Angel Oak Capital Advisors

Angel Oak Capital Advisors, LLC

Angel Oak Multi-Strategy Income Fund Quarterly Review

June 30, 2018

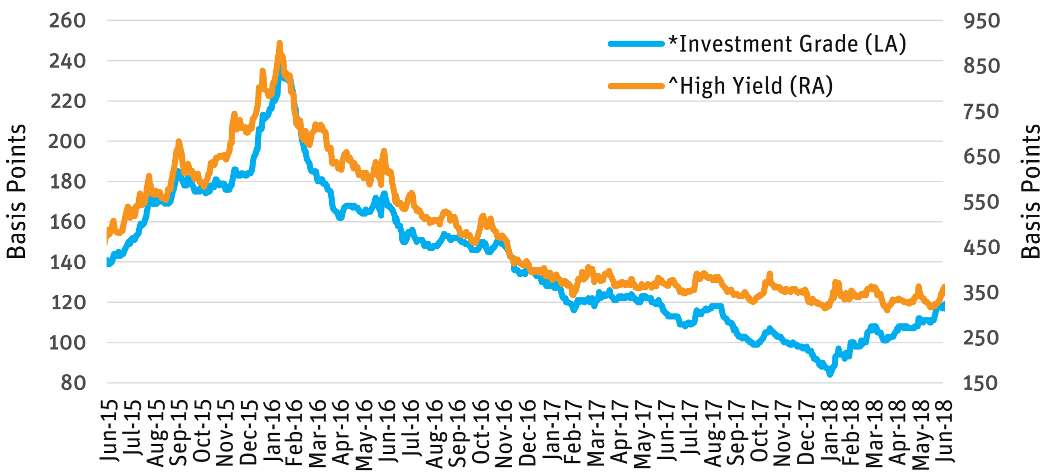
Quarter in Review

- Risk asset returns were mixed in the second quarter of 2018 as market participants digested an evolving macro environment, tightening monetary policy in the U.S., and increased global trade tensions. U.S. equities were higher, while corporate credit spreads moved wider on the quarter. The S&P 500 was up 3.43%, as investors shifted from U.S. bonds to U.S. stocks. The U.S. yield curve bear flattened as the Federal Open Market Committee increased the federal funds target rate range to 1.75%-2.00% during its June meeting. The 2s10s spread tightened by 14 basis points to +33 basis points. The 10-year Treasury yield rose 12 basis points to 2.86%.
- Fixed income returns have struggled this year, given wider spreads and rising Treasury yields. For the first half of 2018, global bond markets have struggled to create positive total returns. The Bloomberg Barclays U.S. Aggregate Bond Index is down 1.62% year-to-date, while the Investment Grade and High Yield equivalent indices are -3.27% and +0.16%, respectively.
- Legacy non-agency residential mortgage-backed securities (RMBS) were the best performer according to Bank of America Merrill Lynch Research. Various sectors combined to be up approximately 2% year-to-date, while commercial mortgage-backed securities (CMBS) were mixed as rising interest rates put pressure on the longer-duration asset class, down approximately 1% for the sector. Collateralized loan obligations (CLOs) performed well in the face of heavy supply. Their floating rate nature was a benefit as AAA through BBB tranches were up approximately 1-2% for the cohort. Asset-backed securities (ABS) were mixed but was net positive, up approximately 0.5-1% for 2018 year-to-date.
- The BLS released its June labor market report, which provided mixed results. The establishment survey reported net +213k jobs created in June – better than the market consensus of +195k. Additionally, the prior 2-month net revisions rose +37k. The headline unemployment rate rose 0.2%, to 4.0%, as the labor force participation rate rose 0.2%, to 62.9%. Average hourly earnings came up marginally short of expectations, rising 0.2% month-over-month (versus 0.3%) and +2.7% year-over-year (versus 2.8%).
- On the housing front, the S&P CoreLogic CS 20-City Index rose 6.56% year-over-year through April, up 0.20% month-over-month (slightly below expectations). New home sales rose 6.7% month-over-month in May to a 689k annualized pace. Notably, rising lumber costs are putting pressure on homebuilder margins. Since the beginning of 2016, futures on lumber prices are up over 120% through Friday. For a median-sized home in the U.S., the rise in lumber costs just in 2018 has increased costs by an average of $9,000 per home.
- Government- sponsored enterprises (GSE) Fannie Mae and Freddie Mac are expected to go through significant changes over the next few years as Congress rewrites rules and regulations with respect to housing and the amount of taxpayer backing required by lawmakers. Initial plan blueprints discuss the two GSEs exiting conservatorship as shareholder-owned corporations. This would relieve much of the risk to the U.S. taxpayer; however, many headwinds exist, including raising additional public capital (which is estimated to be over $100 billion) and determining which other companies will be allowed to directly compete with Fannie and Freddie.

