Q4 2019 FPA New Income, Inc. (FPNIX)/ FPA Flexible Fixed Income Fund (FPFIX) Webcast
January 29, 2020

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You should consider FPNIX and/or FPFIX (each a "Fund", and collectively the "Funds") investment objectives, risks, and charges and expenses carefully before you invest. The Prospectus details each Fund's objective and policies and other matters of interest to the prospective investor. Please read the Prospectus carefully before investing.

This transcript must be preceded or accompanied by a prospectus for the Funds. The prospectus for FPNIX dated July 25, 2019 can be accessed at: https://fpa.com/request-funds-literature. The prospectus for FPFIX dated April 30, 2019 can be accessed at: https://fpa.com/request-funds-literature The most current prospectus can always be obtained by visiting the website at www.fpa.com, by calling toll-free, 1-800-982-4372, or by contacting each Fund in writing.

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Moderator: Hello and welcome to today's webcast. My name is Joella 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. Click the green Q&A icon on the lower left-hand corner of your screen, type your question in the open area, and click Ask to submit.

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

Kristina: [Please reference slide 1] Thank you. Good afternoon and thank you for joining us today. We would like to welcome you to FPA New Income and FPA Flexible Fixed Income Fund Fourth Quarter 2019 Webcast. My name is Kristina Surkova and I am the relationship manager for the Fund.

The audio, transcript and visual replay of today's webcast will be available on our website, FPA.com. In just a moment you will hear from portfolio managers Tom Atteberry and Abhi Patwardhan and members of the Fixed Income investment team.

Tom Atteberry is a partner at FPA and joined the firm in 1997. Tom has been a portfolio manager of FPA New Income, Inc. since 2004 and a Portfolio Manager for FPA Flexible Fixed Income Fund since its inception in December 2018.

Abhi Patwardhan is a partner at FPA and has been with the firm since 2010. He has been Director of Research for FPA New Income since April 2015 and portfolio manager for the Fund since November 2015. He has served as a portfolio manager for FPA Flexible Fixed Income Fund since its inception in December 2018.

As many of you know, we typically hold an Investor Day here in Los Angeles every two years. This year, rather than asking our friends across the country to come to LA, and in an effort to increase [and] to ease travel considerations for those interested in attending, we have decided to take the show on the road. We will shortly be posting on our website and sending out a Save the Date for the upcoming events. These events will take place in late April, with the locations being Los Angeles, Atlanta, New York, and Chicago. Please stay tuned for more details over the coming weeks.

[Please reference slide 2] Now let's talk about what happened during the quarter. The Treasury yield curve unwound its inversion, with two-year and short-term maturities declining in yield, while three-year and longer maturities increased in yield. We continued to focus on two to two-and-a-half year maturity within high-quality structured product securities. In general, credit-sensitive securities are expensive; however we continue to find a few attractive situations.

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As part of today's agenda, Tom and Abhi will discuss the highlights for both funds, provide commentary on the markets, review performance and portfolio activity, and then will open it up to question and answer session. Tom, over to you now.

Thomas: [Please reference slides 3-4] Thank you, Kristina. And thank you for everyone for joining us this afternoon. I am quickly going to go through the highlights of the investment objectives for both funds. As you all should be aware, the FPA New Income Fund seeks to have an absolute positive return on a 12-month period. It is trying to get CPI plus 100 basis points over a five-year period, and has a maximum allocation to securities rated less than A- of 25 percent. Fixed Asset, same, absolute positive return except it's over a 36-month period; it is trying to get CPI plus 200 basis points over a five-year period, and it could have a maximum of over 75 percent of its assets in securities rated less than A-.

[Please reference slide 5] Looking at our general statistics, nothing really surprising here from what people have probably seen in the past as far as the relationship of yield and duration to the various indices. We had 2.71 to worst in the New Income Fund at the end of the year, with an effective duration of 1.57 years. So we are capturing about 117 percent of the yield of the aggregate index, while taking 73 percent less interest rate risk via duration.

Looking at the Flexible Fixed Income Fund, you see that where we've got a 2.80 yield to worst, and a 1.74 effective duration. What's of note here is that we're—now that the fund is sort of fully up and operating and invested—you're seeing that same characteristic of higher yield to worst than the general index, 106 percent of that yield, and a duration that is, again, taking about 69 percent of the interest rate risk of the index. So we have sort of got it set up the way it would look in a relationship standpoint as you would expect from New Income, and that kind of relationship should continue going forward.

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[Please reference slide 6] From a return perspective, our last year was okay to pretty good. We managed to outperformed CPI plus 100 over a one-year period for the New Income Fund, although we did lag a little bit the Barclays 1-3 Year Agg. That said, if you look back over a three-year or five-year period, or even a ten-year period, you find that we have outperformed the 1-3 Year Agg. And while we haven't necessarily been able to achieve CPI plus 100, we have gotten in a range of CPI plus whether it's 33 basis points over a ten-year period, to 78 over a three-year period. Not something that's surprising, given that monetary policy has been one of really looking at zero or negative real rates on high-quality assets for most of the past ten years.

