Dear Shareholders:

Performance

During the fourth quarter of 2018, the net asset value per share of Source Capital, Inc. (the "Fund," or the "Company") decreased 9.96% for the quarter and 7.69% for the calendar year (both percentages including the reinvestment of the distributions paid during the period). These changes compare with returns of -13.52% for the quarter and -4.38% for the calendar year for the S&P 500 Index, 1.64% for the quarter and 0.01% for the calendar year for the Bloomberg Barclays U.S. Aggregate Bond Index, and -7.56% for the quarter and -2.35% for the calendar year for the 60/40 blended S&P 500 / Bloomberg Barclays U.S. Aggregate Bond benchmark during the same period.

The Fund's top five winners and losers for the fourth quarter and full year 2018 are presented below.[1]

Fourth Quarter 2018

Winners	Performance Contribution	Losers	Performance Contribution
Broadcom	0.18%	American International group	-0.94%
Naspers	0.14%	Baidu	-0.85%
Nexon	0.05%	Citigroup	-0.74%
Jardine Strategic Holdings	0.00%	Arconic	-0.74%
Thermo Fisher Scientific	0.00%	United Technologies	-0.66%

Calendar Year 2018

Winners	Performance Contribution	Losers	Performance Contribution
Microsoft	0.55%	American International group	-1.25%
Cisco	0.50%	Arconic	-1.18%
Broadcom	0.43%	Citigroup	-0.80%
Thermo Fisher Scientific	0.30%	Baidu	-0.79%
Aon	0.29%	Mylan	-0.78%

Source Capital continues to maintain an approximately 60% allocation to equities and 40% allocation to fixed income. As you can see from the tables above, equities continue to be the main drivers of performance for the Fund.

Below is a discussion of our thoughts of the equity and fixed income markets.

[1] Reflects the top contributors and top detractors to the Company's net asset value 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 weights of the winners and losers within the portfolio as of December 31, 2018 were: Broadcom (2.9%), Naspers (1.0%), Nexon (0.6%), Jardine Strategic Holdings (0.6%), Thermo Fisher Scientific (0.0%), American International Group (3.6%), Baidu (2.3%), Citigroup (2.2%), Arconic (2.6%), United Technologies (2.4%), Microsoft (1.9%), Cisco (0.0%), Aon (1.7%), Mylan (1.7%). 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. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities listed. **Past performance is no guarantee, nor is it indicative, of future results.**

Equities

The price of a company's stock can perform better or worse than its underlying business, sometimes for extended periods. Such was the environment last year that the businesses of the companies we own performed on average within the range of our expectations – the companies we held for the full year actually *beat* analyst expectations. But we believe their stock prices failed to reflect that performance. It may further an understanding of our portfolio positioning to discuss what we don't own, for example, real estate investment trusts (REITS), utilities and consumer staples. Simply, we do not believe that the stock of the typical company in these sectors will offer reasonable risk-adjusted returns over the next decade, given a combination of current valuation and prospective growth.

Proctor & Gamble, or P&G, the storied consumer products company, is an example of a company we don't own. Like many consumer staples companies, its moat is still substantial but not what it once was. The result is earnings growth of less than 2% over the past seven years, but its stock inexplicably trades at 20.8x 2019 consensus earnings estimates. Nonetheless, the Fund would have been better off owning it rather than many of its existing positions last year, as P&G delivered a total return of 3.57%. Yet P&G's historic growth rate has generally been lower than the Fund's portfolio holdings, which more importantly in our eyes, trade more inexpensively and offer better growth prospects. P&G is no better nor worse than a number of other consumer staples companies we could have discussed.[2]

We find this illogical. Maybe the valuation disparity is due to expectations for a weaker economy that might allow consumer staples to outperform for a time. Or maybe it is due to passive investing, which makes indiscriminate purchases as a function of inflows. However, if the stock market didn't offer irrational moments, everyone would invest in passive vehicles, and we wouldn't be in business. We prefer our portfolio.

A stock can trade higher or lower than one might expect, but if the underlying business successfully grows over time and generates free cash flow that management then allocates intelligently, said stock should make its shareholders happy over a longer period. We are happy with what we own – more happy than we have been in a number of years – and as much as we look forward to looking back, we appreciate where we are in the moment.