Benchmark Performance	6/30/18	3/31/18	Monthly Change (bps)
1-Month LIBOR	2.09	1.88	+21
3-Month LIBOR	2.34	2.31	+3
2-Year Treasury	2.53	2.27	+26
5-Year Treasury	2.74	2.56	+18
10-Year Treasury	2.86	2.74	+12
30-Year Treasury	2.99	2.97	+2
2s/10s Curve	0.33	0.47	-14
2s/30s Curve	0.46	0.71	-25
S&P 500 Total Return Index	5,351	5,173	+343
IG Corporate OAS*	123	109	+14
HY Corporate OAS^	363	354	+9

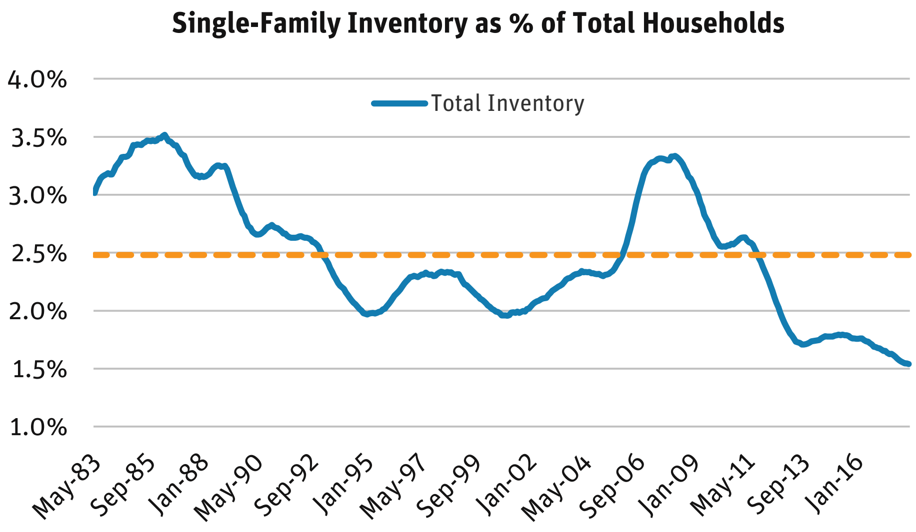
Sources: Bloomberg and Yieldbook as of 6/30/18.

