



THIRD AVENUE VALUE FUND

THIRD AVENUE SMALL-CAP VALUE FUND

THIRD AVENUE REAL ESTATE VALUE FUND

THIRD AVENUE INTERNATIONAL VALUE FUND

## **LETTERS TO OUR SHAREHOLDERS**

First Quarter Commentary

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January 31, 2004

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**The information in these portfolio manager letters represents the opinions of the individual portfolio manager 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 and may differ from those of other portfolio managers or of the firm as a whole. Also, please note that any discussion of the Funds' holdings, the Funds' performance, and the portfolio managers' views are as of January 31, 2004, and are subject to change without notice.**

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**If you should have any questions, please call 1-800-443-1021, or visit our web site at: [www.thirdave.com](http://www.thirdave.com), for updated information or a copy of our prospectus. Current performance results may be lower or higher than performance numbers quoted in certain letters to shareholders.**

**M.J. Whitman LLC Distributor. Date of first use 2/27/2004.**



## Third Avenue Value Fund



**MARTIN J. WHITMAN**  
**Co-CHIEF INVESTMENT OFFICER**  
**& PORTFOLIO MANAGER OF**  
**THIRD AVENUE VALUE FUND**

Dear Fellow Shareholders:

At January 31, 2004, the unaudited net asset value attributable to the 73,493,709 common shares outstanding of the Third Avenue Value Fund (“TAVE,” “Third Avenue,” or the “Fund”) was \$42.84 per share. This compares with an audited net asset value at October 31, 2003 of \$40.30 per share, and an unaudited net asset value at January 31, 2003 of \$29.36 per share, both adjusted for a subsequent distribution to shareholders. At February 23, 2004, the unaudited net asset value was \$43.07 per share.

### QUARTERLY ACTIVITY\*

Principal activities during the quarter were as follows:

Principal Amount	New Positions Acquired
\$10,000,000	Danielson Holding Corp. 12% due 12/15/04 (“Danielson Notes”)
\$17,500,000	Mirant Corp. Bank Notes (“Mirant Bank Notes”)

### Principal Amount or Number of Shares

\$9,000,000
313,400 shares
208,750 shares
158,296 shares
1,280,213 shares
1,148,200 shares
100,000 shares
100,000 shares

### New Positions Acquired

Parmalat Finance BV 6.25% due 2/7/05 (“Parmalat Senior Notes”)
Encana Corp. Common Stock (“Encana Common”)
Levitt Corporation Class A Common Stock (“Levitt Common”)

### Increases in Existing Positions

Catellus Development Corp. Common Stock (“Catellus Common”)
Danielson Holding Corp. Common Stock (“Danielson Common”)
Hutchison Whampoa Ltd. Common Stock (“Hutchison Whampoa Common”)
Investor AB Class A Common Stock (“Investor AB Common”)
Toyota Industries Corp. Common Stock (“Toyota Industries Common”)

\* Portfolio holdings are subject to change without notice. The following is a list of Third Avenue Value Fund’s 10 largest holdings, and the percentage of the total net assets each security represented, as of January 31, 2004: Toyota Industries Corp., 6.01%; Millea Holdings, Inc. ADR, 4.41%; Tejon Ranch Co., 4.36%; MBIA, Inc., 3.56%; The St. Joe Company, 3.56%; AVX Corp., 3.53%; Forest City Enterprises, Inc. (Class A), 2.92%; Mitsui Sumitomo Insurance Co., Ltd., 2.84%; Kmart Holding Corp., 2.80%; and Legg Mason, Inc. 2.72%.

**Number of Shares**

1,712,251 shares

3,383,500 shares

556,750 shares

251,300 shares

65,000 shares

2,000,000 shares

1,350,300 shares

493,681 shares

495,000 shares

4,458,200 shares

588,600 shares

100,000 shares

208,676 shares

300,000 shares

500,000 shares

500,000 shares

**Decreases in Existing Positions**Electro Scientific Industries, Inc.  
Common Stock  
("Electro Scientific Common")FSI International, Inc. Common Stock  
("FSI Common")SWS Group, Inc. Common Stock  
("SWS Common")**Positions Eliminated**Analogic Corp. Common Stock  
("Analogic Common")BKF Capital Group, Inc. Common Stock  
("BKF Common")CIENA Corp. Common Stock  
("CIENA Common")Credence Systems Corp. Common Stock  
("Credence Common")IXYS Corp. Common Stock  
("IXYS Common")J&J Snack Foods Corp. Common Stock  
("J&J Common")KEMET Corp. Common Stock  
("KEMET Common")Kendle International, Inc.  
Common Stock ("Kendle Common")KLA-Tencor Corp. Common Stock  
("KLA-Tencor Common")Novellus Systems, Inc. Common Stock  
("Novellus Common")Photronics, Inc. Common Stock  
("Photronics Common")Sun Microsystems, Inc. Common Stock  
("Sun Common")Veeco Instruments, Inc. Common Stock  
("Veeco Common")**DISCUSSION OF QUARTERLY ACTIVITY**

The last quarter was an active one. New positions were acquired in two distressed credits, Mirant and Parmalat; one new common stock position was established in a Canadian natural gas exploration and production company, Encana Corp.; and one common stock of a homebuilder, Levitt Corporation, was acquired as a result of a spin-off by Bankatlantic Bancorp. Positions were increased in five common stocks. Three companies, Hutchison Whampoa, Investor AB and Toyota Industries, are large, blue chip companies which are quite well financed. Each common stock was acquired at prices that appear to reflect meaningful discounts from readily ascertainable Net Asset Values ("NAV").

Danielson Common Stock and Danielson Notes were acquired from Danielson as part of the financing for that company's proposed acquisition of Covanta Corp., an enterprise engaged primarily in operating plants which convert waste to energy. Covanta is currently in Chapter 11. Additional Catellus Development Corp. Common Stock was acquired as a dividend in connection with Catellus' conversion to a Real Estate Investment Trust ("REIT") from a real estate operating company.

Thirteen common stock positions were eliminated and three common stock positions were reduced. Ten of the thirteen positions eliminated, and two of the positions reduced, were the common stocks of high-tech companies whose market price performance was spectacular during 2003. Going forward, the Fund expects to reduce its diversification among high-tech issuers. Instead, TAVF will concentrate its high-tech investments into the common stocks of a lesser number of larger, extremely well-financed, high-tech companies. The three most important high-tech common stock positions held by TAVF are Applied Materials, American Power



Conversion and AVX Corp. The other three common stock positions eliminated, BKF Capital Group, J&J Snack Foods and Kendle International, were sold based on price considerations.

