LETTER TO SHAREHOLDERS

Dear Fellow Shareholders:

This Semi-Annual Report covers the six-month period ended March 31, 1997. Your Fund's net asset value (NAV) closed at $10.93. Income dividends of $0.17 were paid on October 15, 1996, and January 6, 1997, to holders of record on September 30 and December 31, 1996, respectively. The January payment also included a $0.05 short-term capital gains 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 Periods Ended March 31, 1997		
	1 Year	5 Years	10 Years
FPA New Income, Inc. (NAV)	6.83%*	8.63%*	9.66%*
FPA New Income, Inc. (Net of Sales Charge)	2.02%‡	7.63%‡	9.16%‡
Lipper "A" Rated Corporate Debt Fund Average	4.23%	6.96%	7.78%
Lehman Brothers Government/ Corporate Bond Index	4.46%	7.32%	8.13%

The Fund's total rate of return for the six months was 3.25%* versus 2.22% and 2.17% for the Lipper Average and the Lehman Index, respectively. For the calendar year ended December 31, 1996, total returns were: FPA New Income, Inc., 7.12%*; Lipper Average, 2.49%; and the Lehman Index, 2.90%. We would like to point out that we are using a new Lipper Average since the previous one was discontinued. We selected the "A" Rated Corporate Debt Fund Average since it was the closest in structure to that of your Fund. The long-term returns were also very close to those of the previous Average.

Commentary

Calendar 1996 proved to be a difficult year for the bond market. Yields rose approximately 70 to 80 basis points for the two- to thirty-year segments of the yield curve. Since September 30, yields have moved up 30 basis points in a parallel fashion for all maturity segments. Expectations of weaker, then stronger, economic growth buffeted the bond market. Your Fund managed to migrate through this volatile period reasonably well. As longer term yields moved past the 7% level, we began to extend maturities and durations. Since September, the average portfolio duration has increased from 4.14 years to 4.87 years.

The best performing areas of the bond market, other than short-term securities, have been mortgage-backed securities and high-yield bonds. We are at a relatively low exposure to high-yield bonds. We do not like their valuations, since their yield spreads over similar maturity Treasury bonds are quite narrow. We feel that we are not being compensated sufficiently for the higher credit risk. Despite such limitations, we did add selectively in this area. We have increased the portfolio's exposure to mortgage securities because we believe they are one of the few areas still providing some measure of value. Approximately 89% of the government/agency securities or 51% of the portfolio are agency mortgage-backed securities. An additional 4% is invested in AAA mortgage-backed securities. We have continued to add to our mortgage "Z" bond position. These are very long duration securities that provide very attractive yields in the 8.25% to 8.50% range. They represent 77% of the total derivatives exposure of 11%.

During the first quarter of calendar 1997, your Fund continued its historical trend of generating positive total returns during periods when the bond market experiences negative total returns. Your Fund's total return was a positive 0.56%* while both the Lehman Index and Lipper Average were a negative 0.86%. Your Fund was able to achieve this positive relative performance because it was maintaining a somewhat shorter portfolio duration as well as keeping a "barbell" maturity structure. The "barbell" strategy entails offsetting longer maturity bonds with higher levels of short-term liquidity. At March 31, short-term liquidity, or securities with maturities of less than one year, totaled almost 25% of total assets. We will deploy this liquidity when interest rates rise more, credit quality spreads expand or stock prices decline sufficiently to create some attractive convertible and straight bond investment opportunities.

Long-term Treasury yields are now above the 7% level, which is towards the higher end of a 6.25% to

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

‡ Reflects deduction of the maximum sales charge of 4.50% of the offering price

7.50% range that we have been writing about for the last three years. This recent rise has been fueled by investors' fears of accelerating economic growth. In our last shareholder letter, we expressed our opinion that economic growth was likely to come in at higher-than-consensus expectations. Since then, consumer confidence has risen to its highest level in 25 years and we are at record levels of employment as a percentage of the adult population. The initial estimate for first quarter GDP growth was recently reported at 5.6%, the highest in nine years. This strength now increases the probability that the Fed will raise short-term rates further. It would not surprise us to see another 50 basis point rise in the Federal Funds rate, in addition to the initial rise of 25 basis points on March 25. The debate continues as to whether we can have strong economic growth without any real acceleration in inflation. We still believe the pressures are building in terms of wage inflation and rising unit labor costs. The most recent data on wage inflation shows that it grew at a 4% rate over the past year. Our last shareholder letter argued that benefits inflation was on the verge of accelerating due to rising medical costs. In a January Foster Higgins survey of employers, it was reported that employers expect their average employee health costs to rise about 4% in 1997, after increasing just 2.5% in 1996. More troubling is that they expect costs to accelerate at a 10% rate in 1998.

Fears of accelerating economic growth and rising inflation are likely to keep longer term interest rates above the 7% level for a period of time. The magnitude of increase and the length of time that yields stay above 7% will be heavily influenced by the dimension of recovery of our foreign trading partners' economies and the continued growth of our own. Both of these will be especially important in the second half of 1997. We view this positively since we see fear as one of the key elements in creating attractive buying opportunities.

Our attention is still focused on the budgetary talks. Today, a tentative agreement has been reached on achieving a balanced budget by the year 2002. While no real details have been released yet, the details are the key. Previously proclaimed balanced budget agreements have been based on assumptions that are too optimistic. The President's most recent budget proposal would achieve its balance in 2002, with 99% of the cuts occurring in the final two years, after he has left office. Our initial analysis indicates that economic growth has to continue unabated throughout this entire period, that is, no recession can take place. Should this occur, the current economic expansion will have lasted more than 50% longer than the longest on record. We also want to see how this budget deals with the growth in entitlement spending. This has been an extremely contentious issue so that we are a little suspicious that major changes could be achieved so easily. Finally, we want to examine how other areas of the budget are dealt with, in particular, defense spending. We have witnessed negative real growth in this area since 1986. If this budget assumes the same, as in previous proposals, then by 2002 we will have witnessed sixteen years of virtually no real (adjusted for inflation) growth. The last time this occurred was after WW I. We hope that this is real budgetary reform, but we still maintain a high level of skepticism until we see the finer elements of this package. A fixed income investor must maintain a more cautious attitude towards investing since, with bonds unlike stocks, you cannot grow your way out of a problem.

We are patiently waiting before we deploy more liquidity into longer term securities. A higher level of yields will be required before this is done. We thank you for your continued support and investment in FPA New Income, Inc.

Respectfully submitted,

Robert L. Rodriguez

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

May 2, 1997