

**TWEEDY, BROWNE GLOBAL VALUE FUND
TWEEDY, BROWNE AMERICAN VALUE FUND**

Correction Notice to
March 31, 2005 Investment Adviser's Report

On page 10 of the Investment Adviser's Report to Shareholders, we cite an analysis of Julian Robertson's Tiger Fund based on a review of Daniel Strachman's biography of Julian Robertson, **A Tiger in the Land of Bulls**. We incorrectly attributed an analysis of Tiger Fund's performance to Chip Tucker of the Davis Funds. Chip Tucker did not make the analysis, but only forwarded on to us an email from Whitney Tilson of the Tilson Funds. Whitney Tilson is a frequent and very good commentator in the money management world. A more careful reading of Whitney Tilson's email states that the analysis of Tiger Fund's performance is from "...another friend----an old timer who prefers to remain anonymous." Our apologies to Chip Tucker and Whitney Tilson. Both individuals are, in our opinion, reliable sources.

July 12, 2005



TWEEDY, BROWNE
GLOBAL VALUE FUND

Investment Adviser's Report

March 31, 2005



TWEEDY, BROWNE
AMERICAN VALUE FUND



Left to right: John Spears, Tom Shrager, Chris Browne, Bob Wyckoff and Will Browne.

To Our Shareholders:

We are pleased to present the Investment Adviser's Report for the Tweedy, Browne Global Value Fund and the Tweedy, Browne American Value Fund for the fiscal year ended March 31, 2005. Investment results* for the last six months and fiscal year, along with results for the past three, five, and ten years, and since inception of both Funds are presented in the tables on the following page:



Period Ended 3/31/05	Tweedy, Browne Global Value Fund	MSCI EAFE ⁽¹⁾⁽²⁾	
		US \$	Hedged
6 Months	11.65%	15.13%	10.59%
1 Year	14.75	15.06	11.55
3 Year	8.60	11.64	-0.52
5 Year	7.02	-1.15	-4.81
10 Year	13.15	5.41	7.04
Since Inception ⁽³⁾	12.52	5.88	5.94

Period Ended 3/31/05	Tweedy, Browne American Value Fund	S&P
		500 ⁽¹⁾⁽⁴⁾
6 Months	5.00%	6.88%
1 Year	4.18	6.68
3 Year	2.76	2.73
5 Year	5.47	-3.16
10 Year	11.72	10.78
Since Inception ⁽³⁾	11.03	10.52

* The preceding performance data represents past performance and is not a guarantee of future results. Total return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. The returns shown do not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares. Current performance may be lower or higher than the performance data shown. Please visit www.tweedy.com to obtain performance data, which is current to the most recent month end. See page 19 for footnotes 1 through 4, which describe the indices and inception dates of the Funds. Results are annualized for all periods greater than one year.

US market gains in the year ended March 31, 2005 were virtually all achieved during the quarter ending December 31, 2004 following the presidential election. The S&P 500 Index was approximately flat for the first two fiscal quarters, gained 9.2% in the third quarter and gave back 2.1% in the March quarter. Stocks outside the US as measured by MSCI EAFE hedged to the US dollar, which shows returns that are generally close to local market returns, were up in three of the four quarters of last year. MSCI EAFE in US dollars, the unhedged version of the index, achieved nearly its entire return in the December 2004 quarter when the dollar declined against most other currencies. In the most recent quarter ended March 31, 2005, our Global Value Fund gained 3.84% while MSCI EAFE in US dollars declined 0.17%, primarily as a result of a strengthening of the dollar against the euro and the yen. (More on the hedging debate is presented below.)

In the most recent year, the Global Value Fund recorded a gain of 14.75% which was 320 basis points better than EAFE Hedged. Simply stated, our stocks



performed better than the stocks that comprise the index. EAFE in US dollars bested the Global Value Fund by 31 basis points due entirely to a declining dollar from year to year. However, this year-over-year decline in the US dollar was not linear. The hedged index and the unhedged index each “won” in two of the last four quarters. Deciding whether or not to hedge on a quarterly basis is not an easy task.

Periodically, and at least annually, we like to analyze where we made our gains and where we lost money. Theoretically, the results of such an analysis would indicate whether certain stock sectors or investments in certain countries were better or worse than the overall return of the Funds. Perhaps this information would lead to conclusions that might help us manage the Funds in the future. Unfortunately, what works in theory may not work in practice. The two stocks that had the greatest positive impact on the Global Value Fund’s performance over the past twelve months were Jardine Strategic Holdings and Almanij NV.⁵ Jardine Strategic, a Singapore-based holding company with interests in Hong Kong real estate, automobile distribution and hotels, more than doubled last year. The share price most likely benefited from rising real estate values. Almanij NV is a Belgian holding company that controls KBC Bank. Holding companies are an arcane relic of European corporate structure. A shareholder who owned 51% of a holding company that in turn owned 51% of an operating company could effectively have voting control of the operating company by having an economic interest in only 26% of its shares. This was a common structure used to increase control of companies with only a limited investment. Ten or twenty years ago, many French companies had multiple holding companies to insure control with a small minority economic interest in the operating company. Holding companies typically trade at discounts to the underlying value of the operating company. In the case of Almanij, our estimate of the discount at the time of our investment was 35%. For more than two years, we suggested to the management of Almanij that they merge with the underlying operating company, KBC Bank. We argued that such a merger would increase liquidity in the shares of KBC Bank and increase the share price of Almanij. And for two years, the management said the controlling family had no interest in a merger because it would reduce their voting control of KBC from approximately 60% down to 34%. Finally, last year, the controlling shareholder let the merger take place and the shares of Almanij rose more than 70%.

