



**SOURCE CAPITAL, INC.**

**THIRD QUARTER REPORT**

September 30, 2018

# SOURCE CAPITAL, INC.

## LETTER TO SHAREHOLDERS

**Dear Shareholders:**

### Performance

During the third quarter of 2018, the net asset value per share of Source Capital, Inc. (the “Fund,” or the “Company”) increased 3.04% for the quarter and 2.53% year to date (both percentages including the reinvestment of the distributions paid during the period). These changes compare with returns of 7.71% for the quarter and 10.56% year to date for the S&P 500 Index, 0.02% for the quarter and 3.14% year to date for the Barclays U.S. Aggregate Bond Index, and 4.59% for the quarter and 5.64% year to date for the 60/40 blended S&P 500/ Barclays U.S. Aggregate Bond benchmark during the same period.

Source Capital continues to maintain an approximately 60% allocation to equities and 40% allocation to fixed income. The Fund’s top five winners and losers for the third quarter and year to date periods of 2018 are presented below. The winners contributed 3.37%, while the losers detracted 1.48%.

### Winners and Losers<sup>1</sup>

<u>Winners</u>	<u>Performance Contribution</u>	<u>Losers</u>	<u>Performance Contribution</u>
<b>Q3 2018</b>			
Arconic	1.02%	JD.com	-0.55%
Oracle	0.87%	Facebook	-0.42%
United Technologies	0.53%	Baidu	-0.20%
Aon	0.53%	WPP	-0.17%
Microsoft	0.43%	HeidelbergCement	-0.14%
	<u>3.37%</u>		<u>-1.48%</u>
<b>YTD 2018</b>			
Microsoft	1.27%	Arconic	-0.75%
Cisco Systems	0.87%	JD.com	-0.55%
Alphabet	0.75%	American International Group	-0.52%
Aon	0.66%	Mylan	-0.49%
Thermo Fisher Scientific	0.51%	WPP	-0.46%
	<u>4.06%</u>		<u>-2.77%</u>

We report performance by top and bottom securities in the portfolio over short time frames as a matter of convention and client preference. This data frequently reveals nothing more than a chart of recent weather would, as shares of public companies move around a lot more than the value of their underlying businesses.

We have little idea where sentiment might cause any security to trade in the near term. Business value and stock price should converge over time. We therefore prefer the more sapient pursuit of understanding and valuing businesses, and that is what we hope our commentaries will convey.

We write longer letters discussing markets and economy at mid-year and year-end. Our more global views, which can be accessed in the Fund’s Semi-Annual Report, have not changed since last quarter.

## Open Market Repurchases

We started the third quarter with the market discount to net asset value of 10.35% and ended the quarter with the discount at 11.53%. We repurchased 25,268 shares in the third quarter of 2018 at an average discount of 11.24%. The purchases during the quarter were accretive to shareholders by adding \$0.015 per share to the Fund's NAV.

As a reminder, Source Capital is authorized to make open-market repurchases of its common stock of up to 10% of the Fund's outstanding shares at such times as the Fund's shares trade at a greater than 10% discount to the Fund's net asset value, when in FPA's judgment such repurchases would benefit shareholders, subject to various factors, including the limitations imposed by the federal securities laws governing the repurchase of an issuer's stock by the issuer and the managers' ability to raise cash to repurchase shares in a tax-efficient manner. There is no assurance that Source Capital will purchase shares at any specific discount levels or in any specific amounts in the future.

Respectfully submitted,

Source Capital Portfolio Management Team  
October 25, 2018

<sup>1</sup> Reflects the top contributors and top detractors to the Fund's performance based on contribution to return for the quarter and year-to-date. Contribution is presented gross of investment management fees, transactions costs, and Fund operating expenses, which if included, would reduce the returns presented. The information provided does not reflect all positions purchased, sold or recommended by FPA during the quarter or year-to-date. A copy of the methodology used and a list of every holding's contribution to the overall Fund's performance during the quarter and year-to-date is available by contacting FPA Client Service at [crm@fpa.com](mailto:crm@fpa.com). It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities listed.

