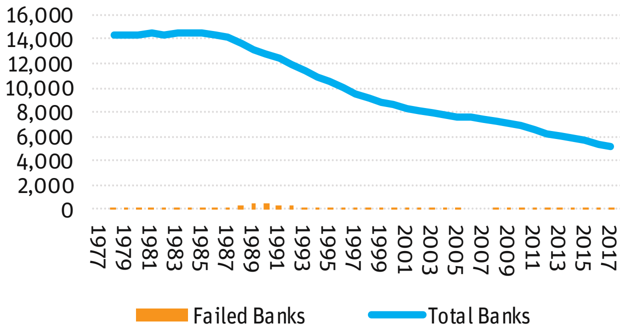
Banking Industry Well-Positioned for Sustained Improvement

The Great Recession, although now fading into history, was certainly devastating to financial markets in general and banking institutions specifically. However, the strategic response to the crisis by financial institutions, coupled with legislative initiatives that drastically altered the regulatory landscape, has resulted in a fundamental reboot of the banking industry. Balance sheets have largely been scrubbed of troubled assets, capital and loan loss reserves are at all-time highs, and earnings are approaching pre-crisis levels. There are many environmental factors at work that point to continued strong performance from banking institutions across the board.

Historical Bank Failure Rates

Banks have historically experienced very low rates of failure compared with the default rates of other corporate entities. The average failure rate for banks over the past 40 years was 0.77%[1], which is substantially lower than the average default rate of 1.16% for all rated corporations over the same period[2]. Almost a quarter of failures during this period were in Texas - hence the popularity of the "Texas Ratio" as a key bank risk indicator. Of all failures since 1977, 58% were banks with less than $100 million in assets, and 87% had less than $500 million in assets. The clear majority of these failures occurred during the savings and loan crisis of the late 1980s-early 1990s and in the aftermath of the Great Recession of 2007-2008.

Figure 1: Failed Bank vs. Total FDIC Insured Commercial Banks



Source: FDIC as of 12/31/2017

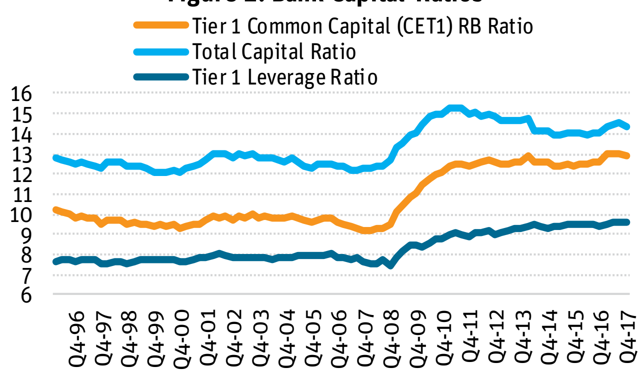
Evaluating a "normalized" period of relatively stable economic performance (1996-2007) reveals that the overall bank failure rate was only 0.04% over this horizon - four basis points! Of these failed institutions, 76% were banks with less than $100 million in assets, and 88% had less than $500 million in assets. Outside the two recent crises cited above, the likelihood of a bank failing has historically been vanishingly remote and has generally been prevalent only among relatively small institutions.

Overhaul of the Bank Regulatory Framework

The Dodd-Frank Act (DFA) and other regulatory initiatives introduced after the Great Recession have required substantially higher levels of core capital, restrictions on risky lines of business and increased investment in risk management infrastructure. These supervisory requirements have resulted in much stronger balance sheets and dramatically improved asset quality and earnings across the industry. Going forward, bank failures should be even less frequent than in the past.

However, in many respects, the regulatory burden that bankers have endured since the economic downturn has been overwhelming, as this flood of new requirements significantly increased compliance costs and diverted substantial amounts of management's time from

Figure 2: Bank Capital Ratios



Source: SNL as of 12/31/2017

[1]Source: FDIC Failures and Assistance Transactions – Historical Statistics on Banking.
[2]Source: Moody's Corporate Default and Recovery Rates, 1920–2015.

core business activities. Community banks have suffered proportionately more under the new regulatory regime because they inherently have a smaller asset base over which to spread compliance costs. Initiatives to reduce banking regulations have already been announced by Congress and the White House, although to what extent they are ultimately implemented remains to be seen. However, any regulatory relief is likely to bring substantial cost savings and enhanced efficiencies, especially for community and regional banks.

