

Introduction

We devote a lot of time to the consideration and writing of our quarterly commentaries. This allocation of precious time away from our day-to-day research and portfolio management responsibilities allows us to look beyond the immediate tasks of today so that we may ponder tomorrow, giving us perspective and, at the same time, educating and informing our shareholders. We feel time dedicated to these commentaries is well spent, because a well-informed client is a better partner, one more likely to stick through the thin while awaiting the thick.

Periodic volatility (market or portfolio) and lagging returns typically lend itself to poor client buy/sell decisions; however, the market's ups and downs incubate opportunity that may not be reflected in returns for some period of time. The majority of decisions to redeem from a manager occur when their portfolio lags its benchmark. However, a good manager will frequently lag. We believe the only way to outperform longer-term is to be willing to underperform shorter-term.

Investing is an evolutionary process. We now analyze businesses, products, asset classes, and industries that did not exist twenty years ago. We therefore regularly take it upon ourselves to explain our action or, at times, inaction. Though we evolve as investors, our goal, philosophy and strategy remain constant. Up to this point, the only way to have gained a deep understanding of our thought process was to have read our past commentaries. We aim to correct that now by publishing the goal, core beliefs, and philosophies that guide our management of the Contrarian portfolios. This policy statement will summarize our investment approach, principles, and core beliefs, and we encourage all of our clients to read it.

Investment Objective and Strategy

The FPA Contrarian Value Strategy (including the FPA Crescent Fund) seeks to generate equity-like returns over the long-term, take less risk than the market and avoid permanent impairment of capital.

Philosophy

- Absolute value investors. We seek genuine bargains rather than relatively attractive securities.
- Alignment of interests. We invest our money alongside yours, and we act as stewards of our shared capital.
- Broad mandate. We invest across the capital structure, asset classes, market caps, industries, and geographies. We are willing to hold cash.
- Long-term focus. We believe the best way to accomplish our goals is to accept short-term underperformance in exchange for long-term success.
- Macroeconomic view. We incorporate an understanding (sometimes limited) of the economic environment.
- Volatility. If we have performed our research correctly, volatility creates opportunity, not risk.
- Downside protection / Risk minimization. We aim to protect capital first and create long-term equity-like returns second. We cannot eliminate risk, but we conduct ourselves by hoping for the best, while preparing for the worst.

Process

- We seek the out-of-favor, unloved, or misunderstood. We are, in a word, “contrarian.”
- We recognize that returns will not just be driven by what we own, but also by what we do not own.
- We invest in securities that we believe offer advantageous upside/downside characteristics, and we focus on five categories:
 - Long Equity – 3:1s, Compounders, Shorter-Term Opportunities, Sum-of-the-Parts, Intra-Company Arbitrages.
 - Short Equity – Deteriorating Businesses, Balance Sheet Issues, Paired Trades, Intra-Company Arbitrages.
 - Credit – Performing Credit, High Yield, Distressed.
 - Other – Illiquid Investments and other Special Situations.
 - Cash – A residual of our investment process, rather than a macro-driven rationale.
- We invest after conducting thorough research.

We believe our flexible approach greatly enhances the likelihood that we will deliver an equity-like return with less risk over the long-term.

Investment Objective and Strategy

The FPA Contrarian Value Strategy (including the FPA Crescent Fund) seeks to generate equity-like returns over the long-term, take less risk than the market and avoid permanent impairment of capital. We think of long term as five to seven years. We define equity rates of return as the returns provided by a broad equity benchmark, such as the S&P 500, Wilshire 5000, or Russell 3000. We view risk primarily as the likelihood of suffering a permanent impairment of capital, on a portfolio basis.

The terms "long term" and "equity-like return" have an exactness and measurability. The term "risk," on the other hand, is inherently imprecise, commands imprecision and its meaning is different from one individual to another. Risk stems from the uncertainty that exists in the world. We (along with the rest of humanity) simply do not know what will happen, so we are left with trying to guard against all manner of eventualities, while recognizing that more things can happen than will happen.

Philosophy

We are absolute value investors.

