FPA Capital Fund, Inc.
First Quarter 2017 Commentary

You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. The Prospectus details the Fund's objective and policies and other matters of interest to the prospective investor. Please read this Prospectus carefully before investing. The Prospectus may be obtained by visiting the website at www.fpafunds.com, by calling toll-free, 1-800-982-4372, or by contacting the Fund in writing.

Average Annual Total Returns
As of March 31, 2017

	Since 8/1/84*	20 Years	15 Years	10 Years	5 Years	3 Years	1 Year	YTD	QTR
FPA Capital Fund, Inc.	13.35	8.76	7.15	4.32	3.73	-3.02	18.09	-3.73	-3.73
Russell 2500	11.80	9.85	9.17	7.71	12.60	7.43	21.53	3.76	3.76

Periods greater than one year are annualized. Performance is calculated on a total return basis which includes reinvestment of all distributions.

* Inception of FPA management was July 11, 1984. A benchmark comparison is not available based on the Fund's inception date; therefore data from August 1, 1984 is presented.

Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. This data represents past performance and investors should understand that investment returns and principal values fluctuate, so that when you redeem your investment it may be worth more or less than its original cost. The Fund's expense ratio as of its most recent prospectus is 0.77%. A redemption fee of 2% will be imposed on redemptions within 90 days. Current month-end performance data may be obtained at www.fpafunds.com or by calling toll-free, 1-800-982-4372.

Dennis Bryan and Arik Ahitov have been co-portfolio managers since November 2007 and February 2014, respectively, and manage the Fund in a manner that is substantially similar to the prior portfolio manager, Robert Rodriguez. Mr. Rodriguez ceased serving as the Fund's portfolio manager effective December 2010.

Please see important disclosures at the end of the commentary.

Déjà vu

One of the side effects of running a highly focused portfolio is volatility. We do not mind that volatility because, paraphrasing Warren Buffett, we prefer a higher return that is lumpy over a lower return that is smooth. This is especially true if that volatility allows us to add to our positions at a low price and trim our positions at elevated prices. At one point during last year's first quarter, our portfolio returned -13.26%. We ended the year up 22.86%. This quarter was another one of those where a number of positions worked against us and our portfolio returned -3.73%. For the fiscal year ending March 31, 2017, the portfolio was up by 18.09%. Our energy investments, collectively, detracted -2.02% from our performance for the first quarter of the year; however they contributed 6.95% to performance for the trailing twelve month period. Large detractors for the fiscal year were Babcock & Wilcox Enterprises (-2.45%) and Vista Outdoor Inc. (-0.82%). We will highlight them later in this letter. Last year, we mentioned that despite some of the "hits" the portfolio had taken, there were catalysts that could lift many portfolio companies up substantially. Our objective has been to construct our portfolio similarly for this year.

Market commentary

There is a new sheriff in town.

On Election Day 2016, your Portfolio Managers talked late into the night discussing which stocks we would buy the next morning. We had a list of 11 (including many existing portfolio holdings). The futures market was down about 10% with the news that the next president of the United States would be Donald Trump. Early the next morning, we had to draw up a different list. What are we selling into this strength? As of the end of the first quarter 2017, the Russell 2500 index is up 14.78% since the Nov. 8, 2016 presidential election. Investors decided President Trump's programs would stimulate the economy. It is hard to disagree with the market's conclusion when we consider each component of his platform independently: tax reform, defense spending, infrastructure spending, fewer regulations, etc. We believe that any one of those, in a vacuum, could be very beneficial to the U.S. economy, and hence, to stock prices.

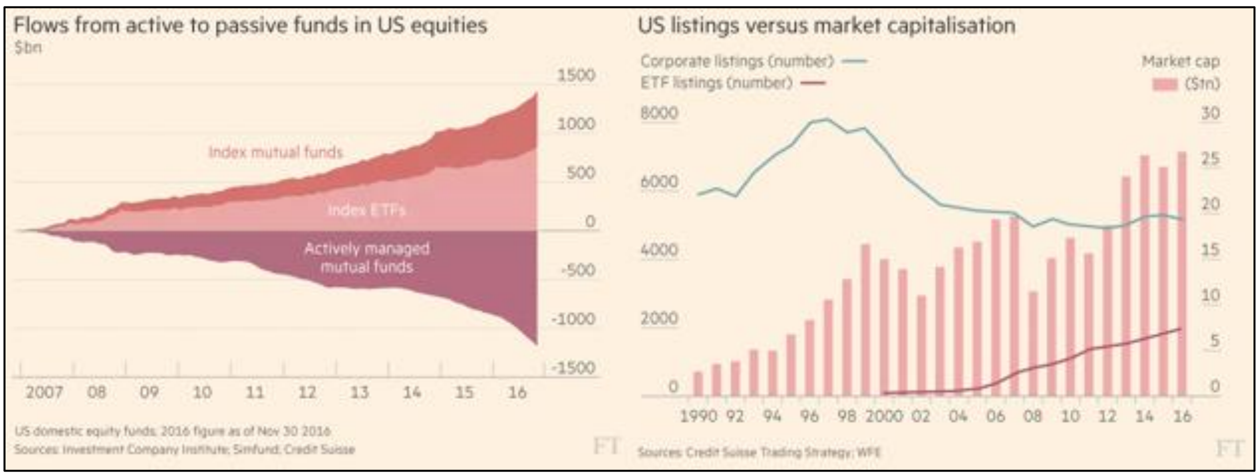
In reality, however, no clear progress has been made in any of those areas. Cabinet appointment confirmations have been taking longer than expected, and a number of them have been very contentious. Additionally, President Trump's tweets continue to divide an already divided country, so why should we expect any bipartisanship today? How will the president's legislative agenda move forward without bipartisan agreement? The market is pricing in success, but what about failure or a substantial delay? Despite control of both houses of the United States Congress, the Republican Party failed to repeal the Affordable Care Act. We would not call this a good start.

