



**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

January 31, 2007

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If you should have any questions, please call 1.800.443.1021, or visit our web site at: [www.thirdavenuefunds.com](http://www.thirdavenuefunds.com), for most recent month-end performance data 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 March 5, 2007.



## Third Avenue Value Fund



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

Dear Fellow Shareholders:

At January 31, 2007, the unaudited net asset value attributed to the 167,581,812 shares outstanding of the Third Avenue Value Fund (“TAVF”, “Third Avenue”, or the “Fund”) was \$61.00 per share. This compares with an audited net asset value at October 31, 2006 of \$56.95 per share and an unaudited net asset value at January 31, 2006 of \$53.46, both adjusted for a subsequent distribution to shareholders. At February 28, 2007, the unaudited net asset value was \$60.90 per share.

### QUARTERLY ACTIVITY\*

Principal activities during the quarter were as follows:

Number of Shares	New Positions Acquired	Number of Shares or Principal Amount	Positions Increased
11,907,000 shares	Hang Lung Group Ltd. Common Shares (“Hang Lung Group Common”)	1,323,000 shares	Cheung Kong Holdings Common Stock (“Cheung Kong Common”)
8,913,000 shares	Henderson Investment Limited Common Stock (“Henderson Investment Common” or “Investment Common”)	582,876 shares	Forest City Enterprises Class A Common Stock (“Forest City Common”)
4,930,000 shares	Mitsubishi Estate Co. Ltd. Common Stock (“Mitsubishi Common”)	45,000 shares	SFSB, Inc. Common Stock (“SFSB Common”)
		50,000,000 shares	Henderson Land Ltd. Common Stock (“Henderson Land Common”)
		29,465,000 shares	Wharf Holdings Ltd. Common Stock (“Wharf Common”)
		14,855,000 shares	Wheelock and Company Ltd. Common Stock (“Wheelock Common”)
		\$70,950,000	<b>Position Reduced</b> USG Industrial Revenue Bonds (“USG Munis”)
		2,150,000 shares	<b>Position Eliminated</b> Trammell Crow Common Stock (“Trammell Crow Common”)

\* Portfolio holdings are subject to change without notice. The following is a list of Third Avenue Value Fund’s 10 largest issuers, and the percentage of the total net assets each represented, as of January 31, 2007: Cheung Kong Holdings, 6.83%; Toyota Industries Corp., 6.58%; Henderson Land Development Co., Ltd., 5.84%; The St. Joe Company, 3.44%; Forest City Enterprises, 3.20%; Brookfield Asset Management, 3.14%; Posco (ADR), 2.89%; Nabors Industries, Ltd., 2.69%; Investor AB, 2.51%; and MBIA, Inc., 2.44%.



Because The Stock Exchange of Hong Kong Limited (“Hong Kong Stock Exchange”) seems to be relatively inefficient compared to U.S. equity markets, it is sometimes possible to acquire the equities of extremely well-financed companies at prices that represent substantial discounts from the discount prices at which the publicly-traded common stocks of shares owned in controlled subsidiaries are selling. Two of these “double discount” issues – Hang Lung Group Common and Henderson Investment Common – were acquired during the quarter.

Hang Lung Group Common was acquired by the Fund at a price that values 100% of the outstanding Hang Lung Group Common at US \$4,113,800,000. Around 97% of Hang Lung Group’s net assets are represented by its ownership of 50.6% of the outstanding common stock of Hang Lung Properties Limited. That 50.6% interest in Hang Lung Properties Common had a market value of US \$5,733,000,000 at January 31, 2007. Put simply, the Hang Lung Group Common was acquired at a 28% discount from the market price of Hang Lung Properties Common at January 31, without attributing any value to the small amount of other assets, net of all debt, owned by Hang Lung Group. The Hang Lung entities seem to be a very interesting growth play, as the companies over the next five years or so embark on developing 12 major multi-use projects in various secondary cities in the People’s Republic of China.

Henderson Land (“Land”) and Henderson Investment (“Investment”) are both actively developing real estate assets in the People’s Republic of China (“PRC”). In addition, the Henderson entities control a substantial amount of earnings assets – both real estate and non-real estate – in Hong Kong and the PRC. Investment Common, which is 67.94% owned by Henderson Land, seems to be an attractive pre-arbitrage opportunity in that there may be possibilities that Henderson Land, for the third time since 2002, will try to privatize Investment by making it a wholly owned subsidiary of Land.

In late 2005 to early 2006, Land tried to acquire the minority interest in Investment Common by exchanging 1 share of Land Common for 2.5 shares of Investment Common. Based on TAVF’s cost of US \$1.88 per share, 2.5 shares of Investment Common would have a market value of \$4.70 per share. Land Common closed on January 31, 2007 at \$5.78 per share. At the 2.5 to 1 ratio, Investment Common, based on the Fund’s cost, was priced at an 18.7% discount from the price of Land Common.

Hong Kong Stock Exchange rules state that in order to accomplish a takeover, no more than 10% of the non-control shareholders can vote against the transaction (“the 10% Threshold”). In January 2006, 14.3% of the non-control shareholders of Investment voted against a transaction in which 2.5 shares of Investment would have been exchanged for 1 share of Land. Completion of the transaction would have resulted in Investment becoming a wholly-owned subsidiary of Land.

The apparent reason for the 2006 defeat of the Land – Investment combination proposal (a similar proposal in 2000 also failed to meet the 10% Threshold) was that short sellers borrowed shares of Investment Common and these borrowed shares came with full voting rights that were exercised by the “shorts”. The “shorts” voted against the transaction.

It is possible that Hong Kong Stock Exchange Rules will be changed to eliminate, or modify, the 10% Threshold rule; or, that the right to vote common stocks will be restricted to beneficial owners. If so, Land might again try to privatize Investment, possibly at an exchange modestly more favorable for Investment stockholders than 2.5 for 1.

Meanwhile, both Land Common and Investment Common appear to be issues of very high quality companies, which the Fund seems to be acquiring at meaningful discounts from readily ascertainable Net Asset Values (“NAVs”). At the end of the January quarter,



TAVF owned 103,328,000 shares of Land Common with a market value of US \$596,870,000 and 8,913,000 shares of Investment Common with a market value of US \$16,759,000.

Mitsubishi Estate Co., Ltd. is a broadly based real estate empire. Its key assets include 31 office buildings in the Marunouchi District of downtown Tokyo, and two Class A office buildings in midtown Manhattan. In particular, the prospects for good-sized rent increases in the Marunouchi District in the years ahead seem favorable. It appears as if the Fund has acquired its position in Mitsubishi Common at a meaningful discount from NAV.

Three of the other issues added to during the quarter – Cheung Kong Common, Wheelock Common and Wharf Common – are Hong Kong-based entities combining both real estate assets and other businesses. Again, the issues seem to have been acquired at prices representing a meaningful discount from readily ascertainable NAVs. The Fund acquired a block of Forest City Common when it became available during the quarter.

