THIRD AVENUE FUNDS

Third Avenue Value Fund

Third Avenue Small-Cap Value Fund

Third Avenue Real Estate Value Fund

Third Avenue International Value Fund

Third Avenue Focused Credit Fund

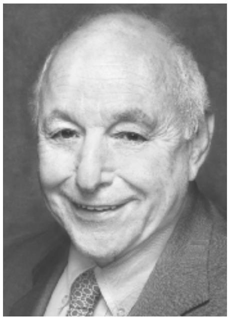
THIRD QUARTER PORTFOLIO MANAGER COMMENTARY

JULY 31, 2012

If you should have any questions, please call 1-800-443-1021, or visit our web site at: www.thirdave.com, for the most recent month-end performance data or a copy of the Funds' 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 of portfolio manager commentary: August 28, 2012.

Letter from the Chairman
(Unaudited)



Martin J. Whitman
Chairman of the Board

Dear Fellow Shareholders:

For market participants seeking satisfactory returns in mid-2012 it seems no longer possible to do so as a cash return investor. Interest rates are just too low. Rather the market participant has to focus on being a total return investor, i.e., income plus capital gains. The futility of being a cash return investor is demonstrated by holding a 2% 10-year Treasury note priced at par. The investment is almost a sure loser. No credit instrument ever achieves a market price much above its call price, no matter how much interest rates go down, so it is hard to foresee meaningful capital appreciation for the Treasury Note. If interest rates go up (seems a reasonable possibility from 2%), the market prices of the Treasury Note will decline. This dire position is ameliorated if the portfolio holding the Treasury Note is continually getting new funds to invest and reinvest so, over the long term the portfolio becomes a dollar averager. Nonetheless, insofar as is feasible given constraints imposed legally and by "prudent-man" rules, a diminished portion of these portfolios in mid-2012 ought to be invested in investment grade credit instruments and an increasing portion ought to be invested in high quality total return securities.

Most of the funds managed at Third Avenue Management ("Third Avenue") seek total return by acquiring "what is" on the bases that guard against investment risk, defined as the threat of a business or its' securities suffering permanent impairments, but not market risk, defined as Outside Passive Minority Investor ("OPMI") price fluctuations. In striving to achieve satisfactory returns on an overall risk adjusted basis, Third Avenue's approach is markedly different from the approaches used by almost all others who also are primarily OPMIs. Almost all others are influenced strongly by the writings of Graham and Dodd ("G&D") and/or the teachings of most academics under the rubric of Modern Capital Theory. ("MCT"). The basic goal of both G & D and MCT is to study the factors that affect market prices for common stocks in OPMI markets, especially short run factors. For Third Avenue, in contrast, the basic goal is to obtain deep understanding of specific businesses and the securities they issue, especially emphasizing long-term factors. G&D and MCT seemed focused, almost exclusively, on the needs and desires of OPMIs. Third Avenue's approach is more balanced, recognizing the needs and actions not only of OPMIs, but also the company itself, creditors, managements, control groups and Wall Street activists. The Third Avenue belief is that underlying values, and growth in underlying values, will eventually be recognized in OPMI market prices, especially if potential catalysts such as changes in control, or going private, exist.

G&D and MCT are helpful, and in many senses, essential to understanding OPMI equity markets, trading strategies, and near term price movements in OPMI markets. However, G&D and MCT seem not at all helpful and, in a sense, counterproductive in helping control buyers, distress buyers and long-term investors gain understanding of a business in depth as well as the securities that businesses issue. These shortcomings of G&D and MCT seem attributable to four factors, three of which characterize G&D and all four of which characterize MCT:

1. G&D and MCT believe in the Primacy of the Income Account as measured by recurring earnings and/or cash flow from operations. However, to appraise a business, its securities and its management, an analyst has to weigh three separate factors, not just recurring flows as reflected in income accounts. A decent analysis of the management of any corporation has to assay the people from three general angles:

a) As an operator creating recurring earnings or cash flows. (Earnings are defined as the creation of wealth while consuming cash).

b) As an investor, i.e., deal maker. Virtually no public corporation in the U.S. goes as long as five years without being involved in resource conversion activity, such as a merger or acquisition, change of control, going private, including leveraged buy-outs, sale of assets in bulk and spin-offs.

c). As a financier, financing, refinancing and reorganizing troubled issuers. Probably more wealth has been created for corporations and promoters in the U.S. by gaining super attractive access to capital markets than any other way. It appears as if the most important talent leveraged buy out ("LBO") sponsors bring to deals is super attractive access to capital markets, not only for obtaining attractive secured financing from banks, but also for obtaining mezzanine finance and for access to IPO markets for common stocks.

2. G&D and MCT are involved with short-termism. The most important thing for them to measure is immediate price impact in OPMI markets. This emphasis becomes irrelevant for control buyers and long-term investors, unless the particular asset is to be sold in the immediate future into a market or is margined. Short-termism is not something that contributes to understanding in depth a going-concern with a perpetual life. For example, both G&D and MCT emphasize the importance of common stock dividends, largely because dividend payments impact immediate market prices. G&D and MCT pretty much ignore the probabilities that retaining earnings can foster future company growth.

3. G&D and MCT overemphasize top-down analysis at the expense of bottom-up analysis. G&D, in particular, attach great importance to forecasting gross domestic product, general stock market levels and interest rates. At this writing a principal top-down concern seems to be whether or not certain European Sovereigns (Portugal, Italy, Ireland, Greece and Spain) will suffer money defaults on outstanding Euro Bonds (I bet they will default sooner or later). At Third Avenue, however, it seems more important to focus on the bottom-up facts, like that the well-financed Wheelock & Company has its common stock selling at a 50% discount from readily ascertainable net asset value ("NAV") and that Wheelock's long-term growth prospects seem bright without worrying much about the general economy.

4. For MCT there is a belief in equilibrium pricing, i.e., the price of a security in an efficient market represents a universal value and prices change as the market receives new information. Equilibrium pricing does not exist in the world of corporate valuation. It does exist for a tiny minority of OPMI securities but a somewhat larger proportion of OPMI trading. An efficient market is faced by those involved in "sudden death securities" analyzable by reference to a very limited number of computer programmable variables and encompass derivative securities such as options and convertibles as well as risk arbitrage situations where there is likely to be a near term workout. For going concerns of any kind of complexity there is no understanding implicit in assuming an efficient market. For most of the securities in Third Avenue portfolios, pricing for the securities would be very different from what it is if prospects for changes of control existed. There just isn't one right price for the vast majority of equities, MCT beliefs notwithstanding.

Using the Third Avenue approach it is feasible today as a total return investor to buy into blue chip common stocks which have the following characteristics and which, in my opinion, are attractively priced:

- Super strong financial position
- Priced at discount from NAV of 25% or more (Wheelock and Company Common and Henderson Land Common are at discounts of about 50%). These

NAVs do not reflect any control premiums that would exist if any of the issuers were "in play."

- Full comprehensive disclosures in English with audits by the "Big Four"
- Trading in markets where protections for OPMIs are strong
- Prospects seem good that that over the next three to eight years NAV will grow by not less than 10% compounded annually after adding back dividends. If such growth is achieved, the investments seem very likely to be profitable because if they are not, the discounts from NAV would have widened to unconscionable levels. For example, at this writing, Wheelock and Company is selling at HK$28.75 per share; NAV at December 31, 2011 was HK $60.32. Given 10% NAV growth for Wheelock, NAV in three to five years would be HK$ 78.63 and HK$94.09 per share respectively, after allowance for an annual dividend of HK$0.50 per share, the dividend rate established at the end of 2011. For the five years prior to December 31, 2011, after allowance for annual dividends of HK$0.125 per share, Wheelock's growth in NAV was 17% compounded annually. Wheelock Common's NAV increased each of the five years, as seems bound to be the case for 2012.

Other than a lack of catalysts, there does not seem to be much, if any, economic justification based on comparative analysis for the existence of any NAV discounts at all for the securities held in the various Third Avenue portfolios, where the NAV discounts average over 25%. In contrast, at July 31, 2012, the S&P 500 index was priced at a 116.2% premium above the book values of the companies making up the S&P Index. The asset-rich Third Avenue common stocks seem to be issues of companies much more strongly financed than the S&P 500 constituents. Also, growth prospects seem, to me, to be far better for the Third Avenue securities than they are for the issues in the S&P 500.

Growth in NAV seems a far better measure of how a business performed than is looking at growth in recurring earnings or cash flows from operations simply because the change in NAV measures management performance not only as operators but also as investors and financiers. On a macro basis, long-term growth in NAV seems mighty likely for well financed companies. Book value is only a surrogate for NAV, but often is a meaningful one, at least in the aggregate. In the 18 years prior to December 31, 2011, the book value of the S & P 500 increased in 16 of the 18 years, despite the severe recession which started in 2007-2008.

For the last five years, most of the issues held in Third Avenue Value Fund in companies with strong financial positions exceeded the 10% growth bogey, despite the fact that 2007-2012 was a recessionary period. More important to me though are the market results of the three issues that didn't meet the 10% growth bogey: Capital Southwest, Investor AB and Toyota Industries. The market prices of two were modestly higher five years later and one, Toyota Industries, was down about 5% after being barraged by the worst publicity visited on almost any major company during the period.

While I, as an OPMI, am a true believer in the Third Avenue approach it would be incomplete if I did not enumerate what I think are the shortcomings of the approach:

1. Third Avenue could deal with a lot of dead head managements who don't care about their OPMI constituencies, in great part because they own little or no common stock in their companies; and also their companies have no need or desire to access capital markets. Obviously, the securities of such issuers should be avoided. These dead-head managements seem to be much more of a problem in Japan than the U.S., in great part because in the U.S. there seems to be much, much more of a change of control threat for underperforming managements than is the case in Japan. The control groups in each of the Hong Kong companies in Third Avenue portfolios are all major shareholders in their companies. Together with the

families, each control group usually owns at least 50% of the outstanding common stock.

2. In concentrating on companies with strong financial positions, Third Avenue is dealing in 2012 with managements willing to sacrifice return on equity (“ROE”) and return on investment (“ROI”) for the safety and opportunism inherent in a strong financial position.

3. Third Avenue is involved largely with really deep down discounts from our estimates of NAV. The OPMI markets seem efficient enough to reason that in most cases deep discounts reflect a lack of near to intermediate term catalysts.

4. Third Avenue does not borrow money. Third Avenue pretty much ignores market risk and goes to great lengths to try to avoid investment risk. If one is to borrow money, it is advisable to try to guard against market risk.

5. Most asset-rich securities in the Third Avenue portfolios are general market securities. Near-term price performance seems likely to be dominated by top-down considerations, e.g., the Eurozone.

I will write you again when the shareholder letters for the year to end October 31, 2012 are published.

Sincerely yours,

Martin J. Whitman

Third Avenue Value Fund
(Unaudited)

Ian Lapey
Portfolio Manager of
Third Avenue Value Fund

Dear Fellow Shareholders:

During the quarter we initiated four new positions and added to nine existing positions. A discussion of the significant purchases follows below. We trimmed several large positions (Brookfield Common, Forest City Common, Posco Common, Covanta Common, Toyota Common and Investor AB Common) to maintain prudent position sizes as the Fund continued to experience net redemptions, albeit at more moderate levels as the quarter progressed. We also continued to reduce the Fund's Hong Kong exposure (currently 35%, down from 39% on April 30th) to make the portfolio more diversified, a strategy I have discussed in each of the last two shareholder letters. The Fund no longer has any individual positions that exceed 10% of total assets. Finally, we exited a few small non-core positions. The Fund's cash position totaled 8% at quarter end.

QUARTERLY ACTIVITY

Number of Shares	New Positions
14,499,000 shares	Daiwa Securities Group, Inc. Common Stock ("Daiwa Common")

Number of Shares	New Positions (continued)
130,000 shares	Nintendo Co. Ltd. Common Stock ("Nintendo Common")
92,333 shares	Stanley Furniture Co. Inc. Common Stock ("Stanley Common")
1,550,000 shares	Symantec Corp. Common Stock ("Symantec Common")
	Positions Increased
28,201 shares	Alleghany Corp. Common Stock ("Alleghany Common")
1,105,000 shares	Applied Materials, Inc. Common Stock ("Applied Materials Common")
185,000 shares	Comerica, Inc. Common Stock ("Comerica Common")
607,195 shares	Devon Energy Corp. Common Stock ("Devon Common")
425,000 shares	KeyCorp Common Stock ("Key Common")
4,000,000 shares	Lai Sun Garment Intl., Ltd. Common Stock ("Lai Sun Common")
271,890 shares	Sycamore Networks, Inc. Common Stock ("Sycamore Common")
3,201,350 shares	Tellabs, Inc. Common Stock ("Tellabs Common")
10,892 shares	White Mountains Insurance Group, Ltd. Common Stock ("White Mountains Common")
	Positions Decreased
701,522 shares	Brookfield Asset Management, Inc. Class A Common Stock ("Brookfield 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 July 31, 2012: Henderson Land Development Co., Ltd., 9.88%; Posco (ADR), 8.27%; Wheelock & Co., Ltd., 7.83%; Cheung Kong Holdings, Ltd., 7.81%; Hang Lung Group, Ltd., 4.96%; Toyota Industries Corp., 4.80%; Investor AB, 4.57%; Brookfield Asset Management, Inc., 4.55%; Bank of New York Mellon Corp., 4.53%; and Covanta Holding Corp., 4.52%.

