Recent Allocation Shifts in Preparation of Increased Market Volatility

The fourth quarter of 2018 has been a volatile time in the marketplace. The risk-off environment can be attributed to many factors, including an aggressive Fed, continued trade war issues, a collapse in oil prices, and a slowdown within the once red-hot tech sector. The risk-off move across markets has caused the S&P 500 to fall -9.39% quarter-to-date, retracing most of the 2018 gains, as the index is now up 0.19% year-to-date. The corporate bond marketplace has struggled as well, as the Bloomberg Barclays U.S. Corporate High Yield Bond Index is off -2.87% quarter-to-date and -0.37% year-to-date, and the Bloomberg Barclays U.S. Investment Grade Corporate Bond Index is off -1.43% and -3.73% year-to-date. In recent history, when risk-off moves permeate markets, traditional fixed income, represented by the Bloomberg Barclays U.S. Aggregate Bond Index (AGG), typically performs well. However, this has not been the case in 2018. Quarter-to-date, the AGG is off -0.33% and down 1.92% year-to-date. However, not everything has been negative in 2018. The Angel Oak Multi-Strategy Income Fund (ANGIX) is up 0.39% quarter-to-date and 3.14% year-to-date.

Within ANGIX, we have been preparing for increased market volatility over the past 12 to 18 months, as the Fed was becoming less accommodative to the markets by raising short-term rates and unwinding its post-crisis balance sheet. We have been able to improve the overall quality of our holdings while maintaining a distribution yield of 5.02% (as of 10/31/18). First, we have increased our allocation to legacy non-agency RMBS which has strong technical and fundamental support, and time and again has proven to exhibit price stability in times of volatility. Most legacy RMBS are rated below investment grade, and as a result, we believe it is misleading to look at the overall rating of our portfolio. However, when you look closely at our holdings outside of the legacy non-agency RMBS allocation, there is a significant increase in rating quality which further points to the upgrade in portfolio quality. For example, currently, ANGIX has approximately 20% of its assets in A-rated or higher assets. In 2016, approximately 8% of the assets were A-rated or higher. Also, we have been wary of adding duration risk within the portfolio since its inception, as we felt that investors were not being rewarded to take duration risk with yields so low. While we will never be completely insulated from broad market sell-offs, we feel that the current allocation should potentially have substantially less downside risk.

Within our non-agency portfolio, we have continued to focus on legacy prime and Alt-A senior securities that are currently floating rate. This allocation represents 57% of the Fund. These borrowers continue to de-lever on a monthly basis, building equity in their homes, and because they have floating-rate loans, we have seen a continued elevation in prepayments, which helps performance as the bonds trade at a discount. These assets are slightly weaker in price on the quarter and could potentially see some further technical spread widening, but should continue to perform well, as the price sensitivity has not been as correlated to the broader corporate credit markets. Areas within legacy that we have avoided over the years due to lower credit quality and higher volatility are the subprime sector and mezzanine tranches. Within the new issue non-agency market, which represents 10% of the Fund, we have been focused on non-qualified mortgage (QM) transactions while shying away from areas such as CRT, which are more correlated to the high-yield corporate credit market and have exhibited more weakness in the recent sell-off. Overall, we remain bullish on housing fundamentals in general, and view any widening as a selective buying opportunity in legacy and new issue RMBS.

One area within ANGIX that we invest in, which is more correlated to corporate credit, is our CLO allocation, which represents 11% of the Fund. As interest rates have been rising, we have been shifting our allocation higher up the capital stack from BB and BBBs into AA and AAAs. Currently, 73% of the CLO allocation is in AA and AAAs, while less than 1% is in BBs. AAA-rated CLOs currently yield between 4.0% and 4.5% and float on a quarterly basis. We believe that bank loan risk has increased over the past two years, as strong demand for floating-rate credit has led to more risk within the sector as covenants have been loosened and credit spreads have compressed. While we do not believe a collapse in the bank loan sector is imminent, we believe that volatility, especially down in lower-rated CLO tranches, should remain elevated.

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However, AAA CLOs have a 35% credit enhancement or "loss protection" and have strong demand from the banks and insurance companies while having a similar 12-month distribution yield to the bank loan BKLN ETF, which currently yields 4.03%. Since October, AAAs are approximately 0.1 to 0.3% lower in price, while BBBs are approximately 2% to 3% lower, and BBs are approximately 3% to 5% lower.

