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Angel Oak Strategic Credit Fund Quarterly Review

December 31, 2018

Angel Oak
CAPITAL ADVISORS

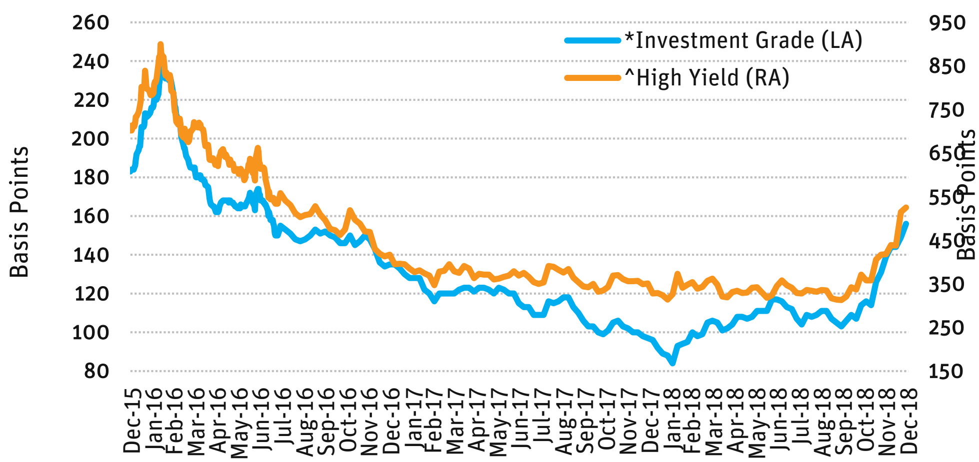
Quarter in Review

- 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.