[Please reference slide 7] have the returns for the Flexible Fixed Income in here. Quite frankly, it's a one-year number. It's not critical for us, looking at this, especially when you consider that we've really had the fund in a more fully-invested position for only about six months. The first six months was much more of a ramp-up period. So we don't find these necessarily that germane to have much of a discussion point today.

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[Please reference slides 9-10] So moving on to the market commentary, what I want to spend a couple of minutes with is just talking about what were some of the big issues in 2019 that we discussed; the first one we have here is the shape of the yield curve. We talked about its inversion during the year, and what that could mean. Historically, when the yield curve or difference in yield between a 10 Year Treasury and a three month Treasury bill gets to be negative, if it was to stay that way for about ten days, historically that's meant somewhere on average, about 311 days later, the economy would tend to go into a recession.

If we look at the last economic expansion that ended in 2008, that number was at 478 days. So simple math tells you if you want to put those going forward, we were inverted through the May and June period of time, into July, so you go, "Okay, somewhere around the second quarter, maybe to the fourth quarter of this year," that indicator tells you that you could find yourself in a recession. It's an open question of whether we will or not; the point is that just because you've uninverted the yield curve doesn't mean that necessarily went away. And you can see that when you look at past recessions, which are the grey bar, you see that while the curve is no longer inverted, the economy still did go into a recession.

[Please reference slide 11] A couple of other big issues for the year; the first one on the left is looking at the dollar amounts of negative yielding bonds in the Bloomberg Barclays Global Aggregate Index. That peaked at about $17 trillion towards the end of the summer. It declined to about $11 billion at the end of the year, and as about a week ago has moved back up to $12 billion.

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A couple of interesting things that have happened in the beginning of the year as it relates into high-quality bonds, especially that in Europe. This is looking at data in the last week as an example. Spain had a 10 year auction for a 10 year bond in which they wanted to raise 10 billion. They had orders for 53 billion. Italy wanted to raise 1 billion euros for a 30 year bond. They had 7 billion in interest for that bid for it. And then Sweden and Belgium, Cyprus and Slovenia, they were four times oversubscribed in some longer-maturity issues that they auctioned off last week. And the yield range for those was between 11 basis points and 53 basis points. There continues to be a very significant demand for a positive yielding bond in the European environment, as evidenced by this sort of data.

On the right hand side, just to look at this survey; Bloomberg does as economists. They expect a recession in 12 months. And currently that's about 30 percent; they had peaked at about 34-35 percent in the middle part of last year.

And then finally, the Federal Reserve injected some liquidity, to put it mildly, into the repo market in the fourth quarter. And as I put out the question at the top, is this another QE? And we'll discuss that in a moment.

[Please reference slide 12] But first I wanted to draw your attention to the left hand side. That pink portion of that graph is the purchase of Treasury bills that the Fed is currently undertaking. They do about $60 billion a month, and they said that they will continue to do that into the second quarter of this year. They have at least said that they will be doing it into April. That orange portion is term repos. Again, that is something that they are doing. They will be doing that again until the second quarter, sort of the April timeframe. And that also includes the blue bar, which is the overnight—the blue portion is just the overnight portion of the repo facility.

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During this whole period of time—that graph is basically the fourth quarter—they have injected roughly $400 billion into the system in order to create more of an excess reserve in order to control the overnight market and the repo side. That $400 billion, if you look on the right hand side, retraces about half of the balance sheet shrinking to the curve between 2018 and the middle of 2019.

[Please reference slide 13] So I had asked the question at the top—is this another QE? And part of it is; it's going to be a permanent injection, and other is the looking at definitions of quantitative easing. So on the left hand side here is 2009, then-Chairman Bernanke said here's the definition we're using for quantitative easing. In a pure QE regime, the focus of policy is the quantity of bank reserves, which are liabilities to the central bank. The composition of loans and securities on the asset side of the central bank's balance sheet is incidental. Basically what it's saying is, "We need to put money into the system, which is bank reserves, and how we do it is somewhat immaterial, whether it's a three-month Treasury bill or a 30-year Treasury bond."