Subsequent to the end of the quarter, Third Avenue eliminated its final position in USG by selling the USG Munis held. The reason for the sale was that while USG Munis pay interest which is tax exempt for federal income tax purposes, such tax advantages cannot be passed through to TAVF shareholders. During the quarter, Trammell Crow Common was acquired by CB Richard Ellis at a substantial premium over market (and the Fund's cost basis) in a takeover transaction. The takeover of American Power Conversion closed in February and Safelite Glass is scheduled to close this month or next, both at a substantial premium to the Fund's cost.

Management of TAVF is unable to find Henderson Investment, Hang Lung Group and Toyota Industries (Toyota Motor at a discount) type discounts in the common stocks of financially strong companies in the

U.S. Perhaps, that just means that Japanese and Hong Kong stock markets are a lot less efficient than U.S. stock markets. In any event, the TAVF common stock portfolio is now about 50% North American, 45% Far Eastern and 5% European. I am pleased with the Fund's portfolio, even recognizing that there may be less political stability in the Far East than in the U.S.; and there certainly is less securities law protection. All Hong Kong companies whose common stocks are held have substantial activities in Mainland China and/or Singapore. Growth for these businesses in the next three to five years ought to be much more dynamic than is the case for U.S.-based businesses.

The Fund is not hedging foreign currencies versus the U.S. Dollar. As such, the Far Eastern investments serve as a speculation on the prospects for a decline in the relative value of the U.S. Dollar. While I am not a currency expert, this seems a reasonable bet. U.S. governments are now a lot less credit-worthy than they had been in the 20th Century; trade deficits and government borrowing deficits seem likely to continue; and the U.S. as a whole seems to be spending much more of its income and wealth on non-productive activities, i.e., consumer goods and military expenditures including Iraq, than other economies. This does not, of itself, spell disaster. It may spell a weaker U.S. Dollar, though.

#### **FAIR PRICES IN TAKEOVERS**

"Fair" is defined as that price, and other terms, that would be arrived at in a transaction between willing buyers and willing sellers, both with knowledge of the relevant facts and neither under any compulsion to act.

The problem is that in many transactions for companies whose common stocks are publicly traded, especially Management Buy Outs ("MBOs"), the real world situation is one of willing buyer-coerced seller; where the buyer is also an agent who is supposed to represent the interests of the seller. The seller, whose interest is supposed to be represented by the buyer, is the public shareholder, or Outside Passive Minority Investor



(“OPMI”). The buyer, at least in part, is usually corporate management and/or control shareholders.

Coercion of OPMI occurs in two ways:

1. In a merger, an OPMI is bound by the requisite vote (anywhere from 50% of those voting to 2/3 of the outstanding shares) where the vote process is rigged in favor of management and/or others who control the proxy machinery and whose proxy solicitation is financed by the corporate treasury. It tends to be utterly impractical for OPMI to dissent from transactions and then perfect their rights of appraisal, in the event that relevant State Statutes even give OPMI rights to seek an appraisal.
2. In tender offers (or occasionally other market purchases), OPMI may face the threat of the company going “dark” in that the non-tendering (or non-selling) OPMI common stockholder will be left owning a security for which there is no public market. Once “dark”, there may be no real market for the common, and there could be a lack of many securities law protections for the OPMI.

Therefore, the purpose of fairness opinions, and fairness in general, ought to be to simulate a willing buyer–willing seller environment even though there tends to be in the real world, a willing buyer–coerced seller environment. Many appraisals by investment banks, and others, do not recognize this and market price often will be the principal determinant of the transaction price even where there is a willing buyer–coerced seller situation. Put otherwise, in rendering many fairness opinions, little or no consideration is given to the important question, “What is the company worth to the buyer?”. For example, in Delaware, the leading corporate state, there are no appraisal rights for OPMI in

transactions involving an exchange of common stocks where both issues of common stock are publicly traded. Also in Delaware courts, fair value excludes consideration of values arising out of the merger itself; in effect, do not consider or weigh what the deal might be worth to the buyer.

What makes an OPMI a willing seller? A premium over market.

What makes a control person a willing buyer? A price that represents a discount from what the buyer thinks the business is really worth to him, or his institution.

**“Given that OPMI are willing sellers and control persons are willing buyers, it is logical to assume that most of the time there will be a wide disparity between what a willing seller will assume is a fair price and what a willing buyer will assume is a fair price.”**

Thus, the Efficient Market Hypothesis notwithstanding, there frequently is a huge gap between the price that would satisfy a willing seller and the price that would satisfy a willing buyer. For example, TAVF owns many securities selling at 30%-50% discounts from readily ascertainable NAVs – Toyota Industries, Wheelock, Hang Lung Group, Henderson Investment and St. Joe. If these companies were to be acquired, I think TAVF ought to receive a very substantial premium over market.

Given that OPMI are willing sellers and control persons are willing buyers, it is logical to assume that most of the time there will be a wide disparity between what a willing seller will assume is a fair price and what a willing buyer will assume is a fair price. Each group tends to focus on different factors. The OPMI seller will tend to focus on those corporate variables most likely to affect near-term market prices, to wit, short-term outlooks for earnings, Earnings Before Interest, Taxes, Depreciation and Amortization (“EBITDA”), dividends and industry identification. Control buyers, on the other hand, tend to focus on how they can finance the transaction, the



quality and quantity of resources in a business and long-term outlooks.

Obviously, takeover prices tend to be a lot more favorable for OPIMs when the price arrived at is the result of competitive bids rather than only negotiations between parties. A sale of assets under Section 363 in a Chapter 11 case is always a bidding contest where open bidding more or less assures a fair price. The problem for most healthy companies is that most corporate endeavors have to be negotiated – transactions are complex. Contracts for negotiated transactions almost always contain “no shop”, “break up fee” and “topping fee” clauses. These discourage the conversion of negotiated transactions into bidding contests.

The argument is made by OPIM representatives, including the Plaintiff’s Bar and by Ben Stein, a *New York Times* columnist, that in an MBO-type transaction, the control persons should be obligated to pay the OPIMs that price which represents what the business is actually worth to the buyer.

I, on behalf of TAVF, demur. If control persons were unable to buy businesses at prices that represent discounts for them, then buying interest by control persons would dry up. TAVF runs a portfolio. Many of the securities contained in the portfolio are issues of companies which are takeover candidates. The last thing the Fund wants to do is to discourage major buying interests, which offer premiums over market prices, from trying to acquire the common stocks of TAVF portfolio companies. I think willing buyer-willing seller is a much more useful standard than requiring a buyer to pay full value.

As such, TAVF will give a wide berth and tend to vote in favor of most merger transactions which offer the Fund a substantial premium over market. However, where the price seems egregiously low compared to what we think the business is worth to the buyer, the Fund will oppose (and certainly vote against) such merger transactions, even where the prices offered reflect good sized premiums over market.

I will write to you again when the report for the period to end April 30, 2007 is published.

