

LETTER TO SHAREHOLDERS

Dear Fellow Shareholders:

This Semi-Annual Report covers the six-months ended September 30, 2009. Your Fund's net asset value (NAV) per share closed at \$31.36. An income dividend of \$0.03 per share was paid on July 6 to holders of record on June 30.

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.

	Periods Ended September 30, 2009						
	Average Annual Total Return						
	<u>1 Year</u>	<u>5 Years</u>	<u>10 Years</u>	<u>15 Years</u>	<u>20 Years</u>	<u>25 Years</u>	<u>6/30/1984 Inception</u>
FPA Capital Fund (NAV)	2.78%*	4.22%*	9.55%*	12.96%*	13.35%*	14.77%*	14.95%*
FPA Capital Fund (Net of Sales Charge)	(2.62)**	3.11%**	8.96%**	12.56%**	13.04%**	14.53%**	14.70%**
Lipper Mid-Cap Value Fund Average	(2.45)%	2.98%	7.11%	8.48%	8.91%	NA	NA
Russell 2000	(9.55)%	2.41%	4.88%	7.32%	7.86%	8.95%	9.08%
Russell 2500	(3.78)%	3.29%	6.28%	9.03%	9.37%	10.75%	10.95%
Standard & Poor's 500 Stock Index	(5.43)%	1.02%	(0.15)%	7.62%	8.00%	10.36%	10.66%

The Fund's six-month total return, which includes both the changes in NAV and the reinvestment of distributions paid, was 55.04%*. This compares with total returns of 45.51% for the Lipper Mid-Cap Value Fund Average, 43.96% for the Russell 2000, 44.40% for the Russell 2500 and 34.03% for the S&P 500. For the calendar year-to-date period, these same comparisons are 45.42%* for FPA Capital Fund, 30.62% for the Lipper Mid-Cap Value Fund average, 22.43% and 27.89% for the Russell 2000 and 2500, and 19.26% for the S&P 500.

Robert L. Rodriguez Final Fund Commentary

With these comments, the process commences of handing your Fund's leadership over to Dennis Bryan and Rikard Ekstrand, who will assume this responsibility beginning January 1, 2010. As announced in the March 31, 2009 Letter to Shareholders, I will be stepping down from day-to-day active management on December 31, 2009 to take a one-year sabbatical. I will return in 2011 to assist Dennis and Rikard as they lead your Fund. While I am away, I will retain my entire FPA ownership as well as all of my investments in the FPA Funds. I believe this will demonstrate to you my faith and confidence in your new lead managers and will help to allay any concerns you might have. I thank all of you for having entrusted me, as well as the team, with a portion of your assets. I still find it amazing how investors, most of whom we have never met personally, have the confidence to convey their hard-earned dollars to "strangers." We take our fiduciary role very seriously and have worked conscientiously to never betray it.

It has been an honor and a privilege for me to have been your lead manager for more than twenty-five years. When I first began this journey, I laid out in my initial shareholder letter, September 30, 1984, the investment philosophy and strategy that would guide me in the management of your Fund. As additional investment professionals were added

* 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.

to form a team, we all worked diligently to meet these goals. We have always strived to maintain the highest standards of trust, reliability and integrity, which are core values at FPA. It has been our policy to be straightforward and candid in all our communications with you and to hold ourselves accountable for the decisions we make. I have seen too many times in my career, business and investment professionals attempting to place the blame elsewhere for their mistakes. This negative attribute has been all too often demonstrated by our politicians and regulators as well, especially in this financial crisis. During a period when there have been many transgressions within and outside of the investment industry, FPA has stood for ethics and integrity.

Dennis, Rikard and I are pleased to report some very good news to you. According to Lipper Analytical, your Fund's 14.77% annualized return for the twenty-five years ended September 30, 2009 ranks it as the number one U.S. diversified equity fund out of 216 such funds with twenty-five year records. By comparison, the total returns for the various indexes were as follows: Russell 2000, 8.95%; Russell 2500, 10.75%; and the S&P 500, 10.36%. Your Fund's total return is after all fees and expenses that have averaged approximately 93 basis points. Out of these 216 funds, only 20 have been led by the same manager for the entire period. We pride ourselves on the level of stability within our investment teams and employee ranks. Since there are now over 15,900 funds, with all of their various classes included, we can understand the confusion that exists for consumers in selecting a fund for their investment.