Number of Shares	Positions Decreased (continued)
1,447,000 shares	Cheung Kong Holdings, Ltd. Common Stock ("Cheung Kong Common")
1,348,361 shares	Covanta Holding Corp. Common Stock ("Covanta Common")
2,849,297 shares	Forest City Enterprises, Inc. Class A Common Stock ("Forest City Common")
1,297,000 shares	Hang Lung Group, Ltd. Common Stock ("Hang Lung Common")
5,448,000 shares	Hang Lung Properties, Ltd. Common Stock ("Hang Lung Common")
8,101,858 shares	Henderson Land Development Co., Ltd. Common Stock ("Henderson Common")
7,789,000 shares	Hutchison Whampoa, Ltd. Common Stock ("Hutchison Whampoa Common")
1,298,032 shares	Investor AB, Class A Common Stock ("Investor AB Common")
210,472 shares	Posco ADR Common Stock ("Posco Common")
56,025 shares	SFSB Inc. Common Stock ("SFSB Common")
70,500 shares	Toyota Industries Corp. Common Stock ("Toyota Common")
2,239,000 shares	Wharf Holdings, Ltd. Common Stock ("Wharf Holdings Common")
	Positions Eliminated
5,459 shares	Carver Bancorp, Inc. Common Stock ("Carver Common")
752,574 shares	Cenovus Energy, Inc. Common Stock ("Cenovus Common")
21,798 shares	Forest City Enterprises, Inc. Class B Common Stock ("Forest City B Common")

PORTFOLIO ADDITIONS

The significant portfolio additions during the quarter fall into three buckets: financials, high tech, and oil and gas exploration and production ("E&P"). The following is a review of each area.

FINANCIALS

The common stock prices of many global financial institutions are depressed owing to a host of factors including the European sovereign debt crises, a slowing global economy, increased regulation and capital requirements, lingering litigation issues from the 2008-2009 financial crises and several well publicized blow-ups including JP Morgan's massive "London Whale" trading loss. This gloomy environment has created opportunities to buy the common stocks of well-capitalized and prudently managed companies at discounts to tangible book value. The discounts to net asset value are considerably larger when factoring in off-balance sheet assets, which for various financial holdings of the Fund include fee generating assets under management, low cost federally insured deposits and the float of the insurance business that results from being able to invest premiums before paying claims.

During the quarter, we added to our positions in the common stocks of two regional banks (KeyCorp and Comerica, Inc.) and two property and casualty insurers (White Mountains Insurance Group and Alleghany Corp.). These investments were discussed in last quarter's letter. In all four cases, business performance in 2012 has been healthy and market volatility presented opportunities to add to our holdings at wider discounts to tangible book value during the quarter. We also initiated a new position in the common stock of Daiwa Securities Group, Inc. This investment was sourced by Senior Research Analyst Jakub Rehor and initially purchased in the Third Avenue International Value Fund in late 2011 and discussed in that Fund's first quarter shareholder letter. Daiwa is the second largest Japanese brokerage. The company has a strong and profitable retail business and a growing asset management business. Recently, the company has been restructuring its wholesale business, and the results have been reflected in two consecutive profitable quarters. Daiwa's track record is reasonable, as it largely avoided trouble during the financial crises, and it has a very strong financial position with a 27.4% capital adequacy ratio versus a required minimum of 8%. Importantly, the company does not focus on proprietary trading, unlike many of its global peers. While the company's primary focus is Japan, it also offers comprehensive stock research pan-Asia. Shares of Daiwa were purchased at a 27% discount to June 30th tangible book value and more than a 35% discount to estimated net asset value.

OIL AND GAS E&P

The Fund significantly reduced its energy exposure in 2011, exiting its position in Cimarex Common. During the most recent quarter, the Fund exited its small position in Cenovus Common, allocating the capital to Devon Common, which appears to be much more attractively valued. The Fund initiated its position in Devon Common in January 2012, and the investment has been discussed in each of the last two shareholder letters. Devon's common stock price has been falling recently, owing primarily to weakness in commodity prices. In Devon's recently reported second quarter, oil, natural gas and natural gas liquids prices fell 19%, 54% and 26%, respectively, compared to a year ago. Nevertheless, the company reported a profitable and cash flow positive quarter (including proceeds from the closing of its previously announced joint venture with Sinopec). The company also announced a new $1.4 billion joint venture with Sumitomo Corporation, in which Sumitomo will pay $340 million in cash upon closing and fund 70% of Devon's future capital requirements for a 30% interest in 650,000 acres (no proved reserves) in two oil shale developments in Texas. Devon will continue to operate the properties and retain a 70% ownership interest. The transaction appears to be very attractive for Devon, as Sumitomo is effectively paying up for Devon's expertise by funding most of the capital.

Despite the pressure from falling commodity prices, Devon continues to have a very strong financial position, with $7 billion of cash compared to $10.6 billion of debt. Net debt totals only 14% of capital and $0.20 per thousand cubic feet equivalent ("mcfe") of proved reserves. Devon added to its hedges during the quarter and now has 65% of its gas production hedged for the rest of the year at $3.76 per mcfe (versus the current price of about $3) and 85% of its oil hedged at $97 (versus the current price of about $90). The valuation seems to be very compelling at about $9 per barrel of oil equivalent ("BOE") of proved reserves. In 2009 and 2010, Devon exited its less attractive Gulf of Mexico and international operations at a price of about $45 per barrel of proved reserves. More recently, Nexen, a Canadian E&P company, agreed to be sold to CNOOC for about $19 per BOE of proved reserves. Although Nexen's reserves are more heavily weighted to oil, Devon's assets carry less development risk as evidenced by its much lower percentage of proved undeveloped ("PUD") reserves (26% versus 53%).

"The Fund's approach to investing in technology common stocks is to look for companies with extremely strong financial positions (cash in excess of total liabilities and / or net cash of at least $1 billion), competent management teams and healthy long-term growth potential. In terms of pricing, we pay less than two times revenues and ten times peak earnings, provided that we believe the next peak will be higher."

HIGH TECH

The Fund's approach to investing in technology common stocks is to look for companies with extremely strong financial positions (cash in excess of total liabilities and / or net cash of at least $1 billion), competent management teams and healthy long-term growth potential. In terms of pricing, we pay less than two times revenues and ten times peak earnings, provided that we believe the next peak will be higher. Often, these opportunities only occur when the near-term earnings outlook is poor either owing to cyclical or product timing issues. Given the inherent difficulty in picking the winners and losers in this industry, we usually select a basket of securities, limiting individual positions to 1%-3% of the portfolio.

We initiated a position in the common stock of Symantec Corp., a leading provider of security, backup / recovery and storage management software. The company's products are sold to both consumers (through its Norton product line) and corporations. Symantec's end markets seem to be generally healthy and growing, and the software business is very attractive owing to recurring maintenance revenue, high margins (gross margins in excess of 80%) and robust cash flow generation. Symantec has a very strong financial position with $4.1 billion of cash and investments, compared to total debt of $3.0 billion. During the quarter, the company issued $1 billion of long-term debt at very attractive rates (2.75% and 3.9% for five and ten year maturities, respectively). Owing primarily to the weak near term outlook for enterprise IT spending, particularly in Europe, the Fund purchased shares of Symantec Common at only about five times earnings before interest, taxes, depreciation and amortization ("EBITDA"). Transactions in the software industry typically occur at much higher multiples, including, most notably, Intel's purchase of Symantec's competitor, McAfee, in 2011 at about 15 times EBITDA. Subsequent to quarter end, Symantec's CEO was replaced by Chairman Stephen Bennett, who was formerly Intuit's CEO from 2003-2007. The move was in response to the weak stock performance of Symantec Common over the last couple of years and enhances the possibility of some type of resource conversion activity to increase shareholder value.

The Fund also initiated a small position in Nintendo Common. Based in Japan, Nintendo is a producer of video game hardware and software. Throughout most of its history, the company has been quite profitable owing to successful products, such as the Wii video game console (hardware) and the Super Mario Brothers and The Legend of Zelda software franchises. However, currently the company is losing money because of fierce competition from traditional competitors (Sony's Playstation and Microsoft's Xbox), as well as new competition from mobile gaming platforms. Despite these significant challenges, Fund Management believes that the company has numerous levers to return to profitability, including the potential success of some of its upcoming products and / or a shift in its operating model to allow its software to be used on competitors' platforms. The shares were purchased at a price that equates to the value of the company's cash and investments, land and 55% ownership stake in the Seattle Mariners, ascribing no value to its tremendous software library and brand name.

We added to our positions in the common stocks of telecommunications equipment suppliers Tellabs and Sycamore. These two common stocks are the lone remaining investments from the basket of telecom equipment companies purchased by Third Avenue funds about 10 years ago, that also included the common stocks of Ciena Corp., Comverse Technology, Inc. and Ulticom, Inc. While Sycamore and Tellabs have retained very strong financial positions, the business and stock performance has been disappointing compared to our previous holdings in this industry, resulting in current valuations that are extremely depressed. Shares of Sycamore Common were purchased during the quarter at a discount to the company's cash and investments, meaning that we paid nothing for the existing business, new products, patents and net operating losses totaling about $1 billion. Tellabs Common was purchased at a valuation that equates to about 15% of revenues and only a slight premium to the company's cash and short-term investments despite the company's strong customer base (40 of the top 50 carriers worldwide) and recent business momentum, including second quarter sequential revenue growth of 12%, operating margin improvement of more than 1000 basis points and positive free cash flow.

We also added to our position in Applied Materials Common, which was discussed in last quarter's letter. The share price has been weak of late owing to a deteriorating 2012 earnings outlook. Demand for semiconductor capital equipment appears to have been negatively impacted by the slowing global economy. Nevertheless, Applied Materials' financial and market positions remain strong, and the shares were purchased at an attractive price of about nine times 2011 earnings.

POTENTIAL IMPACT OF A HARD LANDING IN CHINA ON TAVF'S HONG KONG HOLDINGS

Barron's recently published a cover story titled "FALLING STAR. The Chinese economy is slowing and is likely to slow a lot more. Get ready for a hard landing with growth falling to 3% to 4%. Big trouble for Hong Kong housing stocks." This article prompted a flurry of questions both internally and from clients. The crux of the article is that the economy in China will continue to slow and that residential real estate prices and the common stock prices of leveraged China homebuilders will fall.

Company Name	Debt to Equity	Price to NAV
China Homebuilders[1]		
China Overseas Land & Investment Ltd.	62%	2.1
China Resources Land Ltd.	101%	1.5
Everglade Real Estate Group Limited	158%	1.4
Longfor Properties Co., Ltd.	109%	2.2
Country Garden Holdings Company Limited	100%	1.5
Poly (Hong Kong) Investments Limited	166%	0.6
Shimao Property Holdings Ltd.	139%	1.0
Hopson Development Holdings Ltd.	86%	0.2
New World China Land Ltd.	50%	0.5
Guangzhou R&F Properties Co., Ltd.	126%	1.2
Agile Property Holdings Ltd.	102%	1.2
Franshion Properties (China) Ltd.	96%	0.8
Sino-Ocean Land Holdings Ltd.	95%	0.5
Yuexiu Property Company Limited	111%	0.7
Shui On Land Limited	99%	0.5
Greentown China Holdings Limited	374%	0.9
Median	**102%**	**1.0**

	Debt to Equity	Price to NAV
TAVF Hong Kong Real Estate and Investment Companies[2]		
Cheung Kong Holdings Ltd.	14%	0.7
Hang Lung Group Ltd.	11%	1.1
Henderson Land Development Co Ltd.	30%	0.6
Wheelock & Co. Ltd.	15%	0.5
Median	**15%**	**0.7**

[1] Source *Barron's*, 7/2/12. Valuation data updated for 7/31/12.
[2] Source Company reports. Based on last reported NAV (6/30/12 for Cheung Kong and Hang Lung; 12/31/11 for Henderson and Wheelock). Prices as of 7/31/12.

We certainly acknowledge that there has been over-investment in residential real estate (the article points out that new residential real estate as a percent of GDP has increased to about 14% from 5% in 1998), and we would never own the common stock of a leveraged China homebuilder. Nevertheless we continue to be very excited about our Hong Kong holdings, even with a slowing Chinese economy, for the following reasons:

- **Strong Financial Positions.** Unlike the China homebuilders listed in the *Barron's* article, the companies in whose common stocks the Fund is invested have very strong financial positions. As the table above indicates, the debt to equity ratios of the Fund's significant holdings range from 11% to 30% compared to 50% to 374% for the sixteen companies in the *Barron's* article. These strong financial positions served the Fund's holdings well during the Great Recession and Credit Crises in 2008-2009, when none had to raise dilutive equity. I would expect a similar outcome if the 3-4% China GDP growth hard landing scenario discussed in the article materializes.
- **A slow down creates opportunities.** Economic slowdowns can create great opportunities for strongly financed companies with opportunistic management teams. Each of our companies is expanding their presence in China and would welcome the opportunity to buy land or other assets at distressed prices. For example, in late 2011, Hang Lung

purchased land in China (Kunming) for the first time since 2009, as the slowdown created a much less competitive government land auction.

More recently, in June 2012, Wheelock and Company, whose common stock is owned by the Fund and discussed in this quarter's Chairman's letter, announced that its subsidiary, The Wharf Ltd., whose common stock is also a small fund holding, made a $HK 5.1 billion capital infusion into Greentown China. Founded in 1995, Greentown is a leading China homebuilder with a strong brand name and a 41 million square foot land bank. The capital infusion consisted of common stock at a 3% discount to the market price at the time of the announcement and a 9% perpetual security convertible at a 38% premium. Through the transaction, Wharf and Greentown will become strategic partners in China, and Wharf will be represented on Greentown's board. Since the transaction was announced, Greentown China common has appreciated 53% giving Wharf a 35% effective ownership stake and huge paper gain on its investment. The opportunity was created by the softening residential property market over the last year and Greentown's over leveraged balance sheet. This is the type of capital infusion that the Fund would look to make directly in a U.S. company, but in China we are happy to participate through Wheelock and Wharf Common.

