Q4 2021 FPA Crescent Fund (FPACX) Webcast
February 2, 2022

Note: Items in brackets [ ] are meant to be clarifying statements but are not part of the actual audio recording of the webcast.

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You should consider FPA Crescent Fund's (the "Fund" or "Crescent") 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 for the Fund dated April 30, 2021 can be accessed at: https://fpa.com/request-funds-literature, by visiting the Fund's website at www.fpa.com, by calling toll-free, 1-800-982-4372, or by contacting the Fund in writing.

(00:00:06)

Moderator: [Please reference slide 1] Hello, and welcome to today's webcast. My name is Sarah and I will be your event specialist today. All lines have been placed on mute to prevent any background noise. Please note that today's webcast is being recorded.

During the presentation, we will have a question and answer session. You can ask text questions at any time. Type your question in the Q&A box located on the bottom left side of your screen. Questions will be addressed at the end of the presentation. If you need technical assistance, as a best practice we suggest you refresh your browser.

It is now my pleasure to turn today's program over to Ryan Leggio. Ryan, the floor is yours.

Ryan: Good afternoon and thank you for joining us today. We would like to welcome you to FPA Crescent's Fourth Quarter 2021 Webcast. My name is Ryan Leggio and I'm a partner here at FPA.

The slides, audio, visual replay and transcript of today's webcast will be made available on our website FPA.com in the coming days.

Momentarily, you will hear from Steven Romick, Brian Selmo and Mark Landecker, the portfolio managers of our Contrarian Value Strategy, which includes the FPA Crescent Fund. Steven has managed the FPA Crescent Fund since its inception in 1993, with Brian and Mark joining Steven as portfolio managers in June of 2013.

[Please reference slide 2] Before I hand the call over to Steven, we want to show longer-term performance here for disclosure purposes.

And at this point, it's my pleasure to turn the call over to Steven Romick. Steven, over to you.

Steven: [Please reference slide 3] Thanks, Ryan. Crescent posted good absolute and relative returns in 2021. Given that stocks aren't as expensive as they—inexpensive as they were, the Fund's net equity exposure has declined modestly.[1]

We believe that we have positioned Crescent to perform reasonably well in most scenarios. This requires us to seek to protect our portfolio from the diminution of real returns that inflation can cause. To accomplish this, we own more stocks than [the] historical average, including the Fund's holdings of lower-priced overseas-based businesses that we believe offer better potential for risk-adjusted returns than their U.S. counterparts. [The Fund] holds good-to-great quality businesses at good prices. Owning shares in these businesses that are both less expensive and growing faster than the stock market should help to achieve our goal. And we have avoided low-yielding bonds, particularly those with unappreciated credit risk.

(00:02:32)

[Please reference slide 4] Most of you appreciate that Crescent maintains the - ability to invest across asset classes in different parts of the capital structure and around the world. While this breadth allows us to consider more varied opportunities than most of our public fund peers, it does not mean that valuations always justify exposure as broadly as our charter. To meet our goals of achieving an equity rate of return while assuming less risk means we must remain mindful of the price paid.

[1] Past performance is no guarantee, nor is it indicative, of future results. Portfolio composition with change over time due to ongoing management of the Fund.

[Please reference slide 5] Crescent gained about 2% [net] in the last quarter of 2021 and gained about 15% [net] for the full calendar year. While respectable in the absolute, the Fund's 2021 total return, at 64% of the average of the S&P and MSCI ACWI, did underperform its own almost 76% average net risk exposure. Crescent's long equity exposure, however, did return 23.2% [gross].

[Please reference slide 6] Growth stocks were back in the driver's seat last year, posting a 32% return. Though buoyed by the returns of U.S. stocks, the MSCI ACWI and World Index returns still lagged the S&P 500. If one were to remove U.S. stocks from the MSCI ACWI, you can see this return—almost to the far right of this chart—was just 7.8%, while emerging markets did take up the caboose here in the far right, with negative returns, looking at a 2.54% loss.

(00:03:58)

[Please reference slide 7] I've previously said that we are sensitive to the price we pay for a business. The manifestation of that is Crescent has delivered returns on this portfolio of long equities that have exceeded that of the pertinent equity benchmarks over time.[2]

Since we first started and tracking the performance of the Fund's long book in 2007, it has bested the S&P 500 by 0.7%. And, when looking at the international market, as the portfolio became more global, tracking the MSCI ACWI became more relevant, beginning in 2011, and since then, Crescent's long equity book has bested the ACWI by 4.2%.

[Please reference slide 8] Economic recovery and persistent easy money continue to underpin the financial markets, allowing 2020's global stock market to continue on into 2021 and, of course, benefiting certain positions held in the Fund as much as global stock volatility temporarily hurt many of these same stock prices in Q1 of 2020.

[2] Comparison to Indices are for illustrative purposes only. The Fund does not include outperformance of any index or benchmark in its investment objectives. An investor cannot invest directly in an index.

Crescent's top five contributors added 8.2% to the Fund's return last year, about, a little more than three times the sum of the top five detractors. Importantly, there was a lack of significant news that impacted these individual investments.

