Q2 2021 FPA New Income, Inc. (FPNIX) and Flexible Fixed Income (FPFIX) Webcast
August 3rd, 2021

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

This transcript must be read in conjunction with the corresponding webcast slides, posted on fpa.com. The webcast slide page numbers are referenced below. Please also reference the Important Disclosures at the end of this transcript and throughout and at the end of the webcast presentation.

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 January 28, 2021, and supplement dated April 19, 2021, can be accessed at: https://fpa.com/request-funds-literature. The prospectus for FPFIX dated April 16, 2021 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: [Please reference slide 1] Hello, and welcome to today's webcast. My name is Jen and I'll 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 by locating the Q&A panel on the lower left-hand corner of your screen, type your question in the open area and click Send to submit.

For optimal viewing and participation, please disable your popup blockers. And finally, should 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 you, Kristina Surkova. Kristina, the floor is yours.

Kristina: Thank you, Jen. 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 Second Quarter 2021 Webcast. My name is Kristina Surkova, and I am relationship manager for the Fund. The audio, transcript, and visual replay of today's webcast will be made 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, director of research for FPA New Income since April 2015, and portfolio manager for the Fund since November 2015. He has served as portfolio manager for FPA Flexible Fixed Income Fund since its inception in December 2018.

(00:02:18)

[Please reference slide 2] Before we get started, I want to mention that Morningstar invited FPA Crescent Corporate Portfolio Manager, Brian Selmo, to speak on a panel during the Morningstar conference in Chicago on September 23 this year. If you will be in Chicago for the conference, please stop by his session and, better yet, drop by our booth afterwards to spend time with Brian. You can also attend the Morningstar conference virtually if you prefer.

[Please reference slide 3] Now let's talk about what happened during the quarter. Higher inflation expectations have lowered real yields. [We believe the] bond market is expensive and the portfolios are invested accordingly.

As part of today's agenda, Tom and Abhi will provide a team update, discuss highlights for both Funds, provide commentary on the market, review performance and portfolio activity, and then open it up to question and answers. And now I transfer the floor to Tom. Tom?

Tom: Thank you, Kristina. And I appreciate everybody joining us today. Let me start out with a team update.

[Please reference slide 4] After almost 25 years at FPA, I've decided to step down from the partnership and transition from a co-manager to a senior advisor effective July 1, 2022. I made this decision really in consultation with and in the full support of my other partners and the Funds' Board of Directors. We've been working on this transition for a long time and today is just the optimum time for this change, after careful planning and preparation. Abhi and I have assembled an investment team these past years that have the skillsets and the redundancy to carry forward the investment philosophy and process started in July of 1984 by Bob Rodriguez. And once I formally step aside, I fully expect that to continue.

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By design, the transition continues over the next year, with Abhi and team continuing to increase their day-to-day management of the Fund. As I transition to a senior advisor in July of 2022, Abhi and I will work to really conclude the final items associated with him assuming the full responsibility for the Fixed Income strategy.

I'll make a few short comments on the senior advisor role, and that really revolves around the length of time and the specific responsibilities of this role. They're going to evolve organically, and it's going to be based on the needs of the team and the needs of the firm. That said, in the event of any emergency, I will be available to step back into any active role that is required by either the firm or the team. We're still a year away from this final transition so there's no need for the trips down memory lane. That's for another time.

It's clear to me that nothing is changing, not for the next year, but critically, thereafter as well. With that clarity, I will continue to have significant personal investments, not only in the Funds, but also in the firm's other strategies.

At the end of our formal presentation today, we will be more than happy to take any additional questions on this topic and that will come at the Q&A session at the end of the webcast.

[Please reference slide 9] So, with that, now let's move forward to slide 9 and look at summary statistics of the Funds as of June [30th] of this year. Excuse me. Nine, one more, there we go.

(00:06:17)

Okay, you've seen all—everyone has seen this before. I mean, we put this out every quarter. Now, bonds continue to have a favorable yield-to-worst divided by duration ratio versus the benchmarks. In the case of New Income, it's either the Barclays Bloomberg Aggregate Index or the 1-3 Year Agg. For us, it's a 0.9 on that ratio, whereas you look at the indices, those two indices, it's more like 0.19 and 0.23.

We're generating, between the two Funds, somewhere between 75% and 93% of the benchmark yield while we're only taking on about 13% to 19% of the interest rate risk. And that's what you've come to expect from us and this is sort of a consistent flavor in characteristics of the two Funds.

[Please reference slide 10] So now I'll move to some comments on the fixed income markets and we'll move forward here.

[Please reference slide 11] So looking at this—we'll call it commentary—I might add only one thing into that fiscal policy missing from this commentary. And I can't say that I know what animal I would make it if I was to be a cartoonist and draw one. But these three items—whether it's ZIRP [zero interest rate policy], whether it's [QE] quantitative easing, whether it's fiscal policy, are consuming all the discussions of the fixed income markets this past quarter.

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[Please reference slide 12] What we have in front of you here, it's a lot of information. I really just want to focus on a few things here. This is from the Atlanta Fed, and it's associated with a piece that they have, out of a research piece that they've had a while ago. And they divide the CPI into two items: those that were flexible and those that were sticky. And the definition sort of was based on could the adjustment happen in less than five months or greater than five months.