The two distressed credits acquired, Parmalat Senior Notes and Mirant Corporation Bank Notes, seem interesting. Parmalat, a massive fraud, is an Italian-based worldwide company essentially selling dairy products. The Fund established a toehold position based on the view that Parmalat seems reorganizable because it is likely that many of its businesses are well entrenched and profitable. These good businesses are those around which Parmalat would be reorganized. Given the fishbowl in which the Parmalat reorganization is taking place, it seems likely that TAVF will be in a position to be well informed about Parmalat and its potential. It is impossible at this time to state whether, or not, the Fund will participate in Parmalat in a meaningful way, or at all. Third Avenue could either continue to buy Parmalat Senior Notes at huge discounts from claim, or participate as a DIP lender (i.e., enjoy a post-petition super-priority), or both. If TAVF does participate, it would hope to become a significant holder of common stock in a reorganized Parmalat.

Mirant Corporation is one of the largest U.S. generators of electricity and also has a presence in the Philippines and the Caribbean. TAVF expects much of the Mirant Bank Debt to be converted to Mirant Common Stock on reorganization. The Fund has committed to acquire \$17,500,000 principal amount of Mirant Bank Notes, but as of January 31, 2004, the transactions had not closed. It is probable that the transactions will be reflected for the first time in TAVF financial statements sometime during the quarter to end April 30, 2004.

TAVF has been rather steadily increasing its positions in Hutchison Whampoa Common, Investor AB Common and Toyota Industries Common. Each of the companies

are relatively large, well-financed, blue chips whose common stocks seem to be selling at meaningful discounts from readily ascertainable NAVs. Each of the three companies are basically long-term wealth creation entities, rather than companies striving to maximize near-term earnings per share or cash flows. I love to invest in these types of businesses, especially because TAVF's experience in acquiring Japanese non-life insurance equities proved to be so satisfactory. In each case, these Japanese common stocks had been acquired at discounts from NAV of at least 50%, while the comparable discounts for Hutchison Whampoa, Investor AB and Toyota Industries today range from 10% to 40%. Most of our Japanese non-life investments were made in 1997, when the Nikkei 225 Stock Average hovered around 20,000; that index now is about 10,700. Nonetheless, at January 31, 2004, the Fund's Japanese non-life portfolio had a market value of approximately \$302,000,000, versus a cost basis of approximately \$205,000,000. Furthermore, these satisfactory results were achieved even though I could not have been more wrong in 1997 in predicting what the macro outlook would be for these companies. In my wildest dreams in 1997, I never thought that the Japanese business recession-depression would last as long as it did or be as deep; nor did I ever dream then that Japanese interest rates would stay so low for the past seven years, hurting insurance companies' profitability because of the dearth of interest income from their loan portfolios. Obviously, the Fund's okay results in Japanese non-life insurance equities stem from being price conscious rather than outlook conscious. And so it is with Hutchison Whampoa, Investor AB and Toyota Industries. The pricing is attractive relative to NAV and perhaps I will be a lot less wrong about how the future unfolds for these companies than I was about Japanese non-life insurance. As to outlooks, Hutchison Whampoa seems a free speculation on the prospects that 3G (i.e.,



third generation) telephony will take off. Investor AB is a way of getting into a number of large European businesses, and Toyota Industries seems to be a free speculation on the possibility that Toyota Motor (Toyota Industries is Toyota Motor’s largest shareholder and Toyota Motor is Toyota Industries’ largest customer, as well as Toyota Industries’ largest shareholder) might become the Wal-Mart of automobile assemblers on a worldwide basis.

### THE MUTUAL FUNDS SCANDALS AND THIRD AVENUE

Disclosure of fund shareholdings by Directors and Officers of mutual funds is a front burner proposal currently being put forth by the Securities and Exchange Commission (“SEC”) and others. When (or if) adopted, it would place mutual fund Directors and Officers in the same position as the Directors and Officers of all other companies whose equity securities are publicly traded.

The fact is that not only I, but also the managers of the other Third Avenue funds, have meaningful proportions of our net worths invested in the various Third Avenue Funds. At January 31, 2004, my wife and I had the following fully-vested, beneficial interests in the various Third Avenue Funds:

<u>Name of Fund</u>	<u>Shares Held</u>
Third Avenue Value Fund	1,408,733 shares
Third Avenue Small-Cap Value Fund	91,141 shares
Third Avenue Real Estate Value Fund	215,993 shares
Third Avenue International Value Fund	72,970 shares

Like all other Third Avenue shareholders, my wife and I acquired these shares for cash, priced at NAV at the date of purchase. No Third Avenue shares have ever been, or

could ever be, issued for the exercise of stock options or for any consideration other than cash or cash equivalents, or at any price other than NAV at the time of issue. This is true for any mutual fund, not just Third Avenue. This is not the case, of course, for corporations which are not registered investment companies. These non-investment companies issue common stock to Directors and Officers on promotional terms and/or at promotional discount prices.

Obviously, my economic interests are strongly aligned with those of all the other Third Avenue shareholders. Moreover, I am convinced that the libido interests, not

only of myself, but also of everyone else at Third Avenue Management, are also strongly aligned with those of all other Third Avenue shareholders. Even if we in management were not large shareholders, it remains as important as it possibly could be for us to manage the Funds as reasonably

well as we can—to be honest, to be conservative, and to have the expense levels of the Funds be reasonable.

Were I not a manager at Third Avenue Management, I would still have substantial investments in Third Avenue Funds and/or other value funds with investment approaches similar to TAVE. The reason why this is so revolves around the substantial, substantive protections for investors arising out of the operation of the Investment Act of 1940. These substantive protections include the following:

- 1) A fund’s ability to borrow is severely limited. Third Avenue Funds can borrow only for emergency purposes and such borrowings may not exceed 5% of the Fund’s total assets at the time of borrowing.
- 2) Funds are required to diversify holdings.

**“The fact is that not only I, but also the managers of the other Third Avenue Funds, have meaningful proportions of our net worths invested in the various Third Avenue Funds.”**



- 3) Expenses tend to be limited.
- 4) Non-arms length dealings with affiliates and related parties are proscribed vigorously.
- 5) Custodial and administrative requirements prevent stealing of fund assets.
- 6) As a practical matter, funds are required to distribute annually virtually all net income and realized capital gains.
- 7) Accounting audits in compliance with Generally Accepted Accounting Principles (“GAAP”) are much more straightforward, reliable, useful, and informative for investment companies, pricing most of their assets at market prices, than GAAP are for operating companies which are going-concerns rather than investment companies.

John C. Bogle, the former Chief Executive Officer of Vanguard Funds, is leading a campaign to have mutual fund management fees reduced. According to Mr. Bogle, actively managed mutual funds do not outperform index funds *consistently*, and actively managed funds have higher expense ratios than index funds. TAVF, an actively managed fund, pleads guilty on both counts. Third Avenue does not outperform indexes *consistently* insofar as consistently means “all the time”, which is what consistently seems to mean for Mr. Bogle and academics. Also, the Fund’s expense ratio is higher than that of index funds.