I would like to share a few thoughts about your new lead managers. I brought both of them into FPA to work with me on your Fund. Dennis has been with me since 1993, and Rikard joined us at the beginning of 1999. Prior to coming to FPA, they each had several years of investment experience as well as having advanced academic degrees. Accordingly, your Fund will be under the leadership of very senior and experienced investment professionals. Our investment philosophy and styles are extremely close. Both have made major contributions to your Fund's long-term record with investments in retail, technology and energy, to name but a few sectors. The portfolio has been cleansed of any residual investments so that this burden will not be there when they assume leadership. Their focus will be on when and how capital should be deployed.

One final thought that brings me to the intensifying issue that we have written about several times before — the explosion in Treasury debt outstanding. Since September 30, 2008, Treasury debt has risen from \$10 trillion to \$11.9 trillion, a rate of \$5 billion per day. There is no end in sight for this out of control debt growth, as reflected by federal government deficit forecasts, which we consider optimistic, that total between \$7 and \$9 trillion for the period 2010 to 2019. In our March 2009 Letter to Shareholders, we estimated that US Treasury debt would swell to between \$14.6 trillion and \$16.6 trillion by the end of 2011. If we stay on this present trend, we should reach this range which, in our opinion, is outrageous and fiscally irresponsible. This insanity is not a Democratic Party or a Republican Party "thing." Both parties are responsible, but who is ultimately more responsible than these two parties? It is we, the citizens, who keep re-electing these power-centered financially inept politicians and it will be our children and grandchildren who will have to "pay the piper." It is not right and is morally reprehensible that one generation would do this to another.

Our country is currently in this financial mess because consumers, corporations and government succumbed to the temptations of excessive spending, debt growth and risk taking. Just as any family or company can get into trouble with too much debt, so can a state or country. California is a perfect example of a state government that has been devoid of economic reality and totally irresponsible in its finances, with spending far exceeding revenue growth for years. Our federal government also exemplifies this unsound and unwise trend. Before new expenditure programs are created and laid upon preexisting ones, we should be demanding that federal, state and local governments get spending under control first. We cannot trust most politicians because they practice "bait and switch" tactics in proposing new programs. The true long-term program costs are always understated because new benefits are added subsequently that were not included in the original optimistic cost estimates — Social Security, Medicare and Medicaid are perfect examples of this process, and the proposed new health care spending program, if passed, will likely follow this same course.

As a beginning, no new programs should be created until others have been eliminated to offset these costs in the year of origination. We should have government prove to us first that this new budgetary balance can be achieved and maintained. Once at approximate equilibrium, we can begin to focus on debt reduction through the process of expenditures growing at less than the rate of revenue growth. Most families know that before they can regain control of their finances, they first have to control their spending. If our elected officials cannot agree to meet this principle of fiscal discipline and be held accountable to it immediately, they should be ousted from office. Most of our current elected representatives would fail this test. As is the case with any company or family that does not deal with its pre-existing debt first, and then proceeds to take on additional debt beyond its means to pay, foreclosure or possibly bankruptcy will likely result. The same goes for a country, unless it can continue issuing debt denominated in its own currency. In this case, it can expunge its debt through the process of printing money and, thus, it can create a monetary inflation that destroys the purchasing power of previously issued debt. Our lenders will not stand for this and current trends show that foreign central banks are beginning to shift their holdings from Treasury notes and bonds to much shorter term Treasury bills. This is an ominous trend. At FPA, we began this process several years ago in our fixed income management accounts.

I urge all of you to convey to your elected representatives that this spending madness must stop. If it does not, we will eventually face a crisis that will be far worse than the one we are in now. This potential risk is in our thinking at FPA and we are making contingency plans, as we did for this current crisis, so that we may manage through it well. As a first generation American, I hope and pray that we make the difficult decisions rather than pass them on to the next generation.

I leave for my sabbatical knowing that the reputation of First Pacific Advisors, LLC is the highest ever and that its financial strength has never been greater. I thank you for the confidence that you have shown in me, as well as FPA, by your investment and I look forward to returning in 2011. The letter that follows reflects the thoughts and expectations of the Fund's "new" lead managers.

Dennis Bryan and Rikard Ekstrand Commentary

Before we lay out our investment strategy and process for you, our clients, the two of us would like to express our deepest gratitude to Bob, our partner, mentor, and friend for nearly two decades. Since the early 1990s, Bob has endowed us with his investment discipline, invaluable macro-economic insights, and investment knowledge that have allowed him to become among the best investors of our time. Clearly, the two of us owe much of our own business success to Bob, and the best way for us to pay back our debt of gratitude to him is to continue and build on Bob's legacy. In order for us to achieve this objective, we need to be steadfast to the investment discipline that we have successfully developed together over the last two decades.