So, on the left-hand side, where we're looking at the flexible items, I've highlighted a few items, you know, car and truck prices, lodging, car and truck leasing and rental, things that you've seen in the press here of late that have been on a fairly accelerated increase in prices primarily associated with supply chain issues and just a reopening of the economy after being shut down for such a long period of time. Everyone seems to want to label those as transitory.

On the right-hand side, these are sticky items, things that take more than five months to readjust in price. And what we've highlighted is housing, whether its owners' equivalent rent or just rent of primary residence. And that makes up 30.4% of what is classified in this report as sticky items and CPI.

[Please reference slide 13] So if we look forward, go to the next slide, we can look at, well, how did these two elements, how have they moved over the last, roughly, 20 years? And what you have on this graph is the blue line represents those flexible items. Then, as you would expect, it's fairly volatile. Usually it's volatile because flexible items include food and gas as well.

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When we look at today's, when we have food, we have gas, we have the other items that we talked about previously, and it's increase is the highest that it's been since roughly 1990 when this picture was incepted..

The yellow or orange line is the sticky items and, as you'd expect, it's less volatile. It has risen somewhat, if you look to the right. But, really, it's just at the high end of its range at about 2.73%. But what could make that necessarily change? And that's housing costs. If they break out, [we believe] that's going to definitely impact the sticky side of CPI. And the next slides go through to illustrate housing prices.

[Please reference slide 14] So we have two items we're looking at on here. The first one is the blue line and that represents owners' equivalent rent. Think of it this way. It's the rent that would have to be paid if you substituted someone's own house for an equal house as a rental property.

And then the green line, which is rent of primary residence, is what you would expect it is, it's just, okay, what's, you know, the change in apartment rents, what's the change in it if I rented the same—those sorts of things. And when you look at them, all this equivalent rent on the far right, it has turned up. If you look back over time, in along with primary residence, it's sort of increased in a two to something over a low 4% range if we look back at history. But it is turned up. And many that you talked to said that that upturn has been associated with the indirect impact of higher prices on real estate. But rent of primary residence seems to be lagging. It hasn't turned up much at all. It's very small.

[Please reference slide 15] But if we look at the next slide, we can see sort of what's the element that could make that change as we look forward over the next three, six, nine months?

(00:12:10)

And I want to just focus first on the graph on the right. Evercore ISI [Research], which is where this comes from, it's an institutional investment banking and brokerage firm, and for many years it's done a lot of extensive survey work talking to various individuals and businesses, and the graph on the right, it's as of July 14, the last date reported on here, where they'd go out and survey apartment managers relating to their view on what they're going to do with rents going forward.

A rising line equates to more of those participants looking to raise rental rates and then vice versa for the falling one. And that current survey's back to just about the levels that you were seeing in 2019.

The bullet points to the left come from the same report. And that's just a hypothetical example of what could happen if. And so it looks at core CPI and says, well, what if rent was to increase by 0.5% per month?

And rent makes up about 40% of CPI—rent and owners' equivalent rent. Well, what would that mean on an annual basis? Well, that means that's going up 2.4%. Well, they further just posited, well, if everything else just sort of goes up to 2% that the Fed thinks about long-term, then all of a sudden you've got a CPI at 4.4%, and that can then equate to a risk that you see which is, okay, inflation is rising in a much faster and higher rate than the Fed has said they would be comfortable with.

[Please reference slide 16] So looking at this, how is the market thinking about this risk and this eventuality, if it is to occur? And the next slides start to look at this.

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So you can calculate a breakeven rate for inflation by just taking the yield of a nominal Treasury and subtracting the yield of an inflation-protected period and that will give you an implied inflation rate. And we've picked three time periods here. March 31, 2013—that's when the real yield got the lowest it had been ever, at that period of time. December 15 of 2015, that put—that's the day before the Fed made their first Fed increase. And then we've got July 30—sorry, June 30—of this year.

When you look at the three columns, you look at March of 2013 and the December of 2015, and short rates—implied inflation rates—tend to be less than long rates. So investors were thinking that over time the economy will grow and inflation will tend to rise. But you look at the June 2021 and it's inverted. Currently investors think, no, inflation's a transitory problem, it will go away over time, because short implied breakeven rates are higher than long implied breakeven rates. That's the consensus view today.

And so, you look at the data and think, well, what if the consensus is wrong? Does that present a problem for the market?

[Please reference slide 17] So, a couple of other things. I want to spend a little [time] on 2013 to 2014 to just give you the historical perspective, and that's on the next graph.

This takes the yield curve of TIPS [Treasury Inflation-Protected Securities] bonds, so the real yield that you get. And the green line is 2013 of March and then the blue line is a year later, 2014.

During that period of time, Chairman Bernanke came out and made his famous statements about they were going to taper or, as some like to call, the Taper Tantrum that went on. And what was the result of that over that one-year period? The very negative rates of real yields of the March of 2013, not terribly dissimilar to today—some similarities—well, they didn't completely disappear, they became far less negative a year later. There was a shift in what was going on in investor thinking.

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[Please reference slide 18] So let's focus a second on just the five-year TIPS bond and look at the next slide and how that gives us an historical perspective.

This slide shows you the real yield on a five-year TIPS bond for the past 20 years. When you look across and you get somewhere sort of in 2009 long and there, it started to go negative. And then you notice at 2013-ish to 2014 time period a spike up where it went from—it was still negative but made a significant adjustment, as evidenced by the two graphs on the previous page. But after that, it continued to work its way to a positive real yield over the next several years as the economy expanded and the Fed's policy changed.