On the right-hand side, this is when they undertook what was QE2 in the fall of 2010. And Chairman Bernanke wrote an editorial that appeared in the Washington Post, and this is an excerpt from that editorial. Keep in mind, at that time they were going to do $600 billion of quantitative easing. He's speaking about the very first quantitative easing that happened about a year or so before this, a year and a half:

"This approach eased financial conditions in the past, and so far looks to be effective again. Stock prices rose, and long-term interest rates fell when investors began to anticipate this additional action. Easier financial conditions will promote economic growth; for example, lower mortgage rates will make housing more affordable, and allow more homeowners to refinance. Lower corporate bond rates will encourage investment. And higher stock prices will boost consumer wealth, and help increase confidence, which can also spur spending. Increasing spending will lead to higher incomes and profits that, in a virtuous cycle, will further support economic expansion."

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[Please reference slide 14] So this is how it was defined in the beginning of the recovery we experienced in 2010. So how is that look at it, if we take that look and apply it to today? Well, to start this off, let's sort of look at the schematic of what they're talking about. This is, to put it into pictures, what we have. And so we have put, “You are here” in the nice red bar, right in front of asset price reflation, easier financial conditions that lead to stronger economic growth that then lead to Fed tightening, which is what occurred in 2016 to 2018; asset price deflation; tighter financial conditions; weaker economic growth; and then in 2019, Fed easing, and the cycle starts all over again.

This is the thought process and the picture of what they’re trying to accomplish.

[Please reference slide 15] First off, how did the mortgage refinancing index look over the past year? Lo and behold, if you look to the far-right, it’s a pretty significant spike up at year-end as the Fed is putting in all this reserves into the system. You do see an increase January through July, which is a function of declining interest rates, but it does show evidence here that hey, when they decide to put more money in the system, we got a higher refi rate.

[Please reference slide 16] If we look at investment-grade corporate, and the graph is showing is two things: the red line is the effective yield on a Bank of America Merrill Lynch US Corporate Master Index—this is investment grade corporate—and the blue line is the spread. Look about three-quarters of the way across, looking at September of 2019, and lo and behold, spread starts to decline, so does yield, as the Fed undertakes this putting liquidity into the system.

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[Please reference slide 17] From a maturity standpoint, and a yield standpoint, looking at just treasuries, the indications are a little different. The lower lines represent the three-month bill, the two-year, and the five-year, very much tied to Fed funds rates. You see them decline during the year. It stays really flat that fourth quarter. But if you look at the green line, and what is in actuality a much darker blue line, which represents the 10-year Treasury and the 30-year Treasury, as they undertook the injection of money into the system, those yields tended to rise. It's not that surprising, because investors at that point are thinking, "Okay. The Fed is putting money into the system. The economy is going to get better." Think about the schematic again that I showed you several graphs ago. Economic things are going to get better; tends to make longer-term interest rates rise some.

[Please reference slide 18] So going forward, so how did risk assets do during that fourth quarter period of time? This is a look at both stock and bonds. I'm not going to go through all of them. I'm going to go through a few at the top, the two at the top, which is US high-yield bonds, and US levered loans. And you look at the fourth quarter versus the third quarter return; much better. In fact, it was much better than anything back to the first quarter for both leveraged loans and high yields.

If you jump to the bottom of that graph, you can see what BB, B, CCC rated bonds did in the fourth quarter, and the lower the quality, the better the return. People saying, "Oh, money is coming in the system; it's comfortable to take more risk." And then at the top section, if you look at the bottom, there's the S&P 500, the Russell 2000, the Dow Jones; as you would expect, the fourth quarter, very attractive returns when you compare it against the second quarter or the third quarter of the year. Everything in anticipation of the fact the Fed is putting money in the system, back to what Bernanke's definitions were and what he was trying to accomplish. So assets are going to rise because the economy is going to do better.

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[Please reference slide 19] And then finally, a couple of pictures just on high yield. If you notice, on the left, that's the yield on the worst of the Bloomberg Barclays high-yield index. And that's the beginning of the November/December time period, the rather precipitous decline in yield; same on spread against people going in looking for risk because they think the economy is going to do better as they look out to 2020 and beyond.

[Please reference slide 20] So wrapping all this up, they talked about households feeling better, being more confident, having more wealth, spending more money, virtuous cycle. Well, how has that worked out? The top graph looks at household investments and how they are allocated. Starting at the bottom with that more grayish-blue, that is equities direct that households own in mutual funds. The next one above that is debt, so that it would be bond mutual funds, such as the FPA New Income Fund; and at the very top is equity and noncorporate businesses, or private businesses. The line represents the allocation, how much they have in real estate. And at this point in time, you look at equities, the household has more of its net worth in equities than it does in its home.

If you look back in time, other than a period around 2000 on the spike, dot-com bubble, and sort of if you get back to the very late Sixties, nifty fifty, typically the house has been the biggest piece of net worth for the consumer. Well, now it's now it's stocks, bonds, and other items. So having a Fed policy to go in and try to keep those elevated in order to keep the consumer confident and happy seems to make some sense from that standpoint.