However, despite its higher expense ratio, TAVF has outperformed the Vanguard 500 Index Fund on average, most of the time, and over the long term but probably not “consistently”, as Mr. Bogle would use that word. The relevant statistics are as follows as of January 31st year ends:

**Average Annual Percentage Returns**

**As of January 31, 2004**

	1 year	3 years	5 years	10 years
Third Avenue Value*	45.5%	5.2%	10.4%	13.1%
Vanguard 500 Index	34.4%	-4.7%	-1.1%	10.8%

\* *Third Avenue Value Fund’s one-year, three-year, five-year, ten-year and since inception (11/1/90) average annual returns for the period ended December 31, 2003 are 37.08%, 6.13%, 10.25%, 12.74% and 16.26%, respectively. Returns include reinvestment of dividends and interest. Vanguard 500 Index Fund’s one-year, three-year, five-year, ten-year and since inception (TAVFX-11/1/90) average annual returns for the period ended December 31, 2003 are 28.50%, -4.17%, -0.63%, 10.99% and 12.59%, respectively.<sup>1</sup>*

Source: Zephyr Style Advisor<sup>1</sup>

**Expense Ratios**

**As of December 31, 2003**

Third Avenue Value	1.09%
Vanguard 500 Index	0.18%

Source: [www.vanguard.com](http://www.vanguard.com)<sup>1</sup>

I, for one, am glad that my wife and I are invested in TAVF rather than an index fund. The Fund is not interested in outperforming benchmarks consistently. Indeed, TAVF strives to buy value, i.e., common stocks selling at discounts from estimated private values or takeover values. In order to get that pricing most of the time, the near-term outlook for the businesses in which the Fund invests, tends to be poor. Poor outlooks do not tend to equate to consistent outperformance.

Mr. Bogle and academics seem to think that the appropriate standard for measuring performance is to outperform a risk-adjusted benchmark consistently. This standard probably serves as a good test for measuring the

<sup>1</sup> Information obtained from sources believed to be reliable, but can not be guaranteed. Subject to change without notice.



relative success of day traders operating with maximum margin borrowings. It doesn't seem relevant to TAVF.

Besides investing at a time when near-term outlooks are poor, there are several other reasons why TAVF will never outperform relevant indexes consistently:

- 1) Sometimes, as an active manager, I make stupid decisions, such as acquiring common stock positions in Long Term Credit Bank of Japan (an absolute fraud) in 1998; or acquiring a position in 2000 in MONY Group Common Stock, given that MONY appears to be poorly managed.
- 2) Sometimes, I am going to be wrong about the general market, as was the case when the Fund invested in Japanese securities in 1997, just before the Nikkei 225 Stock Average declined by 50%.
- 3) Sometimes, TAVF, as a strict value investor, will fail to participate in the most buoyant sectors of the market. Such was the case during the speculative bubble from 1998 through early 2000 when the Fund, and almost all other value funds, performed poorly compared with most stock market indexes.

Getting away from Third Avenue and looking at the mutual fund industry in general, a good case can be made that the industry has performed valuable services for the investing public, including even funds which have failed to outperform relevant indexes on average, most of the time, and over the long term. Certainly unsophisticated investors have, over the years, fared a lot better investing in mutual funds than they ever did investing in typical products pushed by Wall Street. These other products include margin-buying, tax shelter investing, promoting Initial Public Offerings ("IPOs") at premium prices in the IPO after-market, and pushing trading systems, such as day trading. Probably these alternative investments have frequently resulted in wipeouts of outside, passive, minority investors. In contrast, probably very few mutual

fund investors have ever been wiped out because they owned mutual fund shares.

We Americans live in a generally well-functioning mixed economy where there are roles for both private enterprise and government. One area where the private enterprise-government regulation marriage has worked particularly well revolves around the Investment Act of 1940, the statute under which mutual funds are regulated. Though no one meant it that way, the 1940 Act seems to be a product of genius combining very good, substantive protections for investors at what seems to be a reasonable cost to those investors, while at the same time permitting money manager-promoters, such as myself, to profit mightily.

Admittedly, I chafe under the increasingly onerous regulation imposed on mutual funds especially since the passage of the Sarbanes-Oxley Act, but the increasing regulation is understandable. From a regulatory point of view, those being regulated have to be regulated uniformly. That means that rules and regulations have to aim for the lowest common denominator, i.e., the rules and regulations are designed to protect the public from incompetents, chiselers and crooks. The rules and regulations cannot be designed to make it easier for ethical, honest, money managers to function. Put simply, TAVF has to be subject to a lot of onerous, unneeded and superfluous rules and regulations because there are unethical, dishonest people in the industry. It seems as if we at Third Avenue continue to cope well with this 1940 Act environment, all things considered.

Much waste exists both in the government sector and the private sector. The political extreme right wing notwithstanding, the government sector does not have a monopoly on inefficiency and the private sector does not have a monopoly on efficiency. In the private sector it is just plain wrong (and inefficient) to single out money managers as overcompensated for the services



performed. Money manager compensation in the form of management fees seems to be a relatively modest excess compared with private sector compensations given to top corporate executives, attorneys, investment bankers, venture capitalists, hedge fund managers, movie stars and top athletes.

The current governmental charges against a few, unsavory money management firms revolve around late trading and market timing, none of which activities are condoned by any manager at any Third Avenue Fund. We do not trade. Each Fund has now put in place redemption fees (which fees are payable to the Funds) to discourage trading in Fund shares. The trading practices, while reprehensible, it seems to me, are “nickel and dime” stuff. There could be some harm to long-term shareholders but it seems minimal. Aiding and abetting market timing and late trading by mutual funds is stupid but I doubt very much if it involves big dollars in terms of the suffering visited on non-trading fund shareholders.

Probably much bigger damages are involved today in the “load fund” lawsuits and arbitrations being handled primarily by the private bar where, in effect, securities salesmen, and their firms, are accused of overcharging outside passive minority investors who had acquired shares of mutual funds with sales loads (Third Avenue Funds are no-load funds and are not involved in these actions). There may have been widespread abuses here, and outside, passive, minority shareholders may have been bilked out of many millions. Nonetheless, there certainly is an important role for salesmen to play in the mutual fund industry if one wants U.S. capital markets—the world’s best—to allocate resources reasonably well. Many outside, passive, minority

investors are notoriously unsophisticated. They need the guidance of honest securities salesmen, even if none of these salesmen ever would recommend a no-load fund. In return for reasonable investor guidance, it is important that the securities salesmen be well compensated. Sales abuses ought to be proscribed; sales compensation ought not to be eliminated.

I will write you again when the report for the period to end April 30, 2004 is issued.

