Staying Power: Jean-Marie Eveillard

Jean-Marie Eveillard is a legend in the world of value investing. Widely recognized as the first truly global value investor, Jean-Marie achieved his status by adhering to the investment principles of Graham and Dodd, and expanded upon by Warren Buffett.


On March 26, 2007 First Eagle Funds and its investment advisor, Arnhold and S. Bleichroeder Advisers, officially announced that Jean-Marie would resume portfolio management responsibilities for the First Eagle Global, Overseas, Gold, Overseas Variable and U.S. Value Funds.

Q: It seems that every value investor has their own story about how they stumbled upon value investing. Can you tell us your story?

JME: I had been working since the early 1960’s with a French bank doing securities analysis in Paris. The French bank sent me to New York presumably for a year or two. I got to New York City for the first time in January of 1968. I didn’t know many people, but I knew a few people in the French community, and I got to meet two French students attending Columbia Business School whose interests were not investing – their interest was marketing. During that summer, we bicycled together on weekends in Central Park. They knew that I was in the field of investments, and they had heard of Ben Graham. Investments were not their interest, but they mentioned Ben Graham to me. So, I went to a bookstore and bought The Intelligent Investor and Securities Analysis. The Intelligent Investor in particular sort of struck me. There is a story in France about a famous French poet named Paul Claudel who had not believed in God. One day, he was standing by a pillar at a Cathedral near Paris and he said: “I was illuminated by faith.” In a sense, I was illuminated not by faith, but all of a sudden, it seemed to me that Ben Graham simply made sense. The idea of margin of safety, the idea of intrinsic value, the idea of Mr. Market, the very humble idea that the future is uncertain - it made sense to me. I stayed in New York for another few years, but I could not convince Paris headquarters because their whole approach was completely different. Their approach, in a sense, was more of a trading approach – trading the big stocks. Neither in New York, nor when I went back to Paris for a few years, could I convince anybody to look at value investing. Still today to my knowledge, the French banks and institutions do not have value investing. Societe Generale sold our operation to Arnhold and S. Bleichroeder at the end of 1999, and I’ve kept in touch with some of the people there. I have tried to convince them over the past seven years that they should make some room somewhere in a little corner for value investing, but they are not into it.

So in any case, I came across The Intelligent Investor in 1968 and, then, had to wait a little more than 10 years until late 1978 when Paris headquarters was getting tired of hearing me talk about value investing. They said: “Hey – we have a small fund in New York - $15 million – why don’t you go back to NY and run it?” Because it was small and because I was across the ocean, they basically let me run it the way I wanted. Within a few months of when I came back to New York in late 1978, I also came across the annual
Q: You have been managing the First Eagle Global fund since 1979, and you spoke about how your philosophy has shifted over time. How have you seen the philosophy of Value Investing in general evolve over that time?

JME: I think today, to some extent because of the extreme popularity of Warren Buffett, there is more competition. If you think of the previous generation of true value investors – individuals like Walter Schloss and the like - they were truly very close to the Graham approach. And I think today when you look at the various value shops in the U.S. - keeping in mind what the late Bill Ruane tried to figure out six or seven years ago, and it is probably true today - there was really no more than 5% of professionally managed money in the U.S. that was invested on a value basis, broadly speaking. And there was much less than that outside the U.S.

So there are not a great number of value shops, although I must confess that there are quite a few value shops on the hedge fund side. Usually they are long only. They have the ability to borrow, the ability to short, but there are very few value investors that get involved in shorting because if you are a value investor, you are a long term investor. If you are a long term investor, you don’t have to worry about market psychology. As Ben Graham said: “Short term - the stock market is a voting machine; long term - it is a weighing machine.” But it is very hard to get involved in shorting without taking market psychology into account. Of course, by definition, there are two characteristics to borrowing. Number one: borrowing works both ways. So you are compromising the idea of margin of safety if you borrow. Number two: borrowing reduces your staying power. As I said, if you are a value investor, you are a long term investor, so you want to have staying power.

I’m not familiar with many of the value shops on the long only hedge fund side, but if you look at the mutual fund world, you don’t have that many value shops. You have Marty Whitman’s Third Avenue, you have Mason Hawkins at Southeast, you have Oakmark in Chicago, you have Tweedy Browne, and a few others, but you don’t have that many.

