Q4 2024 FPA New Income Fund (FPNIX) and Flexible Fixed Income Fund (FPFIX) Webcast
January 30, 2025

Note: Items in brackets [ ] are meant to be clarifying statements but are not part of the actual audio recording of the webcast.

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You should consider FPNIX and/or FPFIX (each a "Fund", and collectively the "Funds") investment objectives, risks, and charges and expenses carefully before you invest. The Prospectus details each Fund's objective and policies and other matters of interest to the prospective investor. Please read the Prospectus carefully before investing.

This transcript must be preceded or accompanied by a prospectus for the Funds. The prospectus for FPNIX dated April 30, 2024 can be accessed at: https://fpa.com/request-funds-literature. The prospectus for FPFIX dated April 30, 2024 can be accessed at: https://fpa.com/request-funds-literature. The most current prospectus can always be obtained by visiting the website at fpa.com, by calling toll-free, 1-800-982-4372, or by contacting each Fund in writing.

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Moderator: Please note that today's webcast is being recorded. During the presentation, we'll have a question and answer session. You can ask text questions at any time. Submit your question in the questions and answers panel and click New Question to submit. If you would like to view the presentation in a full-screen view, click the corner of the slides panel to drag and resize to best fit your view. To restore the panels to their original view, click the Restore icon from the icons on the right side of the screen.

And finally, should you need technical assistance, as a best practice, we suggest you first refresh your browser. If that does not resolve the issue, please submit your issue in our question and answer panel, and someone will assist you.

It is now my pleasure to turn today's program over to Kristina Surkova. Kristina, the floor is yours.

Kristina: [Please see slide 2] Good afternoon and thank you for joining us today. We would like to welcome you to FPA New Income and FPA Flexible Fixed Income Fund Fourth Quarter 2024 Webcast.

[Please see slide 3] My name is Kristina Surkova and I am relationship manager for the funds.

[Please see slide 4] The audio, transcript, and visual replay of today's webcast will be made available on our website fpa.com.

In just a moment, you will hear from portfolio manager Abhi Patwardhan and members of the Fixed Income investment team.

[Please see slide 5] Abhi is a partner at FPA and has been with the firm since 2010. He has been a portfolio manager for FPA New Income since November 2015 and has served as portfolio manager for FPA Flexible Fixed Income since its inception in December 2018.

[Please see slide 6] As part of today's agenda, Abhi will discuss the highlights for both funds, provide commentary on the market, review performance and portfolio activity, and then open it up to question and answers. Abhi, over to you.

(00:02:03)

Abhijeet: Good afternoon. We'll start with a quick refresher on how we think about debt investing. We use absolute value to determine whether an investment is attractive or not. That means our first requirement is that there needs to be enough expected absolute return to compensate us for the risks involved. This absolute value-based approach to fixed income investing relies on current market prices. In comparison, there are other bond managers who try to predict changes in interest rates and other aspects of the market and then bet on that. We believe trying to predict the market is speculative and has a mixed record of success, which is why we don't do it. Rather, we believe our value-based approach has done a better job of making money over the years.

Let's begin with an overview of the funds we'll discuss today, which are outlined on this slide. In the middle, we show FPA New Income. FPA New Income seeks positive absolute returns over rolling 12-month periods, and in the long term seeks positive real returns of CPI plus 100 basis points over rolling 5-year periods. FPA New Income [invests in] largely investment grade or high-quality [assets] [and] has to have at least 75% of its assets in investments rated single-A or higher. [FPA New Income] can, but does not have to, have 0% to 25% of its portfolio in investments rated BBB or lower. We refer to these BBB or lower holdings as Credit. The amount of Credit [FPA New Income owns] is a function of the individual investment opportunities that we see.

FPA Flexible Fixed Income is shown on the right. Flexible Fixed Income is managed with the same investment philosophy as New Income. The key distinction is that FPA Flexible Fixed Income can, but does not have to, take on more Credit exposure. [FPA Flexible Fixed Income] can have up to 75% of its assets in investments rated BBB or lower, and must have at least 25% of its assets in investments rated single-A or higher. FPA Flexible Fixed Income's higher credit capacity is in service of a higher long-term return objective of CPI plus 200 basis points over rolling 5-year periods. To accommodate potentially greater credit exposure and the volatility that might come with it, in the short term, Flexible Fixed Income seeks positive absolute returns over rolling 3-year periods.

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We recently launched an ETF called the FPA Short Duration Government ETF, which is shown on the left. Many people are already familiar with our 100 basis point duration test. For those who aren't familiar, we'll discuss it again today.

This ETF will typically own government bonds, specifically Treasuries, and its duration will be actively managed using the same 100 basis point duration test that we use to manage the duration of New Income and Flexible Fixed Income. We won't discuss the ETF during today's webcast but anyone who is interested in learning more can visit our website fpa.com, where they will find a webcast that explains the ETF in detail.

