

# FPA NEW INCOME, INC.

## LETTER TO SHAREHOLDERS

Dear Fellow Shareholders:

This Annual Report covers the fiscal year ended September 30, 2008. Your Fund's net asset value (NAV) per share closed at \$11.06. During the fiscal year, your Fund paid four income dividends totaling \$0.49. There were no capital gains distributions.

The following table shows the average annual total return for several different periods ended September 30 for the Fund and 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.

	Periods Ended September 30, 2008					
	1 Year	5 Years	10 Years	15 Years	20 Years	6/30/1984 Inception
FPA New Income, Inc. (NAV)*	4.84%	4.03%	5.56%	6.05%	7.52%	8.97%
FPA New Income (Net of Sales Charge)**	1.17%	3.30%	5.19%	5.80%	7.33%	8.81%
Lipper A-Rated Bond Fund Average	(2.78)%	2.09%	3.87%	4.87%	6.60%	NA
Lehman Brothers Govt/Credit Index	2.41%	3.34%	5.00%	5.73%	7.19%	8.44%

The Fund's total rate of return for the fiscal year was 4.84%\* versus -2.78% and 2.41% for the Lipper "A" Rated Bond Fund Average and Lehman Brothers Government/Credit bond Index, respectively. For the second half of the fiscal year, the total returns were: FPA New Income, Inc., 1.19%\*; Lipper Average, -4.58%; and the Lehman Brothers Index, -3.12%. Finally, on a calendar year-to-date basis, the total

returns were: FPA New Income, Inc., 3.04%\*; the Lipper Average -4.41%; and the Lehman Brothers Index, -0.67%.

### Commentary

This shareholder letter will be a somewhat longer and difficult one for you to read but we hope that it will provide you both insight and confidence as to how we are managing your Fund during these tumultuous times, so please have the patience to persevere. We are very pleased to report that we have been able to provide an island of stability to our shareholders. Our philosophy of "winning by not losing" is again very apparent when you compare your Fund's performance to the relative benchmarks. During the past six months, both the Lipper "A"-Rated Bond Fund Average and the Lehman Brother's Government/Credit indexes produced significant negative total returns of -4.58% and -3.12%, respectively, while your Fund achieved a positive 1.19% return. Your Fund's return outperformed the 0.94% return of the three-month Treasury bill as well.

We believe the strategy that we have deployed over the last three years, as well as since we first wrote "Buyer's Strike" on June 16, 2003, has been severely tested and it has passed with flying colors. First, we have been unwilling to buy longer-term bonds when Treasury yields are in the 3% to 4% range since we do not believe they provide sufficient compensation for risk of future inflation or governmental policy changes. Second, starting in 2005, we began a process of increasing the credit quality above our already high standards so as to provide both liquidity and principal protection. While many investors and bond fund managers were reaching for the perceived benefits of higher yields through complex structured finance securities, we did not. This cost your Fund short-term relative performance since it appeared that it was losing out on the benefits of these higher yields. Now that this market has crashed and burned with virtually no market values available for these types of securities, we believe our prudence and discipline have been

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

\*\* Reflects deduction of the maximum sales charge of 3.5% of the offering price

rewarded. Finally, we eliminated virtually all credit risk from the portfolio, as exemplified by our having less than 0.4% exposure to the high-yield sector. It was June of last year that I made the comment on the Morningstar bond manager panel that, "I would not touch the high-yield sector with a 5,000 foot pole. There is insufficient compensation for credit risk and it would not surprise me to see this sector set a new all-time high yield spread in the next recession or crisis." At that time, the Merrill Lynch Master Index provided a yield advantage over a similar-maturity Treasury bond of 280 basis points and that was up from a recent record low 241 basis points. As of September 30, this spread had risen to 1096 basis points, above the 1076 record of 2002, and then proceeded to skyrocket to 1681 basis points on October 27. This has been the most devastating period for the high-yield market in history. While this was occurring, high-quality corporate bond spreads were also blowing out to record levels. The escalating credit crisis was responsible for these sectors coming under such severe strain. Your Fund did not experience virtually any of this negative price action because of our strategy of staying in Treasury bonds, selected government Agency securities and seasoned government Agency mortgage-backed securities that protected your Fund's principal value. We also had the advantage of being able to obtain real market prices for the securities we owned since they were of a vanilla nature. Nearly three years ago, Tom Atteberry and I agreed that the Fund would no longer be like Baskin & Robbins with 31 different flavors of debt securities. We would become a new ice cream store that specialized in only one flavor, vanilla. This strategy has proved to be very successful, especially in the past six months.

