



# VALUE IN US SMALL-CAP INVESTING

## WHY KNOWING WHAT YOU OWN AND BALANCE SHEET MATTERS.

- 1** Small-Cap long-term outperformance despite recent past
- 2** Considerable imbedded risk built up
- 3** Why active management is critical

### SMALL-CAP LONG-TERM OUTPERFORMANCE DESPITE RECENT PAST

The small-cap factor was an important breakthrough used to help explain a component of market fluctuations in the Nobel Prize winning research of Eugene Fama. Citing Ken French’s data, it has been quantified that over the past 59 years small-cap stocks have returned, on average (Neutral), **300+ basis points (bps)**<sup>1</sup> per year more than large-cap stocks.

Despite the historic outperformance, large cap stocks (proxy: S&P 500) have outperformed small caps (proxy: Russell 2000) by historical amounts over the past ten years as depicted in the chart to the right.

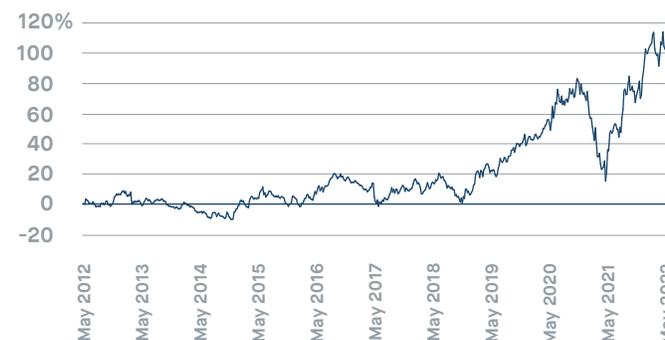
The massive liquidity injected into the economy over the past few years created dislocations, with disproportionate benefits to a select group of large cap companies. The easy monetary/fiscal policy also benefitted companies with weak financial positions.

### UNITED STATES 1963-2022

	Value	Neutral	Growth
Large	12.1%	10.3%	10.2%
Small	15.2%	13.6%	8.4%

Source: Ken French Data Library

### S&P TOTAL RETURN MINUS RUSSELL 2000 TOTAL RETURN LAST TEN YEARS

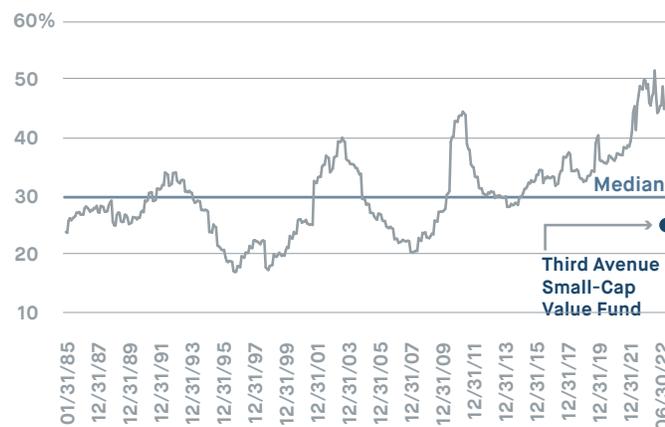


Source: Factset

### CONSIDERABLE IMBEDDED RISK BUILT UP

Looking across the broader small-cap universe, we have witnessed the deteriorating quality of small-cap indices. Leverage levels and the percentage of non-earners in the Russell 2000 Index<sup>2</sup> are near all-time highs. Specifically, **42.3% of the companies** counted in the Russell 2000 as of June 30, 2022 are non-earners on a trailing twelve-month basis, compared to the historical average of 29.6%.

### LAST TWELVE MONTHS NON-EARNERS % BY COUNT IN RUSSELL 2000



As of 6/30/22. Source: Jefferies, S&P Capital IQ

Similarly, debt levels across small caps are near all-time highs as shown in the Net Debt to Capital chart to the right. It has been painful watching reckless companies benefitting from recent market conditions, but not tempting. By taking a creditors perspective and balance sheet approach to security selection, **our portfolio has a net debt to capital less than half of the index.** With tighter financial conditions in 2022 and beyond, patience, discipline and risk management should be rewarded. Additionally, we are aligned with management teams that not only avoid excessive risks, but are also prepared to take advantage of dislocations when they occur.