Credit Index Performance

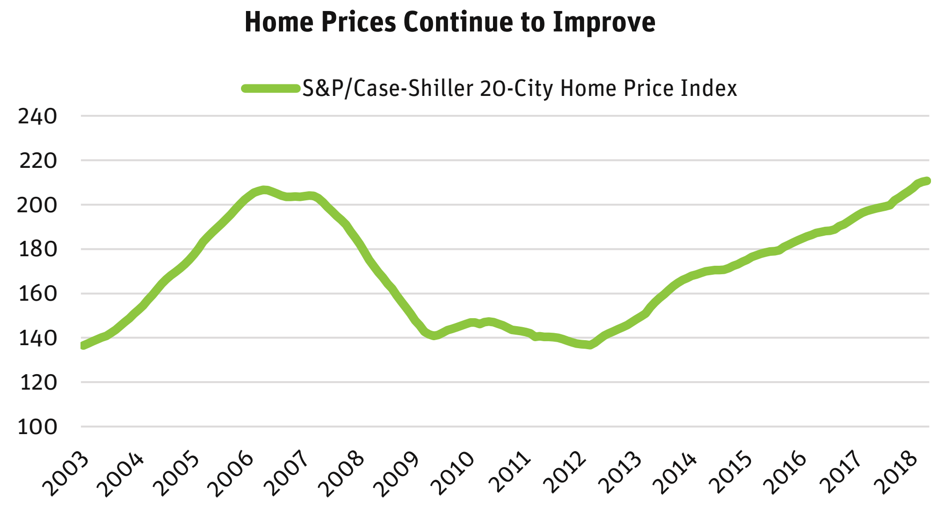


Source: Bloomberg as of 6/30/18.
*Bloomberg Barclays U.S. Corporate Total Return Value Unhedged
^Bloomberg Barclays U.S. Corporate High Yield Total Return Index Value Unhedged

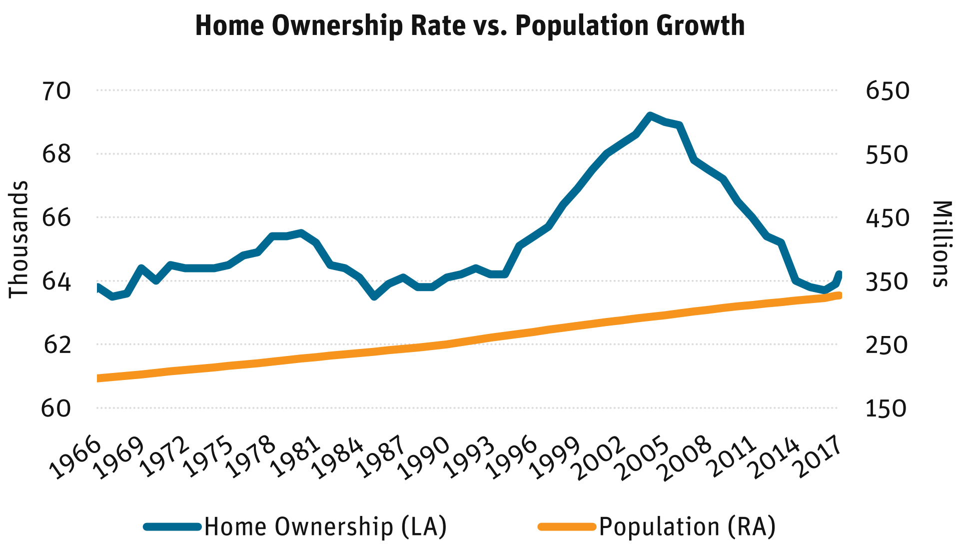
Fundamentals = Scenario Improvement



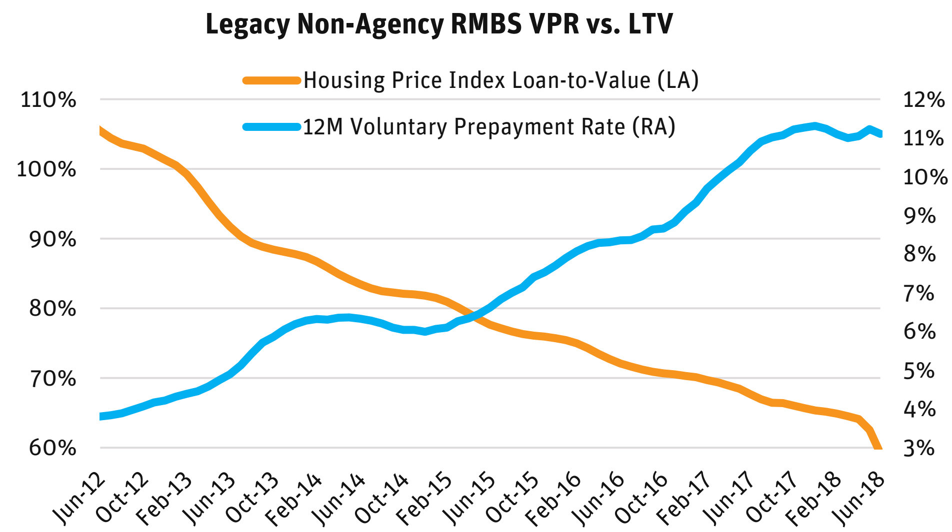
Source: Morgan Stanley as of 3/31/18.