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The two graphs at the bottom, we sort of want to show you the financial health of the consumer; on the left hand side is the asset to liability ratio, and with assets up, yes, that ratio tends to look better. And it has looked better since early 2009. Some of that is driven by the house price going up; a lot of it driven by equities going up as well. And on the right hand side with low interest rates, the debt/service ratio is low.

So the consumer looks to be, in general—we can obviously find pockets where they may not be—but in general looks to be in very good shape. They've got a lot more assets than they've got liabilities and their ability to service the debt is quite good. The thing that can be somewhat troublesome is the fact that it's being driven by equity values, and they tend to be a lot more transitory than necessarily your home does.

[Please reference slide 21] So a couple of comments going forward—not a lot, but a couple of them. This is a graph that we look at stocks, bonds, and commodities, look at every year, and plot what was the worst return of any of those. Most of the years that you have from 1994 forward, something—stocks, bonds, commodities—one of those indices had a negative return during the year. Rarely do you have everything positive. In 2004, 2005, and 2006, everything was slightly positive, and then this year. And then back in 2017. So you'd kind of look at this and say, "Well, not everything is going to be positive all the time."

[Please reference slide 22] So thinking about that, and looking forward to this next page we look at, takes us to a high-yield index, the Treasury index, leverage loan index, the S&P 500, investment-grade corporate and the Russell 2000, how did they do every year? And we just went back to 2004 with this data. And in general, when you look at this, very good years are followed by mediocre and lackluster years, whether you look at '04 to '05—'04 was better than '05—or if you look at hey, '06 was okay, but then '07 got worse, and then obviously '08 was horrible. And then in '09, 2010, and 2011, it sort of declines once you go away from the really spike of big years.

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So you work across that and go, “Okay, everything did really well in 2019, do we really think they are going to really well in 2020?” It wouldn’t surprise me to see much more mediocre returns going forward. When you’re looking at an equity market and realize, “Okay, P/E ratios are quite high. Yes, if equities can continue to go up, it’s probably going to be more earnings-driven.” Thus, P/E multiple expansion.

You look at the fixed market that we’re concentrated on; spreads in high-quality assets are narrow, everything is rosy and good so to speak; probably not a lot of upside; yields are extremely low as well.

You look at credit. Spreads are very low. It’s probably not going to get much lower from here. They kind of look like as low as they’ve been over the last ten or so years. So you look forward and think, “Okay, it may be more of a coupon year at best, not a lot of capital appreciation.”

[Please reference slide 23] So from looking at all these events that had gone on in the last 12 months, I’m going to spend a minute on the high quality side and go, “What changed for us? What activities did we do in reaction and in dealing with those events that were recurring over the last 12 months?” So this is a look at the big pieces of our high-quality holding. Prime auto, subprime auto, equipment, and mortgage pools. And you look at the auto, the prime side, these are quarterly looks at our allocation, and the last two quarters of this year, there's been much more of an emphasis for us to add to prime auto.

Next to it is subprime auto. That's been dwindling off as an allocation. It's not something we've been purchasing. And what you're looking at is just the runoff and the amortization of the things that we own.

The equipment ABS space is another space where we've had much focus. You see the pretty consistent growth in the allocation to that. And you saw what looks like an allocation, fairly steady for our mortgage pools, our seasoned ten-year and 15-year mortgage pools. And then in the fourth quarter it drops off.

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And then finally, looking over the right, our Treasury holdings have actually gone up in the last two quarters. A lot of that is a function of okay, there are other things to the left that are going down; you're not really paying as much anymore with spread. Going to higher quality, what we've talked about, and our Treasury allocation has tended to increase.

[Please reference slide 24] So to close out with this piece, and look at the yield on those various instruments that were on the previous page—why is the graph somewhat busy? We're going to poke at a couple of areas. If you look at that red line, that represents equipment, AAAs, three-year. It's been consistently over the last year the top of all the lines. That's why we've had a focus there. That's where we've been able to find the better yield. It passes our stress test. We can stress it against widening spreads, and it works for us.

You will notice, below it, that there is a green line that represents subprime auto. But as the previous slide showed, our subprime auto has been declining as far as in allocation. Two reasons: one, you'll notice that AAA is only a two-year. So it's sort of suboptimum from a duration extension standpoint that we want to accomplish. Well, if I change the spread, and I look at higher defaults and delinquencies, that subprime auto is not going to pass our stress test. So from a fundamental standpoint, and from an optimization of our duration that we want to accomplish, subprime auto doesn't work for us.

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Buried within there is a look at, it says non-spec Fannie Mae 15 year 3s, 2013. It's a reasonable representation of the age of the age of the mortgage pools that we own. And that yield has been declining. And as that yield has declined, those bonds have ceased to pass our stress test. Some still do, we obviously own them; others have not. And so they've been finding themselves failing the stress test, so they get sold.