Jardine Strategic and Almanij are about as different as two companies can get. They are located 10,000 miles apart and operate in completely different businesses, yet they provided our largest gains. The only common characteristic we can discern is that they were both undervalued. The events that led to an unlocking of their value appear to us to be totally random.



We can reach a similar conclusion about the predictability of individual stock returns if we look at the Global Value Fund's worst performing stocks of the previous year. The two stocks which had the greatest negative impact on the Global Value Fund's results last year were Pfizer, the large cap global pharmaceutical company, and Shionogi & Co., a Japanese pharmaceutical company. Pfizer now trades at a price/earnings ratio that is approximately 70% of the price/earnings ratio of the S&P 500 despite the fact that we believe pharmaceuticals are a much better business than the average company in the index. Pharmaceutical stocks in general did not do well last year.

The two stocks in the American Value Fund which contributed most to its performance were GATX Corp., which leases rail, tank and freight cars as well as aircraft, and ProQuest Company, which publishes content such as scientific journals for libraries and provides technical information for the automotive dealer industry. GATX's share price rose nearly 50% last year in anticipation of a recovery in the leasing business. ProQuest's shares rose nearly 24% last year as it came into favor with street analysts when its business shifted into more educational products. The American Value Fund's biggest dogs last year were Pfizer and MBIA Corp., an insurer of municipal and corporate bonds. Despite meeting earnings targets and a price/earnings ratio less than 10X, the share price of MBIA fell 16.6%. MBIA has been the object of numerous rumors about its accounting and financial condition that, to date, do not appear to be true.

Discerning which stocks will perform the best and which will perform the worst in any limited time period such as a year is a task way beyond our capabilities. And searching for any common characteristics among the best and worst stocks does not produce any obvious conclusions. The only common characteristic we strive for in our stocks is that they should be cheap relative to their intrinsic value. But just being cheap is no assurance that a stock cannot get even cheaper, or that some unforeseen event may have a negative impact on a particular company's intrinsic value. Fortunately, it has been our experience in the past that the unforeseen, what we call "event surprises," is more often positive than negative. A value-oriented portfolio tends to be comprised of stocks for which the investment community has low expectations. Expected bad news is often priced into the shares. When and if bad news appears, it can be greeted with a yawn rather than a yelp. This is the opposite of stocks that trade with high expectations and thus high valuations. With high-expectation stocks, disappointing news can result in a severe correction in share price. The bursting of the tech bubble in 2000 is the most recent and obvious example of the risks of owning high-expectation stocks. And the risks are greater than just a temporary decline. High-expectation stocks have the greatest chance of producing what we call permanent capital loss. By this we mean the stock is unlikely ever to regain its highs. The rubble following the bursting of the tech bubble is full of such examples.



As we assume you are all aware, both Tweedy Browne Funds closed to new investors on May 4, 2005. Existing shareholders may continue to add to their holdings. As of March 31, 2005, the cash position of the Global Value Fund stood at more than 21%, and the American Value Fund was nearly 19% in cash. We would prefer to have very little cash since cash cannot produce any significant returns. In the past year, cash was a real drag on the performance of both Funds as it will always be in a rising market. However, these large cash positions are not a result of any conscious decision on our part, but purely a result of having few investment opportunities that meet our criteria at current stock market levels and more frequent opportunities to sell stocks at prices around our estimate of intrinsic value.

The investment principles that we employ in managing both your and our money are pretty simple, although the execution can become pretty difficult. We look to invest in companies where the share price is significantly less than our estimate of the underlying or intrinsic value of the business. This is where we hope to get our investment edge. Our definition of intrinsic value is the price a knowledgeable buyer would pay for the entire company. We look for comparable previous sales of similar businesses as a benchmark for value. To put it in a more mundane context, it is a bit like selling your house. You price your house based on prices paid for similar houses in your neighborhood. Companies are valued in much the same way. And like a house, it is the inspection that confirms your estimate of the fairness of the price. Termites and a leaky roof are like fraudulent accounting, or accounting that is a bit too aggressive to present an honest picture of what you are buying. Or you may learn that a six-lane highway that is being built next to the house will significantly impair its value, which is like figuring out if there is a competitor who is about to wreck a company's business model and impair its profitability. These are all questions that need to be answered before we can develop a sufficient level of confidence to make an investment.

Assuming our estimate of intrinsic value is within an acceptable margin of error, we then look to invest when we can make a purchase at a much lower price. Why would stocks trade for less than their intrinsic value? The primary reason is that the average shareholder has no way to compel the directors of a company to sell and realize intrinsic value. Other factors that create discounts to intrinsic value are a general fear about economic conditions that drive investors to sell more stock than the market can absorb, or concerns that a particular company will not do well, driving investors to sell and depress the price below intrinsic value. Such events create opportunity for value investors who take a long view. Over time, equilibrium will develop between those who want to sell and those who want to buy. Then, hopefully, the process reverses itself as fear wanes and the disequilibrium between buyers and sellers works to our advantage, driving the price of the stock up. This is a cycle that has repeated itself since stock markets were invented.