Q: What are the characteristics that draw you to an investment and how do you go about finding new ideas?

JME: Well, in terms of hunting grounds, in general, we don’t do screens because we like to check the accounting carefully and make our own adjustments. To take an extreme example, take a look at an American forest products company. If they still own tim-
berland, as is the case of Weyerhaeuser, which they acquired about a century ago, they continue to carry it on the balance sheet for about $1 an acre. Today, it is more like $1,000 an acre or more in the south and $2,000 an acre in the Pacific Northwest. So a screen would not help you in any way in that respect.

The way we go about it is that if we decide to look into a particular investment idea we have to do most of the work in-house, hence the extreme importance of the in house research department. This is because sell-side research is directed towards the 95% or so of professional investors who are not value investors, so their time horizon is usually more along the lines of six to twelve months as opposed to five or more years for us.

The work, of course, starts with public information – running numbers. Sometimes, we make adjustments to the reported numbers, which is particularly important today because every chief financial officer in this country, and even some outside the U.S., seems to be trying to show the highest possible reported earnings without going to jail. In order to do so, they have to make sure that they observe the letter of the regulation, but they don’t hesitate to betray the spirit of the regulations. So, we run the numbers coming from public information, and it’s not a matter of having fifteen pages of numbers. I like the idea that the important numbers have more or less to fit on a single page or two pages at the most.

Then, there is the qualitative side, which is of course judgmental and has a lot to do with trying to figure out the three, four or five major characteristics of a business. For instance, in the early 1970’s, Buffett figured out that the major characteristics of the newspaper business had to do with the fact that many newspapers had a quasi-monopoly. Buffett determined that what was important was not the fact that already in the 1970’s circulation was not growing much, if at all, but that the local department store automatically advertised in the local newspaper. On top of that, it was not a capital intensive business. It was a service business with higher margins, not that they could charge any price, but they were the advertising instrument of choice for local businesses. Wall Street was entirely focused on the fact that they were not growth companies, presumably because circulation was not going up.

This fits in with Buffett’s idea that value investors are not hostile to growth. Buffett says that value and growth are joined at the hip – value investors just want profitable growth and they don’t want to pay outrageous prices for future growth because, as Graham said, the future is uncertain. And also, what is probably more important from Buffett’s point of view is to identify the extremely small number of businesses where, after doing a lot of homework and exercising judgment, you come to the conclusion that the odds are good that the business has a ‘moat’, the business has a competitive advantage, and that business will be as profitable five or ten years down the road as it is today. This is opposed to simply extrapolating 20% or 25% annual growth observed over the past three years. There is a very limited number of businesses that can continue that type of growth. In any case, Buffett never insisted on 20% - 25% growth. I think he even said something to the effect that a profitable business that is not growing is not a business that has no value. A business can have value even if it is not growing. In that sense, value investors tend to think like private equity investors – we are looking for stable and profitable businesses - sometimes in what appears to be mundane areas.

The analysts here keep track of what we own but in our case, most of the work is done before we start buying a stock. Afterwards, it is just a matter of updating and we don’t spend any time trying to figure out the next quarter. So our nine analysts keep track of the securities we own, they investigate the ideas that the portfolio manager may have which, at least in my case, usually comes from reading newspapers or flipping through some sell-side research and saying “hmm, maybe we should look at this.” Of course, for a value investor the devil is in the details, so sometimes the analyst investigates an idea for a few days or for a few weeks and comes back to me and says “Sorry, but this is not a very good idea and here are the reasons why.” This is fine with me. Third, we always make sure the analysts have enough time left to initiate and develop their own investment ideas. They come to me first, but it is very rare for me to tell them that I think they are barking up the wrong tree, wasting their time for such and such reasons. It very seldom happens.

So the analysts go out, run the numbers according to public information, and make the adjustments to the numbers as necessary. For instance, for quite a while, we had to make the adjustments for the issuance of stock options because there were many companies that until they were forced to do it, just didn’t do it.