Now, part of that stress test will go, "Well, what if the speeds slow down some? What of rates rise?" Those two elements happen, and they don't work. And most of that is being driven by there being a bigger demand for them; the spread versus Treasury has declined, and they just aren't working out for us. So that has been an area that we have continued to decline in our allocation, and as we look into the beginning of this year, there's nothing that has changed yet, that has said, "Okay, we're going to move in a different direction.

At this point, I'm going to turn over to Abhi to make more comments specifically about the portfolio, and about the returns that we've been able to generate over the last year.

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Abhijeet: [Please reference slide 25] Thanks, Tom. So we will go through performance and portfolio comments on both New Income and Flexible Fixed Income.

[Please reference slide 26] So let's start with New Income. This slide shows the performance for the fourth quarter of 2019 and calendar year 2019. New Income's total return in the fourth quarter was 50 basis points before fees, as shown at the bottom of the third column. The largest, second largest, and third largest contributors to performance were equipment asset-backed securities, agency mortgage pools, and ABS backed by auto loans. As Tom pointed out, those are mostly prime quality loans in our portfolio. For all three of these, the return was predominantly driven by coupon payments.

From a sector standpoint, there were no meaningful detractors from performance during the quarter. However, within our corporate holdings, our common stock investments in PHI detracted from performance. PHI[1] is an energy and healthcare-related helicopter transportation services company. We wrote about this investment in our third quarter 2019 commentary, so please refer there for more details.

For the calendar year 2019, New Income's total return was 4.24 percent before fees. The largest, second largest, and third largest

[1] PHI Inc. portfolio weight as of December 31, 2019 was 0.1%. **Past performance is no guarantee, nor is it indicative, of future results.**

contributors to performance were agency mortgage pools, ABS backed by auto loans, and equipment ABS, respectively. For all these investments, the return came from coupon payments and price appreciation.

In the past, we have talked about how we actively managed the fund in its duration. We often refer to our duration test in which we try to buy the longest duration investments that we can find that we expect will have a break-even total return in a rising interest rate environment. Specifically, we assume that yields on bonds will rise by 100 basis points over a 12 month period. This approach limits the potential decline in the value of the portfolio in a rising interest rate environment.

On the other hand, this approach creates upside optionality in the event that interest rates decline, because that should cause the prices of our bonds to rise. 2019 was the realization of that upside optionality. In 2018, when interest rates were higher, we bought bonds with durations of close to three years. As rates declined in 2019, those bonds appreciated in price, generating returns that were greater than what would have been expected based on the yield to worst at the time we made those investments.

In the calendar year 2019 from a sector standpoint, there were no detractors from performance during the year. However, within our corporate holdings, our investment in PHI detracted from performance.

[Please reference slide 27] The next slide shows the yield and duration in our high-quality holdings. Those were the investments rated A or higher. We also slowed the yield on the two-year Treasury. The two-year Treasury yield declined, dragging down the yield on our high-quality investments over the course of 2019, though not in the past few quarters. The duration has not declined as much because we continued to try to push out the duration as far as we can; again, subject to the duration test that I described a few moments ago. The goal is to maintain an attractive upside versus downside with respect to interest rate risk.

[Please reference slide 28] Here we show New Income's credit exposure versus the yield and spread on the Bloomberg Barclays high-yield index. We define credit as an investment rated BBB or lower. We use these high-yield indices as a rough proxy for our credit investment opportunity set. The takeaway from this slide is that credit markets became more expensive in the fourth quarter. To underline this point, I will highlight the right side of the chart, where it shows that the yield and spread on the index make a significant downward move as if they are falling off a cliff.

[Please reference slide 29] However, despite that, in the fourth quarter, we were able to increase the credit exposure slightly, as shown on the next slide. The left side of this table shows that the credit exposure increased by approximately 80 basis points from 5.8 percent at the end of September 2019, to 6.6 percent at the end of December 2019. This increase was via investment in bank debt, and came in three forms: one, we were able to add to existing positions at attractive prices; two, we found a couple of new investments during the quarter; and three, we dusted off some old ideas.

On that last point, the team here is constantly turning over rocks trying to find attractive investments. Even when the market is expensive, we research ideas, document them, and file them away until the price gets cheaper. This past quarter, we were able to pull a couple of ideas off of the shelf as the price and the investment evolved in such a way that the risk versus reward became attractive.

[Please reference slide 30] The net effect is that the yield to worst increased slightly over the quarter, despite the duration decreasing slightly. This is shown at the bottom of this slide. The specific two to three year part of the Treasury curve where our high-quality investments are concentrated, didn't move that much in yield during the fourth quarter, and additional credit investments we made added a bit to the overall yield.