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, 2007, the end of the Fund's fiscal first quarter, the unaudited net asset value attributable to the 92,191,656 common shares outstanding of the Third Avenue Small-Cap Value Fund ("Small-Cap Value" or the "Fund") was \$26.17 per share, compared with the Fund's audited net asset value of \$25.12 per share at October 31, 2006, adjusted for a subsequent distribution, and an unaudited net asset value at January 31, 2006 of \$24.28 per share. At February 28, 2007, the unaudited net asset value was \$26.15 per share.

### QUARTERLY ACTIVITY\*

During the quarter, Small-Cap Value established five new positions, added to nine of its existing positions, eliminated six positions and reduced its holdings in five companies. At January 31, 2007, Small-Cap Value held positions in 83 common stocks, the top 10 positions of which accounted for approximately 23% of the Fund's net assets.

### Number of Shares

859,013 shares

354,931 shares

333,000 shares

616,260 shares

204,805 shares

112,500 shares

657,800 shares

470,244 shares

81,819 shares

100,000 shares

23,047 shares

31,800 shares

100,000 shares

2,621 shares

### New Positions Acquired

A.S.V., Inc. Common Stock  
 ("ASV Common")

Bristow Group, Inc. Common Stock  
 ("Bristow Common")

Orient Overseas International Ltd.,  
 Common Stock ("Orient Common")

Glatfelter Common Stock  
 ("Glatfelter Common")

Sanderson Farms, Inc. Common Stock  
 ("Sanderson Common")

### Increases in Existing Positions

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

Canfor Corp. Common Stock  
 ("Canfor Common")

Canfor Pulp Income Fund Units  
 ("Pulp Units")

Cimarex Energy Co., Common  
 Stock ("Cimarex Common")

Fording Canadian Coal Trust Units  
 ("Fording Units")

National Western Life Insurance Co.,  
 Class A Common Stock ("Western  
 Common")

St. Mary Land and Exploration Co.,  
 Common Stock ("St. Mary Common")

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

Vail Resorts, Inc., Common Stock  
 ("Vail Common")

\* Portfolio holdings are subject to change without notice. The following is a list of Third Avenue Small-Cap Value Fund's 10 largest issuers, and the percentage of the total net assets each represented, as of January 31, 2007: Pogo Producing Co., 3.01%; Brookfield Asset Management, 2.85%; Cimarex Energy Co., 2.80%; The St. Joe Company, 2.35%; Whiting Petroleum Co., 2.29%; Bandag, Inc., 2.28%; Comstock Resources, Inc., 2.09%; CommScope, Inc., 1.90%; Forest City Enterprises, 1.88%; and St. Mary Land and Exploration Co., 1.79%.



<b>Number of Shares</b>	<b>Positions Reduced</b>
120,930 shares	Avatar Holdings, Inc., Common Stock ("Avatar Common")
46,133 shares	Bandag Inc., Common Stock ("Bandag Common")
150,000 shares	Lexmark International, Inc., Class A Common Stock ("Lexmark Common")
50,000 shares	PAREXEL International Corp., Common Stock ("PAREXEL Common")
8,950 shares	Westwood Holdings Group, Common Stock ("Westwood Common")
	<b>Positions Eliminated</b>
730,400 shares	American Axle & Manufacturing Holdings, Inc. Common Stock ("Axle Common")
525,804 shares	Andrx Corp. Common Stock ("Andrx Common")
800,000 shares	Rosetta Resources, Inc., Common Stock ("Rosetta Common")
153,770 shares	Sears Holding Corp., Common Stock ("Sears Common")
211,300 shares	Trammell Crow Company Common Stock ("Crow Common")
502,200 shares	Willbros Group, Inc., Common Stock ("Willbros Common")

#### **QUARTERLY ACTIVITY**

Fund management established modest positions in five new names, made material additions to a few existing holdings, and eliminated or reduced its holdings in several issues. Comments on the most meaningful changes are provided below.

A.S.V., Inc. manufactures rubber-tracked suspension systems and undercarriages for vehicles used in construction, landscaping, rental, agricultural and related markets. The company's success appears to rest with its ability to out-innovate much larger competitors, and

such innovation will likely be key to its future prosperity. While near-term market conditions, particularly in construction related segments, appear to be deteriorating, the company seems to have terrific growth opportunities in the years ahead. Shares of ASV Common were purchased at a modest discount to Fund Management's estimate of the current private market value of the business (i.e., the value an acquirer might pay for the whole company). The current market value, however, seems to accord much more weight to the weakening current business conditions than to the company's attractive long-term growth prospects.

With a fleet of more than 341 aircraft and operating in more than 20 countries, Bristow Group is the largest contractor of helicopter services to the global oil and gas industry. A majority of Bristow's work comes from offshore production activity, a less volatile source of revenue than that derived from exploration activities. The company's longer-term stability is further enhanced by the presence of multi-year contracts on a meaningful portion of its work. Competitive forces in the next two years or so ought to be relatively tame as demand for helicopter services seems to be outpacing supply, a supply that is constrained as helicopter manufacturers are fully booked for a number of years. Bristow Common was purchased at a modest discount to Fund Management's conservative estimate of Net Asset Value ("NAV"), a value that is likely to grow at above-average rates should the company's ambitious fleet expansion capitalize on the attractive growth prospects offered by opportunities in the Middle East and Southeast Asia. A liquid market for helicopters exists outside the energy industry for medical, tourism, corporate, law enforcement and similar activities, underpinning the company's asset values, and lending significant downside protection to this investment.

Founded in 1864, Glatfelter produces specialty papers and owns a modest tract of timberlands that it is in the process of monetizing. Specialty papers include paper



used in the production of high quality hardbound books and envelopes as well as other highly technical customized products. Additionally, the company produces other specialized items such as tea bags, coffee filters and metallized products for bottle labels. The company boasts leading shares of its served markets – markets that have benefited from consolidation and rationalization of producer capacity – and low cost production based on its vertically integrated operations. The company’s cyclically depressed current earnings profile ought to improve as recent acquisitions start to contribute, and as debt reduction occurs over the next 12-24 months.

Shares of American Axle, a maker of driveline systems and components for the auto industry, were sold during the quarter as that company continued to suffer from the difficult conditions characterizing the domestic U.S. auto supply business, and as the company’s financial condition deteriorated to a point that was no longer acceptable to Fund Management. As mistakes go, this one was not so bad, as the Fund essentially broke even on its investment. Were the company capitalized more sensibly, it is plausible that we would have continued to hold the shares. Fund Management disposed of Rosetta Common with attractive returns, as a means of managing the Fund’s overall exposure to the oil and gas exploration and production industry (i.e., portfolio considerations). The Fund’s nearly four year holding in Sears Common, initiated as part of the reorganization of Kmart in early 2003, came to a close this quarter. The shares were sold pursuant to the terms of call options used as part of a costless collar program meant to protect the downside value of the Fund’s once sizable investment. The Fund’s investment was nothing short of spectacular, and we can only hope for a few more Kmart’s! Trammell Common was sold in December 2006 as part of its sale for cash to

CB Richard Ellis at a handsome multiple of the Fund’s cost basis.