Exposure to each of the top five contributors was reduced in 2021 as their respective valuations reached levels high enough to warrant a reduction in holding size, but not their complete elimination from the portfolio. We did sell out of nine stocks completely last year, however. We similarly moved on from these positions largely as a result of valuation, which also drove other changes in the portfolio. Along with the reduction in position size of six financial service companies, we also eliminated positions in Bank of America and CIT Group. The Fund's exposure to travel-related companies was also reduced as a function of selling some of our Marriott International and all of Booking Holdings stakes. We believe that the portfolio changes in the last year resulted in the exchange of less appealing risk/reward opportunities for more attractive ones. But of course, only time will tell.

(00:06:03)

Ten new equities were added in 2021, including new positions in video game stocks—Ubisoft Entertainment and Activision Blizzard—which joined Nexon and Epic to comprise our current sector exposure of 2.8%. Video game exposure is destined to contract, as Microsoft announced last week that they will be purchasing—not last week, a couple of week ago—purchasing Activision.

Unsurprisingly due to low yields, there were no new high yield positions and just one new private credit investment.[3]

[Please reference slide 9] Crescent ended the year with net exposure of 72% excluding the SPAC basket, lower year over year by about 2 percentage points. A couple of percentage

[3] The information provided does not reflect all positions purchased, sold or recommended by FPA during the period. References to any particular security or sector should not be considered as a recommendation to purchase or sell such security or sector.

points change in exposure doesn't mean much of anything and could happen just from market movement in any given month.

[Please reference slide 10] While the U.S. stock market remains at more elevated valuation levels, the potential for continued financial repression and its inflationary consequences is the reason why Crescent has a larger position in equities than has been typical—and, you know, by default, less in corporate bonds. We believe that more balanced portfolios of stocks and bonds, you know, for example that 60/40 equity/fixed income benchmark that a lot of people hew to, are likely to generate weaker long-term returns, dragged down by the low-yielding bonds, both investment grade and high yield, and particularly when compared to a more equity-centric portfolio. The poor performance of fixed income instruments last year might just be a harbinger of things to come.

[Please reference slide 11] As you can see in this slide, Crescent's exposure moves around. When equities weren't taking into account the potential fallout from the mortgage crisis in 2008, the Fund was less invested in stocks—this shaded blue area. Corporate bonds, largely high yield and distressed, is depicted in green. As you can see, and consistent with our negative view of low-yielding credit, we have negligible exposure to corporate bonds today.

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Crescent's risk exposure moves around as a function of opportunity. One can assume that an investment that makes it into the Fund has the attributes of more potential upside than downside, and that the larger the position—and the larger positions rather are those in which we have a greater conviction as to a favorable outcome.[4]

[Please reference slide 12] As a function of finding attractive risk/reward opportunities overseas, Crescent's exposure to equities domiciled outside the U.S. has been in the 40% range,

[4] Future events or results may vary significantly from the views expressed. There is no guarantee current or future portfolio investments will profitable.

give or take, for the last couple of years. If one were to take into account where these companies actually conduct business then 60% of that is from outside of the United States.

[Please reference slide 13] This chart shows that international stocks traded on average at a lower price/earnings ratio or P/E than its U.S. peers, using the MSCI ACWI ex-U.S. and the S&P 500 for the respective international and domestic proxies. Since 2001, foreign stocks have traded at an average discount of 13% when compared to U.S. stocks. Today though, foreign stocks trade at an almost 33% discount—a 20-year low. We do not believe that the businesses we own outside the U.S. are so substantively different in quality and growth prospects to justify such a wide discount, and thus our significant exposure to foreign-domiciled companies.

[Please reference slide 14] I want to show this slide that depicts the almost 40-year decline in interest rates. I would argue that this downward trend to a zero cost of capital has been the single greatest driver of global stock market returns. Some analysis suggest as much as 40% of the market's returns over the last few decades have been due to lower interest rates. A lower discount rate, increases the value of the future stream of cash flows as well as pushes terminal value multiples[5] higher, which in turn drives equity prices higher. In addition, with bonds yielding so little, investors have put more risk in a question for return, tilting their portfolios away from bonds and towards stocks, although we've seen somewhat of a reversal of this thus far in 2022.

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[Please reference slide 15] But these low interest rates, combined with huge increases in fiscal borrowings in a generally easy money environment since the Great Financial Crisis, set the stage for higher inflation. The pandemic has made things worse, impacting both size and availability of the labor pool, and causing supply chain disruptions while durable goods

[5] The terminal multiple is another method of calculating the terminal value. This method assumes that the enterprise value of the business can be calculated at the end of the projected period by using existing multiples on comparable companies.

consumption was rebounding. And then you can add in the pressure of higher energy prices. U.S. inflation was 7% last year, a four-decade high.

