LETTER TO SHAREHOLDERS

Dear Fellow Shareholders:

This Annual Report covers the fiscal year ended March 31, 2008. Your Fund's net asset value (NAV) per share closed at $36.84. Distributions of $1.39 and $3.29 per share were paid on July 6 and December 21, 2007 to holders of record on June 29 and December 14. Included within these distributions were income dividends of $0.35 and $0.32 and long-term capital gains of $1.02 and $2.97, respectively. Short-term gain of $0.02 was included in the July distribution.

The following table shows the average annual total return for several different periods ended on that date for the Fund and comparative indices of securities prices. The data quoted represents past performance, and an investment in the Fund may fluctuate so that an investor's shares when redeemed may be worth more or less than their original cost.

	Average Annual Total Return					
	1 Year	5 Year	10 Year	15 Year	20 Year	FPA Inception 7/1/84
FPA Capital Fund (NAV)	-6.45%*	15.67%*	9.70%*	14.63%*	15.57%*	16.24%*
FPA Capital Fund (Net of Sales Charge)	-11.36%**	14.42%**	9.11%**	14.21%**	15.26%**	15.97%**
Lipper Mid-Cap Value Fund Average	-11.72%	15.22%	7.85%	11.13%	11.18%	NA
Russell 2000	-13.00%	14.90%	4.96%	9.04%	9.79%	10.17%
Russell 2500	-11.27%	15.67%	6.89%	10.72%	11.52%	12.22%
S&P 500	-5.08%	11.32%	3.50%	9.45%	10.95%	12.24%

The Fund's six-month total return, which includes both the changes in NAV and the reinvestment of distributions paid, was -5.74%*. This compares with total returns of -13.90% for the Lipper Mid-Cap Value Fund Average, -14.03% for the Russell 2000, -13.29% for the Russell 2500 and -12.46% for the S&P 500. On a calendar year-to-date basis, these same comparisons are +0.35%* for FPA Capital Fund, -9.32% for the Lipper Mid-Cap Value Fund Average, -9.90% and -9.37% for the Russell 2000 and 2500, and -9.44% for the S&P 500.

Commentary

What a year this has been. In last year's annual report we included, for the first time, a Special Commentary section to highlight various issues and risks that we saw developing in the capital markets. We thought it was extremely important to pay particular attention to these issues since we were of the opinion that "the word 'risk' does not seem to be in the vocabulary of many investors." This section provided the basis for my speech, "Absence of Fear," that I gave to the CFA Society of Chicago on June 28. Since that time the credit market has experienced the most severe disruption since the Great Depression and RISK has re-emerged into investor thinking.

The stock market responded to this financial chaos by peaking in October with several indexes experiencing declines that many refer to as "bear market" declines. For the fiscal year, your Fund experienced a negative 6.45% return versus -11.72% for the Lipper Average, -13% and -11.27% for the Russell 2000 and 2500 and -5.08% for the S&P 500. During the first half of the fiscal year, your Fund underperformed with a slightly negative total return while the other averages experienced positive total returns. Our retail exposure held back your Fund's performance; however, this action was only a prelude to what the stock market was about to experience. The comparison market indexes as well as the Lipper Index had negative total returns between 12.5% and 14% while your Fund experienced "only" a negative 5.7% total return. Your Fund started to really differentiate itself with a positive 0.35% total return, for the recent quarter ended March 31, while the Lipper Index and all of the comparison indexes had negative returns between 9.3% and 9.9%. The stock market not only caught up with us but went way past us in terms of negative performance. Our defensive portfolio positioning was finally starting to pay off. Though your Fund is outperforming on a relative basis, we still do not like reporting negative total returns.