Sincerely yours,

Martin J. Whitman  
Chairman of the Board



## Third Avenue Small-Cap Value Fund



**CURTIS R. JENSEN**  
**CO-CHIEF INVESTMENT OFFICER &**  
**PORTFOLIO MANAGER OF THIRD AVENUE**  
**SMALL-CAP VALUE FUND**

Dear Fellow Shareholders:

At January 31, 2004, the end of the fiscal first quarter, the unaudited net asset value attributable to the 33,702,167 common shares outstanding of the Third Avenue Small-Cap Value Fund ("Small-Cap Value" or the "Fund") was \$19.65 per share, compared with the Fund's audited net asset value of \$17.91 per share at October 31, 2003, and an unaudited net asset value at January 31, 2003 of \$13.00 per share, both adjusted for a subsequent distribution to shareholders. At February 23, 2004, the unaudited net asset value was \$19.49 per share.

### QUARTERLY ACTIVITY\*

During the quarter, Small-Cap Value established one new position, added to ten of its existing positions, eliminated three positions and reduced its holdings in eight companies. At January 31, 2004, Small-Cap Value held positions in 64 common stocks, the top 10 positions of which accounted for approximately 24% of the Fund's net assets.

### Number of Shares or Units

584,700 shares

50,000 shares

42,500 shares

108,500 shares

9,700 shares

10,000 units

133,826 shares

12,700 shares

50,000 shares

### New Position Acquired

Quanta Services, Inc. Common Stock  
("Quanta Common")

### Increases in Existing Positions

AMN Healthcare Services, Inc.  
Common Stock ("AMN Common")

CommScope, Inc. Common Stock  
("CommScope Common")

Cross Country Healthcare, Inc.  
Common Stock

("Cross Country Common")

The Dress Barn, Inc. Common Stock  
("Dress Barn Common")

Fording Canadian Coal Trust Units  
("Fording Units")

JAKKS Pacific, Inc. Common Stock  
("JAKKS Common")

Lindsay Manufacturing Company  
Common Stock ("Lindsay Common")

PAREXEL International Corp.

Common Stock ("PAREXEL Common")

\* Portfolio holdings are subject to change without notice. The following is a list of Third Avenue Small-Cap Value Fund's 10 largest holdings, and the percentage of the total net assets each security represented, as of January 31, 2004: Brascan Corp. (Class A), 3.03%; Forest City Enterprises, Inc. (Class A), 2.94%; CommScope, Inc., 2.73%; LNR Property Corp., 2.62%; Electro Scientific Industries, Inc., 2.60%; Trinity Industries, Inc., 2.38%; E-L Financial Corp., Ltd., 2.19%; TimberWest Forest Corp., 2.11%; The St. Joe Company, 2.01%; and Arch Capital Group, 1.85%.

**Number of Shares  
or Units**

31,800 shares

140,300 units

57,100 shares

150,000 shares

268,000 shares

700 shares

282,400 shares

20,000 shares

233,600 shares

466,600 shares

181,900 shares

750,000 shares

75,000 shares

**Increases in Existing  
Positions (Continued)**The St. Joe Company Common Stock  
("St. Joe Common")TimberWest Forest Corp. Units  
("TimberWest Units")**Decreases in Existing Positions**Advanced Power Technology, Inc.  
Common Stock ("APT Common")Credence Systems Corp. Common  
Stock ("Credence Common")CyberOptics Corp. Common Stock  
("CyberOptics Common")Electro Scientific Industries, Inc.  
Common Stock ("ESI Common")FSI International, Inc. Common Stock  
("FSI Common")IXYS Corp. Common Stock  
("IXYS Common")KEMET Corp. Common Stock  
("KEMET Common")TriQuint Semiconductor, Inc. Common  
Stock ("TriQuint Common")**Positions Eliminated**Century Aluminum Co. Common Stock  
("Century Common")CIENA Corp. Common Stock  
("CIENA Common")SWS Group, Inc. Common Stock  
("SWS Common")**DISCUSSION OF QUARTERLY ACTIVITY**

The Fund initiated a single new position during the quarter, in Quanta Services, Inc. Common Stock. Quanta is a leading provider of specialized contracting services, offering solutions to the electric power, gas, telecommunications and cable television industries. In a way, Quanta Common does not seem to fit within Third Avenue Management's ("TAM's") normal investment framework. The Company's finances, subsequent to a new equity infusion, seem no better than adequate after years of acquisition-led growth layered significant funded

indebtedness onto the balance sheet. The simultaneous and unprecedented downturns in recent years across the telecom, utility and cable industries — more than 80% of the Company's customer base — only highlighted the company's less-than-stellar finances.

Nevertheless, Fund management, mindful of being too doctrinaire, elected to make an exception as Quanta's business appears to have stabilized, coincident with improvements — at least directionally — among the Company's customer base. Operationally, the business has returned to profitability and should continue to generate solid free cash flow that will cushion the balance sheet. Longer term, the Company ought to benefit as outsourcing continues to gain broader appeal among the Company's customer base, as the country's aging, and in some cases dangerously inadequate, energy and utility infrastructures attract much needed attention (and funding!), and as broadband-related spending regains momentum.

Fund management continued to trim the portfolio's exposure to technology holdings, a group of common stocks that had significantly appreciated in value during 2003 (which had peaked at more than 20% of the Fund's assets) while lifting its stake, opportunistically, in 10 existing holdings.

Three positions were eliminated entirely, including Century Common, CIENA Common, and SWS Common. Century, which owns or has interests in 525,000 metric tons per year of primary aluminum production, has benefited considerably with the strengthening of the world's commodity markets, particularly that in base metals. Nevertheless, Century's highly-leveraged balance sheet — which transformed radically during the Fund's period of ownership over the last four years — combined with a rich valuation, left the Fund with too much riding on volatile and unpredictable commodity prices, and with an unacceptably low margin of safety. CIENA, a maker of telecommunications equipment, has also benefited as spending on its products appears to be in a recovery phase, rising from the depths



of a terrible industry recession. However, the implied business valuation at which the Fund exited CIENA Common — in a range of \$2 billion to \$2.5 billion — appears excessive for a business with annualized sales of \$300 million to \$400 million, and one that continues to spend (and lose) money like a drunken sailor. The relatively new management team at SWS Group, a Dallas, Texas-based regional broker-dealer, seems to be doing a fine job, admittedly with the wind at its back. However, Fund management sold SWS Common on a number of accounts: i) a desire to reduce the Fund's overall exposure to securities that are tightly linked to the general U.S. equity markets, particularly the day-trading firms that comprise a significant portion of SWS's clearing customers; ii) Fund management's concern about margin lending (i.e., brokerage customers borrowing to buy securities) that has reached record levels, and other pockets of speculative excess that appear to be growing; and iii) less clarity about the long-term earning power of the Company, following the spin-off of SWS' money management operations.