While this chart only depicts the U.S., the Eurozone recorded its highest inflation rate since the monetary union, at almost 5%, and German inflation was at a 29-year high, just over 5%. Emerging markets also have had sharp inflation increases, with some countries recording double-digit levels although inflation has been, admittedly, more muted in some of the largest Asian economies.[6]

[Please reference slide 16] While one can reasonably argue that domestic inflation in the future could be lower than 2021, we believe that inflation will likely average higher the next decade than the preceding one—something that is not currently expected, as you can see in this chart, with inflation over the next five years forecasted to be less than 2.5%.

[Please reference slide 17] Stocks around the world have historically high valuations, with U.S. companies leading the way. This chart shows the U.S./international stock market capitalizations as a percentage of the size of the local economies. The most expensive companies are driving much of these higher valuations, leaving many companies trading less expensively.

(00:11:50)

The Fund’s portfolio, on average, is of a higher quality than it has been historically, trades less expensively than both the U.S./international market average, and has posted better earnings growth in the trailing three years. In addition, consensus estimates have our portfolio companies growing faster than the average public company in the next three years.

[Please reference slide 18] This table supports that last statement. It shows that the companies are less expensive, as you can see, at P/E on a 1-year forward basis is 15.6 times for Crescent versus the ACWI at 18 times and the S&P at 20.9 times. Price-to-book is similarly lower at 1.8 times for our long equity book as compared to over 3 times and almost 5 times for the ACWI

[6] https://tradingeconomics.com/country-list/inflation%20rate?continent=g20

and S&P respectively. Trailing earnings growth for our portfolio has been in excess of 20% in the trailing 3 years versus single-digit rates of growth for the market.

Prospectively—and these are not our estimates but the consensus estimates, you know, by analyst on Wall Street and around the world—the Crescent portfolio is expected to grow, earnings, the long book, expected to grow 21% over the next three years versus 9% and 10% for the MSCI ACWI and the S&P 500. We can speak to the veracity of the historical but the future is yet to be written. But it's nice at least to see that what we believe to be, to happen, will hopefully happen.

[Please reference slide 19] U.S. stocks, with how much to own of—sorry, wrestling with how much to own of stocks versus bonds doesn't seem like much of a contest today. The low starting yields of bonds in general, as you can see in the blue line in this chart, and corporate bonds more specifically with their additional burden of potential default, offered a negative real yield at quarter end and into the beginning of 2022. With such an anemic starting point, it appears that the earnings growth potential of stocks affords the better opportunity for those with a longer-term view, despite higher-than-average equity valuations.

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The S&P 500's estimated P/E for this current year is 21.5 times which, in its inverse, translates to an estimated earnings yield of 4.7%. Given the lower stock valuations outside the U.S., as pointed out in previous slides, the estimated 2022 earnings yield for the global MSCI ACWI is a higher 5.6%. Now, contrast this, if you will, with a 1.5% 10-year U.S. Treasury yield—or worse, the 0.07% and -0.09% yields for Japanese and German government bonds.[7]

Assuming positive economic growth over the next decade, we believe the total return potential of stocks should exceed that of bonds, albeit with greater volatility. As I mentioned, while volatility satisfies the institutional definition of equity risk, some ups and downs in a company's

[7] Source: Bloomberg. As of December 31, 2021.

share price over the short term do not speak to what a business might be worth over the long term. It is not a truism to say that more invested equals more risk. There are different kinds of risk. We believe, for example, that being less invested in risk assets invites the greater risk of inflation eroding the value of your cash or, in quotes, "conservative" fixed income investments. [8]

[Please reference slide 20] High yield bonds offer a gross yield of just 4.4% in the U.S. and 2.8% in the E.U. These paltry yields though are before some inevitable level of default. Using historic averages as a guide suggests that the net yields in the U.S. might only be 2.5%, and 0.2% in the E.U., as shown in this table. High yield bonds have offered very poor yields in recent years, and we haven't had a distressed cycle since the 2008-2009 downturn. The insignificant yields of this sector have kept us away. Just because we can invest in an asset class doesn't mean we should. If we had lowered our standards though and owned more high yield, the Fund's performance would have benefited as the combination of lower rates and tighter spreads have increased corporate bond prices. The high yield market's good performance is in spite of increasing corporate leverage, declining average credit quality, and weaker covenants for borrowers. And the U.S. Federal Reserve and the European Central Bank are doing their best to inhibit what should have been a historic opportunity to buy high yield bonds.

(00:16:20)

Low and negative interest rates take money away from savers and lenders, and gives it to borrowers and investors, including speculators. When money costs almost nothing, or even less than nothing, it perverts price discovery.

Investors' thirst for yield, along with the Fed and ECB's purchase of high yield and corporate bonds have propped up prices at higher levels than they otherwise would be. If there is

[8] A Risk Asset generally refers to an asset that has a significant degree of price volatility, such as equities, commodities, high yield bonds, real estate and currencies, but does not include cash and cash equivalents.

no cost to capital, then one theoretically can pay an infinite price for an asset, which creates a difficult backdrop for investors such as ourselves who insist on a margin of safety.

We wish we could tell you the Crescent portfolio is as cheap as it's ever been, but given the market and the Fund's strong performance since Q1 2020's market bottom, you know that can't be true.[9] We have repositioned the portfolio as a function of old opportunities that have come to fruition, and new opportunities that we believe offer reasonable prospects for attractive risk-adjusted future returns. The portfolio is also built to withstand multiple potential outcomes like inflation, stagflation, or recession.