The CMBS allocation represents 10% of ANGIX and consists mostly of government-guaranteed Agency multifamily deals and single-asset, single-borrower transactions. This allocation is starkly different from our allocation in 2016, as ANGIX was mostly allocated to A and BBB conduit transactions. Credit quality has been weakening over the past few years within conduit deals, as the retail sector has come under pressure and quality loans in well-populated areas have become fewer of the transactions. For the quarter, Agency multifamily deals are 0.1% to 0.3% lower in price, while BBB-rated conduit deals are off approximately 3% to 4% lower.

The other 13% of the allocation consists mostly of short-dated AAA-rated ABS deals and investment-grade-rated community bank corporate debt. This allocation is roughly 7% higher than in 2016, leaving us "dry powder" if spreads continue to widen.

In summation, as interest rates moved higher, we have taken several steps over the past 12 to 18 months that have improved the credit quality and lowered the volatility of the portfolio while still maintaining income. This has been achieved as the coupon of the floating rate assets, which represent 67% of the Fund have increased, allowing us to shift into higher-rated assets with lower volatility within CLOs, CMBS, and ABS. This higher-quality positioning will potentially allow us to quickly shift into areas of credit that have strong fundamental profiles but have experienced weakness from technical widening in the markets.

DAVID WELLS
Managing Director, Senior Portfolio Strategist

David serves as the Managing Director for Angel Oak Capital. Since inception of the firm, David has had many responsibilities including portfolio management, trading, and most recently marketing. David has over 18 years of fixed income trading and portfolio management experience. Prior to Angel Oak, David worked at SunTrust securitizing commercial mortgage loans and managing the banks $500 million commercial conduit loan warehouse. Prior to that, he spent six years managing a $3 billion commercial mortgage-backed securities (CMBS) and $10 billion agency mortgage pass though position of the bank's investment portfolio. He also served as the Head Analyst for the bank portfolio specializing in asset-backed securities, CMBS, and residential mortgage-backed securities.

Total Returns (as of 9/30/18)	3Q18	YTD	1 Year	3 Years	5 Years	Inception[1]
Class I	0.89%	2.74%	3.60%	4.16%	4.58%	7.30%
Class A at NAV	0.83%	2.56%	3.26%	3.88%	4.32%	7.08%

30-Day SEC Yield (as of 9/30/18)	Class A	Class I
Subsidized	4.34%	4.70%
Unsubsidized	4.34%	4.70%

[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.

Expense Ratios by Share Class*

	Class A	Class I
Gross	1.37%	1.12%
Net	1.24%	0.99%

*Gross expense ratios are reported as of the 5/31/18 prospectus. The net expense ratios are reported as of the 1/31/18 Annual Report and are referenced in the 5/31/18 prospectus. The Adviser has contractually agreed to waive fees through 5/31/19.

Performance quoted is past performance and is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. 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 for the most recent month end for the Angel Oak Funds can be obtained by calling 855-751-4324 or by visiting www.angeloakcapital.com.

ABS: Asset-backed securities.
CLO: Collateralized loan obligation.
CMBS: Commercial mortgage-backed security.
CRT: Credit risk transfer.
RMBS: Residential mortgage-backed security.
SASB: Sustainability Accounting Standards Board.

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. Investment Grade Corporate Index: An index that covers the publicly issued U.S. corporate and specific foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.
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.
Duration: Measures a portfolio's sensitivity to changes in interest rates. Generally, the longer the duration, the greater the price change relative to interest rate movements.
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.
Spread: The difference in yield between LIBOR and a debt security with the same maturity but of lesser quality.
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.

It is not possible to invest directly in an index.

Fund holdings and/or sector allocations are subject to change at any time and are not recommendations to buy or sell any security.

As of 9/30/18, none of the Angel Oak Funds directly held the securities mentioned in this article.

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 rating agency will classify the security as nonrated.

Must be preceded or accompanied by a prospectus. To obtain an electronic copy of the prospectus, please visit www.angeloakcapital.com.
Past performance is no guarantee of future results.

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. For more information on these risks and other risks of the Fund, please see the Prospectus.

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