[Please reference slide 31] The next slide shows the portfolio broken down by investment idea, as of September 2019 on the left, and December 2019 on the right. Each slice of the pie represents an investment idea that is greater than four percent of the portfolio. Any idea that is individually less than four percent of the portfolio is included in the orange slice labeled Other.

Most of the money that was invested during the quarter was in auto ABS, mostly prime quality auto ABS bonds; equipment ABS, and non-agency mortgages that altogether had an average duration of approximately 2.25 years. Comparing the two pie charts, you can see that the auto ABS and the equipment ABS ideas increased by about a percentage point each. The nonagency mortgage idea is included in the Other category.

Other notable changes include the corporates, which are up about a percentage point, that is where the additional credit investments were made this quarter. And then the Other category grew largely because credit card ABS and subprime auto ABS now fall under that category as they decrease in size. Credit card ABS and subprime auto ABS decreased in size because we hold short duration bonds that we sold to fund our longer duration investments.

And then finally on this slide, the mortgage pass through, or agency mortgage pool investment, declined by about four percentage points because we sold agency mortgage pools with a duration of approximately 2.8 years.

As I discussed earlier, we had bought longer duration bonds in 2018 when interest rates were higher. These are pools that we had bought in 2018 when interest rates were higher. Over the course of 2019, as yields declined, those pools appreciated in price, contributing to a greater than expected total return as we discussed earlier. The extra return was nice, but on the flip side, when we re-evaluated the investments at the higher price, we concluded that these pools were no longer attractive for us to own, because they no longer offered an attractive return for the duration risk going forward.

Our discipline led us to sell them at the very end of the year, which also explains why the cash and equivalents increased from four percent of the portfolio to seven percent, as we did not have the time to reinvest the proceeds of those pool sales.

[Please reference slide 32] We'll wrap up with New Income by showing the portfolio level duration stress test. The bars on this chart show the expected return before fees, assuming the changes in yield shown on the x axis. The blue bars show the results of these yield changes on the portfolio as of the end of 2019. The green bars show the results as of the end of 2018, and the red bar shows the results as of the end of 2017.

As an example, as of the end of 2019, if yields increased by 100 basis points across the board, the expected one year return before fees would be approximately 1.9 percent. These yield changes could come via a combination of changes in risk-free rates, and/or spreads. Lower yields have reduced the upside potential on the portfolio, as shown by the fact that the bars on the left are lower now than they were a year ago. However, the portfolio today has a better return profile than it did at the end of 2017. Notably, at the end of 2017, risk-free rates in the two to three year part of the yield curve were about 30 to 40 basis points higher than they are today. Today's better return profile versus 2017, despite today's lower yields, partially reflects our effects to add more duration into the portfolio over the past couple of years.

[Please reference slide 35] Now let's move on to Flexible Fixed Income. This slide shows the performance for Flexible Fixed Income for the fourth quarter of 2019 and the calendar year of 2019. Flexible Fixed Income returned 49 basis points before fees in the fourth quarter. The largest, second largest, and third largest contributors to performance were agency mortgage pools, CLOs, and corporates, respectively. In all three areas, the return for the quarter was mostly driven by coupon payments. Most of the corporate holdings were in leveraged loans which did not move much in price. The coupon return on our high-yield bonds was partially offset by lower prices. And within the corporates, the common stock detracted from performance due to our investment from PHI. Other than that, there were no meaningful detractors from performance during the quarter.

For the calendar year ending December 31, 2019, Flexible Fixed Income returned 4.21 percent before fees. The largest, second largest, and third largest contributors to performance were agency mortgage pools, equipment ABS, and ABS backed by auto loans, respectively. For all of these investments, the return benefited from coupon payments and price appreciation. The price appreciation was a result of the significant decrease in Treasury yields over the course of 2019, and to a lesser extent, lower spreads. Similar to what we discussed with New Income, the additional return via price appreciation represents the duration upside optionality that we achieved by actively managing the portfolio's duration.

From a sector standpoint, there were no detractors from performance during the year. However, within our corporate holdings, our investment in PHI detracted from performance.

As a quick reminder, Flexible Fixed Income was launched at the end of 2018. Much of the fund's 2019 was spent deploying capital, as reflected by the fact that cash represented approximately 21 percent of the portfolio on average for the year. That cash position created a drag on performance which we expect will not be there in the future, at least in such a significant way.

Having said that, we do plan to selectively raise additional capital in Flexible Fixed Income, which could periodically result in higher cash balances. To help mitigate the potential impact of higher cash, we announced at the end of 2018 that we decided to extend the expense ratio caps for an additional year. The result is that the expense ratio will be ten basis points lower than it would have been otherwise. So for 2020, the expense ratio will be capped at 39 basis points. For 2021, the expense ratio will be capped at 49 basis points. 2022 previously had no expense ratio cap, but now the expense ratio will be capped at 59 basis points in 2022. Please refer to the letter that we posted on our website for more details.

