THIRD AVENUE MANAGEMENT

Q2 2024

Portfolio Manager Commentary

VALUE FUND

Matthew Fine, CFA

Joined Third Avenue in 2000
24 yrs investment experience

Dear Fellow Shareholders,

For the three months ended June 30th, 2024, the Third Avenue Value Fund (the "Fund") returned -1.63%, as compared to the MSCI World Index[1], which returned 2.78%. For further comparison, the MSCI World Value Index[2] returned -0.98% during the quarter.

The Fund benefited from quarterly performance contributions from a wide range of industries and geographies, including Canadian copper miners **Capstone Copper** and **Lundin Mining**, Norwegian offshore services company **Subsea7**, recently purchased U.K.-listed **Harbour Energy, Bank of Ireland**, and Chilean holding company **C.S.A.V.** Investments providing negative contributions this quarter included several companies which have been among the Fund's strongest performers in recent periods, such as **Horiba**, **easyJet**, and **Ultrapar**. **BMW** and **S4 Capital** also detracted from performance during the quarter.

THE ALBATROSS OF FINANCIAL WHEREWITHAL

> **"The only function of economic forecasting is to make astrology look respectable."**
>
> *- John Kenneth Galbraith*

One defining characteristic of global capital markets today is a pervasive and intense focus on the future path of U.S. interest rates. Trillions of dollars are being allocated in equity and credit markets on the basis of very specific U.S. interest rate forecasts. While the future path of U.S. interest rates remains uncertain, it does seem quite clear that the predisposition of the Board of Governors of the U.S. Federal Reserve System is to lower the U.S. Fed Funds rate if, and as soon as, a window of opportunity presents itself. I do not personally understand this policy position, but that is unimportant for the sake of this discussion. Furthermore, notwithstanding the ubiquitous use of the phrase "high-rate environment" to describe today's circumstances, that phrase misstates the case by any objective standard, whether one is referring to either nominal or real yields. Over the last 50 years, the nominal U.S. 10-year bond yield has averaged approximately 5.9%. Today the U.S. 10-year bond yields 4.3%. All of that said, even though the future continues to be uncertain, as it always is, it appears that the era of decade upon decade of ever-falling U.S. interest rates is behind us for the foreseeable future.

With these developments in mind, we have frequently been asked how Third Avenue Management's investment approach should be expected to interact with the highest rate environment we have experienced in more than a decade and a half. The most important answers to that question require some historical perspective.

In 1979, prior to founding Third Avenue Management, Marty published his first book, *The Aggressive Conservative Investor*. This now-famous book articulated the basic

Performance is shown for the Third Avenue Value Fund (Institutional Class). Past performance is no guarantee of future results; returns include reinvestment of all distributions. The above represents past performance and current performance may be lower or higher than performance quoted above. Investment return and principal value fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. For the most recent month-end performance, please visit the Fund's website at www.thirdave.com.

The U.S. Lipper Fund Award for Best Equity Small Fund Family is based on a review of 185 qualified fund management companies that were eligible for the three-year period ending on 11/30/23. To qualify for Lipper's Overall Small Fund Family Group Award, Small fund family groups must have at least three equity portfolios. The group award will be given to the group with the lowest average decile ranking of its respective asset class results based on the three-year Consistent Return measure of the eligible funds.

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foundations of the “safe and cheap” investment approach for which Third Avenue Management would later come to be known. Marty developed the foundations of the book throughout an extremely successful career as one of the country’s most well-respected distressed debt investors and bankruptcy experts during the 1960s, 70s and 80s, a period which substantially overlapped with two decades of rapidly rising U.S. interest rates during the 60s and 70s. It is intuitive that, through decades of investing in the credit of indebted companies and steering the restructuring process for a number of them, during an environment in which capital became consistently more expensive and intermittently extremely difficult to obtain, Marty developed a deep appreciation for the importance of corporate financial wherewithal. When adapting his creditor’s mentality to investing in equities, which are only residual claims on the economics of a business after all expenses and liabilities have been satisfied, the principle of focusing on companies with financial wherewithal took on even more heightened importance.