[Please reference slide 19] So when we think through this and we look at this, if the economy continues to expand, what might occur? Well, there are some other elements at play as well that are worth considering, and the next two slides go through them.

And what these slides are illustrating, is there are two graphs on here. And you've got the yellow line which represents the net issuance of Treasury notes and bonds. And you have the blue line that represents how much cumulatively has the Fed been buying. On the left it's a period of time 2008-2013 and on the right is March of 2020 till, basically, the beginning of July. The red bars are the difference between those two. So that's sort of what we're looking at in here.

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And when you look at it, you said that it wasn't until the middle of '13 that the issuance of Treasuries started to exceed the amount of Fed buying. When you look to the right, we've gotten to the point today where those two lines are on top of each other. So, in essence, the Fed is buying as much as being issued. Remember my comment about fiscal policy: if we expand that, we're liable to see issuance to continue to rise as well. So, you're looking at, maybe, the benefit of the Fed keeping rates down by buying more than has been issued diminishing over time as we move forward.

[Please reference slide 20] The next slide looks at the same data but now we're just going to look at TIPS bonds but we're looking at the same time periods and we're looking at the same relationships. And when you look at that period of 2008-2013, the Fed bought more than was being an issuance of TIPS for only a very short period of time and then issuance far exceeded what the Fed was buying. If you look at today, the Fed has consistently been buying more than has been issued, so the availability of what's public is shrinking. Or has shrunk, I should say.

Now, it looks like it's getting close to where those two lines—the yellow and blue—have come together and maybe they will continue on and repeat what we saw after, post 2013. But we look at this and realize this could be having an impact on the real yield of a TIPS bond given the amount that you're seeing the Fed buying.

So, we look at these and go, this is the other issue at play which is, okay, the Fed's changing to its taper that it's talking about to do some time in the future.

[Please reference slide 21] So how is that working? And so, we start to look at broader indices, the broader markets.

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And what we did here is we sat down and we said, okay, I've got the 1-3 Year Agg and I've got the Barclays Agg. And I've got the yield-to-worst in blue, I've got an appropriate CPI breakeven level in red, and then the real yield is the larger green line. And in both cases of both of these indices, that real yield is at a negative level we've never seen before and it's much lower than we saw in that 2010-13 period. Valuation is very, very strained; it's stressed when you look at this.

[Please reference slide 22] But this isn't the only place that that is occurring. In the next slide we're going to take a look at a broad index but a sort of something of the high yield market.

So, we've used this slide to [analyze] the high yield market before—the Bloomberg Barclays High Yield, the BB portion excluding energy. It gives us a look at taking some of the cyclicality and changes in rating movements out over time, it gives us a fairly consistent look. And this graph is similar to what you see on the previous page. You're at a real yield, which today—well, not today but to the end of July—was 0.3, lowest you've ever seen. But when you think of that, you're getting 30 basis points of real yield on a BB-rated index. But you're also, at this point, not factoring in that there's probably a non-zero probability of default, and lender protections are weak. And what we mean by lender protections are weak is on the next slide. It's something that while it doesn't do high yield bonds, it does levered loans. And what it looks at is: What are investor protections? What are lender protections in the form of covenants? [Please reference slide 23] And you see while there was a blip up in sort of the period of first half of 2020, we're now at a level where there is less protection now than there was five years ago.

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So, when we factor in that low real yield, we haven't even compensated for the non-zero risk of default, and our investor protections via covenants are less. We look at the high yield market and realize this is a very over-valued place to be from a general sense and one needs to be extremely careful if they're going to invest in this area.

With those comments, sort of dealing with what we see as the primary tussle and debates going on in the market, I'm going to turn it over to Abhi, who is going to speak much more specific about what we've been doing in the portfolios and why.

Abhi: [Please reference slide 25] Thank you. Let's start with New Income's performance for the quarter.

The bottom right of this table shows that New Income returned 46 basis points before fees during the second quarter. The rows above that show the contributors to that return.[1]

The largest contributors to performance during the quarter were the corporate holdings. Our corporate holdings benefited from higher prices on our high yield bonds and, to a lesser extent, our bank loans, too.

The corporate returns were also aided by an increase in value of the common stock holdings, which are a small part of the portfolio. And if you see on the left-hand column, you can see what the average exposure was during the quarter.

[1] Past performance in no guarantee, nor is it indicative, of future results.

As a reminder, the small common stock exposure represents a compensation we have received in the past from restructurings that we have been involved in, as part of our efforts to fight for the value the Fund is owed on its investments. We plan to hold these equities until they reach our estimate of fair value.[2]

The second and third largest contributors to performance were collateralized loan obligations, or CLOs, backed by corporate loans and asset-backed securities backed by equipment with the return on both predominantly owing to coupon payments.

At the sector level, there were no meaningful detractors from performance though there were individual investments in some sectors that detracted from performance.

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[Please reference slide 26] These pie charts show the New Income portfolio broken down by investment idea. The orange “Other” slice represents the total of all investment ideas that are each individually less than 4% of the portfolio.

Consistent with our earlier comments about the market being very expensive, we have been investing the New Income portfolio with an eye

[2] Such 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.

toward capital preservation, both in the short-term via limiting mark-to-market risk, and in the long-term by focusing on investments where we believe the investment is well-protected from the possibility of permanent losses.

