Dear Shareholders:

Performance

During the second quarter of 2018, the net asset value per share return of Source Capital (or the "Fund") was 0.40%, and 0.23% on a market price basis (both percentages including the reinvestment of the distributions paid during the period). These changes compare with a 3.43% return for the S&P 500 Index, a -0.16% return for the Bloomberg Barclays U.S. Aggregate Bond Index and a 1.99% return for the 60/40 blended S&P 500/ Bloomberg Barclays U.S. Aggregate benchmark during the same period. For the calendar year to date period, the net asset value per share return of the Fund was -0.50%, and -1.29% on a market price basis (both percentages including the reinvestment of the distributions paid during the period). These changes compare with returns of 2.65%, -1.62% and 1.00% for the S&P 500 Index, the Bloomberg Barclays U.S. Aggregate Bond Index and the 60/40 blended S&P 500/ Bloomberg Barclays U.S. Aggregate benchmark during the same period, respectively.[1]

The Fund's top five winners and losers for the second quarter of 2018 are presented below. The winners contributed 1.47%, while the losers detracted -1.56%.[2]

Winners	Performance Contribution	Losers	Performance Contribution
Facebook	0.36%	Arconic	-0.70%
Microsoft	0.30%	Mylan	-0.28%
Alphabet	0.30%	TE Connectivity	-0.28%
Baidu	0.27%	Bank of America	-0.17%
Kinder Morgan	0.24%	Oracle	-0.13%

Equities

Growth continued to outperform value year-to-date, hurting the Fund's performance relative to the broader benchmarks. The Russell 1000 Growth Index returned 7.25%, while the Russell 1000 Value Index declined -1.69% in the first half of the year.

One needn't look much further than the investments that had the greatest impact on the Fund's Q2 performance to drive this point home. The top four contributors are considered "growth" companies. The holdings that hurt Q2's performance largely fall in the "value" category.

For equities, our strategy is largely to purchase equity in undervalued businesses. If we have correctly assessed the opportunity, we believe our investments can deliver a better than market rate of return by virtue of a discounted valuation. The market will define some of these investments as value and others as growth.

Buying growing businesses with an adequate margin of safety is just as much a value investment as buying, say, a financial firm at a discount to tangible book value or a holding company at a discount to readily ascertainable net asset value. We've held all three types of investments in our portfolio over the past decade.

[1] Comparison to the S&P 500 Index and the Bloomberg Barclays U.S. Aggregate Index is for illustrative purposes only. The Fund does not include outperformance of any index or benchmark in its investment objectives.
[2] Reflects the top contributors and top detractors to the Fund's performance based on contribution to return for the quarter. Contribution is presented gross of investment management fees, transactions costs and Fund operating expenses, which if included, would reduce the returns presented.

When analyzing businesses, we focus on the key performance indicators that we believe matter. Sometimes financial statements tell the story, and in those cases, investments typically appear "cheap" based on reported financial results. In other situations, information not in the financial statements might be most relevant, for instance, data like a company's position on the cost curve, its subscribers/user base, its total addressable market, its customer acquisition cost, the lifetime value of a customer, or real asset marked-to-market. In these situations, our holding might appear "expensive" based on reported financial results, but not when one looks at these other factors. Our value approach is the same no matter what the ultimate driver of intrinsic value.