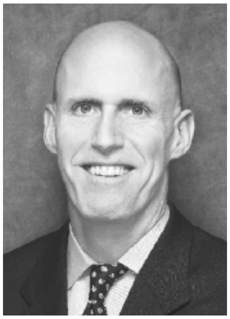
- **Discounted valuations.** The common stock prices of our Hong Kong holdings already seem to discount a hard landing in China. As the preceding table indicates, our four largest Hong Kong holdings trade at median multiples to reported net asset value of 0.7 times, compared to 1.0 times for the China homebuilders listed in the *Barron's* article. These discounts are much wider than they have been historically and seem to imply that the net asset values for our holdings will be falling. However, based on the still healthy leasing income growth and the recent robust property development margins, we believe that net asset values will continue to grow.

  In fact, Hang Lung Group and Cheung Kong recently reported healthy results for the first half of 2012, including leasing income growth of 14% and 33%, respectively. Both companies also reported increases in the fair market values of their investment properties (e.g., office buildings and shopping malls). Surprisingly, despite the well publicized slowdown in the residential property markets in Hong Kong and China, property development margins remained robust (62% for Hang Lung and 39% for Cheung Kong), owing primarily to the companies' low cost land bases. Wheelock and Henderson will be reporting by the end of the month, and we also expect their results to be healthy.

The Fund's performance has improved in 2012, however, it remains very attractively valued. As of July 31, 2012, the Fund traded at only 0.76 times book value, compared to multiples of 2.24 and 1.49 for the S&P 500 and MSCI World indices, respectively. For the most part the Fund's performance in 2012 has been driven by the healthy growth in net asset values of its holdings as discounts remain quite wide. I shall write to you again when we publish our fiscal year-end report, dated October 31, 2012. Thank you for your continued interest in the Fund.

Ian Lapey
Portfolio Manager
Third Avenue Value Fund

Third Avenue Small-Cap Value Fund
(Unaudited)



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

Dear Fellow Shareholders:

During the quarter, Small-Cap Value (the "Fund") initiated seven new positions, added to 18 of its 64 existing positions, eliminated six positions and reduced its holdings in 14 companies. At July 31, 2012, Small-Cap Value held positions in 62 common stocks, the top 10 positions of which accounted for approximately 23% of the Fund's net assets.

Number of Shares	New Positions Acquired
328,302 shares	AVX Corp. Common Stock ("AVX Common")
38,167 shares	Cal-Maine Foods, Inc. Common Stock ("Cal-Maine Common")
217,455 shares	Darling International, Inc. Common Stock ("Darling Common")
232,225 shares	Harman International Industries, Inc. Common Stock ("Harman Common")
336,175 shares	Kennametal, Inc. Common Stock ("Kennametal Common")
255,908 shares	LSB Industries, Inc. Common Stock ("LSB Common")

Number of Shares	New Positions Acquired (continued)
432,505 shares	Progress Software Corp. Common Stock ("Progress Software Common")
	Increases in Existing Positions
2,853 shares	Alleghany Corp. Common Stock ("Alleghany Common")
19,464 shares	Bristow Group, Inc. Common Stock ("Bristow Common")
10,000 shares	Compass Minerals International, Inc. Common Stock ("Compass Common")
83,350 shares	Electro Scientific Industries, Inc. Common Stock ("ESI Common")
11,014 shares	EMCOR Group, Inc. Common Stock ("EMCOR Common")
64 shares	Encore Wire Corp. Common Stock ("Encore Common")
46,882 shares	Excel Trust, Inc. Common Stock ("Excel Common")
31,049 shares	ICF International, Inc. Common Stock ("ICF Common")
33,904 shares	Jos. A. Bank Clothiers, Inc. Common Stock ("Joseph Bank Common")
60,000 shares	Leucadia National Corp. Common Stock ("Leucadia Common")
10,000 shares	Mantech International Corp. Class A Common Stock ("Mantech Common")
7,903 shares	Minerals Technologies, Inc. Common Stock ("Minerals Technologies Common")
75,000 shares	Oshkosh Corp. Common Stock ("Oshkosh 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 July 31, 2012: Teleflex, Inc., 2.73%; Seacor Holdings, Inc., 2.54%; Semgroup Corp., 2.44%; Alleghany Corp., 2.37%; Liberty Media Corp., 2.34%; Madison Square Garden, Inc., 2.29%; Oshkosh Corp., 2.20%; Bristow Group, Inc., 2.01%; Broadridge Financial Solutions, Inc., 1.92%; and Segro PLC, 1.92%.

Third Avenue Small-Cap Value Fund (continued)
(Unaudited)

Number of Shares or Units	Increases in Existing Positions (continued)
18,733 shares	Park Electrochemical Corp. Common Stock ("Park Common")
494,237 shares	Rofin-Sinar Technologies, Inc. Common Stock ("Rofin-Sinar Common")
100,000 shares	Segro PLC Common Stock ("Segro Common")
2,652 shares	Superior Industries International, Inc. Common Stock ("Superior Common")
20,000 shares	Unifirst Corp. Common Stock ("Unifirst Common")
	Positions Reduced
46,338 shares	Ackermans & van Haaren N.V. Common Stock ("AvH Common")
4,566 shares	Alamo Group, Inc. Common Stock ("Alamo Common")
23,682 shares	Alico, Inc. Common Stock ("Alico Common")
271,787 shares	American Eagle Outfitters, Inc. Common Stock ("American Eagle Common")
50,000 units	AP Alternative Assets, L.P. Limited Partnership ("AP Alternative L.P.")
39,555 shares	Bel Fuse, Inc. Class B Common Stock ("Bel Fuse Common")
303,100 shares	Canfor Corp. Common Stock ("Canfor Common")
162,387 shares	Cloud Peak Energy, Inc. Common Stock ("Cloud Peak Common")
150,498 shares	Cross Country Healthcare, Inc. Common Stock ("Cross Country Common")
41,840 shares	Electronics For Imaging, Inc. Common Stock ("EFI Common")
10,000 shares	Haemonetics Corp. Common Stock ("Haemonetics Common")
344,983 shares	Ingram Micro, Inc. Class A Common Stock ("Ingram Common")

Number of Shares	Positions Reduced (continued)
6,452 shares	JAKKS Pacific, Inc. Common Stock ("JAKKS Common")
102,356 shares	Kaiser Aluminum Corp. Common Stock ("Kaiser Common")
65,681 shares	Lanxess AG Common Stock ("Lanxess Common")
23,270 shares	Liberty Media Corp. Common Stock ("Liberty Common")
221,041 shares	Madison Square Garden, Inc. Class A Common Stock ("MSG Common")
579,849 shares	P.H. Glatfelter Co. Common Stock ("Glatfelter Common")
154,336 shares	Pioneer Energy Services Corp. Common Stock ("Pioneer Common")
13,976 shares	SEACOR Holdings, Inc. Common Stock ("SEACOR Common")
30,537 shares	SemGroup Corp. Class A Common Stock ("SemGroup Common")
625,650 shares	Tellabs, Inc. Common Stock ("Tellabs Common")
262,424 shares	Vail Resorts, Inc. Common Stock ("Vail Resorts Common")
1,173 shares	Wacker Neuson SE Common Stock ("Wacker Common")
	Positions Eliminated
164,639 shares	Aeropostale, Inc. Common Stock ("Aeropostale Common")
182,302 shares	Alexander & Baldwin, Inc. Common Stock ("Alex Common")
667,088 shares	Investment Technology Group, Inc. Common Stock ("ITG Common")
857,266 shares	MEMC Electronic Materials, Inc. Common Stock ("MEMC Common")
144,867 shares	Sycamore Networks, Inc. Common Stock ("Sycamore Common")
232,087 shares	Viterra, Inc. Common Stock ("Viterra Common")

QUARTERLY ACTIVITY

Fund Management continued to identify and execute on several new investment ideas during the quarter, four of which are discussed in some detail below. As far as dispositions, the Fund realized a 94% IRR in its relatively brief holding in Aeropostale, evidence that good returns may be made even when connected to difficult businesses like retailing. The Fund completed its successful investments in Alexander Common and Viterra Common, long-time holdings whose values were crystallized via "resource conversions"[1] that unfolded during recent periods. The Fund realized losses on its investments in ITG Common and MEMC Common. Fund Management's thesis for ITG Common coming out of the financial crisis in 2009 rested largely on the assumption that the company's trading and execution platforms, supported by a highly liquid, debt free balance sheet, would benefit as equity markets recovered. While equity markets did recover, heightened competitive conditions and weakness among its institutional investor customers gutted the company's earning power. We do not see these negative trends changing. MEMC, a manufacturer of silicon wafers used in semiconductor fabrication and of solar modules, was overwhelmed by a global supply glut within its solar business and suffered from a complex business model that gobbled up cash, a lethal combination when combined with what had evolved into an inappropriately leveraged capital structure.

Followers of the Fund will remember that a small position in Rofin-Sinar Common was initiated during the April quarter[2]. That position became much more meaningful in the July quarter. Additional shares of Rofin-Sinar were purchased as the discount to our estimate of net asset value widened and became more attractive amidst broader macro and near-term earnings concerns. In our April letter, we noted simply that Rofin-Sinar is an "industrial capital equipment company." In plain English, the company makes lasers and parts for lasers – lasers for cutting, lasers for welding, lasers for marking materials and lasers for medical equipment.

With one of its two headquarters in Germany[3], cyclical end markets, more than 40% of sales from Europe and a third from Asia, there is plenty to dislike in the near-term for top-down investors as macro concerns and uncertainty swirl. In a bottom-up analysis, however, there is much more to like for investors with a time horizon beyond a year or two:

- the balance sheet is rock-solid with about 19% of the company's market cap as net cash and a history of generating excess cash;
- the company has been profitable every year since listing publicly in 1996;
- management has an impressive track record of compounding revenue and earnings at double digit rates over the past 10+ years;
- a service and parts business provides a base of higher-margin recurring revenue;
- shares trade at only a slight premium to book value, while returns on equity have averaged 10%+ as a public company;
- application expertise and a global support network provide differentiation for products operating in demanding manufacturing environments;
- prospects for attractive longer-term business growth are reasonable, as lasers take share from more traditional means of cutting, welding and marking materials; and

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[1] Resource Conversion, broadly defined, may include activities that help to realize value inherent in a company's assets and liabilities and may include mergers and acquisitions, bulk share repurchases, the acquisition and disposition of assets or refinancing of liabilities. Glencore announced its intention to acquire Viterra in a cash transaction while Alexander and Baldwin split the company into two separate, publicly-listed businesses.

[2] Long-time followers of the Fund will recognize Rofin-Sinar as a former holding, exited in 1999.

[3] Rofin-Sinar has dual headquarters in Plymouth, Michigan and Hamburg, Germany. The company is incorporated in Delaware.

- the current market valuation appears to offer limited downside over a reasonable timeframe, yet represents a meaningful discount to precedent transactions in a consolidating market.

In sum, Rofin-Sinar has been a very well managed business with an expanding, albeit cyclical, market opportunity. If past is prologue, management is likely to continue compounding value for shareholders at attractive rates, even as a given quarter or year may fall short of the earnings capacity and longer-term business potential.

Kennametal is a global producer of tools, highly engineered components and advanced materials serving a broad range of industries, including the energy, construction, aerospace, transportation and machine tool industries. Examples of Kennametal's products include radial bearings used in oil and gas drilling operations or grader blades used for road maintenance. These products have to work in environments where thermal shocks, corrosion and other harsh conditions are commonplace. Such demanding conditions require products with wear resistance and long lives on the one hand, but also translate into "consumables" that provide a high degree of recurring revenue for the business.

Kennametal's operations are highly cash generative and enjoy strong competitive positions. Meanwhile management seems to be focused on the right things, both commercially and as capital allocators: improving the customer value proposition through innovation, balancing organic growth and acquisitions and sharing excess capital with shareholders via buybacks and a growing dividend. Kennametal derives more than half its sales from outside the U.S., however, where economic headwinds of late have stiffened considerably, while some of the company's end markets, such as oil and gas, have softened for industry specific reasons. For investor/speculators hewing to a short-term timeframe, these may be legitimate concerns. As investors with a long-term time horizon, we are willing to tolerate temporary weakness in a business when the company has compelling longer-term business prospects, an impregnable financial position, a sensibly incentivized and competent management team and where the shares trade at a significant discount to intrinsic value. In Kennametal's case, we view the opportunity to acquire shares in the mid $30's per share, equating to about nine times earnings, an attractive one given our estimate of intrinsic value in excess of $50. Operating in what we view as "cyclical growth" markets where the "growth path" is unlikely to be a straight one, Kennametal, nonetheless, ought to have ample opportunities to grow at above average rates in the coming years.

The positions initiated in LSB Common and Harman Common reflect the value of patience and the importance of an inventory of investment candidates.

LSB Industries is the unlikely combination of a heating, ventilation and air conditioning (HVAC) business and a nitrogen-based chemical products company. The business mix had been more eclectic until the 1990s, when management focused the company on those businesses in which it had a more compelling market position.

The HVAC business is a market leader in geothermal and water source heat pumps, which are highly efficient heating and cooling systems. The business is leveraged to commercial, institutional and residential construction, as well as a longer-term trend towards "green" or more energy-efficient construction. We think the business is under earning its potential in an economic recovery, something that we are not paying for at present.

The chemicals business provides nitrogen or ammonia-based agricultural, mining and industrial chemicals to the North American market. Low domestic natural gas prices are providing attractive feedstock costs relative to imports, while longer-term "cost plus" agreements for industrial and mining products mitigate feedstock price volatility and help provide a steadily profitable base load.

