

December 31, 2016

Chip Rewey, CFA | Lead Portfolio Manager
Yang Lie | Portfolio Manager

Dear Fellow Shareholders:

CARPE DIEM, PATIENTLY

We believe one of the greatest differentiators of our investment philosophy is how we think about time. Time is a precious commodity and we are all familiar with the popular colloquialisms such as “Carpe Diem”, “Time is Money” and “Tempus Fugit”. Indeed, in the investment community at large there seems to be a focus on speed, with some funds trying to differentiate themselves by even building their own fiber optic networks to shave milliseconds off order entry. This is hardly how we think about time or our competitive advantage.

We highlight the notion of speed in the financial markets that comes from the mathematical term “Theta”, which is defined as the “measure of the rate of decline in the value of an option due to the passage of time”¹. In other words, in derivatives or in other finite-lived financial contracts, the option value embedded in the financial instrument loses value over time, even if all other parameters are held constant.

In contrast, we, as value investors, are patient investors and view time as our friend. As long as an underlying corporation is financially healthy, its equity has an infinite time horizon. This attribute enables our investment philosophy of creditworthiness, book value compounding and purchasing at a significant discount to fair value, i.e. valuation. Creditworthiness is the key, and this is why our investment philosophy starts with the balance sheet. If the corporation has a strong balance sheet, defined by low leverage and no or low legacy liabilities that can drain cash flow, it is more likely to be able to survive short-term economic bumps and not be forced into selling actions that can destroy equity value. A strong balance sheet lets us risk time as our friend and partner, vs. a value that will decay upon inaction. A strong balance sheet enables patience, which is in our opinion, a true key to successful value investing. As patient buyers and patient holders, we focus on the long-run ability of an organization to build and compound book value growth over time, with our initial investment horizon of three to five years.

Patient buying is a critical feature of our investment process, as we build our portfolio over time. Our investment teams identify and research many more companies than we will

ever invest in over a given year. As we seek out companies that have the requisite balance sheet strength and generate superior value creation, as measured by book value growth, many of these companies do not initially present compelling valuation discounts that would justify immediate purchase. The Value team, and indeed all of Third Avenue’s investment teams, thus create what are in effect wish-lists of securities we would like to purchase if the valuation discount ever materializes. When our well-researched names on this list reach a compelling valuation discount to our estimates of fair value, we will Carpe Diem – and act aggressively to add to our portfolio, as our patience has been rewarded.

Time, as our friend, along with a strong balance sheet also shapes how we think of downside protection in an investment. With a strong balance sheet and a business model that can compound over time, we are not forced, or really even tempted, to sell our equity holdings when an enterprise encounters short-term headwinds. If the ability to build book value is not impaired, and this is a critical decision point, we will look to add to the position on weakness with the view that the discount to fair value, i.e., potential upside, has only increased. Thus, with a long-term focus, we are not short-term players joining the herd in selling, but accumulators on weakness.

PERFORMANCE

For the calendar fourth quarter of 2016, the Third Avenue Value Fund (the “Fund”) returned a positive 4.72%² vs. the MSCI World Index³ at 1.97% and the S&P 500⁴ at 3.82%. For the full year 2016, the Fund returned 13.39% vs. 8.15% on the MSCI World and 11.96% on the S&P 500.

TOP PERFORMERS

Patience was rewarded in the quarter with the top three contributors all being banks. Regional banks Comerica and PNC Financial Services were the top two performers while The Bank of New York, a trust and custody bank, also was up strongly. We have written consistently about the opportunity we see in banks and we believe 2016 is likely only the start of a strong period of performance for banks, as investors finally seem to have embraced the fact that the problems facing banks today are completely different than the problems that faced the banks generally during the financial crisis. Today, the banks are very well capitalized, but face low loan growth, restrictive capital regulations that are

¹ “Theta”, www.investopedia.com, January, 2017

² Please see Appendix for performance table and information.

³ The MSCI World Index is an unmanaged, free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of 23 of the world’s most developed markets.

⁴ The S&P 500 Index is an unmanaged index (with no defined investment objective) of common stocks. The S&P 500 Index is a registered trademark of McGraw-Hill Co., Inc.

preventing large buybacks and dividend increases, and low interest rates that have dramatically narrowed the spreads banks can earn on their strong capital positions. Looking forward we see several strong trends continuing for the bank group generally, including:

- Earnings upside from Federal Reserve interest rate increases, as rate hikes will likely not be passed fully on to depositors, especially on initial increases.
- Loan growth should continue to strengthen with a recovering economy.
- For Comerica, and to a lesser extent PNC, recovering oil prices should be a positive to credit quality and lending.
- The regional and trust banks should be a major beneficiary of Trump Administration policies. Assuming these policies are enacted, there should be less regulation, allowing for a more efficient use of the banks' balance sheets and the ability to return more of the banks' excess capital to shareholders. Any increase in infrastructure spending should drive increased loan demand.
- With their pure play domestic footprint, the regional banks should benefit from any reduced corporate tax burden.
- Last, fewer regulations should mean more M&A, and we see Comerica as a key target.