Because of our defensive portfolio posturing, the underperformance that we wrote about in our March 31, 2008 shareholder letter has been completely eliminated and then some. By not experiencing the losses that recently occurred in both the Lipper and Lehman benchmarks, your Fund's long-term relative performance has also improved materially. A

comparison of our March 31 shareholder report with this one will demonstrate this quite easily. This outcome reconfirms to us that protecting the downside, especially in a bond fund, is critically important and that is why we spend so much time trying to minimize our investment mistakes. As of September 30, your Fund is at its highest credit quality ever. Securities rated AAA or higher represent 99.6% while high-yield is 0.4%. Within the 99.6% AAA component, 74% are government/Agency securities, with cash and equivalents totaling 22%. We should also point out that we do not and have not owned debenture securities issued by the government Agencies of Fannie Mae or Freddie Mac for over two years. We placed these two issuers on our restricted list because of their inability to issue financial statements. In their place, we owned other Agency securities that were able to issue financial statements. We did this without any give-up in yield. In our mind, we could not justify lending money to an entity that was not filing financial statements unless we were investing in some type of corporate bankruptcy situation. Had other investors restricted these entities like FPA did, maybe these two agencies would not have gotten into the mess they found themselves in, which necessitated a governmental takeover via conservatorship. In addition to placing these companies on restriction, more than two years ago we reduced the number of companies qualifying for our commercial paper investment approved list by 75%. American International Group was one of those companies and thus, your Fund did not experience any of the negative fallout from AIG's problems or the rest of the commercial paper market which is now requiring governmental assistance. The entire FPA team is to be thanked for their dedication in this area as well.

Your Fund's September 30 duration was a short 1.07 years, which approximates the average duration of the Fund for the last five years. A short duration will protect your Fund from the negative effects of a rise in interest rates. This means the Fund has very little price volatility per unit of interest rate increase. On the other hand, should intermediate and longer-term interest

rates decline, your Fund will likely underperform the comparison benchmarks because of its short duration. We are unwilling to take the risk of a longer-term duration (maturity) with yields as low as they are presently. We will not extend the term of the securities we purchase until we are being appropriately compensated for the risk. For Treasury securities, this would require a yield in at least the mid-5% or 6% range.

One final thought, “would we consider buying high-yield securities now that their yield spreads are at an extraordinary wide level?” We are evaluating this question and if we do, it will most likely initially be in bank debt since it is first in line in the pecking order should a company fail. We are focusing on the highest-quality segment of high-yield market because we believe this credit crisis still has a long way to go and the negative effects of it on the economy are still to come.

## **Outlook**

The worst of the credit crisis still lies ahead, in our opinion. It will likely be driven by the increasingly severe economic contraction, which we expect to be far worse than what the consensus economic forecast is anticipating. If we are correct, the Federal Reserve, the U.S Treasury and the rest of the federal government will experience added stress.

Since the fourth quarter of 2007, we have argued that we were entering a recession and that it would be severe. Recent economic data appears to be confirming that we are in a recession and that it is getting much worse. The initial third-quarter real GDP report showed that consumer spending fell at a 3.1% annual rate. This was the sharpest decline since 1980 and the first drop in 17 years. The Conference Board’s September Consumer Confidence Index tumbled 23.4 points to 38, the worst reading since the index’s records first began in 1967, and the third-largest monthly decline on record. The devastation that has taken place in the consumer’s net worth because of declines in home values and stock prices is unprecedented, other than during the Great Depression. In light of this, the only way for the consumer to begin to climb out of the