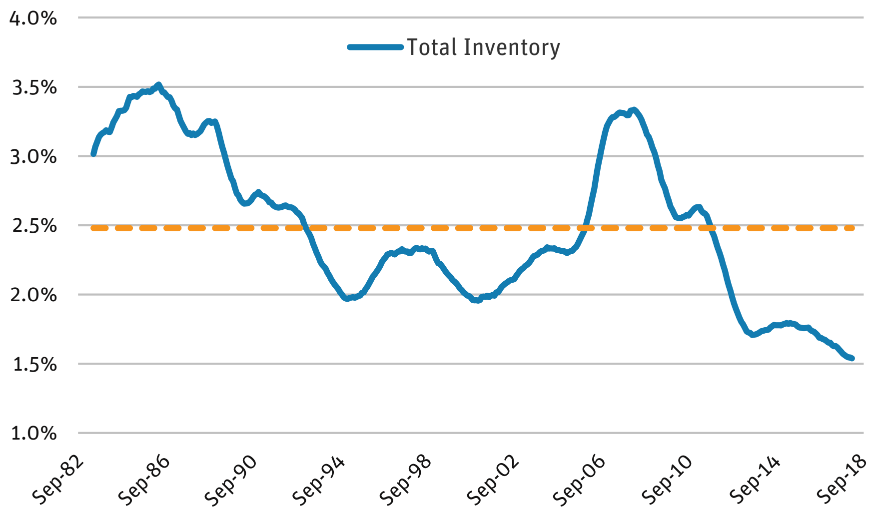
Credit Index Performance



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

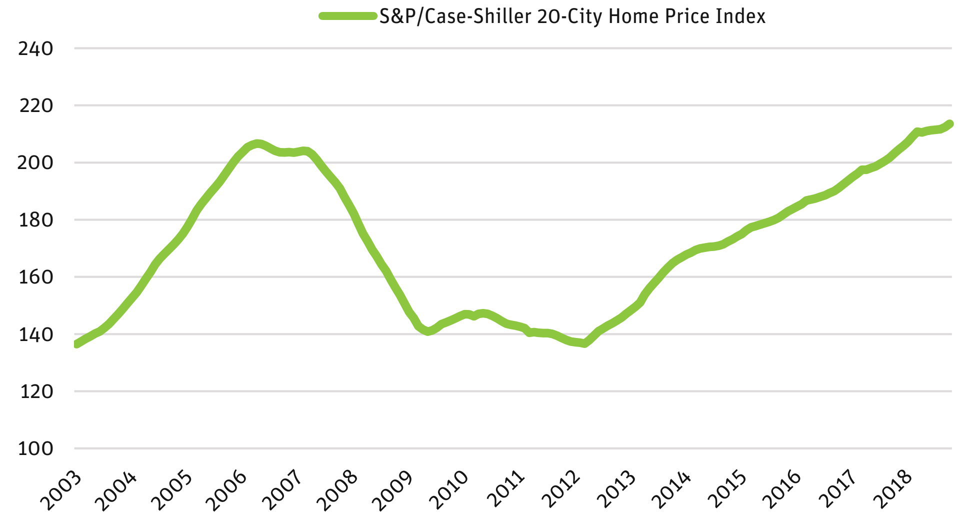
Fundamentals

Single-Family Inventory as % of Total Households



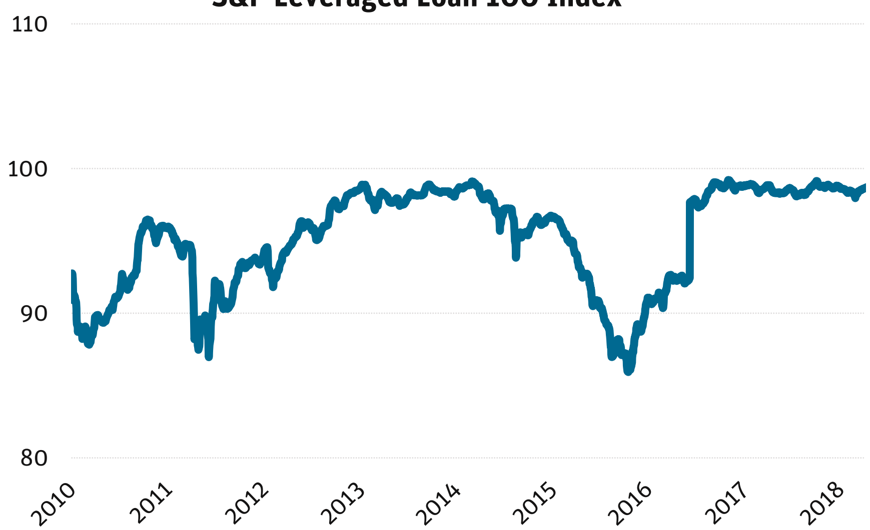
Source: Morgan Stanley as of 9/30/18.

Home Prices Continue to Improve



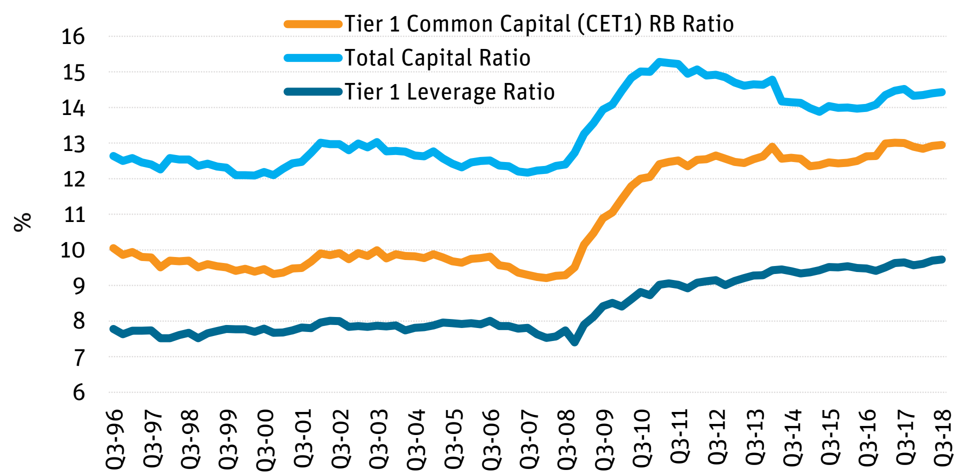
Source: Bloomberg as of 10/31/18.

S&P Leveraged Loan 100 Index



Source: Bloomberg as of 11/30/18.

Bank Subordinated Debt



Source: SNL of 9/30/18.

Portfolio Performance

Summary

- The Fund was down 67 basis points in the third quarter of 2018, underperforming the benchmark by 231 basis points. The Bloomberg Barclays U.S. Aggregate Bond Index was up 1.64% over the same time period, as U.S. interest rates rallied throughout the quarter amid rising fears of an economic slowdown. For the calendar year, the Fund was up 4.85%.
- Duration strategies were negative contributors to Fund performance in the third quarter, as the U.S. yield bull curve flattened on the risk off sentiment. Credit positioning versus the index also weighed on Fund performance as spreads widened across risk assets in the fourth quarter.
- CMBS were the best performing subsector in the fourth quarter, producing a total return of approximately 54 basis points, contributing 4 basis points to Fund performance. RMBS produced a total return of approximately 8 basis points, contributing 3 basis points to Fund performance. CLOs were the worst performer, with a total return of -268 basis points which detracted 42 basis points from Fund performance.