TOP DETRACTORS

The top two detractors were thematic as well, with healthcare names Brookdale Senior Living and LivaNova PLC weakening in the quarter, in line with the sector in general. We continued to build our LivaNova position, as the market sell-off brought shares back to our cost level, and we continue to see the real estate value of Brookdale alone worth more than the enterprise value of the company. CK Hutchison was the third largest detractor in the quarter.

As we wrote to you in November, we continue to see the sell-off in the healthcare sector as an opportunity. We continued to add to Amgen and LivaNova and we initiated a new position in Cerner common stock. While stock market valuations have suffered under the rhetoric of a potential repeal of the Affordable Care Act (ACA), we believe that a new plan will, at least in part, continue with the critical component of coverage continuing for all Americans. We see the Trump Administration focusing on generic drug pricing, and insurance reform (across state lines) as top priorities, to which the securities in the Fund have little or no exposure.

NEW POSITIONS

Cerner (CERN)

Cerner is a leading health care information technology company. We have long admired Cerner as it is a well-financed compounder, having compounded book value at an average rate of 16% over the past 10 years. Delays in customer adoption of healthcare Information Technology (IT) systems as regulatory mandates have lengthened,

exacerbated by concerns about potential changes to the ACA and the impact on healthcare IT spend, have negatively pressured Cerner's common stock price down from over \$67 to our initial purchase cost of approximately \$48, giving us an opportunity to acquire shares of Cerner common stock at an attractive valuation.

Healthcare IT has been in the sweet spot of spending for hospitals as regulatory reform and increasingly complex regulatory requirements have driven a greater need for IT solutions. The ACA and Health Information Technology Economic and Clinical Health Act (HITECH) were established to transition the U.S. healthcare system from fee-for-service towards value-based outcomes, i.e., incentivizing hospitals and providers for increasing quality of care and patient outcomes rather than the volume of procedures performed. As part of this initiative, electronic health records systems were required and analytics and data collection to monitor outcomes is increasing. Cerner is one of the market leaders in these systems. Similar to other IT companies, services and software for the installed base of systems generates high-margin recurring revenue. Further, many legacy systems are in need of upgrades to enable them to meet the new regulatory requirements. Given its market leading position, Cerner has been gaining share and is well-positioned to continue to take share. In addition, there has been consolidation within the industry, including some vendors discontinuing products.

While uncertainty remains regarding the ultimate resolution of the ACA, we believe the benefit of increased efficiencies that enhanced IT systems provide, along with increasing use cases, e.g., population health, will continue to bode well for Cerner's business, enabling the company to grow and compound value over the longer-term.

Lennar Corporation (LEN)

We initiated Lennar in October, and thus wrote up our comments in our prior shareholder letter, but due to the shift in our letter cadence, we are republishing our thoughts from our initial purchase.

Marty Whitman said in October 1996: "Given Third Avenue's investment criteria, it is more accurate to view the situation as the industry selecting the Fund, rather than Third Avenue choosing the industries in which to invest." We think this quote superbly describes the opportunity the Value Fund saw in establishing a position in Lennar Corporation common in the quarter, as the shares sold off somewhat inexplicably from nearly \$50 per share at their recent peak and allowed us to establish a position at just over \$41.

We have followed Lennar for years as the Real Estate team reviewed the position at our weekly research meetings, and think the investment case has only improved on a fundamental level despite the widening valuation discount in the shares. Lennar meets every tenant of our investment philosophy.

The balance sheet is strong and improving. Homebuilding net debt to total capital has fallen to 33% as of FY4Q16. Much of this improvement is the result of management's soft pivot land strategy, which is reducing the duration of its owned land bank and converting its undervalued balance sheet assets into cash.

