



# Angel Oak UltraShort Income Fund Quarterly Review



**Angel Oak**  
CAPITAL ADVISORS

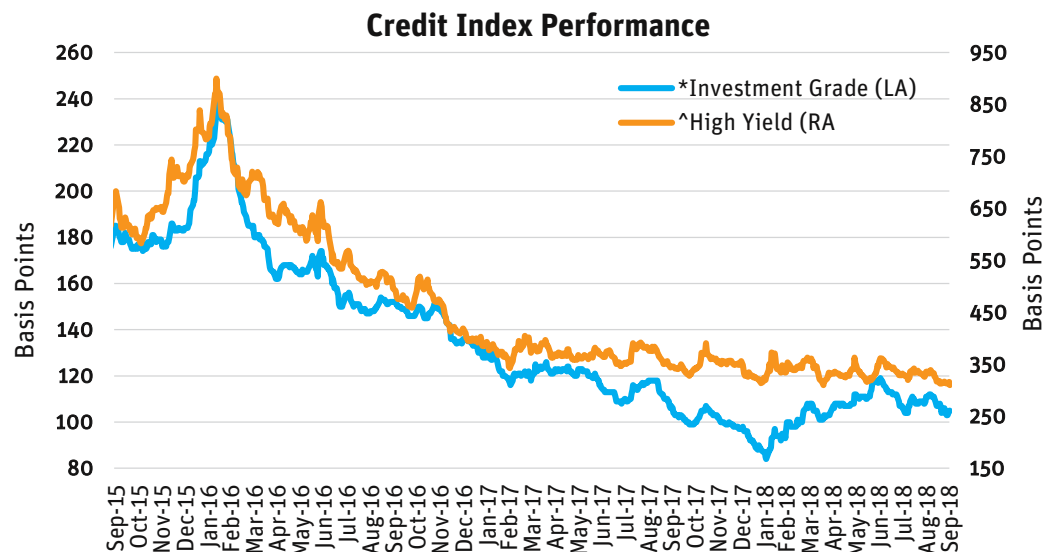
September 30, 2018

# Quarter in Review

- Risk assets moved higher for the quarter amid geopolitical tensions and trade rhetoric. The S&P 500 was up 7.71% during the quarter. Excess returns for U.S. corporates were positive, as both IG and HY credit were tighter. The Bloomberg Barclays Investment Grade Index was tighter by 17 basis points to +106 option-adjusted spread (OAS), while the High Yield Index was tighter by 47 basis points to +316 OAS. Total returns for the IG and HY indices were +0.97% and +2.40%, respectively. U.S. Treasury yields moved higher as the curve bear flattened on the quarter. The U.S. 10-year yield increased by 20 basis points to 3.06%; 2s10s flattened by 9 basis points to 0.24%.
- The labor market report for September continued its momentum from the previous month. Average hourly earnings rose 0.3% month-over-month and 2.8% year-over-year. Nonfarm payrolls came in at +134k in September, a slight decline from +201k in the previous month, predominately due to Hurricane Florence. Surveys illustrated the number of workers who reported reduced hours due to bad weather was approximately 6x larger than the typical figure for September. Absenteeism from work due to bad weather was approximately 7x higher than the average number for the trailing 10-yr period (299k vs. 44k). Prior 2-month net revisions were 87k more than previously reported. After revisions, job gains have averaged 190+ per month over the last 3 months. The headline unemployment rate declined to 3.7%, reaching the lowest rate since 1969, while the labor force participation rate remained at 62.7%.
- U.S. home price increases eased on the margin, with the S&P 500 Core Logic CS 20-City Home Price Index up 5.92% year-over-year through July 2018, coming in below expectations of 6.20%; the trailing 12-month period through June was revised up to 6.36% from 6.31%.
- The Federal Open Market Committee increased its target rate range by 25 basis points to 2.00-2.25%, which was the third hike this year and the eighth hike of this tightening campaign. The FOMC statement dropped the reference to policy being “accommodative.” Powell said that dropping “accommodative does not signal any change in the likely path of policy – they still expect further gradual increases in the target range for the Fed funds rate.” The Fed’s dot plot of member expectations for interest rates was effectively unchanged, and signals for one more 25 basis point hike in 2018 and three more hikes in 2019.
- Consumer confidence remains high as the University of Michigan Consumer Sentiment Index came in at 100.1 for the month of September. This is the highest reading since March 2018, which came in at 101.4. The ISM Index came in at 59.8 in September, a decrease of 1.2 from 61 in August.

