

LETTER TO SHAREHOLDERS

Dear Fellow Shareholders:

This Semi-Annual Report covers the six months ended September 30, 1999. Your Fund's net asset value (NAV) per share closed at \$32.30. The NAV reflects a distribution of \$0.99 on July 8, 1999, to shareholders of record on June 30, 1999. This distribution included a \$0.16 income dividend and an \$0.83 capital gains distribution, \$0.68 of which was short-term.

The following table shows the average annual total return for several different periods ended on that date for the Fund and several comparative indices. 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		
	Periods Ended September 30, 1999		
	<u>1 Year</u>	<u>5 Years</u>	<u>10 Years</u>
FPA Capital Fund, Inc. (NAV)	25.16%*	20.11%*	17.28%*
FPA Capital Fund, Inc. (Net of Sales Charge)	17.02%‡	18.51%‡	16.49%‡
Lipper Mid-Cap Value Fund Average	14.10%	13.16%	10.98%
Russell 2000	19.07%	12.38%	10.93%
Standard & Poor's 500 Stock Index	27.80%	25.03%	16.82%

The Fund's six-month return, which includes both the changes in NAV and the reinvestment of distributions paid, was 9.41%*. This compares with total returns of 3.96% for the Lipper Average, 8.25% for the Russell 2000, and 0.36% for the S&P 500. On a calendar year-to-date basis, these same comparisons are: 6.94%* for FPA Capital Fund; -1.26% for the Lipper Average; 2.38% for the Russell 2000; and 5.36% for the S&P 500.

Commentary

Your Fund's relative performance improved for the six-month, year-to-date, and one-year periods versus the major indices and the Lipper Average. The Fund widened its performance spread over that

of the Russell 2000 and narrowed its underperformance versus the S&P 500 since our March 1999 Letter to Shareholders. This is encouraging because a large measure of this improved performance emanated from many of our new holdings added last year. A takeover of Marshall Industries by Avnet, Inc., at a price approximately double the last sale, contributed to the performance results.

We would like you to note that the Lipper Average is a different average from that used in our March 1999 Letter to Shareholders. Lipper recently changed its mutual fund categories and the one that we were previously using is no longer in existence. According to their new classification methodology, Lipper determined that your Fund should be included in the Mid-Cap Value segment. As you know, we have emphasized the investment in small- to medium-sized companies based upon market capitalization (common shares outstanding multiplied by the price of the stock). Should our investments prove to be successful, many of these smaller companies can become medium- to large-sized over time. Depending upon when the portfolio is measured, this descriptive calculation can vary over time. You should be assured that our style is not changing. As some of these larger company holdings are recycled into new and smaller companies, the average and median market capitalization of the portfolio can change dramatically.

The stock market continues to be very challenging. Small-cap stocks started to outperform early in the second quarter, but then the entire market began a broad-based decline in the September quarter as interest rates rose. Unless one was invested in a limited number of large-cap stocks and some selected technology stocks, it was difficult to make any headway. In essence, the market continues to be narrowly focused. According to a recent study by the brokerage firm Sanford C. Bernstein & Co., the top quintile of price momentum

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

‡ Reflects deduction of the maximum sales charge of 6.5% of the offering price

stocks has generated 73% of the S&P 500 returns, which compares to 51% last year and an average of 31% since 1959. On average, 56% to 67% of small-, mid- and large-cap stocks are down for the year through September. What is interesting is that 58% of the stocks in the S&P Small Cap Index are down at least 20% from their highs for the twelve months ended September, and this is measuring from almost the low of last year. Comparing the S&P Small Cap Index to the S&P 500 for this same time period, 25% of the small-cap stocks are down at least 40% versus only 12% for the large-cap stocks. The better performance continues to come generally from growth-oriented companies with a technology emphasis. This is not a new trend. The October 11 issue of *Barron's* shows that the top ten mutual funds for ten years were growth funds. Eight of the ten are technology sector funds. The number one fund is Fidelity Select Electronics. Over the years, I have noticed that whenever a sector fund rises to the top for ten years, it generally is a caution sign, "Beware, this sector could be hazardous to your investing health." This simple observation caught the peaks in energy, biotech, healthcare, and financial services. It will be interesting to see what happens from here.

Two years ago our stock market analysis indicated that equity investment returns were probably going to migrate to the 5% to 7% range. This conclusion was based upon the idea that stock prices could not continue to escalate at rates faster than profitability growth, unless one believed in ever expanding P/E ratios. It now appears that this trend is developing. For the past 2 3/4 years, the Russell 2000 has generated a 7.5% annual total return. Unfortunately, this has not been the case for larger-capitalization stocks. The S&P 500 achieved an annual total return of 24% for this same period. However, this trend appears to be changing since the S&P 500's total return for this year through September 30 is only 5.4%. We will keep you apprised as to how this trend unfolds.