Then there are the inconsistencies. For example, President Trump pledged to make blue-collar workers relevant again, but he is talking about tariffs, which could result in a stronger dollar. The higher dollar may make U.S. manufacturing less competitive and endanger blue-collar jobs. In our opinion, a Border Adjustment Tax would likely result in higher consumer prices, which would hurt financially strapped blue-collar workers. Cutting taxes helps companies, but how would the government plug that hole in revenue and increase defense and infrastructure spending at the same time? Chair Janet Yellen's Federal Reserve raised interest rates at the March 15 meeting and we believe more interest rate hikes are expected. Higher interest rates mean higher outlays by the government for interest expense on its debt (further widening the budget gap).

The same is true for companies. The total debt outstanding for Russell 2500 companies is $2.1 trillion (vs. a market capitalization of around $4.8 trillion). Every one percent rate increase would translate to over $20 billion of additional interest expense over a period of time (assuming a parallel shift up in the yield curve). Even if all the efforts to stimulate the economy work without a hitch, we would most probably end up with higher inflation (do people still remember what inflation means?).

Are ETFs the new weapons of mass destruction?

Notwithstanding any of the concerns mentioned above, investors appear excited about the future as they continue to pour money into the stock market. They express this excitement by allocating a tremendous amount of capital into index funds and Exchange-Traded Funds (ETFs). Last year, passive funds had $563 billion of inflows, while active funds experienced $326 billion of outflows, according to Morningstar. Active U.S. equity funds manage $3.6 trillion and passive instruments are about to catch them at $3.1 trillion.[1] When we add the $124 billion poured into ETFs in the first two months of 2017,[2] active and passive investments are almost at parity. This does not even include the so-called active managers that tend to hug an index. The long-term trend is very pronounced. Since 2007, $1.2 trillion dollars disappeared from actively managed U.S. domestic equity funds and $1.4 trillion dollars were added to passive strategies. As the number of corporate listings continues to dwindle, more and more ETFs are brought to the marketplace. This leads to more ETFs (financial vehicles), some of which use leverage, chasing fewer and fewer actual companies. Financial vehicles using leverage to purchase a shrinking pool of real assets—sound familiar?[3]



The consequence of unrelenting inflows into passive funds is that stocks that are included in a major index receive ongoing support by the indiscriminate purchases made by these funds regardless of a company's fundamentals. The benefits are amplified for companies that are owned by dozens of ETFs and index funds. On the flip side, those unfortunate stocks that are not included in a major index receive the reverse treatment, as active managers that tend to be fully invested are forced to sell shares to meet the onslaught of redemptions they are facing. But the worst fate is saved for those orphan securities that are removed from an index. These stocks face both indiscriminate selling from index funds on their removal date and continued redemption-related selling from actively managed funds. Unfortunately, these buy and sell decisions are entirely disconnected from a company's fundamentals. This potentially sets the stage, should the tables turn, for an exceptionally compelling investment environment where companies with strong fundamentals are available for purchase at cheap valuations for those searching outside of the indices (as we often are).

Moreover, as more investors move from active to passive investments, the market for many individual stocks becomes less liquid. With reduced liquidity, we expect increasing volatility in the marketplace. Last month Kopin Tan wrote in Barron's, "For weeks, the stretch from 3 p.m. to 4 p.m. became known as the market's happiest hour, since a surge in late-day buying often nudged indexes from the red into the green. This happened because ETFs and passive index funds, unlike actively managed ones, must rebalance by the end of the day to match the benchmarks they track. According to JP Morgan, a whopping 37% of daily New York Stock Exchange trading recently took place in the last 30 minutes of each session. But when the indexes turn down, will this be the unhappiest hour?"[4]