Source: Bloomberg as of 4/30/18.



Source: Bloomberg as of 12/31/17.



Source: Bloomberg as of 6/30/18.

Portfolio Performance

Summary

- The Fund was up 0.96% in the second quarter of 2018, outperforming the benchmark by 1.12% as the Bloomberg Barclays U.S. Aggregate Bond Index was down 0.16% over the same time period as U.S. interest rates rose throughout the quarter, putting pressure on traditional fixed income assets. For year-to-date 2018, the Fund is up 1.83%, outperforming the benchmark, which is down 1.62%. Structured credit outpaced traditional corporate credit from a spread perspective. Non-agency mortgage credit had positive excess returns thus far in 2018, while U.S. IG corporate credit posted negative excess returns.
- Duration strategies were positive contributors to Fund performance, as the U.S. yield curve rose rapidly in the first two quarters of 2018 as markets repriced Fed expectations. Duration short of the benchmark was a positive net contributor for the Fund.
- All structured credit strategies produced positive results for Fund performance during the second quarter. NA RMBS was the best contributor to Fund performance with a total return of 1.28%, contributing 0.86% to the Fund. CMBS was the second best contributor, up approximately 1.48% (net of hedges) and contributing approximately 0.16% (net of hedges) to the Fund. CLOs and ABS were also positive contributors to Fund performance, with total returns of 0.85% and 0.61%, respectively.

					Annualized		
Net Total Returns as of 6/30/18	1 Mo.	3 Mo.	YTD	1 Yr.	3 Yr.	5 Yr.	SI[1]
Class I	0.06%	0.96%	1.83%	4.04%	3.64%	4.56%	7.44%
Class A at NAV	0.04%	0.91%	1.72%	3.79%	3.36%	4.28%	7.22%
Class A at MOP[2]	-2.22%	-1.37%	-0.58%	1.46%	2.58%	3.80%	6.87%
Bloomberg Barclays U.S. Agg. Bond Index	-0.12%	-0.16%	-1.62%	-0.40%	1.72%	2.27%	2.54%

Current performance may be lower or higher than performance data quoted. Performance quoted is past performance and is no guarantee of future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance to the most recent month-end can be obtained by calling 855-751-4324. [1]The inception date of the Angel Oak Multi-Strategy Income Fund A Class (ANGLX) was 6/28/11, while the inception date of the Institutional Class (ANGIX) was 8/16/12. The returns of ANGIX shown for periods prior to the inception date include the returns of ANGLX and are adjusted to reflect the operating expenses of ANGIX. [2]Maximum Offering Price takes into account the 2.25% maximum initial sales charge.