financial hole that has been created by the collapse in his net worth is through actual saving. This means a lower level of consumption for a prolonged period of time. Earlier this year, before this latest phase of the credit crisis, we estimated that real GDP growth for the next five years was likely to fall to a low 2% annual growth rate from the 2.93% growth rate that took place between 2002 and 2007. This prior five-year period benefitted from the credit excesses that were available to consumers through lax lending standards that allowed consumption to rise from approximately 66% of GDP to 71%. This will not be the case over the next five years and, thus, we anticipate consumption returning to this prior level. This five-year growth expectation may prove to be optimistic, in light of the severity of impact on the economy from the credit crisis. For example, it is reasonably likely that the fourth-quarter nominal GDP report will actually show a negative growth rate. A negative nominal GDP decline has occurred only eleven times out of 244 reporting periods since the beginning of 1947. The last negative reading was the fourth quarter of 1990—a recession year that should prove to be milder than the current recession. We do not believe this potential negative outcome has been factored into investors’ general expectations. Additionally, 2009 will likely be the first worldwide recession year since 1981-82—a view that is not shared by the consensus. Finally, this negative economic outlook should result in a severe hit to corporate profits. During this past economic expansion, corporate profit margins rose to all-time record highs that we believe were positively impacted by the credit excesses. A 40% decline would only get them back to an average margin level that was experienced during typical inventory recessions. This recession is not an inventory recession but rather a capital destruction recession. It is far worse. Again, we do not believe this view is reflected by the consensus. Earnings expectations for 2009 are much too optimistic, in our opinion.

## Credit Crisis

Where to begin on this topic? This credit crisis is the worst of its kind since the Great Depression. During the past three years, we have tried to warn and detail what we thought might develop. This journey began with a discussion of a mortgage security backed by Alt-A mortgages in our September 30, 2005 FPA New Income shareholder letter. The negative credit trends that we saw developing raised the issue of unsound lending practices that might be taking place in the mortgage market. We followed this up by additional discussions on this topic. Our first ever **Special Commentary** section appeared in the March 2007 shareholder letter that detailed the excesses we believed were taking place in our financial system. Out of this letter was developed a speech I gave to the CFA Society of Chicago on June 28, 2007 entitled, "Absence of Fear." It detailed the risks and excesses in virtually every area of our financial system and concluded that "We see most investment sectors as providing little in the way of a margin of safety," and, "Investors/speculators, in all sectors of the investment universe, appear to be willing to engage in highly risky strategies or investments." This was followed up by "Credit Crisis" on January 22, 2008. In "Crossing the Rubicon," March 30, 2008, we stated that we believe "a new financial system is in the process of being created. This is the beginning of a new era." We also argued that, "The extraordinary actions taken by the Bernanke Federal Reserve reflect acts of desperation rather than long-term policy solutions." In essence, decisions are based upon expediency rather than well-reasoned long-term thinking. This type of thinking and action is what got us to this terrible place today. Finally, my associate, Steven Romick, wrote a wonderful commentary, "The Elephant(s) in the Room," September 23, 2008, that details the critical issue of the destruction of bank capital and how the new salvation of the \$700 billion "rescue/bailout" program does not address this issue. All of these commentaries may be found on our website at [www.fpafunds.com](http://www.fpafunds.com) under *Latest News*. They are a good source for better understanding of what is taking place today in this crisis.

This rehash of history demonstrates that a potentially serious crisis has been in our thinking for several years and, thus, we believe we have a very good basis to evaluate, criticize and estimate what the likely outcome may be. Since the middle of last year, our opinion has been that the Federal Reserve and the U.S. Treasury Department did not understand the nature and size of the challenge they were facing. We argued that the issues developing in subprime and Alt-A mortgage-backed securities were more akin to canaries in the financial industry coal mine. When they died, instead of seeing a serious problem in the financial system, they thought they just had sick canaries. Both the Fed and Treasury viewed the developing crisis as one of being a liquidity crisis rather than a capital crisis. We were of the view that the demise of the structured-finance market would lead to a shift to the left in the supply curve of credit and thus, for any price level for credit, the supply provided would be less. The collapse of the structured-finance market would hammer the valuation of these types of securities and, thus, serious charge-offs were in order for institutions that held them. The destruction of capital within our banks and insurance companies would lead to a lending contraction of the first order. In our opinion, both the Fed and Treasury were addressing the symptoms of the disease, Liquidity, rather than the disease itself, Capital Destruction. All of the newly developed programs by these two organizations have been about restoring liquidity to the system. Until the capital destruction question was addressed, we viewed these new programs as haphazard, ad hoc and likely to be ineffective. The July \$200-billion backstop program to support both Fannie Mae and Freddie Mac again reflected questionable thinking by both these organizations as well as Congress.