As we discussed in our September 30, 2004 mid-year report, the greatest part of our gains in the past have come from buying stocks at a discount to intrinsic value. Moreover, as Ben Graham said, the discount from intrinsic value was his margin of safety. If he was wrong in his analysis of a particular company, or the value of that company happened to decline, the cushion of the discount provided some protection from permanent capital loss. Ben Graham was first a credit analyst. Like a banker who is asked for a loan, the banker wants to know what collateral the borrower is putting up to secure the loan. If the collateral is sufficiently greater than the amount of the loan, the loan will be made. In the same vein, Ben Graham saw the intrinsic value of a business as the “collateral” covering his investment. Typically, Graham liked to have coverage of 1½ times his purchase price in intrinsic value, which equates to buying stocks at about 65% of intrinsic value.

The issue that confronts us today, and the reason we have chosen to close our Funds to new investors, is that the discount from intrinsic value at which the vast majority of stocks trade has never in our experience been narrower. To paraphrase Warren Buffett, why pay \$80 for a stock that is only worth \$83? The discount from intrinsic value provides downside protection in the event of some unforeseen negative event and has been a major source of our gains in the past. However, with several investments, the growth in intrinsic value over a long period of time has also been an important contributor to gains. Without a significant discount, returns should be more modest.

With all major stock market indices still below their highs reached in 2000, one could logically ask why there are so few cheap stocks. At the risk of repeating ourselves, but by way of a reminder, in early 2000, the universe of stocks was arrayed over a much wider spectrum of valuation. At one end, we had the technology, media and telecommunications stocks (“TMT”) that were trading at ridiculously high valuations while more mundane companies such as financials, consumer and manufacturing issues were trading at much lower valuations. Then things changed. The so-called TMT stocks collapsed, bringing the market indices down, while almost all other kinds of stocks, from value stocks to small and mid-cap stocks, rose. While the rise of non-tech stocks was not enough to offset the magnitude of the tech collapse for the broad market indices-- an indication of just how excessive tech valuations were at their peak-- it did eliminate much of the undervaluation in non-tech stocks. This result was most obvious in calendar years 2000 and 2001. Using our results as a proxy for the non-tech segment of the market, for the two years of 2000 and 2001, the S&P 500 experienced a cumulative loss of 19.9% while the American Value Fund achieved a cumulative gain of 14.3%. Over the same period, the Global Value Fund rose 7.15% while EAFE in US dollars fell 32.6% and EAFE hedged was down 19.6%. The divergence in performance among stock sectors over that two-year period was enormous. In 2002, almost all stock sectors declined. However, tech stocks declined more than the overall market,



further narrowing the spread between tech and non-tech valuations. Stock markets rebounded in 2003 and 2004, but again tech stocks were not the market leaders.

In a matter of four or five years, the stock market has gone from being as irrationally priced as we can remember, to one that is uncommonly rationally priced. We say “uncommonly” because at almost any time there are industry sectors and/or individual stocks that are significantly mispriced, either on the upside or, more generally, on the downside. That is not the case today. It is almost as if there is no fear in any segment of the stock market. Generally, some constituency within the investment community is spooked by some economic condition which results in excessive undervaluation somewhere. However, today it is as if most stars in the economic sky are in alignment. The economy is growing at better than historic rates, unemployment is near historic lows, as are inflation and interest rates. And if the stock market had some fear about the budget and trade deficits, it would be reflected in the price of the market. It is not. Perhaps it is this apparent lack of fear which concerns us most. Nothing can be as perfect as the current level of the stock market seems to say it is.

Despite the extraordinary gains the broad stock market indices achieved in the five years from 1995 through 1999, the longer term returns from the indices through March 31, 2005 have been fairly paltry. The table below presents the annualized rate of return of the S&P 500, the NASDAQ Composite, and EAFE both in US dollars and in local currency.

<i>Annualized Data</i>				
	S & P 500 ⁽¹⁾⁽⁴⁾ (Total Return)	Nasdaq ⁽¹⁾⁽⁶⁾ Composite	EAFE ⁽¹⁾⁽²⁾ (US\$)	EAFE ⁽¹⁾⁽²⁾ (Local)
1 Year	6.68%	0.83%	15.06%	11.92%
2 Year	20.07	22.72	34.64	24.36
3 Year	2.73	3.06	11.64	0.52
4 Year	2.11	2.36	6.22	-1.54
5 Year	-3.16	-15.08	-1.15	-4.77
6 Year	0.07	-3.24	2.81	-0.01
7 Year	2.51	1.38	3.27	0.49
8 Year	7.33	6.49	5.07	3.43
9 Year	8.65	6.97	4.66	4.16
10 Year	10.78	9.47	5.41	6.09
11 Year	11.22	9.51	5.47	4.70
12 Year	10.37	9.36	6.79	5.69
13 Year	10.74	9.73	7.15	5.89
14 Year	10.76	10.77	5.99	4.59
15 Year	11.00	10.77	5.76	3.96



Annualized Data

	S & P 500 ⁽¹⁾⁽⁴⁾ (Total Return)	Nasdaq ⁽¹⁾⁽⁶⁾ Composite	EAFE ⁽¹⁾⁽²⁾ (US\$)	EAFE ⁽¹⁾⁽²⁾ (Local)
16 Year	11.50	10.54	4.58	3.46
17 Year	11.88	10.42	4.98	4.40
18 Year	10.65	8.97	5.59	4.22
19 Year	11.42	9.27	7.96	5.63
20 Year	12.60	10.40	10.91	7.21

As the table shows, returns from these broad market indices have been fairly dismal for a number of years. The annually compounded rate of return of the S&P 500 for the past seven years has been only 2.5%, while EAFE in US\$ has compounded at 3.3%, and EAFE in local currency compounded at less than 1/2 of 1%. One has to go back ten years for the S&P 500 to have compounded in its historic long-term range of 10% to 11%. For the longer-term periods, the rates of compounding for the eleventh through twentieth years are either within or slightly above that range. The rates of compounding for EAFE in US\$ and EAFE in local currency have been significantly below the S&P 500 in almost every period. Indexing has not been much of a wealth builder for quite some time.