With that in mind, we would like to repeat and reinforce what Bob laid out a quarter of century ago in his first client letter. Namely, our investment strategy is to own a concentrated group of businesses with leadership positions that are trading substantially below their intrinsic value and hold those investments for the long term. The strategy also includes owning companies that have a strong management team with a proven track record of success and that have a history of good profitability. That is, we do not want to speculate that a company might one day become profitable, rather we want to see a history of good returns on capital and profits. The investment strategy further endeavors to invest in companies with strong balance sheets, exhibited by limited private or public debt. Lastly, our strategy embraces an "ownership" mentality rather than Wall Street's commonly held view today that stocks only should be "rented." Our long-term view allows us to increase the odds of compounding our clients' assets at attractive returns, and not be seduced into selling a holding because of short-term perception changes by other investors or traders.

Our investment process boils down to searching for and understanding why industry leading companies are selling at bargain prices, and then determining whether they ought to be included in our clients' portfolios. The process starts with identifying the companies that meet certain quantifiable metrics. For example, we want to buy small- to mid-capitalization companies so we screen for companies within a range of market capitalizations between \$1 billion and \$4 billion. We have several other key metrics for which we screen and additional ways to identify our initial list of potential stocks for the portfolios, including identifying companies whose stock prices are trading at their 52-week low.

After we identify potential investments, we then start a thorough fundamental analysis that often quickly weeds out many companies that passed the initial identification stage. The analysis includes a rigorous review of a company's financial statements, often extending back a decade or longer. This step also includes assessing the company's operations and its competitive position; our goal here is to avoid value traps. The fundamental analysis can take many months to complete, and sometimes ends because we cannot sufficiently understand the risks posed by owning equity in a complex or challenging business.

The third step is to put all the companies which have passed the first two steps through a valuation analysis. This step includes analyzing a company's valuation based on its sales, earnings, cash flow, and book value. Finally, the companies that pass all three steps are then candidates for inclusion in our clients' portfolios. At this point we may end up with between 20-40 companies for the portfolios that we manage, and three industry sectors often represent more than 50% of the portfolio's assets.

The important factor to remember is that we have been executing this strategy everyday for nearly the past two decades at FPA, and Bob has been doing it for the last twenty-five years at our firm. We do not expect any changes to this fairly simple investment strategy, but the key is to execute the strategy when the valuations warrant either a buy or sell of a security. One of Bob's favorite terms is that we like to invest in the "land of tall trees." That is, we don't want a bunch of small positions, but rather a few great saplings that will grow as their dominance in the market earn larger profits for shareholders. Thus, our job is to continue to follow the trail map that we have been on and periodically prune back investments as they reach maturity and occasionally plant a new seed that will bear fruit and be ready to harvest in five, ten, or more years down the road.

Portfolio Commentary

What a difference six months can make. In our March 31, 2009 letter we lamented the difficult stock market results and the Fund's negative performance despite seeing early on the credit bubble that was building earlier this decade. However, for the six months ended September 30, 2009, your Fund appreciated 55.04% versus 43.96% and 44.05%, respectively, for the Russell 2000 & Russell 2500. As we explained in the prior shareholder letter, we viewed the Fund's decline as temporary rather than a permanent hit to the Fund's assets, unlike many other investors that had large exposures to financial companies. Our large exposure was, and still is, in energy companies, which declined rapidly late last year and early this year as oil and gas prices fell roughly 75%. We believe the supply and demand fundamentals for energy did not warrant the precipitous fall in oil prices, and the energy markets have rallied recently to reflect the better prospects for the industry than what many investors feared would be a large decline in global demand due to the economic recession.

The International Energy Agency, or IEA, in October revised their demand forecast for 2009 to be 84.63 million barrels per day versus an April 2009 forecast of 83.4 million barrels a day. Thus, the decline from 2008 will likely be 1.7% versus the earlier forecast of a decline of 3.1%. These changes may not seem large to the casual observer, but a 1.2 million barrel per day change in demand expectations is unusually large given the mature nature of the oil business.

