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Dear Baupost Fund Shareholder,

We are pleased to report a gain of 22.51% for the year ended October 31, 1996. Due to our significant underinvestment in the U.S. stock market (a topic to which we will return shortly) this gratifying result comes in spite of, rather than as the result of, similarly robust results for the U.S. equity markets. We are chagrined that we could have achieved approximately the same returns had we initiated the Baupost Index Fund a year ago. We are pleased, however, that we managed to do so with a vastly lower risk profile.

As we reflect back at fiscal year end, let us reiterate that Baupost's investment philosophy has remained consistent over time: bottom up, risk averse, absolute value oriented. In making tradeoffs among competing alternatives, we have distinguished ourselves from other professional investors in several ways: our willingness to hold cash balances, sometimes substantial, awaiting opportunities; our preference for investments with a catalyst for the realization of underlying value; our willingness to accept varying degrees of illiquidity in exchange for incremental return; and our flexibility in pursuing opportunities in new areas.

Baupost has long enjoyed a very flexible investment charter, one that has permitted us to depart considerably from our initial conception as US equity and high quality debt investors. This flexibility has been, we believe, at the core of our investment success over the years. Like Baskin Robbins ice cream, opportunities come in dozens of flavors, not all of which are served at the same time. (Like Haagen Dazs, some of these flavors are fantastic.) Investors who find an overly narrow niche to inhabit prosper for a time but then usually stagnate. Those who move on when the world changes at least have the chance to adapt successfully.

Our flexibility has served us very well over the years, allowing us to move into areas of temporary and compelling opportunity (usually characterized by falling prices, distressed or uninformed sellers, and/or decreased liquidity) and away from areas of full or excessive valuation, thereby enhancing return while simultaneously reducing risk. The same flexibility that led us into a heavy concentration in thrift conversions in the mid 1980's and distressed corporate debt in the mid-late 1980's, and a smaller hedging bet on Japanese stock market puts in the late 1980s, has led us into a moderate investment in Russian stocks earlier this year, and an important position in European holding companies in 1995-1996.

The primary risk of entering new investment areas is unfamiliarity itself: the rules of the game might be unfamiliar or changing; others that have been in the area longer might have a significant advantage; and to paraphrase Warren Buffett, if you look around the poker table and cannot identify the patsy, it is probably you. Cognizant of this risk, we have worked diligently to understand new areas as well as existing participants do before we enter, utilizing external resources when necessary. We have entered timidly, probably foregoing some opportunities but ensuring that we had time to gain comfort and any expertise we were lacking.

Risk is also mitigated by both our constant emphasis on investment fundamentals and on knowing why each investment we make is available at a seeming bargain price. We regard investing as an arrogant act; an investor who buys is effectively saying that he or she knows more than the seller and the same or more than other prospective buyers. We counter this necessary arrogance (for indeed, a good investor must pull confidently on the trigger) with an offsetting dose of humility, always asking whether we have an apparent advantage over other market participants in any potential investment. If the answer is negative, we do not invest.

We have always told you that we invest the Fund's assets as if it were our own money (which, of course, a portion of it is). We thus enter a new area only when we gain conviction that our analytical, valuation and risk assessment skills will be useful in that area, and that we understand the potential risks and returns of specific opportunities in that area; then, we manage the size of the investment based upon our degree of conviction, assessment of risk, and opportunity for diversification within the area. Typically, a new area is not a wild leap from anything we have done before, but rather a smaller step from something we already do, with only one variable changing.

One of the consequences of entering new areas has been an increase in the portion of our assets invested in opportunities outside the U.S. This has not been the result of some top down asset allocation strategy, but rather the outcome of a bottom up, investment by investment search for opportunity. Like the underlying businesses, markets, too, have become more global over time. Most companies compete globally, capital flows are global, and many companies now maintain listings in more than one market. Popular US companies like Coca Cola earn well over half their profits overseas, while large European and Asian enterprises often have substantial US subsidiaries. Thus the most important investment criterion for us is not where a company does business, or where it is listed, but an understanding of the factors that might cause a company or security to be particularly undervalued in the market.

Of course, it seems reasonable that at this time we would be finding more opportunities overseas than at home. The U.S. stock market has been in a protracted bull market. With more and more very sophisticated pools of money pursuing opportunities in the U.S., we believe the market has become more efficient than ever (and even when for some reason a stock is not priced efficiently, it is nonetheless considerably more likely to be overvalued than undervalued). The number of sizable, highly sophisticated, professional investors in overseas foreign markets is far fewer, making those markets more fertile fields to till.