Net Total Returns as of 12/31/18	1 Mo.	3 Mo.	YTD	1 Yr.	3 Yr.	SI[1]
Class I	-0.92%	-0.67%	4.85%	4.85%	n/a	4.77%
Bloomberg Barclays U.S. Agg. Bond Index	1.84%	1.64%	0.01%	0.01%	n/a	0.38%

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 Strategic Credit Fund Class I (ASCIX) was 12/26/17. Periods less than one year are cumulative. ^The Adviser has agreed to waive fees and may amend, extend, or discontinue this waiver at any time without notice.

FUND INFORMATION AS OF 12/31/18

	Class I
Gross Expense Ratio	3.14%
Net Expense Ratio^	0.75%
SEC Yield (Subsidized)	7.50%
SEC Yield (Unsubsidized)	-3.98%

FUND CHARACTERISTICS

Fund Assets (All Classes)	$6.5 mm
Number of Securities	36
NAV	Daily
Dividend Frequency	Monthly
Liquidity Provisions	Quarterly
Floating Rate (%)	49.5

FUND STATISTICS

(Since Inception)	Fund[3]	Index
Standard Deviation	2.8	3.4
Sharpe Ratio	2.1	-0.8
Correlation to Index	0.1	1.0
Positive Months (%)	83.3	50.0
Negative Months (%)	16.7	50.0

[3]ASCIX

Sector Attribution

		Q4 2018*	YTD 2018*
	% of Market Value	Attribution (%)	Attribution (%)
Residential Mortgage Credit	43.1	0.03	2.59
Commercial Mortgage Credit	6.6	0.04	0.83
CLOs	17.6	-0.42	1.14
Corporates	19.0	-0.11	0.56
ABS	4.4	-0.08	0.16
Cash	9.4	0.05	0.33
Fund Expenses	-	-0.19	-0.75
Total	100.0	-0.67	4.85

*Estimated returns, net of hedges, and unaudited.

Portfolio Update

- The Fund continues to adhere to its thesis of moving throughout the credit markets to invest in the subsectors that present the most attractive risk-adjusted return opportunities.
- The Fund steadily increased its allocation to residential mortgage credit throughout the second half of the year, as tight credit spreads across the risk landscape made higher beta asset classes look less attractive.
- RMBS finished the year with a total return of approximately 10.60%, contributing approximately 2.6% to Fund performance. RMBS returns were driven by high current carry, led by the allocation to credit risk transfer bonds.
- CMBS had the second best total return on the year at approximately 10.50%, contributing 79 basis points to Fund performance. We reduced our exposure to CMBS in the second half of the year, after it had a very strong start. Within the CMBS allocation, we have reduced exposure to the conduit subsector of CMBS in favor of owning Single Asset/Single Borrower deals. While spreads are wider in the conduit sector, a drift in underwriting standards has us cautious on that subsector.
- CLOs had a total return of 4.60% on the year, contributing 1.14% to Fund performance.
- The corporate allocation produced a total return of 2.95% on the year, contributing 0.56% to Fund performance. We continue to be overweight non-bank financials within the allocation.

Definitions

Basis Point (bps): One hundredth of one percent and is used to denote the percentage change in a financial instrument.
Beta: A measure of a stock's risk of volatility compared to the overall market.
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.
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.
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 Leveraged Loan 100 Index: A capitalization-weighted syndicated loan index based upon market weightings, spreads and interest payments.
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.
Tier 1 Common Capital (CET1) RB Ratio: Measurement of a bank’s core equity capital compared with its total risk-weighted asset that signifies a bank’s financial strength.
Tier 1 Leverage Ratio: The relationship between a banking organization's core capital and its total assets.
Total Capital Ratio: The percentage of a bank's capital to its risk-weighted assets.

Disclosures

Investing involves risk. Principal loss is possible. The Fund's Shares will not be listed on an exchange in the foreseeable future, if at all. 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. The Fund will be subject to risks associated with adverse political and economic developments in foreign countries, including seizure or nationalization of foreign deposits, the imposition of economic sanctions, different legal systems and laws relating to bankruptcy and creditors' rights and the potential inability to enforce legal judgments, all of which could cause the Fund to lose money on its investments in non-U.S. 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 current prospectus. To obtain an electronic copy of the prospectus, please visit www.angeloakcapital.com.

It is not possible to invest directly in an index.

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.

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