FPA Paramount Fund
Fourth Quarter 2014 Commentary

Dear fellow shareholders,

During the fourth quarter of 2014, the Fund rose 0.28% compared to the MSCI All Country World Index's (Net) (the "Index") gain of 0.41%. For all of 2014, the Fund declined 5.31% versus a gain of 4.16% for the Index. Looking at full year performance in more detail, the Fund slightly outperformed the Index in the first quarter and underperformed in the second quarter, ending the first half of the year with a 3.78% gain. At the start of the third quarter continuing through the fourth quarter, worries about deflation in Europe, slowing growth in emerging markets and commodity weakness began to impact aspects of the portfolio. Sectors like mining and to a lesser extent luxury goods sold off because of these concerns. As a result individual companies we consider to be high-quality experienced significant price corrections. We bought into these opportunities where prices had already declined 30-50%. As is often the case with our investment style, even though we waited patiently for these high-quality businesses to become attractively valued, large discounts at the time of purchase can and often do become larger afterward. The combination of the decline in **Fugro** (discussed in the third quarter commentary and in the following section), the weakening of the Euro and British Pound against the Dollar (many of our companies are based in Europe) and the continued fall in the share prices of these new additions were primary contributors to the Fund's decline. For the full year, Fugro itself negatively impacted the Fund's return by -4.88%. Finally, as several of the newly purchased companies had additional price declines in the fourth quarter, we were able to increase certain sizing in certain positions as their discounts to intrinsic value widened. Based on the experience of 2014, we believe it is important for shareholders and future investors to understand our performance objective and the return profile implied. Our portfolio management goal is to continuously maximize the Fund's discount to intrinsic value, and therefore maximize long-term potential returns. Doing so with a concentrated portfolio means performance will be lumpy, including underperformance like we have experienced recently. We are willing to tolerate this type of short-term volatility because we believe increasing discounts create the best chances for long-term outperformance.

Key Performers

Our best absolute performer in the quarter was **Oracle** which gained 17.84% (in U.S. currency). Based in the U.S., Oracle is a leading provider of database and enterprise application software. The company has an installed base of roughly 400,000 customers that generates an extremely profitable (gross margins 90+%) annually recurring stream of maintenance revenue. The business model produces returns on capital employed (including intangibles) of 30%. Senior management owns 25% of the company, which leads to appropriate capital allocation decisions. Financial strength is abundant with a net-cash balance sheet and prodigious cash flow generation. Selling at 9x operating profit, we continue to believe Oracle offers an attractive discount to intrinsic value.

Our worst performing holding in the quarter was Fugro, which declined 31.00% (in U.S. currency) on an absolute basis. While we discussed the holding in our last letter we wanted to revisit our assessment of the company. Based in Holland, Fugro is a leading global provider of geotechnical and geophysical analyses, primarily for oil and gas projects, with meaningful exposure to offshore and pre-investment decision activity. The sharp decline in oil prices has had, and will likely continue to put negative pressure on the company's results. It has also caused some permanent asset impairment. Longer-term, we expect market conditions to improve as depleting oil fields will ultimately need to be replaced. In the interim, management is taking actions to adjust its cost base, reduce capex, and manage the balance sheet through the downturn. While we have had to revise our estimation of intrinsic value to factor-in these recent developments, the dramatic drop in share price caused the discount to even our lowered assessment of intrinsic value to increase further, and we have added to the position accordingly.

Portfolio Activity

One new addition to the portfolio was **Cognizant Technology Solutions**. Cognizant, based in the U.S., is a world-leading provider of IT services with a unique global delivery model. After reporting third quarter growth below expectations due to contract delays, we had the opportunity to purchase the company at an attractive discount to intrinsic value. Limited tangible asset needs and high levels of profitability allowed the business to produce returns on capital employed in excess of 50% on average over the last ten years. Historically, the balance sheet had no debt, and we have a favorable impression of the management team. At the time of our purchase, Cognizant was trading at 10.5x operating profit and a 6% free cash flow yield. We believe this provided an attractive margin of safety[1] for this high-quality business.

Turning to companies exiting the portfolio, we sold out of **CVS** and **WABCO**. CVS, based in the U.S. with its namesake retail drug stores and Caremark pharmacy benefit manager, dispenses a little more than one-in-five U.S. prescription drugs. That scale allows CVS to purchase pharmaceuticals at prices well below its smaller competitors, which results in industry-leading profitability. Operating returns on capital employed exceed 20%, and abundant free cash flow and modest financial leverage limit the business's financial risk. Despite these high-quality attributes, recent increases in the share price eliminated our margin of safety. Based in the U.S., WABCO is a manufacturer of safety and efficiency components for heavy-duty trucks and buses. WABCO operates in an attractive industry oligopoly with one other strong global competitor. Since coming public in 2007, returns on capital employed for the business have averaged 20%. The company has also maintained modest financial leverage and demonstrated effective

[1] Margin of safety - Buying with a "margin of safety," a phrase popularized by Benjamin Graham and Warren Buffet, is when a security is purchased for less than its estimated value. This helps protect against permanent capital loss in the case of an unexpected event or analytical mistake. A purchase made with a margin of safety does not guarantee the security will not decline in price.

cash flow conversion. Here too, increases in its share price caused us to exit the position due to a reduced margin of safety. Finally, we also sold our shares in French luxury goods company **Hermes**, which we received as a distribution from our investment in Christian Dior. While we find Hermes to be a high-quality business, we do not think its valuation offers an appropriate margin of safety.

Portfolio Profile

In line with our low-turnover approach, the Fund's overall profile is little changed. We owned 33 companies at the end of the quarter. This remains within the range of the 25 to 50 businesses that we would expect to own at any given point in time. The top ten holdings represented about 47% of Fund assets, and position sizes are based on the relative discount to intrinsic value of each (largest weightings correspond to the largest discounts). Most of the positions are still large-caps (median $15 billion) including several considered mega-caps. As always, those holdings are based on each company's combination of quality and discount to intrinsic value, and not an attempt to target a specific market capitalization.

Companies domiciled in Europe and the U.S. continue to represent most of our portfolio, with Asia Pacific and a few emerging market investments making up the balance. Where a company is domiciled generally matters little to us, however. Since many of these are large companies, they typically conduct business on a global basis. That means they often generate significant amounts of their cash flows outside their home countries, rendering traditional country classification less useful.

Investment approach

We focus on competitively advantaged businesses, with solid balance sheets and strong cash flows, run by management teams that both operate the businesses well and deploy capital in a value-creative manner, whose shares we can purchase at significant discounts to our estimates of intrinsic value.

We are grateful for your confidence as shareholders of the FPA Paramount Fund, and look forward to continuing to serve your interests.

Respectfully submitted,

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