The analysts try to figure the 3 – 5 major characteristics of the business. I don’t ask them to write about this, but it comes in the conversation that we have after we look at the numbers. Then there is the back and forth between me and the analyst.

Many years ago, when our
younger daughter was six or seven years old, somebody at school must have asked her, “What does your father do?” She was embarrassed because she didn’t know. And so that evening, when I came home, she asked “What do you do at the office?” I thought, rather than trying to explain what money management is to a six year old, I said, “I spend half of my time reading and half of my time talking with my colleagues.” My daughter said: “Reading? Talking? That’s not work!” But in fact, that is what I do! I spend a considerable amount of time talking with the analysts, looking with them at the various angles, trying to make sure that they have properly estimated the strengths and the weaknesses of the business – then they go back and investigate further.

We invest, if in the end, we agree with them from an analytical point of view. In other words, we think we understand the business, we think we like the business, and we think investors are mis-pricing the business. For value investors, the edge is seldom in unusual information which the rest of the market doesn’t have. There is a fine line between unusual information being obtained by regular means or by ‘not so regular’ means. It is more in the interpretation of the information. It is more figuring out the major characteristics of a business. Buffett didn’t know more than Wall Street knew about the newspaper business. He just decided that looking at the advertising power of the newspaper was more important that the flat circulation numbers.

Q: You said that occasionally you will tell an analyst they are barking up the wrong tree. Are there any recurring traps that investors with less experience might fall into?

JME: It might be the impression I might have had because maybe I looked at the businesses six or eight years before, and I was under the impression that management was intellectually dishonest. In terms of management, of course there is the Buffett quip that when rowing a boat - what matters less is how strong your arms are, what matters more is whether the boat is leaking. This is, of course, a metaphor for the fact that Wall Street tends to pay a great deal of attention to how good the management is, but Buffett has also said that he wants to buy into businesses that even an idiot could run. It is the quality, or lack thereof, of a particular business.

I could think, again because I came across the stock before, this is a business where the accounting is dubious, or I could be under the impression that there is a major weakness to the business that may not be apparent immediately.

Only after the analysts have already done a lot of work will they go and meet management, because management figures out very early in the conversation whether we already know a lot about their business, so they are less likely to lie. I am exaggerating here, but sometimes there are instances where either they tell you nothing, or they tell you lies, or they tell you things that they shouldn’t tell you in the first place. We have to be very careful, not because management deliberately tries to give us inside information, but sometimes, particularly if we own 10% - 15% of a business, we are the second largest holder after a family that controls the business and we’ve held the stock for 7 or 10 years, so management truly looks at us as long term partners.

Q: You have often been quoted as saying you have a five-year time horizon vs. Wall Street’s six-to-twelve month time horizon – When do you think about selling a stock? Especially given that your performance is measured against other mutual funds, how do you have the staying power to remain disciplined?

JME: That is a key question – to answer the second question first – if you are a value investor - you are a long-term investor. Warren Buffett did not become very rich trading securities. If you are a long-term investor, you accept in advance that you are making no effort whatsoever to keep up with your benchmark or your peers on a short term basis. So you know in advance that every now and then you will lag. We lagged sometimes in the 1980’s, in the early 1990’s we lagged as well, but then in the late 1990’s we lagged terribly for several years. We were still producing absolute returns, but relative to our benchmark and to our peers we were lagging terribly because I had declined to participate in technology, media and tele-com, together with many other value investors.

In less than 3 years, between the fall of 1997 and the spring of 2000, our Global Fund, which I had run since early 1979 and had a long term record, lost seven out of ten shareholders. One has to live with that because a mutual fund is open to subscriptions and redemptions every day. You don’t get to choose your investors. You take whoever is sending the check. You try in your sales effort to explain very clearly what you are trying to do, so that you don’t get the wrong type of investors. But there are many investors who will either not understand what we’re trying to do or will understand what we’re trying to do, but if we lag for a year or two, they will forget about it. There is impatience among investors. Ideally, if you run money professionally on a long-term basis, you would want shareholders in your fund to be long-term investors, but that’s not always what happens.