From a compounding point of view, Lennar continues to build value through developing its land bank into saleable housing units, and by monetizing further transaction values through its mortgage origination and title insurance offerings to its home buyers. Notably, we are pleased and supportive of Lennar's offer to acquire WCIC Communities (WCIC), a top holding of the Third Avenue Small-Cap Value Fund, as Miami-based Lennar knows WCIC's 100% based Florida assets intimately. Lennar not only sees compelling opportunities to monetize WCIC's over 14,000 homesites, but also synergy opportunities from management and supplier overlap. Further, in our opinion, Lennar negotiated an extremely good price for WCIC, which, when considering the value of WCIC's brokerage operation and the hidden value of WCIC's owned coastal tower pads, will likely bring tremendous value as Lennar has a strong balance sheet to move construction of these assets forward.

Lennar's resource conversion outlook is compelling, with management likely to monetize its non-homebuilding investments in FivePoint and Rialto over the next 12-18 months through sales or spin-outs, and then over time, potentially further monetize its Multi-Family and even its Financial Services divisions through sales or partnerships. The value creation of Rialto, its 3rd party asset-light asset management unit with over \$7.3 billion in AUM, and of FivePoint, its development and management company with over 40,000 homesites and 20 million square feet of commercial real estate assets in highly coveted California markets are, in our opinion, completely overlooked by the markets from a net asset value perspective, as their income statement impact today belies their true value to Lennar despite being worth more than 25% of the underlying value.

Perhaps Lennar's most exciting aspect is the strength of the investment case and current undervaluation taken without the likely strong tailwind of an improving housing cycle. At our Value Conference we talked about taking advantage of optically poor headlines, and Lennar is a real-time example. We think some of the weakness in Lennar shares in October was due to a weak single family home starts number for September, down 9.5%. The noise of monthly home start numbers do not impact the long-term value we see in Lennar. While Lennar's sales and earnings are likely to strengthen as the single family construction cycle continues to recover from an extended cyclical low looking back to 2007, we see this as icing on the cake of our strong investment case. At our cost of just over \$41 per share, we see over 25% upside to our estimate of fair trading value of \$53 per share, and longer term potential for shares to

trade to over \$66 per share if the single family cycle gains steam.

TEAM UPDATE

At the end of 2016, Vic Cunningham left Third Avenue Management. We wish him well in his new endeavors. Chip Rewey continues as Lead Portfolio Manager for the Fund and is partnered with Co-PM Yang Lie, a 20-year veteran of Third Avenue Management. We firmly believe that we have all the resources we need to manage the Fund with the support of the Value Team, and indeed as the Flagship strategy for the firm, the broader support of the Real Estate Team and the International Team.

CONCLUSION

As we look into 2017, we are excited by the opportunities we see to evaluate new securities for purchase and to patiently build our weightings in our existing positions, as the uncertainty around a new political administration continues to drive individual stock opportunities. At the end of the year, the Fund held 37 positions, representing a concentrated, eclectic and undervalued collection of assets having little correlation with its primary benchmark and active share of over 99%. As we look forward over our long-term (i.e., three to five year) horizon, we are confident in the ability of the Fund's investee companies to continue to compound book value and close the undervaluation gaps to our estimates of fair value. Time is a friend of the Fund. We are confident in our path to outperform both in a relative and absolute sense over time. We thank you for your trust and support.

Sincerely,

The Third Avenue Value Team



Chip Rewey
Lead Portfolio Manager



Yang Lie
Portfolio Manager

December 31, 2016

FUND PERFORMANCE

	as of 12/31/16	1 yr	5 yr	10 yr	Since Inception	Inception Date
TAVFX (Institutional)		13.39%	10.55%	2.17%	10.97%	11/1/1990
TVFVX (Investor)		13.08%	10.27%	(n/a)	5.63%	12/31/2009

TOP TEN HOLDINGS

	% of Portfolio
Bank of New York Mellon Corp.	6.1%
Weyerhaeuser Co.	5.6%
PNC Financial Services Group, Inc.	5.3%
Comerica, Inc.	5.2%
Total S.A.	3.9%
White Mountains Insurance Group, Inc.	3.8%
Cavco Industries, Inc.	3.7%
Brookfield Asset Management, Inc.	3.7%
Alleghany Corp.	3.7%
CK Hutchison Holdings, Ltd.	3.6%

Allocations subject to change

Past performance is no guarantee of future results; returns include reinvestment of all distributions. The above represents past performance and current performance may be lower or higher than performance quoted above. Investment return and principal value fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. For the most recent month-end performance, please visit the Fund's website at www.thirdave.com. The gross expense ratio for the fund's institutional and investor share classes is 1.13% and 1.38%, respectively, as of March 1, 2016. Risks that could negatively impact returns include: fluctuations in currencies versus the US dollar, political/social/economic instability in foreign countries where the Fund invests lack of diversification, and adverse general market conditions.

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

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