We invest our money alongside yours – an alignment of interests we maintain across FPA. We view ourselves as the guardians of the capital entrusted to us. We manage the various investment products in the Contrarian Value strategy, including its public fund FPA Crescent, in a way that makes us comfortable having our family and friends commit their savings to it. Should our portfolios lag, we will most likely feel more pain than our shareholder partners.

We view ourselves as pragmatists with a healthy respect for what we do not know. We are neither optimists nor pessimists, as we invariably find ourselves hoping for the best, while preparing for the worst.

Value investing is a familiar discipline, but Contrarian Value pursues a relatively unique and advantaged strategy. Contrarian Value is unique because we have an unfettered mandate, we invest on an absolute basis, we consider the macroeconomic environment, and we have a long-term orientation.

- **Absolute Value Investing**

We seek genuine bargains, not relatively attractive securities.

We invest only in positions that we believe offer a compelling economic risk/reward proposition on an absolute basis. If prospective investments do not meet that requirement, then we wait until they do. We have no interest in merely buying the inexpensive. We want to purchase a stock at a substantial discount to that company's worth, or intrinsic value.¹ Our broad mandate gives us more tools to pursue an "absolute" path to value investing, where success is measured by positive returns. We reject the "relative value" path, where some may declare victory when the stock market has declined 40% and they lost just 35% of their client's principal.

- **Unfettered Mandate**

Contrarian Value operates with one of the industry's most expansive charters. Unlike most traditional money managers, we can invest almost anywhere, using practically any instrument. We have proven our ability to successfully invest across a company's capital structure, as well as in a variety of market capitalizations, industries, geographies, and other asset classes, while frequently holding cash. Our partners' support and understanding of our process allows us to invest in those assets that appear most

attractive on an absolute basis without regard for style box or conventional wisdom. Our investor base allows us to make the asset allocation decisions and to take advantage of compelling opportunities, no matter where we might find them. Sometimes those opportunities are in places other managers cannot or will not go.

We believe our freedom to go most places (without the requirement to do so) along with our willingness to hold cash, gives us a significant long-term advantage. For example, if large-cap stocks appear expensive, we can buy small-caps (1998-99). If high yield bonds appear less expensive than equities, we can increase our exposure to the former at the expense of the latter (2008-09). If the shares of foreign-domiciled companies appear less expensive than their U.S. counterparts, then we may invest more money overseas (2010). If common stocks and corporate bonds appear priced to perfection with little regard for exogenous risks, then our cash residual may build (2004-2008) as we wait for opportunities to invest with less downside and more upside. This approach to cash holdings is discussed further in our 2004 Special Commentary, *The Case for Cash*.ⁱⁱ We believe our investment flexibility greatly enhances the likelihood that we will deliver an equity-like return with less risk over the long-term.

- **Long-Term Focus**

We believe the only way to accomplish our goal is to, at times, accept short-term underperformance. We measure our investment term in years, rather than in quarters, months, or days. We do not carry the bogey of excelling each calendar year on our back. We consider five to seven years a market cycle. What happens over any fraction thereof lies outside our capability (and concern). Over shorter periods, temporary excesses in both the securities market and the economy have a tendency to distort reality and cloud understanding. Recent examples of such distortions would include the tech-stock/internet insanity of 1997-2000, and the housing bubble that reached its zenith in 2005-2006.

We avoid the temptation to look out further than five to seven years by remembering John Maynard Keynes' observation that "in the long run we are all dead." Nevertheless, great patience may prove necessary even in intermediate-term time frames.

Average Annual Returns as of June 30, 2014:

Fund/Index	QTR	YTD	1 Year	3 Years**	5 Years**	10 Years**	Since Inception**
FPA Crescent	2.94 %	5.04 %	16.04 %	11.52 %	13.30 %	8.72 %	11.19 %
S&P 500	5.23 %	7.14 %	24.61 %	16.58 %	18.83 %	7.78 %	9.31 %
CPI	0.87 %	1.33 %	2.04 %	1.84 %	2.05 %	2.32 %	2.40 %
60% S&P500/40% BC Agg	3.95 %	5.90 %	16.24 %	11.48 %	13.32 %	6.93 %	8.21 %
60% R2500/40% BC Gov/Credit	2.94 %	5.22 %	16.80 %	11.20 %	15.20 %	8.31 %	9.38 %

