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# Angel Oak Multi-Strategy Income Fund Quarterly Review

March 31, 2019

Angel Oak
CAPITAL ADVISORS

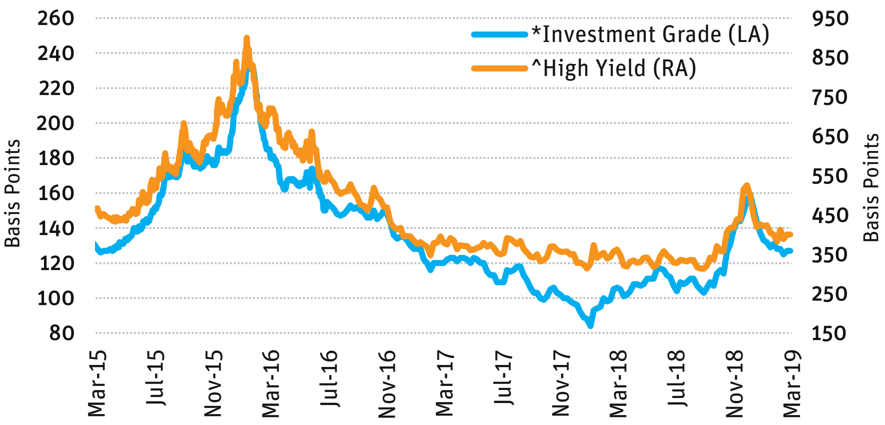
# Quarter in Review

- U.S. risk assets moved sharply higher in the first quarter of 2019, retracing most of the downside deviation from the fourth quarter of 2018. The S&P 500 had its best quarter since 2009, finishing up 13.65%. Technology stocks led the move, with the NASDAQ Composite Index up 16.81% in the first quarter of 2019. Rising stock prices also benefited corporate credit. Spreads tightened rapidly throughout the first quarter. The Bloomberg Barclays IG Corporate Index tightened 34 basis points to 119 OAS, while the HY equivalent tightened by 135 basis points to 391 OAS. U.S. Treasury yields fell across the curve, flattening the 2s10s spread by 5 basis points to 0.14%. The 10-year Treasury yield decreased 28 basis points to 2.41%. Interestingly, 3M LIBOR decreased throughout the first quarter, down by 21 basis points to 2.60% as market participants lowered their expectations to zero hikes from the Federal Open Market Committee (FOMC) in 2019. At the end of the quarter, there was a 0% probability of a hike (and a 32% probability of a cut) this year according to Fed Funds futures.
- Structured credit spreads' excess returns were positive in the first quarter as risk premiums decreased across stocks and U.S. credit. The broad spread tightening across U.S. credit was a benefit to U.S. securitized assets, and the credit curve flattened for most Structured Product sectors. Legacy non-agency residential mortgage-backed securities (RMBS) posted positive returns of approximately 1.2% across most sectors in the first quarter, with positive excess returns of 0.5%–0.9%. U.S. collateralized loan obligations (CLOs) were up 1.9% on average across the capital stack in the first quarter. The credit curve flattened, with positive excess returns of 0.6%–3.4% for A and higher tranches and 3.4%/4.6% for BBB/BB-rated tranches. Commercial mortgage-backed securities (CMBS) benefited from the tightening spread environment, posting positive excess returns of 1.3% for AA-BBB-rated tranches. Asset-backed securities (ABS) sectors were an underperformer in the first quarter compared with other U.S. structured credit, posting positive returns of 1.2% for both auto and cards ABS but excess returns of only 0.1% for the quarter.
- As expected following numerous public appearances and speeches during the first quarter, the FOMC turned much more dovish within their March meeting minutes. The discussion led to implications of no rate hikes for the rest of 2019 and only one hike in 2020. Additionally, the Fed announced the tapering of the balance sheet runoff, which is now expected to end in 2019 and will shift the total asset mix toward more Treasury holdings relative to agency mortgage-backed securities by reinvesting more within U.S. Treasuries. Core PCE rose 1.8% year-over-year through January, 0.1% below market expectations of 1.9%, giving further room for the FOMC to remain on hold at the current Fed Funds Target Rate range. The third release of Q4 GDP came in at +2.2%, 0.1% below market consensus.
- The U.S. labor market continues to remain extraordinarily healthy. Nonfarm payrolls rose 196k in March and have averaged +180k during the first quarter. The unemployment rate is currently running at 3.8%, with average hourly earnings continuing to rise at approximately 3.0%–3.5%.
- On the housing front, the S&P CoreLogic CS headline index rose 0.11% month-over-month (versus 0.30%) and +3.58% year-over-year (versus 3.80%) through January. Housing starts fell 8.7% month-over-month in February to an annualized pace of 1.16MM; however, new home sales rose 4.9% month-over-month to an annualized pace of 667k. Also, January was revised higher to 636k, up from the initial estimate of 607k.