The core issue is that bad loans were made to individuals and other borrowing entities that cannot support them with their current income, and the underlying asset values have declined below the amount of debt owed. All actions taken to date have been about delaying or obfuscating this issue rather than dealing with a classic debt deflation problem. We

view the actions taken as being short-term oriented as well as expedient and that they will most likely prove costly in the long run. Until these questionable assets are allowed to clear at market values, we will travel a long and arduous path to economic recovery.

Since August of last year, nearly \$360 billion of private sector capital has been thrown at troubled financial institutions in the U.S. and \$688 billion worldwide, according to Bloomberg's October 31, 2008 estimate. What is so disappointing is that nearly all of these capital infusions are at a loss. Private sector capital has become quite scarce because there is no confidence in counterparty balance sheets; therefore, the federal government is attempting to ride to the rescue. The newly enacted \$700 billion Troubled Asset Relief Program (TARP) is another attempt to address liquidity issues while beginning to bolster capital in our banking system. \$250 billion of this total is to be invested in a number of banking institutions of varying size through 5% senior preferred stock. Unfortunately, we are of the opinion that the TARP, as presently designed and being implemented, has serious and fundamental flaws. It was crafted under extreme financial and political pressures that do not lend themselves to a holistic approach in dealing with the crisis. Among the flaws we see is that there are no requirements that this cheap capital be lent out. It is implied but not legally required. Those that are accessing this program do not have to cut or eliminate paying dividends to their shareholders. In our opinion, if banks or other financial institutions believe they have to access government capital, dividends should not be paid out to shareholders so as to accelerate the rebuilding of the financial institution's capital. If they do not like this feature, let them go to the public market for capital. It will be far more costly. Will this new capital attract private capital? This is a key question that revolves around trust and confidence in financial statements. At present, there is virtually no confidence in financial-company balance sheets. At one point this year, both Fannie Mae and Freddie Mac were said to have sufficient capital and access to capital by regulators, various politicians and administration

officials. We were of a different opinion since we placed both of these companies on our restricted list for purchase of their debt securities more than two years ago. On October 29, Fannie Mae took a valuation allowance that wiped out \$20.6 billion of its \$47-billion regulatory capital as of June 30. Several transactions have taken place in the banking sector where the companies were acquired at a small fraction of their stated equity value. For the Treasury and the Fed to attract large levels of private capital, we believe a new template must be created. We thought a possible template might be in the form of the Citigroup Inc. acquisition agreement with Wachovia Corp. The potential losses on Wachovia's balance sheet were to be capped at \$42 billion by the government, while the government would co-invest \$12 billion in a preferred stock, with Citigroup raising an additional \$10 billion in new capital. Citigroup could raise this new capital since new investors would have a better idea of the potential risks. This transaction did not go through because Wells Fargo & Co. made a higher offer after a tax rule was changed that made it more attractive for Wells Fargo to bid for Wachovia. At this time, we do not know what the relative long-term merits are of one strategy over the other. We do believe that if we do not see material downward movement in credit spreads and the deployment of new private capital into the banking system shortly, the TARP will likely prove inadequate and, thus, we could face a new phase in the credit crisis. Furthermore, we are of the opinion that the problem loans that reside in our economic system could be as high as \$2 trillion, while we have seen other estimates that run as high as \$2.8 trillion. Should this estimate prove to be accurate, will the TARP be sufficient? We do not know.

Both the Treasury and the Fed have moved to secure other areas of the financial system by temporarily guaranteeing money-market mutual funds, creating a \$600-billion commercial paper purchase program, partially guaranteeing bank debt for a period of time, providing back-up guarantees of \$300 billion to our Government Sponsored Enterprises (GSE), purchasing 79.9% of American International Group

and now reformulating a prior plan that will increase the government's cash contributions from \$83 billion to more than \$160 billion, and increasing FDIC insurance to \$250,000 per account until January 1, 2010. The array of actions taken by the Fed and Treasury has been nothing short of stunning. Our most negative scenario never envisioned all of these actions.

