ANGLX | ANGIX | ANGCX

Angel Oak Multi-Strategy Income Fund Quarterly Review

December 31, 2018

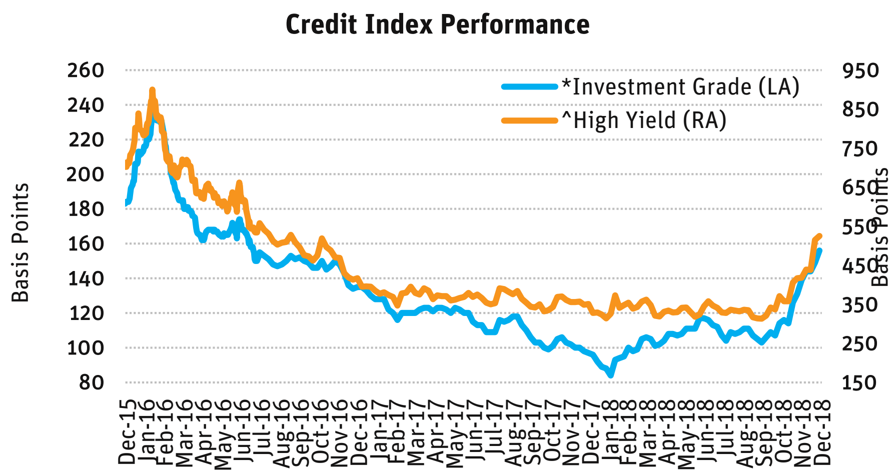
Angel Oak
CAPITAL ADVISORS

Quarter in Review

- U.S. risk asset volatility rose sharply throughout the fourth quarter as the S&P 500 Index fell 13.52%, erasing the initial gains of 2018 and putting the broad U.S. equity index down 4.39% for the year. The initial spark to downside volatility has been attributed to Powell's miscommunication during his PBS NewsHour interview in which he noted that the current federal funds target rate was far from neutral. This rhetoric created fears of a Fed that will potentially overtighten monetary policy into a recession. Alongside falling equity valuations, U.S. IG and HY corporate spreads increased toward their widest levels of the year (see the Benchmark Performance table), pushing their total returns down 0.18% and 4.53%, respectively, for the quarter. The U.S. yield curve bull flattened as the 2-year and 10-year yields fell 33 and 38 basis points, respectively.
- Structured credit spreads moved wider on the quarter alongside rising risk premiums across U.S. credit. According to BAML, legacy (prime and Alt-A) non-agency mortgage-backed security (MBS) spreads were the most immune to broadly wider credit spreads within BBB-rated and lower tranches across U.S. fixed income. For the legacy residential mortgage-backed securities (RMBS) asset class, spreads widened by 15-30 basis points across sectors, while BB/B-rated bank loans widened by approximately 100-120 basis points, BB/B-rated HY corporates widened by 165-250 basis points, and BBB/BB-rated U.S. collateralized loan obligations (CLOs) widened 95-185 basis points. Within IG credit, commercial mortgage-backed securities (CMBS) bonds were the largest underperformers, widening by approximately 175 basis points on the quarter. BBB-rated consumer asset-backed securities (ABS) also performed quite similar to legacy RMBS, widening by approximately 10-30 basis points on the quarter.
- On the back of higher capital market volatility, U.S. economic data remained quite strong. The December jobs report came in far above market consensus. The headline number was a +312k net jobs created, better than the 184k expected. Two-month net revisions were a positive 58k. The headline unemployment rate rose 0.2% as the labor force participation rate increased 0.2% to 63.1%. Average hourly earnings rose 0.4% month-over-month, boosting the year-over-year figure to 3.2%, better than the 3.0% expectation. The Federal Reserve released its updated report on the U.S. consumer. Consumer credit increased by 4.31% year-over-year through November. Non-revolving debt grew at a faster pace than revolving debt (5.08% versus 2.19%, respectively, year-over-year).
- The ISM Non-Manufacturing Index declined 0.9 to 57.6 in December, a modest move lower but still north of the crucial level of 50. The Consumer Price Index (CPI) fell to an annualized rate of 1.9% year-over-year, as falling gas prices put pressure on the headline number. Core CPI remained at 2.2% year-over-year through December as markets expected.
- Looking into 2019, a more pragmatic and cautious Federal Open Market Committee (FOMC) has appeared. As Federal Reserve Chairman Jerome Powell said at the Atlanta Fed's economic conference on January 4, 2019, the FOMC will continue to reduce the size of its balance sheet in the form of quantitative tightening but be more data-dependent with respect to increases in the target rate. Most enlightening from the conference, he reiterated, "[The Fed] will be prepared to adjust policy quickly and flexibly and to use all of our tools to support the economy, should that be appropriate to keep the expansion on track, to keep the labor market strong and to keep inflation near 2%." The bottom line is the FOMC is not looking to overtighten in 2019 but to support robust growth over the medium term.