[Please see slide 7] This is a snapshot of the FPA New Income and FPA Flexible Fixed Income as of December 31, [2024]. Shown at the top, FPA New Income had a 4.86% yield-to-worst and a duration of 3.4 years. Shown at the bottom, FPA Flexible Fixed Income had a 5.07% yield-to-worst and a 3.4 year duration. Flexible Fixed Income's yield has been moving toward New Income's yield over the past several quarters.[1] This is happening because we think the market has become expensive so we've been reducing the credit exposure in Flexible Fixed Income. This is expected and consistent with what we've told Flexible Fixed Income investors since we launched the fund six years ago. When markets are expensive, expect Flexible Fixed Income to look similar to New Income, and when markets are cheaper, expect the two funds to diverge. We saw the divergence happen from 2021 to 2023 as the market got cheaper, and now Flexible Fixed Income is moving toward New Income as the market gets more expensive.

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For comparison purposes, we show the [Bloomberg] Aggregate and Universal Bond indices solely to help our investors understand our funds' profile in comparison to the opportunity set, not because we are tracking these indices.

[Please see slide 8] Our investment approach doesn't change with the market but the execution can change. Since September, risk-free rates

[1] Past performance is no guarantee, nor is it indicative, of future results.

are higher and spreads are lower, but market prices are still in the realm of where they were a few months ago, so the execution of our investment approach hasn't changed recently. Because of the absolute level of yields and low spreads, we still think buying longer-duration, highly rated or high-quality bonds makes sense, and we still think high yield and lower-rated debt aren't appealing in general. That's not a market call; that's simply based on conclusions from individual bonds we've looked at. Prices for lower-rated debt don't look attractive to us at the moment, but we're happy to pivot if and when that changes.

[Please see slide 10] Before we talk about what's been going on in the market, let's establish a baseline just to make sure everyone is on the same page. Coming out of the pandemic, inflation shot up. The Fed raised rates to combat inflation. Inflation started coming down and the Fed started cutting rates. The market had been expecting additional rate cuts. As of the end of September [2024], the market was expecting approximately seven 25 basis point rate cuts over the course of 2025.

All along, the Fed said that future cuts would be data-dependent. The Fed cut rates again in November [2024] but since then, the economic data has not shown a clear trend. Inflation wasn't obviously heading lower.

On top of that, the election further clouded the economic picture. The Fed ended up cutting rates by 25 basis points again in December [2024] but the Fed communicated that it will be cautious about further cuts. That led the market to lower its expectations to two rate cuts in 2025, down from seven.[2] And we just saw the Fed's caution, with the Fed opting to hold rates steady yesterday.[3]

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Against that backdrop, rates rose during the [4th] quarter [2024], as shown here. We can also see here, when comparing the yield curve as of September 30, [2024] shown in light blue, to the yield curve as of December 2023, shown in green, that rates were decreasing for much of the year. But in Q4 [2024], the table at the bottom shows that rates rose by 60-80 basis points, depending on the part of the curve, and that rates—and that drove rates higher overall for the year by 25-75 basis points.

In light of the volatility in rates, it's worth spending a minute to explain a bit more about our investment approach. A lot of people like to "invest in bonds"—and I'm putting that in air quotes—by trying to guess

[2] Source: Bloomberg.
[3] Source: The Federal Reserve. https://www.federalreserve.gov/newsevents/pressreleases/monetary20250129a.htm

which way the market will go. For example, they may think that rates will go down so they buy longer-maturity and longer-duration bonds, or they might think rates will rise so they move to cash or short-duration bonds. They might think that spreads will decrease for some reason so they buy high yield, for example, to try to capture that benefit.

We think it's really hard to make money that way, let alone make money consistently. We put that style of investing in the category of speculation rather than investing because it's really hard to have conviction in the future. The rate moves this past quarter show that things can move sharply in the opposite direction and suddenly you're on the wrong side of the bet. And let's not forget 2022 and how many people found themselves on the wrong side. A lot of funds are still trying to climb out of the hole from 2022, but not us.

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We don't try to pretend that we can predict with any conviction whether rates will be lower or higher in the future or by how much. We're not sure anyone can. We prefer to focus on current prices and what those prices tell us about valuation. We think that's a higher-conviction way to invest.

[Please see slide 11] We gave that background a few minutes ago on the Fed, inflation, and the economy just to try to help our investors understand how we got here. But from our standpoint, the takeaway is that rates are higher now and they remain near decade-plus highs, as shown on this chart.

As rates have been increasing over the past few years, we have been adding duration. When rates rise further we see this appealing investment idea become incrementally more appealing because it is incrementally cheaper.

The rationale behind adding duration is twofold. First, we want to lock in higher yields while we can and own those yields for multiple years. To understand why, we can think about periods when rates have gone down. When rates decline, people regret not buying higher yields when they were available. When rates rise, there's a temptation to hold cash or buy shorter-duration bonds, but there is an opportunity cost of doing that because you potentially miss out on higher returns if yields subsequently decline. We want to avoid the opportunity cost of cash and short-duration bonds.

Second, we think that adding duration improves the short-term return profile of the portfolio. We're not saying that because we have any idea where rates are going to go. To be clear, we have no idea where rates are going to go. But we can do math, and the math gives us confidence in our view. Here's what the math looks like.