#### **'RESOURCE CONVERSION' ACTIVITY**

With Keynes' 'Animal Spirits'<sup>2</sup> evidently resurfacing among some of the world's largest corporations, manifested, in my opinion, by the spate of recent, large and, in some cases, hostile merger and acquisition ("M&A") deal announcements, I wanted to reflect on M&A activity within the Fund's portfolio. Historically, M&A activity has made significant, positive contributions to the Fund's performance, largely because the Fund's holdings get taken over or merged at a premium to both existing market prices and the Fund's

cost basis. (Our recent experience with MONY Group, described in our last period's Annual Report, may be a glaring exception!)

**“Historically, M&A activity has made significant, positive contributions to the Fund’s performance, largely because the Fund’s holdings get taken over or merged at a premium to both existing market prices and the Fund’s cost basis.”**

As the table below suggests, however, the Fund seems likely to benefit in the future largely because during the past year, the Fund's portfolio companies have made, or are in the process of making,

acquisitions. At TAM we refer to both activities — portfolio holdings getting taken over, or the redeployment of assets by portfolio companies for growth purposes — as forms of Resource Conversion.

<u>TAM Portfolio Company</u>	<u>Business/ Assets Acquired</u>	<u>Impact</u>
Alamo Group, Inc.	Rousseau Holding, S.A.	Strengthens European presence
Bel Fuse, Inc.	Insilco Technology	Doubles sales per share
Brascan Corp.	Canary Wharf	Bid pending
Coherent, Inc.	Lambda Physik	Control/cost savings
CommScope, Inc.	Avaya LAN assets	Doubles sales per share; patents
Cross Country Healthcare, Inc.	Med-Staff, Inc.	Broadens service offering and distribution
Leucadia National Corp.	WiTel Communications	Telecom assets; net operating losses
LNR Property Corp.	Newhall Land JV	Adds valuable California land holdings
TriQuint Semiconductor, Inc.	Agere optics business	Patent portfolio; broadens product line

<sup>1</sup> My paranoia gets fed by commentary like that found in a recent front page article in *The Wall Street Journal* titled "With the Market Up, Wall Street High Life Bounces Back, Too", February 4, 2004, and that found on websites like [www.cross-currents.net](http://www.cross-currents.net).

<sup>2</sup> Keynes, John Maynard, *The General Theory of Employment Interest and Money*, 1936.



In each case, the Resource Conversion activities share a number of common themes. First, the acquisitions appear to be opportunistic, in some cases taking advantage of distressed sellers, an approach that largely coincides with TAM's own philosophy; second, they appear to be generally sensible, and value-enhancing (i.e., additive to sales, earnings and cash flow on a per share basis); and third, none of the management teams appears to have "bet the ranch" on the deals. All in all, the Fund ought to continue to benefit from such Resource Conversions in the periods ahead.

I look forward to writing you when we publish our Second Quarter Report dated April 30, 2004.

Sincerely,

Curtis R. Jensen  
Portfolio Manager,  
Third Avenue Small-Cap Value Fund  
Co-Chief Investment Officer



## Third Avenue Real Estate Value Fund



**MICHAEL H. WINER**  
PORTFOLIO MANAGER OF THIRD AVENUE  
REAL ESTATE VALUE FUND

Dear Fellow Shareholders:

At January 31, 2004, the end of the first fiscal quarter of 2004, the unaudited net asset value attributable to the 41,942,443 common shares outstanding of the Third Avenue Real Estate Value Fund (the "Fund") was \$22.11 per share. This compares with an audited net asset value of \$19.64 per share at October 31, 2003, and an unaudited net asset value of \$15.19 per share at January 31, 2003, both adjusted for a subsequent distribution to shareholders. At February 23, 2004, the unaudited net asset value was \$22.48 per share.

### QUARTERLY ACTIVITY\*

During the first quarter of fiscal 2004, the Fund's outstanding shares increased to 41.9 million shares from 32.1 million shares—an increase of 30.5%; net assets increased to \$927 million from \$647 million—an increase of 43.3%; and net asset value per share increased to \$22.11 from \$19.64 (as adjusted for a subsequent distribution to shareholders). Cash and short-term investments at quarter-end totaled 24.1% of net assets, compared to 14.0% at the end of the last fiscal quarter.

The following summarizes the Fund's investment activity during the quarter.

### Principal Amount or Number of Shares

71,500 shares

1,204,600 shares

147,900 shares

4,000,000 shares

\$4,250,000

First Mortgage Revolving Credit Loan

40,146 shares

### New Positions Acquired

BPO Properties Ltd. Common Stock  
("BPO Common")

Falcon Financial Investment Trust  
Common Stock ("Falcon Common")

First Capital Realty, Inc. Common  
Stock ("First Capital Common")

Killam Properties, Inc. Common Stock  
("Killam Common")

### Increases in Existing Positions

Frank's Nursery & Crafts, Inc., 10.15%  
due 5/21/05 ("Frank's Revolver")

Avatar Holdings, Inc. Common Stock  
("Avatar Common")

\* Portfolio holdings are subject to change without notice. The following is a list of Third Avenue Real Estate Value Fund's 10 largest holdings, and the percentage of the total net assets each security represented, as of January 31, 2004: LNR Property Corp., 8.36%; Forest City Enterprises, Inc. (Class A), 7.81%; The St. Joe Co., 7.72%; Catellus Development Corp., 6.85%; Brookfield Properties Corp., 6.38%; ProLogis, 3.53%; PS Business Parks, Inc., 3.02%; Vornado Realty Trust, 2.80%; Trammell Crow Co., 2.79%; and American Financial Realty Trust, 2.01%.



<b>Number of Shares</b>	<b>Increases in Existing Positions (continued)</b>
608,549 shares	Catellus Development Corp. Common Stock ("Catellus Common")
18,700 shares	Forest City Enterprises Class A Common Stock ("Forest City Common")
23,963 shares	Frank's Nursery & Crafts, Inc. Common Stock ("Frank's Common")
100,000 shares	LNR Property Corp. Common Stock ("LNR Common")
89,470 shares	Modtech Holdings, Inc. Common Stock ("Modtech Common")
73,700 shares	One Liberty Properties, Inc. Common Stock ("One Liberty Common")
440,300 shares	ProLogis Common Stock ("ProLogis Common")
41,600 shares	PS Business Parks, Inc. Common Stock ("PSB Common")
242,600 shares	The St. Joe Company Common Stock ("St. Joe Common")
391,200 shares	Trammell Crow Company Common Stock ("Trammell Crow Common")
	<b>Positions Eliminated</b>
31,000 shares	Atlantic Realty Trust Inc. Common Stock ("Atlantic Common")
63,000 shares	Public Storage, Inc. Common Stock ("Public Storage Common")

#### **DISCUSSION OF QUARTERLY ACTIVITY**

During the quarter ended January 31, 2004, the Fund initiated positions in the common stocks of three Canadian real estate operating companies (BPO Common, First Capital Common, and Killam Common) and one real estate investment trust ("REIT") (Falcon Common).