The stronger than expected oil consumption bodes well for our energy investments, and in the last six months many of these securities appreciated more than 50%, with Rosetta Resources alone gaining 196% during that time period. We take great pride in not being frightened into selling our energy investments at the market bottom, and greater pride in having the strength of conviction to add considerably to our energy stake, and other securities as well, during a very stressful period of time.

We think Yogi Berra phrased it well when he said “it’s déjà vu all over again.” Yogi’s malapropism is helpful when we look at the recent performance results of the portfolio and the major indices. While your Fund generated a healthy double-digit return in the third quarter, similar to the second-quarter result, the similarities of returns are more striking when we review the major index performance. For example, the Russell 2500 gained 20.06% in the third quarter versus 20.27% in the prior quarter, and the S&P 500 appreciated 15.59% in the third quarter versus 15.93% in the second quarter. Perhaps Mae West said it better than Yogi when she reportedly once said “too much of a good thing can be wonderful.”

The natural contrarian in us would like to add another line to Yogi’s and Mae’s famous phrases, and that would be that “déjà vu all over again” and “too much of a good thing can be wonderful” are not sustainable. That is, we should not expect the fourth quarter’s performance to be similar to the prior two quarters’ returns, unless one believes we live in a parallel universe. Moreover, it may behoove us to be prepared for less robust returns in the future as much of the near-term earnings improvement has been discounted by the stock market, in our opinion. Clearly, the market can continue to rise in the coming quarters, but corporate revenues need to start growing in order to justify higher prices for many stocks.

One variable of the portfolio that continued to pay big rewards was the buy program that we started in the fall of 2008, and one which we have mentioned in our prior shareholder letter. To refresh memories, from October 2008 through March 2009, we deployed roughly 35-40% of the portfolio’s cash reserves to nineteen different stocks, and we have tracked the performance of these purchases. This buy program was the largest of its kind in terms of names and dollars for the portfolios under our management. As of September 30, 2009, the buy program generated a return in aggregate of 83%, versus returns of 11.56% and 8.11%, respectively, for the Russell 2500 and Russell 2000. During the same time frame, the S&P 500 returned 6.11%. Another way of measuring the buy program’s success is to understand that this tranche of investment dollars has contributed approximately 30% of this year’s return.

As mentioned in the previous Fund letter, we increased the total number of securities in the portfolio by roughly 50% through our new security additions. We purchased five new exploration and production companies, CNX Gas, Cabot Oil and Gas, Cimarex Energy, Newfield Exploration, and St. Mary Land & Exploration. These were companies we had been vying to buy for over five years, but didn’t reach the right purchase price until late last year. We also added two new oil service companies, Pride International and BJ Services, and a basic material company, Reliance Steel. We also added to about half of our existing securities. Clearly, we had an extraordinary opportunity to buy a number of companies that met our strict investment strategy, and we seized that opportunity aggressively. On the other hand, we still have plenty of cash reserves to allocate to either new or existing positions should the opportunity present itself again.

While we did not actively purchase any new stocks in the two quarters, there was a new addition to the portfolio because of Pride International’s spin-off of its Seahawk Drilling (HAWK) subsidiary. HAWK operates an offshore drilling business that provides contract drilling services to the oil and natural gas exploration and production industry in the Gulf of Mexico. The company’s twenty mat-supported jackup rigs are capable of operating in water depths of up to 300 feet and drilling to depths of up to 25,000 feet. HAWK has the second largest fleet of jackups in the Gulf of Mexico. The company contracts with customers on a dayrate basis to provide rigs and drilling crews. HAWK’s customers

are independent oil and natural gas producers, drilling service providers and Petróleos Mexicanos (PEMEX), the state-owned petroleum company of Mexico.

It should come as no surprise to you that we did not purchase any new stocks during the most recent period, considering the enormous run-up in stock prices over the last six months. We prefer to buy stocks in periods of market weakness, like what we experienced in the second half of 2008 and the first quarter of this year. We do not expect another major collapse in stock prices like that of last year and earlier this year, but volatility has not been outlawed. Therefore, we believe we will have more opportunities to deploy your capital in the future at more attractive valuations and under more stressful market conditions than what has prevailed over the last couple of quarters.

In contrast to the lack of recent purchases, we were moderately active in trimming back a number of positions that have appreciated to levels that we believe represent fair valuations or slight premiums to fair valuation. With the big run-up in oil prices to the \$70 mark, a number of our energy investments rose to a value that we deemed prudent to trim back the holding. However, we also trimmed back technology and consumer discretionary stocks.