| Benchmark Performance | 3/31/19 | 12/31/18 | Quarterly Change (bps) |
|---|---|---|---|
| 1-Month LIBOR | 2.49 | 2.50 | -1 |
| 3-Month LIBOR | 2.60 | 2.81 | -21 |
| 2-Year Treasury | 2.26 | 2.49 | -23 |
| 5-Year Treasury | 2.23 | 2.51 | -28 |
| 10-Year Treasury | 2.41 | 2.69 | -28 |
| 30-Year Treasury | 2.81 | 3.01 | -20 |
| 2s/10s Curve | 0.15 | 0.20 | -5 |
| 2s/30s Curve | 0.55 | 0.53 | +2 |
| S&P 500 Total Return Index | 5,665 | 4,984 | +1,366 |
| IG Corporate OAS* | 119 | 153 | -34 |
| HY Corporate OAS^ | 391 | 526 | -135 |

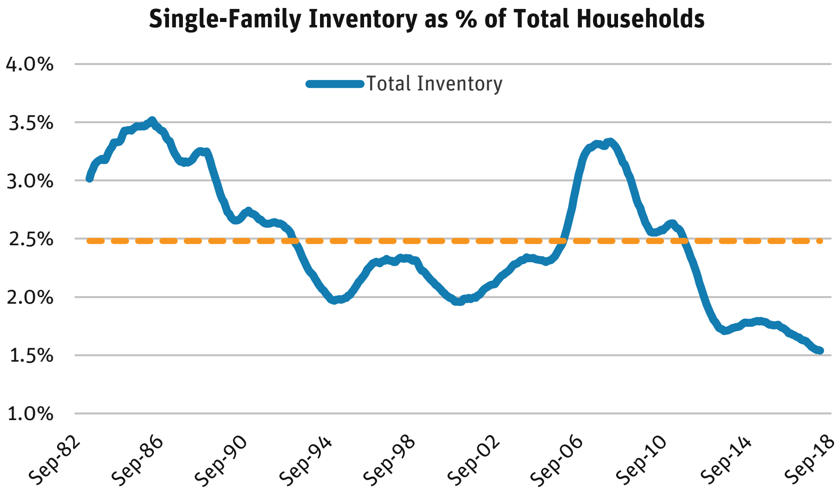
Sources: Bloomberg and Yieldbook as of 3/31/19.

**Credit Index Performance**

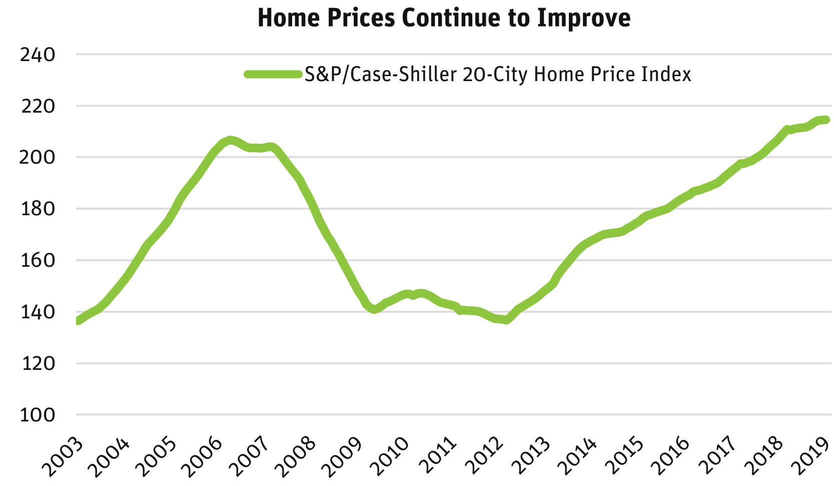



Source: Bloomberg as of 3/31/19.
*Bloomberg Barclays U.S. Corporate Total Return Value Unhedged
^Bloomberg Barclays U.S. Corporate High Yield Total Return Index Value Unhedged