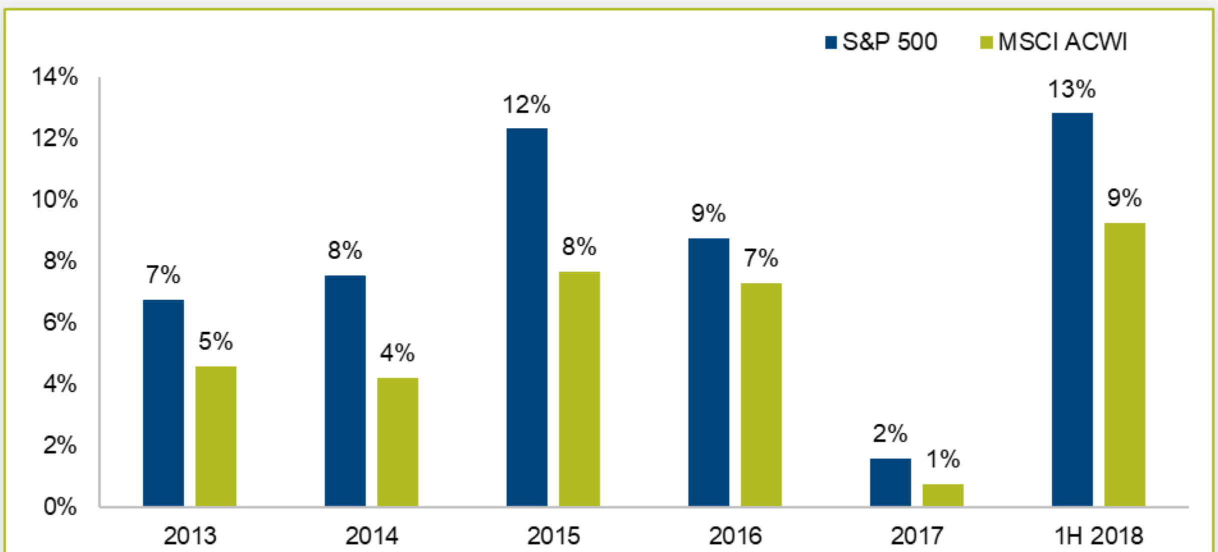
We suspect that balance sheet sources of value will prove a less fertile source of opportunities than in the past, given evolutionary changes in the economy and business models over the past thirty years. In the past few years, the team has spent much time building a base of knowledge in businesses that are capital light, demonstrate outstanding economics and are likely to offer substantial organic growth over the next decade. Some of these companies are too hard for us to underwrite and others trade at values that seem devoid of a margin of safety, but others, like Facebook, Expedia, JD.com and Baidu, have made it into our portfolio.

Admittedly, no bright line divides growth and value. Lacking a more robust methodology, index funds place some companies into both buckets. A company with a low price-to-earnings ratio but a high price-to-book may find some portion of its market capitalization allocated to a value index and the remainder in a growth index.

With active and passive funds building ever larger exposure to growth stocks, the lack of oxygen left in the room for value stocks has triggered some wilting in price. That, along with somewhat higher volatility, has allowed us to initiate new positions.

Last year the U.S. market posted the lowest volatility on record, but 2018 has seen bigger ups and downs.[3] The S&P 500 has already declined more than 1% on four times as many trading days in 2018 than in all of last year; the MSCI ACWI, six times as many.

Percent of Days Per Year S&P 500 and MSCI ACWI Declined > 1%



Number of days index declined > 1%	2013	2014	2015	2016	2017	1H 2018
S&P 500	17	19	31	22	4	16
MSCI ACWI	12	11	20	19	2	12