During the last six months, all but one of the stocks in the portfolio appreciated, and we had no stocks that declined in the September quarter. Obviously, batting 1000 is neither common nor expected to continue in subsequent quarters or years. With that in mind, two investments that helped the performance in the last six months were BJ Services (BJS) and Western Digital (WDC).

BJ Services appreciated more than 95% from March to September and closed the third quarter at \$19.43. We initiated our investment in BJS in the fall of last year, when many other energy stocks were rapidly declining as the financial crisis unfolded. BJS provides pressure pumping and oilfield services for the petroleum industry in the United States and internationally. It primarily offers pressure pumping services used in the completion of new oil and natural gas wells and in remedial work on existing wells, both onshore and offshore, to independent oil and natural gas producing companies. The company's pressure pumping services comprise cementing services, as well as stimulation services that include fracturing, acidizing, sand control, nitrogen services, coiled tubing, and service tools. BJS also offers oilfield services, such as casing and tubular services that comprise installing or running casing and production tubing into a wellbore; process and pipeline services, including oil and natural gas production, refineries, and gas and petrochemical plants; chemical services; completion tools; and completion fluids services consisting of filtration and reclamation. BJS recently received a merger offer from Baker Hughes (BHI), which will make the combination of the two a much more competitive company in the oil field services industry. We are still evaluating the merger offer from BHI, but are initially favorably disposed to the deal.

Our investment in WDC dates back a few years when the stock was trading in the mid-teens. WDC appreciated nearly 89% over the last six months and closed at \$36.53. Despite a difficult technology spending environment, WDC is expected to remain very profitable and produce an abundant amount of free cash flow this year. The company's balance sheet is rock solid with nearly \$6 of net cash (approximately \$1.3 billion) on the balance sheet. During recessionary periods, strong companies generally get stronger and add products to their portfolios at a low expense. WDC's recent acquisition of Silicon Systems Inc. (SSI) is an example of a strong company adding to its business products that will help the company grow in the future. WDC purchased SSI for \$65 million, but more importantly SSI positions WDC to take advantage of the expected rapid growth of Solid State Drives, or SSDs. The SSD market is currently \$1 billion of annual sales, but it is expected to grow to \$5 billion over the next four to five years. Thus, for a nominal investment, WDC quickly positioned itself to be among the leaders in a potentially larger and lucrative emerging market. Our expectation is that WDC could earn over \$3.50 a share over the next year, even if the economy remains sluggish. We also believe WDC could earn over \$4 a share as the economy stabilizes and grows very modestly

over the next couple of years. Thus, it would not surprise us to see WDC trade above \$40 in a better economic environment. Nonetheless, we recently trimmed back our WDC position as the stock has more than tripled from its low set in late 2008.

FPA Capital Fund continues to carry a valuation advantage over the market indices. As of September 30, 2009, the Fund's P/E and P/BV (Price/Book Value) ratios were 10.2x and 1.3x, respectively, compared to the Russell 2000's 174.8x and 1.7x, and the Russell 2500's 152.0x and 1.8x, respectively. The ratios for the Fund are among the lowest we've seen in more than two decades. Our companies are also in a very strong financial position, with a 21.5% Total Debt/Total Capitalization ratio, which compares well to the 39.1% and 44.4%, for the Russell 2000 and Russell 2500, respectively.

Outlook

We think the run-up in the stock market has gotten ahead of the fundamentals. The issues the U.S. is facing have not gone away. The outlook baked into the stock market, with the S&P 500 north of 1090 at the moment, is too optimistic. We don't think the primary ingredients are there to support the 64% bounce in the S&P 500 from the early March low of 666, nor the 82% increase in the Russell 2000 Index from its March low. These moves indicate this was a normal recession and that we will resume our past real GDP growth rates going forward. We disagree. We believe that the U.S. consumer is still under duress, that the banks and the shadow banking system are not in a position to drive credit growth, and that the economy, as a result, will experience subpar economic growth of less than 2% in the foreseeable future. This is likely to lead to significant disappointments in corporate profits. We also remain concerned about the fiscal imprudence of the U.S. government, which is running record budget deficits, and the explosion in debt this is leading to. Our creditors have taken notice of the large increases in debt and continue to reduce the maturities of their U.S. Treasury holdings. We maintain our investment focus in companies and sectors that have positive long-term fundamentals in this environment, and that we think carry significant upside and at a minimum will retain their long-term purchasing power. As we have worked to meet our objective, real capital protection has always been, and will always remain, one of our foremost criteria.