Consolidation Trends

As noted in Figure 1 on the previous page, the number of commercial banks in the U.S. has been steadily declining for decades, and this trend is expected to continue, given the many incentives that exist for banks to acquire or merge with other institutions. Economies of scale can be realized by larger institutions, which generally result in lower cost structures and improved efficiency ratios. Many smaller banks have found that the substantial increases in compliance costs associated with the DFA and other regulatory requirements have severely diminished the value of their business model. Consequently, many of these banks are not meeting earnings targets and are up for sale. Acquirers are usually larger institutions healthy enough to receive the necessary regulatory approval to engage in merger or acquisition activity.

This industry consolidation generally has had a very favorable impact on the value of bank debt, especially those securities issued by smaller institutions, which tend to be acquired by larger and stronger banks. In most merger/acquisition scenarios, the acquirer assumes the liabilities and continues to service any outstanding debt of the acquired institution. The outcome is often an upgrade in the overall perceived credit quality of the debt, leading to substantial price appreciation.

"PINNACLE FINANCIAL TO ACQUIRE AVENUE FINANCIAL IN QUEST FOR TOP MARKET SHARE IN NASHVILLE, TN"

Target: Avenue Financial Holdings Inc.
Total Assets: $1.2 Billion
Sub-debt issued:
- Size: $20 million
- Structure: 10NC5
- Rate: 6.75%

Acquirer: Pinnacle Financial Partners Inc.
Total Assets: $8.7 Billion
Sub-debt issued:
- Size: $60 million
- Structure: 10NC5
- Rate: 4.875%
  (Fixed to floating - 3ML + 3.128%)

Relative Value – Bank Equity vs. Bank Debt

In spite of the recent volatility in stock prices, U.S. equity indices are still up substantially since the 2016 election. Banks and other financial institutions have experienced particularly favorable appreciation in equity values, propelled by a broad array of factors. The Trump administration has made regulatory relief a cornerstone of its agenda. In addition, signals from the Federal Reserve and the futures markets give strong indications of higher interest rates in the near term, which would have a positive impact on bank earnings. As rates rise, assets of banks tend to reprice upward faster than their liabilities, resulting in increased net interest margins. The U.S. economic outlook should continue to be very favorable if the Trump administration delivers on its promise of a large-scale fiscal stimulus on top of the recent substantial cuts in corporate tax rates. Banks are likely to be among the biggest benefactors of these policies.

This positive outlook for financials has been clearly reflected in the performance of the S&P 500 Financials Index, which had a one-year annualized return of over 18% through February 2018. While financial equity prices have performed well, spreads on debt securities issued by banks have been slower to tighten. From a relative value perspective, we believe that the continuing strength of the banking industry will accelerate spread tightening, driving the price of bonds issued by these institutions substantially higher.

Investment Thesis for Bank Debt

Angel Oak has a long track record in evaluating the credit quality of the banking industry. We are a market leader in investing in bank subordinated debt, with over $500 million invested in this unique asset class over the past two years. Most of these investments were issued by community banks with assets between $500 million and $10 billion, a sector of the market where we believe there is the highest potential for realizing relative value appreciation. Community bank DNA runs in our blood. We have also taken opportunistic positions in select widely traded senior debt securities of regional, super-regional and global banks.

Angel Oak's investment managers collectively bring decades of experience to driving the implementation of a value-backed fixed income investment thesis with a focus on financial institutions. Our team has deep experience gained from former roles as bank CFOs, regulatory examiners and capital markets experts, as well as quantitative skills developed from the completion of advanced academic programs.

To learn more about Angel Oak Capital Advisors, please visit www.angeloakcapital.com.

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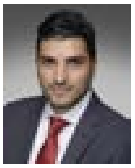

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Navid is a Senior Portfolio Manager at Angel Oak Capital and a Portfolio Manager of the Flexible Income Fund. He has over 10 years of experience in fixed income markets, focusing on corporate credit trading, risk management, credit derivatives and structured products.

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Johannes is a Managing Director and Portfolio Manager at Angel Oak Capital. Johannes' primary focus is on investment research and management of community and regional bank debt across the firm's strategies.

ABOUT ANGEL OAK CAPITAL ADVISORS

Angel Oak Capital Advisors ("Angel Oak Capital") is an investment management firm focused on providing compelling fixed income investment solutions for its clients. Backed by a value-driven approach, Angel Oak Capital seeks to deliver attractive risk-adjusted returns through a combination of stable current income and price appreciation. Its experienced investment team seeks the best opportunities in fixed income with a specialization in mortgage-backed securities and other areas of structured credit.

As of March 31, 2018, Angel Oak Capital has approximately $8.7 billion in assets under management across its mutual funds, private funds and separately managed accounts.