Incidentally, not only does value investing make sense, at least to me, but it works.
In that respect, you are probably familiar with the piece written by Buffett – “The Superinvestors of Graham and Doddsville” – and then 20 years later, the piece written by Louis Lowenstein (“Searching for Rationality in a Perfect Storm”). Buffett himself considered another nine value investors. So then the question arises - why are there so few value investors if it makes sense, if the approach makes sense and it works? I think the answer is truly psychological, and that is what I was referring to when I said that if you are a value investor, you have to accept in advance that you will lag. And if you lag, you suffer. Yes, you say to yourself, I’m a long-term investor so my day will come, but if it goes on too long, it is not only the doubt, but there is a genuine suffering associated with lagging, and human nature shrinks from pain. Sometimes, there are non-value investors who tell me, well I would love to do what you do, but, if I did it and start lagging, either my boss or my shareholders will fire me. Of course, the answer is you have the wrong boss or wrong shareholders or both!

Q: You must have experienced that, especially early in your career when you were with Societe Generale?

JME: That is why very early, late 1997, after only a few months of net redemptions, they made the decision of selling our investment advisory firm. They were extremely impatient. One thing is that if I look back, we ran a total of $6 billion in the fall of 1997. Even though we continued to make money for shareholders, funds were down to $2.5 billion in the spring of 2000. Today we manage close to $35 billion. So what I am saying here is that it seems to me that it goes to show that if you do what you think is right for the shareholders, even if they don’t seem to agree themselves, if you think you do what is right for the shareholders, in the end, it benefits your business from a long-term point of view because $35 billion is not only a lot more than $2.5 billion, it is also a lot more than $6 billion. It goes back to when Peter Lynch was running the Fidelity Magellan fund. Lynch had a superior long-term track record, but he discovered to his dismay that the great majority of shareholders of the Magellan Fund during his management had done much worse than Peter Lynch’s record because they usually bought into the fund after Peter Lynch had really hit the ball and then they would leave if for six or nine months if he was doing less well or if the market went down during that period. I hesitate whenever I meet with financial planners or brokers, who are our real constituency, because they are the ones who decide to choose which mutual fund to invest in for their own clients. I am reluctant to try to tell them how to run their businesses, but it seems to me that they are much too worried about asset allocation, they should be trying to find three, four or five good value managers and just stay with them. Maybe they are worried that if they pick three, four or five value managers and stick with them, after two or three years the clients will say “What am I paying you for?”

Q: I recently read that Tweedy Browne opened their Global Value Fund, Third Avenue is opening their Partners Fund, and you just opened your Global and Overseas funds. Does this mean that investment opportunities are beginning to appear on the horizon?

JME: That is right - I saw the press release from Third Avenue and I also saw the press release from Longleaf. Longleaf is saying “We see opportunities today.” Third Avenue and we are saying much more that the market is very turbulent. To paraphrase Ben Graham, Mr. Market seems to be moving from fear to greed and back. Both Third Avenue and we are saying that maybe there will be opportunities if the turbulence continues, but neither one of us is saying we see an opportunity right today. I believe Mason Hawkins is saying that there are currently opportunities and for all I know, he may be right.

Q: Your answer leads me to believe that you would currently be looking at some of the most turbulent areas of the market right now? Is that true and where might that be?

JME: Yes, but if you look at the U.S. equity market, we are in the midst of what appears to be a major and worldwide credit crisis. In August, the crisis was identified as a sub-prime housing American problem. Today, four months later, it appears to be a worldwide credit crisis, and yet the American stock market is 5% off its
High at the end of the fifth year of a Bull market. Except for the Tokyo stock market, which I think is about 20% off its high, markets in the U.S. and Europe and most emerging markets are very close to their high. Combined with the fact that we are in the midst of a major financial crisis, it seems to indicate that investors, and for all I know they may be right, believe that we’ll get out of the crisis reasonably soon. Otherwise, markets would be much lower than they are today. So that is why, speaking very generally, we don’t find a tremendous amount of investment opportunities right now. You know value investors are bottom-up investors, but I do pay some attention to the top-down. First, it cannot be completely ignored. Second, the intrinsic values we establish for the businesses we are invested in or that we consider investing in do not assume eternal prosperity. They assume that the world muddles through, which is usually what the world does. They do not assume a year or two or three of very difficult economic and financial circumstances, because if that were the case, those intrinsic values would be at least temporarily too high, and accordingly, the risks associated with our equity portfolio would be bigger than I think they are. So, to the extent that we consider the top-down we look from a negative standpoint. What could screw up, from the top-down, the investments we make with a bottom-up approach?