What do all these new funding, guaranteeing, capital injections mean to us? We are unsure what the long-term consequences of these actions will be. We do know that once the genie is let out of the bottle, it is very difficult to get him to go back into the bottle. Once we have guaranteed money-market funds, provided public-sector funding for commercial paper, made direct investments into various types of financial institutions and "temporarily" increased the FDIC deposit guarantee to \$250,000, how do we return back to a market-based economy? Once you go down this road, the markets know that in the future, if there is a problem, the government will ride to the rescue. This template is personified with what took place in September when the federal government placed both Fannie Mae and Freddie Mac into a conservatorship. We were told for years that these were independent private companies that had a limited line of credit to the U.S. Treasury. Once they got into trouble, they were "too big to fail" and now their more than \$1.7 trillion in corporate debt and more than \$5 trillion in mortgage-backed securities are effectively guaranteed by the federal government. These are two good examples of the unsound concept of privatizing profits while socializing risk. There is no question that large segments of our financial-services industry have been socialized or partially nationalized, depending upon your choice of words. All of these programs require the U.S. government to either issue substantially more Treasury debt or have the Federal Reserve print more money. We estimate that Treasury borrowings have the potential to increase, over the next twelve months, by \$1.5 to \$2 trillion above what would have been scheduled to be borrowed. These borrowings would be in addition to an escalating budget deficit that may rise to \$1 trillion in 2009 because of declining tax receipts

and a fiscal stimulus plan that could be \$350 billion. Hopefully, the new stimulus plan will be much better designed than this year's plan, which accomplished very little. What will be the impact from this huge increase in borrowing upon interest rates? We do not know other than the yield curve may end up being steeper and thus, intermediate and longer term yields remain elevated. In addition to the increase in debt borrowing, the Federal Reserve's balance sheet has grown from \$800 billion, in the middle of September, to \$1.8 trillion, by the third week in October. At the current pace of growth, along with the addition of the newly announced liquidity support programs, within the next 60 days, we could witness its balance sheet rising to \$3 trillion. A large portion of this increase will be funded by the printing of money.

To say that we are concerned about these trends is a gross understatement. In the short run, one to two years, we anticipate disinflation or in some economic segments, deflation. What concerns us is the period that covers three to ten years from now. We believe that inflation will be a more significant issue than is currently anticipated by the consensus and, thus, this poses a potentially serious risk to our financial system. Currently, it appears this risk is not much of a concern to the various sectors of government or to the financial markets. Their primary concern is "how do we get the economy out of this mess, and don't worry about what will take place beyond the near term." During the last thirty years, it has been this type of short-term thinking that has led to this predicament. At First Pacific Advisors, we worry about a longer-term horizon, as exemplified by our commentaries on our website and in our shareholder letters and, thus, we were in a good position to weather this crisis effectively. Our concern is for the future generations of Americans that will be forced to pay a high price for the unsound financial practices currently taking place. Unless spending is brought under control at all levels of government and the American public relearns what it is to be financially prudent, this nation will likely face a difficult and volatile future. We are hopeful but highly concerned.

With these closing comments, Tom Atteberry will convey his thoughts to you.

### **Thomas H. Atteberry Commentary**

While we have maintained a very conservative investment posture focused on preservation of capital, we have been actively seeking out investment opportunities that complement this posture. Portfolio investments have focused in three distinct areas, the Agency-backed mortgage segment of the bond market, with securities backed by mortgages issued prior to 2005, and prepayment structures focused on average lives of 2-5 years. The second area is securities that benefit from inflation activity, and lastly, to a unique Mortgaged-Backed Interest Only security.

As financial institutions of all types have tried to de-lever and raise capital, they have attempted to sell their most attractive mortgage holdings as those are the ones that can bring them the best price. We have found this activity a very fertile hunting ground.

The largest area in which we took advantage of this forced selling of assets was in seasoned mortgaged-backed securities issued by either FNMA or FHLMC. The basis for these investments was as follows: First, it is our opinion that the turnover rate in existing homes would decline during 2008 and 2009, which would result in a lower prepayment speed for our purchases. If we concentrated on those mortgages issued prior to 2005, then the decline in house values would have less of an impact, given that the asset we had lent on probably experienced some price appreciation after it was underwritten. Additionally, these older mortgages tend to have better underwriting standards. We concentrated on mortgages which had interest rates of 5.50% to 6.50%. The idea was that in this range of rates the borrower would not be in a strong position to re-finance the mortgage. We also felt that mortgage rates in general would not decline significantly below these levels, given tighter underwriting standards and high fees from FNMA and FHLMC. Finally, by investing in older mortgage loans, the borrower had passed through at least one re-finance

opportunity and for some reason had chosen to maintain the current loan. From a price perspective, we paid slightly over par for all the bonds purchased. Over the past year we have accumulated this position with a range of expected yields-to-maturity of between 4.25% and 5.45%, with corresponding average lives of between 1.4 and 5 years.