This past quarter, within the high quality part of the portfolio—those are the holdings rated single-A or higher—these investments included auto loan or lease asset-backed securities backed by subprime or prime-quality borrowers, CLOs backed by corporate loans, CLOs backed by commercial real estate loans, and equipment ABS.

When comparing the pie chart on the right which is as of the second quarter with the pie chart on the left which is as of the first quarter, many of the exposures look like they haven't changed much, despite the investment activity. That's because of maturities during the quarter and also because we sold some of our shortest duration holdings to find new investments.

The result is that the net change in exposures in some areas is not significant despite the fact that we put capital to work in those areas.

The commercial real estate CLOs show up as a new high-quality idea on the right-hand side. In reality, this is an investment idea that has been building for several quarters. Prior to this quarter, those investments were included in the Other slice because they were less than 4% of the portfolio.

These commercial real estate-backed CLOs that we own are AAA-rated bonds and have a blended average life of 1.4 years with most of our bonds having an average life between 1.5 and 2.5 years, though individual bonds could be up to a couple of years longer in some instances, depending on market conditions. These bonds are backed by transitional real estate loans and pay a floating rate coupon.[3]

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Not all of the bonds that we have seen make sense for us. But the ones we own have made sense because the loan-to-value of the underlying loans and through the bonds that we own is low enough. And, even after taking a conservative view on the underlying property values, we believe that our capital will be protected.[4]

As noted earlier in this presentation, [we believe] credit is expensive, so it has been tough to find credit investments that fit the New Income mandate. Within credit, approximately 1% of the New Income

[3] Ratings reflect the Barclays Capital Family of Indices ratings rules and use the median if more than two ratings are available from the Nationally Recognized Statistical Ratings Organizations (NRSROs) DBRS, Inc., Fitch Ratings, Inc., Kroll Bond Rating Agency, Inc., Moody's Investors Service, Inc., and S&P Global Ratings. Lower of the two is used if only two ratings are available from all NRSROs.

[4] Loan-to-value ("LTV") is calculated by dividing the amount borrowed by the appraised value of the property. Typically, the lower the LTV, the less risky the loan is considered.

portfolio was invested in newly issued bonds backed by non-performing residential mortgages. In aggregate, these bonds are only a few percent of the portfolio so they're captured in the Other slice.

We also invested a small amount in short maturity bank loans this quarter. The bank loan investment shows up under "corporates" on these pie charts.

[Please reference slide 27] At the end of the quarter, the credit exposure in New Income was 7.7% of the portfolio, shown on the bottom left of this table.[5] That exposure includes any investment rated BBB or lower. The exposure is lower this quarter due to past investments maturing or getting called and a limited opportunity to replace them due to an expensive market.

[Please reference slide 28] This table provides some details on the composition of the New Income portfolio's yield and duration. As shown in the third row, the Treasury position, which is the portfolio's Treasury hedge, is approximately the same size as it was last quarter, though the duration is a bit shorter at 3.2 years versus 3.5 years last quarter.

The Treasury hedge is comprised of bonds with a duration of approximately three years and four years. We've spoken and written in

[5] During the audio presentation, the presenters stated incorrectly that the credit exposure for FPA New Income, Inc. was 7.6% of the portfolio at the end of the quarter. The actual number is shown above.

detail about the Treasury hedge so we refer you to past webcasts and commentaries for more details.[6]

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We continue to adjust the duration in size of the hedge as economic data unfolds with the goal of generating a positive absolute return for the overall portfolio over the next 12 months in the event that yields increase and providing upside return in the event that market yields decline. Even with the hedge, the overall portfolio duration is still relatively short at 1.3 years, as shown on the second to last line.

[Please reference slide 29] On this next chart we show a simulation of the New Income portfolio's returns. Each bar shows the portfolio's modeled return before fees over the next 12 months based on the change in benchmark yields shown on the x-axis. For example, the bar above 100 shows that the benchmark yield on every bond in the portfolio, regardless of maturity, could increase in yield by 100 basis points and the portfolio would have an expected return over the next 12 months of approximately 65 basis points before fees.[7]

[6] Q1 2021 FPA New Income, Inc. (FPNIX) and Flexible Fixed Income Fund (FPFIX) Webcast on April 28th, 2021 presentation **slides** and **transcript**, and can always be accessed from the FPNIX and FPFIX home pages on FPA's website: https://fpa.com/funds/overview/new-income or https://fpa.com/funds/overview/flexible-fixed-income.

[7] Stress test data is hypothetical and provided for illustrative purposes only and is intended to demonstrate the mathematical impact of changes in yield. **Past performance is no guarantee, nor is it indicative, of future results.**

The far right-hand side shows that even with the—at least for us—longer duration Treasuries in the portfolio, the portfolio should be able to withstand a 200 basis points increase in yield across every bond in the portfolio and still have a positive return before fees over the next 12 months.

The benefit of the Treasury hedge shows up on the left-hand side by contributing to higher returns in declining yield environments. [Please reference slide 34] Moving on to Flexible Fixed Income. We will start with performance.

The bottom right of this table shows that Flexible Fixed Income returned 73 basis points before fees during the quarter.[8] The largest contributor to performance during the quarter was the corporate holdings which benefited from some price appreciation. We also got some benefit from an increase in value of the common stock holdings which, here again, are a small part of the portfolio.