**NET DEBT TO CAPITAL IN SMALL-CAP WEIGHTED MEDIAN, EX FINANCIALS**

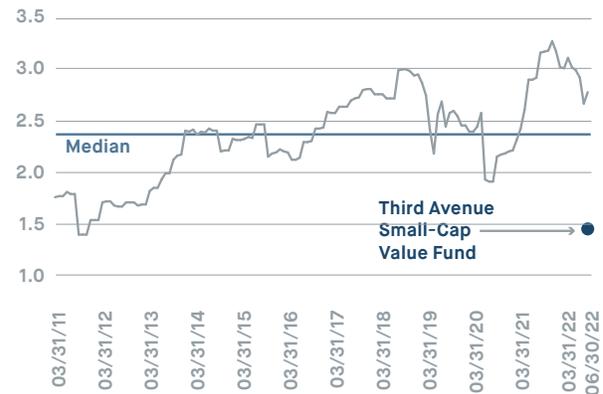


Note: Figures reflect weighted median, excluding financial companies. Third Avenue Small-Cap Value Fund data point reflects position weights as of 3/31/22. Source: RBC

**WHY ACTIVE MANAGEMENT IS CRITICAL**

With deteriorating quality of small-cap indices, the challenge for value-oriented investors has been that valuations of indexed companies have grown due to healthy inflows into passive index vehicles (passive is now 47% of the small-cap market<sup>3</sup>) despite worsening fundamentals. The chart to the right shows the valuation of the Russell 2000 Index (ex-financials) using the enterprise value to sales ratio compared to the Fund. Fund Management chose enterprise value to sales<sup>4</sup> as the valuation benchmark given how many companies in the Russell 2000 are not making money currently.

**RUSSELL 2000 EV-TO-SALES**



As of 6/30/22. Note: Figures reflect weighted median, excluding financial companies. Source: Jefferies, S&P Capital IQ, Factset

And the next chart shows how the Return on Assets of the Russell 2000 has deteriorated over the past 10 years. In both charts you can see how our portfolio is positioned compared to the index—more compelling from both a valuation and return on assets standpoint.

**RUSSELL 2000 RETURN ON ASSETS**



As of 6/30/22. Note: Figures reflect weighted median, excluding financial companies. Source: Jefferies, S&P Capital IQ, Factset

With recent trends that appear to be reversing course, we believe that now more than ever, **knowing what you own is critical.** We feel that small-cap value stocks could be set up for potential outsized future returns. Third Avenue believes the best way to capture the inherent value gap between small/large cap companies is through fundamental security analysis, to focus on underfollowed opportunities and to prudently concentrate on our highest-conviction ideas.

## MORE ABOUT THIRD AVENUE SMALL-CAP VALUE FUND

Third Avenue Small-Cap Value Fund is one of the longest-tenured deep-value small-cap mutual funds. Its differentiated strategy focuses on long-term capital appreciation and by investing opportunistically across an expansive universe of underfollowed/underappreciated assets, including long-term wealth creators and time arbitrage/special situation opportunities. Some notable byproducts of our security selection are 98% active share<sup>5</sup>, low turnover and lower standard deviation<sup>6</sup> when compared to the Russell 2000 Value Index. The Fund has a 4-Star overall Morningstar rating.