That concludes our prepared remarks. I'm going to turn to Q&A. But as a reminder, we won't be discussing companies where we are currently engaged in transacting, whether it be a buy or a sell, or discussing those positions that are so small as to not be terribly relevant as to Crescent's performance.

I'm going to start with answering some questions that have come over—that came earlier in the week, and then I'm going to hand off to Mark and Brian to handle some of those questions as well, and there are some questions that are coming across the transom as I speak, and we'll get to those next.

(00:18:02)

There is a question that: Do you feel that we have entered a period similar to 2000-2002 where there is a significant rotation to value and international, and out of growth?

So, value and international stocks doing well has certainly been a recent trend but the short answer is that we don't ever know what's going to happen to any sector of the market. The longer answer is that our focus is to own high-quality, growing businesses at valuations where we think we think we should not only make a good return but, in the event that things don't go as

[9] The performance of the Fund, the S&P 500 and the MSCI ACWI NR for the period since the Q1 2020 bottom, 03/24/2020, to 12/31/2021 was 77.77%, 119.03,% and 102.12%, respectively. Fund performance is net of fees and expenses and includes reinvestment of distributions.

planned, that we should still do okay. As we pointed out in the prepared remarks, our portfolio companies, in the aggregate, when compared to the market, are less expensive, growing faster, and expected to grow faster, and around 40% of these companies are based outside the U.S. While we expect that these less expensive businesses, you know, many of which are foreign-domiciled, to perform well over time, we can't tell you that that will definitely happen over any timeframe.

Which are worst in 2022, bonds or stocks, was a question that was posed.

You won't ever hear us make a short-term market call. While the future is always uncertain, that's even more true over shorter timeframes. Our longer-term view is that stocks should outperform bonds, and as we've pointed out in our prepared remarks, that supports our larger-than-average allocation to equities.

Another question is: Curious about your thoughts on opportunities on the short side given the present backdrop of high market valuations and rising rates.

Although we have, on occasion, shorted stocks, that has never been a significant part of our book. Most of our shorts have been tied to specific long positions. At times, we have hedged some industry exposure by shorting shares in a different publicly traded company. At other times, we have shorted a publicly traded company's stake in another publicly traded company to create an inexpensive stub position. We don't view looking for short investments to be the highest and best use of our time, given some of the inherent structural disadvantages in shorting stocks. All else equal, inflation can be problematic when shorting, as inflation puts upward pressure on stock prices. This is in addition—now that's an interest rate-agnostic statement—this is in addition to the tax inefficiency and generally poor asymmetry of short investments. In conclusion, shorting hasn't ever been a big part of what we do, and won't likely be the case in the future.

(00:20:19)

I'm going to begin to pass some of these questions around to make sure Mark and Brian are engaged. How does the portfolio valuation compare now relative to historically? Are there more opportunities presently abroad and among midcap names? Mark? Are you muted, Mark?

Mark: Oh, can you hear me?

Steven: Yes, we can hear you.

Mark: Great. Thanks, Steven. So with respect to how the portfolio valuation compares now relative to historically, I think it's difficult to compare apples to apples. You have almost to break the Fund into discrete intervals, given Steven started this strategy 25+ years ago. As for my tenure, I would describe the period in which we emerged from the GFC as being particularly rich with opportunity.[10] If one looks back 10 or 12 years ago, we were able to buy rather high-quality businesses such as Thermo Fisher, Lowe's, Covidien, Microsoft, Google, TE, Analog Devices amongst other. And what I will loosely describe is the low double-digit multiple to current earnings.[11]

Right now, it feels like those opportunities are behind us, although it does remind me of a story about a well-known money manager who made hay in the 1980s when he had the chance to buy growth stocks at high single-digit P/Es. Some of you on the call may know who I'm referring to. Anyhow, after experiencing great success with those purchases, he allocated capital in a trepidatious manner for the rest of his career, waiting for similar opportunities to return. Well, they never did. And ultimately, he passed away a few decades later.

(00:22:06)

As we sit here today in the battle for investment survival, we remain committed to focusing on capital appreciation plus capital preservation, cognizant that to succeed over the long term in this industry, you want to think of yourself as the learning machine, always trying to get better over time.

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[10] GFC or Great Financial Crisis or Global Financial Crisis is the period generally defined as 2007-2008.
[11] References to any particular security should not be considered as a recommendation to purchase or sell such security.

Now to bring this rambling answer to a close, as Steven mentioned in the prepared remarks, I think our portfolio looks more expensive than it has at various points in time over the past 25 years on near-term earnings, but I also think it's of a higher quality and has greater long-term growth prospects than in the past. So provided, of course, that you have the wherewithal and patience to cast your eyes three to five years forward, I think we're sitting in a good place.

Now, as for ideas, generally speaking we'd say we're not finding table-pounders anywhere, but we are finding a lot of names that merit research and consideration as starter positions. These range from domestic megacaps down to international midcaps, but we won't call out any one area as particular fruitful ground for hunting.