#### **“SHOW ME THE MONEY!”**

The famous exchange<sup>1</sup> between sports agent Jerry Maguire and his faithful client Rod Tidwell in the 1996 movie “Jerry Maguire” seems to perfectly echo today’s investment landscape, as impatient shareholders agitate for more aggressive “returns of capital” – whether in the form of share buybacks or dividends. Indeed, with increasing frequency, it seems almost every conversation we have today with senior managers includes a larger discussion about corporate capital management. All of this has been taking place against a backdrop of record corporate share repurchases during the past few years<sup>2</sup>. With our innate bias towards conservatism and risk reduction at Third Avenue Management (“TAM”), we remain distinctly at odds with the conventional wisdom – or maybe we are part of a small minority—regarding corporate capital management. I recently outlined our thoughts describing TAM’s views on the topic for the CEO of Electro Scientific Industries, one of our portfolio companies, a modified version of which is reproduced in the bullet points below.

- Our preference is for management to use excess resources in the business to grow the per share value of the business. Only if management concludes that it is not likely to use that surplus capital in such a manner should it consider returning that capital to shareholders (i.e., the corporation comes first);
- A strong balance sheet is a competitive advantage, and is especially critical in cyclical industries like the ones in which the company participates;
- The company’s operations have - over the course of several business cycles - been self-funding, while the

<sup>1</sup> In the 1999 film “Austin Powers: The Spy Who Shagged Me,” Dr. Evil also tells the U.S. Government to “Show me the money.”

<sup>2</sup> Share buybacks more than tripled from 2003 to 2006, rising to an estimated \$437 billion in 2006. *The Wall Street Journal* “Buybacks Lag, Squeeze Looms for Earnings,” Scott Patterson, January 24, 2007.



company itself has carried large cash balances for many years, suggesting that an element of surplus capital exists;

- In the past few years, the company appears to have earned less than 4% on its portfolio of cash and securities, which comprise nearly one-half of the company's assets. While net interest income appears to be rising, it makes little economic sense to retain so much capital earning sub par returns;
- A committed share repurchase program requires management to make a judgment about the value of its share price since, presumably, management will not pay more than "fair value" for its shares or more than the company is worth. Share repurchase programs are most effective when management acts opportunistically in this regard;
- The benefits of a long-term share repurchase program likely accrue more to long-term holders of your shares, in the form of higher reported EPS and the avoidance of taxes at the shareholder level, in contrast to a large, one-time dividend whose benefits would accrue to even short-term oriented investors;
- A share repurchase program and an extraordinary dividend almost certainly carry different "signals" to the market (i.e., share repurchases suggest undervaluation of the shares, a dividend may connote limited growth opportunities);
- A share repurchase program can be implemented in various forms, including Open Market Purchases,

Fixed Price Tender Offers, Dutch Auction Tender Offers and Privately Negotiated Transactions;

- A share repurchase program, in contrast to a one-time dividend, may be modified in the case of a prolonged industry downturn, or should an extraordinary growth opportunity present itself, and the company needs capital;
- Were the company to need capital, it appears that it has the requisite and properly-oriented shareholder base

**"In short, at TAM, our preference is for management teams to retain capital in their business to the extent management perceives attractive growth opportunities. Only after a sober appraisal of the company's needs, competitive dynamics and growth opportunities should management consider returning capital to shareholders in the form of share repurchases and/or dividends."**

that might participate in a rights offering, a cost effective, quick and shareholder friendly approach to capital raising;

- Given the company's extensive international business, it's not clear how much of the company's cash resides outside the United States and how much would need to be repatriated in order to pay a large dividend. On the surface, it does not seem to make sense to pay U.S. taxes on repatriated funds simply to return capital to shareholders;
- It is likely that a large, one-time extraordinary dividend would correlate with a smaller market capitalization. Less clear, perhaps, is the effect of a long-term share repurchase program on the company's market capitalization;
- A share repurchase program, if large enough, may adversely affect share liquidity, in contrast to a dividend, which would have no such effect on the stock, *per se*.



In short, at TAM, our preference is for management teams to retain capital in their business to the extent management perceives attractive growth opportunities. Only after a sober appraisal of the company's needs, competitive dynamics and growth opportunities should management consider returning capital to shareholders in the form of share repurchases and/or dividends. The current flavor du jour – whether it originates with private or public capital – seems diametrically opposed to TAM's viewpoint, and even encourages the employment of heavy leverage as a means of “optimizing” or maximizing Returns on Equity (“ROE”). In contrast, at TAM, we are happy to sacrifice ROE for a higher degree of safety in our portfolio holdings.

I look forward to writing you again when we publish our Second Quarter Report dated April 30, 2007.

Sincerely,

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



## Third Avenue Real Estate Value Fund



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

Dear Fellow Shareholders:

At January 31, 2007, the end of the first fiscal quarter of 2007, the unaudited net asset value attributable to the 94,930,012 shares outstanding of the Third Avenue Real Estate Value Fund (the "Fund") was \$35.61 per share. This compares with an audited net asset value of \$32.82 per share at October 31, 2006, and an unaudited net asset value of \$27.06 per share at January 31, 2006, both adjusted for subsequent distributions to shareholders. At February 28, 2007, the unaudited net asset value was \$35.75 per share.

### QUARTERLY ACTIVITY\*

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

Number of Shares	New Positions Acquired
3,212,000 shares	Henderson Investment Ltd. Common Stock ("Henderson Investment Common")
379,000 shares	Mitsubishi Estate Co. Ltd. Common Stock ("Mitsubishi Common")

### Number of Shares

143,010 shares
3,531,000 shares
36,598 shares
8,652,770 shares
4,538,000 shares
11,551,000 shares

### Number of Shares

5,402,000 shares
2,995,000 shares

### Increases in Existing Positions

Acadia Realty Trust Common Stock ("Acadia Common")
Henderson Land Development Co. Ltd. Common Stock ("Henderson Land Common")
Thomas Properties Group, Inc. Common Stock ("Thomas Common")
FNC Realty Corp. Common Stock ("FNC Common")
Wharf Holdings Ltd. Common Stock ("Wharf Common")
Wheelock and Company Ltd. Common Stock ("Wheelock Common")

### Decreases in Existing Positions

Midland Holdings Ltd. Common Stock ("Midland Common")
Unite Group plc Common Stock ("Unite Common")

\* Portfolio holdings are subject to change without notice. The following is a list of Third Avenue Real Estate Value Fund's 10 largest issuers, and the percentage of the total net assets each represented, as of January 31, 2007: Forest City Enterprises, Inc., 12.87%; The St. Joe Company, 8.68%; ProLogis, 8.35%; Brookfield Asset Management, 7.96%; Vornado Realty Trust, 4.52%; British Land Company, 3.69%; Henderson Land Development Co., Ltd., 3.28%; Brookfield Properties Corp., 2.95%; PS Business Parks, Inc., 2.56%; and Wharf Holdings Ltd., 2.44%.