[Please reference slides 36-37] This next slide shows the Flexible Fixed Income portfolio's holdings by rating. As shown on the bottom, the credit exposure—again, defined as investments rated BBB or lower—increased by approximately 120 basis points, to 9.6 percent of the portfolio. The additional investments we made were in leveraged loans, and were similar to those we made in New Income, but typically with larger exposures, given Flexible Fixed Income's more flexible mandate. At the bottom of the slide, we show the quarter over quarter change in yield to worst in the duration of the portfolio. The yield increased slightly, reflecting the additions to the credit holdings. The overall portfolio duration declined by about a third of a year, due to a combination of the aging of existing positions, the addition of floating-rate bonds to the portfolio, and a higher balance of cash and equivalents at year end.

[Please reference slide 38] These pie charts show flexible fixed income by investment idea. When looking at these pie charts on a quarter over quarter basis, it's helpful to keep in mind that the assets grew by almost 20 percent during the quarter as a result of inflows. This becomes relevant when you see that the agency mortgage pass through exposure declined from 27 percent to 19 percent. Part of that reduction is a result of the sales of longer-duration pools that increased in price and eventually become unattractive to own, similar to what we discussed earlier with New Income. But part of that reduction in the pool exposure, is that inflows were invested in other parts of the market so the relative size of the agency mortgage position declined.

The areas that received that capital were leveraged loans, which show up in the corporates on this page; CLOs; equipment ABS; nonagency commercial mortgage bonds; auto ABS; and lastly, nonagency and agency mortgages. Cash and equivalents were higher at year-end, as we work to invest proceeds from bond sales and inflows.

And now we'll conclude with Q&A.

(00:41:19)

Thomas: [Please reference slide 39] Okay, thank you Abhi. If anybody has any questions, just type in the appropriate box and we will get to them. We have several that came in advance that I will go through now, and either Abhi or myself will probably answer them.

The first one to work through is, I have one that says, "Do you think the increasing deficits in US will eventually lead to inflation?"

Inflation will probably not be caused by that. The reason we have a low level of inflation today to periods of deflation is one of we're carrying a much higher global supply of goods and services than we need. The key word there is "global." It used to be one of, "Okay, most of this was domestic to drive this supply and demand equation. It's now become global in nature.

And so because of that when you look forward in inflation, there doesn't seem to be any reason the demand is outstripping supply, forcing prices up. Now having said that, that's in a general broad sense. If you look within some of the services areas domestically, say whether it's health care, or whether you look at housing, you are seeing accelerated or higher levels of inflation there, that are driven by, “Okay, there’s a strong demand, and it’s outstripping what is the known supply.”

(00:42:45)

We had another question that just did come in during this broadcast that deals with inflation as well. And it says, “What are your thoughts on the Bank of England research that shows a decline in real rates going back to the 1300s? Inflation has been low, except in the 20th century. Do real rates continue to stay low in your opinion?”

Well, first off, I’ve only seen the summary piece of this from the Bank of England, but there’s nothing better than digging into something that goes back to 1300. Do we think, though, that real rates are going to continue to be at this lower level? Thinking back to that negative rates from the global agg, thinking back to the times we’ve talked about demographics and the increase that we have and baby boomers retiring, and this need for savings, that demand for high quality assets continues. And because of that demand for high quality assets, it is probably to going to have pressure on real rates and tend to keep them low.

If you further think about okay, we’ve got larger deficits, we’ve got more debt in the economy in general, what are we going to do? You look at those and realize those are additional areas that said, “All right, this demand is telling me at the end of the day, I’m probably going to probably tend to have low real rates. And with this excess supply that’s floating around, you probably also need to figure in that all right, I’m going to have excess supply of goods and services.

(00:44:30)

Another question that we got in, and we get this periodically, so this always fund. I’m going to let Abhi take this one. What are your biggest concerns regarding the fixed income markets presently?

Abhijeet: I do love this question. So Tom made this comment earlier, and I think it’s completely appropriate. We think that the market has a lot of good things baked into it. There’s really not much bad, if anything. So we would probably turn that question on its head and ask—what is there not to worry about?

We’re pretty much worried about everything. We’re worried about the risk of a potential recession, as Tom had illustrated in some of the curve inversion data that he spoke about earlier. We’re worried about permanently low interest rates. We’re worried about negative rates. We’re worried about political risk; specifically the political risk creating policy uncertainty that could impact the fundamentals of investments out in the world.

So we worry about all these things. And because we feel like there's only good news baked into bond prices, whenever we buy bonds, our research is very much focused on all the things that could go wrong, which means that we are essentially only buying bonds when we think we're getting compensated for the possibility of one to 20 different things going incorrectly.