** Annualized. Inception of FPA Crescent is June 2, 1993.

A redemption fee of 2.00% will be imposed on redemptions. Expense ratio calculated as of most recent prospectus is 1.23%. **Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. This data represents past performance and investors should understand that investment returns and principal values fluctuate, so that when you redeem your investment it may be worth more or less than its original cost. Current month-end performance data may be obtained by calling toll-free, 1-800-982-4372.** The Fund commenced investment operations on June 2, 1993. The performance shown for periods prior to March 1, 1996 reflects the historical performance of a predecessor fund. FPA assumed control of the predecessor fund on March 1, 1996. The FPA Crescent Fund's objectives, policies, guidelines and restrictions are, in all material respects, equivalent to those of the predecessor fund.

As a history lesson, let us view the five-year period beginning January 1, 1998. Small capitalization stocks traded at a 20% discount to their larger capitalization brethren, despite what we believed to be better growth prospects. We therefore heavily tilted our portfolio to smaller companies, but the discount to larger companies expanded to 40%, yielding a temporary decline in portfolio value. We also avoided internet stocks, which further depressed our near-term performance. So Crescent, as a net-of-fees proxy for Contrarian Value, lost 3.7% over the next two years. Our results looked bleak compared to the S&P 500 Index, which appreciated 55.5% over that same period. Most investors (including foundations, endowments, pensions, and consultants) in professionally managed investment products (e.g., mutual funds, hedge funds and separately managed accounts) make buy-sell decisions predicated on recent performance – and we had underperformed the market by 5,919 basis points!ⁱⁱⁱ We had unintentionally tested our clients' patience – and most fled to those portfolio managers who they believed offered better future returns.

As a result, Crescent lost about 90% of its assets, due to shareholders redeeming their investments, from its early 1998 peak to its trough in early 2000. (Maybe more would have left, but we figured some of them might have forgotten they had invested with us.) The S&P 500 then declined in each of the next three years, while Crescent's few remaining stalwart holders (including ourselves) enjoyed consistent gains. Looking back over a five-year period, a Crescent shareholder who invested \$1,000 at the beginning of 1998 would have ended 2002 with \$1,409. A similar \$1,000 investment in the S&P 500 Index would have declined to \$972. A Crescent shareholder who capitulated at year-end 1999 and invested in the S&P 500 at the beginning of 2000, would have had just \$625 remaining, a devastating loss and less than half what they would have earned if they had remained in Crescent.^{iv}

Patience as an investment virtue may only be attained through education. We believe you should only invest with a manager whose philosophy and process you understand. Otherwise, you could find yourself unable to stomach what will certainly be more challenging periods.

Current and prospective Contrarian Value investors need ask themselves how they would have behaved if they had been invested with us in our difficult 1998-99 period. We will likely underperform in the future as well. We doubt, however, that such poor relative performance will be of the same magnitude, since back then, growth stocks were trading at the highest levels seen in the twentieth century, with valuation multiples measured not in earnings, in some cases, but in revenues.

We believe the best clients/shareholders are those who understand our goal, philosophy, and process/strategy. We provide quarterly shareholder letters, special commentaries, speeches, a soon-to-be-published core values declaration (The FPA Way) and this policy statement as part of a constant effort to educate those who have entrusted us with their capital. We urge you to read all of them (available at www.fpafunds.com), because only then can you gain the confidence to have us as your manager.

- **Macro-Economic Considerations**

Unlike many value investors, we incorporate an understanding (sometimes limited) of the macroeconomic environment in our security analysis and portfolio construction. We recognize that we must consider bigger-picture extremes as we assess a company's current and prospective intrinsic value.

We seek to understand the company and industry metrics of an investment and how that business and its valuation might fare against our macroeconomic views. This has caused us to overweight certain industries and asset classes, and, at times, to completely avoid others.^v

Whether we use a top-down or bottom-up approach will depend on the company, industry, valuation, economy, and our conviction in our assessment of each.

- **Risk – Permanent Loss of Capital or Volatility?**

We cannot eliminate risk, but we seek to identify it, understand it, minimize it, and be adequately compensated for it.