Our first encounter with LSB Industries occurred at a conference in early 2011, where we were intrigued by its resource conversion potential as a small company with disparate businesses, a healthy balance sheet with a net cash position, and apparent alignment of management with shareholders given management's ownership of more than 20% of the company. We elected to wait on the sidelines watching the business develop and business value grow until this past quarter when operational issues associated with the restart of a long dormant facility in Pryor, Oklahoma and a separate explosion at an El Dorado, Arkansas plant clouded the near-term earnings picture, providing entrée for the Fund. Earnings from the HVAC business, replacement value of the chemical assets, a longer-term feedstock cost advantage provided by U.S. shale gas production and insurance coverage appear to more than offset the near-term disruption and decline in share price. We estimate intrinsic value is north of $40 per share.

Harman International is a leading provider of premium branded audio systems, consumer electronics and related technologies found in automobiles, homes and professional venues. Founded in the 1940s by Dr. Sydney Harman[4], the company's rich history has produced not only a legacy of highly-regarded and familiar brands such as Becker, Harman/Kardon, JBL, Infinity, Lexicon and Mark Levinson, but also more than 4,000 patents. By 2007, those brands and an enviable growth record attracted the attention of private equity sponsors KKR and Goldman Sachs who proposed and subsequently walked away from a highly-levered transaction that valued the company at $8 billion. The company's growth driver within the auto segment had temporarily fizzled, challenged by cheaper alternatives. The onset of the financial crisis forced the company's newish CEO, Dinesh Paliwal, to cut costs and adopt a more competitive business model. We first looked at Harman Common in 2009 in the aftermath of the failed buyout and have tracked the company's development since. Today, Harman continues to benefit from management's restructuring efforts, including a revamped and somewhat revolutionary and controversial approach to R&D.[5] If the company's recently awarded auto business, which today totals more than $16 billion, is any indication, it appears management has struck a pleasing chord with a customer base that is notoriously risk averse and difficult to please. The company's infotainment systems are not only found in the world's most luxurious automobiles such as Ferrari, BMW and Mercedes, but also in those of developing OEMs such as Geely of China and Tata of India. Harman's automobile infotainment systems appear to sit in the sweet spot of increasing demand for both connectivity and safety. We expect that, along with a growing top line, the company's current order book will generate improving margins at the same time that management aggressively manages its cost structure. Based on the Fund's cost basis, which equates to roughly six times 2012 EBITDA, we believe we have identified a "growth" stock trading at a significant discount to intrinsic value.

FINANCIAL REPRESSION AND RELATIVE INVESTING

Are you a "relative" investor or an "absolute" investor? The remarkable level of interest rates and repressive monetary policies in much of the industrialized world seems to be forcing investors to think more than ever in relative terms. The common refrain among strategists, advisors and other market observers is that stocks, or other risk assets, are cheap relative to government bonds, the traditional benchmark for risk free investing. That comparison goes something like "*the earnings yield on stocks, at 8%, makes them cheaper relative to Treasuries than at any point in the last 50 years.*" This line of reasoning is even used by many to justify the view that what investors can pay for stocks e.g., the PE ratio, should be much higher than historic levels, pointing out that low interest rates benefit companies by lowering their borrowing costs and by implicitly making streams of corporate cash flow more valuable because the same low rates justify a lower discount rate than in the past. For example, within the

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[4] Dr. Harman, who died in 2011, and the company are credited with a number of technical achievements including, for example, redefining the state of the art for motion picture theatre sound in the 1940s and the introduction in 1958 of the world's first stereo receiver, the TA230.

[5] For anyone interested in corporate innovation, I would encourage you to read how Harman changed its product development within the automobile infotainment products segment: "A Reverse-Innovation Playbook," Harvard Business Review, April 2012.

Small-Cap portfolio Kennametal just refinanced 10-year debt with a coupon of 7.2% by issuing 10-year debt yielding $3\frac{7}{8}$%. In simplified form the relationship between what the investor pays[6] and the Required Rate of Return ("RRR") can be expressed as the following:

$$PE = 1/RRR$$

In turn, the RRR is a function of government bond yields and investor's risk appetite, or the return investors demand over the risk free rate[7]. With the 10-year U.S. Treasury note yielding a nominal rate of 1.6% and assuming investors demand a risk premium of 4.1% - a very rough proxy for historic averages[8] - translates to a 5.7% discount rate, or a PE ratio of 18x. All of this may be reasonable, so long as the investor believes one or more of the following: a) that government bond rates remain appropriate benchmarks; b) investor risk premia remain stable; c) inflationary pressures remain subdued and d) business risks, on average, remain unchanged from the past. In wrestling with this valuation question my team and I discussed whether we should consider lowering our return hurdles, i.e., incorporating higher PE multiples or lower discount rates than in the past to value companies, in light of the low interest rate environment. Our discussion made it clear that now, more than ever, we had to swim against this tide of thinking and remain absolute investors, demanding a minimum return hurdle of at least 10%, even when maintaining such a hurdle undoubtedly reduces our investable universe. Maintaining an absolute goal provides a margin of safety against (i) a jump in interest rates; (ii) an elevated level of inflation or, perhaps worse, deflation or (iii) adverse business developments. In our discussions we especially noted the following:

"Our discussion made it clear that now, more than ever, we had to swim against this tide of thinking and remain absolute investors, demanding a minimum return hurdle of at least 10%, even when maintaining such a hurdle undoubtedly reduces our investable universe. Maintaining an absolute goal provides a margin of safety against (i) a jump in interest rates; (ii) an elevated level of inflation or, perhaps worse, deflation or (iii) adverse business developments."

- **Modest Global Growth Prospects.** Given the recessionary tremors across Europe and a slowdown in various parts of Asia and other emerging markets, economically influential markets to which most global companies are exposed, we believe medium-term business risks have, in general, risen during the past year or two. We are skeptical that highly accommodative monetary policies are "growth initiatives" as advertised, but much more akin to "liquidity hospitals" that merely delay the day of reckoning for a growing clutch of insolvent institutions and governments. Our skeptical (or sober) view means we have to assume not only lower growth, but also a wider range of outcomes for the businesses underlying the stocks held in the Fund, implying the use of a more conservative multiple for valuation purposes.

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[6] Alternatively, the analyst might use a multiple of cash flow in place of earnings.

[7] For example, one would presumably assign a higher risk premium to a venture capital start up investment than to an investment in a fully leased office building with highly creditworthy tenants.

[8] Using geometric average from 1928 – 2011. See Equity Premia Around the World, Dimson, March, Staunton, London Business School.

- **Honey, I Shrunk the Multiple.** This reference is not a sequel to the comedy starring Rick Moranis, but a nightmare for common stock investors known in financial parlance as multiple compression. As investors, we have to consider the possibility that we live in an extended period of multiple compression that may impact all equities, where investors are willing to pay less and less for a given amount of earnings. For example, S&P 500 companies, on average, have seen their earnings multiple sliced roughly in half since 2000 despite a nearly doubling in earnings during the past twelve years. In a period of corporate prosperity then, S&P investor returns have basically been flat, as multiple compression undercut corporate progress. PE ratios tend to be correlated with general price trends in the economy. Very high rates of inflation, rapid spikes in inflation or deflation, for example, tend to be correlated with lower PE ratios, while price stability is generally positive for PE ratios[9]. It seems to us that the Age of Financial Repression and Debt De-leveraging may well be associated with further multiple compression. At best, we can not, as analysts, create an investment thesis that depends on multiple expansion to protect us, nor should we depend on historic, public-market multiples as a guide to the future.

- **What's the price of money?** In nominal terms, the U.S. government can borrow at 0.5% for five years and at 1.6% for 10 years; unfortunately, as the Treasury curve sits today, this puts real returns at negative levels out to about 20 years. Even nominal rates on short-term government debt in selected European countries such as Denmark, France, Germany and Switzerland have turned negative, meaning investors are paying those governments to hold their savings. In short, the price of credit seems to be broken[10]. Given that, does it make sense for savers to continue comparisons of prospective returns in risky assets with something whose return reflects both utter panic on the part of savers and manipulation by central banks? We think not.

Coming out of the Great Recession, we spend a bit more time pondering the macro backdrop against which our portfolio companies exist while eschewing any predictions about the future. We have offered up a few snippets from that thinking above and continue to focus with great urgency and energy on the companies in the portfolio and to seek out qualifying investments that meet our investment criteria.

I look forward to writing you again when we publish our Annual Report dated October 31, 2012. Thank you for your continued support.

Sincerely,

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

[9]See Crestmont Research www.crestmontresearch.com

[10]For further evidence that the price of credit, or the system that creates it, is broken, look no further than the unfolding Libor scandal.

Third Avenue Real Estate Value Fund
(Unaudited)

Michael H. Winer
Co-Portfolio Manager of
Third Avenue Real Estate Value Fund

Jason Wolf
Co-Portfolio Manager of
Third Avenue Real Estate Value Fund

Dear Fellow Shareholders:

If portfolio managers were evaluated on the volume of portfolio activity (buys and sells), our quarterly report card might seem to indicate we took the summer off. Rest assured; that is not the case. But sometimes the best action is inaction, especially if one is focused on absolute value instead of relative value when making investment decisions. We have excluded our traditional summary of quarterly investment activity for the simple reason that, during the quarter, activity was inconsequential.

In previous quarters, we highlighted the Fund's elevated activity levels. In the late summer of 2011, we deployed significant capital to a slate of ideas that had reached attractive valuations as a result of a global market correction. In last quarter's letter, we described our sell discipline and how securities may move from the portfolio back to our watch list and how our approach leads to well-lower than average portfolio turnover, as any strategy predicated on patience must. Portfolio activity is driven by the valuations of our holdings and the valuations of securities that we have identified as potential holdings at the right price.

Year-to-date, through July 31, 2012, the Fund generated a return of 20.7%. The Fund's annualized one-year, three-year, five-year, ten-year and since inception (September 1998) returns for the periods ended July 31, 2012 were 15.3%, 12.7%, -1.6%, 8.7% and 10.8%, respectively[1]. We attribute the recent performance to (i) the continued fundamental improvement of our holdings and (ii) the rebound in market prices from the discounted valuations that we took advantage of during the second half of 2011 when much of the Fund's cash reserves were invested. Notwithstanding the Fund's solid year-to-date performance, as highlighted below, several of the Fund's holdings that we believe have substantial embedded value have yet to contribute significantly to performance, as they have not been fully recognized by the public market or the private market (resource conversion potential).

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 July 31, 2012: Forest City Enterprises, Inc., 7.63%; Brookfield Asset Management, Inc., 5.67%; Hammerson PLC, 5.53%; Cheung Kong Holdings, Ltd., 4.61%; Wheelock & Co., Ltd., 4.29%; Weyerhaeuser Co., 3.92%; Westfield Group, 3.36%; Vornado Realty Trust, 3.27%; Lowe's Cos., Inc., 3.17%; and Henderson Land Development Co., Ltd., 3.05%.

[1] Fund performance returns are net of fees and assume reinvestment of dividends. Past performance is no guarantee of future results. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than original cost. Current performance results may be lower or higher than performance numbers quoted. Please call 1-800-443-1021, or visit our web site at: www.thirdave.com, for the most recent month-end performance data or a copy of the Fund's prospectus.

We remain cautiously optimistic about the general state of global real estate and real estate securities given the supportive investment underpinnings for hard assets (e.g., stable cash flows, historically low interest rates, and limited new supply), and see no reason this will change over the medium term despite periodic market spasms. This positive backdrop, however, is becoming the consensus view, which invariably leads to a diminished opportunity set for value enthusiasts. Our recent inactivity is a byproduct of this trend. However, given the number of risk events on the horizon, opportunities are likely to materialize and we will be properly positioned to act decisively given our substantial dry powder (cash and equivalents at the fiscal quarter end totaled 13.3% of Fund net assets). In the meantime, we have re-doubled our analytical efforts on our existing holdings while continuing to survey the landscape for new prospects. For example, we have recently initiated a position in the Senior Notes of JC Penney, a U.S. based department store retailer with substantial real estate assets. We will further outline this security next quarter. In addition, we have expanded our "T-2" portfolio, or list of securities that we want to own at lower prices, as our recent focus in analyzing and visiting with European real estate companies has resulted in several new investment prospects. Our style, though, is to be very disciplined and stingy while waiting for "our" price. In the August 6, 2012 issue of *Forbes* magazine, the Fund was the subject of an article that highlighted our long-term investment approach and several of our holdings in Hong Kong and Australia. The prime take-away from the article was summed in the final quote: "*Says Winer: 'Patience is not only a virtue here. It is a requirement.'*"

Investment patience means maintaining a strict, price-conscious approach at entry, staying diligent in analyzing and adapting to changing information during the holding period, ignoring the noise created by media, politicians and so-called market experts and focusing on industry and individual company fundamentals. Being price conscious at initiation is critical despite the constant pressure to "put cash to work". Of equal importance is the crucial art of staying diligent and realistic through the holding period. Rarely is an investment as simple as buying at a discount and then selling at a target price. Real estate companies' NAVs are dynamic, especially as business plans evolve and corporate developments (i.e., catalysts) unfold. We must monitor corporate developments and continuously reassess our original investment thesis. As is often the case, our original thesis may change or drift toward a new path which could result in re-sizing the position or an outright sale. Furthermore, fickle markets often go through phases that are unaccommodating to our style, which necessitates a disciplined fundamental long-term view to ride out the rough patches. We gain confidence in our positions by continuously reviewing the investment blueprint and reevaluating as the company achieves certain milestones laid out in our plan. The examples below illustrate positions in the portfolio where the business plans changed mid-course and how we adapted.