If the broad market indices have not been wealth builders for a fairly long time, it begs the question as to why there are so few cheap stocks to buy. We have alluded to what we believe is the answer. The broad stock market indices only tell part of the story. While broad indices can be a bellweather for what is occurring in markets as a whole, they may not tell the entire story. The indices are market cap weighted while individual portfolios usually are not. Although the S&P 500 comprises a significant portion of the total market capitalization of US public stocks, it does only include 500 stocks in the US out of a universe of more than 11,000 stocks. When the S&P 500 was trading at more than 30X earnings in 1999 and 2000, there were more cheap stocks for value investors to buy than there are today when the S&P 500 trades around 17X to 18X earnings. The market cap weighting of the broad market indices leads to enormous distortions from time to time in the calculation of index statistics. If a handful of stocks with large market capitalizations are trading for more than 30X earnings (a P/E of 30+ will result in an outsized market capitalization), the average price/earnings ratio is distorted. After the stock market bubble burst in 2000, investors fled the ridiculously overpriced TMT stocks and redeployed their money in other sectors of the market and other asset classes. After the tide receded, sinking such former darlings as Pets.com and other grossly overvalued internet and technology stocks, it returned, lifting all boats. The mantra of growth was replaced by a hunt for pockets of undervaluation. Small and mid-cap stocks, junk bonds, and REIT stocks, bonds, etc., all rose significantly. However, their rise did not affect the market-cap weighted, broad stock market



indices. The difference between the price of a date with Miss Universe and a groundhog went from a ratio of 100 to 1 to 1.5 to 1. The premium an investor was willing to pay for a star over a supporting actor shrank significantly.

In another era not so very long ago, investors required a significantly higher return from more exotic, higher risk investments than they expected from highly liquid and publicly traded securities. That appears to no longer be the case. With every market pundit shouting that investors must reduce their return expectations from publicly traded securities, money has been flowing at great rates into non-traditional, non-stock market correlated investments. Our friend, Howard Marks, the chairman of Los Angeles-based Oaktree Capital Management, recently wrote about the “capital market line,” which is a measure of the risk/reward expectations investors have for various investment categories. The line begins at the risk-free rate of return of short-term Treasury notes and slopes upward to the right as investors assume greater risk for more potential return. Some of the various points along the line are intermediate government bonds, long-term government bonds, corporate bonds, junk bonds, stocks as measured by the S&P 500, moving on to investments that are perceived to be riskier and/or have less liquidity, like real estate, hedge funds, leveraged buyouts and venture capital. Howard observed that not too long ago, the starting point for his capital market line began at about 4%, which was equal to the risk free rate of return an investor received from short-term government bonds. The line rose through longer term bonds, through the S&P 500, which was expected to return approximately 10% per annum, on to leveraged buyouts and venture capital, where returns were expected to be in the range of 25% to 30%. Howard has observed that both the starting point of the capital market line and the steepness of its slope have declined significantly in recent years. The risk free rate of return is now around 2%, and the expected return from readily marketable securities as in the S&P 500 is only around 6% or 7%. With expected returns from more conventional investments so low, investors are increasingly reaching for returns in riskier, less liquid asset classes. However, as more and more money flows into these smaller asset classes, their returns should inevitably decline.

Perhaps the greatest growth in assets under management in the past few years has been in hedge funds. According to an article in **The New York Times** in December of last year, the amount of money invested in hedge funds has grown from \$50 billion in 1990 to more than \$1 trillion today, a twenty-fold increase. And the increase did not all come from performance. The number of hedge funds is ballooning, and they come in so many strategies that it is impossible to position them on Howard Marks’ Capital Market Line. Because they are unregulated, hedge funds may only take money from wealthy individuals and institutional investors. This is a great marketing ploy for the hedge fund industry as it implies that access to these superior performing funds is open only to the rich. There is a perception that the “rich” have an



advantage over the little guy in gaining access to the top performing money managers. A more in-depth analysis of the hedge fund industry may show that this is not such a great advantage.

Much of the reputation of hedge funds rests on the records of George Soros, whose Quantum Fund produced excellent returns in the 1980s and early 1990s, and Julian Robertson's Tiger Fund, which also did well over much the same period. Both men produced superior returns for their investors and amassed great fortunes for themselves along the way. However, a more detailed analysis of their performance may reveal that their success was less a function of their superior investment acumen and more a result of their willingness to assume risk. In Daniel Strachman's biography of Julian Robertson, **A Tiger in the Land of Bulls**, it is reported that Robertson's Tiger Fund reportedly produced a compounded annual rate of return of 28% for its investors over a twenty-year period. This is a truly superior investment record. However, Chip Tucker, of the Davis Funds, took a closer look at the Tiger Fund record and calculated that the investment return before the use of leverage was more like 12% per annum in a period of perhaps the greatest bull market in history. Tucker estimates that the Tiger Fund "was always leveraged to the max, generally 200% to 400% invested...." Leverage equals risk. It can significantly increase returns if the market is going in your direction. It can also significantly increase losses if the market goes against you.