[Please see slide 12] We actively manage and choose duration by using our 100 basis point duration test, which looks for the longest bonds that we expect will produce at least a breakeven return over 12 months if we assume that a bond's yield will increase by 100 basis points over those 12 months.

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This chart illustrates our 100 basis point duration test. The dark blue bars on this chart show the Treasury yield curve as of December 31, [2024]. The green bars show a simulation of the returns over 12 months on each Treasury maturity, assuming that the yield at each maturity increases by 100 basis points over 12 months. The green bars represent the results of our 100 basis point duration test, and we think of those green bars as our downside scenario with respect to duration. We look for the longest bonds where the green bars have an expected return that is at least breakeven.

For example, the 5-year Treasury traded at a 4.38% yield at the end of December [2024]. If we had bought the 5-year Treasury at that yield and then the yield increased by 100 basis points over 12 months from 4.38% to 5.38%, we would expect a positive 12-month total return of 0.83%. Since the expected total return is better than breakeven, the 5-year Treasury was a candidate for our portfolios at the end of the year. The 7-year Treasury, on the other hand, has an expected total return loss of minus 0.58%, so it was not a candidate for our portfolios.[4]

Because we look for the longest bonds that get us to at least a breakeven expected return, all things being equal, we would buy bonds with a duration between the 5-year and 7-year Treasury. And though this analysis on this slide is focused on Treasuries, in many instances we are buying bonds with spread. That spread creates extra yield which, when

[4] The hypothetical stress test data discussed herein is for illustrative and informational purposes only and is intended to demonstrate the mathematical impact of a hypothetical change in Treasury yields on Treasury returns. No representation is being made that any account, product or strategy will or is likely to achieve profits, losses, or results similar to those shown. Hypothetical results do not reflect trading in actual accounts, and does not reflect the impact that all economic, market or other factors may have on the management of the account. Hypothetical results have certain inherent limitations. There are frequently sharp differences between simulated results and the actual results subsequently achieved by any particular account, product or strategy.

run through this analysis, can [identify] bonds that are a bit longer [duration] than what this chart would suggest.

The appeal of using this test is that it helps us create an attractive short-term upside versus downside return profile. Again, this is just math. If rates end up rising from here, within reason, we think the capital that we deploy on these longer-duration investments will be roughly preserved at 100 cents on the dollar, and then we can recycle that capital into an even higher yield later on down the line. In that rising rate scenario, we could stair-step to a higher-yielding portfolio, which is what we have been doing for the past few years coming off the low yields in 2021.

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On the other hand, if rates end up decreasing for whatever reason, longer-duration bonds offer more short-term total return potential, which we show in the light blue bars. The light blue bars show the expected 12-month total return if yields decrease by 100 basis points. For example, if yields were to decline by 100 basis points over 12 months, the 5-year Treasury could return over 8% in a year.

[Please see slide 13] We have been using this duration test to guide us toward a higher duration for a few years now. As we show here, we have increased the duration of New Income from 1.4 years to 3.4 years since 2021, and we have increased the duration of Flexible Fixed Income from 1.0 year to 3.4 years. Comparable funds[5] or indices have either barely moved their duration or moved their duration much less in that time, even though yields have increased 300-400 basis points since 2021.

[Please see slide 14] Looking forward, this chart estimates the total return before fees on New Income over the next 12 months based on the changes in reference rates shown on the x-axis. These estimates assume that we don't touch the portfolio during those 12 months.

For example, the bar above +100 shows that New Income could return 2.1% before fees over 12 months if the reference yield on every bond in the portfolio increased by 100 basis points over 12 months. Towards the right, we see that yields could increase by more than 175 basis points over 12 months, and New Income could have a positive return before fees. And on the left, the bars above -100 show that New

[5] The average duration of the comparable funds is represented by the Morningstar U.S. Short-Term Bond Category (FPA New Income Fund) and the Morningstar Nontraditional Bond Category (FPA Flexible Fixed Income Fund).

Income could return 7.5% before fees if reference yields decreased by 100 basis points over 12 months.

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The potential to get positive or breakeven returns in a rising rate environment, coupled with a potential high single-digit return in a lower rate environment, is the attractive upside versus downside that we think we've been creating by adding duration to the portfolio.

[Please see slide 15] This is the same chart for Flexible Fixed Income. Flexible Fixed Income could return 2.35% before fees if reference rates rose by 100 basis points over 12 months. Flexible Fixed Income could also withstand a greater than 175 basis point increase in yield and have a positive return before fees. And finally, Flexible Fixed Income could potentially return 7.7% before fees if reference rates decreased by 100 basis points over 12 months.[6]

So that's the math, and hopefully it’s clear why we think our investment approach is a higher-conviction, less risky approach to

[6] Stress Test data is hypothetical and provided for illustrative purposes only, and is intended to demonstrate the mathematical impact of changes in yield. No representation is being made that FPFIX or FPNIX will or is likely to achieve results similar to those shown. Hypothetical results do not reflect trading in actual accounts, and does not reflect the impact that economic or market factors might have on the results shown. Hypothetical results have certain inherent limitations. There are frequently sharp differences between simulated results and the actual results subsequently achieved by any particular account, product or strategy.

investing. There are no bets. We are not hoping that rates move our way. We are 100 percent certain that rates will move. We are zero percent certain about the direction and the timing, but we can address that uncertainty by being thoughtful about valuation. In summary, we are buying some short-term downside protection with upside optionality.

