

June 30, 2019

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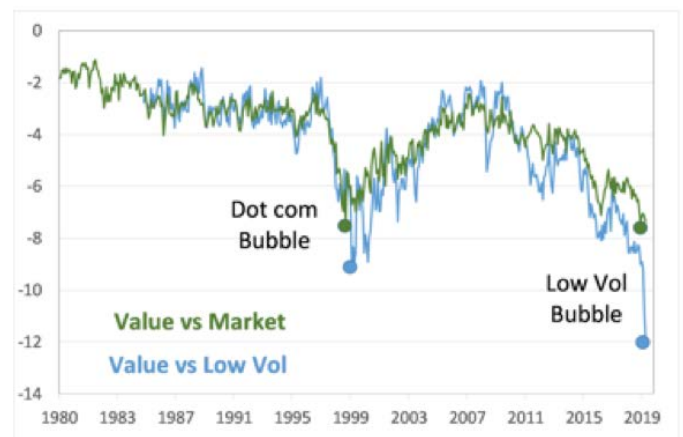
Dear Shareholders,

For the three months ended June 30th, 2019, the Third Avenue Value Fund (the “Fund”) returned -2.04%, compared to the MSCI World Index, which returned 4.18%<sup>1</sup>. During the month of May, a deterioration in trade negotiations between the United States and China, followed by the threat of tariffs on virtually all goods imported into the United States from Mexico, led to a substantial change in sentiment surrounding the Fund’s industrial holdings, causing underperformance during the period.

The Fund has been intentionally out of step with broad market indices by focusing on smaller capitalization companies, by pursuing opportunities globally and by sticking to an orthodox value strategy. Each of these components of our strategy proved a headwind during the quarter and, moreover, in recent years, as larger capitalization U.S. growth stocks, as well as equities perceived as defensive in nature, have been highly dominant from a performance perspective. We view our strategy as simply rational and remain resolute. Furthermore, notwithstanding palpable nervousness and uncertainty in global equity markets, from the perspective of long-term global value investors, we view the current investment environment as the most attractive since the aftermath of the Global Financial Crisis. Assets crudely categorized as “risk assets” are, in some cases, offering extraordinary value, precisely because capital has continued to flow from those asset classes towards perceived safety. It is our view that, for a number of companies, critically important traits such as: the resilience of the business model, the long-term record of returns on capital, returns to shareholders and the safety afforded by a strong balance sheet are deeply underappreciated and belied by the classification of “cyclical” or “risk asset”. At the other end of the spectrum, the data points supporting a conclusion that we are experiencing bubble-like conditions in many assets perceived to provide safety are accumulating rapidly precisely because high prices in and of themselves create investment risk to the holder of the asset.

Further, at Third Avenue Management, we arrive at investment decisions through bottom-up fundamental analysis and our commentary above derives from such bottom-up observations. However, corroborating analysis is being published by those who arrive at similar conclusions using a wide variety of additional tools. For example, JP Morgan’s Global Quantitative & Derivatives Strategy team recently published a report entitled “Largest Divergence Ever Presents Opportunity for Value and High Volatility Stocks.” The report goes on to say that “The bubble of low volatility stocks vs value stocks is now more significant than any relative valuation bubble the equity market experienced in modern history”, where value is defined as the cheapest quintile of the market and “low volatility” is defined as the least volatile quintile of the market over the past twelve months.

**Value is Trading at Record Valuation Discount vs. Low Vol**



Source: J.P. Morgan QDS.

Several other investment banks have recently published interesting work highlighting how extreme the current environment has become with regard to underperformance of cyclical, industrial and value equities relative to defensive and growth equities as well as underperformance of smaller capitalization companies compared to larger. Many have noted

<sup>1</sup> 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. Please see Appendix for performance table and information.

that the phenomenon is global as well with French investment bank Oddo BHF recently noting “At over three standard deviations from the 10-year average, the P/E value-growth gap has never been so great.” Through a mounting slew of observations, we view the investment environment during the last several years as unsustainable and, notwithstanding recent underperformance, view the Fund’s holdings as exceptionally attractive, arguably in the extreme. To us, the current environment looks like a once-in-a-decade opportunity for contrarian value investors.