Steven: Thanks, Mark. Let me stay with you and just, since you're not—Brian's sitting next to me and since you're not in the office with us, we'll just, in the interests of trying to be efficient, we'll just go through a series of questions for you then we'll pass stuff to Brian. But let us combine three questions on inflation—there are actually even more than that—which is why we did devote some of the prepared remarks to, as much as we did, to inflation. But given rising rates of inflation, how well are our companies positioned? What companies do you own to benefit from inflation? How resilient is the Fund against high inflation? Mark?

Mark: Sure. So if you could see us all on video, you'd know that none of us are a bunch of spring chickens. We're effectively all on the other side of the hill, and we spent much of the first side of the hill reading Jim Grant's Interest Rate Observer every two weeks. So for those of you not familiar with Jim's writing, he instilled in each of us the belief that inflation is, and always will be, a clear and present danger that we must protect against.

(00:24:11)

As for how this moves from theory to practice, you can look back to when we first purchased AON in, I believe, 2009. And on one of these very conference calls, I believe, I vaguely recall Steven pointing out that AON would be a beneficiary of both inflation and higher rates should they come to pass. Now, I don't think he had 2022 in mind when he made those comments but it seems like we may finally see the benefit. But the important point is we didn't buy AON with a thesis that inflation or higher rates were going to be necessary to make a profitable investment. We simply bought it with the belief that the company's earnings would be well-positioned to grow on a real basis regardless of the economic environment.

Now if you look at our current portfolio, I would argue you can see the same theme in many of our holdings because they either naturally benefit from inflation, like say Alphabet or Facebook, or because they have pricing power to protect profitability if required, such as say NXPI and Analog Devices, or Richemont.[12] Steven?

Steven: Yes. Have you seen opportunities emerge during the recent selloff in businesses that may—I think you've probably addressed part of this already, Mark, but can they optically appear expensive, you know, in areas like software, etc.?

Mark: Sure. So we started studying many of these companies years ago and we've been like lions in the weeds waiting to pounce. When you see an update on our holdings next quarter, you will observe we have been gently leaning in to the selloff in growth stocks, with the addition of several new names and additions to others. We aren't ringing the bell at this time to swing for the knockout punch, but we do see enough opportunities that we have at least stepped into the ring.[13] Steven?

Steven: Yes, and Brian, let me just turn it over to you. Anything in the floating rate (inaudible @ 00:26:00) appealing given rates at 4%-4.5% in high-quality with collateral in floating rates so low duration?

(00:26:05)

Brian: I'll just answer it succinctly and say no. I think that we are looking for meaningfully higher absolute returns in fixed income investments than 4% or 5% floating. I think it's a comment, follow-up on

[12] Please see slide 24 of the presentation for a list of Fund holdings as of December 31, 2021.

[13] The reader is advised that FPA's investment strategy includes active management of its client portfolios with corresponding changes in allocations from one period of time to the next. Therefore, any data with respect to investment allocations as of a given date is of limited use and may not be reflective of FPA's more general views with respect to proper geographic, instrument and /or sector allocations.

what Steven said, spreads are still pretty tight across credit markets and you know, I think you should expect, as in the past, to see us participate more in credit and fixed income at those times when credit spreads are wider.

Next question is what's your outlook for banks and insurance holdings now? And I guess I would say sort of a general comment, and if you look at our holdings also, the earnings outlook is terrific for them. You know, as just mentioned, there's very little in terms of credit stress, so that [we expect] will manifest itself in very low credit losses and reserves for financial companies. In addition, interest rates on the short side look like they are moving up, and many of those companies are interest rate-sensitive so that should also help their earnings over the next year or two. And I would say we also, though, would observe that the valuation has changed pretty materially for many of those companies over the last two years, certainly from the early days in the pandemic, and so that would result in us responding to that change in valuation and reducing holdings in some names and exiting others all together.[14]

The other thing that one never knows when investing or holding financial businesses is that credit cycles show up unexpectedly, and panic or fear manifests itself in the market, and usually is expressed in financial companies in one way or another. And so that's something that is incredibly benign right now but we would expect to present itself again some day.

(00:28:01)

You know, there's two names in particular that we own that we probably have not reduced to any great degree, and that's Citigroup and AIG. They've both probably lagged over a number of years. I think there are a few corporate actions, whether it's spinoffs, sales or divestitures or refocusing, that both those companies are going through. We'll get some fruition on that in 2022 and we're hopeful that that will be positive in terms of both focusing the businesses, reducing some

[14] 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.

of the spectrum and risk profile, and also resulting in a higher sustainable return on tangible equity over time.[15]

The other slight long-term comment I would make here is that I think we would have a much greater sensitivity to the potential for venture or DeFi-based businesses to disrupt the financial companies over the next, say, ten years than one would have thought sitting five or ten years ago. And so I think that that's something that one will keep in mind going forward, that there's a lot of capital chasing disruption in this industry, and I think it's something we'll pay attention to.