* Does not reflect deduction of the sales charge which, if reflected, would reduce the performance shown

** Reflects deduction of the maximum sales charge of 5.25% of the offering price

Portfolio transaction activity was essentially non-existent for the last six-months and especially for the quarter ended March 31. We did add another new name, Signet Group plc, just before the beginning of this reporting period. Rikard Ekstrand will discuss it in his part of this letter. On December 14, 2007, we placed a buy halt on the purchase of stocks and high-yield securities. This was in response to what we believed was a worsening credit crisis that appeared to be of a magnitude not seen since the Great Depression. The purpose of the halt was to convey the seriousness of the crisis to our clients and shareholders that only a buy halt would demonstrate. We do not believe many investors, clients or anyone else had fully comprehended the breadth of this crisis. The Federal Reserve appeared to be starting to realize the seriousness of the situation when, on December 12, it established the Term Auction Facility that was designed to provide enhanced liquidity to the financial system by having the Fed accept a wider array of qualifying securities from depository institutions. Even with this new facility, we did not believe the Fed truly understood what it faced. Our January 22 "Credit Crisis" commentary, available on our website at www.fpafunds.com, refers to an internal email of December 14 that conveys this viewpoint. This commentary was followed up with "Crossing the Rubicon" on March 30. If you have not read these yet, we would strongly advise that you do since they reflect the decision making that will be guiding your Fund's asset deployment over the next few years.

In our opinion, from the beginning of this credit crisis, the Fed has been behind the curve and did not fully comprehend its seriousness nor its nature until sometime in January. Federal Reserve Chairman Bernanke gave us this impression because of his Congressional testimony and public speeches. He expressed his and the Fed's opinion that there would be no contagion to other areas of the financial system from the subprime mortgage collapse. As recently as August, the Fed's minutes of their meetings reflect a view of continued moderate economic growth.

Since the Fed took its extraordinary actions between March 11 and 16, the creation of two primary dealer credit facilities and the forced Bear Stearns marriage with JPMorgan Chase, there appears to be a sense within the financial markets that the credit crisis peak has passed and that we are on the road to recovery and normality. We do not share that opinion. There has been a gradual contraction in capital market credit spreads within some segments of the bond market. This narrowing of credit yield spreads is being viewed as proof that the worst is behind us. Again, we are not of that opinion and thus, we believe we have a very long road to go before this economy and the credit markets return to some degree of normalcy. The three-month Treasury-bill yield remains at a substantial discount to the Fed Funds rate, thereby indicating a continuing flight to liquidity and quality.

During the last four years, we have received criticism for holding high levels of liquidity. During the fiscal year, it got as high as 45% and closed the fiscal year at 38%. We began this defensive portfolio positioning back in early 2004. On January 18, 2004, we wrote "Slim Pickings," where we argued that we were not finding sufficiently attractive investments in which to deploy capital. We even closed your Fund to new investors on July 11. As of March 31, 2004, liquidity represented approximately 28%. Since then, the Fund's liquidity level has averaged over 35%. Many of our investors were concerned that we would be missing attractive investment returns and that there would be a heavy performance penalty to be paid for carrying an enhanced level of liquidity. Furthermore, several financial planners have expressed the viewpoint that they are making the asset allocation decision for their clients and that our strategy of holding a high liquidity level was disrupting their clients' asset allocation. We understand this argument and it is one that is made by many professional investment consultants and advisors. It would be far easier for us to subscribe to this argument since it would relieve us of the responsibility of worrying about building liquidity for defensive purposes. Unfortunately, we are of the old school and we believe that it is our responsibility to make the best possible investment decisions and this includes the decision about the liquidity level. All of us personally hold sizeable positions of FPA Capital Fund, and we will continue to invest all the Fund's assets as if they were our own.

Has your Fund been severely disadvantaged by this liquidity decision strategy? From January 16, 2004 (the "Slim Pickings" commentary) through March 31, 2008, your Fund generated a 7.14% compound total

return. By comparison, the Russell 2000 and 2500 total returns were 5.11% and 6.65% along with a 5.47% return for the S&P 500. Thus, your Fund achieved a higher total return while being substantially less invested. In technical terms, we took on less investment risk to get a higher return. Some would say we achieved a high risk-adjusted total return. During this period, the three-month Treasury bill averaged a 3.4% total return and one-to-three year Treasury notes produced a 3.9% return. The stock market indexes achieved higher investment returns but not by a significant degree over these risk-free returns. The risk that had to be taken was, in our opinion, substantially greater than the reward achieved. We continue to see the investment landscape in this fashion.