Bank lending is not likely to get back to pre-crisis levels any time soon. At the beginning of 2009, banks had a very limited cushion of equity capital. This cushion does not factor in large amounts of potential future losses coming from commercial real estate. About half of the \$3.4 trillion in outstanding commercial real-estate debt is held by banks, according to a *Wall Street Journal* article on the subject, "Fed Frets About Commercial Real Estate," 7 October 2009. We estimate that up to 20% of the banks' \$1.7 trillion exposure could end up as bad loans. Should our estimate be anywhere close, this would likely slow bank lending further in 2010 and 2011.

Structured finance or, as it is also called, the shadow banking system, is in its third year of decline. This doesn't bode well for credit generation outside of the banking system. Even with governments around the world pumping liquidity into the securitization sector, it is expected to be down 70% from the peak of \$2.7 trillion three years ago, according to *Asset-Backed Alert*, an industry source on worldwide securitizations. The shadow banking system is on supportive breathing via liquidity from governments across the globe. Without this support, the 70% decline from three years ago we've witnessed would likely have been much larger. For example, U.S. issuance of asset-backed bonds would be a fraction of the current level without the government-sponsored TALF program — this year, over 70% of the \$110 billion in asset-backed issues contain senior classes eligible for TALF financing.

We think the consumer is in retrenchment mode and that this will negatively impact consumer spending which accounts for 70% of U.S. GDP. Consumers are pressured on multiple fronts, including a doubling in their household

debt since year 2000 by spending well in excess of income during the last decade and in excess of \$13.9 trillion at the peak. Adding to this pressure is a significant hit in net worth due to falling house prices and a decline in major stock indices, which are still 30% below the highs of 2007, and an unemployment rate that has doubled to 9.6%. Each of these points deserves additional thought.

According to *MacroMavens*, a research service, the consumer spent north of \$1 trillion in excess of spendable income at the spending peak in 2006, loading up on debt in the process. This was clearly not sustainable, which is why we significantly lowered our exposure to retailers starting in 2005 with sales of Michaels Stores and then following with Ross Stores, Big Lots, and Rent-A-Center, along with reductions in other retail positions. As a result of this spending binge, household debt exploded from the beginning of this decade by staging a doubling from \$7 trillion to a recent peak of \$13.9 trillion. The last twelve months, household borrowing has taken a nosedive. From being positive the last 30 years and peaking north of \$1 trillion a few years ago, the consumer is currently repaying \$200 billion annually. This is a U-turn in borrowing behavior.

Another negative for consumer spending is the unemployment rate, which has gone from 4.5% in mid-2007 to a current 9.6%. This more than doubling in unemployment is a major drag on future economic growth. We have to go back 25 years to 1982 to find an unemployment rate that is higher. In 1982, the unemployment rate peaked at 10.7%. The environment was different then with the Federal Reserve discount rate having been at 14% a year earlier, leaving a lot of room to stimulate the economy by reducing the discount rate over time, without having to resort to the quantitative easing which is happening now.

Thus, with the consumer under pressure on multiple fronts and being such a large part of the U.S. economy, we have trouble seeing how a strong enough rebound will take place to support the earnings expectations incorporated in the stock market. The most likely scenario to us is a slower growth economy, with less than 2% real GDP growth, which is substantially less than in this country's history. For perspective, our expectation of lower than 2% is less than 40% the growth of 4.65% annually achieved during the 1960s.

We believe corporate earnings are set to disappoint in 2010. Corporate after-tax profit margins peaked in 2007 at north of 12% for non-financials. This was double the 6% margin level they had averaged the last 30 years. As recently as 2002, these profit margins were 2%. We expect that over time these profit margins will move closer to the long-term mean of 6%. Should we be right, this means that the medium to long-term profit expectations incorporated in the stock market are too high. A recent Morgan Stanley research report on S&P 500 earnings expectations highlights this issue. If sales growth for 2010 is 6% instead of the 9% expected, and the net margin is 1.5% lower than the estimate, which is close to a 30-year peak, then S&P 500 earnings will be \$60 instead of \$75. A small change in the sales and margin estimates produces a significant 20% reduction in the 2010 profit.

