# SOURCE CAPITAL, INC.

## THIRD QUARTER REPORT

September 30, 2016

# LETTER TO SHAREHOLDERS

Dear Shareholders:

During the third quarter of 2016, the net asset value per share of Source Capital (or the "Fund") increased 4.32% and on a market price basis increased 0.71% (both percentages including the reinvestment of the distributions paid during the period). These changes compare with a 3.85% return for the S&P 500 Index, a 0.46% return for the Barclays U.S. Aggregate Bond Index and a 2.49% increase for the 60/40 blended S&P 500/ Barclays U.S. Aggregate benchmark during the same period.

Year to date, the Fund has increased 5.57% on a net asset value basis and 9.42% on a market value basis (both percentages including the reinvestment of the distributions paid during the period). These changes compare with a 7.84% return for the S&P 500 Index, a 5.80% return for the Barclays U.S. Aggregate Bond Index and a 7.13% increase for the 60/40 blended S&P 500/ Barclays U.S. Aggregate benchmark during the same period.

Source Capital's top five winners and losers for the third quarter of 2016 are presented below. The winners contributed 2.13%, while the losers detracted -0.30%.

| Winners[1] | | Losers[1] | |
|---|---|---|---|
| American International Group Inc. | 0.48% | Oracle Corporation | -0.19% |
| Bank of America Corp. | 0.46% | General Electric Company | -0.09% |
| Citigroup Inc. | 0.42% | GNR Series 2013-63 IO 0.772% Due 9/16/2051 | -0.01% |
| Microsoft Corp. | 0.39% | GNR 2015-108 IO Due 10/16/2056 | -0.01% |
| Cisco Systems Inc. | 0.38% | Occidental Petroleum Corp. | -0.01% |

**Distributions**

On August 8, 2016, the Board of Directors declared a regular quarterly distribution of $0.41 per share. The distribution was payable on September 15, 2016 to shareholders of record on August 26, 2016.

Our discussion last year in Source Capital's 2015 Annual Report noted that we set the quarterly distribution at an annualized rate of approximately 4.5% of net assets, with the expectation that the distribution rate would likely decline in the fourth quarter to a level more commensurate with dividend and interest income. Based on our most recent estimates, we believe that adjusting the quarterly distribution rate down to an annualized rate of approximately 3.5% is appropriate. Going forward we will continue to adjust the quarterly distribution rate based on our best estimates of the Fund's investment results at that time. As a result, on November 14, 2016, the Board of Directors declared the fourth quarter regular quarterly distribution of $0.35 per share, payable December 15, 2016 to shareholders of record on November 25, 2016.

**Open Market Repurchases**

We started the quarter with the market discount to net asset value of 5.14% and ended the quarter with the discount at 8.52%. With the discount remaining below 10% during the quarter, Source Capital did not make any open-market repurchases of its common stock. On November 14, 2016, the Board renewed the Fund's stock repurchase program for calendar year 2017. Details regarding the stock repurchase plan can be found in the November 17, 2015 press release available at http://www.sourcecapitalinc.com.

[1] Reflects the top contributors and top detractors to the Fund's performance based on contribution to return for the quarter.

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 the Fund's 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.

**Portfolio Strategy Update**

As described in the fixed income philosophy section of the Fund's investment policy statement, the fixed income sleeve will be managed similar to the FPA Absolute Fixed Income ("AFI") strategy which seeks to achieve a combination of income and price appreciation with an emphasis on capital preservation. We further described in the investment policy statement that, in applying our investment process to fixed income, we divide the bond market into two segments – High-Quality (securities rated AA- and above) and Credit-Sensitive (securities rated A+ and below) – and that we would target an allocation of 75% of the fixed income sleeve to High-Quality assets and 25% in Credit-Sensitive assets.

Earlier this year we began transitioning FPA's AFI strategy such that the High Quality segment will now include securities rated A- and above and the Credit-Sensitive segment will now include securities rated BBB+ and below. Since the fixed income sleeve of the Fund is managed consistent with FPA's AFI strategy, we are implementing a similar change for the Fund.

Our rationale for the change is that we have found that the performance of single-A rated bonds more closely resembles that of AA rated bonds than the performance of lower rated bonds. In fact, our research has revealed that, historically, the losses and price volatility of single-A rated bonds have been similar to AA rated bonds. These findings resulted in our reevaluating the ratings constraint in FPA's AFI strategy. After much discussion and testing, we decided to change the Fund's policy to include A- or higher rated investments in the High Quality segment of the portfolio. We concluded that the change in the ratings threshold would improve our ability to achieve our long-term investment objectives while preserving the character of the Fund's fixed income portfolio as a high quality, low volatility, conservative fixed income vehicle.

**Portfolio Composition Update**

On the following pages you will see that as of September 30, 2016, net assets were $347,515,622 with 55.48% of net assets invested in common stocks, 37.45% invested in fixed income, and the remaining 7.07% in cash and equivalents. Further, the top ten holdings accounted for 35.71% of net assets.

We thank you for your continued support.

Respectfully submitted,

Source Capital Portfolio Management Team
November 14, 2016

**Important Disclosures**

***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 benchmark(s). Overall Fund performance, characteristics and volatility may differ from the benchmark(s) shown.***

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.sourcecapitalinc.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.

Stock 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.

Non-U.S. investing presents additional risks, such as the potential for adverse political, currency, economic, social or regulatory developments in a country, including lack of liquidity, excessive taxation, and differing legal and accounting standards. Non-U.S. securities, including American Depository Receipts (ADRs) and other depository receipts, are also subject to interest rate and currency exchange rate risks.

