Today's Case for FPA New Income, Inc.

November 2016

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Average Annual Total Returns

As of September 30, 2016

Fund/Index	QTR	YTD	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years	30 Years
FPA New Income	0.75 %	2.17 %	1.52 %	1.28 %	1.33 %	2.61 %	3.19 %	4.30 %	6.15 %
Bloomberg Barclays U.S. Agg Bond	0.46 %	5.80 %	5.19 %	4.03 %	3.08 %	4.79 %	4.80 %	5.60 %	6.56 %
CPI + 100	0.71 %	2.00 %	2.50 %	2.05 %	2.26 %	2.76 %	3.06 %	3.17 %	3.68 %

Periods greater than one year are annualized. Performance is calculated on a total return basis which includes reinvestment of all distributions.

Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. This data represents past performance and investors should understand that investment returns and principal values fluctuate, so that when you redeem your investment it may be worth more or less than its original cost. The Fund's expense ratio as of its most recent prospectus is 0.49%. A redemption fee of 2% will be imposed on redemptions within 90 days. Current month-end performance data may be obtained at www.fpafunds.com or by calling toll-free, 1-800-982-4372.

Please see important disclosures at the end of the commentary.

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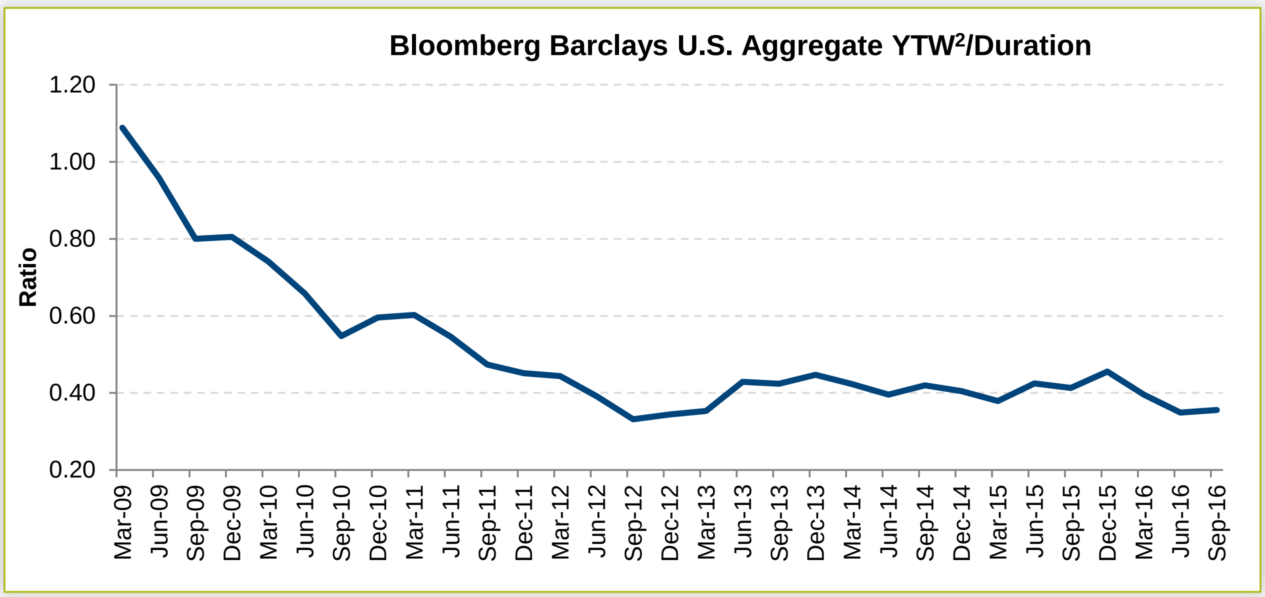
With U.S. Treasury yields, once again, near record lows we felt it prudent to examine key aspects of the bond market and highlight how we have positioned FPA New Income, Inc. (the "Fund") in light of this. The 10-year Treasury note's yield has fallen from 3% in 2014 to less than 1.4% earlier this year. We have long-discussed the risks these low rates create for the bond market. As a result "core" bond funds – those funds that have similar yield and duration[1] characteristics to the Bloomberg Barclays U.S. Aggregate Bond Index (the "Index") – find themselves in a particularly precarious position.

Investors might utilize core bond funds to achieve one or both of the following roles in a portfolio:

- Add a less volatile source of income and return to a portfolio.
- Reduce overall portfolio volatility through the use of an asset class that does not have a strong positive correlation to equities or other equity like investments.