During the buy-halt period, we received several inquiries about whether share prices had fallen enough for us to withdraw the halt. As of June of last year, my value screen went to a new all-time low of 35 companies, out of a universe of 9,600, versus the previous record low of 47. During periods of recession or economic strain, the number of qualifiers typically rises to between 200 and 400. In early January, the number rose to 200 and then went to 254 on January 22. This was the good news. The bad news was that the screen qualifiers were heavily concentrated in consumer names. In previous periods, the screen identified a far more diversified list of companies. I interpret this to mean that there is still unfinished business on the downside and that a broader range of companies will eventually develop. Patience will be required to benefit from this likely outcome.

Given the uncertain outlook for economic growth and profits, we are being even more deliberate in our investment selections. Your Fund's equity holdings have significant valuation advantages, when compared to the various metrics for the benchmark indexes. As of March 31, 2008, the Fund's P/E and P/BV (Price/Book Value) ratios were 10.7x and 1.7x, respectively. By comparison, the P/E ratios of the Russell 2000 and the 2500 were 22.1x and 19.7x, while their P/BV ratios were 1.9x and 2.0x. Our companies are financially stronger, with a 20.7% Total-Debt/Total-Capitalization ratio, which compares favorably to the 39.9% and 42.9% for the Russell 2000 and 2500. Finally, our companies are more profitable, with a weighted Return on Average Equity of 14.7% versus the Russell indexes of 12.5% and 14.5%.

Outlook

Nominal and real GDP growth for the five years ended December 31, 2007, has averaged 5.67% and 2.93%, respectively. To achieve these rather average growth rates, the Greenspan Fed had to lower the Fed Funds rate to a record low level of 1% and keep it in the 1% range for nearly three years, plus there was an explosion in structure finance issuance and the emergence of consumer home-equity withdrawals that enhanced consumer purchasing power. Furthermore, corporate profit margins expanded to near-record levels with financial-service company profits as a percentage of total corporate profits rising from slightly over 20% to above 40%, according to *The Bank Credit Analyst*. This growing profit share by financial-service companies drove their weighting within the S&P 500 from 12% to 24%. During the past three years, we have conveyed our growing concern about the excesses developing in the financial-service sector and that corporate profits and reported S&P 500 profits were substantially overstated because financial-service companies were under-reserving for loan losses and that a large part of their earnings were being driven by unsound and aggressive lending practices. Given that charge-offs have now passed $300 billion and the International Monetary Fund estimates that worldwide losses will likely approach $1 trillion, we believe our viewpoint has been validated.

In the next five years, it is unlikely that structured-finance creation and mortgage equity withdrawal will be even remotely close to the levels we just witnessed in the preceding five years. Whether the capital markets realize it or not, with the collapse of these areas, and the greater restrictions that will likely be placed upon financial institutions, the U.S. economy should experience a structural reduction in credit availability. It was the explosion in non-bank credit creation that allowed the economy to expand in this last cycle. With the re-intermediation of banks into the credit creation process, a lower level of credit availability will result since the banks have risk based capital requirements along with the requirement that loan loss reserves be established. Even with the capital contributions that are currently taking place, we are of the opinion that financial company

leverage ratios will be forced to be lowered, especially for the investment banks, and thus, capital availability is in a contracting phase. As such, economic growth will likely be constrained during this future period. With slower growth, eroding profit margins and constrained credit availability, it seems reasonable that prospective equity returns should be lower than the preceding five-year range of 4% to 7%.