In another respect, we’ve been in a twenty-five year credit boom, since the early 1980’s, interrupted painfully but briefly in 1990. I say painfully because at the end of 1990 you can point to Rupert Murdoch’s News Corp. almost going bankrupt until the banks, and we - although I made the mistake of buying the bonds instead of buying the stock - and a few others understood that what they had was a liquidity problem, but not an insolvency problem. Even on a conservative basis, the sum of the parts of the assets was quite a bit in excess of the debt. They simply had a temporary cash flow problem. Also in 1990 is when Sam Zell’s real estate empire almost collapsed. So, we have been in a twenty-five year credit boom with one interruption, which is a truly long credit boom.

We seem to be facing a worldwide credit crisis. The central banks are pedaling as fast as they can to mitigate the damage. This is crisis number six or seven. You had October 1987, you had 1990, you had the late 1994 Mexican crisis, you had the 1997 Asian crisis, in 1998 the Russian crisis and the Long Term Capital Management collapse. You had the bursting of the technology/media/telecom bubble and now the sub-prime housing crisis. The odds are pretty good that crisis number six or seven in twenty years will be gone in a few months, but maybe it will take longer or maybe the financial system is truly fraying at the edges.

I think it is Peter Bernstein who said sometimes what matters is not how low the odds are that something truly negative happens - and the odds are pretty low that the system blows up - sometimes what matters is what the consequences would be if it happened. For example, if I tell you if you do this, the odds are one-in-ten that you will lose $50, no big deal. If I tell you the odds are one-in-one hundred, even better odds in the sense that the risk of losing is minute, that you die, then the consequences are so drastic that even the odds as low as one-in-one hundred are just not good enough.

I think there is a mindset among many professional investors that if I go down the drain, well it is o.k. as long as everyone else is going down the drain with me. I think that with the hedge fund business, at least so far, the regulators have been careful enough to basically prevent the middle class from getting involved with hedge funds. But in the mutual fund business, we have almost one-million shareholders in our funds and while we have some institutional accounts and some very wealthy individuals, the great majority of the one-million are middle class people. If I screw up, I can make daily lives difficult. Financial planners have told stories about individuals who did not have a great nest egg, but thought they had enough of a nest egg to retire. They invested the money with conventional money managers who proceeded to lose 30% to 40% between the spring of 2000 and the spring of 2003. These people had to go back to work, or sell the boat.

I remember the day after I retired, which was January 1, 2005, I got up late, took a stroll in Central Park and I felt lighter than air. The responsibility was off my shoulders. That is why I
wasn’t particularly eager to come back, but I had been treated very well here at Arnhold and S. Bleichröder, and also there was a side to it where particularly the old fund, which I have run since 1979, was in a sense my baby. I didn’t want to just leave it. In view of the size of assets under management, it was odd in a way that there was only one portfolio manager. I mean myself for twenty-six years. Of course if you have a single portfolio manager and he leaves or is run over by a bus, what is left is a big void. Although it is true that value investors, at least in our case, it doesn’t matter who has the biggest battalions. What I mean is if I had forty-five analysts, we wouldn’t be doing any better than nine or ten, but I think it is the kind of approach where we want as many people on the in-house research staff and as few people as possible on the portfolio management side.

Q: You spoke about risk being the consequence, not necessarily the odds. How does this thinking come into your investment process?

JME: Risk to us is absolutely not volatility. We always have this discussion with financial consultants - it is not volatility. Marty Whitman is unusual in a sense that there are not many value investors who were very good practitioners and also could write from a theoretical point of view. Marty, in one of his books, makes a key distinction between what he calls temporary unrealized capital loss, which is you buy a stock at $35 and, after a year or two or three, it is at $25 or $30. If you think you have done your original homework before you bought the stock in a proper manner, if you kept reasonably close to the situation as the business evolves over time, and if you believe that nothing major has changed for the worse since you started buying the stock, that is what Marty calls temporary unrealized capital loss, which is nothing to worry about. If anything, it is probably an opportunity to buy more of the stock. The key distinction is what Marty calls permanent impairment of capital, which are fancy words for “Damn it, I made a mistake.” Not a mistake because I bought a stock at $35 and now it is at $27. I made a mistake because either my original analysis of the business was wrong or because after I started buying the stock, I failed to observe that the business model was changing for the worse. In this case you have to acknowledge your mistake, sell at a loss, and move on.

