- to offer just a glimmer of the upside that has been created by the collapse. Make no mistake;

the decline has been of an historic order of magnitude. Feel free to compare it to the 1970's or 1930's.

But if history is a guide, the opportunities will similarly be of an historic order of magnitude. And they will be realized – in unpredictable fits and starts – over a multi-year period. The investment opportunity created by such a major downturn will not be limited to a one-quarter 15% flash in the pan.

Such thinking is consistent with the sense that getting the economy back to normal will be a multi-year process. The economic free-fall that was triggered last fall has slowed. But economic conditions remain dismal. I think we are all amply aware of how difficult current conditions are – there is no need to lay out a laundry list of painful economic data. The cold statistics span from unemployment to asset value declines to foreclosed homes. These numbers reflect real turmoil being played out in homes across the country as families are faced with some truly difficult decisions.

Such conditions do not turn on a dime. They only improve gradually over the course of quarters and years. And surely there will be some negative surprises and bumps in the road along the way.

Consistent with this notion, I expect the recent market rally to be only one of several that play themselves out over the course of the next several years. Economic conditions have not returned to normal. Is there a reason to conclude that market levels have? To me it seems completely reasonable that it will take several years for each to be achieved. Looking out over that longer period, as we transition over several years from economic contraction to economic prosperity, the extreme

Top 10 holdings* :

1. Bank of America PFD
2. Wells Fargo PFD
3. Constellation Energy PFD
4. 3M Company
5. Boston Scientific
6. McGraw Hill
7. Micron Technology
8. Rowan Company
9. Boeing Company
10. Pfizer Inc.

—as of 06/30/09—

*see notes on p4 for additional
Information

market dislocation should gradually recede into history.

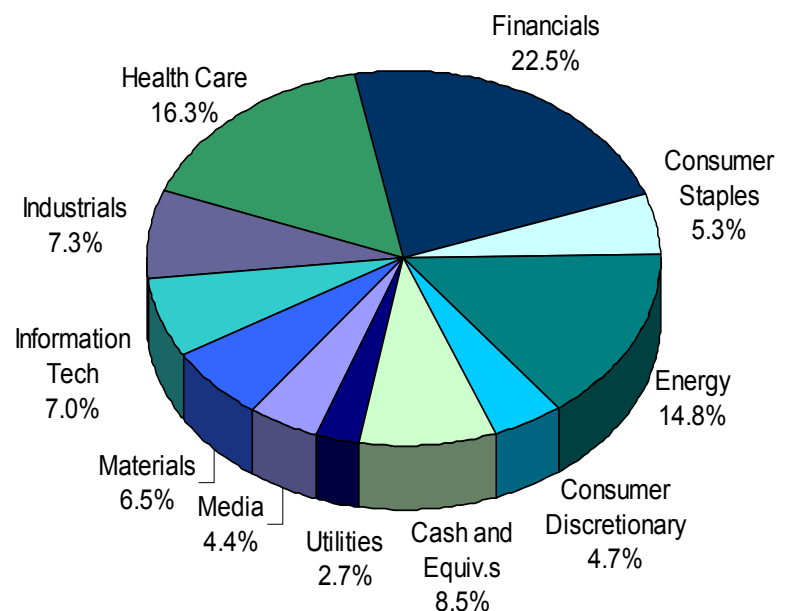
I expect that to be achieved through a series of sharp market rallies that will tend to occur well ahead of the actual economic improvement they reflect – just as the recent rally occurred well ahead of real economic improvement. As that plays out, it would be consistent with history for the market to regain and then surpass its previous high levels. If so, the advance we experienced in the last quarter will prove to be only a modest foreshadowing of the kind of opportunity that has been created by this economic disaster. Such an outlook is consistent with our assessment of security-by-security valuations and the broad logic of the type of opportunities that are created in these periods of economic hardship. And in fairness, those that have the discipline, conviction and foresight to put money to work in these periods (rather than flee to the sidelines) truly earn those outsized returns.

In light of all of these recent events there are two other practical points that should be made. First, predicting the timing and degree of these market moves is treacherous to the degree of foolhardy. Sure, at any point over the past several years one could have called for more market declines. But could one have then turned that view around and captured the 40% rally that happened in the blink of an eye from March 6th? There may be some that time such moves perfectly. But those trading in that way are speculators not investors. And the great majority of those speculators will be badly burned.