BPO Properties Ltd. is a publicly-traded subsidiary of Brookfield Properties, Inc. (one of the Fund's largest holdings). BPO Properties is Brookfield's Canadian commercial real estate operating company and owns 17 commercial properties and development sites, primarily in Toronto and Calgary, totaling 14 million square feet. BPO Properties is extremely well financed with total assets (book value) of nearly CDN \$2 billion including CDN \$786 million in cash and CDN \$743 million in total liabilities. The Fund has been acquiring BPO Common at a level that represents a substantial discount to net asset value. During 2003, Brookfield Properties offered to acquire the remaining outstanding shares of BPO Properties for consideration including cash and Brookfield Common, but terminated its offer when it lacked shareholder support. BPO Properties has instituted a share buyback program that will continue to reduce the public float and could ultimately lead to another attempt by Brookfield at taking the company private at a price closer to net asset value.

First Capital Realty is a Toronto-based real estate operating company engaged in the development, acquisition, expansion and redevelopment of neighborhood and community shopping centers in Canada. First Capital owns a portfolio of 81 properties with approximately 10.6 million square feet. The Company has been an active acquirer of properties, nearly doubling its portfolio in the last three years. While substantially increasing its portfolio, First Capital has strengthened its balance sheet by issuing new common shares and converting outstanding debentures to common shares. First Capital management seems very talented at acquiring under-performing properties and enhancing value through redevelopment and expansion.

Killam Properties is a Halifax-based real estate operating company focused on the acquisition, redevelopment, and management of multi-family residential properties in the provinces of New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland. The Company owns



and manages 18 properties, consisting of 1,918 apartment and manufactured home units. Killam is intent on becoming the dominant owner of multi-family residential properties in the Atlantic Province, in which multi-family property ownership is very fragmented. Killam raised CDN \$22 million in an unregistered offering of common shares in November 2003. The Fund acquired 4 million shares of Killam Common in the offering. The proceeds from the offering are being employed to make additional acquisitions.

**“Fund management has always emphasized that the Fund’s investment goal is long-term capital appreciation, and we don’t consider current income (dividends) an important factor in evaluating investment opportunities.”**

Falcon Financial is a real estate investment trust that specializes in originating and servicing loans to automotive dealerships. Falcon’s management team has established an excellent track record of conducting thorough credit and collateral underwriting and successfully selling the loans to create asset-backed securities. Falcon’s business model going forward will be to complete on-balance sheet securitizations (effectively non-recourse financing) instead of selling its loans as in the past. This will allow Falcon to retain all of the future economic benefits of its portfolio and optimize its return on equity. Falcon raised \$118 million in its initial public offering in December 2003. The Fund acquired its position in Falcon Common in the initial public offering.

Pursuant to the Amended Loan Participation Agreement with Kimco Realty Corp. (an unaffiliated real estate investment trust), the Fund funded its 25% share of additional advances on the \$45 million Frank’s Revolver. The Frank’s Revolver and the \$20 million term loan (in which the Fund also has a 25% participation interest) are secured primarily by first mortgages on Frank’s retail stores and second liens on Frank’s inventory and other assets. The loans bear interest at 10.15% and mature in May 2005. The Fund’s total commitment pursuant to

the Participation Agreement is \$16,250,000. The Fund also owns Frank’s common stock and warrants. Frank’s operates in a very competitive retail environment and 2003 results were weaker than expected, resulting in recent management changes. Fund management

continues to believe that Frank’s should be able to operate a successful and profitable business, however, new management must implement a successful turn-around. If a turn-around is unsuccessful, the term loan and revolver appear to be well collateralized.

#### **DEMAND FOR REAL ESTATE SECURITIES REMAINS STRONG, BUT DIVIDENDS ARE NOT THE MAIN ATTRACTION**

According to a recent survey conducted by UBS Securities and the Gallup Organization, 46% of investors surveyed expect to invest some portion of their portfolio in real estate securities during 2004, compared to 44% currently and 40% three years ago. It is likely that most of the additional funds invested in the sector will ultimately find their way into common stocks of REITs. The UBS/Gallup survey indicated that diversification and capital appreciation came in as the two main factors for investing in real estate securities. Surprisingly, dividend yield came in third. It is interesting that a substantial number of REITs still consider their dividend to be the primary driver for attracting investors’ dollars when it is apparent that investors are more interested in capital appreciation. Fund management has always emphasized that the Fund’s investment goal is long-term capital appreciation, and we don’t consider current income (dividends) an important factor in evaluating investment opportunities.

REITs are required to pay out at least 90% of their taxable income in dividends to shareholders. All equity REITs (those that own properties as opposed to



mortgages) are able to reduce taxable income by non-cash expenses (primarily depreciation expense). This generally results in cash flow, or funds from operations (“FFO”), exceeding taxable income. Many REITs pay out greater than 90% of their taxable income. In fact, some REITs consider their dividend sacrosanct and instead of reducing it in times of reduced cash flow (as is the case for many apartment REITs today), they stretch their finances and pay out more than 100% of FFO—effectively going into debt to pay their dividend. The requirement for REITs to pay dividends is inescapable; however, Fund management is uncomfortable investing in REITs that pay out significantly more than is necessary to comply with IRS regulations. While Fund management has always preferred to invest in the common stocks of real estate companies that are able to retain their cash flow, we no doubt will continue to invest in REIT common stocks. We will just try to avoid those REITs that consider their dividend payment to be the most important feature of their common stock.

As of January 31, 2004, approximately 24% of the Fund’s net assets were invested in REIT common stocks. The weighted average dividend yield on the Fund’s REIT common stocks was 4.3% compared to 5.5% for the entire REIT universe. The Fund’s largest three REIT holdings—Catellus, ProLogis and PS Business Parks—have dividend yields of 4.1%, 4.5% and 2.7%, respectively. For the three years ended December 31, 2003, these REITs generated annualized total returns to shareholders of 18.2%, 19.7% and 18.4%, respectively. This compares to the 16.9% annualized total return for the Morgan Stanley REIT index for the same three-year period, illustrating that high total returns are not dependent upon high dividend yields.

#### NON-U.S. INVESTMENTS

At quarter end, the Fund had approximately 11% of its net assets invested in the common stocks of non-U.S. companies (8% Canada, 2% Great Britain and 1% Hong Kong). Fund management believes that investments in common stocks of U.S. real estate companies will always make up the vast majority of the portfolio. However, we will continue to seek investment opportunities in real estate companies throughout the industrialized world. As portfolio manager for the Third Avenue Real Estate Value Fund, I am most fortunate to have as my colleague Amit Wadwhaney, the portfolio manager of the Third Avenue International Value Fund. Amit’s knowledge of international markets and experience in making foreign investments has helped me (as well as all Third Avenue portfolio managers) to understand and evaluate the unique risks and rewards of investing outside the U.S. borders.

