



Markets again edged higher in the second quarter, eking out a large number of record closes while posting only a modest overall advance. The Dow closed the quarter with a 2.8% gain, leaving it up 2.6% for the year. The Nasdaq and S&P 500 both did a bit better, with quarterly advances of 5.3% and 5.2% respectively, and 6.1% and 7.1% for the first half. Coming off a very strong 2013, our portfolios continued to perform quite respectably given the modest overall market move.

The pace of underlying economic activity justifies a pause in the recent market advance — especially after last year's powerful second-half rally. And a positive element of what I would view as a very choppy first half is the rotation that has gone on within the overall market. Some of the areas that led the market advance last year had reached quite extended levels, and have leveled off, while other areas that lagged last year are picking up the advance. Big cap biotech stocks basically doubled last year, so a correction was quite in order. Consumer discretionary shares (as measured by the S&P 500 Consumer Discretionary Index) advanced by roughly 45% last year, but are basically flat this year. Meanwhile energy, utility and

telecom shares materially underperformed last year, but are doing better than the overall market this year. Specifically, those S&P 500 sub indexes advanced 25%, 13% and 11% respectively last year (against the S&P 500 which advanced 32%). This year their respective gains are 13%, 18%, and 4%.

While the economy seems to have done better in the second quarter than the first quarter, the improvement is off of a very poor base. It is easy to attribute poor economic performance in the first quarter to really bad weather. But the improvement in the second quarter was quite underwhelming, and to me a bit puzzling and concerning. Taking everything into consideration (monetary and fiscal policy in the US, stable activity from Europe, modest growth in China, latent US consumer and industrial demand, solid housing conditions, etc.), I would expect the economy to be growing at better than 3%, and it does not appear that it is. The consensus for GDP growth in the second quarter is 2.2%. We are seeing marked weakness in commodity prices like copper and iron ore that suggest demand is fairly weak. Shipping rates as indicated by the Baltic Dry Bulk Index are similarly reflecting weakness. Beyond those, there

are quite a number of anecdotal indications that the economy is not performing as well as it might.

This may prove to be a temporary anomaly. The monthly jobs numbers have been reasonably robust, with 288,000 jobs added in June. In that case, we may see a quarter in the next three where economic growth tops 5%. If that plays out, the fact of a first half pause in economic growth may create the conditions for the advance to extend a bit longer, and lead to a better overall outcome. It would provide a little more room for the economy to advance before inflation fears lead to a Federal Reserve tightening. We have quite a few securities in the portfolio that would benefit from such an upturn.

But we have done some specific things in the portfolio to protect on the downside if that positive view does not play out. Our pharmaceutical exposure — which is inherently non-cyclical and offers important dividend protection — should perform well if the economy slows and the markets reverse. Our decision to swap out of Williams Companies common and into Williams Pipeline, with its higher dividend and

more stable earnings, have cost us in terms of capital appreciation thus far, but continues to provide protection in the event of an economic contraction, and a reasonable overall return in the meantime.

All that said, a too-close reading of current conditions can lead one to miss the big picture. It still remains clear to me that the conditions are in place for a long-term, extended economic advance, and an equity market that expands along with it. Our collective experience over the past decade has created a more cautious, somber overall operating environment. Businesses are less leveraged, and investors are less willing to accept uncompensated risk. The question on everyone's mind is: what did you learn from the last downturn, and what would you do differently. The consensus answer: build on a more solid foundation, be prepared for large amounts of volatility and make sure you are not overextended. That more cautious approach translates to a rebound that takes place more slowly, but lasts much longer.

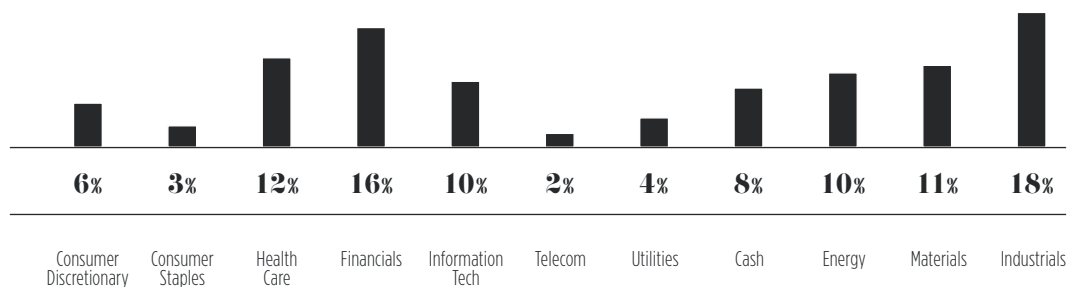
TOP 10 HOLDINGS

1. American Express
2. Xerox Corporation
3. Boeing Company
4. Calpine Corp.
5. National Oilwell Varco Inc.
6. Dow Chemical Company.
7. Paccar Inc.
8. Bombardier, Inc. cl B
9. Zimmer Holdings Inc.
10. Williams Partners LP

—As of 6/30/14—
*see notes on pg 4 for additional details

—Charles Lemonides, CFA

SECTOR DIVERSIFICATION— CAPITAL APPRECIATION COMPOSITE



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.