Last question for me: Are you—

Steven: Why don't you take that question you're about to read, go in and look at the two at the top that came over the transom as well, and just tie them all together, on SPACs.

Brian: They're general questions on SPACs. Have we bought any during the selloff? How do we feel about the SPACs? Has it been working? So I'll say general question on SPACs.

You know, I think the SPAC basket, just to refresh everyone, we've been doing on a statistical basis where we can buy units which represent the underlying stock and a warrant for less than the trust value, where we can put the underlying stock back for. So we're doing them on a low or no risk of capital basis. We certainly have volatility risk and we have sort of timing risk, but—maybe mark-to-market. But I think we're ultimately backed by more than what we're paying in Treasury holdings of the underlying SPACs.[16]

(00:30:15)

So with regard to that, we still are pursuing that strategy when there's availability of SPACs at a discount to a unit—when units are available at a discount to trust value, we will buy

[15] Tangible equity or tangible common equity is a measure used to evaluate the strength of a financial institution. It is considered a conservative measure of total company value. The measure is calculated by subtracting preferred equity and intangible assets from total book value.

[16] Special Purpose Acquisition Companies ("SPACs") are complex financial instruments. Please refer to the Important Disclosures section of the presentation for important risk information relating the Fund's SPAC holdings.

them. You know, we've got kind of a limit in sizing perspective on how big we want to make that in the Fund but as long as we have some capacity there, yes, we continue to buy them.

In terms of how is it working, we've had 12 SPACs that have announced transactions, which means we've either had a chance to sell the stock at a premium or put the stock back, and then we own warrants that have, you know, in general, five years of life and value. And so that's kind of what we are playing for in the SPACs. And so, you know, cautiously optimistic that that will continue to play out.

Mark: Brian, maybe you just want to add the role that the SPAC exposure really plays in our portfolio holistically, if you just step back for a second.

Brian: Sure, thanks, Mark. Yes, when we went into SPACs, we thought about them as a better credit investment than high yield. And so I think our perspective or thesis is that we have Treasury-like downside risk, and that if you make some reasonable assumptions in terms of what warrants will be worth when deals are completed and the likelihood of the SPACs completing deals, that our expectation is that that basket of SPACs we bought will, over time, produce better returns with shorter duration and less risk than what was available in the high yield market and, to Steven's earlier point, continues to be available in the high yield market.

I would say that we are noticing some pockets of weakness in credit markets that are tied, probably, on the convert side, tied to more speculative businesses. And so we may change our mind about what the sort of best thing to do from a fixed income perspective is, but lately—or at least last year and into this year—it's been SPACs.

(00:32:21)

Steven: There's a question that I'm just trying to think of the specific names, but we have some names in the—investments in the portfolio that seem, at least superficially, to stretch the—questioner, forgive me for the poetic license I've taken with your question—but that seem to stretch kind of the definition of value. And I guess the question is being kind of asked about value in the most traditional sense of value.

And so some of the companies that we own, superficially, look expensive but years ago, we made the determination, as Mark was referencing, that if we have to evolve as investors, we have to make sure we're able to generate return. When we think about protecting capital and margin of safety, it's migrated to an extent from what's on the balance sheet of the company, but to what the value of that enterprise is. So if you will, migrated from the balance sheet to the business.[17]

So that creates a little bit more uncertainty because it's a little bit more in the future than what's in the here and now, but that explains some of the investments we have in the portfolio, and maybe Mark or Brian want to address something that's in the portfolio as an example of that.

Brian: I don't know if I would…

Mark: I'll do the general and Brian, why don't you pick up if you want to take the baton after. But we've said in the past, and some of you may have heard the expression "value and growth are joined at the hip". And so if you step back, it's really a belief, more than just an expression.

(00:34:05)

On our end, we tend to be cash flow-based investors in many of our investments. And so what that means is we're thinking about the value of the cash flows going forward in the future. Now, those cash flows could be a growing earnings stream or it could be a stable earnings stream, or possibly even a declining earnings stream. The most important point to us is that we purchased those cash flows at a discount to what we believe is the intrinsic value.

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[17] 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 seek to protect against permanent capital loss in the case of an unexpected event or analytical mistake. Determining a company's "true" worth or intrinsic value is highly subjective. There is no guarantee that the methods used to evaluate intrinsic value will be accurate or precise or that an investment made with a margin of safety will not decline in price.

So we don't invest based on narratives. We don't invest based on sentiment. What we really invest in is based on fundamental belief on what the future earnings are going to be of the business. So at times, that might mean that there's greater opportunities in names where you have more of those earnings in hand, where you can see them, based on the very near-term earnings. Others, it might be based on further-term earnings, possibly two, three, four or five years out. But ultimately, the value and growth being tied at the hip means that the value is ultimately driven by the discounted basis of those future cash flows, whether they're declining, stable or growing.

And so that leads us, as we have in the past and continue, to look for names that we think trade at a discount to our estimates. Some of those names might be faster-growing names, some slower. Brian, I don't know if you want to jump in and add to that.

Brian: No, I think that's fine. I will jump to a specific one. Can you update us on Charter Communications and its competitive position?