Since the long-term Treasury bond's yield moved above 6%, the stock market has had great difficulty moving forward. It has been our opinion that a long-term Treasury bond yield of more than 6% would start to become very competitive to the potential returns from common stocks. The dramatic

rise in bond yields this year is verging on the second worst performance year for bonds. In light of this, my associate Tom Atteberry did a study of the total returns from stocks for the periods ended three, six, and twelve months after a rise in yield of 30% or more for the ten-year Treasury bond. In each case, the total return was only modestly positive or quite negative. As the time period lengthened, the variation became wider with a positive bias. The ten-year Treasury bond yield has now risen 45% from its low and is coming close to matching the record 53.5% rise in 1980.

We are now seeing the emergence of economic recovery overseas, which should put further pressure on the Fed. We still do not see the economy slowing to any material degree. Inventory/sales ratios are at all-time low levels. We still have not seen the anticipated build-up of inventory because of Y2K concerns. Shortly, September data will be reported and if inventories do not show substantial growth, we will enter early next year with low inventories and high consumer confidence. This should bolster economic activity.

Consumer spending will likely remain at high levels since, according to the Conference Board's survey, the consumer views the availability of jobs as plentiful and easy to get. Initial unemployment claims and growth in the labor force are at the lowest levels in forty years. The sluggishness in labor force growth appears to be more a function of the lack of qualified workers. Should this negative trend continue, an acceleration in unit labor costs may begin to emerge. Unless productivity remains high, employment cost inflation may start to erode corporate profit margins, should they not be able to pass these increased costs forward. We see these trends potentially impacting the Consumer Price Index (CPI). We believe this increases the likelihood that the CPI will remain at or above its average growth rate of 2.6%, for the twelve months ended August, for at least the next six months. These trends are likely to maintain upward pressure on interest rates. A key variable that can disrupt this expectation is the potential impact from Y2K. It would not surprise us to see a rally in the bond market helping to support stock prices before year-end. This possibility does not change our outlook for

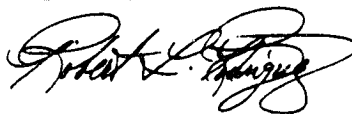
continued above-trend economic growth into next year and its potentially negative impact on interest rates.

Despite this cautionary outlook for interest rates and the stock market, we are more optimistic now than six months ago about the opportunity to deploy your capital effectively. Our "bottom-up" computer screens for companies are now showing the highest levels of qualifiers since 1994-95. We see this outcome in the form of a two-tier stock market. A few large companies gather the majority of investor attention, while vast numbers of companies are being ignored. This is encouraging. As a result, we are deploying more capital into existing holdings, or we expect to add new positions. During the past six months, we increased our investment in six holdings while reducing our exposure in six companies. We also eliminated two holdings: Komag, Incorporated and Lam Research Corporation. We decided to sell Komag since its business continues to deteriorate and better alternative investment opportunities were available. Komag was a residual holding of a very profitable investment experience. We sold our Lam Research position because its price exploded to the upside. In our opinion, its valuation became far too expensive for us to maintain the investment. After quarter-end, we eliminated Seagate Technology, Inc. which was a long-term holding that has treated us extremely well. Again, we felt that too much of its valuation was being determined by investment holdings that were at valuation levels way beyond what we were willing to accept. We added one new position, Manpower Inc., the largest temporary help agency in the world. Manpower provides us with participation in the European economic recovery, since France accounts for approximately 40% of its business. We acquired our initial position at 13x earnings and 2.6x book value. Unfortunately for us, we were not able to acquire a full position. A slow and steady flow of redemptions, totaling 6% of the Fund's assets for the past six months, has made establishing new positions more difficult.

After these adjustments, the portfolio continues to maintain a competitive valuation advantage over that of the market. At the end of September, the Fund's P/E and P/BV (Price/Book Value) ratios were 18.9x and 1.8x, respectively. By comparison,

the P/E ratios of the Russell 2000 and the S&P 500 were 26.9x and 30.1x, while the P/BV ratios were 2.3x and 4.9x, respectively. Our companies are financially strong with a 28.4% average Total-Debt-to-Total-Capitalization ratio, which compares favorably to the 39.1% and 44.1% for the Russell 2000 and the S&P 500. The portfolio's median market capitalization was \$468 million, while its weighted average market capitalization was \$1.5 billion. The Russell 2000's median and average market capitalizations were \$430 million and \$800 million, while those of the S&P 500 were \$7.5 billion and \$106 billion, respectively. We thank you for your continued investment and support.

Respectfully submitted,



Robert L. Rodriguez, C.F.A.
President and Chief Investment Officer
November 2, 1999