Dear Shareholders:

Performance

During the second quarter of 2019, the net asset value per share return of Source Capital (or the "Fund") was 3.35%, and 2.29% on a market price basis (both percentages including the reinvestment of the distributions paid during the period). These changes compare with a second quarter return of 4.30% for the S&P 500 Index and a return of 3.96% return for the 60/40 blended S&P 500/ Bloomberg Barclays U.S. Aggregate Bond Index during the same period. For the calendar year to date period, the net asset value per share return of the Fund was 13.92%, and 13.91% on a market price basis (both percentages including the reinvestment of the distributions paid during the period). These changes compare with returns of 18.54% and 13.64% for the S&P 500 Index and the 60/40 blended S&P 500/ Bloomberg Barclays U.S. Aggregate Bond Index during the same period, respectively.[1]

The Fund's top five contributors and detractors for the second quarter of 2019 are presented below. The winners contributed 2.91%, while the losers detracted 1.88%.[2]

Q2 Contributors	Performance Contribution	Percent of Portfolio	Detractors	Performance Contribution	Percent of Portfolio
Arconic	0.97%	3.7%	Baidu	-0.65%	1.6%
AIG	0.87%	4.3%	Mylan	-0.51%	1.0%
TE Connectivity	0.41%	2.3%	Alphabet	-0.36%	4.0%
Citigroup	0.33%	2.8%	Glencore	-0.19%	1.2%
Facebook	0.33%	2.4%	Altaba	-0.17%	2.5%

The Fund's top five contributors and detractors for the year to date period ended June 30, 2019 are presented below. The winners contributed 5.26%, while the losers detracted 0.74%.[2]

YTD Contributors	Performance Contribution	Percent of Portfolio	Detractors	Performance Contribution	Percent of Portfolio
Arconic	1.45%	3.7%	Baidu	-0.64%	1.6%
AIG	1.33%	4.3%	Mylan	-0.51%	1.0%
Facebook	0.86%	2.4%	PHI Inc. Company	-0.10%	0.2%
Citigroup	0.82%	2.8%	Glencore	-0.06%	1.2%
Analog Devices	0.80%	2.9%	Olympus	-0.01%	0.5%

Markets

[1] Comparison to the S&P 500 Index and the Bloomberg Barclays U.S. Aggregate Bond Index is for illustrative purposes only. The Fund does not include outperformance of any index or benchmark in its investment objectives.

[2] The 2Q 2019 and 1H 2019 top five contributors and detractors to the Fund's performance is based on contribution to return for the periods noted. 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. 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 returns.

Interest rates have helped drive stock market returns over the past few decades, and now, while only marginally higher than thousand-year-plus recorded lows, rates are again expected to remain low -- and perhaps sink even more -- for even longer.

Low interest rates make stocks more valuable. We use the Dividend Discount Model, or DDM, as a simple proxy for valuing businesses to illustrate that principle.

$$P = \frac{D_1}{r - g}$$

In the DDM formula, *P* is the fair price of a particular stock; D_1 is the expected annual dividend; *r* is its discount rate, and *g* is its dividend growth rate. Assume that the value of a business is equal to the sum of cash flows received by the shareholder over time. (Of course many companies reinvest their free cash flow and pay no dividend. We assume dividends and cash flow are interchangeable for this simple example.)

We will assume a dividend growth rate of 5% and set the expected annual dividend at $1 a share and leave them constant to isolate the effect of changes in interest rates. We will assign a discount rate based on a U.S. government bond plus an equity risk premium. In this example, we use the yield of a 10-year U.S. Treasury note in 2007, which was 5%, and the same note in 2019, when it was 2%, and then added a 5% risk premium for a discount rate of 10% and 7%.

Interest Rates – A Driver of Business Value[3]

2007	2019
$\$20 = \dfrac{\$1.00}{\mathbf{10\%} - 5\%}$	$\$50 = \dfrac{\$1.00}{\mathbf{7\%} - 5\%}$

In this case, the value of a business in 2019 that looks the same as one in 2007 would be worth 2.5 times as much, thanks to a discount rate that is 30% lower. In other words, low interest rates have added 7.9% to the return of the market since 2007, all else being equal; i.e., the rate of return from $20 to $50 over 12 years.