The word risk has no precise meaning in an investing context. In order to avoid confusion, we must clearly explain what type of risk we mean. There are a plethora of risks to consider when investing. The list of potential pitfalls include: credit, currency, obsolescence, fraud, sovereign, interest rate, inflation, litigation, expropriation, customer concentration, vendor disruption, competition, economic, balance sheet, political, permanent impairment, mark-to-market losses, and more – many more.

Risk goes hand in hand with investing. If you do not like the stock market and choose to remain in cash, then you will have assumed inflation risk. If inflation subsequently moves higher, the value of your cash erodes. Every choice (and doing nothing is still a choice) trades one risk for another. If we tried to avoid all risk, then we would have little chance of accomplishing our goal. So in a world where risk is unavoidable, the Contrarian Value mission, on a portfolio basis, is to minimize the risk of permanent capital impairment.

We reject volatility as a measure of risk. (Using volatility to measure risk is a bit like using a thermostat to measure a car's speed. You'll get a number, but not much understanding.) However, we know a highly volatile investment may not serve our clients well, since large fluctuations in price may create stress, causing our clients to invest in or cash-out at precisely the wrong times. Lower volatility is not the aim of Contrarian Value's investment process, but it has proven to be a natural by-product.^{vi}

Investors need to understand their own risk tolerances – both psychological and practical – instead of adopting a theoretical model prescribed by age bracket or wealth. Although we view risk as the potential permanent loss of capital, we recognize that other investors may feel differently, and that those investors might let volatility drive their investment decisions. Volatility creates extreme price movements, during which an investor can choose to buy or sell.^{vii} We believe our investors must be aware of how they will react to price volatility. We are not oblivious to the institutional imperative, however, and we realize that most individual and institutional investors can find themselves in the awkward position of defending investment decisions to their clients, employers, spouses, or even themselves for holding a stock that keeps declining, or even for owning any common stocks in a declining market.

A Morningstar study of mutual fund investors' trading demonstrated that there is a financial cost to trading decisions triggered by market volatility. In addition to reinforcing the established fact that mutual fund investors have a "tendency to buy high and sell low," the study also demonstrated that investor returns generally lagged those of funds' published total returns" and pointed to a fund's volatility as "a key determinant in whether its investor returns are good or bad." The findings are not surprising. Letting volatility dictate investment decisions has proven the bane of many mutual fund (and stock) investors.^{viii} We want our investors' return experience to closely match our publicly reported returns.

We seek to have Contrarian Value provide a better-than-average experience for its clients/shareholders. We can have neither pride nor sense of accomplishment if our clients, the very people we are in business to provide a service to, do not appropriately benefit from the relationship.

Although we do not directly manage volatility and can offer no assurances, we believe our approach gives us a good chance of providing a less volatile ride than the stock market. We hope our strategy, Contrarian Value's return pattern and our communications with you improve the odds that your return more closely mirrors the strategy's composite return.

More important, regardless of the environment, we aim to distinguish ourselves by using volatility to our advantage, rather than our detriment. Instead of composing a portfolio designed to mimic the performance of some benchmark or index, we utilize a deeply held contrarian philosophy oriented toward pushing back on a rising market by reducing exposure (thus allowing cash to increase), and conversely, leaning into a falling market and spending that cash to opportunistically buy inexpensive securities.

Hopefully, we have made it evident that we spend a disproportionate amount of our time evaluating and managing investment, company-specific, and economic risk. We believe that if we look to limit the downside of your portfolio, the upside will take care of itself.

- **Upside/Downside**

We invest your money in securities that have what we believe to be advantageous upside/downside characteristics; that is, we want to make sure that we could potentially make a multiple of what we could potentially lose. In managing our portfolios, we accept that we will not always win, and that "good" bets will sometimes be lost. What we seek to avoid is making bad bets. In addition to targeting asymmetric payoffs, we try to improve our odds further by conducting deep due diligence to gain a clear understanding of the underlying business and its industry, and then, wherever possible, applying some differentiated knowledge.