The key to increasing our international exposure in recent years was gaining comfort that we understood the potential risks and returns of foreign markets, something we could only achieve over time by immersing ourselves in a flow of information about companies and markets, by meeting directly with managements, and by making some toehold investments and observing their success or

failure over time. We did all of this over the past seven years. The increased size and capability of our investment team allowed us to better analyze foreign opportunities; the increase in our assets under management (as compound returns were reinvested over the years) gained the attention of foreign brokers and analysts. We were also able to utilize our existing network of friends on the buy side to gain an ongoing exchange of information. Thus late last year when European holding companies sank to record-wide discounts to underlying asset values, which themselves were quite depressed, we were in a position to act.

Similarly, when we identified the opportunity unfolding in the former Soviet Union, we were able to dispatch three different analysts to cover the area, spending several man-months on the ground there and building relationships with brokers, analysts, and other emerging market investors. Our total assets under management demonstrated that we had the potential to be a very important client to a number of brokerage firms, and we did indeed become among the largest customers of several.

A key component of our investment strategy is sufficient but not excessive diversification. Rather than own a little bit of everything, we have always tended to place our eggs in a few dozen baskets and watch them closely. These bargain-priced opportunities are selected one at a time, bottom up, which provides a margin of safety in case of error, bad luck or disappointing business results. However, we are always conscious of whether these different investments involve essentially the same bet or very different bets. If each of our holdings turned out to involve similar bets (inflation hedges, interest rate sensitive, single market or asset type, etc.), we would be exposed to dramatic and sudden reversals in our entire portfolio were investor perceptions of the macroeconomic environment to change. Since we are not able to predict the future (it is hard enough to understand the present), we cannot risk such concentrated exposures.

The same is true for securities, even of very different companies, trading in a single stock market. Owning a diverse portfolio in one market may greatly reduce the risk associated with a single company hitting a bump in the road but will not at all reduce the risk of being in that market. If that market runs into a pothole, its components could all break down at once. This is particularly true if that market is trading at record levels of valuation, supported more by money flows than by fundamentals, as happens sometimes (read "U.S. equity market"). Exposure to a myriad of markets and asset classes will mitigate certain risks that even broadly diversified exposure in a single market cannot. (Of course, diversification is for us only the starting point for risk reduction. Solid fundamental research, emphasis on catalysts, value discipline, preference for tangible assets, hedged short selling, market put options and other strategies combine to create an overall portfolio safety net for our portfolio that we believe is second to none).

During fiscal 1996, the Fund posted numerous healthy gains and only one substantial loss, that being on stock market put options which we buy as insurance against a steep market decline. Our largest gains and losses for the fiscal year, both realized and unrealized, are presented in Table 1 below.

Table 1

The Baupost Fund
Largest Gains and Losses
For the Twelve Months Ended 10/31/96
($ in millions)

Largest Gains		Largest Losses	
Maxwell notes	$3.0	Market put options	($1.6)
Lukoil common	2.8	Chargeurs/Pathe/BSkyB (hedged equities)	(0.5)
Mosenergo common	2.1	RJR Nabisco common and options	(0.4)
RIT Capital Partners common	1.4	Adam & Harvey common	(0.4)
Allmerica Financial common	1.3	Imperial Oil common	(0.3)
Semi Tech Global common	1.2	Northwestern Steel common	(0.2)
Emcor common and notes	1.2	Dun & Bradstreet common & options	(0.2)
Pullman common	1.1	Eagle Picher debt	(0.2)
Fourteen other investments	0.8-0.3 each		

We believe that we are well positioned as we enter 1997, with attractive, well diversified long positions, a healthy balance in cash and cash equivalents, and a material position in market put options to protect against a serious decline. Many of our positions have either full or partial catalysts for the realization of underlying value. We continue to find attractive opportunities for our portfolio, increasingly outside of the frenzied U.S. stock market.

We are grateful for your ongoing confidence and support, and are working diligently to remain worthy of it.

Very Truly Yours,

/S/Seth A. Klarman

Seth A. Klarman
President

Average Annual Total Returns (1) For Periods Ended 10/31/96	**1 Year**	**Life of Fund (since 12/14/90)**
The Baupost Fund	22.51%	16.17%

Total return is an historical measure of past performance and is not intended to indicate future performance. The investment 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.

(1) Assumes reinvestment of all dividends.

GROWTH OF AN ASSUMED $50,000 INVESTMENT IN THE BEAUPOST FUND FROM 12/14/90 THROUGH 10/31/96

	FUND	S&P	BF	S&P
12/14/90	$50,000.00	$50,000.00		
10/31/91	$59,787.48	$61,807.01	19.57%	23.61%
10/31/92	$65,471.71	$67,963.62	30.94%	35.93%
10/31/93	$82,134.71	$78,116.01	64.27%	56.23%
10/31/94	$91,217.43	$81,134.73	82.44%	62.27%
10/31/95	$98,430.31	$102,587.46	96.86%	105.17%
10/31/96	$120,585.06	$127,306.16	141.17%	154.61%

(1) Assumes reinvestment of all dividends.