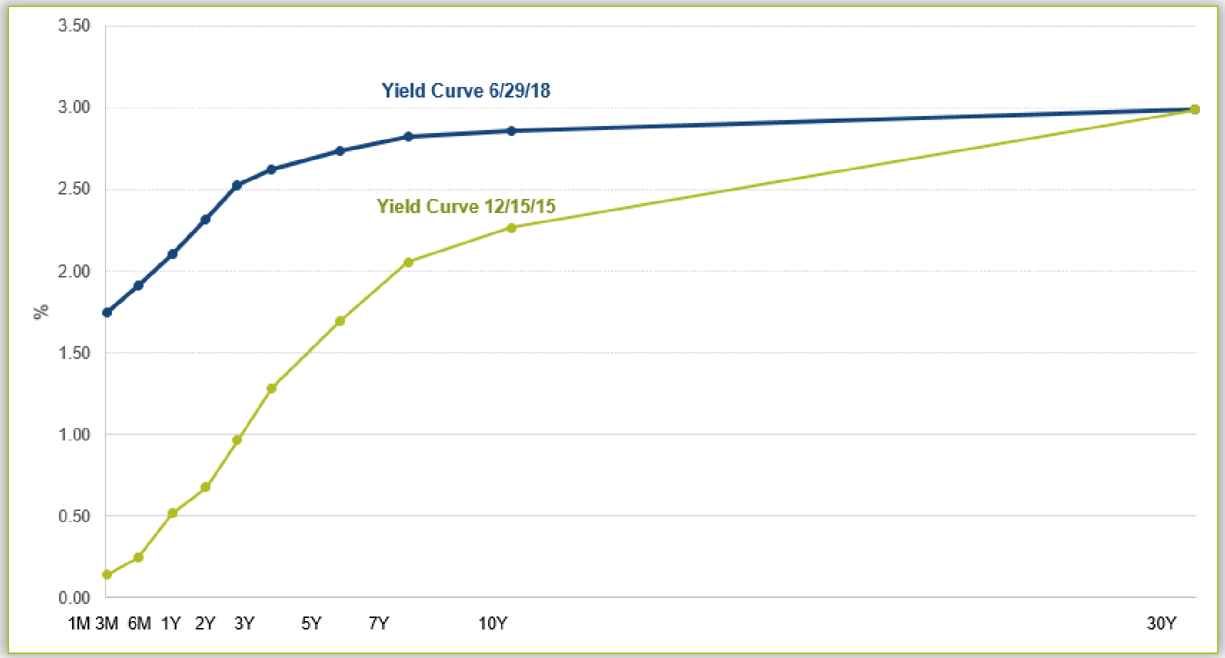
Source: Bloomberg

[3] The VIX Index

When investors become fearful, we like to take advantage of indiscriminate selling. In the first half of the year, that allowed us to establish ten new long positions and exit five. This is more portfolio movement than we've had in years.

Fixed Income

At mid-year, the investment community appears to be comfortable with a gradual increase in the Fed Funds rate. The Federal Reserve began tightening monetary policy via increases in the Fed Funds rate in December 2015. The next increase occurred at the end of 2016, followed by three increases in 2017 and a market expectation of three or four increases this year. The chart below compares the yield curves as of December 15, 2015 (green line) and June 30, 2018 (blue line).



Source: Bloomberg.

The chart shows that increasing rates on the short end of the curve have been accompanied by less significant increases in other parts of the curve, causing the yield curve to flatten significantly over the past two-and-a-half years.

One immediate impact of the Fed's tightening path is that it has introduced more yield into bond markets, particularly in the one- to five-year portion of the yield curve. As we have stated before, as long as rates are sufficient to compensate us for taking on duration risk, we are willing to do so.

Open Market Repurchases

We started the quarter with the market discount to net asset value of 10.16% and ended the quarter with the discount at 10.35%. We repurchased 3,128 shares in the second quarter of 2018 at an average discount of 10.54%. While the number of shares repurchased was modest, it was accretive to shareholders by adding $0.002 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 its 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.

Respectfully submitted,

Source Capital Portfolio Management Team

July 2018

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 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.

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 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, 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. In addition, 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.

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.

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 Depository Receipts (ADRs) and other depository receipts, are also subject to interest rate and currency exchange rate risks.

The return of principal in a fund that invests in fixed income securities is not guaranteed. The Fund's investments in fixed income securities have the same issuer, interest rate, inflation and credit risks that are associated with underlying bonds owned by the Fund. Lower rated bonds, convertible securities and other types of debt obligations involve greater risks than higher rated bonds.

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

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.

Indices are unmanaged, do not reflect any commissions or fees which would be incurred by an investor purchasing the underlying securities. Investors cannot invest directly in an index.

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