With respect to rate duration, in comparisons to broad market indices, we think we can participate in a lot of the short-term return potential of these indices with better short-term downside protection.[7]

Now these charts are simulations but they're not fanciful. In fact, there have been 12-month periods as recently as September where rates had declined significantly and our investors in both funds experienced high single-digit returns[in the following slide].

[Please see slide 16] The first column shows returns for New Income and Flexible Fixed Income over the 12 months ending in September 2024 in comparison to the Aggregate and Universal Bond indices. Rates declined around 100-125 basis points during that time, helping New Income return 9.7% and Flexible Fixed Income return 10.7%.

[7] Downside protection refers strictly to a strategic investment goal and is not meant to imply any guarantee against loss, including the loss of the entire principal amount invested.

these returns ended up capturing 84-93% of the Aggregate and Universal indices as shown at the bottom left. That illustrates the upside potential that we've been talking about.

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On the other hand, the second column shows that rates rose by 70-80 basis points during the fourth quarter, which hurt bond returns. New Income and Flexible Fixed Income only participated in about a third of the negative returns experienced by the broader market during these three months. This illustrates the downside protection that we've been discussing.

With that said, not every aspect of our investment process is so objective. Other parts of our process are more subjective and require more judgment, but there is a common theme in that process in that the process still focuses on current valuations rather than trying to bet on the market.

[Please see slide 17] With that in mind, let’s talk about spreads. From a credit standpoint, Treasuries are the so-called risk-free investment. Simplistically, spread is the extra yield you get above the yield on Treasuries to compensate you for taking on credit risk. Going back to our earlier comments, other folks might buy bonds with spread because they think the spread will decrease, which leads to higher prices, all things being equal. That strikes us as speculative. We prefer to focus on the fundamentals, and the question there is are we getting enough extra yield to compensate us for the credit risk. The answer recently has generally been no.

We see why when we look at charts like this. This charts shows the yield and spread on the High Yield Index. We also show the BB component of the High Yield Index excluding energy. We think that this BB index gives us a more consistent view of the high yield—gives us a more consistent view of high yield pricing than the overall High Yield Index.

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Spreads on this BB index ended the year at about 200 basis points, which is at the 5th percentile of this history. The lower the percentile, the more expensive the market is. The overall High Yield Index ended the year at approximately 310 basis points of spread, which was at the 4th percentile.

[Please see slide 18] This chart shows the spread on different ratings of high yield bonds versus investment grade corporate bonds. For example, the green line shows the spread on the BB High Yield Index excluding energy which we saw in the previous slide, and subtracts the spread on investment grade corporate bonds. High yield bonds have more credit risk than investment grade bonds. This chart measures how much extra yield you get for that extra credit risk.

Here again, these charts suggest the market is expensive. This incremental spread ranges from 130 basis points for BB nonenergy bonds, to 240 basis points for the broad High Yield Index, to 510 basis points for CCC nonenergy bonds. These spreads are at the 5th to 14th percentile.

Low spreads pose two problems. One, on an absolute basis, low spreads mean either that the likelihood of a bad outcome has gone down, or the probabilities of good and bad outcomes haven't changed but the compensation has gone down. There is always uncertainty in investing but it seems like there's more uncertainty these days, so we’re not willing to bet that the odds of something bad happening have gone down. In other words, we don’t like making investments that are priced to perfection. We also don't like paying historically high prices in the form of historically low spreads for the same credit risk. We haven't even factored into these comments [what we believe is] the nefarious activity that has been happening in high yield loan and bond markets, which makes us feel even stronger about our statements. In short, when coupled with our desire for investments with duration, these low spreads don't pass our absolute value test.

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The second problem posed by low spreads is that low spreads increase mark-to-market risk. Increases in spread can translate into lower dollar prices, all things being equal. The lower the spreads go, the more potential price downside there is, because there is more room for spreads to increase in the event that they return to more normal levels. In fact, the historical data suggests that when spreads get into the area where they are now, the odds of outperforming Treasuries over the next few years aren't great.

We don't invest based on charts like these but they affirm what we've seen in individual situations, which is that [we believe] we're not getting enough compensation for the risk. And because the incremental spread is so low, we think we can capture a lot of the available return in high yield by buying investment grade bonds. In other words, we think the opportunity cost of buying investment grade debt instead of high yield-rated debt is low.

So we haven't been investing in lower-rated debt and have actually been reducing our exposure there.

[Please see slide 19] Which brings us to the investment grade debt markets. There, as well, spreads are very low, we can see here. This chart shows the yields and spread on the investment grade Aggregate Bond Index. Investment grade bond spreads are at the 1st percentile. Even after adjusting for changes in the Treasury component of this index over the years, spreads are still very low.

Investment grade bonds are probably covered, meaning you'll probably get your—meaning you'll probably ultimately get your money back at maturity. But that's not always the case, and we've certainly seen new asset classes and new issuers come to the market that we do not think are obviously covered, which to us is yet another sign of an expensive market.