Tiger Fund closed shop in March of 2000. In 1999, it recorded a loss of 19% and declined a further 13% in the first quarter of 2000. According to Tucker, in 1991, Tiger Fund had \$2 billion in assets. It subsequently swelled to \$25 billion in the mid-to-late 1990s as its success attracted new money from the rich. In the last six years of its existence, Tiger Fund returned a compounded annual rate of return to its investors of 9.9% while the S&P 500 returned a 24.7% compounded annual rate of return over the same period. Early investors in Tiger Fund had a good ride. However, the vast majority of the sophisticated investors the Fund attracted experienced mediocre returns while assuming significant risk through leverage.

The attraction of hedge funds like Tiger and Quantum in the 1980s and 1990s was their ability to produce what the investment world calls "alpha." Alpha is a measure of outperformance relative to some benchmark like the S&P 500. The other popular measurement yardstick of investment performance is "beta," which is a comparison of the volatility of performance relative to an index. Some newer and smaller hedge funds derived much of their alpha in the late 1990s through allocations of "hot" IPOs (initial public offerings) of technology and internet stocks. Even a small allocation could have a significant impact on a fund's results if the hot IPO doubled or tripled, which many did, in the first few days after its debut. As a fund's assets grew, it became harder to derive the same impact from IPOs.



Following the collapse of the NASDAQ Composite and the S&P 500 in 2000 through 2002, a result mostly of the collapse of technology stocks, hedge fund investors shifted their focus from “alpha” to “beta.” Investors were less interested in “shooting out the lights,” performance wise, and more interested in garnering steady returns irrespective of what the overall stock market was doing. This was a classic case of shifting emphasis from outperformance to risk aversion. Lo and behold, the hedge fund industry was more than willing to accommodate this renewed emphasis on risk aversion.

While so-called “market neutral” hedge funds had been in existence for some time, they began to attract significant capital following the collapse of the popular stock market indices after 2000. Employing strategies such as merger arbitrage, or arbitraging spreads between different grades of fixed income securities, they were thought to produce steady, if not spectacular returns while avoiding any significant declines in any given short-term period. Because traditional hedge funds could go long and short stocks, bonds, commodities and currencies, they were implicitly market neutral so long as the market did not go too far against their bets. Traditional hedge funds were also marketed on the basis of producing “alpha,” superior returns, not “zero beta,” a lack of volatility. However, as everyone knew, significant alpha can require significant risk either because of leverage or concentrated investment bets, or both. The market neutral funds got a pass on alpha.

We have no gripe with paying a hedge fund manager a flat fee of 1% to 2% plus 20% of any gains so long as performance significantly outpaces the overall stock market, which should be our reward for assuming greater investment risk. However, we do question paying such large fees to money managers who only promise modest returns with low volatility. In soon-to-be published research, Roger Ibbotson, a Yale University finance professor and chairman of the investment research firm, Ibbotson Associates, makes the case that the alpha of hedge funds is approximately equal to the hedge fund fees.

Some investment consultants make the case that hedge funds are less risky than conventional investment strategies. However, the “less risk” comes from having a diversified portfolio of many hedge fund investments so that if one fund has really bad results, it will theoretically be offset by another fund with really good results. Unfortunately, this approach can lead to really mediocre results as the average of a number of funds may not be all that spectacular.

Only a handful of investors have enough money to qualify for a diverse number of hedge funds. Not to worry. The investment industry has come to your rescue with “funds of funds.” These investment vehicles gather assets from less affluent investors, pool these assets and invest them across a spectrum of hedge funds. These multi-manager funds have ballooned in the past few years and now number more than 2,300 with assets of \$224 billion, approximately one-quarter of all the assets invested in hedge funds. For the privilege of



investing like the rich, fund-of-funds investors get to pay even more fees on top of the already generous fees the hedge fund managers are making. Fees for a fund-of-funds can be as high as 1% of assets plus an additional 10% of any gains. To do the math, if a hedge fund had a gross gain of 20%, its manager would take a 1% management fee and 20% of the remaining 19% of gain for a total of 4.8% netting the investor 15.2%. Tack on an additional 1% fee for the fund-of-funds manager and a further 10% of the remaining 14.2% return, and the fund-of-funds investor nets about 12.8%. Approximately 36% of the investor's gross return has been eaten up in fees. Put another way, for an investor to net 12.8%, which is only slightly higher than the long-term performance of the S&P 500, the underlying hedge fund must perform 56% better. Tough to do year in and year out.

For an investor who pays taxes, the math can get even worse. Hedge funds tend to have high portfolio turnover rates. One study produced by the Hennessee Group, a hedge fund industry research firm, shows that more than 50% of hedge funds have turnover rates exceeding 200%. High turnover would indicate that most, if not all, returns from hedge funds are short-term capital gains, which are taxed at a federal rate of up to 35%. If we assume an average state income tax rate of 8% (California is 9.3%, and for a New York City resident, the rate is 12.15%), which is deductible against the federal rate, you have an effective tax rate of 40.2%. The hedge fund investor's net return after tax in our theoretical example is 7.65% ($12.8\% \times 0.598 = 7.65\%$). Put another way, an investor in a hedge fund using a fund of funds netted after tax 38.3% of the gross return of 20%. If the same 7.65% return was earned through long-term capital gains and dividends taxed at 15% at the federal level and 8% at the state level, an investor would only need a gross return of 9.78% ($7.65\% \div 0.782 = 9.78\%$). A return of 9.78% is below the long-term rate of return of the S&P 500, which was earned without the risk of leverage or concentration. As most of the gains in an index fund in any given year are not realized, the actual net return only gets better, and you have the psychic pleasure of not paying for the hedge fund manager's McMansion and NetJet. As our friend, Paul Isaac, commented, hedge funds are not so much an industry as a compensation formula.