The same year *The Aggressive Conservative Investor* was published, Paul Volcker was appointed chairman of the Board of Governors of the Federal Reserve. Two years and a number of aggressive rate hikes later, the United States’ multi-decade battle with rising inflation and interest rates would finally reach an inflection point in 1981, though not before seeing the U.S. 10-year bond yield crest at roughly 16%, having risen by almost 13 percentage points over three decades. Five years later, in 1986, Third Avenue Management was founded. It’s first mutual fund, the Third Avenue Value Fund, was incepted in November 1990. Shortly thereafter, Marty laid out the Fund’s investment approach in a 1992 shareholder letter. He identified the central principles of his equity investing philosophy, the very first of which was:

> **“The issuer has to have a strong financial position measured not only by balance sheet data but also measured by off balance sheet liabilities and contingencies, whether or not disclosed in footnotes to financial statements.”**
>
> *Marty Whitman – October 1992*

Over the years, Marty would write scores of investment letters and several more books. A substantial portion of these writings were devoted to the importance of a balance sheet-focus as a central tenet of our firm’s value investing approach.

One key concept of the approach is that, when seeking bargains in equity markets, it is frequently the case that Third Avenue invests in companies and industries for which the near-term outlook is genuinely challenging. We strive to limit our investing activities to companies that have the financial wherewithal to endure the challenges they are facing and do so without having to conduct value-destructive activities, such as selling assets or raising capital at inopportune times at disadvantageous terms.

Another key concept is that some business models simply require continuous access to debt and equity financing and do not afford the company or its management the luxury of choosing the timing with which they access capital. If access to various forms of capital becomes unavailable or onerously expensive, which happens from time to time, one’s equity investment in such companies can quickly become permanently impaired.

Further, Marty had an unusually deep understanding of financial statements and the inter-relationship between them. Through experience, he developed a great appreciation for balance sheet assets as the raw material for shareholder wealth creation processes that occur through the income statement and cash flow statement, and then ultimately flow back into the balance sheet. Enterprising companies with access to unencumbered resources control the wealth creation process by virtue of the ability to deploy resources, at times of their own choosing, into wealth creating activities, most of which are capital-consumptive, at least in the early stages. This attribute is obviously particularly advantageous in times when access to new capital is scarce.

As an aside, there are rare periods of fear and calamity, such as the Global Financial Crisis, when capital is pervasively scarce. However, on a near-constant basis, somewhere in the world there are industries or countries for which the near-term outlook is sufficiently dire such that access to capital is either unavailable or prohibitively expensive. These areas represent frequent sources of opportunity for the Fund, provided we are able to identify companies which are very likely to remain capital self-sufficient.

With all of these principles in mind, Third Avenue has largely avoided business models which require significant amounts of financial leverage to produce adequate returns. Similarly, businesses that have been set up to produce reliable cash yields to equity holders (a “Yield Co.”), such as most utilities, often pay out the vast majority of their income, which does not permit retention of capital for reinvestment and demands that they consistently access debt and equity capital markets to refinance debt or undertake wealth creating investment. This same concept applies to our firm’s historical preference for real estate operating companies, as compared to real estate investment trusts (“REITs”). The latter are required to pay out the vast majority of their income to shareholders in order to maintain their pass-through tax attributes.

However, when crafting those key principles of our firm's investment approach, Marty had no way of foreseeing that the decade of lower U.S. interest rates in the 1980s, would be followed by three more decades of consistently falling interest rates.

To help frame the significance of decades of falling interest rates, consider that when Third Avenue was founded in the mid-1980s, Michael Milken and colleagues at Drexel Burnham Lambert had only recently begun to create markets for the previously non-existent issuance and trading of junk bonds. The high-yield market as we know it today quite literally did not exist. Kohlberg Kravis Roberts & Co had not yet defined the beginning of the leveraged buyout era with its hostile leveraged takeover of RJR Nabisco. And the popularization of publicly traded real estate assets was still a decade or so away. Reflecting on that period today, one can't help but marvel at what a difference four decades of consistently falling borrowing costs can make.