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As noted earlier, our common stock holdings represent compensation we have received in the past from restructurings that we have been involved in, and those are part of our efforts to fight for the

[8] **Past performance is no guarantee, nor is it indicative, of future results.**

value we are owed on our investments. We plan to hold these equities until they reach our estimate of fair value.[9] The second largest contributor to performance was collateralized loan obligations—again CLOs—predominantly due to coupon payments. The third largest contributor to performance was asset-backed securities backed by loans to late stage, mostly software, companies with the return owing to coupon payments.

At the sector level, there were no meaningful detractors from performance though there were individual investments in some sectors that detracted from performance.

[Please reference slide 35] Here we show the Flexible Fixed Income portfolio broken down by investment idea. The Other category, again, represents ideas that are each individually less than 4% of the portfolio. The largest areas of capital deployment during the quarter were in high quality bonds rated single-A or higher, including CLOs, equipment ABS, subprime auto ABS and commercial real estate CLOs. In credit—those are investments rated BBB or lower—we made investments in bank debt, lower-rated tranches of new issue CLOs, new issue bonds backed by non-performing residential mortgages and some high yield bonds. With that said, though Flexible Fixed Income's more flexible mandate gives us more

[9] Such 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.

capacity to own credit, because credit is so expensive these days, most of our investments this past quarter were in high quality bonds with just under a third of our total capital deployment this quarter in credit. At the sector level, repayments of existing investments and inflows left many of the sector exposures relatively unchanged from quarter-to-quarter. [Please reference slide 36] The next table shows that the overall credit exposure in Flexible Fixed Income is relatively unchanged at 23.7% of the portfolio versus 23.3% last quarter.[10, 11]

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[Please reference slide 37] As a reminder, we don't target allocations to certain sectors, investment ideas or credit tiers. Instead, we focus on bottom up investing where we look for specific investments that meet our absolute return criteria. In the absence of that, we will own cash or other high quality, liquid assets. Along those lines, while we don't target a certain credit exposure in the portfolio, when we step back and see how expensive the market is, it makes sense to us that we have approximately a third of Flexible Fixed Income's credit capacity deployed. Even in today's

[10] Ratings reflect the Barclays Capital Family of Indices ratings rules and use the median if more than two ratings are available from the Nationally Recognized Statistical Ratings Organizations (NRSROs) DBRS, Inc., Fitch Ratings, Inc., Kroll Bond Rating Agency, Inc., Moody's Investors Service, Inc., and S&P Global Ratings. Lower of the two is used if only two ratings are available from all NRSROs.

[11] During the audio presentation, the presenters stated incorrectly that the credit exposure for FPA Flexible Fixed Income Fund was 23.5% last quarter. The actual number is shown above.

market, we do find credit investments here and there that make sense for Flexible Fixed Income because Flexible Fixed Income has the benefit of a three-year horizon to achieve a positive return.

For example, we have found some longer maturity bank loans that make sense for this strategy that are not a good fit for New Income because of the short-term mark-to-market risk. Nevertheless, despite the greater flexibility, attractive credit investments are still hard to find.

The second to last row on this slide shows that Flexible Fixed Income—shows that the Flexible Fixed Income portfolio has a 1.68% yield-to-worst and 0.8 year duration. That short duration is due in part to our holdings of floating rate bonds which are approximately a third of the portfolio.

[Please reference slide 38] Here we show the return simulation for Flexible Fixed Income. Again, these bars show the modeled return before fees over the next twelve months based on the changes in benchmark yields shown on the x-axis. As shown on the far right, the Flexible Fixed Income portfolio can withstand a greater than 200 basis points increase in benchmark yields across all maturities and still expect to have a positive return before fees over twelve months. For those comparing this portfolio to New Income, please note that this portfolio has more spread duration or mark-to-market exposure due to higher spreads than the New Income portfolio as a result of the greater credit exposure in Flexible Fixed Income. That is not modeled here.[12]

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[Please reference slide 40] We'll now move on to Q&A but before we get into questions that were submitted, we want to take this opportunity to address an important topic that's at the top of our minds. That topic is the future leadership of this team once Tom steps away from his day-to-day leadership role in a year.

We've been thinking about and working on this for a while now in tandem with Tom's plans. As Tom mentioned in his prepared remarks, this investment team has been built over the course of 10 years. In doing that, we have always been proactive, rather than reactive in building the team. To that end, at the appropriate time, someone will join me in a leadership role. We expect that this person is already on the team because we look for leadership qualities when we hire people. There's no fixed timeline for this leadership appointment to happen. Instead, just like with other additions to our team, our focus will be on identifying the right person because we view this as a multi-decade decision.

[12] Stress test data is hypothetical and provided for illustrative purposes only, and is intended to demonstrate the mathematical impact of changes in yield. **Past performance is no guarantee, nor is it indicative, of future results.**

Lastly, before we get to the submitted questions, I want to take a minute to acknowledge Tom's years of work to get us to today. The objective he set several years ago was that when he leaves, it should be seamless, non-event. I think this transition in a year will, in fact, end up being a seamless non-event and that does not take anything away from Tom. In fact, it's a testament to how methodically this team has been built over a long period of time. I know Tom is not ready to go down memory lane so I won't do that, but I think this seamless transition will go down as yet another of Tom's many accomplishments.

Now getting to the questions that we've received, I will take the first one which was: Will staff be added?