Because of low spreads, we've been investing in high-quality bonds, which we define as bonds rated single-A or higher. More specifically, we have been buying longer-duration, high-quality bonds, as we discussed earlier. But even in those longer-duration, high-quality investments, we have been generally focused on higher-quality bonds that we think are more liquid. We think these higher-quality bonds will be less prone to wider spreads. If the market gets cheaper, we think we'll be able to rotate out of these higher-quality investments into other investments that have become even cheaper.

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[Please see slide 20] As we survey the markets, it appears that we are in a risk-on environment. Asset prices of all sorts are up, including the prices of some things that may not actually be assets, and yet we are reducing risk in our portfolios. It's a move that's against the grain. It's not unlike when we added duration as rates started rising a few years ago, or when we added credit exposure in 2022 when others were vacating the market. Going against the grain potentially has costs in the short term but because of our willingness to deviate from the crowd, our investors have made more money over the years, with less volatility and a smoother ride along the way.

This chart shows the value of an investment in New Income over the last 10 years. We've also provided comparisons to other short-term bond funds, the 1-3 Year Aggregate Bond Index, and the Aggregate Bond Index.

Looking at the dark green line, over the last 10 years, [we believe] New Income investors are wealthier now than they would have been had they owned something like one of these other alternatives. The table at the bottom shows the smoother ride and the better Sharpe and Sortino ratios and smaller drawdowns during this time. There's no magic here. We’re simply paying attention to current prices and valuation, being disciplined, and avoiding bets on the market.

[Please see slide 21] And it’s a similar story for Flexible Fixed Income. Since its inception six years ago, the green line shows that our investors have made more money than the [Morningstar U.S. Fund Nontraditional Bond] category in general and the indices shown here, with less volatility along the way. And we can see the smoother ride not only in the smoother line but in the better Sharpe and Sortino ratios and smaller drawdown in the table. In comparison to New Income, Flexible Fixed

Income has further benefited over the years by the ability to own more credit when it has made sense.[8]

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[Please see slide 22] Let's go into detail now about what these funds did during the quarter. We'll start with New Income.

[Please see slide 23] The bottom right of this table shows that New Income returned minus 0.92% before fees during the quarter.

The largest contributor to performance during the quarter was cash and equivalents due to interest income.

The second-largest contributor was collateralized loan obligations or CLOs backed by corporate loans. The return on those bonds came from coupon payments. Also, whereas a lot of fixed rate bonds saw lower prices during the quarter because of higher rates, most of these CLOs are floating rate so they largely avoided that type of price decline.

The third-largest contributor was the corporate holdings, mostly due to coupon payments. The corporate loans are floating rate and saw higher prices due to lower spreads, but the corporate bonds saw lower prices

[8] Past performance is no guarantee, nor is it indicative, of future results. Comparison to indices are for illustrative purposes only. FPA New Income and FPA Flexible Fixed Income do not include outperformance of any index or benchmark in their investment objectives. An investor cannot invest directly in an index.

because they are fixed rate and the increase in rates exceeded the decline in spread. Lastly, the common stock holdings, which averaged 1.5% of the portfolio during the quarter, also contributed due to price appreciation and dividend payments.

The three largest detractors from performance were agency mortgage pools, Treasuries, and agency-guaranteed commercial mortgage-backed securities or CMBS. All three of these investments declined in price because of the increase in risk-free rates during the quarter.

[Please see slide 24] The bottom right of this slide shows that New Income returned 5% before fees in 2024.

The largest contributor to performance during the year was the asset-backed securities or ABS backed by equipment. The return on those bonds was driven by coupon payments and price appreciation caused by lower spreads.

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The second-largest contributor was agency CMBS, mostly because of coupon payments. Spreads on our agency CMBS also declined over the year but that was largely offset by higher risk-free rates, so prices didn't change much.

The third-largest contributor was the corporate holdings. Coupon payments and higher prices on loans and bonds drove the performance of the corporate holdings. The common stock holdings also contributed due to price appreciation and dividends.

There were individual bonds that detracted from performance during the year but there were no meaningful detractors at the sector level over the year.

[Please see slide 25] This slide shows the breakdown of the portfolio by sector, with the yield, duration, etc. for each sector. At the bottom, we see that the portfolio's yield increased [from] September [2024] by about 34 basis points, which is mostly due to higher risk-free rates as spreads decreased. The duration increased by about 0.2 years.[9]

[Please see slide 26] These pie charts show the New Income portfolio broken down by investment idea. There is a slice of the pie for each investment idea that is at least 4% of the portfolio. The other slice is

[9] **Past performance is no guarantee, nor is it indicative, of future results.**

the total of all of the individual ideas that are each less than 4% of the portfolio. These charts compare Q3 [2024] to Q4 [2024].

During the quarter, we ended up focusing our investment activity on adding high-quality duration. In addition to extending the duration of our existing Treasury holdings, we bought high-quality bonds such as Treasuries, agency residential mortgage pools, ABS backed by equipment, agency CMBS, non-agency CMBS, ABS backed by prime-quality auto loans, utility cost recovery bonds, and nonagency residential mortgage-backed securities or RMBS. These investments had a weighted average life of 5.1 years and a weighted average duration of 4.6 years.