"Rarely is an investment as simple as buying at a discount and then selling at a target price. Real estate companies' NAVs are dynamic, especially as business plans evolve and corporate developments (i.e., catalysts) unfold. We must monitor corporate developments and continuously reassess our original investment thesis."

EQUITY INFUSION TO TURNAROUND SITUATION (FIRST INDUSTRIAL REALTY TRUST)

The Fund initiated its investment in First Industrial Common during 2010. At the time, the U.S.-based REIT owned a diversified portfolio of industrial properties across the country, but it was priced as a high-probability-reorganization candidate. Acknowledging the substantial headwinds facing the company, we took a view that its primary obstacles (too much debt and sub-optimal occupancy) were temporary and surmountable. Our initial business plan involved taking a position in the common stock and then offering to make an equity infusion (direct investment) at a discounted price (significantly below net asset value) to quickly remediate the high debt levels that restricted management's ability to execute on an occupancy recovery that would boost cash flows and create a virtuous value enhancement cycle. Management was against issuing highly-dilutive equity, choosing instead to reduce leverage gradually through diligent organic growth and by selling non-core assets. Management believed that a combination of postponing new developments, discontinuing common dividend payments, and a gradual economic recovery, would help the company steadily rebuild its cash flow over time, allowing for gradual debt reduction and value recovery in the shares. After detailed discussions with management, we supported the plan and adjusted our investment thesis to a more pedestrian-type turnaround. We scaled back our targeted position sizing based on the risk-adjusted return prospects. After two years in this investment we have substantial unrealized gains from our very attractive entry price. Management's path turned out to be successful. Leverage has declined, overall borrowing costs were reduced and occupancy gains have been impressive. The company has completed two equity offerings at prices substantially higher than our entry price. We anticipate the final milestones - reinstatement of the common dividend and resumption of value-enhancing development activity - will occur in the near future, which should be the catalyst for First Industrial Common to trade in-line with net asset value and its REIT peers.

REIT CONVERSION TO FUTURE POTENTIAL RESOURCE CONVERSIONS (WEYERHAEUSER)

Weyerhaeuser Common is an example of a security that offers multiple ways to win. The Fund initiated its investment in Weyerhaeuser Common at a significant discount to conservative estimates of NAV during a severe cyclical downturn in housing and forest products. Weyerhaeuser is one of the largest timberland owners in the U.S., with secondary businesses in homebuilding, wood products, and cellulose fibers. Our initial business plan was to invest prior to the company converting its structure into a real estate investment trust. Weyerhaeuser's timber REIT peers traded at much narrower discounts to NAV, notwithstanding our opinion that Weyerhaeuser had a superior financial position and owned higher-quality timberlands. We believed that upon conversion to a REIT, Weyerhaeuser Common would trade more in-line with its REIT peers. Additionally, once Weyerhaeuser's subsidiaries (homebuilding and wood products) returned to profitability, they could be candidates for resource conversions (e.g., spin-off or sale). Our initial assessment was correct. In a complex transaction, Weyerhaeuser converted into a REIT in mid-2010. Shortly thereafter, the price-to-value discount shrunk materially. Throughout the housing recession, Weyerhaeuser's cellulose fiber division continued to be profitable while its timber, housing and wood products divisions struggled. For the quarter-ended June 30, 2012, the wood products division had its best quarter in six years and the homebuilding division reported increased profits coupled with dramatic improvement in closings and backlog. With the housing market in the U.S. starting to show signs of a recovery, the company may now be in a position to consider spinning off its homebuilding and wood products divisions. While we believe these two divisions could be worth 15% to 20% of Weyerhaeuser's value, market participants seem to ignore their value because they have not generated consistent profits throughout the downturn. As a result, Weyerhaeuser Common is still undervalued based on private market comps in the timber industry, but with the U.S. housing recovery gaining momentum and Weyerhaeuser's business turning the corner, our patience appears to be paying off. Plus, with recent additions to the Board and upcoming management changes, resource conversion seems more imminent than it did at the time of our initial investment.

BANKRUPTCY EMERGENCE TO RESOURCE CONVERSION (NEWHALL HOLDING COMPANY)

It is wise to avoid borrowing money against assets that do not generate predictable cash flow. During the 2008-09 financial crisis, very few leveraged land owners escaped bankruptcy, foreclosure or restructuring. High quality assets with inappropriate debt levels create opportunities for distress investors to buy the fulcrum security (the most senior issue in a capital structure that will participate in a reorganization) at a discount to intrinsic value and then exert influence over the restructuring process. In 2008, the Fund acquired the senior secured bank debt of Landsource, which owned one of the most prime land banks in the U.S., with the expectation that we would influence and participate in the reorganization under a Chapter 11 bankruptcy proceeding. The company emerged from bankruptcy in 2009 with no debt (our debt securities were converted into equity). The Fund is one of the largest equity owners (approximately 9.5% of the outstanding equity) and has representation on the board of directors.

Not only did we have influence over the restructuring process and long-term business plan, but we continue to have a seat at the table to help the company implement its business plan. The equity interests in Newhall are not exchange traded because Newhall is closely held by seven holders that control approximately 78.5% of the outstanding units. The 21.5% that is not closely held occasionally trades "over-the-counter." The implied equity market capitalization (based on current pricing) is approximately $412 million. This compares to the 2007 pre-bankruptcy appraisal that valued the land holdings at $2.7 billion. Clearly, land values are dramatically lower than five years ago, but the current pricing for Newhall Units represents a mere 15% of the value in 2007. Newhall's primary asset consists of 27,850 homesites and 681 commercial acres in Valencia/Newhall Ranch, located approximately 30 miles north of downtown Los Angeles. The company also owns the Valencia Water Company, a public utility that presently services approximately 115,000 people and will be the water provider for all future customers in the district.

A simple approach to understanding Newhall's current valuation would be to subtract $175 million (estimated value of Valencia Water Company, non-Newhall assets and cash) from the $412 million market cap, resulting in a $237 million valuation for Newhall's 27,850 homesites and 681 commercial acres. Using a conservative valuation of $100,000 per acre for commercial land, the implied valuation for Newhall's homesites is $169 million, or about $6,000 per homesite. Finished lots for single family homes in Valencia are selling for an average of $225,000 and multifamily units are $150,000. Improvement costs and fees (the costs of converting unimproved land to finished, builder-ready lots) are roughly $150,000 for single family and $125,000 for multifamily. Simple math reveals that homesites (paper lots) should be worth $75,000 for single family and $25,000 for multifamily based on current market conditions. It would be improbable to bulk-sell over 27,000 lots (probably a 20-year supply) for the same price as if selling a few hundred lots. Therefore a bulk discount should be applied. Applying a 50% discount to the above "paper lot" values, and assuming two-thirds of the lots are single family and one-third are multifamily, the implied value for Newhall's 27,850 lots is about $812 million, or $643 million greater than the value implied by the market price of Newhall Units. This "back-of-the-envelope" calculation results in a total equity value of over $1 billion (compared to the market cap of $412 million).

Residual land value analysis is used extensively by appraisers, homebuilders and developers to estimate the underlying value of land. The formula for estimating land value is: Revenue - Profit Margin - Costs = Land Value. Applying residual land value analysis illustrates why land value is so sensitive to home prices. If home prices increase, land values tend to increase more dramatically, particularly if fixed costs (e.g., land improvement and building costs) are relatively stable. The opposite also holds true: as home prices decline, land values decline more dramatically. In 2009, for example, it could be argued that some land actually had negative value, because the costs to develop buildable lots exceeded what a home builder would be willing to pay for them. The table below illustrates how a 20% increase in house prices can result in 112% increase in residual land prices with no cost inflation, and a 76% increase with 10% cost inflation. Newhall's single family homesites might be worth $75,000 each in the current market environment, but the prospects for dramatic appreciation with even modest increases in home prices is very compelling.

	Base	20% Appreciation No cost inflation	20% appreciation and 10% cost inflation
House price	$ 525,000	$ 630,000	$ 630,000
Less builder profit	(105,000)	(126,000)	(126,000)
Less finished lot cost	(225,000)	(225,000)	(240,000)[2]
Less building costs	(120,000)	(120,000)	(132,000)
Residual Land Value	75,000	159,000	132,000
Land residual increase		112%	76%

The obvious question anyone should ask is: with all of the hidden value in Newhall, when will that value be realized by the Fund or recognized by the market? Based on first-hand knowledge, the business plan is on schedule and the company expects to begin selling the first lots in Newhall Ranch by the end of 2014. Prior to that time, the company will need to raise capital to begin construction of infrastructure (grading, utilities, roads, etc.). The company is exploring raising private capital as well as public equity (initial public offering), among other options (including business combinations with other owners of large master-planned communities). We expect that any such transaction would serve to crystalize value and establish a market price more in line with intrinsic value.

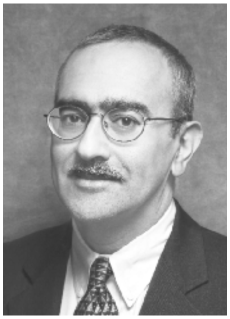
Similar to First Industrial, Weyerhaeuser and Newhall, there is a "business plan" in place to unlock value in each one of the Fund's 28 holdings. Some are in the early innings, like Newhall, Segro, and Tejon Ranch. A number of holdings are in the middle innings, as it seems to us that part of the discount to underlying value has closed but it could be a couple more years until the entire value of the positions are recognized. These include Weyerhaeuser, Brookfield Asset Management, Westfield and Lowe's. Meanwhile, a few of the Fund's positions seem to be closer to reaching the catalysts necessary to unearth value. Some of the companies that we would characterize as being in the later innings include First Industrial, Forest City, Hammerson and our Australian REITs. As these "business plans" continue to play out, we fully expect the Fund's underlying investments to more closely reflect intrinsic value. And with the Fund currently trading at more than a 15% discount to our conservative estimates of net asset value, on average, and more than a 25% discount to public and private market comps, we believe that investors who share our patient mindset and long-term view will ultimately be rewarded.

Sincerely,

Michael H. Winer	Jason Wolf
Co-Portfolio Manager	Co-Portfolio Manager

[2] Finished lot cost includes 10% cost inflation on $150,000 (land improvement costs only).

Third Avenue International Value Fund
(Unaudited)



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

MATTHEW FINE
CO-PORTFOLIO MANAGER OF
THIRD AVENUE INTERNATIONAL VALUE FUND

Dear Fellow Shareholders:

In the most recent quarter, Third Avenue International Value Fund (the "Fund") established two new positions, added to positions in the common shares of eight companies, reduced five existing positions and eliminated two positions.

QUARTERLY ACTIVITY:

Number of Shares	New Positions Acquired
1,192,120 shares	Piramal Enterprises Ltd. Common Stock *held via swap* ("Piramal Common")
451,133 shares	Vivendi S.A. Common Stock ("Vivendi Common")
	Increases in Existing Positions
20,183 shares	GlaxoSmithKline PLC Common Stock ("GSK Common")
428,000 shares	Guoco Group Ltd. Common Stock ("Guoco Common")
562,000 shares	Kinross Gold Corp. Common Stock ("Kinross Common")
61,938 shares	Nexans S.A. Common Stock ("Nexans Common")

Number of Shares	Increases in Existing Positions (continued)
91,900 shares	Otsuka Corp. Common Stock ("Otsuka Common")
815,800 shares	Precision Drilling Corporation Common Stock ("Precision Drilling Common")
17,123,102 shares	Rubicon, Ltd. Common Stock ("Rubicon Common")
100 shares	Titan Cement Co. S.A. Common Stock ("Titan Common")
	Decreases in Existing Positions
78,034 shares	Alma Media Corp. Common Stock ("Alma Media Common")
219,000 shares	Mitsui Fudosan Co., Ltd. Common Stock ("Mitsui Fudosan Common")
2,181,917 shares	Resolution, Ltd. Common Stock ("Resolution Common")
549,550 shares	Viterra, Inc. Common Stock ("Viterra Common")
299,615 shares	Weyerhaeuser Co. Common Stock ("Weyerhaeuser 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 July 31, 2012: WBL Corp., Ltd., 8.72%; Netia S.A., 5.94%; Weyerhaeuser Co., 3.97%; Sanofi, 3.82%; Taylor Wimpey PLC, 3.66%; White Mountains Insurance Group Ltd., 3.47%; Daiwa Securities Group, Inc., 3.33%; Leucadia National Corp., 3.08%; Munich Re, 2.83%; and Segro PLC, 2.72%.

Number of shares or warrants	Positions Eliminated
200,900 shares	Dundee Precious Metals, Inc. Common Stock ("Dundee Common")
500,400 warrants	Dundee Precious Metals, Inc. June 2012 Warrants ("Dundee Warrants")

REVIEW OF QUARTERLY ACTIVITY

During the quarter, the Fund made its first investment in India, a market we have followed for over a decade but avoided until recently. Our reticence has primarily resulted from valuation and corporate governance considerations. The long-term growth prospects for the country are quite attractive, which has generally resulted in lofty valuations for publicly-traded Indian equities. But in 2011, Indian stock prices depreciated sharply; the BSE Sensex declined by over 35% in U.S. dollar terms, reflecting both the sharp decline in locally-denominated share prices, in addition to a rapidly weakening Rupee, amid bad government policy, the cooling of what had been an overheated market, and capital flight.

Against the backdrop of valuations generally becoming more interesting, we identified an individual opportunity which we find compelling. During the quarter, the Fund purchased shares of Piramal Enterprises Ltd. ("Piramal"), an Indian-listed holding company with investments in pharmaceuticals, healthcare information technology and financial services. However, Piramal is not merely a collection of interesting businesses and assets; it is a company undergoing a substantial transformation, which we believe has created a very attractive investment opportunity.