(00:35:55)

Tom commented on this briefly in his opening remarks but, just to add some more detail, we've been planning for the eventuality of Tom's retirement for many years now. In advance of his announcement, we wanted to get the team to a point where Tom could feel comfortable leaving without having a negative impact on our investors or the team. And that's the definition of a successful transition: you can leave and there's no impact. With our most recent hires, which happened over two years ago, we got to the point where we have the people we need to manage these strategies going forward and we think we have redundancies of capabilities.

With that said, if we see a need to add more capacity on the team, we'll of course do that proactively, just like we have in the past. But as of today, even with Tom's future departure, we think the team is in good shape.

Kristina, over to you.

Kristina: Thank you, Abhi. And thank you for those of you who have submitted your questions in advance. We addressed many of them in the prepared remarks and now will work through the remaining ones and then take the questions that came in during the live webcast.

The first one is: How has the soft close impacted the Fund's—and that would be FPA New Income—the Fund's performance? Abhi, and that's for you.

Abhi: Thanks, Kristina. So, we don't know, because we have no idea how big the Fund would have been if we had not soft closed. And we can't say for sure what that larger portfolio would have looked like which means we can't say for sure what the performance would have been. But what we can say is this: we can bracket the two extremes.

On one end, the incremental flows, if we had not soft closed, could have been de minimis in which case the portfolio would be essentially the same portfolio you see today, which means that the performance would have been similar to what we've actually done so far.

(00:38:02)

On the other extreme, we could have had a huge amount of inflows. As I mentioned, it's hard to know what the portfolio would look like under that scenario because there are so many variables involved. Our guess is that the portfolio would be less attractive in that scenario and the return would probably be worse than what we have actually had, but that's just a guess.

The more important point is that from our investors' perspective the risk of more inflows is skewed to the downside. In other words, our guess is that the portfolio return is not better if we had a large amount of inflows which means that [we believe] limiting the inflows tilts the balance toward a better return profile for our investors. That's why we soft-closed New Income and that's why, given the unattractive opportunity set, New Income is still soft-closed today and we have no plans as of now to change that.

Kristina: Thank you, Abhi. Our next question, I believe Tom is going to take it: What is going on in the bond market? Will government be able to maintain negative real yields indefinitely or will the bond market eventually revolt? With junk bonds sporting negative real yields, what does a thoughtful bond manager do these days?

Tom: Thank you, Kristina. I kind of chuckle a little bit because I liked the wording and the “eventual revolt”. You know, many years ago there was sort of this group that was called the bond vigilantes, and occasionally you’ll see commentary where the bond vigilantes appear again, and only time will tell.[13]

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What’s going on in the bond market is it’s things we’ve talked on, specifically more to the Treasuries, is what we’ve spoken about before which is the Fed has decided that the best course of action is a very heavy-handed quantitative easing in order to try to make, you know, interest rates low, encourage people to borrow money in order to do some economic activity just to grow.

Some of that was also, let’s make interest rates low so that those who are trying to stay afloat through the pandemic can borrow money in an inexpensive manner. Is that a rational approach? Only time is going to tell us.

Are they able to maintain negative yields indefinitely? I have no idea if they can or not, and I have no idea if they are going to try to or not. But it is something that when you think about that, you go: that is definitely

[13] **A bond vigilante is** a bond market investor who protests against monetary or fiscal policies considered inflationary by selling bonds, thus increasing yields.

a risk that that attempt may be made and if it doesn't succeed, the other side is a pretty difficult and bad endeavor.

As it relates to the negative yields being supported by junk bonds, I thought that Abhi did a really good job in the presentation as far as what we own and how we attack that. How do we deal with that and try to find some value out there? And I think he laid out several areas of which we've done that, yes, they're not great but they're areas of high yield that can make sense for the objectives that we have.

Kristina: Come our next question: Is this the worst opportunity set you've ever seen in your career? Why is the Fed buying bonds when inflation is over 5%? And, maybe to go with this: Given such a challenge in fixed income environment, and the Fund having [soft] closed last year, is there a compelling reason to retain one fixed income allocation?

(00:42:06)

Tom: Well, first off, you know, and I'm not going to go down memory lane, but yes, I have been doing this for quite some time. And I never remember ever getting these kinds of questions. And it's one of those things that I appreciate our clients asking these kinds of questions because it gives us a good—it gives us a sense of what you're thinking about and what your concerns are. So those are sort of the prefaces.

Now, is it the worst opportunity? If we think back at previous market selloffs in fixed income in the near late Eighties, early Nineties periods or the early 2000s, 2002, and then the Great Financial Crisis of 2007 and '08, as credit and other forms sold off dramatically because of economic problems or financial service problems, you were always able to sort of look to short Treasuries or other very high quality AAA investments and find yields that looked like inflation—might have been slightly higher than inflation—but where a reasonable return could be gotten and you could go high while the storm was upon you.

Today, the Fed seems to have taken out a massive quantitative easing hammer and taken that off the table. And for that reason, yes, this is the worst opportunity set because the ability to find things to go sort of high and ride out the storm are far fewer than they are.

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Thinking about allocations to fixed income, how are we going to be managing New Income and Flexible? And I will speak—and some of this is specific to New Income.