In a commentary written for Bloomberg News on February 14, 2005, John F. Wasik notes that "hedge fund returns are beginning to lag leading stock indexes." While the S&P 500 was up 10.9% last year, the Hennessee Hedge Fund Index showed the average hedge fund only gaining 8.7%. As Wasik observes, "Like most managed products, hedge funds will ultimately join the mediocrity dance called regressing to the mean, where most funds underperform or equal average industry returns over time. It's a statistical fact of investing." Wasik writes on that it is not easy to get a clear picture of hedge fund returns primarily because the industry is largely unregulated, and there is no requirement to report performance to any authority. "Several academic



studies have noted that hedge fund index performance is inflated because they typically don't include funds that have gone out of business or funds that have only reported positive 'backfilled' data." Wasik cites a study done last year by Burton Malkiel, a noted and often-quoted Princeton finance professor, that reported hedge fund index returns "may be overstated by 3.74% to 5% due to these biases."

In an article dated December 9, 2004 in *The New York Times*, entitled *Hedge Funds Better at Managing Data Than Managing Money*, reporter Alan Krueger further explored the overstatement of hedge fund results citing the "survivor bias" in hedge fund index statistics. Along with funds that begin to report performance data once they have racked up a good patch, i.e., "backfilled" data, other funds that may be struggling or about to close often stop reporting performance numbers to the hedge fund indices. Krueger estimates that fully 10% of hedge funds cease reporting data each year, and many of those who do stop go out of business. For example, Long Term Capital Management did not report its losses to any database service from October 1997 to October 1998, a period when it lost 92% of its capital. Krueger quotes Burton Malkiel, "I think there are a lot of people in the financial community who have a vested interest in showing only those pieces of data that help sell products." Now, who would ever do such a thing?

A certain number of hedge funds will do very well for a period of time. But just as we must put a warning label on our reported returns, "Past performance is not a guarantee of future results," ditto for the hedge fund industry. Maybe even more so. Numerous studies have shown that the best performing hedge funds in any prior year are not likely to be in the same category in any subsequent year. Just as hedge funds churn their portfolios, investors in hedge funds are likely to switch from fund to fund as performance disappoints in one while another is doing well. This is classic rearview mirror investing, which has never been a good way to make money. If an investor is still inclined to put money in hedge funds and believes he or she can identify those managers who will outperform, we wish him or her well. Our only note of caution: do not think hedge funds are the "silver bullet" of investing. Just as much care, or perhaps even more care, is required in picking a hedge fund than in picking a mutual fund or an investment advisor. Hedge funds rely more on "brains" to produce performance than process or any given set of investment principles. However, to quote Warren Buffett, "Investing is not a game where the guy with the 160 IQ beats the guy with the 130 IQ. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing."



CURRENCY HEDGING

Given the drubbing the dollar has taken in the past two to three years, it would be irresponsible for us not to review our position on currency and its impact on the internationally focused assets we manage.⁷ We might add that a number of shareholders in our Funds have questioned our continued policy of hedging our perceived foreign currency exposure back into the dollar. We have always maintained that our goal in investing internationally is to capture the local market return of the stocks we own, and to translate those returns back into the currency in which we measure our net worth, US dollars. We buy our food, pay our rent and pay school tuition for our children all in dollars. As currencies fluctuate over time, hedging our currency exposure eliminates the impact of those fluctuations on our foreign holdings. An unhedged position results in currency fluctuations either positively or negatively affecting our returns in our base currency, depending on whether the dollar declines or rises relative to other currencies. The impact can be enormous in either direction.

One shareholder asked whether our policy meant we were making a huge bet on the dollar. We thought long and hard about this question, and concluded it did not. The huge bet we have made on the dollar relates to being Americans and calculating our net worth and budgeting our expenses in dollars. We seek to be currency neutral in dollars, and believe that to be unhedged would mean we were making a huge bet on the euro, the yen and other currencies. Currency speculation is definitely not in our sphere of competence. We have a much better chance of estimating the intrinsic value of a stock and adhering to a discipline of buying it at a significant discount to our estimate. Hopefully, the price of the stock will rise in its local currency and we will profit from that rise.

Many US investors in foreign stocks are seeking a measure of foreign currency exposure within their overall investment holdings. That diversification of currencies is fine with us. However, those investors are still making a bet in favor of foreign currencies, a bet we do not choose to make for our mutual funds. A third approach many investors and international money managers follow is to half-hedge their foreign currency exposure. The most frequent explanation we hear for pursuing this approach is that it provides a degree of neutrality to fluctuations in currency. In our opinion, this is faulty logic. All half-hedging does is limit an investor's exposure to the vagaries of currency for half of their portfolio.