### Continental Europe and Exceptional Value

Over the last two years, the Third Avenue Value Fund investment team has found unusually attractive deep value opportunities across the globe. One significant area of activity is within Continental Europe, where we hold investments in six companies, each initiated within the last two years, with a total portfolio weight of 21.9%. Almost universally, our companies are extremely well-capitalized or even over-capitalized.

Company	Weight
BMW AG	4.8%
Buzzi Unicem SPA	4.7%
Royal Boskalis Westminster NV	4.4%
Bank of Ireland plc	3.2%
Daimler AG	2.6%
Deutsche Bank AG	2.2%
<b>Total</b>	<b>21.9%</b>

The one exception is Deutsche Bank, which is today well-capitalized yet is embarking on an expensive restructuring. We have pursued purchases at prices which are distressed, using almost any measurement one might choose, yet have purchased businesses that are not even remotely in distress and in many cases have unambiguously very healthy profitability and fortress-like balance sheets.

We offer an investment discussion highlighting BMW below, but many of the points related to business durability, financial position and cheapness are equally applicable to the Fund’s other Continental European holdings. In the cases of Buzzi Unicem and recently purchased Bank of Ireland, residing in Italy and Ireland respectively, current valuations rival lows established in the European Sovereign Crisis when the world was rightfully fearful of several coincident

large-scale sovereign insolvencies, including Italy and Ireland, and the dissolution of the Eurozone for which there is no precedent. Moreover, the companies we own in Continental Europe are in far stronger shape operationally and financially than they were in either the Global Financial Crisis or the European Sovereign Crisis. For example:

**BMW AG** – Globally speaking, auto manufacturers have had a challenging couple of years. Many are caught in the midst of a trade war and most are grappling with the rising popularity of electric vehicles, which brings new competitors and the need to spend considerable sums on new technology. Many auto makers have even had to face substantial legal issues, most notably related to diesel emissions and all of that has occurred in an environment in which auto sales growth has slowed in China and the U.S., which are, respectively, the world’s first and second largest auto markets. We are not dismissive and accept that those challenges are real but would also note that they have precipitated a multi-year valuation “de-rating” to extremely unusual levels.



Source: S&P Capital IQ

However, the fact of the matter is that over the last twelve months, enduring all of the challenges noted above, BMW produced EUR 8.22 per share of earnings, which leaves the stock trading at 8x earnings on a trailing basis. Pessimism being acute as it is, the average analyst (and there are many) estimates that BMW will earn EUR 8.72 per share in 2019.<sup>2</sup> We don't dispute the consensus estimate per se but would note that if the estimates are correct, that would translate to a 13% earnings yield accruing to the shareholders, which is a return more than 50% higher than equity markets have provided over the long-term and less than half of the valuation at which the S&P 500 is trading. Furthermore, BMW pays out a substantial portion of its income to shareholders via dividends. During the quarter, BMW paid its annual dividend, which this year amounted to EUR 3.50 per share, translating to a 5.3% cash yield.

Looking through another lens, BMW has four primary sources of value: its auto making operations, its financing operations, which provide auto purchase and lease financing, its ownership interest in its Chinese joint venture and a large pile of net cash. At the current share price, if we subtract the net cash balance as well as the value of the joint venture and the finance business – valuing each at book value, which is an exceptionally conservative valuation - we are left with roughly EUR 9.6 billion of market value attributable to one of the world's preeminent auto manufacturing businesses, which, mind you, produced pretax operating income of EUR 4.7 billion over the last twelve months. That equates to a valuation multiple of 2x pretax earnings for BMW's auto manufacturing business.