We sold high-quality corporate bonds and ABS backed by credit card receivables with an average life and duration of 3.8 years and 3.5 years respectively, and reinvested the proceeds from those sales into Treasuries, which had an average life and duration of 4.8 years and 4.3 years respectively. In doing that, we removed the exposure to changes in spreads while retaining and adding to the interest rate duration.

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With a similar effect, we sold BBB-rated corporate bonds with an average life and duration of 2.9 years and 2.6 years respectively, and reinvested the proceeds into Treasuries with an average life and duration of 4.8 years and 4.3 years respectively.

Those BBB-rated bond sales, along with sales of nonrated bonds backed by nonperforming residential mortgages, reduced the portfolio's credit exposure. The portfolio's credit exposure was further reduced by maturities, repayments, and amortization of existing positions.

Finally, to help fund investments, we sold high-quality bonds with a weighted average life and duration of 1.5 years and 0.9 years respectively. These sales included, but were not limited to, CLOs backed by commercial real estate loans, ABS backed by equipment, ABS backed by datacenters, ABS backed by prime auto loans, and nonagency CMBS.

[Please see slide 27] As just mentioned, we actively decreased New Income's credit exposure. New Income's exposure to credit, or investments rated BBB or lower, ended the year at 4%. That means that 96% of the portfolio was held in a combination of highly rated bonds, Treasuries, and cash and equivalents.[10]

[Please see slide 28] Let's now look at Flexible Fixed Income.

[10] Portfolio composition will change due to ongoing management of FPNIX. The portfolio holdings as of the most recent quarter-end may be obtained at fpa.com.

[Please see slide 29] The bottom right of this slide shows that Flexible Fixed Income returned minus 0.86% before fees during the quarter.

The largest contributor to performance during the quarter was CLOs backed by corporate loans, mostly because of coupon payments. Also, most of these CLOs are floating rate so they largely avoided interest rate-driven price declines as rates rose during the quarter.

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The second-largest contributor was cash and equivalents due to interest income.

The third-largest contributor was the corporate holdings, mostly due to coupon payments. Corporate loan prices increased because of lower spreads. Corporate bond prices decreased because the increase in rates exceeded a decline in spread. Lastly, the common stock holdings, which averaged about 20 basis points of the portfolio during the quarter, also contributed due to price appreciation and dividend payments.

The three largest detractors from performance were Treasuries, agency mortgage pools, and agency CMBS. All three of these investments declined in price because of the increase in risk-free rates during the quarter.

[Please see slide 30] The bottom right of this slide shows that Flexible Fixed Income returned 5.8% before fees in 2024.

The largest contributor to performance during the year was CLOs backed by corporate loans, which benefited from coupon payments, and price appreciation caused by a decline in spread.

The second-largest contributor was ABS backed by equipment. The return on those bonds was driven by coupon payments and price appreciation caused by lower spreads.

The third-largest contributor was the corporate holdings, due to coupon payments and higher prices caused by a decline in spreads. The common stock holdings also contributed due to price appreciation and dividends.

There were individual bonds that detracted from performance but there were no meaningful detractors at the sector level over the year.

[Please see slide 31] Here we show the Flexible Fixed Income portfolio broken down by sector. The bottom two rows show that the portfolio’s yield increased by 25 basis points as the increase in risk-free rates during the quarter made up for the decrease in spreads. The duration increased by about 0.3 years since the end of September.[11]

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[Please see slide 32] These pie charts follow the same format as the charts we looked at a few minutes ago. Here as well, we ended up focusing our investment activity on high-quality, longer-duration bonds. We extended the duration of our existing Treasury holdings. We bought high-quality bonds with an average life and duration of 5.1 years and 4.5 years respectively, including Treasuries, agency residential mortgage pools, nonagency CMBS, ABS backed by equipment, agency-guaranteed CMBS, ABS backed by prime auto loans, utility cost recovery bonds, and nonagency RMBS.

We sold high-quality corporate bonds and ABS backed by credit card receivables with an average life and duration of 3.8 years and 3.5 years respectively, and reinvested the proceeds into Treasuries with an average life and duration of 4.8 years and 4.3 years respectively.

[11] **Past performance is no guarantee, nor is it indicative, of future results.**

We also sold BBB-rated corporate bonds with an average life and duration of 2.9 years and 2.6 years respectively and reinvested the proceeds into Treasuries with an average life and duration of 4.8 years and 4.3 years respectively.[12]

Those BBB-rated bond sales along with sales of high yield bonds, bank loans, and nonrated bonds backed by nonperforming residential mortgages reduced the portfolio's credit exposure. The portfolio's credit exposure was further reduced by maturities, repayments, and amortization of existing positions.

Finally, to raise cash for new investments, we sold high-quality bonds with an average life and duration of 0.8 years and 0.4 years respectively including, but not limited to, CLOs backed by commercial real estate loans, ABS backed by equipment, ABS backed by datacenters, and nonagency CMBS.