You know I don't, there's—you know, I think maybe from between when we last spoke and now, the cable company reported somewhat slower net additions in the broadband business. Other than that, I don't think anything has really materially changed in their positions over the last 6 or 12 months. I think that it's unsurprising that the rate of growth will be slower going forward than in the past. That's both a function of pulling forward from COVID and then also just sort of having consumed a lot more of the DSL competition, and so there being kind of less easy gains to have.[18]

(00:36:24)

I think from our perspective, Charter still has some favorable long-term prospects, and that's in part based on their footprint that is somewhat less overbuilt, and I think will remain less overbuilt, and then also the cellular or mobile agreement that they and Comcast have I think we think sets the cable companies up in a very strong position to compete with their potential

[18] DSL is Digital Subscriber Line, a technology for high speed transmission of information over standard phone lines.

overbuilders over time. And so that perspective hasn't changed. So I would say kind of more of the same.

And the management team is and has been terrific. They continue to, very smartly in our mind, return money to shareholders through buybacks and kind of an optimally managed balance sheet.

Mark: I suppose we'll stick with tradition and I'll take the softball China questions. So there's a few questions. I will sum it up as: Why do you still own what you do in China? And these stocks are down a lot, what do you guys think?

And so we talked about China extensively on our second quarter conference call transcript.[19] We wrote about it a little bit in our third quarter commentary. And the takeaway that I would provide to you is we said at the time, in the third quarter, we've chosen to use the thimble to add to our exposures rather than the bucket. So, if nothing else, we like to think that we're pragmatic investors rather than dogmatic. So in the past, you might have noticed, if you've been a long-term investor in the Fund, we have exposures, for example, to the advertising agencies, WPP PLC and Interpublic Group of Companies (IPG) specifically. When we realized that those industries weren't going to—or those companies I should say—weren't going to have as attractive growth prospects as we had previously thought, we exited our exposure to the industry. If you go back many years ago, the largest exposure in the Fund would have been oil and gas. When we decided the future for the oil and gas industry wasn't going to be as bright as we had previously thought, we largely or almost completely exited our exposure to the industry.

(00:38:33)

Now, we're not there yet on the Chinese companies. It doesn't mean we won't get there one day but for the moment, hope springs eternal. So if we look at our holdings in China, we think

[19] Please access the 2nd Quarter 2021 Webcast by clicking on this link. The 3rd Quarter 2021 can be accessed by clicking on this link.

they're of very high quality in terms of the characteristics of the underlying businesses. They largely have owner-operators at the helm, and they continue to have attractive growth prospects for the foreseeable future. And the punchline is, they trade at valuations that effectively are unheard of for such businesses in the rest of the world. Now, that's obviously due to the regulatory uncertainty that's taken place, combined with a macro slowdown that's happening at the moment in China.[20]

So call it 12 to 18 months from now, we think we'll have a better idea in terms of regulatory environment and, hopefully, China will be emerging from what is currently a period of macroeconomic pressure. I think that'd be the best time to assess what we do with the holdings, and for the moment, simply given the valuations are attractive, as they are, we're seeing the companies buy back stock, albeit gently, and we think that, in comparison to what we can find in the rest of the world, these opportunities stick out like a bit of a sore thumb.

(00:39:56)

As we did write in our Q3 letter, our thumb is getting a little bit swollen from being hammered so hard. But nonetheless, we're riding the course for the moment, but we have not added particularly aggressively to these holdings, and you will have seen that from exposure that is actually somewhat smaller than it would have been in the past, albeit that's due to some sales prior to the decline in the names.

And there's a comment, can you—a question—can you comment on your, why you don't own—why you own ordinaries versus ADRs? We converted all of our holdings to Hong Kong-listed probably about a quarter ago, out of potential delisting concerns for the ADR. So we don't own any of the ADRs at present.[21]

[20] https://www.scmp.com/economy/economic-indicators/article/3163614/china-gdp-economy-beats-2021-growth-target-slowdown

[21] ADR is American Depositary Receipt, which are negotiable certificates issued by U.S. depositary banks representing a specific number of shares of a foreign stock.

There's a question: Small/midcap value stocks look generally cheap right now. Are you looking/finding ideas in this space?

I don't think we're finding—I would say, if anything, we're probably spending a bit more of our time on names that one could think of as growthier rather than value. The names I think that might look value at the moment could end up looking quite expensive down the road, depending on the cyclicality of their underlying earnings. Brian or Steven, I'm not sure if you have anything to add there.

Steven: No. Cyclicality of the underlying earnings as well as the potential disruption to their business. Many of those companies are businesses that—many value stocks, in the traditional sense of the word—are the most easily disrupted businesses, and the companies that aren't don't have the mindset or the capital or the capability to really engage in, grow their business in the face of what is very, very strong competition. I mean, Charter is not an example of that, not a small cap of course, but it is an example of a company that, when you look at the disruption of 5G, it's got a very good setup of its own in broadband and actually had a huge number of wireless customers last quarter, I think approaching—I could have it wrong—like almost 400,000 I think is what it was.[22]

(00:42:10)

There's a question on the U.S. Federal Reserve plans to begin selling down its balance sheet, but at such low yields, who will be buying? Not us.