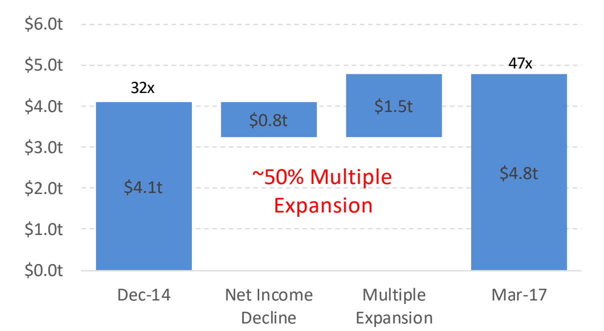
[1] http://www.cnbc.com/2017/02/18/massive-exodus-continues-from-active-funds-and-vanguard-is-reaping-the-gains.html
[2] https://www.wsj.com/articles/small-investors-run-to-etfs-1488586244
[3] https://www.ft.com/content/6dabad28-e19c-11e6-9645-c9357a75844a
[4] http://www.barrons.com/articles/does-oils-slide-signal-weakening-growth-1489210612

The weapons of mass destruction during the Great Financial Crisis were three-letter words: CDS (credit default swap), CDO (collateralized debt obligation), etc. The current weapon of mass destruction is also a three-letter word: ETF (exchange-traded fund). When the world decides that there is no need for fundamental research and investors can just blindly purchase index funds and ETFs without any regard to valuation, we say the time to be fearful is now.

What about the fundamentals?

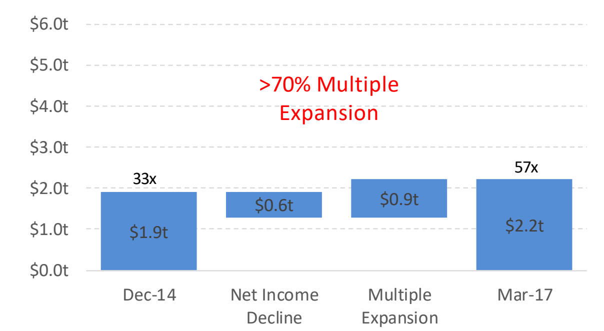
While the indices have all rallied substantially, the fundamentals have not kept pace. In the analysis below, we looked at the performance of the Russell 2500 constituents (as of December 2014). The cumulative market cap of these companies has grown 16% from the end of 2014 through the end of first quarter of 2017 and yet the decline in net income was nearly 20% in 2016 (as shown below) over the past two years. Essentially, stock appreciation has come entirely from multiple expansion. Our analysis also showed that 32% of the companies in the Russell 2500 had negative income in 2016 (about the same as in 2015). Furthermore, when we narrow the Russell 2500 down to the universe of companies with market caps ranging from $1 billion - $4 billion (our sweet spot), we can see that those companies have seen an even more pronounced disparity between their cumulative market cap gain and their deteriorating fundamentals. Net income for this set of companies actually declined by 32%, yet the cumulative market cap grew by over 15%, driven entirely by multiple expansion.

The Rally In the Russell 2500 Is Not Driven By Improvements In Fundamentals



Source: FPA Analysis & CapIQ

For Companies With Market Caps Between $1-4b The Contrast Is Even More Stark



Source: FPA Analysis & CapIQ

Interestingly, according to the Bespoke Investment Group, during March 2017, the 50 S&P 500 stocks with the highest price to earnings ratio lost 0.9% of value. On the other hand, the 50 stocks with the lowest price to earnings ratio lost 4.3% of value. The 50 stocks that experienced the greatest price increase in the first two months of 2017 appreciated another 0.3% in March 2017, whereas the worst performing 50 S&P constituents experienced yet another 3% decline.

What are management teams doing as stock indices continue climbing higher? Evidently, they are selling. According to Vickers Stock Report's latest count, insider sales were eleven times larger than purchases – which amounts to a 3.5 standard deviation above the mean.[5] Another research firm, Washington Service, reported that both total insider buys and the ratio of buyers to sellers were at their lowest points since at least 1988 (29 years). To put it in perspective, there were 3,200 insider buyers in November 2008 and only 279 in January 2017.[6] In the face of these cautionary signs, what are the investors doing? The investors are so excited about the market that margin debt hit an all-time record in February 2017. They borrowed $528.2 billion against their brokerage accounts.[7] Margin debt was also at peak levels in 2000 and 2008. Since 2009, global investors decreased their cash positions to a two-decade low and increased their stock weighting by over 60% (almost no change in fixed income).[8]

5 http://www.cnbc.com/2017/02/28/company-insiders-are-dumping-stock-at-levels-rarely-seen-report-indicates.html
6 https://www.wsj.com/articles/corporate-insiders-havent-been-this-uninterested-in-buying-stocks-since-ronald-reagan-was-president-1489055409?tesla=y&utm_medium=email&utm_source=newsletter&utm_term=170310&utm_campaign=moneystuff
7 https://www.wsj.com/articles/margin-debt-hit-all-time-high-in-february-1490825475?tesla=y&utm_medium=email&utm_source=newsletter&utm_term=170330&utm_campaign=moneystuff
8 https://www.bloomberg.com/news/articles/2017-03-07/cash-dwindling-to-two-decade-low-in-global-investment-portfolio