As would be expected, we are not finding anywhere near the opportunities we were finding a year ago, when we deployed a large share of the cash on hand in attractive opportunities. The "buy program," which began in October 2008 and concluded in March, added significantly to the portfolio's outperformance this year. Another indicator that investment opportunities are not that attractive at the moment is our screens, which are throwing off around 150 qualifiers at the moment. This is down from 450 less than a year ago and below the long run average of 200-250. As a result of the drying up of opportunities, we have not made one purchase since March of this year. Instead, we've been trimming our positions where valuations have gotten closer to fair value. This can change rapidly, and we have a list of stocks we'd like to buy if their prices move down to levels we deem more attractive.

We have been trimming our energy holdings as their prices moved up. As we have communicated, our energy companies have pristine balance sheets, strong cash flows, and long-term assets that are viable and usable for years to come. Their assets are not of the paper variety that was destroyed in the credit crisis. We continue to feel that the international demand factor for oil, in particular demand from developing countries, and the difficulty of increasing the supply of oil in the medium to long-term, will continue to support the oil commodity and help drive the fundamentals for our energy companies. Since 80% of production today comes from fields discovered more than thirty years ago, the ability of these fields to deliver future production is critical to the supply equation. With 50% of non-OPEC production today being past peak, including the U.S., the North Sea, Australia, Mexico, etc., and Russia and China being near peak, accounting for another 28% of non-OPEC production, it is getting harder and harder to drive production growth from areas outside of OPEC. This increasing reliance on OPEC for future production growth means that the downside to oil prices is not what it has been in the past. In addition, our energy investments have provided and, we believe, are likely to continue to provide protection against the U.S. dollar which has eroded some of its value against real assets the last six months, and is at risk for continued erosion over the long-term.

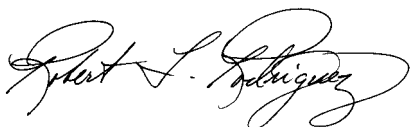
Our view is that the U.S. government is setting the wrong policies by focusing on supporting spending instead of redirecting the economy to become more export oriented for the long term. We feel the U.S. economy would be more competitive and able to drive faster real GDP growth if exports as a percent of GDP could be increased from the 2008 level of 13.1% of GDP to a high-teens level. An example of this is the \$8,000 tax credit to new homebuyers. Since there is an excess of homes on the market, this tax credit is unlikely to do much for real GDP since few new homes will be built as a result. In our opinion, it would be far more effective with a tax incentive to buy productive equipment. This equipment would drive productivity and help exports, as well as have a direct impact on real GDP, as opposed to merely assisting domestic consumption.

A year ago, our fixed income team was talking about the approaching debt explosion. At that time they calculated that the government's Treasury debt could reach \$14.6-16.6 trillion by the end of 2011, or 97-110% of GDP. These estimates include intragovernmental Treasury holdings, since they are also debt and accrue interest. The current Treasury debt level of \$11.95 trillion is already at 85% of U.S. GDP. This puts us in the same league as Egypt, Sudan and Greece, with debt to GDP ratios of 85%, 86% and 90% respectively. These countries are not exactly known for their fiscal prudence. At 85% Treasury debt to GDP, there are only nine countries in the entire world that currently have more debt as a percent of GDP than the U.S. when we include intragovernmental holdings in the U.S. number. We hope that the government will change its course and return to fiscal prudence rapidly, but we are not holding our breath. The government's Congressional Budget Office (CBO) outlook for 2009-2019 highlights the difficulty we are facing. Despite projecting 4% per year real GDP growth from 2011 to 2014, the CBO expects significant budget deficits throughout this period. Should we prove correct in our lower growth estimate, then the budget deficits will be materially higher.

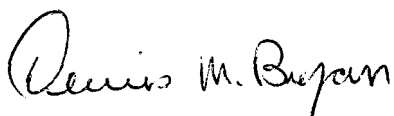
The government's fiscal imprudence is a major reason we have focused the portfolio on companies that have real assets with significant value such as our energy companies, and companies with a large export component such as our technology investments that have half or more of their sales to countries outside of the U.S. We are of the opinion that, as households and the government continue facing difficult decisions going forward, the volatility of the market will increase and provide opportunities to those who are unflappable and composed. Our long-term focus, willingness to take significant positions in companies and sectors when the prospects are there, opportunistic spirit and willingness to wait patiently for the right investments, will continue to serve us well in the difficult environment we see ahead.

With those closing remarks, we want to thank you for your continued support and the trust you have expressed in us through your investment in FPA Capital Fund.

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
November 2, 2009

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.