FUND INFORMATION AS OF 6/30/18

	Class A	Class I
Gross Expense Ratio	1.37%	1.12%
Net Expense Ratio^	1.24%	0.99%
SEC Yield (Subsidized)	4.36%	4.72%
SEC Yield (Unsubsidized)	4.38%	4.74%

FUND CHARACTERISTICS

Fund Assets (All Classes)	$7.1 bn
Number of Securities	1341
Distribution	Monthly
Effective Duration	2.2
Average Price (Portfolio)	$90.0
Average Price (NA RMBS)	$86.0
Floating Rate (%)	67.8

FUND STATISTICS

(Since Inception)	Fund[3]	Index
Standard Deviation	3.3	3.8
Sharpe Ratio	3.2	0.8
Correlation to Index	0.1	1.0
Positive Months (%)	83.3	61.9
Negative Months (%)	16.7	38.1

[3]ANGIX

^The Adviser has contractually agreed to waive fees through 5/31/19.

Sector Attribution

		Q2 2018*	YTD 2018*
	% of Market Value	Attribution (%)	Attribution (%)
RMBS	65.1	0.86	1.72
CMBS	11.7	0.16	0.28
CLOs	13.0	0.11	0.21
Corporates	5.8	0.10	0.17
ABS	3.3	0.02	0.01
Cash	1.1	0.01	0.02
Credit Hedges	-	0.00	0.00
Fund Expenses	-	-0.29	-0.58
Total	100.0	0.96	1.83

*Estimated returns, net of hedges, and unaudited. Attribution is calculated using an internal model, thus, returns may vary from the Fund's total return.

RMBS

- NA RMBS had a total return of 122 basis points in the second quarter, contributing 86 basis points to Fund performance. Legacy RMBS spreads were unchanged quarter-over-quarter, outperforming the widening seen in both Investment Grade and High Yield corporate credit. Legacy RMBS total returns have outperformed other sectors in structured credit this year. This outperformance has been driven by fundamental improvement in the collateral characteristics continuing to translate into better cash flows than the market has modeled. Credit risk transfer (CRT) last cash flow (LCF) spreads widened 20 basis points in the second quarter, while B1 spreads widened 15 basis points. The Fund continues to focus on adding positions with higher scenario improvement potential, with a specific focus on near-term increases in voluntary prepayment speeds.
- This year has been busy in the new issue RMBS markets, with $39.2 billion pricing. The 2018 expected new issue volume is approximately $75.0 billion, putting the market almost 15% ahead of pace. While the Fund is still overweight legacy RMBS, the allocation continues to take advantage of pockets of opportunity in new issue, primarily in non-QM and CRT.

CMBS

- CMBS returned 89 basis points in the second quarter, contributing 16 basis points to Fund performance net of hedges. Generic spreads for the month were slightly wider throughout the credit structure except for BBB-. For example, AAA widened by approximately 5 basis points to 85, while BBB- remained flat at 420. For the quarter, AAA spreads are 8 basis points wider, while BBB- spreads are 35 basis points tighter. In new issue, $22.7 billion priced for the quarter, split equally between conduit and SASB. Year-to-date, $42.2 billion of new issue priced, outpacing 2017 volume by $13 billion.
- Allocations for the second quarter were consistent with the first quarter except for BBB- allocation which declined to 6%, from 10.5% in the previous quarter. The reduction can be attributed to strong demand in secondary market for 2017/2018 BBB-, which provided an opportunity to sell bonds at attractive levels. We continue to be selective in new issue, favoring SASB and Agency Mezz.

CLOs

- CLOs had a total return of 90 basis points in the second quarter, contributing 12 basis points to the Fund. Year-to-date total return is 186 basis points, contributing 21 basis points to the Fund. The focus remained on primary market activity between standard new issue, refinancings, and resets, as a pickup in activity led to slight widening. The Fund has looked to add a combination of AAAs and BBs at relatively wide spreads, given our belief that these are the most attractive tranches on a risk-adjusted basis.

ABS

- The ABS allocation produced a total return of 61 basis points in the second quarter, contributing 2 basis points to the Fund. The repricing of short-term rates continued to be a headwind to performance in June. Spreads were relatively unchanged for AAA-rated prime auto and credit card ABS.

