FPA Crescent Fund FPACX

Analysis

Still nimble enough.
By Dan Culloton 5/3/2019

Bold, independent managers unafraid to take calculated risks help FPA Crescent retain its Morningstar Analyst Rating of Gold.

Veteran contrarians run this strategy. Steve Romick is the architect of this omnivorous value fund and is responsible for most of its strong long-term record. Comanagers Brian Selmo and Mark Landecker have added depth and complementary skills since joining the team about a decade ago. Selmo oversees the research team and has displayed a knack for special situations, while Landecker helps maintain a stable of strong businesses on which the strategy can pounce when their prices are right.

The team jumped on several opportunities in a volatile 2018. It trimmed Microsoft MSFT, sold Oracle ORCL, and parted ways with advertising firm WPP WPP while buying cable companies, construction materials suppliers like LafargeHolcim, and controversial bank Wells Fargo WFC. It also reduced shorts on Chinese Internet names Alibaba BABA and Tencent as their prices fell, which essentially increased the fund's long exposure to those companies through stakes in holding companies Altaba AABA and Naspers. The managers are still shunning corporate and high-yield debt owing to low yields and suspect credit quality but retain positions in Puerto Rico municipal bonds.

These moves are consistent with the fund's strategy. It stockpiles investment ideas and waits for opportune moments to deploy cash, which reached nearly 30% of assets in early 2019 after a first-quarter rally led the managers to trim more positions on valuation. Don't mistake a large cash horde for security, though. This is an idiosyncratic portfolio that has delivered admirable downside protection over time but does not promise it in every market environment. Despite an increased penchant for compounders in recent years, it will still venture into deep-value fare that others find too dicey, such as its current position in bankrupt California utility PG&E PGE. Such holdings can inflict much pain before generating gains, but this fund has delivered more of the latter over time.

Process Pillar: Positive

This fund ranges across asset classes, market caps, sectors, geographies, and public and private markets in pursuit of equitylike returns with less risk.

The managers, who can also short securities, are absolute value investors who view risk as the possibility of suffering permanent loss, not of underperforming a benchmark or peer group. They seek securities trading at discounts to their estimated worth that can deliver at least high single- to double-digit returns, and they'll stockpile cash when they can't find them. This flexible approach earns a Positive Process rating.

The fund's asset allocation varies based on where value resides. In the late 1990s and early 2000s, it favored small caps that had lagged in the 1990s bull market. In 2008, it turned to high-yield and distressed debt, believing they were cheaper than stocks. Since 2009, the fund has shifted to durable "compounders" at decent prices, though it still opportunistically seeks deeper value investments offering at least 3 times as much upside as downside. The managers' macroeconomic views influence, but do not drive, the process. Over the long term it has tended to keep about 63% of its money in "risk assets" such as stocks or high-yield bonds.

The fund usually pairs its shorts with long positions to exploit valuation gaps between expensive securities and their overlooked parents or major owners.

The managers are willing and able to act when valuations beckon and to endure short-term pain. As markets gyrated in 2018, the strategy had one of its busiest years in more than a decade, adding 18 new positions and selling or trimming more

Morningstar's Take

Morningstar Analyst Rating: Gold

Morningstar Pillars

Process	Positive
Performance	Positive
People	Positive
Parent	Positive
Price	Negative

Morningstar Analyst Rating

Morningstar evaluates mutual funds based on five key pillars, which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis.

Analyst Rating Spectrum

Gold Silver Bronze Neutral Negative

Fund Performance

	Total Return %	+/- Category
YTD	13.78	3.78
2018	-7.43	-1.67
2017	10.39	-2.82
2016	10.25	2.91
2015	-2.06	-0.13

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than 20. The fund's net allocation to "risk assets," typically stocks and high-yield bonds, reached 73% of assets in 2018. The managers added mostly stocks because bonds still look priced for disappointment to them; additions often were the subject of controversial headlines, such as regulatory recidivist Wells Fargo WFC and cable companies battling the cord-cutting trend, such as Comcast CMCSA and Charter Communications CHTR. Wells Fargo is cheap and has a solid capital position and asset base, and cable companies' broadband businesses can compensate for video market share losses.

The fund also still held Puerto Rico muni bonds even after trimming them and other positions during 2019's first-quarter rebound. But it also reduced short positions from the all-time high they reached in 2018, so first quarter 2019 net risk exposure of 72% was still about 10 percentage points higher than the fund's long-term average. It would be a mistake to consider this portfolio conservative, even with its higher-than-average cash stake. It remains an idiosyncratic portfolio of stocks and bonds that could require patience before they work out.

Performance Pillar: Positive

The fund's stated mission is to deliver equitylike returns with less risk than the stock market; it has exceeded that goal since inception, earning a Positive Performance rating.

Its 10.1% annualized gain from its June 1993 launch through March 31, 2019, beats the S&P 500 by more than a third of a percentage point per year. Its standard deviation, a measure of volatility, was about 30% lower than the index's.

