

# FPA New Income FPNIX

Safety and stability are the hallmarks of this offering.

## Morningstar's Take FPNIX

**Morningstar Rating** ★★

**Morningstar Analyst Rating** Bronze

### Morningstar Pillars

Process		Positive
Performance		Positive
People		Positive
Parent		Positive
Price		Positive

### Role In Portfolio

Supporting

### Fund Performance FPNIX

Year	Total Return (%)	+/- Category
YTD	2.28	-1.51
2016	2.53	-2.75
2015	0.15	1.56
2014	1.32	0.09
2013	0.67	0.38

Data through 10-31-17

8-17-17 | by Eric Jacobson

FPA New Income hasn't been geared for big returns, but rather to provide a safe haven from losses and bond-market excess. Despite the modesty of its gains, the fund's strong management, process, and risk/reward profile support a Morningstar Analyst Rating of Bronze.

The fund has been lagging its average peer in the nontraditional bond Morningstar Category and struggling against a goal of surpassing the Consumer Price Index plus 100 basis points per year. That's a byproduct of its low-risk approach, though, and its long-term record is good when volatility is taken into account: Its three-, five-, and 10-year Sharpe ratios rank among the category's best. Ultimately, the fund is best considered a bond market safe haven.

You might not know that by a cursory look at the portfolio, which among other novelties includes slices of GNMA IOs (9% as of June 2017) and 7% in

agency-backed relocation mortgages. Nearly every such allocation belies features that distinguish it from plain-vanilla versions. The fund's GNMA IOs are backed by a modest number of project loans with prepayment penalties, rather than hundreds of easily refinanced single-family mortgages. The fund's relocation mortgages, meanwhile, are linked to borrowers who typically move at fairly regular intervals. That kind of stability and predictability help keep a lid on risk among securities the fund has otherwise bought because of compelling valuations.

Tom Atteberry has led the fund since 2010 after years as a co-manager, and was joined by Abhi Patwardhan (who was also named director of research) in November 2015; the team is likely to hire another analyst in 2017. At seven members, that still wouldn't be a large team, but a ruthless focus on value and deep margins of safety has historically sifted that universe to a manageable size. Given the fund's style, the largest risk would seem to be difficulty researching a big number of corporates after a fire-sale sell-off. That's tempered by Atteberry's record and temperament, though, which provide assurance he'd avoid risks for which he lacked sufficient resources to underwrite.

**Process Pillar** Positive | Eric Jacobson  
08/17/2017

The fund attempts to earn positive returns exceeding the Consumer Price Index by 100 basis points over five-year periods and positive returns over 12-month rolling periods.

That focus on positive absolute returns is part of the reason this fund is in the nontraditional bond category. Its duration has been very short since 2002 though (less than two years), and while he has plenty of freedom, skipper Tom Atteberry has said it's very unlikely the team would take its rate sensitivity much higher in the next few years. They target a range of 75% to 100% in high-quality debt, including cash, U.S. Treasuries, and highly rated mortgage-backed, commercial mortgage-backed, and asset-backed

securities. The remainder of the fund can include more-credit-sensitive sectors, including high-yield and lower-quality securitized bond structures.

Those may look like common fare among modern bond funds, but this one looks for opportunities in areas that have unique sets of risks and analytical advantages. Recent examples included loans to mortgage servicers purchasing and working out distressed mortgage pools, and interest-only bonds structured from pools of GNMA project-loan IOs. The fund's managers won't buy anything that can't pass extreme stress-testing while offering significant value, though, and combined with robust issue-by-issue research, those features support a Positive Process rating.

The majority of the fund's holdings are very short-term and highly rated. As of June 2017, the fund carried an effective duration of 1.5 years and only 12% in holdings it deemed credit sensitive. Its biggest shift in recent years has been a ramping up of holdings loosely classified as ABS to 53% of total assets as of June 2017, from around 13% in 2013. That included 13% in high-grade collateralized loan obligations--a notable increase from 2% in September 2016--and 15% in securities backed by subprime auto loans (they held up well despite mid-2017 weakness thanks to very strong credit enhancement), as well as wireless towers, shipping and storage containers, and distressed-mortgage servicer deals. Other exposures included 7% in relocation bonds, and 9% in Ginnie Mae interest-only project-loan tranches with prepayment lockouts, which Tom Atteberry argues carry little refinancing risk or interest-rate sensitivity. The fund has also held legacy nonagency residential mortgages (9% in March 2017).