[Please see slide 33] As just described, we actively reduced the credit exposure during the quarter by selling investments and letting investments pay off. As a result, the credit exposure decreased from 13%

[12] Portfolio composition will change due to ongoing management of FPFIX. The portfolio holdings as of the most recent quarter-end may be obtained at fpa.com.

to 10% in the last few months. That leaves 90% of the portfolio in a combination of highly rated bonds, Treasuries, and cash and equivalents.

(00:36:08)

That concludes the portfolio reviews.

[Please see slide 34] Before we start Q&A, we want to share a note on the wildfires in Southern California. There's been a terrible loss of life, homes, and community in Altadena, the Pacific Palisades, and the surrounding areas. I want to acknowledge and thank our team and our colleagues here at FPA for their resilience and attention to our investors during this really stressful time. We also want to give a huge thank you to the firefighters who have been working tirelessly to protect us.

In case that we're concerned about the impact of our two funds, we investigated our single-family mortgage holdings to verify that our investments are well-protected from exposure to homes in areas impacted by fires. We own agency-guaranteed residential mortgage pools and AAA-rated nonagency CMBS—sorry, AAA-rated nonagency RMBS. Our agency mortgage pools have a *de minimis* exposure to fire-stricken areas but anyway, the principal is guaranteed by the agency.

Our AAA-rated nonagency RMBS bonds have significant credit enhancements to protect against losses. The credit enhancement ranges from 13% to 16%, with a weighted average of approximately 15%. The bonds that we own have exposures to fire-stricken areas ranging from 0% of the underlying loan balance to 4.8% of the underlying loan balance.

The bond that is potentially most impacted has 4.8% of its loans in fire-stricken areas. The credit enhancement on that bond is approximately 16%, so there's protection equal to 3.2 times the amount of fire exposure. That's a simple way to look at it which assumes, among other things, that there's no recovery on the impacted loans. In reality, the protection is [potentially] even greater when factoring in the lower LTV on the loans and the fact that some of the borrowers may keep paying their mortgages and/or insurance may provide some recovery. We also ran cash flow scenarios to validate the conclusions of our research. We believe that [the Funds are] well-protected from this exposure.

(00:38:27)

Now we can move on to Q&A, and we’ll start with some questions that we received in advance.

First question is, **"Trump has promised high tariffs, tax cuts, and deportations, all of which are invitations to nurture higher inflation. What are the funds' strategies to keep up with, and we hope beat, inflation in the coming years?"**

Well, first, we don't know yet the details of the Administration's policies, and I'm not sure that they know. So it's unclear what the impact on inflation could be. Second, our long-term objective is to try to beat inflation. We have an inflation-based return objective because we think the goal of investing is to grow wealth in real terms, not nominal terms. Now I think we're one of the few funds that are so explicit about that.

Having said that, we don't choose our investments using inflation as a return hurdle. For example, if one believes that inflation is going to be 2%, we don't look for investments that yield at least 2%. And remember, remember that it's future expected inflation that matters, not inflation that has already happened. And the reason we don't use inflation as a return hurdle is that it can lead to bad investment decisions.

(00:39:51)

We have a good example from recent history to illustrate that. In 2021, rates were extremely low, almost at zero. Let's assume that back then, people believed that inflation would be 2% going forward, just to pick a number. To get a 2% yield, one would have had to buy long-duration investments and/or take on a lot of credit risk. Recall that at one point, the High Yield Index only yielded about 3.5% so to get to 2% would have required taking on a lot of risk, and that would have only kept up with inflation, again assuming that inflation would be 2%. That doesn't even grow your wealth in real terms.

Now, imagine if you knew that inflation was actually going to be 6% or 7%. Just matching inflation would have required taking on an extraordinary amount of risk. We now know, after the fact, that people got blown up on long-duration and high yield investments when rates rose and spreads increased. We alluded to this earlier, but some investment vehicles still haven't reached their high water mark.

We go through all of that because we think that the best way to beat inflation over the long term is to try to do a good job of preserving capital when markets are expensive and then take advantage of attractive opportunities if and when they show up. That approach isn't going to beat inflation month-to-month or even year-to-year, but our history shows that it generally works over the long term.

And we'll offer one data point to support our approach. The High Yield Index has returned 2.9% a year on average since 2021. FPA New Income also returned 2.9% a year after fees, while taking on a lot less risk; and Flexible Fixed Income returned 3.7% a year after fees. The takeaway is that even those who took on a lot of risk aren't beating the 4.2% annualized inflation that showed up over the past few years. We haven't either but we're closer to the target and have a better shot at catching up over time, and we did that without taking on a lot of risk. We've used this analogy before but we think that slow and steady wins the race in the end.[13]

(00:42:00)

The next question is, **"Is there an internal cap on maximum duration given the funds' short- and long-term mandate? Are most of the opportunities still in intermediate-term Treasuries along with ABS?"**

So New Income is in the short-term bond category. There are some nuances to how the category is defined but, at a high level, the maximum

[13] **Past performance is no guarantee, nor is it indicative, of future results.** There can be no assurance that the Funds will achieve their investment objectives.

allowed duration is approximately 4.4 years. Depending on the year, New Income's maximum duration could be a bit higher or lower than that, but 4.4 years is roughly the maximum duration for New Income.