To reiterate, not hedging or half-hedging is a conscious investment decision in favor of foreign currencies over the US dollar. Currency is an asset class for many investors. It is simply not an asset class for which investors should look to us. There are a lot of other money managers in the currency field who specialize in managing currency investments. Given our long-term, equity-only approach to investing, it has been our observation that currency rate



fluctuations do not have a significant long-term effect on our process. Despite significant year-to-year differences in returns between EAFE hedged and EAFE unhedged, the annualized returns over the past 10 years are 5.4% and 6.1%, respectively, annually compounded. Our Global Value Fund's results for the same 10 year period ended March 31, 2005 are 13.15%.

Naysayers warn that the twin trade and budget deficits of the US will put the dollar in a tailspin versus other major currencies. However, not everyone agrees. In a January 3, 2005 op-ed piece from **The Wall Street Journal**, entitled *Destination USA*, economist Arthur Laffer argues that the trade deficit, which is really a current account deficit, can only exist because foreigners are willing to invest in the US. While the US is importing more goods than it exports, currently 5.6% of Gross Domestic Product (GDP), it can only do so because foreigners are willing to invest those extra dollars back in the US. Mr. Laffer further observes that foreigners are willing to invest in the US because it is the only real growth economy in the developed world. Laffer says that the US is "the most pro-growth, free market, rule of law economy the world has ever known." Germany, the world's largest exporter, has a budget deficit as a percent of GDP just behind the US, a stagnant economy that has not experienced a growth spurt in decades and has been plagued with double-digit unemployment for years. Ditto for France. Japan's stock market is still down 70% from its highs reached in 1989, and has company and government unfunded liabilities "that are out of sight." Laffer calculates that the synthetic value of the euro, had it been in existence in 1992, would have been \$1.47. Over the ensuing 10-year period, the dollar appreciated against the euro, which reached a low of \$.83 in 2000. All the while the US current account deficit rose from 1% of GDP to 4% of GDP. Laffer further contends that the dollar's recent fall fits within historic ranges. We believe equilibrium will eventually occur, and the inherent attractiveness of the US as a haven for capital will persist.

INVESTING IN CHINA

Another question that has been raised in the past year has been whether we have any plans to invest in Chinese companies. We have investigated this issue in the past, and, so far, have decided to take a pass. The obvious allure is that China is one of the fastest growing countries in the world. Unfortunately, it is still a Communist dictatorship with virtually no shareholder rights protection. Some companies are listed on Chinese stock exchanges such as in Shanghai. Observing the trading patterns of stocks on these exchanges brings the word "manipulation" to mind. Others are listed on the Hong Kong exchange, which does have rules. However, many of these "red chips" are controlled by the Chinese Communist government, which possesses and has exercised the power of a controlling shareholder. The public is just along for the



ride with no recourse to object to any actions taken by the government. Valuations would have to be a fraction of where they are now for us to assume that risk.

We have started to invest in South Korea in a very small way. Although it is not the best corporate governance environment, it does have some rule of law and an elected government. Most importantly, the valuations are among the lowest in the world, which makes the risk/reward ratio acceptable to us. Korea is a fairly small market and much of the market capitalization is dominated by a few large conglomerates. However, we believe that a number of companies, mostly smaller and mid-cap stocks, offer compelling values. One large cap stock we own is Korea Electric Power, or Kepco, with a market cap of US \$17 billion. Kepco was originally 100% owned by the South Korean government until shares were sold to the public about seven years ago. Kepco supplies nearly all of the electric power for South Korea, a classic good news/bad news story. It has no competition, but the government sets the price it can charge for electric power. The government originally stated that it would allow Kepco to increase electricity rates to a level where it would earn an 8% return on its capital. That has yet to happen. And, in fact, the government imposed a 1% reduction in electricity rates last year as the price of oil was soaring. However, at the time we first bought Kepco shares, they were selling at 3.5X earnings, and one-third of book value with a 5.5% dividend yield. It was statistically one of the cheapest stocks in the world. At that valuation level, we believed we had a sufficient “margin of safety” to compensate for the risk of government interference.

INDEPENDENT ACCOUNTANTS

The audit committee and directors of the Funds appointed PricewaterhouseCoopers as independent accountants on May 11, 2005, replacing Ernst & Young who had been the Funds’ independent accountants since inception in 1993 and resigned on May 4, 2005. The sole reason for this change was a recent corporate transaction by an affiliate of Affiliated Managers Group, a public company with which the Funds’ Adviser is also affiliated. This transaction resulted in a technical loss of Ernst & Young’s independence according to SEC regulations and required a change in the Funds’ independent accountants. There is not and has never been any disagreement between the management of the Funds and Ernst & Young on matters relating to the Funds’ audits, and the Funds’ independent directors and Ernst & Young would have continued their relationship if not for this technicality.



LOOKING FORWARD

We have never been ones to make predictions about the future for any time period shorter than twenty years. However, we can make some observations given our view of the stock markets today. Absent some significant correction of stock valuations, we would expect that our cash position will either remain constant or increase. Our holdings that are priced close to a sale far exceed the new cheap stocks which could replace them. We must give credit to Seth Klarman, President of the Baupost Group, for synthesizing our thinking on holding cash. To paraphrase parts of his year-end 2003 letter to the limited partners of Baupost Value Partners, L.P., we do not find harvesting profits to be an unpleasant task. However, value investors get their real jollies finding new, tantalizingly cheap investment opportunities. As the rising tide has in the past two years lifted nearly all ships, there are few investment opportunities from which to derive any jollies. Holding cash will not bring outsized performance except in a declining market. However, absent compelling investment opportunities, cash is a rational substitute for stocks that we believe do not provide the potential for outsized returns. If markets rise significantly from this level, we will underperform. That is a risk we are willing to take. The majority of our collective net worth and that of most of our employees is invested alongside our Funds' shareholders. To paraphrase Jean-Marie Eveillard, formerly of First Eagle Overseas Fund, we would rather lose shareholders than lose shareholders' money. In the short term, mutual fund performance is measured relative to a benchmark index. When your performance is down, you are not punished unless you are down more than your benchmark. We prefer to measure ourselves on an absolute basis. Being down is not good regardless of whether we are down less, even significantly less, than the benchmark.