**Number of Shares,  
Principal Amounts  
or Contracts**

	<b>Positions Eliminated</b>
\$6,491,201	FNC Realty Corp. 7% Notes due 7/27/2008 ("FNC Notes")
\$4,000,000	Pathmark Stores, Inc. 8.75% Notes due 2/1/2012 ("Pathmark Notes")
239,783 shares	Brookfield Homes Corp. Common Stock ("Brookfield Homes Common")
1,026,100 shares	RAIT Financial Trust Common Stock ("RAIT Common")
2,443 contracts	Sears Holdings Corp. January 2007 \$155 Call Options ("Sears Calls")
2,443 contracts	Sears Holdings Corp. January 2007 \$120 Put Options ("Sears Puts")
272,951 shares	Sears Holdings Corp. Common Stock ("Sears Common")
1,579,950 shares	Trammell Crow Company Common Stock ("Trammell Crow Common")

**DISCUSSION OF QUARTERLY ACTIVITY**

During the quarter, the Fund initiated new positions in Henderson Investment Common and Mitsubishi Common. Henderson Investment is a 68% owned, publicly-traded subsidiary of Henderson Land Development Co. (a large holding in the Fund). Henderson Investment is a holding company with a significant Hong Kong commercial property portfolio plus strategic interests in three publicly-traded companies, each with extremely strong financial positions: Hong Kong & China Gas Co. (38.5%), Hong Kong Ferry Holdings (31.3%) and Miramar Hotel & Investment Co. (44.2%). Henderson Land has made two attempts in the last four years to privatize Henderson Investment. Both privatization attempts failed. In January 2006, Henderson Land offered one share of Henderson Land Common for every 2.5 shares of Henderson Investment Common. Shareholders rejected this transaction by a very small margin. (In Hong Kong, a privatization requires that 90% of minority shareholders vote in favor of the transaction.)

Henderson Investment Common trades at a substantial discount to Fund management's estimate of net asset value. Additionally, Fund management believes that Henderson Land is likely to make another attempt to privatize Henderson Investment. If Henderson Land was to make an offer similar to its last offer, Fund management would likely be willing to convert its Henderson Investment shares into additional Henderson Land shares.

Mitsubishi Estate Co. is the world's largest publicly-traded real estate company. Mitsubishi's property portfolio consists primarily of office buildings totaling approximately 35 million square feet, with 85% located in Tokyo, Japan. Mitsubishi has a very strong balance sheet and seems to be run by a competent management team with a solid track record of creating shareholder value. Mitsubishi Common trades at a discount to Fund management's estimate of net asset value. Office market fundamentals in Mitsubishi's core markets (primarily Central Tokyo) are very strong as evidenced by sub-3% vacancy rates, rising market rents and significant supply constraints. Prior to 2000, property leases in Japan were for two-year terms, with the tenants given the right to remain in possession indefinitely thereafter with minimal (2.5% annual) rental increases. In 2000, Japan legalized Western-style fixed-term leases, which typically have five to ten-year lease terms with renewals at market rents (or no renewal options). As a result of the new law, Mitsubishi has begun converting its leases to fixed-term leases in conjunction with redeveloping certain properties. Mitsubishi's average in-place rents are approximately 50% of asking rents for new properties. Currently, only about 15% of Mitsubishi's portfolio is leased under fixed-term leases. The balance will be converted over time, as the company redevelops properties and renegotiates with tenants.

The Fund eliminated its holdings in several securities as the result of price appreciation. Pathmark Notes were originally acquired in October 2004 at 91.25% of face amount, with the view that the price did not properly reflect the credit quality. Pathmark Notes were sold in



December 2006 at 100.25% of face amount, resulting in an internal rate of return of 13.8%. Brookfield Homes Common was acquired in January 2003 as the result of a spin-off from Brookfield Properties. The spin-off value per share was approximately \$10.00. The Fund sold Brookfield Homes Common during the quarter, resulting in an internal rate of return of 57.7%. RAIT Common was acquired at various times from December 2001 through September 2006. The Fund sold its holdings in RAIT Common in January 2007, resulting in an internal rate of return of 28.4%.

Trammell Crow was acquired by CB Richard Ellis in an all-cash merger in December 2006. The Fund acquired Trammell Crow Common from June 2001 through May 2004. The merger proceeds resulted in an internal rate of return of 39.6%.

Sears Common was originally acquired for \$10 per share in May 2003 when the Fund (along with other Third Avenue funds) participated in funding Kmart's plan of reorganization to exit Chapter 11 bankruptcy. The Fund sold roughly half of its position in April 2006 for about \$140 per share. In January 2007, approximately 90% of the remaining shares were called at \$155 pursuant to call options sold in March 2005. The balance of the shares was also sold in January 2007 for about \$178 per share. Overall, the Fund's investment in Sears Common resulted in an internal rate of return of 128.1%.

The Fund continued to add to its holdings of Henderson Land Common, Wheelock Common and Wharf Common at prices representing significant discounts to Fund management's estimates of net asset value. The Fund opportunistically reduced its holdings in Midland

Common and Unite Common, as market prices reached levels that exceeded Fund management's estimates of reasonable valuations.

#### **CAPITALIZING ON GLOBAL OPPORTUNITIES**

Over the past three years, the Fund has increased its investments in the common stocks of well-financed, overseas real estate companies. At January 31, 2004, the Fund had approximately 96% of its invested assets in U.S. and Canadian companies. The Fund's initial overseas investments were focused in the United Kingdom, where Fund management identified several extremely well-financed real estate companies trading at substantial discounts to readily ascertainable net asset value. The *raison d'être* for expanding the Fund's investments beyond the U.S. and Canada was not to be different (most long-term Fund shareholders accept the fact that the Fund has always been somewhat idiosyncratic anyway). It was Fund management's view that most (though clearly not all) U.S. REIT common stocks were trading at premiums to NAV and, therefore, too expensive to be included in the Fund, especially in light of the apparent bargains overseas. Indeed, for the three-year period ending January 31, 2007, the FTSE 350 Real Estate Index<sup>1</sup> generated a total return of 146.9%, compared to the 108.7% return by the MSCI US REIT Index<sup>2</sup>. The Fund's UK investments were followed by several investments in Hong Kong-based companies, most of which give the Fund meaningful exposure to the dynamic real estate markets in Mainland China, Hong Kong and Singapore. For the two-year period ending January 31, 2007, the Hang Seng Composite Property & Construction Index<sup>3</sup> generated a

<sup>1</sup> The FTSE 350 Real Estate Index is a capitalization-weighted index of all stocks designed to measure the performance of the real estate sector of the FTSE 350 Index. The FTSE 350 Index includes the 350 most highly capitalized companies traded on the London Stock Exchange.