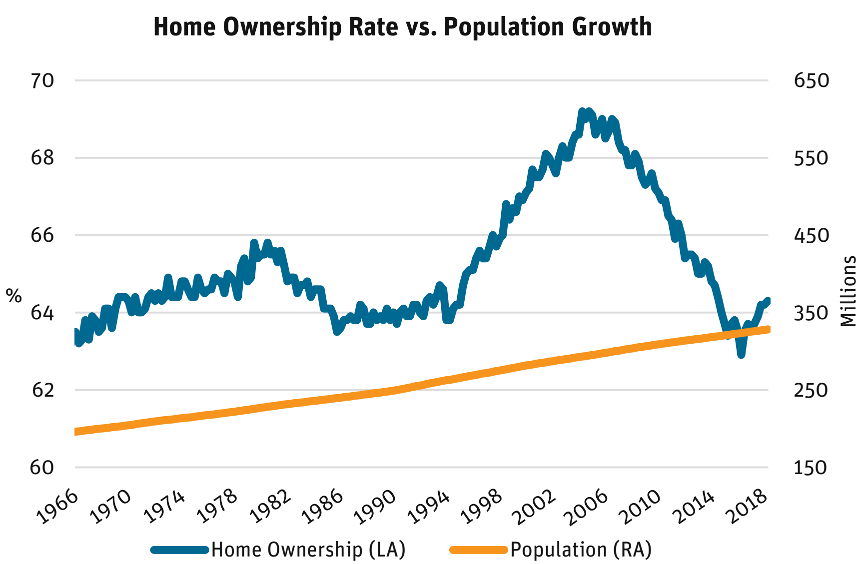
# Fundamentals = Scenario Improvement



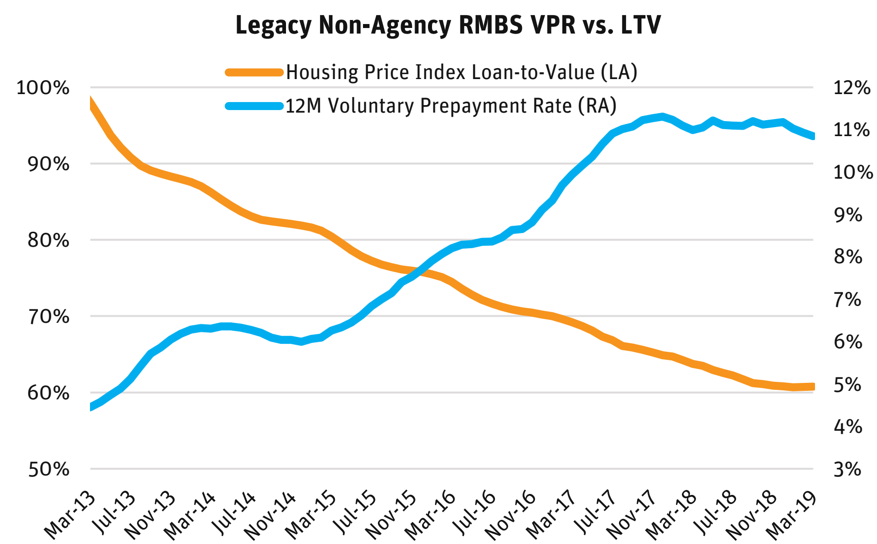

Source: Morgan Stanley as of 9/30/18.




Source: Bloomberg as of 1/31/19.




Source: Bloomberg as of 6/30/18.




Source: Bloomberg as of 3/31/19.

# Portfolio Performance

Summary

- The Fund was up 1.30% in the first quarter of 2019, underperforming the benchmark by 1.64%, as the Bloomberg Barclays U.S. Aggregate Bond Index was up 2.94% over the same time period. Duration positioning drove underperformance relative to the benchmark, as the Fund maintained its duration short of the benchmark. U.S. Treasury yields fell approximately 20-28 basis points across the curve. The sharp decline in risk-free rates across the U.S. term structure in the first quarter was driven by the dovish pivot from the FOMC. This fueled performance for traditional U.S. fixed income benchmarks, notably the Bloomberg Barclays Aggregate due to its high interest rate sensitivity.
- All sector allocations were positive contributors to Fund performance during the month. Non-agency RMBS (NA RMBS) had another strong quarter after several years of outperformance, up 1.48% in total return, contributing 0.98% to Fund performance. The fundamental tailwinds of the broad-based housing recovery have resulted in solid improvement in home equity in the U.S. This has resulted in rising Sharpe ratios for NA RMBS as it continues to exhibit high current carry and lower spread volatility even amid spread widening events such as late 2018.
- CLOs and CMBS were also strong performers in the quarter as they were most correlated with U.S. credit softness in the fourth quarter, CLOs were up 2.33% in total return, contributing 0.21% to total return. CMBS was up 2.05% in total return, contributing 0.14% to the Fund. Corporates were solid performers in the first quarter, driven primarily by the duration of the allocation, up 1.98% in total return and contributing 0.14% to Fund performance.

| | | | | Annualized | | |
|---|---|---|---|---|---|---|
| Net Total Returns as of 3/31/19 | 3 Mo. | YTD | 1 Yr. | 3 Yr. | 5 Yr. | SI[1] |
| Class I | 1.30% | 1.30% | 3.29% | 5.64% | 3.92% | 7.01% |
| Class A at NAV | 1.23% | 1.23% | 3.05% | 5.35% | 3.65% | 6.78% |
| Class A at MOP[2] | -1.01% | -1.01% | 0.72% | 4.57% | 3.18% | 6.47% |
| Bloomberg Barclays U.S. Agg. Bond Index | 2.94% | 2.94% | 4.48% | 2.03% | 2.74% | 2.89% |