FPA Crescent has won by not losing. With an oft-heavy cash stake, it will lag in some rallies. From its 1993 inception through the end of April 2018, it captured 68% of the S&P 500's gains in upturns. However, it was able to preserve those gains in rough environments, suffering just 48% of the index's losses in downturns.

Over longer stretches, performance has been consistent. In 190 rolling 10-year periods from its birth through the end of March 2019, the fund beat the allocation--50% to 70% equity Morningstar Category average 100% of the time and the S&P 500 80% of the time.

It fares well on both an absolute and risk-adjusted basis against rivals and benchmarks with 60%/40% stock/bond mixes. Its Morningstar Risk-Adjusted Return of 6.2% annualized from inception through March 2019 beats the 4.5% of Vanguard Balanced Index VBIAX, which passively invests in the total U.S. stock and bond markets.

People Pillar: Positive

This deep and accomplished team deserves a Positive People rating. Steve Romick has led FPA Crescent since its 1993 inception, compiling a stellar record along the way. The fund isn't a one-man show, though. Analysts and investment committee members Brian Selmo and Mark Landecker have been comanagers since June 2013. Selmo is also research director for the Crescent team, overseeing about seven analysts with an average FPA tenure of 4.5 years and mean industry experience of 7.9 years. In total, 10 investment professionals work on this fund, down from 11 in 2018 after a junior analyst departure.

FPA targets experienced analysts, but it takes pains to ensure its hires share the firm's distinctive investment style. Selmo, for example, had founded his own asset-management firm and was an analyst at value shop Third Avenue before joining in 2008. Landecker worked at Kinney Asset Management and Arrow Investments before joining in 2009.

As a managing partner of the firm, Romick helps oversee FPA’s roughly 30 investment professionals, who have 15 years average industry experience. FPA Crescent remains the only FPA mutual fund he manages, though, and each of the firm’s investment teams operate independently. He, Landecker, and Selmo also run a hedge fund, separate accounts, and a piece of Litman Gregory Masters Alternative Strategies MASFX. Each manager invests more than $1 million here.

Parent Pillar: Positive

FPA earns a Positive Parent Pillar rating by living up to its slogan--investors first.

Steve Romick, the manager of FPA Crescent FPACX and one of the industry's most unique and successful value investors, now runs the firm with managing partner and CFO J. Richard Atwood and serves as its public face.

Like Romick and other now retired or departed luminaries of the firm, such as Bob Rodriguez and George Michaelis, FPA's investment teams strive to be uncompromising, patient, value-oriented investors. While the teams work independently, they share this absolute-return-focused philosophy.

That ethos remains even though there have been personnel changes and fund reorganizations in recent years. Those changes still bear watching, but the firm's clear identity and metier have helped it attract and retain a mix of experienced, like-minded investors and younger talent in their formative stages.

The firm overall and its largest strategy, FPA Crescent, have seen outflows in recent years, but capacity at its $17 billion flagship fund still bears watching. The 64-year-old firm, however, has bolstered personnel and technology and does much else well. Fees are reasonable, and FPA managers eat their own cooking, focus on the long term, disdain trendy fund launches, avoid regulatory snafus, and write smart and engaging shareholder letters. It's still a capable steward.

Price Pillar: Negative

FPA Crescent is expensive relative to its category and gets a Negative Price rating. Its 1.07% annual expense ratio, adjusted for the cost of short positions and acquired fund fees, though lower than in the past, remains above the category average and

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median. This strategy has passed some economies of scale to shareholders, and its fees remain at historic lows despite recent seeing outflows in recent years, but the fund's flat 1% management fee limits the extent to which fees can fall further.

Unless otherwise stated, all performance and other statistical information in the Morningstar Analyst report is as of March 31, 2019.

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 the Prospectus carefully before investing. The Prospectus may be obtained by visiting the website at www.fpa.com, by calling toll-free, 1-800-982-4372, or by contacting the Fund in writing.

Average Annual Total Returns (%)

Trailing Performance (%)										Market Cycle Performance	
As of Date: 3/31/2019	Inception*	20 Years	15 Years	10 Years	5 Years	3 Years	1 Year	YTD	QTD	3/25/00-10/9/07	10/10/07-3/31/2019
FPA Crescent Fund	9.96	8.69	7.36	10.30	5.03	7.74	3.59	10.80	10.80	14.70	6.39
S&P 500	9.49	6.04	8.57	15.92	10.91	13.51	9.50	13.65	13.65	2.00	7.59
MSCI ACWI**	-	-	-	-	6.45	10.67	2.60	12.18	12.18	-	3.81
60% S&P500/40% BBgBarc US Agg	8.04	5.81	6.93	11.14	7.75	8.95	7.78	9.31	9.31	3.97	6.45
CPI	2.22	2.19	2.06	1.81	1.49	2.21	1.86	0.56	0.56	2.75	1.74

Periods greater than one year are annualized. FPA Crescent Fund ("Fund") performance is shown net of all fees and expenses. Fund performance is calculated on a total return basis which includes reinvestment of all distributions. Fund performance does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares, which would lower these returns. Comparison to any index is for illustrative purposes only. An investor cannot invest directly in an index. The Fund does not include outperformance of any index or benchmark in its investment objectives.