Second, while these periods do create significant opportunity, such opportunities will not be uniform. Our experience year-to-date – and in other similar periods -- suggests that good security selection in these types of climates can make a big difference. Fast-paced sell-offs can be broad and indiscriminate while subsequent rallies are likely to be more selective. It is no surprise to us that investors coming back into a sold-off market gravitate towards the type of quality/value propositions we work to uncover.

— 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 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:

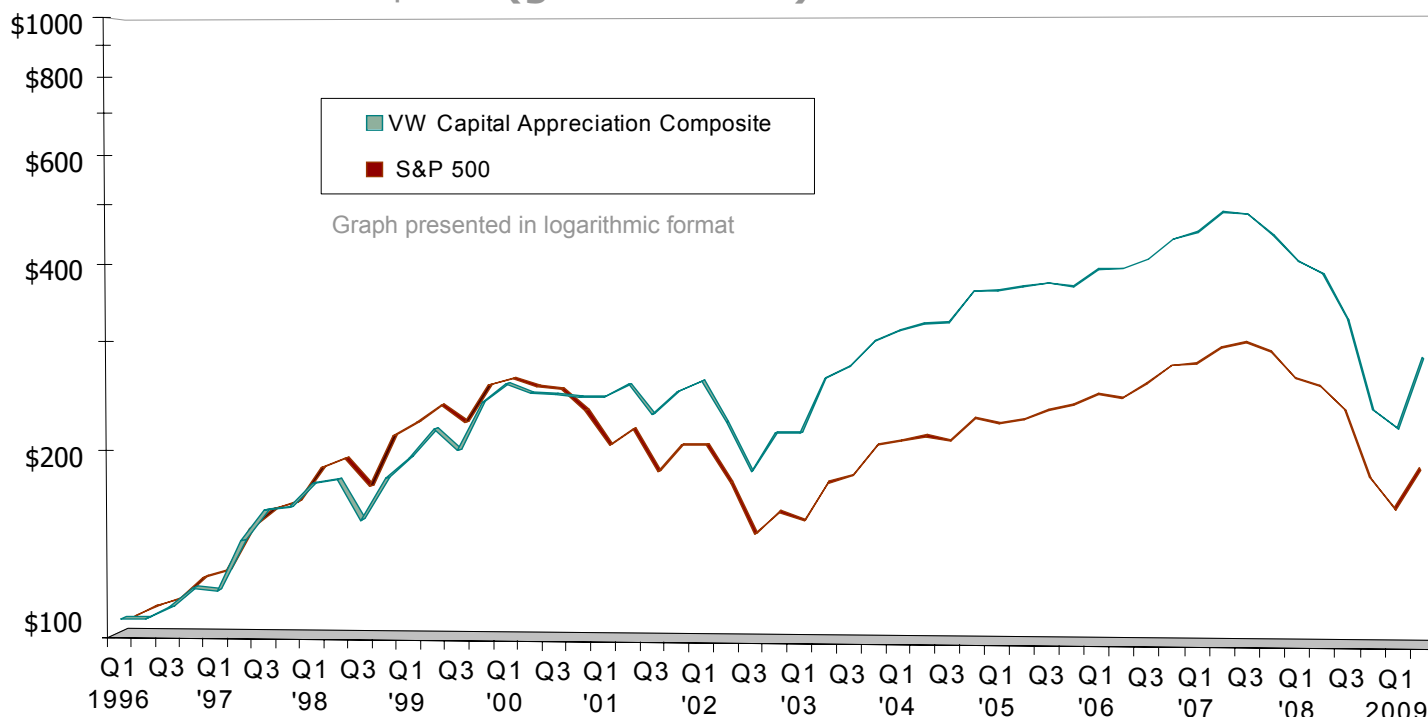
- Individual review of your portfolio requirements
- A separately tailored portfolio created and maintained to your investment objectives and risk tolerance
- Access to the Portfolio Manager on an ongoing basis with timely and responsive communication
- Flexibility to meet your changing tax requirements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

2nd Quarter: March 31, 2009—June 30th, 2009

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	2.77	1.31	-2.21	4.58	2.91	2.38
5 year	-2.36	-3.69	-2.24	0.07	-1.42	1.84
1 year	-26.27	-27.25	-26.26	-20.92	-22.10	-9.97
Q2 2009	29.13	28.73	15.92	27.72	27.27	8.71

*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.

As of 6/30/2009 the Capital Appreciation Composite consisted of 240 accounts and \$60,452,138 in assets; while the Balanced Composite consisted of 76 accounts and \$30,912,488 in assets. Together this represents 99.06% of total accounts and 76.02% of total assets.

Past performance is not a guarantee of future results.