Addressing several of the key debatable issues in as brief a fashion as possible (while inviting a more fulsome discussion from all interested):

I) *The Electric Vehicle ("EV") Revolution* – The concept of the EV revolution is often associated with the rule of thumb estimate that 30% of passenger vehicles sold globally will be electric by 2030. First, while EVs have garnered enormous attention, today they represent approximately 2% of global passenger vehicles sold. Given minimal progress to date on building out charging infrastructure for the masses in most geographies, we are doubtful that hoped for pace of adoption can be achieved. Second, an EV typically requires roughly 3.5 times the amount of copper that is used in a combustion engine car. By our math, the 30% adoption rate by 2030 scenario would translate to a 50% increase in the global growth

rate of copper consumption, even without including the enormous amounts of copper required for charging stations and electric grid upgrades. Research firm Sanford Bernstein has estimated that, when including charging stations and electric grid enhancements, projected adoption of electric vehicles could raise global copper demand from a typical 2% growth per year to 3.5% per year, meaning a 75% increase in the consumption growth rate. Given that it typically takes ten years to permit and construct a new copper mine, we view the challenges to such a pace of adoption as very real and very likely to cause shortages and substantial cost inflation. Third, it is probable that electric vehicles will fit less neatly into ones ESG conscience as it becomes more widely understood that critical battery materials such as cobalt and lithium are produced in meaningful part through child labor and the leaching of environmentally sensitive areas, respectively. These facts will increasingly move into the foreground as EV volumes rise and the scope of the problems grow in step.

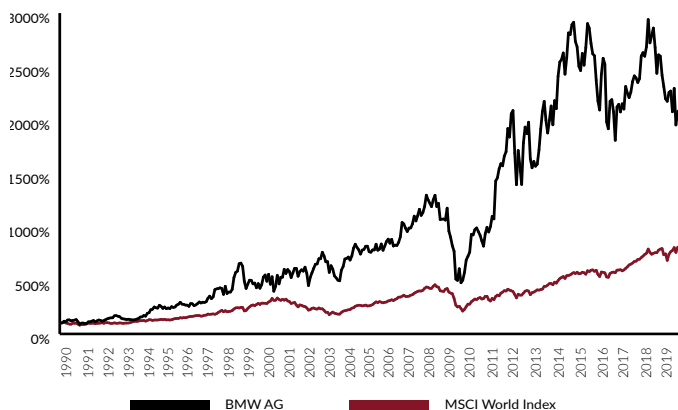
II) *New Competitors* - Should the electric vehicle revolution surmount the challenges described above, we believe BMW will remain one of the world's most successful auto makers. The most fundamental ingredients required of a highly profitable vehicle maker, electric or otherwise, will continue to be engineering prowess, manufacturing efficiency and lots and lots of money to fund research and development of new technologies, materials and manufacturing methods. BMW, already one of the largest EV producers in the world today, has access to the EUR 7 billion of annual pretax profit it generates, has a war chest of roughly EUR 16 billion of net cash on hand and has a global footprint of highly efficient assembly plants in the correct locations. BMW also has a robust global distribution and service network that is very difficult to replicate. Yet the most notable EV "disruptor", Tesla, has produced losses of USD 969 million in the last twelve months, is indebted to the tune of USD 10.5 billion with its bonds rated and trading in junk territory, has struggled mightily to establish manufacturing efficiency and was recently forced to shrink its money-losing dealership footprint. We would also note that 2030 is 11 years away, which means that we are likely to see a couple of model refresh cycles between now and then, likely making existing models and

<sup>2</sup> Bloomberg consensus estimates.

technologies old and tired by then. The product offering Tesla has today may not carry it for very long with extraordinarily well-financed and capable competitors gaining rapidly. Again, a balance sheet, high levels of existing profit and engineering prowess are what enable success across model cycles and over time.

III) *Slowing Growth in China and the U.S.* – It is indisputable that the auto industry has historically been cyclical. We are confident that will continue to be the case though we don't know exactly where we are in that cycle. BMW is a luxury auto manufacturer and it seems not many people appreciate that the amplitudes of luxury auto cycles have historically been much smaller than for mass market autos. That dynamic can also be seen in recent U.S. and Chinese volume statistics, meaning the luxury market has been a good bit stronger than the aggregate numbers you read in the newspaper. Further, that U.S. and Chinese volumes have reached or surpassed previous peaks is not compelling evidence that we will face a near-term downturn. Auto volumes have grown substantially over long periods of time and that simple fact is likely to cause future peak volumes to be higher than past peak volumes. Most importantly, BMW has navigated many auto cycles, including several over the last three decades, during which shareholders have enjoyed a total return, in USD, averaging more than 10.8% per year for a total return of 1,984%, as compared to the MSCI World Index which returned 7.3% per year for a total return of 712%.