**Top/Bottom Contributors (Weight %):** Arconic (3.0%); Oracle (2.4%); United Technologies (3.0%); Aon (2.6%); Microsoft (1.9%); JD.com (1.2%); Facebook (1.6%); Baidu (2.7%); WPP (1.7%); HeidelbergCement (1.4%); Alphabet (4.1%); Cisco Systems (0.0%); Thermo Fisher Scientific (0.3%); American International Group (3.7%); Mylan (1.9%).

A full list of Fund holdings and their corresponding portfolio weights can be found at [www.sourcecapital.com](http://www.sourcecapital.com). **Past performance is no guarantee, nor is it indicative, of future results**

## **Important Disclosures**

On December 1, 2015, a new portfolio management team assumed management of the Fund and the Fund transitioned to a balanced strategy. Performance prior to December 1, 2015 reflects the performance of the prior portfolio manager and investment strategy and is not indicative of performance for any subsequent periods.

*Performance data quoted represents past performance, which is no guarantee of future results. Current performance may vary from the performance quoted. The returns shown for Source Capital are calculated at net asset value per share, including reinvestment of all distributions. Returns do not reflect the deduction of taxes that a shareholder would pay on Fund distributions, which would lower these figures. Since Source Capital is a closed-end investment company and its shares are bought and sold on the New York Stock Exchange, your performance may also vary based upon the market price of the common stock.*

*The Fund is managed according to its investment strategy which may differ significantly in terms of security holdings, industry weightings, and asset allocation from those of the benchmark(s). Overall Fund performance, characteristics and volatility may differ from the benchmark(s) shown.*

*There is no guarantee the Fund's investment objectives will be achieved. You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest.*

The views expressed herein and any forward-looking statements are as of the date of this publication and are those of the portfolio management team. Future events or results may vary significantly from those expressed and are subject to change at any time in response to changing circumstances and industry developments. This information and data has been prepared from sources believed reliable, but the accuracy and completeness of the information cannot be guaranteed and is not a complete summary or statement of all available data.

Portfolio composition will change due to ongoing management of the Fund. References to individual securities are for informational purposes only and should not be construed as recommendations by the Fund, the Adviser, or the portfolio managers. It should not be assumed that future investments will be profitable or will equal the performance of the security examples discussed. Please visit our website, [www.sourcecapitalinc.com](http://www.sourcecapitalinc.com), for a complete list of portfolio holdings.

Investing in closed-end funds involves risk, including loss of principal. Closed-end fund shares may frequently trade at a discount or premium to their net asset value.

Stock markets are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. It is important to remember that there are risks inherent in any investment and there is no assurance that any investment or asset class will provide positive performance over time. Small and mid-cap stocks involve greater risks and may fluctuate in price more than larger company stocks. You risk paying more for a security than you received from its sale.

Non-U.S. investing presents additional risks, such as the potential for adverse political, currency, economic, social or regulatory developments in a country, including lack of liquidity, excessive taxation, and differing legal and accounting standards. Non-U.S. securities, including American Depositary Receipts (ADRs) and other depository receipts, are also subject to interest rate and currency exchange rate risks.

Fixed income securities are subject to interest rate, inflation and credit risks. The return of principal in a fund that invests in fixed income securities is not guaranteed. Lower rated bonds,

convertible securities and other types of debt obligations involve greater risks than higher rated bonds.

Interest rate risk is when interest rates go up, the value of fixed income securities, such as bonds, typically go down and investors may lose principal value. Credit risk is the risk of loss of principle due to the issuer's failure to repay a loan. Generally, the lower the quality rating of a security, the greater the risk that the issuer will fail to pay interest fully and return principal in a timely manner. If an issuer defaults, the security may lose some or all its value.