Benchmark Performance	9/30/18	6/30/18	Monthly Change (bps)
1-Month LIBOR	2.26	2.09	+17
3-Month LIBOR	2.40	2.34	+6
2-Year Treasury	2.82	2.53	+29
5-Year Treasury	2.95	2.74	+21
10-Year Treasury	3.06	2.86	+20
30-Year Treasury	3.21	2.99	+22
2s/10s Curve	0.24	0.33	-9
2s/30s Curve	0.39	0.46	-7
S&P 500 Total Return Index	5,763	5,351	+771
IG Corporate OAS*	106	123	-17
HY Corporate OAS^	316	363	-47

Sources: Bloomberg and Yieldbook as of 9/30/18.



Source: Bloomberg as of 9/30/18.

\*Bloomberg Barclays U.S. Corporate Total Return Value Unhedged

^Bloomberg Barclays U.S. Corporate High Yield Total Return Index Value Unhedged

# Portfolio Performance

## Summary

- Since the Fund's inception on April 3, 2018, the Fund is up 1.52% through September 2018, outperforming the benchmark by 0.64%, as the Bloomberg Barclays U.S. Treasury Bill 9-12 Month TR Index is up 0.88% over the same time period. Portfolio duration decreased to 0.6 from 0.7 during the quarter and the floating rate allocation increased to 55% from 47%.
- For the third quarter of 2018, the Class I Share was up 0.82%, outperforming the benchmark by 0.36%, which was up 0.46% last quarter. Income return (+0.78%) was the primary driver of total return for the quarter, while price return was +0.05% net of hedges. Duration strategies were mixed in the third quarter relative to the benchmark. Spreads were range bound for the structured product allocations in the Fund given the modest roll-down of the short-term assets.
- Residential mortgage-backed securities (RMBS) were the best performing sector in the Fund, up 0.94% but contributing only 0.22% net of hedges due to an underweight allocation. Asset-backed securities (ABS) were the second-best performing sector, up 0.88% and contributing 0.44% to the Fund. Collateralized loan obligations (CLOs) also had a positive excess return during the quarter, up 0.85% in total return and contributing 0.09% to Fund performance.

Net Total Returns as of 9/30/18	1 Mo.	3 Mo.	YTD	SI <sup>1</sup>
Class I	0.14%	0.82%	n/a	1.52%
Class A	0.22%	0.76%	n/a	1.52%
Bloomberg Barclays U.S. Treasury Bill 9-12 Month TR Index	0.09%	0.46%	n/a	0.88%

*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. <sup>1</sup>The inception date of the Angel Oak UltraShort Income Fund I Class (AOUIX) was 4/2/18, while the inception date of the A Class (AOUAX) was 4/30/18. <sup>^</sup>The Adviser has contractually agreed to waive fees through 5/31/19.*

## FUND INFORMATION AS OF 9/30/18

	Class A	Class I
Gross Expense Ratio	0.86%	0.61%
Net Expense Ratio <sup>^</sup>	0.50%	0.25%
SEC Yield (Subsidized)	2.76%	3.08%
SEC Yield (Unsubsidized)	2.25%	2.55%

## FUND CHARACTERISTICS

Fund Assets (All Classes)	\$74.6 mm
Number of Securities	73
Distribution	Monthly
Effective Duration	0.6
Average Price (Portfolio)	\$100.2
Floating Rate (%)	55.1

## FUND STATISTICS

(Since Inception)	Fund <sup>2</sup>	Index
Standard Deviation	0.6	0.2
Sharpe Ratio	2.6	-1.9
Correlation to Index	0.4	1.0
Positive Months (%)	100.0	100.0
Negative Months (%)	0.0	0.0

<sup>2</sup>AOUIX

# Sector Attribution

		Since Inception*
	% of Market Value	
RMBS	21.9	0.37
CMBS	15.2	0.21
CLOs	13.4	0.11
Corporates	0.0	0.01
ABS	45.8	0.84
Cash & Other	3.7	0.08
Credit Hedges	-	0.00
Fund Expenses	-	-0.11
Total	100.0	1.52

\*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

- The NA RMBS allocation produced a total return of 110 basis points in the third quarter, contributing 19 basis points to Fund performance and contributing 37 basis points to the Fund since inception. The strategy focused on a diversified basket of nonperforming loan (NPL) seniors, investment-grade non-QM, floating rate legacy RMBS, and floating rate agency credit risk transfers (CRT). Spreads have tightened by 10-20 basis points for both non-QM and NPL seniors into rising front-end Treasury yields. The Fund continues to favor unrated new issue NPL seniors, which yield approximately 4.0%-4.5%, coupled with investment-grade-rated non-QM while lowering the exposure to agency CRT as spreads outperformed.