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

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.

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.

60% S&P 500/40% Barclays Aggregate Index is a hypothetical combination of unmanaged indices comprised of 60% S&P 500 Index and 40% Barclays Aggregate Index, representing the Fund's neutral mix of 60% stocks and 40% bonds.

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.

***You can obtain additional information by visiting the website at www.sourcecapitalinc.com, by email at crm@fpafunds.com, toll free by calling 1-800-279-1241 (option 1), or by contacting the Fund in writing.***

# SOURCE CAPITAL, INC.
# 10 LARGEST HOLDINGS

September 30, 2016
(Unaudited)

| | Percentage of Net Assets |
|---|---|
| Oracle Corporation | 4.91% |
| American International Group, Inc. | 4.04% |
| United Technologies Corporation | 4.01% |
| Citigroup, Inc. | 3.86% |
| Aon plc (Britain) | 3.72% |
| Alcoa, Inc. | 3.60% |
| Cisco Systems, Inc. | 3.30% |
| Bank of America Corporation | 2.86% |
| Microsoft Corporation | 2.83% |
| TE Connectivity, Ltd. (Switzerland) | 2.58% |
| Total | 35.71% |

# SOURCE CAPITAL, INC.
# PORTFOLIO SUMMARY

September 30, 2016
(Unaudited)

| | | |
|---|---|---|
| **Common Stocks** | | **55.5%** |
| Infrastructure Software | 7.7% | |
| Diversified Banks | 6.7% | |
| Base Metals | 4.1% | |
| P&C Insurance | 4.0% | |
| Aircraft & Parts | 4.0% | |
| Insurance Brokers | 3.7% | |
| Internet Media | 3.6% | |
| Communications Equipment | 3.3% | |
| Semiconductor Devices | 2.7% | |
| Electrical Components | 2.6% | |
| Consumer Finance | 2.3% | |
| Advertising & Marketing | 1.9% | |
| Investment Companies | 1.9% | |
| Electrical Power Equipment | 1.7% | |
| Life Science Equipment | 1.7% | |
| Integrated Oils | 1.1% | |
| Oil & Gas Services & Equipment | 1.0% | |
| Food & Drug Stores | 0.6% | |
| Household Products | 0.6% | |
| Exploration & Production | 0.3% | |
| **Bonds & Debentures** | | **37.5%** |
| Asset-Backed Securities | 21.1% | |
| Residential Mortgage-Backed Securities | 6.9% | |
| Commercial Mortgage-Backed Securities | 6.4% | |
| U.S. Treasuries | 1.4% | |
| Corporate Bank Debt | 0.8% | |
| Corporate Bonds & Notes | 0.7% | |
| Municipals | 0.2% | |
| **Short-term Investments** | | **6.9%** |
| **Other Assets And Liabilities, Net** | | **0.1%** |
| **Net Assets** | | **100.0%** |

# SOURCE CAPITAL, INC.
# COMPOSITION OF NET ASSETS*
September 30, 2016

| | |
|---|---|
| Investment securities (cost $312,622,574): | |
| Common stocks | $192,793,192 |
| Bonds, debentures and other investments | 130,141,382 |
| | $322,934,574 |
| Cash, receivables, short-term corporate notes, less liabilities | 24,581,048 |
| Net assets at September 30, 2016 | $347,515,622 |

# SUMMARY FINANCIAL INFORMATION*

| | For the Periods Ended September 30, 2016 | | | |
|---|---|---|---|---|
| | Nine Months | | Three Months | |
| | Total Net Assets | Per Common Share | Total Net Assets | Per Common Share |
| Beginning of period | $ 632,454,012 | $ 73.07 | $336,497,553 | $38.88 |
| Net gain on investments, realized and unrealized | $ 14,034,093 | $ 1.63 | $ 13,699,699 | $ 1.58 |
| Net investment income | 2,451,268 | 0.28 | 867,018 | 0.10 |
| Distributions to Common shareholders | (301,894,771) | (34.88) | (3,548,648) | (0.41) |
| Capital contributions | 471,020 | 0.05 | — | — |
| Net changes during period | $(284,938,390) | $(32.92) | $ 11,018,069 | $ 1.27 |
| End of period | $ 347,515,622 | $ 40.15 | $347,515,622 | $40.15 |

| | Sept. 30, 2016 | June 30, 2016 | Dec. 31, 2015 |
|---|---|---|---|
| Common market price per share | $36.73 | $36.88 | $66.26 |
| Common net asset value | $40.15 | $38.88 | $73.07 |
| Common market discount from net asset value | 8.52% | 5.14% | 9.32% |

* *The financial information included in this report has been taken from the records of the Fund without examination by independent auditors. Securities are carried at fair value.*

# SOURCE CAPITAL, INC.
## OFFICERS AND DIRECTORS

### DIRECTORS
Allan M. Rudnick, *Chairman*
J. Richard Atwood
Sandra Brown
Mark L. Lipson
Alfred E. Osborne, Jr.
A. Robert Pisano
Patrick B. Purcell

### OFFICERS
Steven Romick, *Portfolio Manager*
Mark Landecker, *Portfolio Manager*
Brian Selmo, *Portfolio Manager*
Thomas H. Atteberry, *Portfolio Manager*
Abhijeet Patwardhan, *Portfolio Manager*
J. Richard Atwood, *President*
Leora R. Weiner, *Chief Compliance Officer*
E. Lake Setzler III, *Treasurer*
Francine S. Hayes, *Secretary*

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