Mortgage securities and collateralized mortgage obligations (CMOs) are subject to prepayment risk and the risk of default on the underlying mortgages or other assets; such derivatives may increase volatility. Convertible securities are generally not investment grade and are subject to greater credit risk than higher-rated investments. High yield securities can be volatile and subject to much higher instances of default. The Fund may experience increased costs, losses and delays in liquidating underlying securities should the seller of a repurchase agreement declare bankruptcy or default.

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

#### Index Definitions

Comparison to any index is for illustrative purposes only and should not be relied upon as a fully accurate measure of comparison. The Fund will be less diversified than the indices noted herein, and may hold non-index securities or securities that are not comparable to those contained in an index. Indices will hold positions that are not within the Fund's investment strategy. Indices are unmanaged and do not reflect any commissions or fees which would be incurred by an investor purchasing the underlying securities. An investor cannot invest directly in an index.

S&P 500 Index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. The index focuses on the large-cap segment of the market, with over 80% coverage of U.S. equities, but is also considered a proxy for the total market.

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

60% S&P 500/40% Barclays Aggregate Index is a hypothetical combination of unmanaged indices comprised of 60% S&P 500 Index and 40% Barclays U.S. Aggregate Bond Index, representing the Fund's neutral mix of 60% stocks and 40% bonds.

***You can obtain additional information by visiting the website at [www.fpa.com](http://www.fpa.com), by email at [crm@fpa.com](mailto:crm@fpa.com), toll free by calling 1-800-279-1241 (option 1), or by contacting the Fund in writing.***

**SOURCE CAPITAL, INC.**  
**TOP TEN HOLDINGS**

September 30, 2018  
(Unaudited)

	<u>Percentage of Net Assets</u>
American International Group, Inc. ....	3.67%
Arconic, Inc. ....	3.02%
United Technologies Corporation ....	3.00%
Broadcom, Inc. ....	2.76%
Baidu, Inc. (ADR) (China) ....	2.74%
Citigroup, Inc. ....	2.66%
Aon plc (Britain) ....	2.63%
Oracle Corporation ....	2.40%
Bank of America Corporation ....	2.32%
Analog Devices, Inc. ....	<u>2.24%</u>
Total	<u><u>27.44%</u></u>

# SOURCE CAPITAL, INC. PORTFOLIO SUMMARY

September 30, 2018  
(Unaudited)

<b>Common Stocks</b> .....		<b>62.6%</b>
Internet Media .....	8.5%	
Aircraft & Parts .....	6.0%	
Diversified Banks .....	5.8%	
Semiconductor Devices .....	5.0%	
Infrastructure Software .....	4.3%	
Cable & Satellite .....	4.0%	
P&C Insurance .....	3.7%	
Cement & Aggregates .....	3.1%	
Insurance Brokers .....	2.6%	
Electrical Components .....	2.2%	
Investment Companies .....	2.1%	
Consumer Finance .....	2.0%	
Generic Pharma .....	1.9%	
Advertising & Marketing .....	1.7%	
Internet Based Services .....	1.6%	
Home Improvement .....	1.6%	
Banks .....	1.5%	
Midstream – Oil & Gas .....	1.5%	
Packaged Food .....	1.3%	
E-Commerce Discretionary .....	1.1%	
Food & Drug Stores .....	0.5%	
Life Science Equipment .....	0.3%	
Base Metals .....	0.3%	
Other Common Stocks .....	0.0%	
<b>Bonds &amp; Debentures</b> .....		<b>33.0%</b>
Asset-Backed Securities .....	18.5%	
Residential Mortgage-Backed Securities .....	7.8%	
Commercial Mortgage-Backed Securities .....	3.2%	
U.S. Treasuries .....	1.7%	
Corporate Bonds & Notes .....	0.9%	
Corporate Bank Debt .....	0.9%	
<b>Short-term Investments</b> .....		<b>5.2%</b>
<b>Other Assets And Liabilities, Net</b> .....		<b><u>(0.8)%</u></b>
<b>Net Assets</b> .....		<b><u><u>100.0%</u></u></b>