When you think about that [goal of positive] absolute return in a 12-month period and go, that's the paramount item that we have to get to for New Income. And I would say that's critical for investors as well. I need to get the return of my capital, because if I can get the return of my capital, sometime in the future I will be able to deploy it into attractive long-term opportunities. If that means that, from a real yield perspective, it has a negative number to it, then that's something that you just sort of have to accept. And we've talked about how in these types of environments, we prefer that return of capital to trying to get that long-term [goal of] CPI plus 100.

And one other thing, final, on the CPI, be careful to look at the 5% number extrapolated in forever and realize that you're in negative territory. The Fed's buying bonds not because they want to buy them at negative real yields, [but] because they think 5% is transitory and it's going to go away. They realize at some point, whether it's the middle of 2022 or the end of 2022, sometime in 2023—Abhi and I have no idea—they're going to start to unwind through tapering. They're going to change their Fed funds policy from ZIRP to some higher number. We don't know how high that is, we don't know how long it's going to take, but we are pretty comfortable that it will change. So, we look at that and we think about fixed income and I think others should think about fixed income is I need to shepherd my capital and wait this out because I realize there is going to be a time when I can redeploy, in either fixed income or equities or anything else with a much better return profile. Hopefully that sort of gives some items for people to think about they ask the kinds of questions, is fixed income even a reasonable allocation today?

Kristina: Thank you, Tom. Our next question is for Abhi: Does either fund participate in middle market loans?

(00:46:03)

Abhi: Yes. So, in two forms we can, and in the past, we have and we do currently have some exposure directly to middle market loans both in the New Income portfolio and in the Flexible Fixed Income portfolio. In addition to that we, somewhat indirectly, have exposure to middle market loans via some of the CLOs that we own in both portfolios. So, broadly speaking, there are two types of CLOs that one can buy. There are CLOs which are backed by, probably, syndicated loans where the underlying loans trade with some regularity. And then there are also CLOs that are backed by new market loans. So within our CLO holdings in both portfolios we have exposure to both types of CLOs, so we have exposure to middle market loans in that respect as well.

Kristina: Abhi, and the follow-up to this question dealing with CLOs: Have the CLOs been increased due to their ability to increase when rates rise? What are the typical floors, for example, LIBOR plus the spread, and how much would rates have to rise to see an increase in these yields? Are the bank loans meant to serve as a counterweight to the nearly 22% on US Treasuries with the longest duration of 3.2 years?

Abhi: And so, a lot of questions there. Let me take this in pieces. So, the first part was: Have the CLOs been increased due to their ability to increase when rates rise? Not really. We own the CLOs and we bought the CLOs because when we look at the landscape of investments that are available to us where we think we are taking on limited short-term mark-to-market risk where we feel comfortable that our capital will not be permanently impaired, CLOs end up rising to the top of that pile in this market. And when we compare CLO investments to other things that are out there, we generally buy them with the view that rates are not moving in either direction—either up or down. And so, it is on that premise that we've made our CLO investments.

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Now, is it nice that the return on the CLOs might be greater than expected if rates rise? Yes, absolutely. That certainly helps in a rising rate environment. But we also buy our CLOs with the knowledge that the opposite could happen which is rates decline and the CLO return has been less than what we expected. And so, on that note, the second part of the question was: Where are the typical floors? So, typically, the CLOs that we buy have a floor of LIBOR set at zero so your floor coupons typically just spread. And as part of that the question asked: How much would rates have to rise to see an increase in yields? Well, given that structure where the LIBOR rate is floor to zero and so the floor coupon is LIBOR plus the spread, I'm sorry, the floor coupon is really just the spread, any increase in yields would add to the return on our CLOs.

The next part of the question was: Are the bank loans meant to serve as a counterweight to the nearly 22% in US Treasuries with the longest duration of 3.2 years?

So, as a point of clarification, as we mentioned earlier in the presentation, the 22% exposure in Treasuries is a hedge for the overall portfolio. And it's actually comprised of a few different maturities that generally circle around a duration of 3 years and a duration of 4 years. But that Treasury position is meant to hedge the entire portfolio in the event that rates end up declining for whatever reason—kind of like what we've seen over the past couple of weeks where it seems like the world is now suddenly concerned about COVID variants, and that's having some ramifications on how people think about growth and opening up of economies, etc. So, it's environments like this where the hedge is helpful.

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The bank loans are in the portfolio because, as a standalone investment, we think the bank loans that we own have an attractive risk versus reward profile. And so, we view the bank loans as sitting within our core portfolio which is a portfolio excluding the Treasury and then we've layered on this Treasury hedge to provide some upside return in the event that the world ends up in a bad spot.

Kristina: Thank you, Abhi. Tom, the next question is for you. Is the Fed targeting a particular maturity of TIPS? Could that be a factor that's created the inverse curve for breakeven?

Tom: The Fed in its use of QE since the March period of time of last year has been very broad in what it buys across the maturity spectrum. It's really not favored one over the other—you know, something short over long or vice versa. This is both in the notes and bonds category along with looking at TIPS.

Now that's not to say that it may not change in the future. And the reason I say it may not change in the future, there have been past periods during the last expansion when they were using QE, when they talked about an operation twist, where they would tend to favor one set of maturities over another. So that's not to say that when they decided tapering other things that they want to say that that could change. But right now it's a broad sense.

What's driving that, a couple of things, but there's a mathematical part that's driving the large sort of breakeven rate that one sees on the short end of the TIPS curve that we showed earlier, sort of the two-year and three-year.