Benchmark Performance	12/31/18	9/30/18	Quarterly Change (bps)
1-Month LIBOR	2.50	2.26	+24
3-Month LIBOR	2.81	2.40	+41
2-Year Treasury	2.49	2.82	-33
5-Year Treasury	2.51	2.95	-44
10-Year Treasury	2.68	3.06	-38
30-Year Treasury	3.01	3.21	-20
2s/10s Curve	0.20	0.24	-4
2s/30s Curve	0.53	0.39	+14
S&P 500 Total Return Index	4,984	5,763	-1352
IG Corporate OAS*	153	106	+47
HY Corporate OAS^	526	316	+210

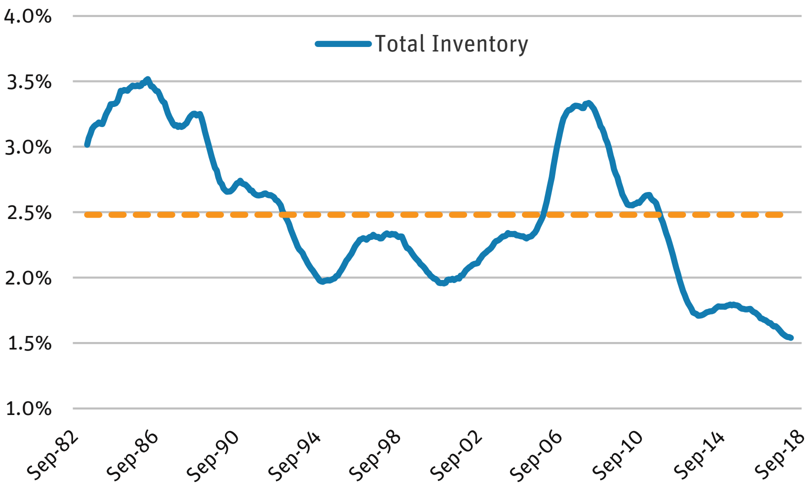
Sources: Bloomberg and Yieldbook as of 12/31/18.



Source: Bloomberg as of 12/31/18.
*Bloomberg Barclays U.S. Corporate Total Return Value Unhedged
^Bloomberg Barclays U.S. Corporate High Yield Total Return Index Value Unhedged