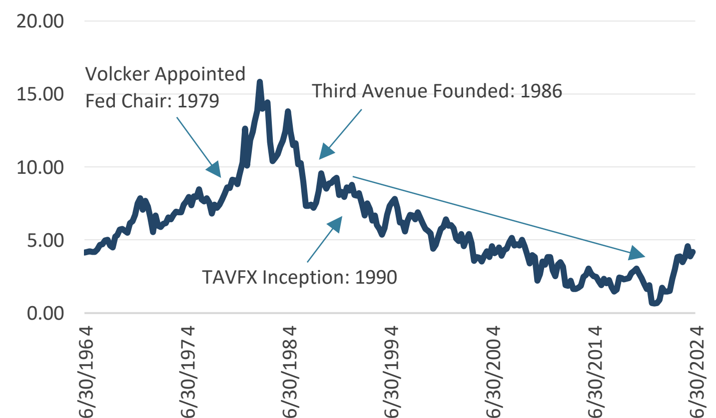
Amidst four decades of ever-falling interest rates, debt-financed asset owners were, almost without exception, presented with opportunities to refinance using more debt, at cheaper costs, just a few years into the future. To the extent trouble did arise, if the can could be kicked down the road a little bit, help was almost always on the way. In more recent decades, cheaper and more available credit has rendered the distressed debt investing industry a shadow of its former self because of, well, a lack of distressed debt. And because asset purchasers could avail themselves of lower cost of debt-financing, and use more of it, asset values of almost all debt-financeable assets have inflated considerably. Commercial real estate asset values increased hugely through the self-reinforcing relationship of cap-rate compression and increasingly available financing. Extraordinary gains broadly accrued to leveraged asset owners, such as U.S. residential real estate owners. Similarly, the leveraged buyout industry – now known by its much more institutional-quality-sounding name, "private equity" – grew into a leviathan consuming the world by feeding on cheaper and cheaper borrowing. Rising purchase multiples and increased use of financial leverage over decades were facilitated by the consistently declining trajectory of borrowing costs.

Further, this last point is worthy of emphasis. The absolute level of interest rates is not the most critical consideration as it relates to investment performance of leveraged strategies. Far more important is whether borrowing costs are rising or falling significantly during the ownership period. To the extent that they are falling, opportunities are created for future buyers to use more leverage and pay higher prices, in turn producing asset inflation and a return tailwind for the current owner. For most financially leveraged investment strategies, the result of four decades of falling rates was a profound performance tailwind taking the form of ever-cheaper recapitalization options, cash-out refinancings, more free cash flow unencumbered by shrinking interest burdens, inflating asset values, and eventual asset sales to new buyers availing themselves of an even more supportive interest rate and credit environment.

Previously unimaginable quantities of capital have been committed to private equity strategies on the back of great performance aided by a powerful tailwind. It seems very wishful to expect that the private equity industry, or other leveraged investment strategies, can return to past performance glory simply because interest rates have stopped rising for now. Furthermore, even though U.S. interest rates have only risen somewhat from exceptionally low levels, we have seen a deterioration of essentially every possible measurement of the health of the private equity industry. Transaction volumes and exits have collapsed, credit quality has deteriorated in the leveraged loan market, industry-wide interest coverage statistics have eroded, and significant private equity performance headwinds have risen to the fore. Again, there is a very strong argument to be made that the trajectory (meaning increases and decreases) of interest rates is much more important than the absolute levels of rates themselves.

U.S. 10-YEAR TREASURY YIELD

As of June 30, 2024



However, on the other hand, strategies focused on financial wherewithal, such as the one Marty Whitman developed and which continues to be employed at Third Avenue Management, have arguably suffered some mild forms of headwind from decades of steadily declining interest rates.

Excess cash and securities on well-capitalized balance sheets have produced less and less income and, in my view, there has been less benefit over recent decades than one might have expected from ownership of companies with balance sheets built to endure a lack of access to capital because capital has generally been extremely available and at ever-cheaper costs. In other words, there has been a relative abundance of access to capital. And strategies focused on leveraged cash flow yields – commercial real estate, infrastructure, telecom tower portfolios, etc. – have performed very well, presenting a relative performance challenge for strategies emphasizing financial wherewithal.

Speaking frankly, taking this multi-decade historical perspective into consideration, I find it somewhat pleasantly surprising that the Third Avenue Value Fund has been able to produce approximately 220 basis points of outperformance relative to the MSCI World Index since its inception 34 years ago. In more recent years, the Fund produced its strongest-ever year of relative outperformance in 2022, a year in which U.S. interest began to rise sharply, and, as of quarter end, has produced a trailing 5-year annualized return of approximately 15.24%, a return that rivals many private equity strategies over that period, without incurring that risk of huge amounts of financial leverage or the considerable inconvenience of locking up one's capital for a decade or so.