In light of current bond market conditions, below we examine our concerns with the ability of core bond funds to fulfill these roles. We also introduce FPA New Income as a potentially attractive investment alternative for meeting these two objectives.

Currently, investors in core bond funds are receiving historically low yields while also taking on historically high levels of interest rate risk. The chart below shows the ratio of yield per year of duration which measures the Index's ability to withstand rising interest rates and credit spreads. A lower ratio means that the Index is more exposed to losses if interest rates and/or credit spreads were to rise.



Source: Barclays.

[1] **Duration** is a measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates.

[2] Yield-to-worst is the lowest possible yield on a callable bond. As of September 30, 2016, the SEC yield was 2.82%. This calculation begins with the Fund's dividend payments for the last 30 days, subtracts Fund expenses and uses this number to estimate your returns for a year. The SEC yield is based on the price of the Fund at the beginning of the month. The income yield stated here reflects prospective data and thus assumes payments collected by the Fund may fluctuate.

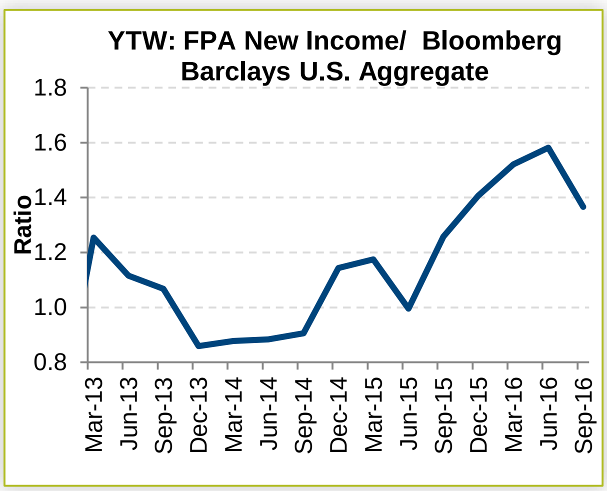
Over the past several years, the Index has generated attractive returns. However, these returns have resulted mostly from price appreciation (yields falling) rather than from income. 2012 was the most recent time that interest rates or yields neared today's levels. Subsequently, in 2013, yields began to rise, resulting in losses, large drawdowns, and higher volatility for the Index. The table below compares the performance of the Index from July 2012 when 10-Year Treasury rates were at the lowest point since the inception of QE[3] through 12/31/13, which marked the post-QE high in rates. Also shown is the performance of FPA New Income over this time period:

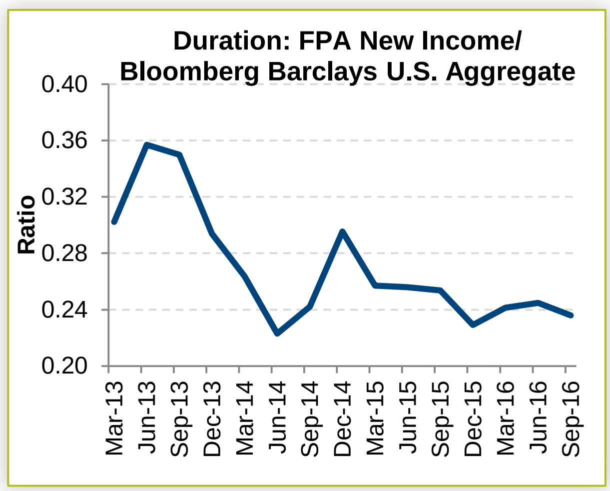
	% Return 7/24/12-1/1/14	Max Drawdown[4] 7/22/12-1/4/14	Standard Deviation[3] 7/22/12-1/4/14
Barclays U.S. Aggregate Index	-1.62	-4.52	3.30
FPA New Income	1.52	-1.14	0.96

Source: Morningstar Direct.

During those 15 months, the Index experienced a loss that erased more than three years of income. Should another retracement occur today, it would not be a surprise to see the Index post similar losses again. Thus, we question whether the Index is well suited today as a low volatility source of income and return. In contrast, during the 2012-2013 period, FPA New Income produced a positive return with a smaller drawdown and much lower volatility.

Indeed, FPA New Income may be in an even better position today to deliver attractive absolute and risk-adjusted returns than it was at the beginning of 2013. As of September 30, 2016, the Fund had a 32% greater yield-to-worst than the Index while taking on just 24% of the interest rate risk. These advantages over the Index are at or near three-year highs.