High stock-market volatility and more credit market stresses accompanied by negative earnings surprises should result in a challenging investment environment for this year and next. As an example, prior to the beginning of the first quarter, the consensus expectation for S&P 500 first-quarter earnings growth was over 6%. The first quarter is now estimated to be down over 14%. The investment consensus appears to be optimistic regarding the likelihood of a second-half recovery for the economy and corporate earnings. This view is taking hold because of the positive response toward the Fed's recent actions, the lowering the Fed Funds rate along with the expanded credit facilities, and tax rebates. In our opinion, the consensus will be disappointed again. Second-half S&P 500 earnings hinge on a fourth-quarter earnings growth rate of over 60% that results in a full year gain of 14.7%, according to Thomson Reuters. We view this expectation as being quite optimistic.

Given our rather cautious return outlook, the recent Fed actions and the prospective Congressional "rescue" (our term is bailout) mortgage-policy actions, we have a heightened level of concern. As we concluded in our "Crossing the Rubicon" commentary, we now expect a higher level of inflation to be the result of actions taken by the Fed as well as the potential new policies that are likely to be implemented by Congress. In light of this, we will need to have the flexibility to respond to these changing events and, thus, the buy halt was taken off with the Rubicon commentary. Over the next two years, we anticipate adjusting the portfolio to reflect this new environment. With those closing comments, Dennis Bryan and Rikard Ekstrand will convey their thoughts.

Dennis Bryan Commentary

I would like to take this opportunity to expand on a major theme of one of the commentaries we recently posted on our website; "Crossing the Rubicon." It suggests a future economic environment which will, in our opinion, experience higher inflation than what occurred in the U.S. economy over the past couple of decades. When we say higher inflation, we do not want to set off alarm bells and have shareholders and clients think we expect a 1970s-style inflationary environment of double-digit annual increase. Although we do not rule out that possibility, we believe the more likely scenario is that the rate of annual inflation will tick up a couple percentage points in the coming years from the low single-digit level over the past decade.

FPA Capital Fund shareholders benefited tremendously over the last two decades as a result of the Fund's large investments in consumer discretionary stocks. For instance, our investments in retailers such as Big Lots, Michaels Stores, and Ross Stores appreciated between 200% to over 2,000%. Those investments among other consumer discretionary stocks, many of which I have been the lead on over the prior fifteen years, met our disciplined investment philosophy. However, those stocks also benefited from a dis-inflationary economic environment. During the past quarter century, the U.S. inflation rate dropped from the low teens to the low single digits. The U.S. has a mature economy, and one that achieves 3-4% real GDP growth with low inflation is an economy that allows wage earners to retain more real disposable income than one that is experiencing higher inflation, all else being equal.

Not surprisingly, over the past quarter century the average U.S. wage earner spent much of what he had left after paying for taxes, food, and living expenses. According to the Bureau of Economic Analysis, over the last twenty-five years the U.S. savings rate as a percent of disposable income declined from 12% in 1982 to roughly 2% in 2007. The average U.S. wage earner/consumer felt confident spending more of their disposable income because he believed his future disposable income would continue to outpace inflation, and he could slow spending if he had to save for a rainy day. The result was that the savings rate fell and Americans consumed more than their annual income allowed, borrowing money to feed their consumption

appetite. According to The Bank Credit Analyst, U.S. household debt as a percent of disposable income has risen from 70% in 1980 to nearly 130% currently. That was a nice tailwind for companies that provided the goods and services consumed during the period, including many consumer discretionary companies.

Unfortunately, the prior tailwind looks like it is reversing, or at least becoming more turbulent. Taking into consideration the more levered consumer balance sheets and our belief that future inflation will challenge wage earners' ability to grow their real disposable income, our expectation is that we will not have the same alacrity to deploy shareholders' capital into consumer discretionary stocks compared to the prior two decades. So where will we deploy the Fund's capital? In the future, we expect more to be deployed into companies that exhibit either the power to pass on higher inflation to their customers or at least have the capacity to hedge out the higher costs within their operations.