<sup>2</sup> The MSCI US REIT Index is a total-return index comprising the most actively traded U.S. real estate investment trusts.

<sup>3</sup> The Hang Seng Composite Property & Construction Index is a market-cap index and sub-index of the Hang Seng Composite Index. It measures the stock performance in the property and construction business. The Hang Seng Composite Index comprises the top 200 companies listed on the Main Board of the Hong Kong Stock Exchange.



total return of 66.4%, compared to the 81.3% return generated by the MSCI US REIT Index. At January 31, 2007, the Fund had about 73% of its invested assets in U.S. and Canadian companies, 14% in UK companies and 13% in Hong Kong companies. The following table illustrates the changes in the Fund's geographic diversification over the last three years.

**Percentage of Invested Assets\* by Country**

	January 2004	January 2005	January 2006	January 2007
United States	86.2%	78.9%	65.2%	58.9%
Canada	9.9%	12.9%	16.1%	13.8%
United Kingdom	3.0%	7.0%	11.3%	14.0%
Hong Kong	0.9%	1.2%	6.3%	12.9%
Australia	0.0%	0.0%	1.1%	0.0%
Japan	0.0%	0.0%	0.0%	0.4%
	100.0%	100.0%	100.0%	100.0%

The most notable recent change in the above table is the increase in the Fund's exposure to Hong Kong-based real estate companies. These consist primarily of investments in the common stocks of Hongkong Land, Hang Lung Properties, Henderson Land Development, Wheelock and Company and Wharf Holdings.

Hongkong Land owns a high-quality portfolio of commercial real estate – primarily Class-A office buildings. 90% of the company's properties are located in Central Hong Kong. Hongkong Land was formed in 1880, and continues to be a dominant owner of office properties in Central Hong Kong. Due to its early entry into the market, Hongkong Land is one of only two companies that own properties on land leased for 999 years – essentially freehold ownership. The majority of land in Hong Kong is owned by the government and leased for terms of 49 to 99 years. The long-term leases

enable Hongkong Land to change uses on the land without additional compensation to the government.

Hang Lung Properties is one of Hong Kong's largest property development and investment companies with a diversified portfolio of properties in Hong Kong and Mainland China. In Hong Kong, the company owns over 6 million square feet of retail and office properties and over 4,000 residential (for sale) apartments. In Mainland China (Shanghai), the company owns 1.6 million square feet of retail and 840,000 square feet of office properties. The company has an excellent track record of timing Hong Kong's historical market volatility (buying land when at the bottom of the cycle), but takes a long-term approach to creating value (as evidenced by its entry into Mainland China in the early 1990's). Hang Lung expects to have nearly 50% of its assets in Mainland China within the next four years (currently under 20%).

Henderson Land is one of the largest property developers in Hong Kong, owning office buildings, retail centers, residential developments, land holdings and hotels in Hong Kong, Kowloon and the New Territories. The company also has strategic investments in other listed companies through its 68% ownership in Henderson Investment (see discussion above). In August 2005, Henderson Land successfully privatized Henderson China Holdings, its 65%-owned subsidiary that owns approximately HK\$10 billion in commercial properties and properties under development in Mainland China.

Wheelock and Company is a Hong Kong-based holding company. Its primary assets consist of investments in two publicly-traded real estate companies: a 74% stake in Wheelock Properties (Hong Kong) and a 43% stake in Wharf Holdings Ltd. (Hong Kong). Wheelock Properties owns interests in several office, retail, industrial and residential development projects in Hong Kong and Singapore in addition to its 75% stake in Wheelock Properties (Singapore), which owns several

\* Invested assets excludes cash and cash equivalents.



high-quality residential development sites in Singapore. Wharf Holdings owns a high-quality portfolio of office buildings and retail centers in Hong Kong, as well as several properties (both completed and under development) in Mainland China. The combined group of companies owns some of the highest quality real estate in Hong Kong in prime locations. Over 90% of the group's revenue and profits are currently generated in Hong Kong. However, planned capital expenditures for property development over the next few years will be concentrated on Mainland China projects.

With the exception of Hongkong Land, the Fund's Hong Kong-based investments are actively increasing their development activities in Mainland China. These development activities include commercial projects (shopping malls, office buildings, etc.) that will be held as long-term investments, as well as residential for sale projects. Fund

management has always had a predilection for companies that develop and hold investment properties, as opposed to those that develop properties for sale (whether residential or commercial), the exception being companies like St. Joe and Tejon Ranch that own large tracts of legacy land at a very low cost basis that will ultimately be developed and sold to realize its value. The economics of developing and holding high-quality commercial projects have been highlighted many times in the Fund's previous quarterly letters to shareholders. The typical residential developer must constantly replenish its land inventory or risk going out of business. Replenishing inventory means either routinely buying enough land at market prices to maintain a consistent production cycle (buy, build and sell), or buying excess land (i.e., land bank) to provide enough inventory for several years of production. Each has its drawbacks and

advantages depending upon the market environment for new housing. Investment property developers tend to create recurring, predictable and growing cash flows that result in increased property values and, in turn, higher net asset value per share.

Mainland China today can be described as a land of opportunity – with expected 7% to 9% annual growth over the next ten years. China's urban centers are experiencing unprecedented growth and its population is becoming wealthier and more educated. Real estate prices, in the long run, tend to follow economic development. The Hong Kong companies in which the Fund owns common stocks seem to be in the right place at the right time. Hang Lung Properties has committed to substantially increasing its commercial property developments in Mainland China, which should translate into long-term growth in net asset value. Henderson Land

and Wharf Holdings are also focused on commercial property developments on the mainland in addition to their residential developments.

There are no guarantees that real estate investments in Mainland China are going to be profitable, though the prospects for huge returns seem very exciting. Each company's success will ultimately depend upon not only China's continued growth and prosperity, but the ability of its management to properly understand and navigate the local system. The Chinese government recently announced that it would strictly implement the Land Appreciation Tax ("LAT") that was introduced in 1993, but was never consistently enforced. The LAT, which was aimed at avoiding speculative demand and encouraging end-user demand, is levied at a progressive rate ranging from 30% to 60% on the appreciation of

**“The Hong Kong companies in which the Fund owns common stocks seem to be in the right place at the right time.”**



land value. If fully implemented, the gross margin of individual projects would be capped at 40%. There is general consensus among real estate developers and analysts that it may take several years before the LAT could be fully implemented. Since the LAT collected at the district level must be paid back to the Central Government, the district governments have little or no incentive to collect the tax because of its impact on developer profits and, consequently, their sentiment to invest in property developments in the district.

While the LAT will primarily impact residential projects, it is an example of the less-than-orderly nature of real estate development in Mainland China. Fund management believes that the safest way to invest in China is through the common stocks of extremely well financed, Hong Kong-based real estate companies with proven track records of success. The Fund's investments in the common stocks mentioned above all seem to have these qualities, and they can be acquired at discounts to reasonable estimates of NAV. Fund management is excited about the long-term prospects of substantial real estate growth and profits in Asia, but tempers that excitement by paying close attention to the Fund's overall exposure to these developing markets.