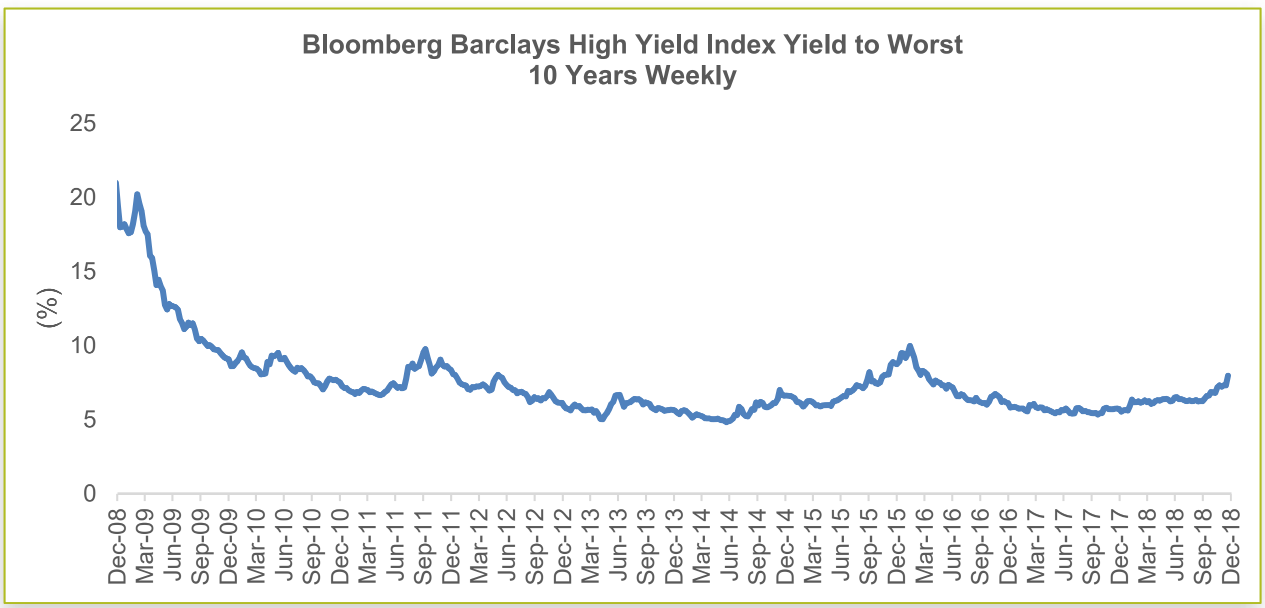
Fixed Income

This year the shape of the yield curve has dominated capital market commentaries. While the shape of the yield curve often signals the next major direction of treasury interest rates, it does not predict the timing of that move. Historically, the economy has exhibited either a significant slowdown in growth or a recession one to two years after the difference in yield between the 10-year treasury and 2-year treasury reaches 50 basis points. Since the end of 2017, that difference in yield has continued to decline, as shown on the following page.

[2] References to individual securities are for informational purposes only and should not be construed as recommendations by the Fund, the portfolio manager, FPA, or the distributor. It should not be assumed that future investments made by the Fund will be profitable or will equal the performance of the security examples discussed. The portfolio holdings as of the most recent quarter-end may be obtained at www.fpa.com. **Past performance is no guarantee, nor is it indicative, of future results.** Please refer to the end of this Commentary for important disclosures.

Source: Federal Reserve Bank of St. Louis; Data in the chart is through December 31, 2018.

We note that historically, the yield-to-worst of the Bloomberg Barclays High-Yield Index would start to increase within 12 months of the Treasury yield difference reaching 50 basis points. As the graph below illustrates, that increase has already begun.



Source: Bloomberg Barclays; Data in chart through December 31, 2018. The yield to worst is the lowest potential yield that can be received on a bond without the issuer actually defaulting.

Economic data over the past year started out very strong based mostly on the corporate and personal income tax cuts. However, that benefit has been dissipating and we believe will continue to do so. Additionally, economic activity worldwide has tended to moderate.

As an analytical team, we do not pretend to have an investable advantage in predicting economic growth, how many times the Federal Open Market Committee will change its interest rate forecast or economic views, or any of the myriad macroeconomic factors affecting the capital markets. We do not profess to have any analytical edge when it comes to how trade negotiations or Washington political infighting will affect bond markets and the economy in the short term—a recurring subject in the financial press. That said, there are certain indicators that cause us concern: the level of debt[3], who is borrowing money, the relationship between debt and economic growth, and how repayment may affect future growth. We discuss these items and our concerns in a special commentary that we wrote, "*Risk is Where You're Not Looking*", which was published January 2, 2019.

Given our long-held concerns discussed in "*Risk is Where You're Not Looking*", we previously wrote a separate commentary titled "*Rare Bond Market Conditions Set Up Complacent Investors for Sub-Par Returns*," (published March 13, 2018), in which we made two statements that expressed our opinions that: 1) Long-duration bonds do not offer sufficient incremental compensation versus short-duration bonds, and 2) Credit markets are expensive. We also noted that it is rare for both conditions to exist simultaneously. Our investment views at that time were to shorten duration and reduce credit exposure. That decision has paid off since long-duration bonds and credit have underperformed in 2018.

With the probability of an economic recession increasing, and what we believe to be the diminished capacity to prop up weak fundamentals with more debt (sovereign or otherwise) and our concerns regarding the corporate debt market beginning to materialize, our focus is on liquidity and seeking high-quality investments that adequately compensate us for duration risk and recession risk, both on a short-term mark-to-market basis and long-term value basis.

Open Market Repurchases

We started the fourth quarter of 2018 with the market discount to net asset value of 11.53% and ended the quarter with the discount at 13.55%. We repurchased 38,100 shares in the fourth quarter of 2018 at an average discount of 13.64%. While the number of shares purchased remained relatively modest, it was accretive to shareholders by adding $0.02 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.

Respectfully submitted,

Source Capital Portfolio Management Team
January 2019

[3] Refers to government, corporate and household debt.

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.

Current performance information is updated monthly and is available by calling 1-800-982-4372. 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 any indices noted herein. 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. 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.

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, the portfolio managers, or the distributor. 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.

Investments, including investments in open-end or closed-end mutual funds, carry risks and investors may lose principal value. Capital 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. Short-selling involves increased risks and transaction costs. You risk paying more for a security than you received from its sale.

The Fund may purchase foreign securities, including American Depository Receipts (ADRs) and other depository receipts, which are subject to interest rate, currency exchange rate, economic and political risks; these risks may be heightened when investing in emerging markets. Foreign investments, especially those of companies in emerging markets, can be riskier, less liquid, harder to value, and more volatile than investments in the United States. Adverse political and economic developments or changes in the value of foreign currency can make it more difficult for the Fund to value the securities. Differences in tax and accounting standards, difficulties in obtaining information about foreign companies, restrictions on receiving investment proceeds from a foreign country, confiscatory foreign tax laws, and potential difficulties in enforcing contractual obligations, can all add to the risk and volatility of foreign investments.

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, asset-backed 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. The Fund does not include outperformance of any index or benchmark in its investment objectives.

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

Other Definitions

Yield to Worst is the lowest potential yield that can be received on a bond without the issuer actually defaulting.