**Total Return BMW vs. MSCI World Index**



BMW's outstanding compounding of shareholder returns has been accomplished by navigating many auto cycles, technological shifts and changes in consumer tastes while manufacturing efficiently and profitably to produce double-digit returns on book

value over decades. Today we are able to acquire BMW shares at a 25% discount to that book value.

Furthermore, while BMW is today our largest Continental European holding, we see similarly attractive opportunities across our other Continental European holdings, which span a wide range of industries and fundamental business drivers. Virtually all points made above in regards to BMW pertain similarly to our position in Daimler AG as well. Our holding in Buzzi Unicem appears to be clearly mispriced, almost entirely as a function of the market in which it is listed. Below we discuss Bank of Ireland, our most recent addition to the portfolio.

### Quarterly Activity

During the quarter ended June 30th, the Fund opportunistically added to several investments including Borr Drilling, Interfor Corp, Mohawk Industries, Subsea7 and Tidewater Inc. The Fund also disposed of its position in Antofagasta, plc, which had been purchased during the fourth quarter of 2018. This uncharacteristically short holding period reflects the appreciation of the position along with the appreciation of the Fund's other mining exposures early in the quarter and the will to limit the Fund's aggregate exposure to mining businesses.

The Fund initiated one new position during the quarter. Bank of Ireland, while a completely different business than BMW, shares much in common with BMW in that it too is a very well-financed business of well above average quality trading at valuations that reflect an extreme degree of pessimism. Bank of Ireland's valuation today is frankly reminiscent of times in which both the Irish government and the company itself were in a troubled financial state, neither one of which is the case today.

**Bank of Ireland** – Bank of Ireland is one of Ireland's two largest lenders and, from a banking perspective, is relatively traditional in its scope of activities. The bank primarily collects deposits and extends retail loans, commercial loans and provides treasury functions in Ireland and the U.K. The company also has a small wealth and insurance products sales business. In many regards Bank of Ireland's fortunes have mirrored that of its home country. The bank was a participant in the heady days of rapid growth during the early 2000s and was not well-prepared for the related events of the Global Financial Crisis followed by the European Sovereign Crisis, similar to Ireland itself. Those statements are largely true for the entire Irish banking sector and many banks in Europe for that matter. What is more specific to the Irish experience

and the Irish banking sector was an early acceptance of the dire state of affairs and a willingness to endure the pain required to facilitate a proper healing. Today, a mere seven years later, Ireland is one of the better capitalized European sovereigns and home to one of Europe's healthiest and most dynamic economies. Meanwhile, Bank of Ireland also underwent a recapitalization following the European Sovereign Crisis followed by a considerable amount of shedding of legacy non-performing asset portfolios. The bank quickly returned to respectable levels of profitability and the combination of the asset quality improvement, recurring profits and a growing domestic loan market have enabled strong and increasing capital base. Today, Bank of Ireland is among Europe's better capitalized banks. More broadly, the post-crisis cleansing of the Irish banking sector has seen several exits and left the industry substantially more concentrated than it used to be, which typically facilitates better pricing and structurally higher profit levels. Meanwhile, the Irish economy and the Irish lending that supports it have regained their dynamism and the Irish banking sector is once again growing.

However, while Bank of Ireland has rightly been focused on fortifying its balance sheet in the post-crisis years, little has been done by way of investing in operating efficiencies that are likely to improve cost-to-income and profitability ratios even further. Those initiatives are now underway in earnest. Yet, in spite of all of that improvement, like BMW, Bank of Ireland has seen a substantial "de-rating" over the last couple of years. Today, the shares are trading at 60% of tangible book value and approximately 7.5x 2019 earnings with earnings on an upward trajectory. Again, like BMW and other Fund holdings, from an earnings yield perspective, the shares currently offer a substantial premium to long-term equity market returns. With the current valuation of 60% of tangible book value with a balance sheet that is in terrific condition and a growing income statement, the probabilities of a positive outcome for shareholders appear far greater, in our view, than of a negative one. This is precisely the type of asymmetry we are attempting to establish. What is special about this moment in time is that the attractive asymmetry is available in very healthy, well-capitalized companies with enduring business models.