Process

There is always a wide array of prospective investments from which to choose. We have to narrow that universe to something more manageable, and we begin by establishing five categories: Long Equity, Short Equity, Credit, Liquidity and a smaller "Other" category. We invest in an opportunistic manner, based on our view of the world and the businesses/situations that we understand. We look for what is out of favor. We look for bad news. We take into account what the landscape is today and how it might change over time, both organically and through exogenous events. We mostly hold our own counsel, speaking to relatively few "investment professionals" outside FPA. We prefer to spend more time with people on Main Street rather than Wall Street because we believe the interaction improves our understanding of businesses and industries. Then we read, read, read. And then, we read some more.

Next, we decide which categories might offer the best opportunities for us to reach our established longer-range goal of market-like return with less than market risk. We then devote our time accordingly.

As we seek to gain comfort with a given investment, we determine what we need to know to prove to ourselves the correctness of the original thesis that drew our interest and triggered further research. We try to support our view in a host of ways, including reading current and historic SEC filings and conference call transcripts, reviewing pertinent periodicals, studying the competition, establishing a model, etc. We then work to gain a knowledge edge, an understanding of the business or industry that may not be universal. Some companies are followed too well for us to differentiate ourselves in this

fashion, but we certainly try. Such due diligence may take the form of conversations with ex-employees, vendors, industry consultants, etc.

We recognize that we must consider bigger-picture extremes as we evaluate a company's current and prospective intrinsic value. Our efforts have helped us identify areas of opportunity (distressed debt that had priced in a depression by early 2009), while avoiding others (financials for much of the '00s because prices failed to reflect the risk of subprime debt proliferation and the interrelated housing bubble). Admittedly, we lack clarity most of the time, and have zero ability to forecast our economy with any reasonable measure of precision, but we have felt capable of protecting clients from the extremes. For instance, we could not predict the magnitude or timing of the U.S. housing market collapse that led the world economy into a deep recession. We did, however, realize that our economy had overindulged amid the housing excess, and that the risk to the system was likely greater than reflected at the time. Knowing the Titanic is unsinkable does not keep it afloat after steering into an iceberg. We study the macro to avoid a similar fate.

Contrarian Value finds its opportunities in the following five categories and sub-groups, recognizing that our returns will not just be driven by what we own, but also by what we do not own.

I. Long Equity^{ix}

- 3:1s – Our traditional bread and butter. An investment in a business possibly of a lesser quality than that of a compounder, but still a good business and likely to have greater upside potential. We prefer to invest in these businesses when the upside/downside (what we can make vs. what we can lose) has a ratio of 3:1 or better.
- Compounders – The world's great businesses. Unquestionable competitive strength. Solid balance sheets. Shareholder-centric management. We think of these as infinite duration bonds with rising coupons.
- Shorter-Term Opportunities – Identified catalyst(s) expected to have positive impact on value of underlying business and therefore its stock price. For example, operational turnarounds, balance sheet optimization, corporate action, etc.
- Sum of the Parts – The value of a company's disparate parts significantly exceeds its current stock price.
- Intra-Company Arbitrages
 - Long one share class of company while being short another of the same company, when we discover and believe an ephemeral market inefficiency to exist.
 - Long a corporate parent or holding company and short one or more of the underlying subsidiaries, creating a stub equity position that is valued at a deep discount to its intrinsic value.

II. Short Equity^x

- Deteriorating Businesses – Fundamental business metrics are in decline and its stock price fails to take that into account.
- Balance Sheet Issues – Certain asset accounts are overstated, creating the circumstance where operating cash flow may fall significantly short of net income.
- Paired Trades – Shorting a company to hedge, in part, a long equity (typically one of the above) position's industry-specific risk.
- Intra-Company Arbitrages – discussed in the Long Equity section.

III. Credit

- Performing Credits – Credit instruments that have a yield-to-maturity reasonably in excess of U.S. Treasuries of comparable maturity and the holder (lender) will most likely receive all interest and principal. Although some credit risk exists, we generally consider these investments as fixed income, with an increase in interest rates being the greatest risk.
- High Yield Bonds – Bonds of corporations we believe have some chance (but a relatively low probability) of needing to restructure its debt. These bonds generally have a much higher yield than the Performing Credits. We view these investments more akin to equities than we do fixed income, i.e., more credit risk than interest rate risk.
- Distressed Debt – Corporate debt that has either defaulted or that we believe has reasonable odds of being restructured, either voluntarily or via default. Even though these were originated as fixed income securities, we regard our distressed investments as equity.