Atteberry has held some high-yield bonds since early 2013, predictably focusing on short-term, callable high-yield names. But while the fund did have trouble with some energy holdings in 2015, they constituted a relatively small allocation in the portfolio, and the

team took down its overall corporate stake to 3.4% as of March 2017, concerned with increasingly tight valuations and deteriorating fundamentals.

**Performance Pillar** + Positive | Eric Jacobson  
08/17/2017

The fund's record is best assessed versus its own goals of avoiding losses and beating the Consumer Price Index by 100 basis points over five-year cycles, and it has scored 30 consecutive years of positive returns. The fund's short duration helped shield it during the 2013 taper tantrum, and a shift toward cash and high-quality bonds helped the fund return 4.3% in 2008 while many of its peers posted losses.

This positioning has left it behind during the past decade's bond rally on an absolute basis. The fund lags most of its distinct nontraditional bond Morningstar Category peers on a trailing 10-year basis and would earn middling slots versus the short-term bond category. Things turned out relatively well in 2015, though, as many funds across categories were buffeted by both interest-rate and credit sell-offs. The fund's overall conservatism helped keep it above water for the year, placing in the category's best third, but left it near the back of the pack when credit sensitive corporates helped fuel the group.

The fund's Positive Performance rating is based on its volatility-adjusted track record, and its returns were nearly the least volatile of any across the nontraditional, intermediate-term, and short-term categories over the trailing 10 years as of July 2017. That helped support a 10-year Sharpe ratio that bested every fund across all three groups as well as a Positive Performance Pillar rating.

**People Pillar** + Positive | Eric Jacobson  
08/17/2017

Tom Atteberry joined FPA in 1997 and has led this fund since 2010 after comanaging it since 2004 with Bob Rodriguez, who retired at the end of 2016.

Atteberry was joined by Abhi Patwardhan in November 2015 (shortly after an earlier corporate-specialist hire departed from a short stint with the firm) when he was also named director of research, and he is considered a potential successor to Atteberry. The team had also brought in Joseph Choi in 2014, hired Prakash Gopinath in 2015, and is

further supported by research specialist Nazanin Pajoom and veteran mortgage specialist Julian Mann. The firm is likely to hire another analyst before the end of 2017 and that would bring this group to seven.

That's not a large team, but a ruthless focus on both value and deep margins of safety, has historically sifted that universe to a manageable size. Given the fund's style the largest risk would seem to be difficulty researching a big number of corporates after a fire-sale sell-off. That's tempered by Atteberry's record and temperament, though, which provide ample assurance he'd steer far from risks for which he lacked sufficient resources to underwrite.

Manager ownership is strong here, and we have long considered Atteberry among the industry's best. Patwardhan has also impressed since coming aboard, helping to underpin the fund's Positive People rating.

**Parent Pillar** + Positive | Eric Jacobson  
04/13/2017

FPA has changed but still earns a Positive Parent Pillar rating.

This is no longer Bob Rodriguez's shop; the outspoken legend retired in 2016. Steve Romick, FPA Crescent FPACX manager and managing partner with CFO J. Richard Atwood, is now its public face. He's no less zealous a contrarian than Rodriguez, though he expresses himself less vehemently and is more apt to nurture investor expectations than leave them to form their own.

The same is true of FPA. It still would, as former First Eagle Global SGENX manager Jean Marie Eveillard said, "rather lose half of our clients than half of our clients' money." But it's more likely to try to convince clients to stay during fallow periods. In addition to naming successors and restructuring funds in recent years as key managers retired, the firm also expanded client service and started hosting biennial investor days. Like other active managers, the firm has seen outflows in recent years.

A core of committed capital and virtues remain, however. Investors still run FPA for investors. They

eat their own cooking and charge reasonable fees. They're focused on the long term, disdain trendy fund launches, avoid regulatory snafus, and write smart and engaging shareholder letters. The firm's focus on achieving good absolute long-term returns via high-conviction, bottom-up strategies also hasn't wavered.