This relatively dramatic increase in valuation without a commensurate improvement in financials is a key driver of the recent rise in our cash balance. Broadly speaking, when prices rise, there are fewer and fewer opportunities to purchase undervalued stocks. What's more, existing stocks in the portfolio begin to approach our exit prices. While this part of the cycle can be frustrating for value investors like ourselves because our hunting grounds shrink, we hold firm to the belief that stock prices cannot remain untethered from fundamentals indefinitely. Ultimately, we believe that the higher stock prices rise without improving company fundamentals, the harder they will fall. And if they do, we will be ready to deploy the capital that you have entrusted us with at much more attractive valuations than what's available today.

Portfolio commentary

Q1 2017 Winners[9]	Performance Contribution	Q1 2017 Losers[9]	Performance Contribution
Western Digital Corp	1.41%	Babcock & Wilcox Enterprises Inc	-1.75%
DeVry Education Group Inc	0.36%	Vista Outdoor Inc	-0.68%
Cubic Corp	0.16%	Arris International Plc	-0.64%
Akorn IncInc	0.13%	SM Energy Company	-0.41%
AGCO Corporation	0.09%	Cimarex Energy Co	-0.39%

Fiscal Year Winners[10]	Performance Contribution	Fiscal Year Losers[10]	Performance Contribution
Western Digital Corp	4.57%	Babcock & Wilcox Enterprises Inc	-2.45%
DeVry Education Group Inc	2.64%	Houghton Mifflin Harcourt	-1.64%
InterDigital	2.05%	Vista Outdoor	-0.82%
Patterson-UTI Energy	1.75%	Undisclosed 1	-0.17%
Dana	1.41%	Barnes & Noble	0.00%

[9] Reflects the top contributors and top detractors to the Fund's performance based on contribution to return for the quarter. Contribution is presented as gross of investment management fees, transactions costs, and Fund operating expenses, which if included, would reduce the returns presented. This is not a recommendation for a specific security and these securities may not be in the fund at the time you receive this report. Past performance does not guarantee future results.

[10] Reflects the top contributors and top detractors to the Fund's performance based on contribution to return for the Fund's fiscal year ended March 31. Contribution is presented as the gross of investment management fees, transactions costs, and Fund operating expenses, which if included, would reduce the returns presented. This is not a recommendation for a specific security and these securities may not be in the Fund at the time you receive this report. Past performance does not guarantee future results.

Energy investments

Energy – a sector that had generated higher returns for us in 2016 – struggled in the first quarter of 2017. Russell 2500 energy companies were down 9.12%, representing 4.26% underperformance vs. the index. We view the sector's weakness as a speed bump on the road to market rebalancing and higher oil prices. Our conviction in this thesis remains firm, as the Organization for Economic Co-operation and Development (OECD) inventory (the proxy for global storage) draws suggest that the market has been under-supplied since Q3'2016. Additionally, OPEC and 13 additional countries have accelerated reductions in excess inventory by largely complying with their November agreement to cut production by 1.8 billion barrels per day (bpd). Meanwhile, global demand has been consistently revised upward. So why have oil prices declined during the quarter? There are a few primary reasons, all of which we believe will prove short-lived.

The first is simply investor impatience surrounding U.S petroleum stocks, which we believe remain stubbornly high relative to the rest of the world. We would note here that weekly imports have been trending downward since January[11], just as refining utilization is set to ramp up after a particularly heavy maintenance season. At the same time, OECD Europe & Asia Pacific stocks have been falling sharply toward their respective long-term averages since mid-2016. The second issue is anxiety about a resurgence in U.S. shale supply. Indeed, the domestic rig count experienced a notable acceleration since November, while crude production has bounced back by over 600,000 bpd over the last five months. Interestingly, The Energy Information Agency's (EIA) data show that more than 100% of the increase from September to December 2016 came from Alaska and federal offshore projects, not from the lower 48 states. Moreover, U.S. production alone is simply insufficient to offset the onslaught of OPEC production cuts, limited OPEC spare capacity, historically muted production gains outside OPEC and the United States, multiple years of lower global capital investment, natural production decline rates, and, yes, steadily growing global demand. Further, there are multiple underappreciated headwinds to U.S. production growth, including service bottlenecks, levered balance sheets, potential imbalances between high- and low-density crude supplies, and a limited footprint of tier-one core acreage.

Finally, many investors worry OPEC will scale back recent cuts in response to surging U.S. shale production. We believe a Saudi-led extension of the cuts is more likely than not, because the International Monetary Fund estimates that the kingdom needs at least an $80 oil price to balance its (slimmed down) budget, and because of Saudi Arabia's publicly acknowledged goal this year of reducing global storage levels back to their five-year average. Moreover, OPEC sources have indicated that the group's members increasingly favor an extension beyond this June.