Will rates need to be materially higher to attract buyers and if so, what does that mean for equity valuations? I mean, we don't know what exactly is going to happen, or even inexactly what's going to happen, candidly. But higher rates are certainly a potential, and what—how they'll get is anybody's guess, and what drives them there is a function of what inflation might be, and how the Fed wants to pull back from what they're doing is something that we just really can't opine. And how that all works together—earnings, growth, and interest rates, and inflation—and they all tie

[22] https://ir.charter.com/news-releases/news-release-details/charter-announces-second-quarter-2021-results

really will dictate what unfolds. So not being able to do that makes it very, makes it impossible for us to really speak to it succinctly.

Brian: Historically—

Mark: Maybe I'll—go ahead, Brian.

Brian: Historically, periods of higher interest rates, higher credit spreads and/or any form of capital scarcity have not been constructive for equity valuations and have not supported equity valuations at the current levels for a long term. But we don't know if or when that will come to pass. I think there's an assumption in the question that it will or is about to come to pass, and that may be right, but we don't know. Sorry, Mark, if I stepped on you.

Mark: No, no, no. I was just going to add, if you think about how we try and invest your capital on a bottoms-up basis, if you told the collective us what rates were going to be 12 months from now, whether it'll be 200 or 400 basis points higher, I don't know if it would actually have any influence on what we do, or change a single purchase or sale. It just doesn't, it's not something we spend a lot of time, or really almost any time, trying to debate. What we do want to do is make sure we buy companies at a reasonable price. Hopefully they've got some tailwinds rather than headwinds, so on and so forth.

(00:44:19)

There's a question, Netflix and Facebook/Meta have missed projections badly. Any concern, or these are short-term, and the long-term case for both is still well-intact?

I'd say we're, to put it succinctly, we're comfortable with the long-term case for both. And so quarterly earnings sort of, I would say, roll off us like water provided our long-term investment thesis is not changed. So I know Brian and I were once on a call with a client, and I think we've owned Google now for 40+ quarters if you do the math. And you know, some of those quarters have been good; some have been less good. Thankfully, most have been good. But if we had sold it every time Google had a bit of a (punk @ 00:45:06) quarter, we'd all be much poorer. And so what we want to do is focus on companies where we've got an estimate of what their future cash flows are going to be, we think we're holding them at a discount to that intrinsic value, and hopefully they've gotten management teams that allocate capital in an intelligent manner, which dovetails to the next question.[23]

How important are Facebook's large investments in the Metaverse to your long-term thesis on the stock?

So, years ago, Brian, Steven and myself all realized we're not technologists. At best, we can turn on our PC each day. I think we're in a much better position to have our capital being allocated by stewards in the technology sector who are much more visionary than ourselves. That means the management team over at Google. I think Mark Zuckerberg, in terms of his prescient foresight to buy Instagram back when he paid a billion dollars for what was essentially a pre-revenue company and, if not mistaken, the popular press took him to task for spending what he did on that company. The same could have been said for Google when they purchased YouTube many years ago.

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So while we very closely monitor all of the investments by our companies, particularly when you've got management teams that have done a good job in the past of seeing around the corners, and maybe we don't, we think you want to give them a bit of room to run.

So, as it relates to Metaverse, if you watch the Connect presentation by Mark probably Q4 of last year[24], we won't know for quite a few years as to what the future of the Metaverse looks like, and we'll have to, unfortunately, say the same as it relates to the investment. Now, we think we can construct a case where we can own Facebook, providing—or excuse me, putting minimal on the Metaverse investments. And so that gets back to somewhat of a margin of safety where we don't

[23] The Fund first purchased Google on August 22, 2011.
[24] https://www.facebookconnect.com/en-us/

think we need the Metaverse to be successful, but we think it provides optionality that it might, and we can definitely understand his vision and why he is making these investments. I think that wraps it up.

Steven: Yes, there are no other questions that we have to address, so Ryan, why don't I turn it over to you for closing comments.

Ryan: Thanks, Steven, Mark and Brian. As Steven mentioned, I believe those are the questions that were submitted in advance and live, and if we missed your question or if you have any additional questions after the call, please feel free to reach out to your relationship manager, or email us at crm@fpa.com.

Thank you for listening to FPA Crescent's Fourth Quarter 2021 Webcast, and we'll now turn it back over to the system moderator for closing comments and disclosures.

Moderator: [Please reference Important Disclosure Section, slides 25-29]] Thank you for your participation in today's webcast. We invite you, your colleagues and shareholders to listen to the playback for this recording and view the presentation slides that will be available on our website within a few days at FPA.com. We urge you to visit the website for additional information about the Fund, such as complete portfolio holdings, historical returns, and after-tax returns.

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Following today's webcast, you will have the opportunity to provide your feedback and submit any questions—any suggestions or comments. We encourage you to complete this portion of the webcast. We know your time is valuable, and we do appreciate and review all of your comments.

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This concludes today's call. Thank you and enjoy the rest of your day.

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