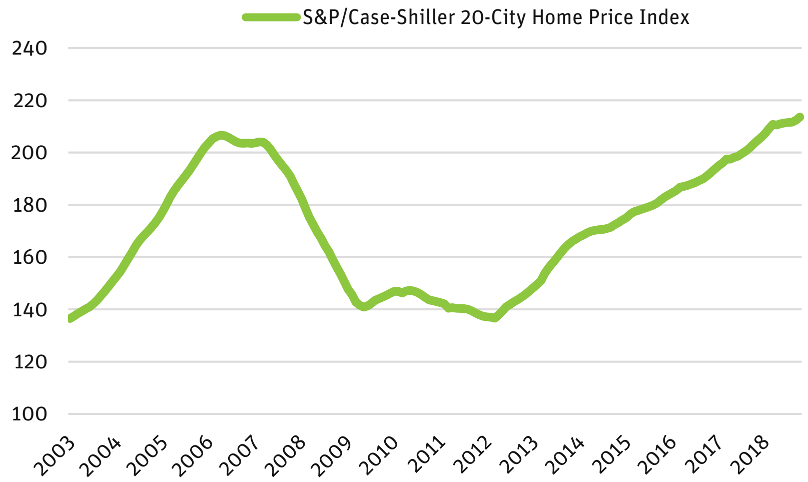
Fundamentals = Scenario Improvement

Single-Family Inventory as % of Total Households



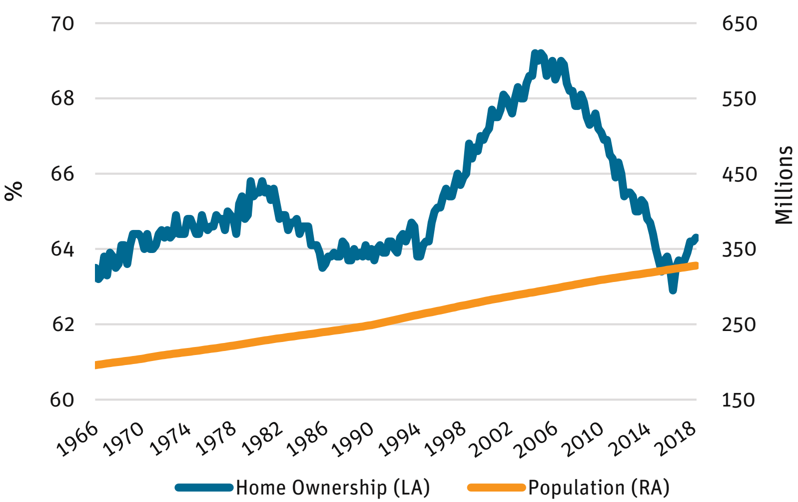
Source: Morgan Stanley as of 9/30/18.

Home Prices Continue to Improve



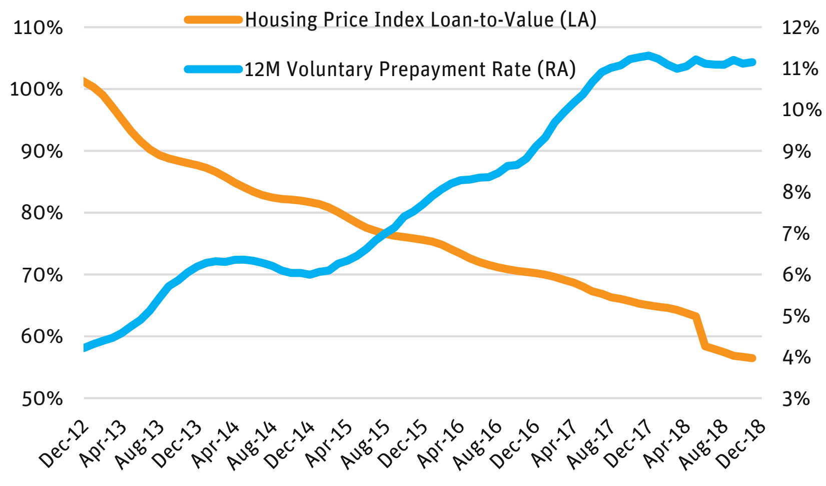
Source: Bloomberg as of 10/31/18.

Home Ownership Rate vs. Population Growth



Source: Bloomberg as of 6/30/18.

Legacy Non-Agency RMBS VPR vs. LTV



Source: Bloomberg as of 12/31/18.

Portfolio Performance

Summary

- The Fund was up 0.11% in the fourth quarter of 2018, underperforming the benchmark by 1.53%, as the Bloomberg Barclays U.S. Aggregate Bond Index was up 1.64% over the same time period. Broader market volatility in the equity and high yield markets headlined a risk-off tone throughout the final quarter of 2018. Year-to-date 2018, the Fund was up 2.85%, outperforming the benchmark, which finished the year up 0.01%. Excess returns for U.S. structured credit (versus swaps/LIBOR) were mostly positive as excess income return offset widening spreads in the fourth quarter.
- Duration strategies were a negative contributor to Fund performance, as the Fund maintained its duration short of the benchmark, and U.S. Treasury yields fell 30-45 basis points across the curve. Spread strategies had their worst quarter of the year as market volatility early in the fourth quarter spilled into structured products to a larger extent in December.
- Sector allocations were mixed contributors to Fund performance during the quarter. Non-agency RMBS were the best contributors to Fund performance, with a total return of 0.37%, contributing 0.25% to the Fund. CLOs were the worst contributors, down approximately 0.38% and contributing approximately -0.03% to the Fund.

				Annualized		
Net Total Returns as of 12/31/18	**3 Mo.**	**YTD**	**1 Yr.**	**3 Yr.**	**5 Yr.**	**SI[1]**
Class I	0.11%	2.85%	2.85%	4.29%	4.13%	7.06%
Class A at NAV	0.05%	2.61%	2.61%	4.04%	3.86%	6.84%
Class A at MOP[2]	-2.23%	0.30%	0.30%	3.27%	3.38%	6.52%
Bloomberg Barclays U.S. Agg. Bond Index	1.64%	0.01%	0.01%	2.06%	2.52%	2.59%

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 12/31/18

	Class A	Class I
Gross Expense Ratio	1.37%	1.12%
Net Expense Ratio^	1.24%	0.99%
SEC Yield (Subsidized)	4.46%	4.82%
SEC Yield (Unsubsidized)	4.46%	4.82%