Finally, this is not to say that we believe the Fund will produce higher absolute returns in a higher interest rate environment, but simply that we have consistently employed an investment approach that has almost certainly acted as a ballast, rather than a spinnaker, in an environment marked by a massive U.S. interest rate tailwind, a long-cycle phenomenon which now appears to have exhausted itself. In our view, the implications for the future relate more to our ability to produce highly attractive returns relative to strategies requiring leverage and those which are otherwise less balance-sheet focused.

QUARTERLY ACTIVITY

During the quarter ending June 30th, 2024, the Fund initiated new positions in **Paltac Ltd.** ("Paltac") and **Close Brothers plc** ("Close Brothers"). The Fund also exited its position in **Hawaiian Holdings**.

Paltac is Japan's largest distributor of health and beauty products, daily necessities, and over-the-counter pharmaceuticals. Operating a nationwide network of highly sophisticated logistics facilities, Paltac serves as a value-adding middleman between myriad consumer product manufacturers and the points of sale through which their products are ultimately sold, primarily drugstores, convenience stores, and other retailers in Japan. Already the most dominant operator in this space, Paltac has steadily added to its market share over the past several years as drugstore chains have increasingly consolidated and increasingly outsourced distribution functions to independent wholesalers, such as Paltac. Paltac's best-in-class technology and extremely difficult to replicate network of facilities enable it to provide low-cost nationwide distribution services to its customers, while also providing value-adding inventory management and data services. Paltac's scale and efficiency have led to industry-leading operating margins, even while it offers its services to customers at highly competitive rates.

Paltac has no debt and its balance sheet cash, which has more than tripled over the past five years, today amounts to about 20% of its current market cap. Paltac's long-term success has generated an admirable record of moderate but steady growth of revenues and earnings. However, its success has not translated into a higher valuation, as trading multiples on both book value and earnings have been roughly cut in half over the past five years.

Tangentially, our team has taken great interest in the rapidly mounting pressure being applied to a great many publicly traded Japanese companies to improve corporate governance and shareholder returns. For example, directives from the Tokyo Stock Exchange request that all companies on the Prime and Standard Markets take "action to implement management that is conscious of cost of capital and stock price." Paltac itself has recently adjusted its capitalization and capital allocation policies to address its patently overcapitalized balance sheet by increasing shareholder returns. Already on its 15th consecutive annual dividend per share increase, Paltac aims to continue boosting dividends, though going forward at a pace faster than its earnings growth. Paltac has also recently committed to initiate share buybacks, a tactic it has rarely used in the past.

While not central to our investment thesis, the looming possibility of Paltac being taken over by its controlling shareholder is also worth mentioning. MediPal Holdings Corporation, a publicly traded prescription drug wholesaler, owns more than 50% of Paltac stock today and sports its own overcapitalized balance sheet. MediPal, which benefits operationally from the technology and automation expertise of its subsidiary Paltac, could at some point offer to acquire Paltac in an effort to improve its own capital efficiency. In the meantime, we intend to own Paltac as an inexpensive, well-run, well-capitalized, going-concern.

The Fund also initiated a new position in Close Brothers, a U.K. banking and financial services business. Through its banking business, Close Brothers is a specialty lender with a diversified loan book of commercial and retail customers. Separately, the company operates an asset and wealth management business, Close Brothers Asset Management, and a U.K. small-cap equity market-making business under the name Winterflood. The motor finance division of the bank, which makes auto loans to retail clients, garnered negative attention in January when the UK's Financial Conduct Authority ("FCA") announced it was reviewing the activities of all lenders who had, in earlier years, participated in a since banned form of commission arrangement between auto lenders and auto dealers, who receive compensation for originating loans. The FCA is currently evaluating the scope of the review and whether retail customers were harmed. The potential actions that lenders like Close Brothers would need to take if their customers were determined to have been treated unfairly remain unclear today. Close Brothers' share price fell more than 60% following the news of the FCA opening its review, compounding an already significant decline in recent years. While there is a great deal of uncertainty surrounding the magnitude of any redress to compensate motor finance customers, the adverse share price reaction at Close Brothers appears to be an excessive reaction to even conservative estimates of the potential impact to the company's capital position.

As it relates to capital position, Close Brothers has laid out a suite of actions it could take to strengthen capital if needed, without permanently impairing the company's capital base or its long-term earnings power. While Close Brothers itself has not yet made any reserve for potential redress losses, multiple other lenders have taken reserves which appear to strongly corroborate the idea that Close Brother's share price reaction has been quite excessive, and its capital position and business operations are not likely to be materially impaired.