Let's end with some simple math to better illustrate why those concerned with today's oil market concerns may be missing the larger picture. On the demand side, the International Energy Agency expects global oil demand to grow by 6 million bpd from YE2016 to YE2022. On the supply side, the EIA estimates that OPEC currently has 2 million bpd in spare capacity (just 3% of global supply); U.S. production is expected to increase by just 800 million bpd by YE2018; and Non-OPEC ex. U.S. production growth has not budged since 2010 while investment has fallen off a cliff. Add in a supply shock emanating from Venezuela, Nigeria, Libya, or elsewhere and the situation becomes more precarious, and yet constructive for higher oil prices. These are the asymmetric scenarios that we look for, and we are confident that our high quality energy companies are well positioned to benefit in this environment going forward.

Babcock & Wilcox Enterprises, Inc. (NYSE: BW)

Babcock & Wilcox Enterprises (BW) is a leader in the construction of power generation systems. The company has an operating history of 150 years (founded in 1867). Babcock & Wilcox designs, engineers, constructs, installs, and services utility and industrial boiler plants, scrubbers, steam generators, environmental control systems, power plant equipment, air pollution control systems, etc. It manufactures large components such as burners, generators, and boilers that can be fired up by many different energy sources (coal, waste, etc.). The company operates three segments: Power (62% of revenues), Renewables (22% of revenues), and Industrial (16% of revenues, but will be higher pro-forma of their latest acquisition).

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[11] Cornerstone Analytics: The Morning Energy Update dated April 3, 2017.

We were initially intrigued by the company's leadership position in its markets, the CEO's experience at larger companies and keen focus on cost cutting, the company's large backlog that provides visibility to future revenues, and our belief in BW's ability to apply its expertise to similar products and different geographies.

We initiated a position in the third quarter of 2015, and the company executed in-line with our expectations. BW spun out its nuclear business, which we subsequently sold at a gain. The company generated strong free cash flow and used it to either buy back stock or make acquisitions that diversify them away from coal. All was going according to plan until March 1, 2017, when BW reported its fourth quarter 2016 earnings and announced a number of project errors in their Renewables division (the other two divisions performed well).

We believe the errors occurred because the company has been emphasizing its goal to increase BW's valuation multiple by decreasing its reliance on coal. In order to achieve this, the company may have grown the Renewables business too fast. Upon bidding and successfully winning a number of projects with its superior technology, BW simply did not have enough engineers at the right time. BW has replaced the top three managers in the Renewables business, reviewed each project in detail, and identified seven problem projects. The company replaced on-site managers, and halted bids on any new projects for six months so it could focus on execution and getting the issues under control. In our view, BW's problems are confined to only one business segment.

When one examines closer, the Renewables business itself could be separated into three divisions: operations & maintenance, technology, and architectural engineering. The operations & maintenance businesses is doing well. The technology BW provides (boilers and grates) is considered superior to that of their competitors. The company has a good technology solution in waste-to-energy (burns almost anything the client wants at high capacity). Where BW struggled was the architectural engineering section. This is the lowest margin, highest risk part of the segment, and there is no reason for BW to perform this phase of any project. The company can simply partner with a different firm – a strategy the management team agreed with in our subsequent conversations.

There is no denying that the management team made a strategic mistake and the company is in the penalty box. On the day of the announcement, BW's stock price decreased by 37%, wiping out $300 million in market value. When we sharpened our pencils and calculated the new normalized earning power of the company (not what they will earn in 2017 when they are working through their problems, but what we expect them to earn over the long-term), we calculated a deterioration of $4 million per year. How the market reacted to this development ties really well to what we wrote about in the market commentary section of this letter. There is simply not enough liquidity in the market for companies with smaller market capitalizations.

Vista Outdoor Inc. (NYSE: VSTO)

Vista Outdoors ("VSTO") derives 56% of revenue from its Shooting Sports segment, which sells consumer ammunition predominantly, and long-gun firearms to a much lesser extent. The remaining 44% of revenue comes from the Outdoor Products segment, which consists of a portfolio of leading brands in firearm accessories, hydration products, water sports, grilling, and action sports helmets. The company is the market leader in all of its primary categories and has a consistent history of profitability.

We initiated a small position in VSTO prior to the 2016 election (smallest position in the portfolio as of Nov. 8, 2016 at less than 50bps). We opted for the small position because of the company's brief independent operating history (VSTO was spun out of ATK in 2015), the limited visibility into how the election would impact the business, and the lower reward-to-risk ratio relative to our opportunity set.