I look forward to writing to you again when we publish our Semi-Annual Report for the period ending April 30, 2004.

Sincerely,

Michael H. Winer  
Portfolio Manager,  
Third Avenue Real Estate Value Fund



## Third Avenue International Value Fund



**AMIT B. WADHWANEY**  
PORTFOLIO MANAGER OF THIRD AVENUE  
INTERNATIONAL VALUE FUND

Dear Fellow Shareholders:

At January 31, 2004, the unaudited net asset value attributable to the 11,009,958 shares outstanding of the Third Avenue International Value Fund (the "Fund") was \$14.85 per share, compared with the Fund's audited net asset value at October 31, 2003 of \$13.19 per share, and an unaudited net asset value of \$9.60 per share at January 31, 2003, both adjusted for a subsequent distribution to shareholders. At February 23, 2004, the unaudited net asset value was \$15.29 per share.

### QUARTERLY ACTIVITY\*

During the most recent quarter of operations, the Fund established a new position in the common stock of one company, added to positions in the common stocks (or units) of 24 companies, reduced its holding in one company and eliminated its holdings in three companies.

### Number of Shares

6,739,000 shares

1,853,000 shares

706,684 shares

195,000 shares

39,200 shares

1,889,000 shares

54,300 shares

49,300 shares

### New Position Acquired

Chuan Hup Holdings Ltd.  
Common Stock ("CHH Common")

### Increases in Existing Positions

Boardroom Ltd. Common Stock  
("Boardroom Common")

BRIT Insurance Holdings plc  
Common Stock ("BRIT Common")

Canfor Corporation Common Stock  
("Canfor Common")

Cresud SACIFYA-ADR ("Cresud ADRs")

Del Monte Pacific Ltd. Common Stock  
("Del Monte Common")

Dundee Precious Metals Inc.-A  
Common Stock ("Dundee Common")

Farstad Shipping ASA Common Stock  
("Farstad Common")

\* Portfolio holdings are subject to change without notice. The following is a list of Third Avenue International Value Fund's 10 largest holdings, and the percentage of the total net assets each security represented, as of January 31, 2004: Tranz Rail Holdings Ltd., 5.16%; Ganger Rolf ASA, 4.30%; Compagnie Generale de Geophysique SA, 3.06%; Canfor Corp., 2.96%; BRIT Insurance Holdings PLC, 2.91%; Smedvig ASA (Class A), 2.86%; Banco Latinoamericano de Exportaciones, S.A., 2.67%; Hutchison Whampoa, Ltd., 2.55%; Telecom Corp. of New Zealand, Ltd., 2.48%; and Guoco Group, Ltd., 2.37%.



<b>Number of Shares or Units</b>	<b>Increases in Existing Positions (continued)</b>	<b>Number of Shares or Units</b>	<b>Decrease in Existing Position</b>
17,500 shares	Fomento de Construcciones y Contratas Common Stock ("FCC Common")	109,600 units	SFK Pulp Fund Units ("SFK Units")
63,900 shares	Ganger Rolf ASA Common Stock ("Ganger Common")	175,000 shares	<b>Positions Eliminated</b> Boosey & Hawkes, plc Common Stock ("Boosey Common")
65,000 shares	Cie. Generale de Geophysique SA Common Stock ("Geophysique Common")	88,000 shares	Makita Corporation Common Stock ("Makita Common")
199,700 shares	Guoco Group Ltd. Common Stock ("Guoco Common")	500,000 shares	Singer & Friedlander Group plc Common Stock ("Singer & Friedlander Common")
7,428,000 shares	Hotung Investment Holdings Ltd. Common Stock ("Hotung Common")		
250,000 shares	Hutchison Whampoa Ltd. Common Stock ("Hutchison Common")		
42,000 shares	Ichiyoshi Securities Co. Ltd. Common Stock ("Ichiyoshi Common")		
40,000 shares	Investor AB-A Common Stock ("Investor Common")		
200,000 shares	JZ Equity Partners plc Common Stock ("JZ Common")		
72,700 shares	Noranda Inc. Common Stock ("Noranda Common")		
30,000 shares	Oslo Bors Holding, ASA Common Stock ("Oslo Bors Common")		
50 shares	Pargesa Holding AG Common Stock ("Pargesa Common")		
2,208,778 shares	Rubicon Ltd. Common Stock ("Rubicon Common")		
150,800 shares	Smedvig ASA-A Common Stock ("Smedvig Common")		
161,216 shares	Telecom Corp of New Zealand Common Stock ("Telecom Corp Common")		
4,527,300 shares	Tranz Rail Holdings Ltd. Common Stock ("Tranz Rail Common")		
124,600 units	Westshore Terminals Income Fund Units ("Westshore Units")		

#### **REVIEW OF QUARTERLY ACTIVITY**

##### **Purchases**

Chuan Hup Holdings ("CHH") is a Singapore-listed company, which began its existence in the 1970's as a provider of tug and barge services to the port of Singapore. It has since grown to become one of Asia's larger owner-operators of marine transport equipment for use in the resource sector, with a particular competence in the mining and energy sectors. Not content with its success in this area, CHH diversified into a variety of unrelated areas including: property development in Indonesia, Philippines and Australia; production of drums for cement mixers; environmental services; and electronics contract manufacturing services. Fortunately, this latter group of businesses has been deemed non-core and slated for divestiture.

CHH's core businesses of marine logistics and offshore support services appear to be well-run businesses with attractive prospects. In addition to the cash-rich balance sheet at the parent company level, there is ample liquidity on the balance sheets of the more capital-intensive subsidiaries. Despite these solid attributes, the Fund was able to acquire shares of CHH at a meaningful discount to their net asset value. In fact, if the divestiture of the non-core businesses were to yield book value, our



purchase price of these shares would imply a valuation for the 100%-owned marine logistics business in the low single digit multiple of its free cash flow.

In addition to the above-noted purchase of Chuan Hup Common, we purchased short-term debt issued by Governments of Canada, New Zealand and Norway in amounts that would effectively hedge our current purchasing intentions for securities in those countries.

### Sales

As foreshadowed by our comments in the last quarterly letter, we profitably tendered Boosey Common in response to the bid by Hg Capital, a private equity firm for whom Boosey's music library was intended to be a cornerstone for a music publishing business. This transaction is another example of how resource conversion activities frequently create value for Third Avenue Funds' shareholders without reliance upon the general market.