IV. Other

- Illiquid investments – We periodically make illiquid investments but only when the following conditions are met:
 - Such investments allow us to take advantage of opportunities unavailable to us in the public markets.
 - Mutual fund: Crescent's position size will remain small enough such that a 75% decline in assets will still leave us with an illiquid position of reasonable size.
 - Separate accounts: clients grant us permission to make such an investment.
 - Special Situations

V. Liquidity^{xi}

- Liquidity (including cash) is a residual of our investment process, rather than a macro-driven rationale. Liquidity helps protect the downside and gives us the ability to take advantage of future opportunities.

Conclusion

We would like Contrarian Value and FPA to be known as respected value investors. We would be honored to continue to earn, over many years, the respect of our clients and peers. At the end of the day, we are investors and we do what we love.

We are value investors because it makes sense to us, fits our risk-averse personalities, and appeals to our sense of intellectual honesty. We believe that value investing is the best means (that we are aware of) to preserve capital and to continue to provide adequate growth over the long term.

Contrarian Value's sound and battle-tested strategy, dedication, and diligence will fall short at times as we will occasionally suffer mark-to-market declines and poor relative performance. We know of no way to achieve our long-term goals without periodically disappointing our shareholders and clients. We hope that through good communication, we will make clear to our clients what to expect from an investment with us, and trust that it will help you make appropriate decisions regarding your investment in the Contrarian Value strategy.

We thank our long-term clients whose trust we have earned, but whose patience we have tested.

Disclosures

ⁱ **Intrinsic value:** The present value of future cash flows or the price a knowledgeable and possibly strategic buyer might pay for the business.

ⁱⁱ See [The Case for Cash on our website, fpafunds.com under Special Commentaries.](#)

ⁱⁱⁱ Basis point is a [basis point](#) is a unit of measure used in finance to describe the percentage change in the value or rate of a financial instrument. One basis point is equivalent to 0.01% (1/100th of a percent) or 0.0001 in decimal form.

^{iv} See standardized performance on page 3. ***Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. Performance has been calculated on a total return basis, which combines principal and dividend income changes for the periods shown. Principal changes are based on the difference between the beginning and closing net asset values for the period and assume reinvestment of all dividends and distributions paid. All applicable expenses such as advisory fees have been included in calculating performance. Total return calculations are based on a \$10,000 investment. This data represents past performance and investors should understand that investment returns and principal values fluctuate, so that when you redeem your investment it may be worth more or less than its original cost. Current month-end performance data may be obtained by calling toll-free, 1-800-982-4372.***

You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. The Prospectus details the Fund's objective and policies, charges, and other matters of interest to the prospective investor. Please read this Prospectus carefully before investing. The Prospectus may be obtained by visiting the website at www.fpfunds.com, by email at crm@fpafunds.com, toll-free by calling 1-800-982-4372 or by contacting the Fund in writing.

^v See [Elephants in the Room](#) and [The Raw Deal on our website, fpafunds.com under Special Commentaries.](#)

^{vi} We believe most individuals and institutions should have their long-term savings managed by those who seek to protect capital *before* pushing to make a return on that capital. The Contrarian Value team, therefore, looks down (to see what risk lies below) before looking up (to see what opportunities might lie amongst the stars). Once we have assured ourselves that capital can be preserved, we then seek ways to grow real after-tax wealth at an acceptable rate. This strategy is aimed at allowing our investors to – at a minimum – win by not losing. We have accomplished that goal over our first seventeen years, and will work to continue to do so prospectively. Cumulative experience (rather than repetitive) and a deeper pool of analytical talent should help.

^{vii} Most investors, consultants, and advisors have greater apprehension with regards to the volatility associated with downward price movements. Upside “vol” is more welcomed – except by short sellers.

^{viii} **Volatility**, the bane of many an investor. We lay out an example of this in our 2007 Q1 FPA Contrarian Value Commentary and further elucidate on the topic in our 2010 Q2 FPA Contrarian Value Commentary.

^{ix} We now have the ability to convert our typical 13G to a 13D filing. We can now add activism as a periodic *defensive* tool should the need arise. We expect 13D filings to be rare, but there have been times in the past when it would have been advantageous and we expect that will be the case, on occasion, in the future.