Finally, several forms of resource conversion could also be pursued to both create value and increase the company's capital base. For example, multiple recent press articles have mentioned the potential sale of Close Brothers Asset Management at prices which would represent a substantial portion of the company's market cap today, despite contributing only a small fraction of company profits.

Historically, Close Brothers has had a conservative underwriting culture, which, along with its strategy of lending in niche business lines, has led to quite high net interest margins and returns on equity. Today, there is little to indicate that the current uncertainties will change the company's ability to earn attractive rates of return on its capital and, today, the company's shares are trading at prices that appear deeply discounted relative to that capital.

Thank you for your confidence and trust. We look forward to writing again next quarter. In the interim, please do not hesitate to contact us with questions or comments at clientservice@thirdave.com.

Sincerely,

Matthew Fine

IMPORTANT INFORMATION

This publication does not constitute an offer or solicitation of any transaction in any securities. Any recommendation contained herein may not be suitable for all investors. Information contained in this publication has been obtained from sources we believe to be reliable, but cannot be guaranteed.

The information in this portfolio manager letter represents the opinions of the portfolio manager(s) and is not intended to be a forecast of future events, a guarantee of future results or investment advice. Views expressed are those of the portfolio manager(s) and may differ from those of other portfolio managers or of the firm as a whole. Also, please note that any discussion of the Fund's holdings, the Fund's performance, and the portfolio manager(s) views are as of June 30, 2024 (except as otherwise stated), and are subject to change without notice. Certain information contained in this letter constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "project," "estimate," "intend," "continue" or "believe," or the negatives thereof (such as "may not," "should not," "are not expected to," etc.) or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events or results or the actual performance of any fund may differ materially from those reflected or contemplated in any such forward-looking statement. Current performance results may be lower or higher than performance numbers quoted in certain letters to shareholders.

Date of first use of portfolio manager commentary: June 12, 2024

[1] The MSCI World Index is an unmanaged, free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of 23 of the world's most developed markets. Source: MSCI.

[2] MSCI World Value: The MSCI World Value Index captures large and mid-cap securities exhibiting overall value style characteristics across 23 Developed Markets (DM) countries. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. Source: MSCI

FUND PERFORMANCE

			Annualized				
	3Mo	1Yr	3Yr	5Yr	10Yr	Inception	Inception Date
Third Ave Value Fund (Inst. Class)	-1.63%	13.93%	13.77%	15.26%	7.40%	10.73%	11/1/1990
Third Ave Value Fund (Inv. Class)	-1.69%	13.65%	13.47%	14.96%	7.12%	7.67%	12/31/2009
Third Ave Value Fund (Z Class)	-1.58%	14.04%	13.89%	15.37%	N/A	9.61%	3/1/2018

TOP TEN HOLDINGS

Holding	%
Capstone Copper Corp.	6.3%
Warrior Met Coal, Inc.	5.3%
Tidewater, Inc.	4.5%
Deutsche Bank AG	4.5%
Bank of Ireland Group PLC	4.0%
Buzzi SpA	3.9%
Bayerische Motoren Werke AG	3.7%
Subsea 7, S.A.	3.5%
Valaris, Ltd.	3.5%
EasyJet PLC	3.4%
TOTAL	**42.6%**

Allocations are subject to change without notice

Past performance is no guarantee of future results; returns include reinvestment of all distributions. The above represents past performance and current performance may be lower or higher than performance quoted above. Investment return and principal value fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. For the most recent month-end performance, please visit the Fund's website at www.thirdave.com. The gross expense ratio for the Fund's Institutional, Investor and Z share classes is 1.20%, 1.47% and 1.13% , respectively, as of March 1, 2024.

Risks that could negatively impact returns include: fluctuations in currencies versus the US dollar, political/social/economic instability in foreign countries where the Fund invests lack of diversification, and adverse general market conditions.

The fund's investment objectives, risks, charges, and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and it may be obtained by calling 800-443-1021 or visiting www.thirdave.com. Read it carefully before investing.

Distributor of Third Avenue Funds: Foreside Fund Services, LLC.

Current performance results may be lower or higher than performance numbers quoted in certain letters to shareholders.

Third Avenue offers multiple investment solutions with unique exposures and return profiles. Our core strategies are currently available through '40Act mutual funds and customized accounts. If you would like further information, please contact a Relationship Manager at:

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MANAGEMENT

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