(00:45:51)

Thomas: That's basically a polite way of saying we usually don't get asked a lot of questions about things—we don't get invited a lot of places, because we're not always the most positive people in the world. We're always looking at what could go wrong for us.

Our next question we have, again, I'm going to hand this over to Abhi once it's read. It says most of the holdings in the fund have third party ratings. Given the ability of the advisors to analyze potential holdings, has the Flexible Fixed Income Fund considered increasing its holdings outside of the rated universe to avoid the fallout of future downgrades, as on mis-rated bonds? For example, DoubleLine's Total Return now has a large unrated portion in its portfolio.

(00:46:41)

Abhijeet: This is a really good, great question. In fact, I wish we got this question more often. So part of the reason why we define credit as BBB and lower, rather than using the industry standard investment definition of BB and lower, is that we actually think that the BBB universe is prone to misrating, and at risk of downgrades. So to avoid the problems associated with future downgrades, we put BBB bonds into the same category as BB bonds, B, CCC bonds, and for that matter, unrated bonds. We consider all that as credit, which means that all those bonds have to compete for our capital on an equal basis.

Now one way to interpret this is that we essentially assume that BBB bonds will be downgraded. And when we look at the BBB universe today, especially a lot of the corporate investment grade, corporate BBBs, I don't think that that's an unreasonable assumption.

Now with respect to unrated bonds, the premise of the question is correct. We do have the ability to analyze unrated bonds. In fact, you can gather from my comments regarding BBB bonds that we don't really use ratings as an arbiter of credit quality. As such, because we do a lot of fundamental work on credit quality, we have invested in unrated bonds in the past, and we are very much open to buying them in the future, as long as we feel like we are being compensated for the credit risk and liquidity. However, we do treat those bonds on a case by case basis, just like we would with any other bond, rated or otherwise.

And because we think we've gone a long way toward addressing the misrating risk by broadening the definition of credit to include BBB bonds, we don't see the need to buy unrated bonds for tactical reasons to avoid the misrating risk. And finally, I want to note that, more broadly speaking, we generally don't do things for tactical reasons because that's usually code for making some sort of speculative bet or yield-chasing, which is just not our style.

So in summary, we're happy to buy unrated bonds if the price is right.

And then one other question that came in: how are fund flows? I think this is referring to Flexible Fixed Income. And the follow up question is, is Flexible Fixed Income available at Raymond James yet?

Those are very good questions. I don't know the answer off the top of my head. We are going to follow up with the person who asked the question. What I do know for sure is that over the course of the fourth quarter, the size of the assets in Flexible Fixed Income increased by about 20 percent, and I believe we ended the quarter with about $140 million of assets in Flexible Fixed Income. So if anyone here is good at math, we can calculate how much in inflows there have been during the fourth quarter. But we will certainly follow up with additional inflow data, and whether or not it is available at Raymond James.

Thomas: Thank you. That concludes the questions that we had for today. We appreciate everybody for being on the call. If you have any follow up questions, please feel free to reach out to any of us on the team, and we would be happy to have a conversation with you.

(00:49:44)

Kristina: [Please reference slides 40-45] Thank you for listening to FPA New Income and FPA Flexible Fixed Income Fourth Quarter 2019 Webcast. We now turn it over for the system moderator for closing comments and disclosures.

Moderator: Thank you for your participation in today's webcast. We invite you, your colleagues, and shareholders to listen to the playback of 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 on the Fund, such as a complete portfolio holdings, historical returns, and after-tax returns.

Following today's webcast, you will have the opportunity to provide your feedback and submit any comments or suggestions. 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.

Please visit FPA.com for future webcast information, including replays. We will post the date and time of the prospective calls at towards the end of each quarter and expect the calls to be held three to four weeks following each quarter end.

If you did not receive an invitation via email for today's webcast and would like to receive them, please email us at crm@fpa.com. We hope that our quarterly commentaries, webcasts and special commentaries will continue to keep you appropriately informed on the strategy.

We do want to make sure that you understand that the views expressed on this call are as of today and are subject to change based on market and other conditions. These views may differ from other portfolio managers and analysts of the firm as a whole, and are not intended to be a forecast of future events, a guarantee of future results, or investment advice.

Any mention of individual securities or sectors should not be construed as a recommendation to purchase or sell such securities. **Past performance is not a guarantee of future results.**

Any statistics have been obtained from sources believed to be reliable, but the accuracy and completeness cannot be guaranteed.

You should consider the Fund's investment objectives, risks and charges, and expenses carefully before you invest.

The prospectus details the Funds' objectives and policies, charges 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 email at crm@fpa.com, toll-free by calling 1-800-982-4372 or by contacting the Fund in writing.

FPA funds are offered by UMB Distribution Services, LLC.

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

(00:53:16)

[END FILE]

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