^x **Shorting** appears on the surface to be a reckless pursuit. It affords no tax efficiency because the IRS treats gains as ordinary income. The asymmetry of return certainly works against you as well, as one's gain cannot exceed 100%, but theoretically, one's losses can be infinite. Nevertheless, we believe shorting offers certain advantages. Judicious shorting helps dampen a portfolio's volatility, which in turn helps reduce the mark-to-market risk that may scare certain investors out of the market at inopportune times. We also find that shorting stocks helps keep us honest when looking at longs. We maintain healthy circumspection as we continually observe company managements playing accounting games, overstating prospects, and more. Shorting has kept us sharp and has frequently allowed us to reach broader conclusions. For example, the analysis and subsequent shorting of Lehman Brothers caused us to continue to avoid all other financials and forced us to consider the risks that might exist in our own custodian. We may also periodically harvest losses to offset portfolio gains, thereby improving tax efficiency. We may reenter those trades after thirty one days to avoid a wash sale, or, in cases where an entire sector is overvalued, we might take a short position in another company in the same industry.

^{xi}**Cash vs liquidity.** We make a distinction between cash and liquidity, although we sometimes use them interchangeably. Cash includes the cash received from securities sold short and, as a result, can appear to overstate the cash balance. Therefore, we believe liquidity, which nets that out, is the more appropriate measure.

Fund Risks

Investments in mutual funds carry risks and investors may lose principal value. Stock markets are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. The Fund may purchase foreign securities, including American Depository Receipts (ADRs) and other depository receipts, which are subject to interest rate, currency exchange rate, economic and political risks; this may be enhanced when investing in emerging markets. Small and mid-cap stocks involve greater risks and they can fluctuate in price more than larger company stocks. Short-selling involves increased risks and transaction costs. You risk paying more for a security than you received from its sale.

The return of principal in a bond investment is not guaranteed. Bonds have issuer, interest rate, inflation and credit risks. Lower rated bonds, callable bonds and other types of debt obligations involve greater risks. Mortgage securities and asset backed securities are subject to prepayment risk and the risk of default on the underlying mortgages or other assets; such derivatives may increase volatility.

S&P 500 Index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. The index focuses on the large-cap segment of the market, with over 80% coverage of U.S. equities, but is also considered a proxy for the total market. Russell 2500 Index is an unmanaged index comprised of 2,500 stocks of U.S. companies with small market capitalizations. Barclays Capital Government/Credit Index is an unmanaged index of investment grade bonds, including U.S. Government Treasury bonds, corporate bonds, and yankee bonds. Balanced Benchmark (60% R2500/40% BCGC) is a hypothetical combination of unmanaged indices comprised of 60% Russell 2500 Index and 40% Barclays Capital Government/ Credit Index, reflecting the Fund's neutral mix of 60% stocks and 40% bonds. Barclays Aggregate Index provides a measure of the performance of the U.S. investment grade bonds market, which includes investment grade U.S. Government bonds, investment grade corporate bonds, mortgage pass-through securities and asset-backed securities that are publicly offered for sale in the United States. The securities in the Index must have at least 1 year remaining in maturity. In addition, the securities must be denominated in U.S. dollars and must be fixed rate, nonconvertible, and taxable. The Consumer Price Index is an unmanaged index representing the rate of the inflation of the U.S. consumer prices as determined by the U.S. Department of Labor Statistics. There can be no guarantee that the CPI of other indexes will reflect the exact level of inflation at any given time. The CPI shown here is used to illustrate the Fund's purchasing power against changes in the prices of goods as opposed to a benchmark which is used to compare Fund's performance. 60% S&P500/ 40% Barclays Aggregate Index is a hypothetical combination of unmanaged indices comprised of 60% S&P 500 Index and 40% Barclays Aggregate Index, the Fund's neutral mix of 60% stocks and 40% bonds. These indices do not reflect any commissions or fees which would be incurred by an investor purchasing the stocks they represent. The performance of the Fund and of the Indices is computed on a total return basis which includes reinvestment of all distributions. It is not possible to invest in an index.

The FPA Funds are distributed by UMB Distribution Services, LLC. 235 W. Galena Street, Milwaukee, WI 53212