In 2010, following 25 years of growth and development that propelled the company into an enviable position among India's largest pharmaceutical companies, Piramal sold its generic pharmaceuticals business, the bulk of its operations at the time, to U.S.-based Abbott Laboratories. The US$3.8 billion transaction was one of the largest ever in the Indian pharmaceutical industry, and was priced at an eye-catching valuation of 30 times EBITDA[1]. Following the sale, Piramal became a company with very little in the way of operating businesses, instead consisting primarily of cash, a $1.6 billion receivable from Abbott Labs (part of the purchase price is being paid in stages), and a couple of small legacy pharmaceutical businesses (principally contract manufacturing and over-the-counter medications).

As a result of the deal, Ajay Piramal, a well-respected Indian businessman with a reputation for deal-making who has long been the driving force behind the company's success, had led the company into the fortunate position of having a substantial amount of capital to invest. He returned a portion of that capital to shareholders through a repurchase of 20% of Piramal's shares, and has been carefully redeploying the remaining capital into four key areas: (i) growing the legacy pharmaceutical businesses; (ii) re-entering the drug discovery business; (iii) acquiring a U.S. healthcare information technology company; and (iv) diversifying into lending and real estate asset management in India, the latter of which represents an area that is capital-starved at the moment.

Piramal's substantial liquidity position, its management team with a proven, long-term track record of creating shareholder value (having compounded book value per share at over 20% per annum on average over the past 24 years), and the retreat by many multinational pharmaceutical companies from the very areas in which Piramal is actively looking to invest (leading to the potential for many interesting deals) combine to create a very exciting situation. The fact that we were able to acquire shares of Piramal in the Fund at a nearly 30% discount to what we believe is a conservative estimate of current Net Asset Value ("NAV") makes the situation all that much more attractive.

Also during the quarter, the Fund initiated a position in the shares of Vivendi S.A. ("Vivendi"), a company that has intrigued various members of our team for more than five years. The Fund had avoided investing in Vivendi's shares for a variety of reasons, not the least of which were the company's long-running addiction to debt-financed acquisitions and

[1] Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA): one frequently used measure of operating cash flow.

the absence of any discernible strategy for building shareholder value. In retrospect, the discipline paid off. The stock has performed very poorly over a long period of time.

Vivendi spent much of its life as a French water utility, but in the mid-1990s was set on a path to become one of the world's largest media and telecom empires. The improbable but very rapid transformation of Vivendi into a telecom and media giant was driven by a number of audacious debt-fueled acquisitions. By the early 2000s, the tech, media and telecom bubble began to burst and the Vivendi empire famously came crashing down under a mountain of debt. The company spent much of the next decade languishing in the absence of strong management and a reasonable strategy.

Most recently, though, considerable change is afoot at Vivendi. The company dismissed the CEO of its largest subsidiary, SFR, which is the second largest telecommunications company in France. SFR had been one of the epicenters of Vivendi mismanagement; the telecom company performed particularly poorly in the areas of cost management and in its failure to adequately address and confront the threat of new and increased competition. Shortly after the dismissal of SFR's CEO, Vivendi's board dismissed Vivendi's own CEO, apparently as a result of irreconcilable strategic differences. Vivendi's Chairman, who, during his own brief stint as CEO of Vivendi in the early 2000s, deleveraged the company considerably, has become the public face of the company and declared a strategic about-face. It appears that none of Vivendi's underlying operating businesses are sacred any longer. As part of a broad restructuring effort, a number of its businesses have become subject to possible disposal in the effort to reduce Vivendi's debt load and make headway in closing the gap between the share price and the underlying value of the company's investee businesses, several of which are crown jewels within their respective industries.

As it stands today, the company controls France's second largest telecommunications company which, when combined with its control of the incumbent telecommunications company in Morocco and a highly successful Brazilian telecommunications company, would comprise a formidable global telecom business were they to be separated into an independent entity, as has been speculated. Vivendi also controls Canal +, France's largest television business, as well as Universal Music and ActivisionBlizzard, the world's largest music and video game businesses, respectively. There is considerable scope for dispositions as well as a sensible reconfiguration of the business into various components, all of which seem increasingly likely.

Shares of Vivendi are trading at a considerable discount to our conservative estimate of its net asset value, essentially the current liquidation value of the company, and it appears that the mounting pressure on the company's board has made value enhancing transactions and debt reduction increasingly probable.

On the sell-side, during the quarter we eliminated the Fund's remaining position in Dundee Precious Metals ("Dundee"), which we had already been trimming following significant share price appreciation. Without rehashing Dundee's history, a number of maneuvers eventually narrowed down the company's once diverse geographic exposures overwhelmingly to one country: Bulgaria. After facing significant regulatory hurdles for the expansion of its operating gold mine there, and a seemingly endless back-and-forth with the Bulgarian government, Dundee was finally able to gain the necessary approvals, and much of the promise that had long been in the "pipeline" began to come to fruition. Dundee, which had for some time became a bit of a "show me" story for investors who had become impatient with the regulatory delays, saw its stock price performance rebound strongly as a result of these positive developments.

Our investments in gold mining companies have tended to focus on companies which operate in and own assets across multiple jurisdictions - preferably reasonable ones - in order to mitigate regulatory and/or political risk through geographic diversification. With this, as well as valuation in mind, we decided to close the book on the successful Dundee investment by eliminating our position. The Fund currently holds investments in two other gold mining companies (Newmont Mining and Kinross Gold) which operate across a wider range of jurisdictions.

HOLDING COMPANIES IN THE FUND

During the quarter under review, both of the new investments could be seen as falling within the *de facto* category of holding companies (as distinct from the industry classification that the portfolio report provides). A holding company, for the purposes of the following discussion, is an entity which holds stakes in various other businesses and/or assets that are organized within separate and distinct entities. Because of this structure, analyzing holding companies often requires a greater focus on capital allocation rather than on operating performance; well managed holding companies tend to create more value via resource conversion (*e.g.*, acquisitions, divestitures, spin-offs, etc.) than through operating earnings. Of the two new holdings discussed above, one (Piramal) "stumbled" into this category, by virtue of the sale of its principal pharmaceutical operating units, and essentially became a holding company with cash receivables, investment holdings and other smaller businesses. The other (Vivendi) has morphed from a water utility to a collection of disparate assets centered around media and telecommunications businesses.

Over the last decade, the Fund has held investments in a number of holding companies with a wide variety of origins, operating across many different business and geographic areas and owning a variety of assets, both listed and unlisted, with differing degrees of ownership of underlying assets. As of July 31, 2012, the portfolio includes holdings in 12 companies that might be considered holding companies under the broad characterization above, which collectively make up nearly 32% of Fund assets. Those holding companies that we find attractive (based on the criteria outlined below) tend to produce lumpy reported earnings and uneven increases in shareholder value, which makes them somewhat difficult to analyze using conventional tools such as earnings and discounted cash flow analysis. Some also have complex organizational structures and financial statements which are obscured by certain accounting principles. We believe these traits that may discourage others have contributed to our ability to find opportunities in the holding company space throughout the history of the Fund.

The fact that holding companies (as we characterize them) make up such a significant proportion of Fund assets may, quite understandably, seem odd to many of our clients, if for no other reason than simply because holding companies are relatively uncommon in the United States. However, the holding company is a type of corporate organization that can be found much more frequently outside of the U.S. Because the Fund focuses its efforts primarily on investment opportunities outside of the U.S., it is incumbent upon us as international investors to have a deep understanding of this class of companies. This fact is made all the more important because the very nature of holding companies lends itself to an overly simplified brand of investment analysis which we believe is misguided and wholly insufficient (as we will explain soon enough). Because of their considerable presence in the Fund (both today and historically), and because this is an asset category which we believe is frequently misunderstood, we thought it worthwhile to outline some of the factors that we weigh in considering holding company-type investments in the portfolio.

WHY DO HOLDING COMPANIES EXIST?

Before we explain how we think about and analyze a prospective holding company investment, it makes sense to begin with the question: why do holding companies exist in the first place? Our experience has been that understanding the various origins and purposes of holding companies has proven helpful in spotting pockets of opportunity within this space, while avoiding common pitfalls that could prove painful for investors. Truth be told, holding companies could exist for any of a variety of reasons, depending on their individual circumstances.

First, one common purpose of a holding company is to provide an organizational structure by which a controlling shareholder could hold and exercise a disproportionate degree of control (relative to its actual economic stake) over a variety of investments. In these cases, the holding company allows for control or significant influence over its constituent investments through majority or near majority ownership of voting rights. For a simple example, suppose a publicly listed holding company is 51%-owned by its founding family. Further, that holding company, in turn, holds 51% stakes in five different operating businesses. In this case, by virtue of its majority control of the holding company, the founding family controls those five operating businesses, even though the family's effective economic interest in each operating business is only about 26% (51% x 51%).

Importantly, while holding companies provide their controlling shareholders with elements of control over subsidiary companies, what is done with the control varies greatly. While some holding companies actively manage or influence the actions of their operating businesses, others simply hold their stakes passively. As noted earlier, resource conversion activities can add considerable value if executed well, but passive holding companies often forgo this opportunity. In general, holding company structures that are used primarily to passively maintain control, while effectively sitting on their collection of investments, with little or no history of taking value additive actions, are of little interest to us as potential investments. Later, we will provide an example of each, with implications for investors.

"The attraction of holding company investments is that they periodically present an opportunity to invest in undervalued assets at a further discount as a result of the holding company structure."

Various other origins and/or purposes of holding companies abound. Holding companies are sometimes used as financing vehicles to take advantage of arbitrage opportunities involving differing parent company and subsidiary credit ratings, taxation differentials, etc. For example, Hong Kong-listed Fund holding Guoco Group Limited ("Guoco") could issue debt in tax friendly jurisdictions where interest payments are tax deductible, in order to finance investments and businesses which subsequently generate profits in other jurisdictions that only lightly tax such profits. In this way, the holding company is a mechanism by which companies such as Guoco may seek tax efficiency.

Additionally, holding companies sometimes are formed as a result of a family or controlling shareholder who uses the proceeds from its cash generative, legacy business as capital, with which to invest in other industries, ultimately creating a web of disparate business interests. Again we return to the subject of resource conversion, as wealth created by the established business is redeployed into new business areas. This is particularly common in countries with poorly developed capital markets, where it is difficult to raise capital at reasonable terms (this might partially explain why holding companies are less common in the U.S.). In such cases, for a family or business owner who wants to invest in new businesses, using the cash generated from the legacy business(es) to finance these new endeavors often offers a preferable alternative to raising external capital at onerous terms and perhaps surrendering a degree of control to market participants. A holding company structure with interests in various businesses sometimes results from this use of a cash generative, legacy business as a financing vehicle for new ventures.

Other holding companies exist as such simply by design, having been run in such a structure throughout most, if not all, of their existence, while others find themselves in a holding company structure almost by happenstance, such as the aforementioned Piramal example.

VALUATION: THE MECHANICAL APPROACH AND ITS SHORTCOMINGS

The attraction of holding company investments is that they periodically present an opportunity to invest in undervalued assets at a further discount as a result of the holding company structure. Typically, the shares of listed holding companies trade at discounts, often sizeable, to the market value of their investments, after netting out liabilities. On the surface, this analytical exercise seems simple and straightforward, especially in cases where the holding companies' investments mainly consist of listed investments with readily ascertainable market values (their respective stock prices).

Indeed, many market participants and analysts who follow holding companies tend to focus heavily on their explicit discount to NAV. For example, suppose the market value of Holding Company A's listed investments and other assets sum to $100 per share (after deducting total liabilities). If Company A's common stock is trading at $70 per share, then that company is trading at a 30% discount to NAV. Once calculated, there seems to be a temptation to focus on the level of this explicit, market-determined discount to NAV. Further, it is not uncommon to see some in the analytical community who then seemingly focus on this explicit discount relative to those of other holding companies ("Company A is 'cheaper' than Company B which is currently trading at a 20% discount to NAV, but not as cheap as Company C which is at a 35% discount") and also relative to that company's own history ("Company A is cheap relative to its average historical discount of only 25% to NAV).

While this methodology seems perfectly reasonable, we believe it is necessary to go deeper in determining which holding company investments are attractive enough to add to the Fund's portfolio. Most holding companies trade at discounts to NAV – *based on the market value of their investment holdings* – that narrow and widen during ups and downs in the market. Additionally, the valuations of the underlying investments - those shares of which are held by the holding company - wax and wane as market sentiment and industry conditions fluctuate and as certain businesses fall into and out of favor among investors and traders. Because of this, relying on market-based NAV calculations without a deeper understanding of the valuations, risks and exposures of the underlying holdings may very well be misguided.

Assessing the investment attractiveness of a holding company is not solely a mechanical exercise of estimating the arithmetical discount and deciding if this is "large enough" as the basis of purchase. It entails assessing the attractiveness of the underlying assets, valuing them conservatively, determining if these are actually undervalued and then calculating the discount to NAV based upon this conservative valuation. The objective of this exercise is to buy ascertainably cheap (and attractive) assets at a discount, rather than "any" assets at a discount. As an oversimplified example, imagine a holding company of high-tech stocks. Suppose it traded at a 30% discount to NAV both in 1999 and in 2001. But in 1999, the "good old days" for many tech stocks, its underlying holdings were trading at price-to-earnings ("P/E") multiples of 50, whereas in 2001, after the dot-com bubble burst, the average P/E of its holdings was 8. Through this lens it is easy to see how a 30% discount in one case might not be as attractive as a 30% discount in the other.