Source: FPA, Barclays

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[3] **QE** (Quantitative easing) is an unconventional monetary policy in which a central bank purchases government securities or other securities from the market in order to lower interest rates and increase the money supply.

[4] Closest time periods to 7/24/12-1/1/14 are chosen based on available data. Only weekly data is available. **Maximum Drawdown** is the maximum loss from a peak to a trough of a portfolio, before a new peak is attained. **Standard Deviation** is a measure of the dispersion of a set of data from its mean.

Risk/reward **(as of 9/30/16)**	**Yield-to-worst (%)**	**Effective duration (yrs)**	**YTW/ Duration**
FPA New Income	2.58	1.30	1.98
Bloomberg Barclays U.S. Aggregate Index	1.96	5.51	0.36
Bloomberg Barclays U.S. Aggregate 1-3 Year Index	1.07	1.91	0.56

Source: FPA, Bloomberg. Past performance does not guarantee future results

Notwithstanding the foregoing, some investors may own core bond funds because of a view that the U.S. may follow Japan and Europe into zero or negative yield territory. It is possible that bond yields could decline even further if, for example, the economy goes into a recession or deflation fears reemerge. However, unless one assigns a high probability to that outcome, core bond funds, in our opinion, now look more like deflation protection with a negative skew[5] than an actual investment.

Alternatively, some investors may own core funds not because of their investment merit but because of their attribute of being less correlated to and less volatile than other investments. For example, core bond funds have typically had a negative correlation to major equity markets during major selloffs. However, the negative correlation feature of the Index has predictably decreased along with the Index's yield. While we do not manage FPA New Income for short-term performance, its longer-term performance has exhibited a low or negative correlation to the S&P 500 Index, similar to the Bloomberg Barclays U.S. Aggregate Bond Index.

Correlation to S&P 500 over rolling 12-month periods

January 2007-September 2016	**Low or negative correlation (<20%)**	**Negative correlation (<0)**
Bloomberg Barclays U.S. Aggregate Index	82%	61%
FPA New Income	76%	54%
Bloomberg Barclays U.S. Aggregate 1-3 Year Index	59%	45%

Source: Morningstar Direct.

In conclusion, upon analyzing the investment characteristics of core bond funds, we believe it is prudent for investors to consider reducing exposure to interest rate risk within the context of their "core" bond holdings. In this environment, unless investors are trying to protect against a tail event, FPA New Income may well serve as an attractive "core" in the portfolio, as it has historically offered more yield than the Index with significantly less interest rate risk while serving as effective portfolio ballast.

Respectfully submitted,

Thomas H. Atteberry
Portfolio Manager

Abhijeet Patwardhan
Portfolio Manager

[5] By negative skew we mean a relatively high probability of small, incremental gains, offset by a modest probability of steep losses that can wipe out weeks or months of gains in short order.

Important Disclosures

The views expressed herein and any forward-looking statements are as of the date of the 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 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. The portfolio holdings as of the most recent quarter-end may be obtained at www.fpafunds.com.

Investments in mutual funds carry risks and investors may lose principal value.

Interest rate risk is the risk that 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 principal 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 of its value. The return of principal in a bond investment is not guaranteed. Bonds have issuer, interest rate, inflation and credit risks. Lower rated bonds, callable bonds and other types of debt obligations involve greater risks. 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.

Capital markets are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. The Fund may purchase foreign securities, which are subject to interest rate, currency exchange rate, economic and political risks. The securities of smaller, less well-known companies can be more volatile than those of larger companies.

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.

<u>Index / Benchmark Definitions</u>

Barclays Aggregate 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.

Barclays Aggregate 1-3 Year 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 a remaining maturity of 1 to 3 years. In addition, the securities must be denominated in U.S. dollars and must be fixed rate, nonconvertible, and taxable.

The Consumer Price Index (CPI) is an unmanaged index representing the rate of the inflation of U.S. consumer prices as determined by the U.S. Department of Labor Statistics. The CPI is presented to illustrate the Fund's purchasing power against changes in the prices of goods as opposed to a benchmark, which is used to compare the Fund's performance. There can be no guarantee that the CPI will reflect the exact level of inflation at any given time.

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

The FPA Funds are distributed by UMB Distribution Services, LLC, 235 W. Galena Street, Milwaukee, WI, 53212.