The Fund also eliminated its position in Singer & Friedlander ("S&F"), a UK-based financial services company. A meaningful part of S&F's asset base was comprised of a 30.9% holding in Carnegie AB, the largest stand-alone pan-Nordic company providing investment banking, securities brokerage and investment management services. An Icelandic bank, presumably lured by this holding in Carnegie, built up a shareholding in S&F. Apparently, in response, S&F management chose to sell roughly 80% of its Carnegie stake at a discount from the market price. Not only did this sale limit the potential realization for S&F's stake (most of which was sold at what we considered to be a low level), it left S&F with a less than 10% stake in Carnegie and little ability to exert influence in any takeover contest.

This loss of control materially reduced S&F's potential attractiveness to any strategic purchaser. Although the Fund made a profit on the sale, we consider this to have been a less than entirely satisfactory outcome for our investment.

### SOME OBSERVATIONS ABOUT THE IMPACT OF THE LOWER U.S. DOLLAR

When most investors speak of "risk" they are usually referring to market risk, the fluctuations of security prices in the general market. At Third Avenue Management, we spend a great deal of time thinking about "risk", but never without an adjective preceding the word. Our primary focus is on evaluating investment risk—anything that could possibly happen to affect the business of a company in which we are considering making an investment. This investment analysis leads us to consider

**“At Third Avenue Management, we spend a great deal of time thinking about ‘risk’, but never without an adjective preceding the word.”**

additional risks, which can include currency risk, interest rate risk, credit risk, liquidity risk, political risk, etc.

Currency risk, as of late, seems to be on the minds of many investors; particularly, we are often asked what impact the falling U.S. Dollar has had on the Fund. The following outlines our thoughts — first, in terms of the possible impact it has on the businesses of our portfolio companies, and by implication, our investment in their securities; and secondly, in terms of the Dollar's impact on the Fund's performance.

Our assessment of the investment merits of a company's securities typically revolves around an evaluation of the underlying business(es) and/or asset(s) of the company. One key element of this assessment is the nature of the currency exposure(s) the company has on the revenue and cost sides (or, equivalently, on the asset and liability sides). Such an examination has, firstly, a bearing on an evaluation of the risk that attaches to a security —



stemming from the currency exposure(s) its business(es) has/have (e.g., we tend to be wary of currency mismatches in businesses with financial leverage, such as banking). Additionally, it plays a part in the valuation of a security. For example, the output of agricultural land in Argentina is, in great part, exported. Accordingly, the valuation of a company whose principal asset is agricultural land would be U.S. Dollar-related (everything else being equal), and impervious to the fluctuations in the local currency. While generalizations about the impact of a falling U.S. Dollar are hazardous, a subset of the Fund's holdings is susceptible to some simple-minded classification.

In order to sufficiently examine the impact of currency fluctuations on the Fund, it is best to discuss three separate categories of companies. The first category of our holdings has both revenues and costs denominated in U.S. Dollars (e.g., Noble Group and Banco Latino Americano de Exportaciones, S.A.) Logically, such companies' businesses will be unaffected by a change in the value of the U.S. Dollar (everything else being equal). A second group of companies whose businesses' operations and profitability will also be (at first approximation) unaffected by the decline in the U.S. Dollar will be those whose revenues and costs are denominated in the identical (non-U.S. Dollar) currency. Falling into this category are the Fund's Japanese holdings, with the exception of Makita, which has a meaningful export component to its revenue stream.

The third group of companies where there is a mismatch between the currencies in which the revenues and costs are denominated is the one where there is an impact upon the companies' operating profitability. This is particularly true for a number of companies in the resource and resource-related industries — where the revenues are traditionally U.S. Dollar-denominated, but the costs are denominated in the local currency. Examples of these would be the Canadian resource

companies (e.g., Fording Canadian Coal Trust, Noranda Inc. or Canfor Ltd.) or the Norwegian companies in the oil service industry (e.g., Smedvig ASA or Farstad Shipping ASA). The operating costs for such companies have risen due to the appreciation of their domestic currencies — potentially resulting in lower short-term operating profitability for these companies. In each of these cases, there is a longer-term phenomenon which could restore or even improve profitability levels beyond previous ones. For example, in the highly concentrated coal industry, the principal competitors of Fording Coal are either South African or Australian companies, whose domestic currencies have appreciated far more than the Canadian Dollar; consequently, rendering the South African and Australian mines non-economic at the prevailing U.S. Dollar price and necessitating sizable increases in U.S. Dollar coal prices to continue supplying, with these increases in coal prices actually improving Fording Coal's profitability over earlier levels.

The inferences afforded by the above are:

- the decline in the U.S. Dollar has not been an unmitigated blessing for the operating results of the non-US companies held in the Fund's portfolio, which are influenced by a number of variables of which the U.S. Dollar is only one; and
- there can be significant company-specific or industry-related factors, (including changes in other currency cross-rates) which could swamp the impact of the U.S. Dollar decline on the companies' profitability.

Everything else being equal, the decline of the U.S. Dollar was a positive contributor to the Fund's performance in 2003. During the calendar year ended December 31, 2003, the Fund returned 54.68%, (average annual return since 12/31/01 inception is 22.57%), including re-invested dividends. Of this return, the decline in the U.S. Dollar is estimated to have contributed approximately 9%. This relatively small "contribution" to performance by a declining U.S. Dollar



can be partly explained by noting that at calendar year end, 22.46% of the portfolio was in U.S. Dollar-denominated assets (including U.S. Dollar-denominated cash); 36.65% was in companies with U.S. Dollar-denominated assets or revenue streams; and 8.45% was in securities denominated in currencies such as the Hong Kong Dollar or the Singapore Dollar which appreciated 0.45% and 2.06%, respectively, against the U.S. Dollar.

*The Fund's performance may be influenced by a foreign country's political, social, and economic situation. Other risks include currency fluctuations, political uncertainty, less liquidity, lack of efficient trading markets, and different auditing and legal standards. These risks may result in more volatility for the Fund.*

#### **GEOGRAPHICAL DISTRIBUTION OF INVESTMENTS**

At the end of January 2004, the geographical distribution of securities held by the Fund was as follows:

	<u>%</u>
Canada	14.36
Norway	12.48
New Zealand	9.58
Singapore	6.48
Japan	6.05
France	5.17
Hong Kong	4.92
United Kingdom	3.81
Panama	2.67
Spain	1.20
Sweden	1.11
Argentina	0.96
Switzerland	<u>0.77</u>
Equities Total	<u>69.56</u>
Foreign Government Debt	9.12
Cash & Other	<u>21.32</u>
Total	<u>100.00%</u>

*Portfolio holdings are subject to change without notice.*

Note that the table above should be viewed as an *ex-post* listing of where our investments reside, period. As we have noted in prior letters, there is no attempt to allocate the portfolio assets among countries (or sectors) based upon an overarching macroeconomic view or index-related considerations.

I look forward to writing to you again when we publish our next quarterly report for the period ended April 30, 2004.

Sincerely,

Amit Wadhwaney  
Portfolio Manager,  
Third Avenue International Value Fund

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