(00:52:07)

The first one to keep in mind is you're looking at a two-year that has been down in the 10, 15, 20 basis points of yield. You then have also looked at a three-year that's been in a 30-handle yield. And you're doing a math equation. And so, you're looking at that and you go, okay, I'm going to take that 30 basis points or that 20 basis points—and we'll use 20 as an example—and I'm going to subtract the two-year real yield on a two-year TIPS bond from it. Well, when you go to make that subtraction, you realize that you're getting a fairly high negative number on the short end of the TIPS bond because you're trying to make the math look reasonable. The bond's going to mature in a couple of years. It's working itself towards par. So, it tends to have this bigger negative real yield to it. That's sort of the mathematic piece that's making it a somewhat distortion, not the fact that the Fed's being a buyer in there.

The other item is that people, or investors today, look at it and have pretty much accepted the Fed's view that inflation is transitory; it's going to go away over time. It's going to go back towards that 2-2.5 number, so they're not uncomfortable with it. So, they also turn around to look at price of short TIPS bonds for that equation and realize no price can make that occur, because there is very little you can do with the price of the two-year Treasury and a three-year Treasury. The Fed's made sure through their a ZIRP, you know, zero interest rate policy that they've pegged those. And they've pegged those because they went to zero interest rates and told you they're going to do it for a longer period of time than they have in the past.

So, so much mathematic, just mathematical enough that you can do—and the other part is what we talked about earlier which is where, by and large, the consensus is that inflation so far is just going to be a transitory event for the next year or so.

(00:54:09)

Kristina: Thank you, Tom. One more question on CLOs for Abhi: Can you walk through an example of one of your most promising CLO ideas—sector, terms, key risks, and so on?

Abhi: Sure. So, I don't know if we have anything that's particularly promising within our CLO holdings. They all kind of fit the general model—especially within the New Income portfolio—they all generally fit the model of very high in the capital structure bond. It's backed by a portfolio of loans. And when we assume bad outcomes on the underlying loan portfolio, meaning high levels of defaults, low levels of recoveries, the analysis ends up showing that the bonds at the top of the capital structure that we own in our CLO portfolios end up being pretty well-protected.

And so, in exchange for that profile, we are buying a bond that has a floating rate coupon, that has a maturity profile of somewhere between one to three years, maybe four years on the longest end, though that's pretty rare. And we're purposely targeting shorter, maturity CLOs because, as we've mentioned in our comments throughout this webcast, the market is really expensive so we're trying to minimize the amount of short-term mark-to-market risk that we have in the portfolio.[14]

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Now, with the CLOs, because they're floating rate, we don't technically have mark-to-market risk associated with the rise in risk-free rates but we certainly have mark-to-market risk associated with the rise in spreads. So, by limiting the average life of the bonds that we're buying, we're limiting that spread duration risk that we have in our CLO holdings.

With that said, we actually went through our CLO investments in quite a bit of detail a few quarters ago so I'll refer the person that asked the question to our website and you can browse through the archive of

[14] Discussion of these sectors is for informational purposes only and should not be construed as a recommendation to purchase or sell such securities, and any information provided is not a sufficient basis upon which to make an investment decision. It should not be assumed that future investments will be profitable. **Past performance is not indicative of future results.**

webcasts and find several detailed slides there which walk through the CLO investment thesis.[15]

Kristina: Thank you, Abhi. And, Tom, a follow-up to your role on change: How long do you expect to serve in the senior adviser capacity after July 2022?

Tom: So, there are a couple of elements that we've walked through and Abhi and I have discussed and considered—one of which, in general terms, I mentioned at the beginning of this webcast—is that senior role and the length of that senior role is, I guess, somewhat a function of what are the needs of the team? What are the needs of the firm? What roles can I play to assist in both of those? And so that, to a degree, is over time, right, going to dictate how long, how short that might be.

As far as giving an exact date, no, I'm not going to give one. I will say from this standpoint though that senior role, expect that to be for an extended period of time. And what I mean by, sort of giving you comfort with an extended period of time, the question got asked I think of Bob and what was his role and how long was it going to be when he stepped off and said he was going to be a senior advisor. While it's less today with me and Bob as a senior advisor that was in the past, I still have conversations with Bob on a periodic basis, and the period initially may be every month

[15] Q1 2021 FPA New Income, Inc. (FPNIX) and Flexible Fixed Income Fund (FPFIX) Webcast on April 28th, 2021 presentation **slides** and **transcript**. You can also access these webcasts on the home page for each Fund on FPA's website at: https://fpa.com/funds/overview/new-income and https://fpa.com/funds/overview/flexible-fixed-income.

or so. Sometimes it is even more. So, it can be a very ongoing relationship longer term.

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But I will say that, however that length of time is, Abhi and myself and the firm is certainly going to make sure that that length of time is one that is of comfort and correct for all the clients we have in either the New Income Fund or in the Flexible Fixed Income Fund.

Kristina: Thank you, Tom. And thank you to all of you that asked questions. There are no more questions at this time.

We thank you for listening to FPA New Income and FPA Flexible Fixed Income Second Quarter 2021 Webcast. We now turn it over to the system moderator for closing comments and disclosures.

Moderator: [Please reference slides 42-47] 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 about the Funds, such as 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 post the date and time of our upcoming webcasts towards the end of each current quarter, and webcasts are typically 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.

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

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