## CMBS

- Commercial mortgage-backed securities (CMBS) produced a total return of 65 basis points for the quarter and approximately 117 basis points year-to-date, contributing 11 and 20 basis points, respectively. Within CMBS, the majority of the allocation is floating-rate agency CMBS backed by multifamily properties. The focus of the allocation is liquidity and stability produced by government-backed bonds with minimal interest rate sensitivity. We continue to focus most of the allocation on these short-duration strategies and are seeking elective opportunities in conduit, single asset/single borrower (SASB), and commercial real estate CLO deals that may provide attractive returns.

## ABS

- The ABS allocation produced a total return of 88 basis points in the third quarter, contributing 44 basis points to the Fund, bringing the year-to-date total return to 151 basis points, contributing 84 basis points to the Fund. Auto ABS and credit card ABS both tightened at the top of the capital structure throughout the quarter, which was a benefit to performance given the overweight to auto ABS. The primary allocation within ABS auto is AAA/AA-rated tranches within 2017/2018 vintage deals. The average duration and weighted average life (WAL) of the ABS allocation increased to 1.44 and 1.60, respectively, as the Fund purchased longer assets down the capital structure.
- \$17 billion of new-issue ABS priced in September, bringing the 2018 total to \$190 billion. As expected, auto and credit card ABS continue to make up the majority of issuance thus far in 2018, with approximately 67% of new-issue supply. The credit curve continued to flatten for ABS. Spreads were tighter at the top of the capital structure and for autos and credit cards by 8 to 10 basis points, while subordinate spreads saw a slight widening by approximately 1 to 5 basis points for BBB-rated autos and credit cards.

## CLOs

- CLOs had a total return of 85 basis points in the third quarter, contributing 9 basis points to the Fund. The year-to-date total return is 123 basis points, contributing 11 basis points to the Fund. The allocation to remaining CLOs is focused on seasoned investment-grade tranches with <3 weighted average life (to worst) and short-duration X tranches in the new-issue market.



# 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 9-12 Month U.S. Treasury Bill Index:** Measures the performance of U.S. Treasury bills, notes, and bonds with a remaining maturity between 9-12 months. The index does not include trading and management costs.

**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.

**Correlation:** A statistical measure of how two securities move in relation to another. Index used for comparison is the Bloomberg Barclays 9-12 Month U.S. Treasury Bill 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.

**ISM Manufacturing Index:** An index that is based on surveys of more than 300 manufacturing firms by the Institute for Supply Management (ISM).

**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.

**Michigan Consumer Sentiment Index (MCSI):** A monthly survey of U.S. consumer confidence levels conducted by the University of Michigan.

**Option-Adjusted Spread (OAS):** The yield spread which has to be added to a benchmark yield curve to discount a security's payments to match its market price, using a dynamic pricing model that accounts for embedded options.

**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.

**Weighted Average Life (WAL):** Average length of time that each dollar of unpaid principal on a loan, a mortgage or an amortizing bond remains outstanding.

# Disclosures

Investing involves risk. Principal loss is possible. The Fund's derivative investments have risks, including the imperfect correlation between the value of such instruments and the underlying asset, rate or index, which creates the possibility that the loss on such instruments may be greater than the gain in the value of the underlying asset, rate or index; the loss of principal; the possible default of the other party to the transaction; and illiquidity of the derivative investments. The Fund may invest in illiquid securities and restricted securities. Investments in restricted securities could have the effect of increasing the amount of the Fund's assets invested in illiquid securities if qualified institutional buyers are unwilling to purchase these securities. Changes in interest rates generally will cause the value of fixed-income instruments held by the Fund to vary inversely to such changes. Below investment grade instruments are commonly referred to as "junk" or high-yield instruments and are regarded as predominantly speculative with respect to the issuer's capacity to pay interest and repay principal. Lower grade instruments may be particularly susceptible to economic downturns. The price paid by the Fund for asset-backed securities, including CLOs, the yield the Fund expects to receive from such securities and the average life of such securities are based on a number of factors, including the anticipated rate of prepayment of the underlying assets. Mortgage-backed securities are subject to the general risks associated with investing in real estate securities; that is, they may lose value if the value of the underlying real estate to which a pool of mortgages relates declines. See the prospectus for a more detailed description of Fund risks.

*Must be preceded or accompanied by a prospectus. To obtain an electronic copy of the prospectus, please visit [www.angeloakcapital.com](http://www.angeloakcapital.com).*

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