Our thesis at initial investment was that the stock price did not fully reflect VSTO's ability to grow earnings over the long term for two reasons. First, despite event-driven cyclicality issues (elections, terrorism, gun control media coverage, etc.), we believe demand for Shooting Sports products should benefit from an industry that now has many more shooting participants (+17 million new shooters from 2009-14), including a higher proportion of women (50% of new shooters) and young people (68% of new shooters).

Further, this larger pool of participants is more interested in target practice than hunting, and the installed base of product has shifted toward more ammunition-intensive firearms. Nearer term, VSTO's relative financial strength and cost leadership strategically positions the company to retake share from smaller competitors that opportunistically entered the market during recent industry capacity constraints.

Second, unlike the highly concentrated ammunition industry, the outdoor product businesses that VSTO competes in are not only highly fractured, but also have very little overlap with other well-resourced competitors. Our research showed that VSTO has an unparalleled distribution relationship with leading retailers of outdoor products, including Walmart, Amazon, Cabela's, and Bass Pro Shops. The company's largest customers actually let VSTO design their annual outdoor product floor plans, providing a valuable advantage when it comes to securing and expanding shelf space. Much of VSTO's recent top-line growth has come from acquiring niche brands with leading category share at reasonable multiples. The company then adds value by growing each brand's presence within its much larger distribution footprint.

The stock has sold off since our small purchase on news of an impairment charge and by concerns about data indicating another cyclical downturn in firearms and ammunition. We are more concerned about the first issue than the latter development. The impairment charge was related to two older acquisitions that already had been widely discussed prior to each deal. We are, however, growing more alarmed about the underperforming organic growth in the recently acquired brands, and the fact that management has not shared key data with investors so they can assess VSTO's progress in achieving synergies.

Regarding the ammunition business, we believe much of the concern is transitory. For instance, inventory levels are elevated partially due to recent retailer bankruptcies, and because many firearm and firearm accessory distributors bet on a Hillary Clinton victory and stocked too much product ahead of the election. Further, the industry is also lapping the one-year anniversary of surge buying associated with the Paris terrorist attacks. These events have contributed to deteriorating comps that are still holding up better than sales levels a year after the Sandy Hook shootings. Admittedly, it is early, but we believe this is yet another cyclical gyration (rather than the end of an Obama-era super cycle) and that long-term growth will remain supported by higher shooting participation and the increased emphasis on target shooting and ammunition intensive firearms.

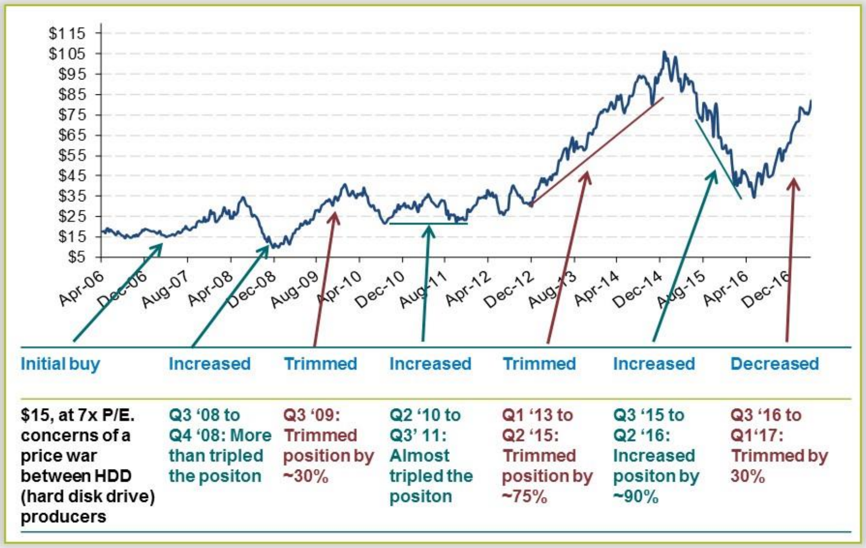
With this in mind, we have slightly increased our position (1.3% as of 03/31/17). We are holding back because we want more clarity on acquisition performance and we believe it will take several quarters to clear out excess firearm and ammunition inventory across the industry. While ammunition sales (VSTO's key driver) have not experienced a peak-to-trough decline of more than a low teens figure over the last 15 years, we are now modeling a 20% consolidated sales decline in our downside case along with 30% decremental margins. In our upside case, we remain conservative by modeling a 10% sales contraction this year, followed by three years of pre-Obama era top-line growth, and margins getting back in line with the last twelve months. Using a low teens multiple gets us to a 3:1 reward-to-risk ratio at a mid-to-high teens stock price.