FUND CHARACTERISTICS

Fund Assets (All Classes)	$7.0bn
Number of Securities	1790
Distribution	Monthly
Effective Duration	1.9
Average Price (Portfolio)	$88.0
Average Price (NA RMBS)	$86.2
Floating Rate (%)	66.9

FUND STATISTICS

(Since Inception)	Fund[3]	Index
Standard Deviation	3.2	3.8
Sharpe Ratio	3.1	0.8
Correlation to Index	0.1	1.0
Positive Months (%)	83.3	62.2
Negative Months (%)	16.7	37.8

[3]ANGIX

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

Sector Attribution

		Q4 2018*	YTD 2018*
	% of Market Value	Attribution (%)	Attribution (%)
RMBS	70.7	0.25	2.72
CMBS	8.1	0.01	0.42
CLOs	9.2	-0.03	0.30
Corporates	6.4	0.08	0.30
ABS	3.1	0.04	0.06
Cash	2.6	0.01	0.04
Credit Hedges	-	0.00	0.00
Fund Expenses	-	-0.25	-0.99
Total	100.0	0.11	2.85

*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 61 basis points in the fourth quarter, contributing 25 basis points to Fund performance. This brings the total return to 420 basis points on the year, contributing 272 basis points to Fund performance. Legacy RMBS have continued to demonstrate stability despite a sharp increase in volatility in other asset classes as evidenced by U.S. stocks, IG corporates, and high yield all posting negative total returns in the fourth quarter. Environments like Q4 reinforce the Fund's overweight to legacy RMBS, specifically at the top of the capital structure. New issue spreads widened across all RMBS products during the quarter. Credit risk transfer last cash flow spreads led the widening, ending the quarter 87 basis points wider for low loan-to-value (LTV) deals and 95 basis points wider for high LTV deals.
- 2018 has been the busiest year for new issuance in the RMBS market since 2007 and shows no signs of slowing down in the fourth quarter. Annual issuance volume is at $120 billion, compared with just $91 billion in 2017. Additionally, every subsector of the market should exceed issuance expectations from the start of the year. The pace and size of new issuance in the market has led to a softening in primary spreads and has created pockets of opportunity for the Fund to add AAA assets at very attractive levels.

CMBS

- CMBS returned 138 basis points in the fourth quarter, contributing 1 basis points to Fund performance net of hedges. For the full year, CMBS returned 308 basis points, contributing 42 basis points to Fund performance net of hedges. Generic spreads for the quarter were wider across the credit structure, predominately due to general market volatility. For example, AAA widened by approximately 27 basis points to 100, while BBB widened by 120 basis points to 435. In new issue, $21.7 billion priced for the quarter, split between $11.6 billion of conduit, $6.1 billion of single asset/single borrower (SASB), and $4.0 billion of commercial real estate CLO. Allocation within CMBS was reduced to 8.1% in the fourth quarter from 12.2% from the previous quarter, predominately in the CMBS liquidity.

CLOs

- CLOs had a total return of -38 basis points in the fourth quarter, contributing -3 basis points to the Fund. The year-to-date total return is 251 basis points, contributing 30 basis points to the Fund. The focus remained on defensive-natured, seasoned bonds closer to the reinvestment period end date as opposed to the standard 5-year reinvest/2-year non-call structure. The curve remains flat, offering relative value in deals with 2- to 3-year reinvestment periods. The Fund will look further down the capital structure for opportunities in bonds that have widened out due to year-end illiquidity and rebalancing and that have been stressed with overly aggressive assumptions.

ABS

- The ABS allocation produced a total return of 122 basis points in the fourth quarter, contributing 4 basis points to the Fund. The year-to-date total return is 231 basis points, contributing 6 basis points to the Fund. The Fund continued to focus on short, relatively attractive auto ABS higher up in the capital structure. Spreads were 5-20 basis points wider for AAA-rated auto and credit card ABS on a year-over-year basis.`

Definitions

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.
Consumer Price Index (CPI): An index that measures the changes in the price of a certain collection of goods and services bought by consumers in an effort to measure inflation.
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.
ISM Non-Manufacturing Index: An index based on surveys of more than 400 non-manufacturing firms' purchasing and supply executives by the Institute of 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.
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.

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.

It is not possible to invest directly in an index.

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 12/31/18 and are subject to change at any time, are not guaranteed, and should not be considered investment advice.

The Angel Oak Funds are distributed by Quasar Distributors, LLC.