**SOURCE CAPITAL, INC.**  
**COMPOSITION OF NET ASSETS\***

September 30, 2018

Investment securities (cost \$338,554,962):	
Common stocks .....	\$244,117,618
Bonds, debentures and other investments .....	128,454,026
	<u>\$372,571,644</u>
Cash, receivables, short-term corporate notes, less liabilities .....	17,529,745
Net assets at September 30, 2018 .....	<u>\$390,101,389</u>

**SUMMARY FINANCIAL INFORMATION\***

For the Periods Ended September 30, 2018

	Nine Months Ended September 30, 2018		Three Months Ended September 30, 2018	
	Total Net Assets	Per Common Share	Total Net Assets	Per Common Share
Beginning of period .....	<u>\$ 388,264,439</u>	<u>\$ 45.06</u>	<u>\$381,814,935</u>	<u>\$44.34</u>
Net gain on investments, realized and unrealized ...	6,107,556	0.71	10,376,540	1.21
Net investment income .....	3,473,471	0.40	1,079,017	0.12
Distributions to Common shareholders .....	(6,455,490)	(0.75)	(2,148,626)	(0.25)
Cost of Capital Stock repurchased .....	<u>(1,288,587)</u>	<u>0.02</u>	<u>(1,020,477)</u>	<u>0.02</u>
Net changes during period ..	<u>1,836,950</u>	<u>0.38</u>	<u>8,286,454</u>	<u>1.10</u>
End of period .....	<u>\$ 390,101,389</u>	<u>\$ 45.44</u>	<u>\$390,101,389</u>	<u>\$45.44</u>
	<u>Sept. 30, 2018</u>		<u>June 30, 2018</u>	<u>Dec. 31, 2017</u>
Common market price per share .....	\$40.20		\$39.75	\$40.76
Common net asset value .....	\$45.44		\$44.34	\$45.06
Common market discount from net asset value .....	11.53%		10.35%	9.54%

\* The financial information included in this report has been taken from the records of the Fund without examination by independent auditors. Securities are carried at fair value.



# SOURCE CAPITAL, INC.



## **DIRECTORS**

Allan M. Rudnick, *Chairman*  
J. Richard Atwood  
Sandra Brown  
Mark L. Lipson  
Alfred E. Osborne, Jr.  
A. Robert Pisano  
Patrick B. Purcell

## **OFFICERS**

Steven Romick, *Portfolio Manager*  
Mark Landecker, *Portfolio Manager*  
Brian Selmo, *Portfolio Manager*  
Thomas H. Atteberry, *Portfolio Manager*  
Abhijeet Patwardhan, *Portfolio Manager*  
J. Richard Atwood, *President*  
David C. Lebisky, *Chief Compliance Officer*  
E. Lake Setzler III, *Treasurer*  
Francine S. Hayes, *Secretary*

## **INVESTMENT ADVISER**

First Pacific Advisors, LP  
11601 Wilshire Blvd., Suite 1200  
Los Angeles, California 90025  
(800) 982-4372 or (310) 473-0225

## **CUSTODIAN AND ADMINISTRATOR**

State Street Bank and Trust Company  
One Lincoln Street  
Boston, Massachusetts 02111

## **LEGAL COUNSEL**

Dechert LLP  
One Bush Street, Suite 1600  
San Francisco, California 94104

## **TRANSFER AND SHAREHOLDER SERVICE AGENT AND REGISTRAR**

American Stock Transfer & Trust Company, LLC  
6201 15th Avenue  
Brooklyn, New York 11219  
(800) 279-1241 or (718) 921-8124  
[www.amstock.com](http://www.amstock.com)

## **INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Ernst & Young LLP  
725 South Figueroa Street  
Los Angeles, California 90017

## **STOCK EXCHANGE LISTING**

New York Stock Exchange: SOR