With this issue in mind, we begin our assessment of the valuation of a potential holding company investment with a wary, skeptical eye. Our objective when investing in holding companies (focusing solely on valuation, for now) is to buy cheap underlying businesses and assets, which are, in turn, subject to an additional discount at the holding company level. Often, this entails buying when the underlying businesses are "out of fashion" and, therefore, available at bargain prices, even before the discount to NAV that comes on top at the holding company level. Ideally, as and when the underlying assets/securities are repriced upward to more normal (*i.e.*, less depressed) levels, the discount to NAV at the holding company level may narrow at the same time, providing for the potential for a rate of return which could be higher than that which would have been obtained by directly investing in the underlying assets. In a sense, buying businesses cheaply at an additional discount creates the potential for magnified returns if conditions normalize, somewhat akin to a margin account but with free "leverage" and without the risk of a margin call.

IT'S NOT ALL ABOUT THE DISCOUNT!

We believe that our approach to holding company valuation analysis effectively addresses the shortcomings of the simpler, purely mechanical approach to NAV calculation. However, we cannot emphasize enough that an attractive statistical discount to NAV – even one based on draconian assumptions – is a necessary, but not sufficient condition for inclusion in the Fund's portfolio. As detailed above, we disagree with the purely mathematical approach that many analysts apply to valuation. However, even if we were all on the same page regarding our calculations of discounts to NAV, we believe that many holding company analyses that we have seen are flawed in that they weigh too heavily the importance of the discount, while seemingly giving less weight to other factors that, nevertheless, contribute heavily to determining whether or not the investment is ultimately profitable. With respect to a holding company's underlying businesses and assets, obviously their general attractiveness, risks, and exposures are vital to the investment thesis. Additionally, it is imperative to consider a host of other factors, which, if ignored, could derail an investment that appears attractive on the basis of valuation alone.

SAFETY AND THE AVOIDANCE OF INVESTMENT RISK

For holding companies, like all of our other investments, one criterion in security selection for the Fund that is of paramount importance revolves around the safety of the investment, with a view toward avoiding situations which run the risk of permanent loss of invested capital. In evaluating the safety of holding companies, there are two layers of consideration, as in the case of assessing their cheapness: at the underlying holdings and at the level of the holding company. This process entails scrutiny not just of the financial risk (borrowings, commitments, contingencies, etc.) at each of these levels, but also the business risk. A seemingly "safe" model that we have encountered on a variety of occasions is that of holding companies which are debt free at the parent level, but with investments in leveraged subsidiary entities underneath, with said entities having "non-recourse" debt. Alas, in periods of economic downturn combined with capital market stress, the financial difficulties experienced by these leveraged entities was such that it threatened to wipe out the parent's equity in the holding, forcing the parent company to make an equity investment in the holding, the non-recourse nature of the debt notwithstanding.

A variation of the case above would be a leveraged parent company, with relatively well financed holdings underneath. In times of economic or capital market stress, such a holding company might seek to extract cash or liquidity from its subsidiaries. While such an action might alleviate the financial stress at the parent company level, the liquidity drained from its subsidiaries might impair their ability to efficiently operate their respective businesses, ultimately compromising the aggregate value of the collection of assets and augmenting the risk exposures of the underlying businesses as a result of their weakening financial positions.

From the perspective of a potential holding company investor, it is easy to see how each scenario would not only add downside risk but reduce the upside potential of the investment as well. A large discount to NAV alone is highly unlikely to be enough to drive superior investment performance in the face of a vulnerable financial position. For these reasons, we seek to avoid either of these situations by investing in holding companies that are well-financed, both at the holding company and subsidiary level.

HOLDING COMPANY CONTROL: CONTRIBUTING TO WEALTH CREATION OR DETRACTING FROM IT?

A holding company that meets our criteria of financial strength and attractive valuation, as outlined above, begins to get exciting from our perspective. Unfortunately, this is still not a strong enough basis on which we would commit the Fund's capital. Of particular issue, holding companies are almost by definition controlled by insiders. For this reason, it is essential that we are able to gain some level of comfort that the holding company in question is structured and intended to generate wealth for all of its shareholders, not just insiders. A strong financial position and attractive valuation could nevertheless fail to translate into strong returns if the company is run by insiders who either enrich themselves at the expense of shareholders, or destroy shareholder value through poor decision-making or benign neglect. There are numerous factors we consider in assessing whether the holding company contributes to value creation for shareholders or detracts from it, including those discussed below, among others.

One of the more objective elements in this analysis is the determination of the operating costs of the holding company itself. While holding companies typically do not directly operate businesses that generate cash flows – instead, they usually hold stakes in separate investee companies which operate businesses – they, nevertheless, have their own collection of operating costs (including compensation) which must be borne by the shareholder. Necessarily, these must be modest; we seek to avoid situations where onerous operating costs at the holding company level impose excessive costs on shareholders.

The operating cost discussion is related to a point made earlier about our preference for companies which have a history of proactively taking value accretive actions, rather than of passively sitting on a collection of assets, insulated from the threat of loss of control by the holding company structure. To put it somewhat bluntly, if shareholders must pay the insiders of holding companies (through their operating costs), the pay should at least be justified by value-added contributions made by those insiders.

Making matters worse, inertia or inaction can take a toll on shareholder returns that greatly exceeds operating costs. To illustrate an example of this, we point to a tale of two European automobile manufacturers, French Peugeot S.A. ("Peugeot") and Italian Fiat S.p.A. ("Fiat"). Peugeot and Fiat share many similarities: both companies are controlled by holding companies (note: neither of which are held in the Fund), operate in a very difficult industry that faces formidable headwinds in the continental European mass market, have relatively weak competitive positions outside of Europe, and had generally been long-time beneficiaries of strong local banking relationships and supportive local governments. Not surprisingly, the global financial crisis hit each of these companies particularly hard and exposed them as not competitive enough on a global scale.

In the depths of the financial crisis, Peugeot's holding company remained passive, to our knowledge taking few (if any) truly aggressive actions to confront its challenges. On the other hand, Fiat's holding company, Exor S.p.A. ("Exor") has been far more aggressive. Sergio Marchionne, hired by Exor to be the CEO of Fiat, structured the acquisition of Chrysler in what we see as a very clever and opportunistic deal designed to address Fiat's exposure to the long-term problems facing the European auto market. In addition, Exor also oversaw the 2011 de-merger of truck and agricultural equipment maker Fiat Industrial S.p.A. from Fiat (Auto), and eliminated the multiple share class structure at each. Cost cutting at Fiat has been impressive, helping the carmaker (even excluding Chrysler) remain modestly profitable in the current environment, while Peugeot is suffering substantial losses.

The resulting difference in stock price performance has been astounding; from March 31, 2009 through July 31, 2012, Fiat common stock generated a total return for shareholders of over 80%, while Peugeot produced a negative total shareholder return of -47%[2]. We provide this example as an illustration of how important proactive versus passive management tends to be to the performance of holding companies and their subsidiaries. Shareholders of Peugeot's holding company have suffered as a result of its inactivity amid crisis, while shareholders of Fiat's holding company have benefitted from their bold actions.

Of course, taking bold actions can be as harmful to shareholder returns as they have been helpful in the case of Fiat; a controlling shareholder that takes aggressive, but foolish, action could do much more harm than a passive controlling shareholder. To that point, another of the softer factors to be weighed in assessing the investment attractiveness of a holding company is the nature of its investment activity, principally the quality of the purchase and sale decisions made by management. Considerable wealth for shareholders can be, and is, created by shrewd resource conversion activities. For example, Fund holding White Mountains Insurance Group, Ltd. has increased its NAV per share by roughly 16% per year on average since its Initial Public Offering in 1985, primarily through

[2] Source: Bloomberg (returns are in euros).

business acquisitions and divestitures, rather than through operating earnings; one recent example was its sale of Esurance to The Allstate Corp. at an excellent price of over two times tangible book. The Esurance sale at a juicy premium to book value provides a good example of how well run companies like White Mountains can build shareholder wealth over time. White Mountains has proven that it is not a "one-trick pony" in this area. In recent years, White Mountains has taken advantage of its strong balance sheet to aggressively repurchase its own shares at a meaningful discount to NAV – another way to increase NAV per share over time – including over $490 million worth of its shares during the first six months of 2012 alone.

We seek to invest in holding companies that are run by management teams with good track records of value creation through resource conversion, such as White Mountains. What might be lost on anyone who focuses almost exclusively on the level of discount to NAV, is that if the Fund's holdings are able to compound NAV at reasonably attractive rates – and their track records attest to their ability to do so – we believe we are likely to do well over time, independent of the potential for discounts to narrow at the holding company and/or subsidiary level. One example of this is the Fund's investment in Compagnie Nationale a Portefeuille S.A. ("CNP"), a long time position that was eliminated in May 2011 following a buyout offer from its controlling shareholder (Belgian billionaire Albert Frere). We initiated the position at an estimated discount to NAV of about 20% and sold into the privatization about six years later at an estimated discount of 7%. Yet the CNP investment generated an average annual return of around 13.5% compounded over its six year life for the Fund, accumulating to more than double our original investment, due largely to its ability to increase NAV over time, with only a modest contribution coming from the closure of the discount. Thus when looking at holding companies, we prefer those run by controlling shareholders who boast a long-term track record of building shareholder value, and who have the ability to take advantage of resource conversion activities going forward.

Along a similar vein, in addition to assessing the historical track record of creating value through major transactions, another softer factor to consider when assessing management of these holding companies, assuming that they exert some control over their holdings, is the quality of the ongoing oversight that has been maintained over these holdings. For example, former Fund holding Lundbergforetagen AB ("Lundbergs") has held stakes, both directly and indirectly, in Swedish bank Svenska Handelsbanken AB ("Handelsbanken"), with representation on Handelsbanken's Board. The conservatism and prudence with which Handelsbanken seems to have been operated is evidenced by the fact that Handelsbanken was alone among its closest Swedish peers (such as Swedbank AB, Nordea Bank AB, and Skandinaviska Enskilda Banken AB), in that Handelsbanken was not forced to raise capital during the most recent global financial crisis of 2008-2009. From our perspective, we look for holding companies where management participates in prudent, fruitful oversight of its investee companies, while we seek to avoid the "absentee landlords" that sit passively on their investments, without adequate oversight.

Notably, because of the holding company's closed-end-like nature, it allows for investments in less liquid assets, facilitating an ability to engage in longer-term investing, in contradistinction to their open-ended peers, where the less predictable redemption patterns can on occasion cause the portfolio of open-ended entities to be tilted toward more liquid holdings. This closed-end structure works particularly to the advantage of skilled management teams who have a track record of successful deal-making and oversight of their investee companies, as highlighted above.

A thorough evaluation of these indicators of whether a holding company adds to or subtracts from value is essential in any analysis of holding companies because they are usually controlled by one or more insiders, making corporate governance considerations particularly important. With Boards of Directors heavily populated by insiders, and the potential for related-party transactions that may be opaque to the eyes of outsiders, particular attention must be paid to whether the controlling shareholders have built a history of building value for *all* shareholders over time. In this regard, we weigh a concrete track record of value creation (as noted above in the cases of White Mountains, Exor, *et al.*) much more heavily than a management team's words.

In sum, holding companies periodically offer attractive investment opportunities, but the individual security selection process must be much more involved than simply calculating a statistical discount to NAV and making an investment decision based primarily on that figure. We believe that the holding companies found in the Fund consist of those that offer much more than just static discounts to NAV. They consist of well-financed companies that own stakes in quality assets, at reasonable prices, that are made even more attractive by the discount at the holding company level. Furthermore, we believe they are run by quality management teams and/or controlling shareholders who have proven to be adept at prudently overseeing their holdings and at building value for all shareholders over the long term. In our opinion, imposing these criteria on the universe of holding company securities when selecting holdings for the Fund helps to stack the odds in our favor in terms of providing upside potential and downside protection.

Geographical Distribution of Investments

At the end of July 2012, the geographical distribution of securities held by the Fund was as follows:

Country	% of Net Assets
Japan	11.09
United Kingdom	10.01
Singapore	9.59
United States	8.58
Germany	7.19
France	6.70
Canada	6.19
Poland	5.94
Hong Kong	5.08
Bermuda	3.47
South Korea	2.65
Taiwan	2.53
Austria	2.47
Switzerland	2.45
Norway	2.10
New Zealand	1.89
Greece	1.88
Chile	1.60
Brazil	1.37
India	0.96
Finland	0.11
Equities-total	93.85
Cash & Other	6.15
Total	100.00%

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

We look forward to writing to you again when we publish our Annual Report for the period ended October 31, 2012.

Sincerely,

Amit Wadhwaney
Co-Portfolio Manager,
Third Avenue International Value Fund

Matthew Fine
Co-Portfolio Manager,
Third Avenue International Value Fund

Third Avenue Focused Credit Fund
(Unaudited)

THOMAS LAPOINTE
PORTFOLIO MANAGER OF
THIRD AVENUE FOCUSED CREDIT FUND

Dear Fellow Shareholders,

Third Avenue Focused Credit Fund (the "Fund") seeks to produce superior total returns over time. In pursuit of this, we often initiate investments during troubled times for issuers of debt securities. At the time of our initial investment in a company, the near-term earnings outlook is often weak, which is why we are able to buy securities at deep discounts from their fundamental value. Because we take the long-term view of each investment, quarterly financial results are not the focus of our analysis. However, the quarterly disclosures do give us insight into the company's operations, its industry, and the larger economy.

What we see in the high-yield bond and loan markets right now are quality companies with proven track records of cash flow generation issuing securities with yields between 5-6%, and durations of five years or longer. New issuers include companies like CIT Group, Lyondell, Community Health, Univision, MediaCom and GM. These are high-yield companies – with good current business outlooks – issuing new debt to retire older, more expensive obligations. That they are able to do this supports our thesis that high-yield default rates will remain below average.