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.

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.

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.

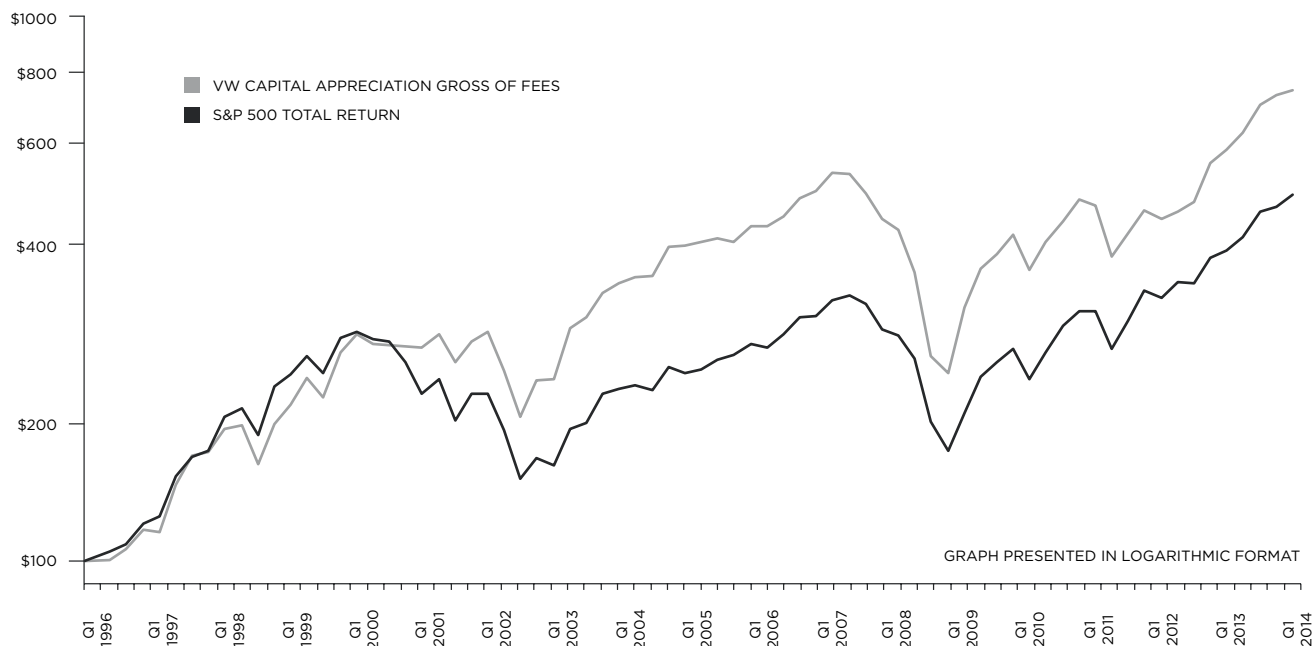
Objective

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.

VALUEWORKS

PERFORMANCE REVIEW

SECOND QUARTER MAR 31 - JUNE 30, 2014



TRAILING PERFORMANCE DATA

VALUEWORKS' CAPITAL APPRECIATION COMPOSITE

	GROSS OF FEES	NET OF FEES	S&P 500 TR
2014 Q2	2.28	1.96	5.24
1 year	26.69	25.15	24.60
3 years	16.37	14.91	16.48
5 years	18.66	17.15	18.77
10 years	7.64	6.22	7.75
Life*	10.86	9.23	8.43

*Life is 18.50 years (inception 1/1/1996)

VALUEWORKS' BALANCED COMPOSITE

	GROSS OF FEES	NET OF FEES	BLENDED INDEX*
2014 Q2	2.92	2.56	2.62
1 year	25.68	24.00	13.09
3 years	15.16	13.58	10.00
5 years	17.43	15.80	11.88
10 years	8.40	6.84	6.74
Life*	11.31	9.56	7.51

*The "Blended Index" is a calculation comprised of 50% S&P 500 and 50% Merrill Lynch Domestic Master Bond Index.

PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

This Newsletter is intended to be presented with the Capital Appreciation Fact Sheet which contains additional disclosure information.

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. Investments in this strategy may lose value.
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