The next most significant investment we have made over the past year actually started in January 2008 and now represents 3% of the portfolio. The portfolio has been systematically accumulating a position in GNMA Project Loan Interest Only Securities. The loans that back these securities consist of permanent mortgage loans on government-assisted housing and nursing homes or other assisted-living facilities for the elderly or disabled. In each case, the facility has a certificate of need from the community in which it is located. These loans are a little different and contain several provisions designed to limit the ability to be refinanced. The loans have a prepayment penalty period that may last up to 7 years and there is a penalty for early retirement of the debt prior to the end of the penalty period. This feature goes a long way to limit the prepayment risk, which has a negative impact on an interest-only security, as the security receives only interest payments and no principal payments. The longer the loan is in existence, the longer the interest payment stream and, thus, the more valuable the Interest Only bond. If for some reason the loan is paid off during the prepayment penalty period, that prepayment penalty payment is allocated to the Interest Only bond holder, so in effect it is a windfall which improves return by a substantial amount. Therefore, our most significant risk is a pure default from non-payment, which results in GNMA paying off the loan. After we factor in default history and loan amortization the resulting yield to maturity on our purchases have been between 7.90% and 8.50% for a bond that is expected to have an average life of 4.5 to 6.5 years. This GNMA Project Loan program has been around for over 20 years and there is very detailed data on defaults and loan performance. We are very

confident that the loss expectations and prepayments should result in the bonds producing the returns listed above. We will continue to accumulate this type of security until such time as we can obtain a 5% portfolio allocation. This of course assumes that the return profile continues to be attractive.

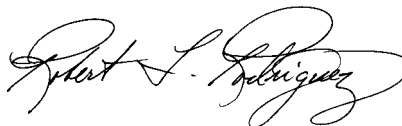
The other area of investment that makes up 5.1% of the portfolio is inflation-linked securities. 80% of this allocation is to Treasury Inflation Protected Securities (TIPS) with a maturity range from April 2010 to January 2012. The other 20% of this allocation is a Toyota Motor Credit Inflation Linked Note due September 10, 2013, which is rated AAA by both Moody's and Standard and Poor's. Each month the Toyota coupon resets based on the year-over-year change in the Consumer Price Index plus 0.80%, or 80 basis points. The first two coupons for the bond have been 5.82% and 6.40% on an annual basis. Even if inflation slows over the next year, we are comfortable that the income generated from this security should be greater than income generated from cash equivalents and it should be a good income hedge to changes in inflation. The extra income generated today is expected to cushion the bond's price if inflation declines to more moderate levels over the next year.

Our purchase of the TIPS bonds at the close of the third quarter has turned out to be premature. While the real yields on these purchases, between 1.70% and 1.90%, were attractive at the time, since the end of the third quarter, prices on these securities have declined and the real yields now stand at between 3.76% and 5.21% as of the end of October. Over the life of these securities it is our opinion that inflation will be higher than the implied rate that existed at both the time of purchase and today. At the time of purchase the implied inflation factor, or the difference between the yield on the TIPS bond before factoring in inflation and the yield on a corresponding nominal Treasury note, ranged between 0.35% over the next 1.5 years to 0.74% annual inflation for the next 3.5 years. While attractive

in comparison to a historical inflation of on average better than 2%, investors have now factored in a disinflation viewpoint. Based on prices at the end of October, that implied inflation now ranges between -3.87% annual inflation for the next 1.5 years to -1.73% annual inflation for the next 3.5 years. Not since the period of 1930 to 1933 has the economy experienced such a negative inflation number. At this point it is our view that this is a low-probability outcome; nonetheless we were early in our purchase and did not correctly factor in the change in sentiment regarding inflation that has accompanied the acceptance of a potentially severe recession.

We hope this extended shareholder letter helps you better understand the nature and complexities taking place in this credit crisis and what actions we have taken in the management of your Fund. We thank you for your support, patience and trust during these challenging times.

Respectfully submitted,



Robert L. Rodriguez  
President and Chief Investment Officer



Thomas H. Atteberry  
Vice President and Portfolio Manager

November 10, 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.