The beneficial impact of low rates on a highly leveraged equity would be even greater, in part because borrowing costs have declined so dramatically and in part because even more cash flow goes to investors.

The impact on a bond holder would be similar. In 2007, a 10-year U.S. Treasury note with a 5% coupon would be priced to yield 5% and therefore trade at $100. In 2019, a 10-year note priced to yield 2% would trade at $127 – or, 27% higher.[4]

Jim Grant of the eponymous Grant's Interest Rate Observer has called today's current low interest rate environment a "yield famine".[5] Taking that thought a step further, a starving person will eat most anything put in front of him, and indeed, investors hungry for returns are replacing low yielding, conservative fixed income and cash-like investments with riskier assets, further fueling markets already running on high octane. In our opinion, features of those assets like low coupons, high leverage and weak covenants are more meal replacements than sustenance.

There is an aura of hopeful complacency floating around the stock market that, in part, finds need replacing want. Investors *wanting* a higher rate of return have often steered bull markets, and this bull market certainly has that characteristic. What's different today is that an investor cohort *needing* return also has a hand on the steering wheel in this market.

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[3] Source: FPA. These calculations are hypothetical and are for illustrative purposes only.

[4] The 27% increase in bond prices has been a benefit for an investor interested in assuming interest rate risk. For investors such as ourselves, who prefer credit risk to interest rate risk, this has been a headwind.

[5] Grant's Interest Rate Observer. May 17, 2019.

Let's say that before the Great Recession in 2007, you sought a conservative return, eschewing credit risk in exchange for a modicum of interest rate risk. You might have purchased a 10-year U.S. treasury note yielding 5.02%, and if you were fortunate enough to have $2.5 million to invest, you would have received an annual return of $125,450 for the next ten years.[6] Today the 10-year Treasury yields a lowly 2.05% and that same investment would give you just $51,125 annually – a 59% decline.

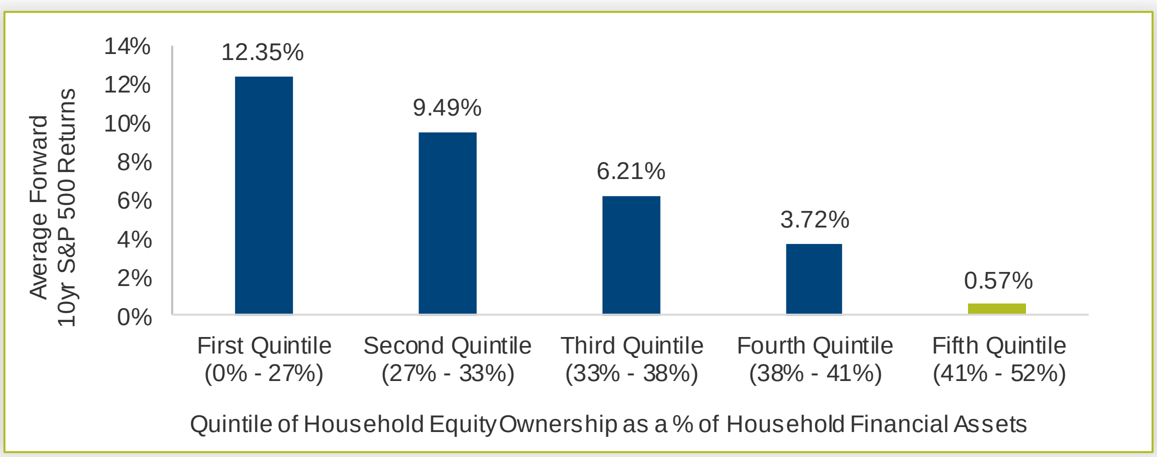
What's more, the ravages of inflation have reduced the purchasing power of that relatively meager return by a further $8,840, so that its real value is an annual inflation-adjusted $42,285 – $83,165 less than it earned just a little more than a decade ago – a 66.3% drop in purchasing power!

That means a retired person investing today is left with three choices: curtail lifestyle, spend principal or take on more risk. As creatures of habit, changing how we live is difficult, particularly if it means consuming less. Watching your nest egg shrink is also discomfiting unless your corpus is unusually large or you are older so that it matters less (assuming you don't plan to leave much to your heirs). So it's not surprising that most people select the third option and assume more risk, perhaps without even realizing they have added risk to their portfolio. They may at first look for yield in vehicles that at least look and feel like conservative bonds, an exercise likely to lead them to high-yield bonds, utilities, master limited partnerships and, maybe, higher yielding common stocks. Eventually they may even find their way to stocks that pay no dividend at all.

