The FPA World Value Strategy (including FPA Paramount Fund)

Investment Policy Statement

Introduction

On September 1, 2013, FPA announced the formation of a new FPA World Value Strategy. The Strategy is overseen by Gregory Herr and Pierre O. Py. Greg and Pierre also manage the FPA Paramount Fund under the new Strategy. This policy statement summarizes who we are and how we think as investors, as well as how we construct and manage the portfolios.

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We are long-term value investors focused on global equities, having helped build strong track records both externally with well-known advisory teams, and internally at FPA.

We spent the last ten years scouring the world to find investment opportunities across a wide range of sectors, researching and analyzing hundreds of businesses, and building local intelligence networks in the process. We maintain a concentrated, disciplined approach to long-term value investing whereby we focus on our best ideas while attempting to weed out higher risk, lower quality, and more expensive businesses.

Investment Objective and Strategy

Our goal is to deliver above-average capital appreciation over the long-term while attempting to minimize the risk of a permanent impairment of capital.

Philosophy

We are absolute value investors. That is to say, we seek genuine bargains rather than relatively attractive ones. Unlike many long-only investment managers, our approach is not to build a fully-invested portfolio based on a chosen index. Instead, our benchmark-agnostic strategy focuses on opportunities that meet all of our investment criteria, and where we think we are exposed to an asymmetric outcome. We commit capital when we can buy a stake in a business at a discount to its intrinsic value, and when we believe the risk of potential losses is limited.

What we mean by losses or permanent impairment of capital is a reduction in intrinsic value that exceeds the discount received at purchase. It is something that cannot be measured based on capital market developments. We do not consider volatility in share prices to be a proper measure of risk, and rather think of that as a source of opportunities.

Over the years, we have identified hundreds of businesses throughout the world that we would like to own, but they often trade at prices that are too high for us to become shareholders. We consistently monitor these companies while patiently awaiting a cheaper share price. We may at times hold cash if we cannot find enough opportunities. However given our broad investment universe and our mandate to maintain minimum levels of exposure to both US and non-US based companies, we would expect to have a limited portion of the Fund’s assets invested in cash.

With capital markets generally short-term minded and susceptible to herd-like behavior, we find that our investment goals are best achieved by taking a long-term and often contrarian approach. We consider ourselves owners of businesses. A successful business owner would not care about what happens in the coming quarter, and neither do we. While in principle we would be happy to be invested in perpetuity under the right conditions, in practice we find that five years is a reasonable timeframe.

Process

We insist that our investments meet the following criteria:

- High Quality – businesses that have sustainable, superior fundamentals. These include high barriers to entry, low threat of product or service substitution, unique competitive advantages, power over customers as well as suppliers, and ultimately, pricing power. We believe that such businesses can generate industry leading margins, realize high levels of free cash flows, and earn attractive returns on capital.
- Financial Strength – companies that have conservative balance sheets and good free cash flow profiles. Our view is that financial robustness enhances a business' ability to weather temporary disruptions or adverse economic circumstances, and puts it in a position to consistently gain strength through difficult times. Value destruction, on the other hand, is often the result of excessive leverage, particularly when combined with unforeseen events.
- Strong Management – shareholder-aligned management teams that we believe not only run operations well, but also allocate capital in a way that creates value over time. Frequently and preferably these managers are shareholders themselves who think and act as owners. We would expect them to appropriately allocate capital by comparing the relative returns of various investment opportunities and, in the absence of attractive options, consider returning capital to shareholders through dividends and/or share repurchases.
- Low Absolute Valuations – an opportunity to invest at a discount to our estimate of intrinsic value. This is how we expect to achieve excess returns in the long run. We recognize that we cannot always be right in our assessment of value which is one of the reasons we only invest in a company when we can purchase its stock at prices below what we think the business is worth. Buying into quality businesses that build value over time, coupled with a margin of safety, helps mitigate the potential negative impact of unforeseen factors and allows the passage of time to work in our favor.