To a certain extent, we are simply further embracing a trend within the Fund that we started at the beginning of the new millennium. In 1999, we added Rik Ekstrand to the team, who, prior to joining FPA, covered oil companies at Bernstein Asset Management. Rik has done a wonderful job picking energy stocks for the Fund that have appreciated substantially more than the market. When Rik joined our team in 1999, the price of a barrel of oil was roughly $12; today oil goes for nearly ten times that price, or nearly $120 a barrel. Clearly, Fund shareholders have benefited from our foresight in hiring Rik and the securities Rik recommended and we purchased. However, higher future inflation does not suggest we are only looking at commodity-related companies. We are very open-minded to investing in any company that meets our four key criteria, and has the ability to benefit from a rising inflationary trend. Those criteria are being among the market leaders in their respective industry, a history of good profitability, a management team with a solid track record, and a cheap valuation on an absolute basis, not a relative basis. These metrics form the bedrock of our bottom-up approach to selecting investments one security at a time. We endeavor to protect our shareholders' capital first and, if we have done our homework and remained disciplined to our strategy, the upside should take care of itself in various economic climates.

Rikard Ekstrand Commentary

A new addition to the portfolio last year was Signet Group plc. It is listed in London and has an ADR here in the U.S. The company owns Kay Jewelers, which, along with its other U.S. chains, Jared and the Regional brands, accounts for 80% of the corporation's profits. Kay is one of the largest jewelry retailers in the U.S. We began acquiring the stock since it was hit hard in the U.K. market due to recession fears and the contagion from the subprime crisis. The stock has over a 5% dividend yield, carries very little debt, has earned attractive double-digit returns on equity, and trades at a single-digit multiple to our estimate for normal earnings. Its track record over the last decade has been impressive and a visit to Signet's U.S. headquarters in Akron, Ohio, confirmed both the depth and the experience of the management team.

Signet is in the enviable position of capitalizing on substantial advantages in marketing, merchandising, credit and field operations that have been built over the last two decades. Signet is poised to continue gaining market share from the local specialty jewelry stores, which account for two thirds of the specialty jewelry market. With stores across the U.S., Signet can exploit national TV advertising to reach its customers. This is more cost effective than the local advertising its competition can afford. Signet also has large supply chain advantages since it purchases merchandise at every stage of the supply chain. For example, 50% of its diamond purchases are loose polished diamonds versus none for the typical specialty jeweler. This gives Signet a much lower purchasing cost. Signet also uses sophisticated merchandising systems to test, track, and adjust store inventory to consumer demand so that inventory turns are kept high, which reduces the build-up of excess, slow-moving items. In addition, the company has its own credit operation. The credit operations are managed centrally from Akron, Ohio, including credit scoring and collections. The average balance outstanding is less than $1,000 and, on average, account balances are paid off every seven months, limiting the risk in a downturn. The most striking part of Signet is its sales organization. It is well trained, very professional, and has clear objectives and properly aligned incentives. Signet will utilize its advantages to continue expanding its square footage over the next five years. We believe this will continue to drive profits and expand the currently depressed margins and valuation.

Another stock the Fund owns in the jewelry industry is Zale Corporation. A recent visit with Neal Goldberg, the new CEO of Zale, confirmed that his actions and strategies have the potential to considerably increase the corporation's earning power. Neal has 27 years of experience in the retail industry including senior roles at Macy's, Victoria's Secret, Gap and, most recently, as president of the Children's Place Retail Stores. In the near term, Neal plans to achieve $65 million in savings via $15 million in corporate payroll reductions, $10 million in non-selling field payroll reductions and distribution savings, and $40 million in non-compensation expenses such as consulting, marketing and travel. There are also substantial savings that could come from the supply chain by increasing direct purchases over the next few years. Most of these savings are low-hanging fruit that can be realized in the short term. We also went through Neal's plans for improving store operations, the marketing message, and merchandising. He is planning immediate changes to store operations including improved training and accountability for execution, and better aligned incentives. Our expectation is that the marketing message will be made more coherent with the history of the Zales brand and spending will be more consistent throughout the year to better capture sales in the slower periods. The savings already described above of $65 million, and the operational changes, have the potential to materially improve the Zale's earning power. Improvements in merchandising, marketing, and store operations could add to this number over time.