Arris International plc (NasdaqGS: ARRS)

We have been investors at ARRS since October 2010 and discussed the company in detail in previous letters. A good summary can be found in our first quarter 2016 commentary (http://fpafunds.com/docs/hc_capital/fcap-q1-letter-2016_final.pdf?sfvrsn=4). In that commentary, we mentioned that the company's then-new acquisition of Pace plc. would be a success, but that the market was in a wait-and-see mode. That thesis worked out throughout the remainder of 2016. In February 2017, ARRS agreed to purchase Ruckus. This is yet another acquisition that needs to be digested by the investment community. We are excited about this combination. Wireless broadband investment is growing rapidly. The convergence of wired and wireless networks is upon us and we believe that ARRS would be a very strong player. In our opinion, this deal will likely increase ARRS' gross margins and will be highly accretive to the company's 2018 earnings. But public investors are worried about increasing DRAM (dynamic random-access memory) pricing, which was up 27% in 2016, and 24% in Q1'17. Memory pricing is volatile and cyclical, so we are not worried about this issue over the long term. ARRS hosted investor day on March 23, 2017. Even during a year with increased DRAM cost and the E6000 Gen2 router delay, ARRS is expected to generate $630 million-$720 million of free cash flow – that would be ~13% free cash flow yield.

Western Digital Corporation (NasdaqGS: WDC)

Our largest contributor this quarter was WDC. This investment had the highest weighting in our portfolio at the end of both the fourth quarter 2016 and first quarter 2017. We have owned WDC continuously over the last 10 years and have written about the company in detail many times. As one can see in the chart[12] below, we have actively managed the position size based on our upside/downside valuations and the prevailing stock price.



WDC's stock price started declining in 2015 when the company announced its intention to acquire SanDisk in a $17 billion deal. The selling pressure was due to the high sticker price on the deal, the increased debt load, and the foray into a new business (NAND flash semiconductors). We, on the other hand, saw this as an incredible opportunity to almost double our position because we believed the deal would catapult WDC into a leadership position in the NAND memory business. While the acquisition did not come cheaply, WDC now has a very competitive NAND offering that we believe should put to rest fears that the company could be disintermediated by NAND memory companies. WDC immediately started integrating the business and used its strong cash flow to decrease its debt load. The big news now involves its flash manufacturing joint venture partner Toshiba, which has recently run into major financial difficulty due to its unrelated nuclear business. These issues forced Toshiba to put its memory business on the selling block, which includes its ownership interest in the joint venture. While it is very difficult to know the impact of a future transaction, we think WDC may be well situated to benefit if they participate in a deal. We continue to track the situation closely.

Conclusion

We will close this letter the same way we closed our first quarter 2016 commentary: We are true contrarian investors, so we own a portfolio of battered-down names. We believe many of them are like a coiled spring waiting to be sprung. We remain very excited about our portfolio prospectively. We thank you for your continued confidence in us.

Respectfully submitted,

Arik Ahitov	Dennis Bryan
Portfolio Manager	Portfolio Manager

April 6, 2017

[12] Percentages are based on the Percentages are based on the absolute number of shares.

Important Disclosures

The views expressed herein and any forward-looking statements are as of the date of the publication and are those of the portfolio management team. Future events or results may vary significantly from those expressed and are subject to change at any time in response to changing circumstances and industry developments. This information and data has been prepared from sources believed reliable, but the accuracy and completeness of the information cannot be guaranteed and is not a complete summary or statement of all available data.

Portfolio composition will change due to ongoing management of the Fund. References to individual securities are for informational purposes only and should not be construed as recommendations by the Fund, the portfolio managers, or the Distributor. It should not be assumed that future investments will be profitable or will equal the performance of the security examples discussed. The portfolio holdings as of the most recent quarter-end may be obtained at www.fpafunds.com.

Investments in mutual funds carry risks and investors may lose principal value. Stock markets are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. The Fund may purchase foreign securities, including American Depository Receipts (ADRs) and other depository receipts, which are subject to interest rate, currency exchange rate, economic and political risks; this may be enhanced when investing in emerging markets. Small and mid-cap stocks involve greater risks and they can fluctuate in price more than larger company stocks.

Value stocks, including those selected by the Fund's portfolio managers, are subject to the risk that their intrinsic value may never be realized by the market and that their prices may go down. Securities selected by the portfolio managers using a value strategy may never reach their intrinsic value because the market fails to recognize what the portfolio managers consider to be the true business value or because the portfolio managers have misjudged those values. In addition, value style investing may fall out of favor and underperform growth or other styles of investing during given periods.

Definitions

The Russell 2500 Index consists of the 2,500 smallest companies in the Russell 3000 total capitalization universe offers investors access to the small to mid-cap segment of the U.S. equity universe, commonly referred to as "smid" cap. The Russell 2500 Value Index measures the performance of those Russell 2500 companies with lower price-to-book-ratios and lower forecasted growth values.

The S&P 500 Index includes a representative sample of 500 hundred companies in leading industries of the U.S. economy. The Index focuses on the large-cap segment of the market, with over 80% coverage of U.S. equities, but is also considered a proxy for the total market.

Indices are unmanaged, do not reflect any commissions or fees which would be incurred by an investor purchasing the underlying securities. Investors cannot invest directly in an index.