### PORTFOLIO SUMMARY CHARACTERISTICS

AS OF 6/30/22

	TASCX	Index <sup>2</sup>
Weighted Market Cap <sup>7</sup>	\$2.1 Billion	\$2.2 Billion
Median Market Cap <sup>7</sup>	\$1.4 Billion	\$809 Million
P/E Forward 1 Year <sup>7,8</sup>	14.8x	16.7x
Price-to-Book <sup>7,9</sup>	1.4x	1.2x
Portfolio Turnover <sup>10</sup>	20%	N/A
Active Share <sup>2,5</sup>	98%	N/A
5-Yr Standard Deviation	18.4%	22.5%

### TOP TEN HOLDINGS AS OF 6/30/22

Allocations are subject to change without notice

	TASCX
UMB Financial Corp.	7.2%
Tidewater, Inc.	6.0%
FRP Holdings, Inc.	6.0%
Seaboard Corp.	5.9%
MYR Group, Inc.	5.8%
Washington Trust Bancorp, Inc.	5.8%
Hamilton Beach Brands Holding Co.	4.9%
ProAssurance Corp.	4.6%
Prosperity Bancshares, Inc.	4.5%
ICF International, Inc.	3.9%
<b>Total</b>	<b>54.6%</b>

### OVERALL MORNINGSTAR<sup>®</sup> RATING



(TASCX) 4 Stars out of 439 Small Value funds as of 6/30/22, based on risk-adjusted return.

### PORTFOLIO MANAGER



**Victor "Vic" Cunningham, CFA**  
 Strategy Portfolio Manager since 2017  
 9 years with the Firm  
 27 years of investment experience



**THIRD AVENUE**  
 MANAGEMENT

Founded in 1997, Third Avenue's **Small-Cap strategy** seeks long-term capital appreciation by investing in equity securities of small-capitalization companies in North America that we believe to be mispriced by the market.

If you would like further information, please visit the strategy page at <https://thirdave.com/strategy-tascx/> or contact a Relationship Manager at:



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## IMPORTANT INFORMATION

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

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Date of first use of portfolio manager commentary: September 14, 2022

- 1 Basis Points The term basis points (BPS) refers to a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%.
- 2 The Russell 2000 Value Index measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.
- 3 Source: EPFR; Jefferies
- 4 Enterprise value-to-sales (EV/sales) is a financial valuation measure that compares the enterprise value (EV) of a company to its annual sales.
- 5 Active Share is the percentage of a fund's portfolio that differs from the benchmark index. Source: FactSet Portfolio Analytics.
- 6 Standard deviation is a statistic that measures the dispersion of a dataset relative to its mean and is calculated as the square root of the variance. The standard deviation is calculated as the square root of variance by determining each data point's deviation relative to the mean.
- 7 Source: FactSet Portfolio Analytics. Based on equity holdings only.
- 8 Price-to-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its earnings per share (EPS).
- 9 The price-to-book ratio, or P/B ratio, is a financial ratio used to compare a company's current market value to its book value.
- 10 For the year ended October 31, 2021.

**FUND RISKS: Please be aware that small-cap investments are subject to higher volatility and lower financial resources than large-cap investments. The markets for these securities are also less liquid than those for larger companies. For a full disclosure of principal investment risks, please refer to the Fund's Prospectus.**

**Third Avenue Funds are offered by prospectus only. The prospectus contains important information, including investment objectives, risks, advisory fees and expenses. Please read the prospectus carefully before investing in the Funds. Investment return and principal value fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. For updated information or a copy of our prospectus, please call 1-800-443-1021 or go to our website at [www.thirdave.com](http://www.thirdave.com). Distributor of Third Avenue Funds: Foreside Fund Services, LLC.**

**Past performance is no guarantee of future results.** Current performance results may be lower or higher than performance numbers quoted in certain letters to shareholders.

Overall Morningstar rating, as of June 30, 2022, vs. 439 funds. TASCX was rated against the following numbers of Small Value Category Funds over the following time periods: 439 funds in the last three years, 412 funds in the last five years and 314 funds in the last ten years. With respect to these Small Value funds, TASCX received a Morningstar Rating of 4 stars for the three-year period, 4 stars for the five-year period and 4 stars for the ten-year period, respectively. Ratings based on risk adjusted return. Past performance is no guarantee of future results.

The Morningstar Rating™ for funds, or “star rating,” is calculated for mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product’s monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period has the greatest impact because it is included in all three rating periods.

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