Definitions

ABS: Asset-backed securities.
CLO: Collateralized loan obligation.
CMBS: Commercial mortgage-backed security.
CRT: Credit risk transfer.
Non-QM: Non-qualified mortgage.
RMBS: Residential mortgage-backed security.
Basis Point (bps): One hundredth of one percent and is used to denote the percentage change in a financial instrument.
Bloomberg Barclays U.S. Aggregate Bond Index: An unmanaged index that measures the performance of the investment-grade universe of bonds issued in the United States. The index includes institutionally traded U.S. Treasury, government sponsored, mortgage and corporate securities.
Bloomberg Barclays U.S. Corporate High Yield Bond Index: An unmanaged market value-weighted index that covers the universe of fixed rate, non-investment grade debt.
Bloomberg Barclays U.S. Corporate Investment Grade Index: An index that measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.
Cash Flow: The net amount of cash and cash-equivalents being transferred into and out of a business, especially as affecting liquidity.
Correlation: A statistical measure of how two securities move in relation to another. Index used for comparison is the Bloomberg Barclays U.S. Aggregate Bond Index.
Credit Spread: The difference in yield between two bonds of similar maturity but different credit quality.
Effective Duration: Measures a portfolio's sensitivity to changes in interest rates. Generally, the longer the effective duration, the greater the price change relative to interest rate movements.
LIBOR: A benchmark rate that some of the world's leading banks charge each other for short-term loans. It stands for Intercontinental Exchange London Interbank Offered Rate and serves as the first step to calculating interest rates on various loans throughout the world.
National Association of Home Builders (NAHB) Housing Market Index: A gauge of builder opinion on the relative level of current and future single-family home sales.
S&P CoreLogic Case-Shiller 20-City Composite Home Price Index: The Index seeks to measure the value of residential real estate in 20 major U.S. metropolitan areas.
S&P 500 Total Return Index: An American stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ.
Sharpe Ratio: A statistical measure that uses standard deviation and excess return to determine reward per unit of risk. A higher Sharpe ratio implies a better historical risk-adjusted performance. The Sharpe ratio has been calculated since inception using the 3-month Treasury bill for the risk-free rate of return.
Spread: The difference in yield between LIBOR and a debt security with the same maturity but of lesser quality.
Standard Deviation: A statistical measure of portfolio risk used to measure variability of total return around an average, over a specified period of time. The greater the standard deviation over the period, the wider the variability or range of returns and hence, the greater the fund's volatility—calculated since inception.
Tranche: A portion of debt or structured financing. Each portion, or tranche, is one of several related securities offered at the same time but with different risks, rewards, and maturities.

Disclosures

Mutual fund investing involves risk; Principal loss is possible. Investments in debt securities typically decreases when interest rates rise. This risk is usually greater for longer-term debt securities. Investments in lower rated and non-rated securities present a greater risk of loss to principal and interest than higher rated securities. Investments in asset-backed and mortgage-backed securities include additional risks that investors should be aware of including credit risk, prepayment risk, possible illiquidity and default, as well as increased susceptibility to adverse economic developments. Derivatives involve risks different from, and in certain cases, greater than the risks presented by more traditional investments. Derivatives may involve certain costs and risks such as illiquidity, interest rate, market, credit, management and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested. The Fund may make short sales of securities, which involves the risk that losses may exceed the original amount invested.

Bond ratings are grades given to bonds that indicate their credit quality as determined by a private independent rating service such as Standard & Poor's. The firm evaluates a bond issuer's financial strength, or its ability to pay a bond's principal and interest in a timely fashion. Ratings are expressed as letters ranging from 'AAA,' which is the highest grade, to 'D,' which is the lowest grade. In limited situations when the rating agency has not issued a formal rating, the Adviser will classify the security as non-rated.

Must be preceded or accompanied by a prospectus. To obtain an electronic copy of the prospectus, please visit www.angeloakcapital.com.

Opinions expressed are as of 6/30/18 and are subject to change at any time, are not guaranteed, and should not be considered investment advice.

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