*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. ^The Adviser has contractually agreed to waive fees through 5/31/20.*

**FUND INFORMATION AS OF 3/31/19**

| | Class A | Class I |
|---|---|---|
| Gross Expense Ratio | 1.37% | 1.12% |
| Net Expense Ratio^ | 1.24% | 0.99% |
| SEC Yield (Subsidized) | 3.82% | 4.18% |
| SEC Yield (Unsubsidized) | 3.82% | 4.18% |

**FUND CHARACTERISTICS**

| | |
|---|---|
| Fund Assets (All Classes) | $7.6bn |
| Number of Securities | 2,645 |
| Distribution | Monthly |
| Effective Duration | 2.0 |
| Average Price (Portfolio) | $88.6 |
| Average Price (NA RMBS) | $87.0 |
| Floating Rate (%) | 63.9 |

**FUND STATISTICS**

| (Since Inception) | Fund[3] | Index |
|---|---|---|
| Standard Deviation | 3.2 | 3.8 |
| Sharpe Ratio | 3.0 | 0.9 |
| Correlation to Index | 0.1 | 1.0 |
| Positive Months (%) | 83.9 | 62.4 |
| Negative Months (%) | 16.1 | 37.6 |

[3]ANGIX

# Sector Attribution

| | | Q1 2019* | YTD 2019* |
|---|---|---|---|
| | % of Market Value | Attribution (%) | Attribution (%) |
| RMBS | 67.0 | 0.98 | 0.98 |
| CMBS | 10.1 | 0.14 | 0.14 |
| CLOs | 11.2 | 0.21 | 0.21 |
| Corporates | 7.1 | 0.14 | 0.14 |
| ABS | 3.5 | 0.05 | 0.05 |
| Cash | 1.2 | 0.02 | 0.02 |
| Credit Hedges | - | 0.00 | 0.00 |
| Fund Expenses | - | -0.25 | -0.25 |
| Total | 100.0 | 1.30 | 1.30 |

Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any security. Totals may not equal 100% due to rounding.
*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 146 basis points in the first quarter, contributing 98 basis points to Fund performance. Legacy CMO and new issue spreads tightened across all RMBS products in the first quarter as the favorable macro news gave way to a broad market rally. Credit risk transfer (CRT) M2 spreads led the tightening, ending the quarter 70 basis points tighter.
- Heading into 2019, the RMBS new issue market continues to be robust, with $21 billion pricing in the first quarter. The expected annual issuance for 2019 is $95.0 billion according to BAML research. Deals backed by reperforming and non-performing loans make up the largest subsector, followed by CRT and non-qualified mortgages (Non-QM). Non-QM issuance is now projected to approach $20 billion in 2019, which would mark three years in a row of fast growth. The pace and size of new issuance in the market have led to a softening in primary spreads and have created pockets of opportunity for the Fund to add AAA assets at relatively attractive levels.

**CMBS**

- CMBS returned 205 basis points in the first quarter, contributing 14 basis points to Fund performance net of hedges. Generic spreads for the quarter were tighter across the credit structure, predominantly due to strong investor demand and supply technical. For example, AAA tightened by approximately 12 basis points to 88, while BBB tightened by 90 basis points to 345. In new issue, $20.7 billion priced for the quarter, split between $8.7 billion of conduit, $7.7 billion of single asset/single borrower (SASB), and $4.3 billion of commercial real estate CLO. Allocation within CMBS was increased to 10.1% in the first quarter from 8.1% from the previous quarter. Over the quarter, the Fund's allocation to floating rate AAA securities coupled with SASB allocation has increased.

**CLOs**

- CLOs had a total return of 55 basis points in March, contributing 6 basis points to the Fund, bringing the year-to-date total return to 233 basis points, contributing 21 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 five-year reinvest/two-year non-call structure. The Fund has also looked to target discount bonds with upside from potential corporate action.

**ABS**

- The ABS allocation produced a total return of 70 basis points in March, contributing 3 basis points to the Fund, bringing the year-to-date total return to 154 basis points, contributing 5 basis points to the Fund. The Fund continued to focus on short, relatively attractive auto ABS higher up in the capital structure. Spreads tightened across the capital structure for both autos and cards. As the Treasury curve inverted toward the end of the quarter, fixed rate paper rallied, and 1–2 year bonds tightened faster than did longer duration assets.

# 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.
**Core PCE Price Index:** An index that is defined as personal consumption expenditures (PCE) prices excluding food and energy prices. The core PCE price index measures the prices paid by consumers for goods and services without the volatility caused by movements in food and energy prices to reveal underlying inflation trends.
**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.
**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.
**NASDAQ Composite Index:** A broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market.
**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.

# 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.*

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