Despite the Federal Reserve's drastic actions in the latter part of March, which culminated in the bailout of Bear Stearns, we are of the opinion that the credit crisis is not over. There are further write-downs coming, which will continue to restrict lending. The IMF recently estimated that losses for the financial sector would approach $945 billion. If their analysis is true, only a portion of losses have been taken so far, leaving the lion's share of losses still ahead. Also, the estimate by the IMF does not take into account a further deterioration in the values of these securities since it's a static picture of where we are today. With the large amount of foreclosures coming to the market, it is hard to believe that house prices will stabilize, not even factoring in a weakening economy and rising unemployment. Further declines in house prices would likely lead to further write-downs of the securities they collateralize and this could become the self-reinforcing cycle that the Fed and the government are trying so hard to prevent. Other credit sectors are also weakening, including auto loans, credit cards, leveraged loans and commercial loans, and this will impact credit markets going forward. The structured-finance markets have not opened to any extent yet. U.S. asset-backed security issuance is still running in the low teens of billions vs. $60 billion at the same time last year. Unless this changes, we believe the credit contraction will continue and that the contagion effects could be large.

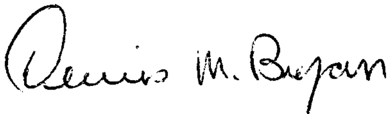
We believe stock market returns will continue to average below the long-term trend because current corporate profit margins are at elevated levels. As profit margins decline to the long-term range, the slowing in profit growth is likely to also depress valuation multiples. The historical average real returns from 1950-1996 was 8.9% including dividends, according to The Bank Credit Analyst. Factoring in 4.2% for inflation, the total nominal equity returns were 13.5%. During the past decade, the nominal returns have averaged 10.6%. We anticipate that the returns the next decade are likely to be less than half the historic returns, if corporate margins move anywhere close to their average level of the last 30 years. Non-financial sector after-tax margins would need to drop by 40% to get back to their long-term average. It would take seven years of 5% nominal GDP growth to offset such a profit margin decline, and produce breakeven profit growth. This would undoubtedly not be helpful to stock market valuations. In this new environment, we expect securities selling at substantial discounts to their underlying values to become more prevalent than the very low numbers we've experienced the last several years. This will provide us with opportunities to invest in companies that meet our stringent criteria, including leadership positions with a history of profitability, strong balance sheets and management teams, and a price substantially below the intrinsic value of the corporation. We anticipate that we will be net purchasers of securities in the future, and if the right opportunities arise, substantial net purchasers.

All of us thank you for your patience, support and trust that you have demonstrated by your investment in

FPA Capital Fund, during this challenging investment environment.

Respectfully submitted,

Robert L. Rodriguez
President and Chief Investment Officer



Dennis M. Bryan
Vice President and Portfolio Manager

Rikard B. Ekstrand
Vice President and Portfolio Manager
April 24, 2008

The discussion of Fund investments represents the views of the Fund's managers at the time of this report and are subject to change without notice. References to individual securities are for informational purposes only and should not be construed as recommendations to purchase or sell individual securities. While the Fund's managers believe that the Fund's holdings are value stocks, there can be no assurance that others will consider them as such. Further, investing in value stocks presents the risk that value stocks may fall out of favor with investors and underperform growth stocks during given periods.

FORWARD LOOKING STATEMENT DISCLOSURE

As mutual fund managers, one of our responsibilities is to communicate with shareholders in an open and direct manner. Insofar as some of our opinions and comments in our letters to shareholders are based on current management expectations, they are considered "forward-looking statements" which may or may not be accurate over the long term. While we believe we have a reasonable basis for our comments and we have confidence in our opinions, actual results may differ materially from those we anticipate. You can identify forward-looking statements by words such as "believe," "expect," "may," "anticipate," and other similar expressions when discussing prospects for particular portfolio holdings and/or the markets, generally. We cannot, however, assure future results and disclaim any obligation to update or alter any forward-looking statements, whether as a result of new information, future events, or otherwise. Further, information provided in this report should not be construed as a recommendation to purchase or sell any particular security.