When the vast majority of new debt issuance is used to refinance existing debt and extend the maturity runway, it is not an environment where you will typically see a major credit crisis. When debt is raised to fund leveraged buyouts, M&A, speculative CapEx, or new business models, there is danger ahead. What we are not seeing now are prior warning signs, like when companies such as Windstream borrowed to build out infrastructure with no realistic plan to pay for it.

Even though strong companies are accessing the capital markets, most of these new issues are not attractive to us, in light of the risks that these companies face. Issues that pay such low coupons have very little cushion against hiccups. Some of these companies, two or three years on, will not look as good as they do today and they will become candidates for the portfolio when we can purchase their securities at large discounts to par. Investors buying new issues at current prices must expect diminished returns going forward. We are not willing to make that concession.

Portfolio holdings are subject to change without notice. The following is a list of Third Avenue Focused Credit Fund's 10 largest issuers, as of July 31, 2012: Lehman Brothers Holdings, 5.80%; IntelSat Luxembourg SA, 3.80%; Sprint Capital Corp., 3.47%; Energy Future Holdings Corp./TXU Corp., 3.26%; Citycenter Holdings, LLC, 3.22%; Hercules Offshore, Inc., 3.14%; Nuveen Investments, Inc., 2.98%; Cemex Finance, 2.94%; Caesars Entertainment Operating Co., Inc., 2.70%; and Clear Channel Communications, Inc., 2.70%.

We have been saying for the past two years that the U.S. economy is improving – perhaps more robustly than many observers think. The year-over-year results of our portfolio companies can help provide micro-level proof of that thesis. Despite worries about a U.S. double dip recession, a hard landing in China, and the recession in Europe, we continue to believe that the U.S. economy, where the majority of our holdings are domiciled and derive revenues, will be stronger a year from now than it is today. We believe that default rates should remain low, due to a lack of maturities and also because corporate balance sheets remain strong. The following highlights from the quarterly results of the Fund's largest holdings indicate that fundamentals continue to improve, in spite of a slowing macroeconomic environment and deteriorating sentiment around the world.

- Intelsat is a 3.8% position in the Fund, and the investment is providing us a cash yield of approximately 11%. In August, the company reported second quarter results delivering stable earnings, with revenue down 1% to $639 million, while adjusted EBITDA eased downward 2% to $492 million year over year. We expect that earnings will improve, due to heavy capex investments that will begin to bear fruit partly in 2012 and to a greater extent in 2013. The company's backlog of contracts remains steady at over $10 billion, greater than five times its annual earnings. In May, Intelsat filed for an initial public offering, though it is not an event we think will get much real attention until next year. The offering will allow the company to continue to focus on retiring its most expensive debt, as it did when it recently redeemed its 11% and 9% notes to issue 7% bonds. As the bonds we hold are among the most levered in the capital structure, we stand to benefit most from the equity raise. Our valuation analysis and valuations suggested by comparable companies suggest a valuation of about nine times next year's EBITDA, which would provide plenty of coverage for our bonds. Most promising, Intelsat signed several long-term contracts for its next generation of telecommunications satellites, with customers including Harris CapRock Communications, Panasonic Avionic Corporation and MTN Satellite Communications.
- Energy Future Holdings ("TXU"), a 3.3% distressed position, with an 11-14% yield to maturity, released a mixed earnings report that did not surprise us. Revenues on the Oncor utility side (where we are invested) continued to rise and the company remains in the midst of a large capex project which should ultimately boost the underlying rate base and provide greater cash dividends to the company parent. Meanwhile, on the power generation side, the baseload business (where we are not invested) remains under significant pressure due to the low price of natural gas; in the short term, the company's hedges are making up for any shortfall, but as these run out, cash flow and liquidity will dry up quickly. We do not expect any value from the power side for our holding company bonds. As such, we are pleased to see that the utility continues to perform well, while the parent company further distances itself from the merchant power business. Proceeds from a recent bond issuance will be used to pay off completely an intercompany note that should significantly reduce the risk that a restructuring at the power generator could drag the parent into a reorganization.
- CityCenter Holdings, a 3.2% position yielding almost 11%, had an excellent quarter, as the property generated record property-level EBITDA of $71 million, up 11% from the prior year, despite a difficult comparison caused by a high table hold (excellent casino luck) in the first quarter of 2011. All aspects of the business improved, from the Aria casino to the Crystals mall, and it does seem that the property is growing nicely into its capital structure. We view the company's choice of switching to paying cash for our bonds' interest (instead of payment in kind) as a further sign that the parent company sees the CityCenter as having matured and we view these bonds as among the most attractive in the gaming space.
- Sprint Nextel, a 3.5% holding that we purchased last year at a significant discount, reported higher revenues and EBITDA. Second quarter sales of $8.8 billion

grew 6% year over year and EBITDA of $1.5 billion grew 10% year over year. Average revenue per user (ARPU) increased 16% year over year, to $63.38, driven by data-devouring smartphones. The company sold 1.5 million iPhones in the quarter and postpaid churn decreased to 1.69%, its best ever. Sprint Nextel's Network Vision deployment appears on track and will deploy 12,000 new LTE (4G) sites by the end of 2012. We continue to believe Sprint Nextel, the third largest wireless company (50 million subscribers), is a great business that will benefit from rapid broadband data growth. The company had $8 billion of liquidity, as of June 30th, 2012, and also increased its 2012 EBITDA outlook to $4.5-$4.6 billion.

- Hercules Offshore, a 3.1% position, with a 10-11% yield, reported a 35% year-over-year increase in EBIDTA. Hercules' jack-up rig business reported its fifth straight quarter of revenue growth and, says management, customers are not pulling back from drilling operations in response to volatile oil prices. Hercules' jack-up fleet is nearly 100% utilized.

"We have been saying for the past two years that the U.S. economy is improving – perhaps more robustly than many observers think."

- Nuveen Investments, a 3% position, reported flattish results after seeing outflows resulting from the departure of one of its star portfolio managers. Nuveen continues to diversify its business by both asset class and distribution channel and should be able to refinance some of its more expensive debt. The company generated adjusted EBDITA of $129 million during the quarter, consistent with results from the 2011 quarter. Nuveen has proven, despite losing some key personnel, that it has an attractive brand and that there is adequate and growing demand for its investment products.
- Clear Channel Communications, a 2.7% position and a distressed investment yielding north of 20%, reported flat revenues of $1.6 billion during the second quarter and cash flow up 6% on flat revenues. Its Radio, Domestic Outdoor and International Outdoor businesses all exceeded expectations. Media advertising tends to be the first hit taken in a slowing economy, but Clear Channel's unique reach and dominance in key markets has allowed it to keep sales up despite the headwinds.
- Caesars Entertainment, a 2.7% position and also a distressed investment with a 20% yield, reported middling results in the recent quarter. Cash flow at the operating company level was off 5%, as almost all regions saw a decline in gaming revenue; while some regions saw an increase in visitors, almost all saw a decline in spend per visit. The company did crystallize further cost cuts and expects to extract more savings in the future while opening several promising new projects. Additionally, the company continues to extend its runway by chipping away at 2015 maturities and issuing longer-term debt.

•Cemex, a 2.9% position in the Fund, has closely tracked the stabilization of, and now improvement in, U.S. housing sales and construction. We were able to purchase Cemex bonds at distressed prices, yielding between 15-17%. Recent earnings were helped by improved pricing in every region, offset by lower volumes in every region on a like-to-like basis. EBITDA was the highest it has been in several years, with the highlight that U.S. EBITDA finally entered positive territory. Better still, guidance for the U.S. was increased to high single digit growth, compared with previous guidance of mid-single digits. This is especially important given that the U.S. contributes 20% of the company's revenues (currently contributing only 4% of EBITDA). A goal of the company is that the U.S. will contribute about a third of EBITDA. While debt levels and credit ratios remain elevated ($17 billion debt and gross total leverage of seven times cash flow), we sit in bonds with some of the most robust guarantees in the capital structure with several turns of value below us.

- On the back of a stronger housing market, Ainsworth, another distressed company yielding between 15-20%, reported much improved results. Second quarter sales increased $10 million year over year, to $90 million, and EBITDA increased from $2.7 million to $17.1 million. Benchmark oriented strand board (OSB) prices in Western Canada increased 54% year over year, to $232/msf, due to increased demand from a pick-up in new home starts. While housing activity remains muted (though it has now climbed above trough levels throughout the U.S.), we believe Ainsworth will be a primary beneficiary when new home starts rebound in North America. As of June 30th, 2012, Ainsworth's liquidity was $59 million and the company has several options for additional sources of capital. The company expects a positive second half, based on industry forecasts for housing starts of between 723,000 and 800,000, 19% to 27% higher than 610,000 starts in 2011.

These companies, which are the Fund's major holdings outside of Lehman Brothers, represent a wide collection of industries and geographies. Lehman Brothers, which is undergoing an orderly liquidation, is exceeding expectations and will be making its next distribution on October 1st. Though signs of a global slowdown are evident, we see good reason for optimism, as managers improve operating results and strengthen balance sheets. For these companies, all massive cash generators, the capital markets remain accessible. We have also seen healthy resilience in sales of products that you might expect would decline, including advertising at Clear Channel and attendance at City Center. Overall, it is a picture of companies bracing for hard times, which certainly could pay unexpected dividends in the event that conditions are better than expected.

RECENT ACTIVITY

During the quarter, the Fund established 15 toehold positions, no small number given the 50-70 issuers we usually hold. The fixed-income markets consist of private transactions between buyers and sellers. Taking toehold positions gives the Fund the opportunity to buy larger swathes of an issue as prices become even more favorable. As we wait for a better entry point, we are being paid attractive current yield. We continue to scour the market for value and look to build meaningful positions at the right price.

While you will be able to see these small $2-10 million positions in our holdings report, they are truly starter positions. We invested about 7% of the Fund in these names. For the most part, they are stressed and distressed secondary purchases of securities that have fallen 10-30 points and yield between 10- 20%. They all have some issues, and the market has punished the securities because of their near-term outlook. We have the ability to double and triple our investments in these companies when we see a clearer picture of the world markets and improvements in their fundamentals or if we are able to purchase them at lower prices. Even in a low default environment, we expect the markets will continue to provide us with select distressed opportunities as they have done in the past.

Today, about 50% of the high yield and loan market trades at yields of 5% or lower and are priced at $106 (even though the company only owes you $100). The average price of a security in the Fund is $87. That nerarly 20 point price difference represents part of the possible future returns not available from more traditional high-yield products. We do not own any of these low yielding securities, as they are more highly correlated to Treasury prices and will feel the pain if interest rates increase, they have longer durations so the price impact will be more meaningful. Most of these companies have a very low chance of defaulting, but all of them have the chance of a misstep over the next 1-3 years, and when they do, we will be there to analyze the issues, assess the risks and possibly purchase securities 20-40% below where they were issued. This is what we do. We are different in that way. We can go years without owning a steel company or a coal or chemical company or any industry. We don't have benchmarks and industry weights that we must adhere to regardless of the attractiveness of that sector of the market. We don't need to be "fully invested."

In a nutshell, we invest our capital (your capital) when we see opportunities to make double digit returns in stressed and distressed securities. In the past year, we purchased many of these: Sprint 25-30 points below where it was trading after they lowered earnings and the stock sank to all-time lows; Cemex, 30 points below par after they lowered earnings guidance; Ainsworth was down 20 points when the market was uncertain about liquidity and lumber prices. Our toehold positions all fit this category, They were purchased for an average price of $85 and yield an average 14%. Since the inception of the Fund nearly three years ago, we have returned 8.5% annually, despite some mistakes and setbacks. The current invested portfolio yields between 11-12% and, because of the low dollar price of its investments, has the potential to generate excess total return in the future.

"In a nutshell, we invest our capital (your capital) when we see opportunities to make double digit returns in stressed and distressed securities. In the past year, we purchased many of these."

The Fund's cash position remains at 28%. This elevated cash level is the result of the risks to the market presented by Europe, which we have written about in past letters. The global search for yield has driven prices up to levels we are unwilling to pay. Although our macroeconomic view is that the world is healing and that the U.S., in particular, is improving, we remain aware that significant tail risks emanate from Europe and China. In some ways, our large cash position acts as a hedge or even a short against current high-yield prices, and will provide us the firepower to buy bonds and loans at more attractive levels. Our security selection process is bottom up, but in the face of such macroeconomic turbulence, our price consciousness is stricter than ever. The Fund's elevated cash can be deployed quickly as opportunities arise, or if we get some clarity from Europe. The Fund's toehold positions are akin to a runner's starting block that positions us for optimum performance.

As always, we thank you for your support of the Fund and we look forward to writing you again at the end of the Fund's fiscal year on October 31, 2012.

Sincerely,

Thomas Lapointe
Portfolio Manager
Third Avenue Focused Credit Fund

OFFICERS

Martin J. Whitman — Chairman of the Board
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Joseph J. Reardon — Chief Compliance Officer
Tara Dempsey — Assistant Secretary

TRANSFER AGENT

BNY Mellon Investment Servicing (U.S.) Inc.
P.O. Box 9802
Providence, RI 02940-8002
610-239-4600
800-443-1021 (toll-free)

INVESTMENT ADVISER

Third Avenue Management LLC
622 Third Avenue
New York, NY 10017

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

PricewaterhouseCoopers LLP
300 Madison Avenue
New York, NY 10017

CUSTODIAN

JPMorgan Chase Bank, N.A.
14201 Dallas Parkway, 2nd Floor
Dallas, TX 75254

THIRD AVENUE FUNDS

Third Avenue Funds
622 Third Avenue
New York, NY 10017
Phone 212-888-5222
Toll Free 800-443-1021
Fax 212-888-6757
www.thirdave.com