If you think it is a temporary unrealized capital loss, if you bought a stock at $35 and two or three years later it is at $27, it becomes painful and the great majority of money managers get very upset. But you have to ask yourself, “Did I miss something?” If the answer is, “I don’t think so,” then you have to accept that fact. For example, if you buy a stock for $25 and four years later it is still at $25 and in the fifth year it goes to $50, I don’t think in terms of I wasted my time for four years or it was what some investors call stale money for four years, I say hey, I doubled my money in five years and that is 15% annualized a year and that is fine.

Going back to what I was saying, not that value investors are masochists, but that accepting in advance that every now and then you will suffer because you will lag. It goes back to what Buffett was saying when he said something to the effect that investing does not require high intelligence, but it requires some temperament.

Q: On the topic of temperament - Buffett has said that he is “wired” a certain way. Do you think temperament is something you are born with or a trait that can be learned?

JME: On the way to view it is in the U.S. and also now in Europe, some people go too easily to the psychiatrist, because if they do so, it shows that there is an expectation that they should be happy every day. Of course, it is true at the other extreme. You have people who tend to believe too easily that life is a valley of tears and that one can only be happy in the eternal. The truth is in between, one has to accept the fact that one is not happy every day. One is not entitled to be happy every day and I think that as an investor it is the same idea that we don’t need to win every day. We just need to win over time. Maybe the people who say, well, I cannot afford to be a value investor because my boss or shareholders will fire me, maybe they are right. But I think there is also the idea that I just don’t want to suffer. I remember there was a movie about baseball called “A League of Their Own” where at some point a woman says to Tom Hanks, who plays the coach, “Baseball is too hard.” Tom Hanks replies something to the effect of “Of course it’s hard. If it was not hard then everybody would be doing it.” It is the idea that everything in life that is worthwhile comes hard.
lumbia. How do you think he will enhance the team you have in place at First Eagle?

JME: Bruce is sixty-one years old, and I first met him several years ago. His entire professional career has been in the academic world, and he was willing to go into the real world, so to speak, as opposed to the academic world. He was intrigued by the idea of being director of research and, in that respect, I think he will do at least two things. Number one, although of lesser importance, he will help us beef up the research department because he knows a lot of people who graduated from Columbia Business School and were enrolled in the Value Investing Program.

Number two, and most importantly, in the value tent, Bruce is definitely on the Buffett side although he is very tolerant. Some people on the Graham side are intolerant of the Buffett side and vice-versa. You know, Buffett has called the pure Graham style “Cigar Butt” investing, which is not very flattering, although I remember Walter Schloss chuckling that he himself thought he got more than one good puff every now and then. However, Bruce has also introduced some refinements of his own to the Buffett side and that will be very helpful to the analysts here. Although the in-house staff here does not need to be energized, you know that Bruce is an energizing personality. So, we are looking forward to his joining the team. To me, he is the ideal director of research.

Q: What advice would you offer an MBA student aspiring to enter the field of investment management?

JME: Join a value shop. Keep in mind there are value shops in the mutual fund field and the hedge fund field, most of which are long only. Also, keep in mind that in the words of Paul Isaac, hedge funds are a compensation scheme and that indeed a reasonably good value mutual fund is, in the end, from the point of view of the shareholder of the funds, a very cheap hedge fund, because all value investors, whether they are with hedge funds or with mutual funds, shoot for absolute returns. If you achieve absolute returns and compound at a reasonable rate over the years the difference between you and a long only hedge fund is that you are charging 1.25% overall expense ratio as opposed to two- and twenty. You should also approach professors who are also practitioners to get their opinions on which firms would be good for you to join.

Thank you, Mr. Eveillard.

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<th>5 Years</th>
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