EBITA (Earnings before interest, taxes and amortization) is a financial indicator used widely as a measure of efficiency and profitability.

Margin of safety - Buying with a "margin of safety" is when a security is purchased at a discount to the portfolio manager's estimate of its intrinsic value. Buying a security with a margin of safety is designed to protect against permanent capital loss in the case of an unexpected event or analytical mistake. A purchase made with a margin of safety does not guarantee the security will not decline in price.

Price/Earnings ratio (P/E) is the price of a stock divided by its earnings per share.

The FPA Funds are distributed by UMB Distribution Services, LLC, 235 W. Galena Street, Milwaukee, WI, 53212.

TICKER	SHARES / PRINCIPAL	SECURITY	MKT PRICE ($)	MKT VALUE ($)	% OF NET ASSET VALUE
AAN	1,137,219	AARON S INC	29.74	33,820,893	4.3%
AGCO	249,611	AGCO CORP	60.18	15,021,590	1.9%
AKRX	380,120	AKORN INC	24.08	9,153,290	1.2%
ARRS	1,580,144	ARRIS INTERNATIONAL PLC	26.45	41,794,809	5.3%
ARW	279,083	ARROW ELECTRONICS INC	73.41	20,487,483	2.6%
AVT	867,520	AVNET INC	45.76	39,697,715	5.0%
BW	2,286,239	BABCOCK + WILCOX ENTERPR	9.34	21,353,472	2.7%
XEC	196,504	CIMAREX ENERGY CO	119.49	23,480,263	3.0%
CUB	286,300	CUBIC CORP	52.80	15,116,640	1.9%
DAN	1,141,274	DANA INC	19.31	22,038,001	2.8%
DV	560,592	DEVRY EDUCATION GROUP INC	35.45	19,872,986	2.5%
FL	68,870	FOOT LOCKER INC	74.81	5,152,165	0.6%
HP	210,778	HELMERICH + PAYNE	66.57	14,031,491	1.8%
HMHC	2,166,977	HOUGHTON MIFFLIN HARCOURT CO	10.15	21,994,816	2.8%
IDCC	223,955	INTERDIGITAL INC	86.30	19,327,316	2.4%
NBL	844,890	NOBLE ENERGY INC	34.34	29,013,523	3.7%
OSK	127,000	OSHKOSH CORP	68.59	8,710,930	1.1%
PTEN	822,558	PATTERSON UTI ENERGY INC	24.27	19,963,483	2.5%
RDC	965,710	ROWAN COMPANIES PLC A	15.58	15,045,762	1.9%
SM	464,453	SM ENERGY CO	24.02	11,156,161	1.4%
VECO	810,280	VEECO INSTRUMENTS INC	29.85	24,186,858	3.1%
VSTO	489,820	VISTA OUTDOOR INC	20.59	10,085,394	1.3%
WDC	723,760	WESTERN DIGITAL CORP	82.53	59,731,913	7.6%
		OTHER		10,413,441	1.3%
		TOTAL EQUITIES:		**510,650,395**	**64.7%**
	25,000,000	TREASURY BILL	99.97	24,991,325	3.2%
	198,000,000	TREASURY BILL	99.95	197,902,980	25.1%
	40,000,000	TREASURY BILL	99.82	39,927,016	5.0%
		TOTAL US GOVT AND AGENCIES:		**262,821,321**	**33.3%**
		CASH & EQUIVALENTS (NET OF LIABILITIES):		15,969,624	2.0%
		TOTAL CASH & EQUIVALENTS (NET OF LIABILITIES):		**278,790,945**	**35.3%**
		TOTAL NET ASSETS:		**$ 789,441,340**	**100.0%**
		NO. OF EQUITY POSITIONS		**23**	

Portfolio Holding Submission Disclosure

TICKER	SHARES / PRINCIPAL	SECURITY	MKT PRICE ($)	MKT VALUE ($)	% OF NET ASSET VALUE

You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. The Prospectus details the Fund's objective and policies, sales charges, and other matters of interest to the prospective investor. Please read this Prospectus carefully before investing. The Prospectus may be obtained by visiting the website at www.fpafunds.com, by email at crm@fpafunds.com, toll-free by calling 1-800-982-4372 or by contacting the Fund in writing.

Investments in mutual funds carry risks and investors may lose principal value. Stock markets are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. The Fund may purchase foreign securities including American Depository Receipts (ADRs) and other depository receipts, which are subject to interest rate, currency exchange rate, economic and political risks; this may be enhanced when investing in emerging markets. Small and mid- cap stocks involve greater risks and they can fluctuate in price more than larger company stocks. Groups of stocks, such as value and growth, go in and out of favor which may cause certain funds to underperform other equity funds.

Portfolio composition will change due to ongoing management of the Fund. References to individual securities are for informational purposes only and should not be construed as recommendations by the Fund, the Portfolio Managers or Distributor.

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