The investment world does not give much credit to a manager who holds cash. Our task is to find investments that will rise, and we should be able to find those investment opportunities no matter the level of the market. However, value investors have the ability to be contrarians and ignore the conventional wisdom of the day. In a recent paper for the Columbia Law School Center for Law and Economic Studies, entitled *Searching for Rational Investors In a Perfect Storm*, Professor Lowenstein examined the boom, bust and partial recovery period from 1999 through 2003 to see if there was any group of managers who were able to avoid this cycle and the permanent loss of capital that resulted from investing in the technology, media and telecommunications bubble, and the Enron fads of the day. Lowenstein, with the help of Bob Goldfarb at the Sequoia Fund, identified 10 mutual funds, including the Tweedy, Browne American Value Fund, that somehow did not join in the rush to invest in the bubble stocks. Over the cycle, all ten funds significantly outperformed the S&P 500 index. While most market analysis concentrates on identifying the



mistakes investors make, Lowenstein was interested in finding out what successful managers did to avoid these common mistakes. His overall conclusion is that value managers do not invest in things they do not understand, regardless of the external pressures such as the threat of shareholder redemptions, cries about not understanding we are in a new world of valuation, or general peer pressure. Their investment principles provide an anchor to the wind, at times a very strong wind, which the average investor cannot resist. So, we hope that you, our shareholders, will bear with us, knowing that we will stick with our principles. We remember we were criticized by some in early 2000 for not being with the times. Maybe we are there again.

Very truly yours,

TWEEDY, BROWNE COMPANY LLC

Christopher H. Browne
William H. Browne
John D. Spears
Thomas H. Shrager
Robert Q. Wyckoff, Jr.
Managing Directors

April 26, 2005



Footnotes

- (1) Indexes are unmanaged, and the figures for the indexes shown include reinvestment of dividends and capital gains distributions and do not reflect any fees or expenses. Investors cannot invest directly in an index. We strongly recommend that these factors be considered before an investment decision is made.
- (2) MSCI EAFE US\$ is an unmanaged capitalization-weighted index of companies representing the stock markets of Europe, Australasia and the Far East. MSCI EAFE Hedged consists of the results of the MSCI EAFE Index hedged 100% back into US dollars and accounts for interest rate differentials in forward currency exchange rates. Results for both indexes are inclusive of dividends and net of foreign withholding taxes.
- (3) Inception dates for the Global Value Fund and the American Value Fund were June 15, 1993 and December 8, 1993, respectively. Except for the S&P 500 Index, information with respect to all other indexes and averages used is available at month end only; therefore the closest month end to each Fund's inception date, May 31, 1993 and November 30, 1993, respectively, were used.
- (4) S&P 500 is an unmanaged capitalization-weighted index composed of 500 widely held common stocks listed on the New York Stock Exchange, American Stock Exchange and over-the-counter market and includes the reinvestment of dividends.
- (5) As of March 31, 2005, Tweedy, Browne American Value Fund and Tweedy, Browne Global Value Fund had invested the following percentages of its net assets, respectively, in the portfolio holdings mentioned above: Jardine Strategic Holdings (0%, 2.03%), Almanij, now known as KBC Groupe, (0%, 2.08%), Pfizer (2.34%, 1.44%), Shionogi & Company (0%, 0.02%), GATX Corp (1.16%, 0%), ProQuest Company (3.07%, 0%), MBIA Corp. (3.73%, 0.45%), and Korea Electric Power (0%, 0.65%). The portfolio holdings and the allocations of investments mentioned above reflect the Funds' holdings on the date indicated and may not be representative of the Funds' current or future holdings.
- (6) NASDAQ Composite Index is an unmanaged capitalization-weighted index composed of all NASDAQ domestic and non-US based common stocks listed on the NASDAQ Stock Market.



- (7) Although hedging against currency exchange rate changes reduces the risk of loss from exchange rate movements, it also reduces the ability of the Funds to gain from favorable exchange rate movements when the U.S. dollar declines against the currencies in which the Funds' investments are denominated and in some interest rate environments may impose out-of-pocket costs on the Funds.

The securities of small, less well-known companies may be more volatile than those of larger companies. In addition, investing in foreign securities involves additional risks beyond the risks of investing in securities of US markets. These risks involve economic and political considerations not typically found in US markets, including currency fluctuation, political uncertainty and different financial standards, regulatory environments, and overall market and economic factors in the countries. Investors should refer to the prospectus for description of risk factors associated with investments in securities held by the Funds.

Tweedy, Browne American Value Fund and Tweedy, Browne Global Value Fund are distributed by Tweedy, Browne Company LLC.

This material must be preceded or accompanied by a prospectus for Tweedy, Browne Fund Inc.



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