Flexible Fixed Income has no duration limit but, as we discussed today, the duration will be guided by our duration test so we're not going to take on duration unless we're getting paid for it. And I think we already discussed the opportunity set during the presentation.

Next question is, **"What is the impact of a steeper or normal-slope yield curve on positioning?"**

So the shape of the yield curve *per se* doesn't impact our positioning. We're trying to maximize long-term returns, return on invested capital, and optimize short-term upside versus downside. As a very broad statement, a steep or normal-shaped yield curve generally means that we'll want to buy longer-duration bonds, but it depends on the absolute level of yields and it depends on the spread that's available. It's possible that shorter-duration bonds with enough spread can get us to the same place as longer-duration bonds with less spread.

As one example of that, again going back to 2021, the yield curve was actually positively sloped back then even though yields were extremely low, and we bought very short-duration floating rate bonds because the spread on those bonds offered a better expected return than what was available in a lot of longer-duration fixed rate bonds. Having said that, we have no preset plans and we're not wedded to anything so we take these on a case-by-case basis and just follow the market where it leads us.

(00:44:00)

And then the last question that we received in advance is, **"What are your expected returns over the next three years?"**

So we don't really know. The best indicator of future returns is yield-to-worst adjusted for fees. Having said that, I think it's rare that actual annual returns end up matching the yield-to-worst at the start of the year because, for one, interest rates and spreads move so bond prices move, and the actual return can be higher or lower than the yield-to-worst would suggest. And two, the yield-to-worst assumes that we reinvest into exactly the same things that we currently own, at the same prices. To the extent that that's not true—and it rarely is true—that can also impact returns.

We received a question asking, **"Do you factor in change in spread to Treasury when subjecting non-Treasury bonds to a stress test and if so, what analysis do you employ to analyze change in yield spread?"**

The short answer is yes. On a case-by-case basis, depending on the spreads that we are contemplating purchasing bonds at, we will attempt to add in an additional increase in yield to our duration test to account for the possibility that spreads increase from today's low levels to what we think is a more normal level.

Now the way that we define normal level is we look at the history of spreads on those particular types of bonds from issuers, in that asset class, etc. to see what spreads have looked like in other environments that are not frothy. But we're also excluding environments that we think are extremely dislocated. So, for example, we are not stress testing spreads to a repeat of the financial crisis. We are also not stress testing spreads to the levels that were seen in March of 2020 when the market sold off tremendously due to the pandemic.

(00:46:09)

Another question that we received asks, **"Over the past year, the ABS exposure has fallen by 12%, with US Treasury up to 9%, agency RMBS and agency CMBS up 10% in aggregate. What makes ABS less attractive during this time, especially IG, relative to mortgages and Treasuries?"**

So, as a very broad statement, generally ABS has not made a lot of sense for us because typically highly rated asset-backed securities tend to have a short maturity or duration profile. So when faced with the choice of buying, for example, a 2-3 year maturity AAA-rated asset-backed security versus buying a Treasury or buying an agency mortgage pool, the latter two which have longer duration, we generally believe that we are going to make more money over time owning Treasuries and agency mortgage pools in comparison to owning those asset-backed securities that have a shorter duration profile. Part of that has to do with the short duration profile; part of that also has to do with the spreads that are available in the market. So as we were mentioning in one of the prior answers, it's theoretically possible that with enough spread, a shorter-duration investment could actually be more attractive than Treasuries or agency mortgage pools, but that's not what we've been seeing recently.

Kristina: I believe we do not have any other questions at this time. Thank you for listening to FPA New Income and FPA Flexible Fixed Income Fourth Quarter 2024 Webcast. We now turn it over to the system moderator for closing comments and disclosures.

(00:48:04)

Moderator: [Please see slides 38-43] Thank you for your participation in today's webcast. We invite you, your colleagues, and shareholders to listen to the playback of this recording and view the presentation slides that will be available on our website, typically within a few weeks, at fpa.com. We urge you to visit the website for additional information about the funds, such as complete portfolio holdings, historical returns, and after-tax returns.

Following today's webcast, you will have the opportunity to provide your feedback and submit any comments or suggestions. We encourage you to complete this portion of the webcast. We know your time is valuable, and we do appreciate and review all of your comments.

Please visit fpa.com for future webcast information, including replays. We post the date and time of upcoming webcasts towards the end of each current quarter, and webcasts are typically held three to four weeks following each quarter end. If you did not receive an invitation via email for today's webcast and would like to receive them, please email us at crm@fpa.com.

We hope that our quarterly commentaries, webcasts, and special commentaries will continue to keep you appropriately informed on the strategies discussed today.

We do want to make sure you understand that the views expressed on this call are as of today and are subject to change without notice based on market and other conditions. These views may differ from other portfolio managers and analysts at the firm as a whole, and are not intended to be a forecast of future events, a guarantee of future results, or investment advice.

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Any statistics or market data mentioned during this webcast have been obtained from sources believed to be reliable, but the accuracy and completeness cannot be guaranteed.

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This concludes today's call. Thank you and enjoy the rest of your day.

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