Portfolio Construction

Given our stringent criteria, we need to look broadly across capitalizations, industries, and geographies to find good opportunities. While there are thousands of listed corporations in the world, only a few combine all of our investment requirements at a given time, which leads us to run a more concentrated portfolio. Concentration allows us, in turn, to spend a disproportionate amount of time getting to know the most attractive companies, helping to reduce the risk of mistake which might otherwise lead to capital loss. We focus only on our best ideas and typically expect to be invested in 25 to 50 stocks.

In analyzing companies, we take a bottom-up, research-driven approach. We eschew businesses that do not lend themselves to appraisal. We limit ourselves to countries with established rules of law and political systems that allow for transparent and unbiased enforcement of those laws. We are also cognizant of macro-economic factors but center our analyses around, and select stocks based on, the fundamentals of the underlying businesses. To understand these fundamentals, we engage in extensive research.

We dedicate a lot of time traveling to visit investment prospects and meet with management teams or key employees to discuss operations, strategy, and capital allocation. We interview competitors, suppliers, customers, and other relevant third parties. We study how industries and companies evolve over time and how adept management is at responding to and taking advantage of changes in the business. We think prospectively rather than looking only at the past to anticipate potential changes. We also review a long history of annual reports, investor presentations, conference call transcripts, third-party research and other relevant publicly available materials for each targeted company, as well as the other industry participants.

Through this process, we seek to obtain an understanding of the value chain, market forces, and strategic dynamics. We use our research findings and analytical work to assess the normal economics of the business, and to estimate the present value of its future stream of cash flows. What we try to determine is how much cash flow it can sustainably generate; how much that cash flow grows over time; and what management does with that cash flow. These are the key tenets of intrinsic value. What other market participants may be willing to pay for the business at a given time based on a particular set of financial circumstances is not relevant to us. We study the company's financial position and how its balance sheet could hold up in challenging conditions. We look at leverage, debt structure, and free cash flow generation profile. We spend a lot of time asking ourselves what could go wrong and, if something did, what it might mean.

The portfolio is the product of that research and valuation process. We only add the companies that meet our qualitative investment criteria and offer enough margin of safety to the list of portfolio investments. We then allocate individual portfolio weightings according to the relative discount to our estimate of intrinsic value. This approach allows our ideas with the greatest discounts (and upside potential) to have a more significant impact on performance.

We continuously monitor each portfolio company to ensure that the original thesis remains intact and that the intrinsic value advantage remains. We may sell a holding when its market price appreciates and approaches our estimate of value; when we find opportunities to reallocate capital to other investments with greater reward potential; or when the original investment thesis no longer holds. While a painful decision, it is preferable in our view to take our losses early rather than simply hoping for a better outcome and increasing exposure as value deteriorates, thus further expanding the possibility of even greater capital impairment.

Conclusion

In conclusion, our approach is to concentrate on a few well thought-out and researched positions. We want to be long-term owners of high quality, financially sound businesses that are run by proven managers who build value over time for shareholders. We invest in these businesses only when we can buy their stocks at what we believe to be low prices.

We adopted this approach because that is the only one that makes sense to us and because that is how we manage our own money. We invest a significant portion of our net worth in the Funds we manage. Should our portfolios lag, we will feel the pain along with our shareholders. At times we expect to experience short-term periods of poor relative performance, but are confident that as patient, long-term investors we should be rewarded.

We thank you in advance for your trust and look forward to future communication.

Disclosures

You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. The Prospectus details the Fund's objective and policies, sales charges, and other matters of interest to the prospective investor. Please read this Prospectus carefully before investing. The Prospectus may be obtained by visiting the website at www.fpafunds.com, by email at crm@fpafunds.com, toll-free by calling 1-800-982-4372 or by contacting the Fund in writing.

Fund Risks

Investments in mutual funds carry risks and investors may lose principal value. Stock 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. Small and mid-cap stocks involve greater risks and they can fluctuate in in price more than larger company stocks. Groups of stocks, such as value and growth, go in and out of favor which may cause certain funds to underperform other equity funds.
Please consult your tax advisor regarding higher capital gains distributions.

The FPA Funds are distributed by UMB Distribution Services, LLC. 225 W. Galena, Milwaukee, WI, 53212