* The Fund commenced operations on June 2, 1993. The performance shown for periods prior to March 1, 1996 reflects the historical performance of a predecessor fund. FPA assumed control of the predecessor fund on March 1, 1996. The Fund's objectives, policies, guidelines, and restrictions are, in all material respects, equivalent to those of the predecessor fund.

** The MSCI ACWI was not considered a relevant illustrative index prior to 2011 because the Fund was not classified as a global mandate until this point in time.

Market Cycle Performance reflects the two most recent market cycles (peak to peak) defined as a period that contains a decline of at least 20% from the previous market peak over at least a two-month period and a rebound to establish a new peak above the prior market peak. The current cycle is ongoing and thus presented through the most recent quarter-end. Once the cycle closes, the results presented may differ materially.

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 1.18%. A redemption fee of 2% will be imposed on redemptions within 90 days. Current month-end performance data, which may be lower or higher than the performance data quoted, may be obtained at www.fpa.com or by calling toll-free, 1-800-982-4372.

Please see important disclosures at the end of the commentary.

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, the Adviser, 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.fpa.com.

Investments in mutual funds carry risks and investors may lose principal value. Capital 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; these risks may be heightened when investing in emerging markets. Foreign investments, especially those of companies in emerging markets, can be riskier, less liquid, harder to value, and more volatile than investments in the United States. Adverse political and economic developments or changes in the value of foreign currency can make it more difficult for the Fund to value the securities. Differences in tax and accounting standards, difficulties in obtaining information about foreign companies, restrictions on receiving investment proceeds from a foreign country, confiscatory foreign tax laws, and potential difficulties in enforcing contractual obligations, can all add to the risk and volatility of foreign investments.

Small and mid-cap stocks involve greater risks and may fluctuate in price more than larger company stocks. Short-selling involves increased risks and transaction costs. You risk paying more for a security than you received from its sale.

The return of principal in a bond investment is not guaranteed. Bonds have issuer, interest rate, inflation and credit risks. Interest rate risk is the risk that when interest rates go up, the value of fixed income securities, such as bonds, typically go down and investors may lose principal value. Credit risk is the risk of loss of principal due to the issuer's failure to repay a loan. Generally, the lower the quality rating of a security, the greater the risk that the issuer will fail to pay interest fully and return principal in a timely manner. If an issuer defaults the security may lose some or all of its value. Lower rated bonds, callable bonds and other types of debt obligations involve greater risks. Mortgage-backed securities and asset-backed securities are subject to prepayment risk and the risk of default on the underlying mortgages or other assets. Derivatives may increase volatility.

Value securities, 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 because the market fails to recognize what the portfolio managers consider to be their 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.

Index Definitions

Comparison to any index is for illustrative purposes only and should not be relied upon as a fully accurate measure of comparison. The Fund may be less diversified than the indices noted herein, and may hold non-index securities or securities that are not comparable to those contained in an index. Indices will hold positions that are not within the Fund's investment strategy. Indices are unmanaged and do not reflect any commissions, transaction costs, or fees and expenses which would be incurred by an investor purchasing the underlying securities and which would reduce the performance in an actual account. You cannot invest directly in an index. The Fund does not include outperformance of any index in its investment objectives.

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.

MSCI ACWI Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 44 country indices comprising 23 developed and 21 emerging market country indices.

The **Consumer Price Index** (CPI) is an unmanaged index representing the rate of the inflation of U.S. consumer prices as determined by the U.S. Department of Labor Statistics. The CPI is presented to illustrate the Fund's purchasing power against changes in the prices of goods as opposed to a benchmark, which is used to compare the Fund's performance. There can be no guarantee that the CPI will reflect the exact level of inflation at any given time.

60% S&P500/ 40% Bloomberg Barclays Aggregate Index is a hypothetical combination of unmanaged indices and comprises 60% S&P 500 Index and 40% Barclays Aggregate Index, the Fund's neutral mix of 60% stocks and 40% bonds.

Additional Definitions

Prospectus Adjusted Operating Expense Ratio ("PA Ratio") – A Morningstar calculated expense ratio for fund companies that engage in shorting that backs out the interest and dividend expenses on borrowed securities to derive a net expense ratio. The Fund's expense ratio as of its most recent prospectus is 1.18% (as of April 30, 2019), and was 1.10% (as of the April 30, 2018 Prospect) versus Morningstar's calculated PA Ratio of 1.07% (as of March 31, 2019) as noted in the Morningstar Analyst report for the Fund.

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