First Pacific Advisors, Inc.

BUYER'S STRIKE

We are on a buyer's strike in regard to the high-quality segment of the bond market. Since our last letter to you, on March 18, 2003, the ten-year Treasury bond yield has declined 76 basis points to 3.14%. We consider high-quality bond yields below 4% as having little or no investment merit and, therefore, we will not deploy your capital into them. It takes very little in the way of an interest-rate rise to produce a zero return for maturities of two years or more.

We still believe that economic data continues to be contaminated by the aftereffects of the Iraq War and, therefore, we place limited value on it. There has been much discussion regarding the potential for deflation and lower interest rates. Federal Reserve Chairman Alan Greenspan has recently voiced similar concerns about the potential for deflation. We believe these fears are way out of proportion and that it is unlikely that this will occur. We would like to remind you that the Federal Reserve has been wrong about the economic outlook on many occasions. It was only a couple of years ago that the Fed was concerned about a shortage of Treasury bonds and that they might have to use corporate bonds for their open-market activities. We never believed that this was a likely outcome.

What concerns us is that, in our entire careers, we have never seen the magnitude of liquidity that is being thrown at the system. Given the lowest level in interest rates since the 1950s, accelerating federal government spending and a very attractive tax reduction package, we see an increased stimulation of the economy over the next year. Low interest rates and easy money are combining to set the stage for rapid economic growth. Over the next twelve months, it would not surprise us to see real GDP grow faster than 4%.

Obviously, the bond market does not believe our view is the likely outcome. However, the stock market continues to rally quite briskly, which implies a positive outlook for both profits and growth. This is one of those very rare times where neither market can coexist with the other in its present state for any extended period of time. One of them is likely to be very wrong. In our opinion, we believe that it is the bond market and not the stock market. If the bond market were to be correct, this would imply a very negative outcome for stocks and the general economy. It would mean that all the monetary and fiscal policy stimulation has failed. We do not see this as the most likely outcome and, therefore, have positioned your FPA New Income defensively. It is close to its shortest duration ever at 1.3 years. We will continue to be defensively positioned until we are rewarded to risk your capital. In summary, we believe that this is a bond market bubble that is quite similar to what took place in the equity market three years ago. Caution is the watchword and our strategy.

Sincerely,

Robert L. Rodriguez and Thomas H. Atteberry

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