I look forward to writing to you again when we publish our Semi-Annual Report for the period ending April 30, 2007.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael H. Winer", written in a cursive style.

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, 2007, the unaudited net asset value attributable to the 106,379,002 shares outstanding of the Third Avenue International Value Fund (the "Fund") was \$21.95 per share, compared with the Fund's audited net asset value at October 31, 2006 of \$20.95 per share, and an unaudited net asset value of \$19.28 per share at January 31, 2006, both adjusted for a subsequent distribution to shareholders. At February 28, 2007, the unaudited net asset value was \$21.89 per share.

### QUARTERLY ACTIVITY:

In the most recent quarter of operations, the Fund established new positions in the common stocks of four companies, added to positions in the common stocks of 13 companies, eliminated holdings in five securities and reduced holdings in four securities.

#### Number of Shares

56,981,000 shares

8,600 shares

#### New Positions Acquired

Fuhwa Financial Holding Co., Ltd.  
 Common Stock ("Fuhwa Common")

Norton Holdings, Ltd. (Bermuda)  
 Common Stock ("Norton Common")

#### Number of Shares or Units

569,000 shares

2,806,000 shares

1,473,483 shares

1,342,841 shares

1,420,700 shares

733,184 units

2,619,000 shares

752,260 shares

6,125,000 shares

#### New Positions Acquired

Orient Overseas International Ltd.  
 Common Stock ("OOIL Common")

Straits Trading Co., Ltd. Common  
 Stock ("Straits Common")

#### Increases in Existing Positions

ABB Grain Ltd. Common Stock ("ABB  
 Common")

Antarchile SA Common Stock ("Antar  
 Common")

Bergesen Worldwide Gas Common  
 Stock ("Bergesen Common")

Canfor Pulp Income Fund Trust Units  
 ("Canfor Pulp Units")

Capital Securities Corp. Common  
 Stock ("Capital Securities Common")

Compagnie Nationale a Portefeuille  
 Common Stock ("CNP Common")

Gigabyte Technology Co. Common  
 Stock ("Gigabyte Common")

\* Portfolio holdings are subject to change without notice. The following is a list of Third Avenue International Value Fund's 10 largest issuers, and the percentage of the total net assets each represented, as of January 31, 2007: Catalyst Paper Corp., 5.52%; BIL International, Ltd., 4.77%; Telecom Corp. of New Zealand, Ltd., 4.00%; Saskatchewan Wheat Pool, 3.29%; Nippon Sheet Glass Co., Ltd., 2.87%; Hutchison Whampoa, 2.83%; Guocco Group, Ltd., 2.78%; Brit Insurance Holdings PLC, 2.62%; CNP-Cie Natale A Portefeuille, 2.45%; and WBL Corp., Ltd., 2.41%.



<b>Number of Shares or Units</b>	<b>Increases in Existing Positions</b>
69,000 shares	Imerys SA Common Stock ("Imerys Common")
347,273 shares	Netia SA Common Stock ("Netia Common")
1,570,000 shares	President Securities Corp. Common Stock ("President Securities Common")
505,303 shares	Telecom Corp. of New Zealand Common Stock ("Telecom Corp. Common")
260,000,000 shares	WBL Corp. Ltd. Common Stock ("WBL Common")
50,000 units	Westshore Terminal Income Fund Units ("Westshore Units")
<b>Positions Eliminated</b>	
250,000 shares	Banco Latinoamericano de Exportaciones, SA Common Stock ("Bladex Common")
8,894,950 shares	Chuan Hup Holdings Ltd. Common Stock ("Chuan Hup Common")
4,291 shares	E-L Financial Corp Ltd. Common Stock ("E-L Financial Common")
49,301 shares	JZ Equity Partners plc Common Stock ("JZE Common")
351,700 shares	Oslo Bors Holdings ASA Common Stock ("Oslo Bors Common")
<b>Positions Reduced</b>	
200,220 shares	Aker Kvaerner ASA Common Stock ("Aker Kvaerner Common")
69,616 shares	Cie Generale de Geophysique SA Common Stock ("Geophysique Common")
670,000 shares	Subsea 7 Inc. Common Stock ("Subsea Common")
2,497,400 shares	Zinifex Ltd. Common Stock ("Zinifex Common")

## REVIEW OF QUARTERLY ACTIVITY

### Purchases

One of the positions established this quarter, Fuhwa Financial Holding Co. ("Fuhwa"), is a Taiwanese bank which also has a sizable securities brokerage business. It is in the process of merging with Yuanta Core Pacific Securities Co. ("Yuanta"), Taiwan's largest securities brokerage firm. The combined company will have a bigger market share in a number of the brokerage activities, with the attendant economies of scale. This would be especially true in margin lending. Other potential benefits of the merger could include easier expansion abroad, synergies between the banking and securities businesses (especially in the area of wealth management), and the standard operating cost synergies from closing redundant branches, consolidating back offices and corporate overhead. Yuanta is extremely overcapitalized (2.5 times the regulatory requirement) and the combined company will have a significantly stronger balance sheet than Fuhwa had on its own. Yuanta also has a history of successfully executing a number of mergers.

The Fund invested in the common shares of Norton Holdings, a newly created Bermuda-based reinsurer. Like an existing fund holding, Blue Ocean Reinsurance Holdings, Norton writes retrocessional policies (i.e., reinsurance coverage for reinsurers). These policies are characterized by low loss frequency (i.e., in most years, no losses occur) but a high loss severity (i.e., if a loss occurs, it represents a large multiple of the premium received and could, *in extremis*, wipe out the capital of the company that wrote the policy).

The unprecedented hurricane season of 2005 caused large dislocations in this industry when a number of providers of retrocessional coverage either lost substantial portions of their capital or decided to scale back their exposure in (or in some cases, to completely withdraw from) the industry. At the same time, the customers (i.e., reinsurers) increased their demand for retrocessional



coverage, as the experience of 2005 made them (and the rating agencies) reevaluate their risk exposure models. A gap thus opened between demand for capital and supply of capital in the retrocessional business that led to skyrocketing prices for coverage.

The unusually mild hurricane season of 2006, together with a small but increasing number of newly created retrocessional companies, has moderated the price increases somewhat. Despite that, pricing remains more than adequate, in many cases, at multiples of the pricing that prevailed prior to 2005. In this environment, Norton Holdings (as well as Blue Ocean Reinsurance) should be able to deploy its capital on attractive terms.

Orient Overseas International Ltd. (“OOIL”), a Hong Kong-based company, is one of the world’s larger container shipping companies. At the time of our initial purchase of OOIL Common, the company’s assets also included a group of highly attractive North American container terminals, an office building in downtown Manhattan and a portfolio of real estate in Beijing and Shanghai. Having previously announced an investigation into the possible sale of container terminals, OOIL proceeded with its plan to opportunistically sell assets into a buoyant market. Shortly after our initial purchase, OOIL announced the sale of its terminals division to Ontario Teachers’ Pension Plan, for a valuation which materially exceeded our estimate of its value.