This has led the average household to have 44% invested in common stocks — the second-highest level in the past 18 years.[7] Crowding into equities has been a prescription that cured most ailments for more than a decade now. We suspect that not everyone knows what is in their portfolio; not everyone understands that volatility will most likely recur at some point, and not everyone fully understands how they might react to a major and sustained market downdraft. Will they panic and reduce their exposure? Or will they ride it out and maybe even buy more? History suggests the former.

Larger equity ownership generally suggests lower future stock market returns. As noted above, household ownership of equities currently stands at 44%, falling into the highest quintile and suggesting dismal prospective returns.

Household Equity Ownership as a Percent of Household Financial Assets vs. Average Forward 10yr S&P 500 Returns from 1961 to 2018[8]



Unusually, both risk-on and risk-off trades are working right now, allowing bulls and bears to win concurrently. Most global stock markets are trading at or near all-time highs, and gold and long-term U.S. Treasury bonds have also rallied. Thus, we have opposing sentiments existing and thriving in the same market.

[6] 10-year US Treasury note yielded 5.018% at 2007 third quarter-end (September 28, 2007).
[7] Source: Federal Reserve Economic Data, Bloomberg. Data as of December 31, 2018.
[8] Source: Federal Reserve Economic Data, Bloomberg.

Bull Market for Risk-on and Risk-off Assets[9]

	Year-to-Date Return	Cumulative Return since 2016 Low (ex. Dividends)	Percent Below All-time High
MSCI ACWI	16.57%	48.14%	At high
S&P 500	18.54%	60.83%	At high
Gold	10.20%	13.54%	-25.60%
US Treasury Bonds (30-year)	12.10%	8.05%	-7.32%

Many investors have placed the fears that sank the market in the fourth quarter of last year aside, pushing global markets higher despite a rising tide of populism around the world; slowing economic growth; looming Brexit, and U.S. corporate debt proliferation that features low coverage ratios for this point in the cycle, not to mention, weak covenants, high sovereign debt, high state and municipal debt, trade wars – we could go on.

Some investors believe that economies and markets will eventually suffer from some combination of the aforementioned woes. Interest rates, they argue, should then decline even from current low levels, and U.S. Treasuries and gold should be a safe place to wait out the inevitable correction. Inevitability we can affirm, timing we cannot. We know not which path the market's mixed signals portend, thereby making any prognostication an unsavory exercise of futility.

There isn't anything, however, that suggests rates can't remain low for a long, long time. As we collectively drink from this trough of easy, cheap money, there is no reason to believe we will escape an unfortunate hangover, unless, of course, long-standing economic rules are up-ended and cycles abrogated.

Open Market Repurchases

We started the quarter with the market discount to net asset value of 12.73% and ended the quarter with the discount at 13.69%. We repurchased 28,114 shares in the second quarter of 2019 at an average discount of 13.33%. The shares repurchased were accretive to shareholders by adding almost $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 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 2019

[9] Data in table through June 30, 2019. The date of the '2016 Low' was February 11, 2016. Gold's all-time high price, as measured by the LBMA Gold Price PM Index, was 1895 recorded on September 5, 2011. The change in the price for the 30-year US Treasury bonds was calculated by comparing the price of two 30-year US Treasury bonds where coupon is held constant. The lowest 30-Year US Treasury bond yield (coincident with its all-time high price) was 2.11% recorded on July 8, 2011. The 30-year US Treasury Bond yield as of June 30, 2019 was 2.52%. **Past performance is no guarantee of future results.**

Important Disclosures

This Commentary is for informational and discussion purposes only and does not constitute, and should not be construed as, an offer or solicitation for the purchase or sale with respect to any securities, products or services discussed, and neither does it provide investment advice. This Commentary does not constitute an investment management agreement or offering circular.

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 indices. Overall Fund performance, characteristics and volatility may differ from the indices shown.

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 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.fpa.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.

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 midcap 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.

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

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.