**Price Pillar** + Positive | Eric Jacobson  
08/17/2017

FPA took the fund's expenses to 0.49% in mid-2016, down from 0.58%. The waiver was renewed in early 2017 and will continue into 2018, when FPA will revisit the decision. At 58 basis points, the fund's expenses ranked as low relative to those of similarly distributed nontraditional bond funds, and 0.49% is an even better bargain. Either price would be reasonable when compared with short- or intermediate-term bond offerings, as well. The fund eliminated a 2% redemption fee in June 2017.



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### Average Annual Total Returns

As of Date: 9/30/17	30 Years	20 Years	15 Years	10 Years	5 Years	3 Years	1 Year	YTD	QTR
FPA New Income, Inc.	6.13	3.96	3.11	2.34	1.41	1.65	2.58	2.23	1.01
BBgBarc US Agg Bond	6.55	5.12	4.23	4.27	2.06	2.71	0.07	3.14	0.85
CPI + 100	3.61	3.17	3.11	2.70	2.31	2.24	3.25	2.14	1.31
BBgBarc US Aggregate 1-3 Yr	NA	3.55	2.50	2.18	0.92	1.07	0.69	1.07	0.34

Periods greater than one year are annualized. Performance is calculated on a total return basis which includes reinvestment of all distributions. Comparison to any Index is for illustrative purposes only. The Fund does not include outperformance of any index or benchmark in its investment objectives.

**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 0.49%. Current month-end performance data may be obtained at [www.fpafunds.com](http://www.fpafunds.com) or by calling toll-free, 1-800-982-4372.**

## 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.fpdfunds.com](http://www.fpdfunds.com).

Investments in mutual funds carry risks and investors may lose principal value.

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. The return of principal in a bond investment is not guaranteed. Bonds have issuer, interest rate, inflation and credit risks. 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.

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, which are subject to interest rate, currency exchange rate, economic and political risks.

Value style investing presents the risk that the holdings or securities may never reach their full market value because the market fails to recognize what the portfolio management team considers the true business value or because the portfolio management team has misjudged those values. In addition, value style investing may fall out of favor and underperform growth or other styles of investing during given periods.

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**As of 10/31/17, FPA New Income Fund was rated against the following numbers of US Fund Nontraditional Bond category over the following time periods: 3 stars out of 260 funds in the last three years, 2 stars out of 166 funds in the last five years, and 2 stars out of 41 funds in the last ten years. Past performance is no guarantee of future results.**

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perform relative to a benchmark, or in the case of exchange-traded funds and index mutual funds, a relevant peer group, over the long term on a risk-adjusted basis. They consider quantitative and qualitative factors in their research, and the weight of each pillar may vary. The Analyst Rating scale is Gold, Silver, Bronze, Neutral, and Negative. A Morningstar Analyst Rating of Gold, Silver, or Bronze reflects the Manager Research Group's conviction in a fund's prospects for outperformance. Analyst Ratings ultimately reflect the Manager Research Group's overall assessment, are overseen by an Analyst Rating Committee, and are continuously monitored and reevaluated at least every 14 months. For more detailed information about Morningstar's Analyst Rating, including its methodology, please go to [global.morningstar.com/managerdisclosures/](http://global.morningstar.com/managerdisclosures/).

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#### Index / Benchmark Definitions

Bloomberg Barclays Aggregate Index provides a measure of the performance of the U.S. investment grade bonds market, which includes investment grade U.S. Government bonds, investment grade corporate bonds, mortgage pass-through securities and asset-backed securities that are publicly offered for sale in the United States. The securities in the Index must have at least 1 year remaining in maturity. In addition, the securities must be denominated in U.S. dollars and must be fixed rate, nonconvertible, and taxable.

Bloomberg Barclays Aggregate 1-3 Year Index provides a measure of the performance of the U.S. investment grade bonds market, which includes investment grade U.S. Government bonds, investment grade corporate bonds, mortgage pass-through securities and asset-backed securities that are publicly offered for sale in the United States. The securities in the Index must have a remaining maturity of 1 to 3 years. In addition, the securities must be denominated in U.S. dollars and must be fixed rate, nonconvertible, and taxable.

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.

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.

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