The Straits Trading Company Ltd. (“Straits”), part of Singapore’s OCBC Group, is a Singapore-listed holding company. During the last two years, Straits sold a number of long-term investments including: a significant commercial property portfolio in Singapore; a large stake in a Malaysian bank; as well as, a commercial building in Perth, Australia. During the same period, Straits increased its investment in the world’s largest producer of tin and began buying back its own shares. At the time of our investment, Straits’ assets, in decreasing order of importance, were: cash and liquid securities; real estate including an office tower in Singapore’s Central Business

District; two hotels; and a controlling stake in the world’s largest producer of tin. Further, the company is virtually devoid of debt and Straits Common was trading at a meaningful discount to a conservative estimate of its net asset value.

#### **SALES**

One of the sales this quarter was that of Bladex Common. We had purchased Bladex Common during a period of difficulty that the company experienced in 2003, participating in the recapitalization of the company’s balance sheet through a rights issue. The company has since prospered by returning to the business of providing intra-Latin American trade finance, which was its particular area of competence. Due to slow growth in business volumes (notwithstanding a relatively low level of loan losses), management sought shareholder approval to diversify its business. Shareholders rejected the proposal. Unfortunately, this was the source of the company’s previous bout of difficulties, when—for the same reasons as at the present time—it diversified into corporate lending, in particular in Argentina and to telecommunication companies, shortly before severe downturns hit both areas. These actions, coupled with a dividend increase and a return of capital, suggests a curious lack of risk-aversion on the part of the management, given their difficulties less than five years ago. Accordingly, we chose to sell our holding in these shares.

#### **LONG-TERM INVESTING – SOME OBSERVATIONS**

The Fund follows a long-term investment approach. Sometimes it is motivated by the quest for companies meeting our valuation criteria. Often, companies that are cheap enough (and safe, of course) tend to be facing a variety of difficulties or factors depressing profitability. These might be either at the level of the individual company or may be industry-wide factors and often can only be resolved with the passage of time. An example of this might be a company operating in an industry which is experiencing overcapacity, price competition and depressed profitability. The resolution of such a situation



might take the form of the closure of capacity at one or more players, and/or possibly a consolidation among the players. This form of a resolution of the company/industry-wide depressed profitability would take some time to unfold.

While this is merely one scenario which would suggest a long-term investment horizon, there are other attractions to this *modus operandi*. The Fund endeavors to purchase companies at significant discounts to their estimated Net Asset Values (“NAV’s”). These discounts tend to wax and wane over time, but it is reasonable to assume that a company with reasonably competent management should be able to increase the NAV over time. To the extent that a security is purchased at a meaningful discount to the NAV of the underlying business and there is subsequent growth of the NAV, this would increase the likelihood of being able to earn attractive compound rates of return over longer periods of time.

Investing with extended time horizons has a number of implications:

- The Fund does not seek out investments with “catalysts” or “value crystallizing events” visible on the horizon, particularly since expectations of such events tend to be reflected in the valuation of the security. Instead, using valuation (and safety) as the principal basis of security selection, and allowing for an open-endedness of the contemplated investment period, has resulted in a broadening of the potential universe of investments.
- The other face of a portfolio of securities held for the long term is low turnover. Low turnover portfolios tend

to be, by their very nature, tax-efficient; in that taxable transactions tend to be fewer than in a portfolio characterized by rapid turnover, and gains on sales, when effected, would tend to attract favorable longer-term capital gains tax rates.

**“To the extent that a security is purchased at a meaningful discount to the NAV of the underlying business and there is subsequent growth of the NAV, this would increase the likelihood of being able to earn attractive compound rates of return over longer periods of time.”**

- In light of the above, a portfolio of semi-permanent holdings clearly has some attraction. However, assembling a collection of potential candidates would necessarily entail greater selectivity than would a portfolio where securities have shorter residence times. This would result in “raising the bar” for acceptability of a security and is likely to result in a portfolio which is somewhat more concentrated in its securities holdings.

- A low-turnover, concentrated portfolio constructed solely upon bottom-up considerations (based upon the attractiveness of individual securities) without regard to geographic or industry representation in comparable benchmark indices will, predictably, perform very differently from broad indices and benchmarks. The performance of a concentrated portfolio managed in this fashion is apt to show considerably greater variance from an index than a similarly constructed but a more diversified portfolio. Given that the Fund’s investment style veers toward more concentration, rather than less, such variation from index performance should be expected.
- Turnover, when it occurs in such a portfolio, is likely to be lumpy in nature, given the varied and unpredictable causes giving rise to the turnover — be it valuation, a security no longer meeting the original investment criteria (e.g., a potential permanent impairment of capital) or a resource conversion (e.g., a merger, takeover or return of capital). The Fund’s portfolio



turnover in the last five fiscal years, ended October 31, 2006, 2005, 2004, 2003 and 2002, has been 34%, 3%, 11%, 4% and 0%, respectively. The unusually large turnover in the most recent period reflects resource conversions among a number of the Fund's larger holdings, combined with securities sales reflecting valuation consideration. According to Strategic Insight Simfund, the comparable turnover rates for the Fund's peer group of mutual funds<sup>1</sup>, for their respective 2006, 2005, 2004, 2003 and 2002 fiscal years were: 86%, 76%, 75%, 90%, and 93%, respectively.

What this means in terms of actual time horizons at the time an investment is made is an unknown, except in situations where there is a determinate outcome within a determinate period of time (e.g., in merger arbitrage). The latter was the cases of GEAC Computer Corp. Common and Overseas Union Enterprises Common, where we added to our holdings after the tender offer for all the shares of the respective companies was announced. In most other investments, there is an open-endedness to the time horizon of the investment, and everything else being equal, longer being preferred.

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

At the end of January 2007, the geographical distribution of equity securities held by the Fund was as follows:

	%
Canada	14.11
Japan	12.51
Singapore	8.55
Hong Kong	7.81
New Zealand	6.77
Norway	6.29
Taiwan	3.73
Australia	3.10
United Kingdom	2.62
Belgium	2.45
France	2.15
Poland	2.02
Denmark	1.63
Chile	1.47
Bermuda	1.01
Netherlands	0.85
Thailand	0.57
Switzerland	0.33
Argentina	0.18
Sweden	0.18
Securities-total	78.33
Foreign Government Debt	2.29
Cash & Other	19.38
Total	<u>100.00%</u>

*Portfolio holdings are subject to change without notice.*

<sup>1</sup> Peer group consists of the U.S.-registered mutual funds classified as "International Equity" by Strategic Insight Simfund.



Note that the table on the preceding page 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 Semi-Annual Report for the period ended April 30, 2007.

Sincerely,

Amit Wadhwaney  
Portfolio Manager  
Third Avenue International Value Fund

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