Thank you for your confidence and your loyalty. We look forward to writing again next quarter.

Sincerely,

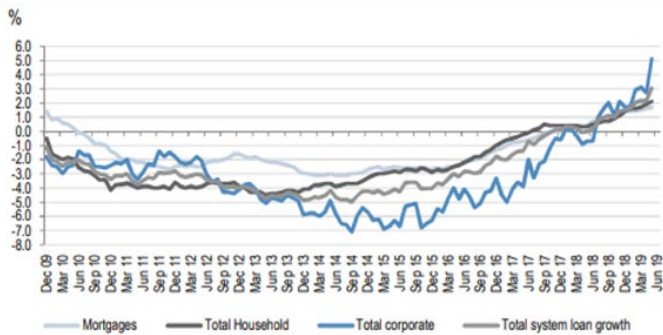


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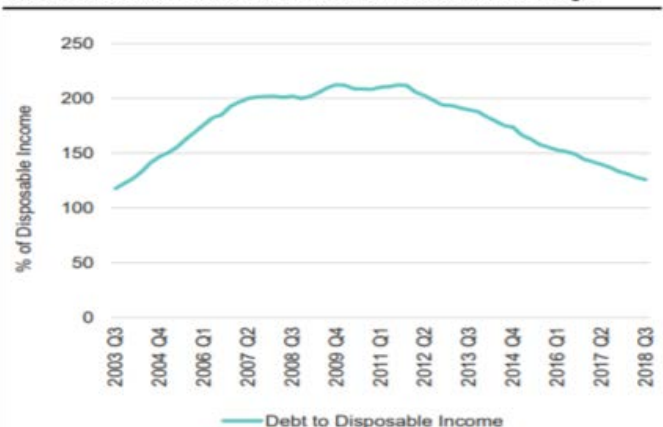
Michael Fineman, CFA, CFP®

Ireland's total system loan growth - currently at 3% yoy - has sustained positive momentum following a period of sustained contraction



Source: Central Bank of Ireland, JP Morgan

The ratio of Irish household debt to disposable income of 125% is at its lowest levels since 1Q 2004 as households continue to deleverage



Source: Central Bank of Ireland

## **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: July 23, 2019

# THIRD AVENUE VALUE FUND

APPENDIX

INSTITUTIONAL: TAVFX | INVESTOR: TVFVX | Z: TAVZX

June 30, 2019

## FUND PERFORMANCE

As of 6/30/19	3 mo.	1 yr.	3 yr.	5 yr.	10 yr.	Since Inception	Inception Date
Third Avenue Value Fund (Institutional Class)	-2.04%	-11.90%	3.81%	0.08%	6.24%	9.96%	9/17/1998
Third Avenue Value Fund (Investor Class)	-2.11%	-12.12%	3.55%	-0.18%	N/A	4.02%	12/31/2009

## TOP TEN HOLDINGS

	% of Portfolio
Lundin Mining Corp.	6.9%
Interfor Corp.	6.5%
Tidewater, Inc.	5.6%
CK Hutchison Holdings, Ltd.	4.9%
Warrior Met Coal, Inc.	4.9%
Bayerische Motoren Werke AG	4.8%
Buzzi Unicem SpA	4.7%
CK Asset Holdings, Ltd.	4.6%
Boskalis Westminster	4.4%
Hawaiian Holdings, Inc.	4.1%
<b>Total</b>	<b>51.4%</b>

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](http://www.thirdave.com). The gross expense ratio for the Fund's Institutional, Investor and Z share classes is 1.17%, 1.45% and 1.09%, respectively, as of March 1, 2019. 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.

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.

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


**THIRD AVENUE**  
MANAGEMENT

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

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