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Angel Oak High Yield Opportunities Fund Quarterly Review

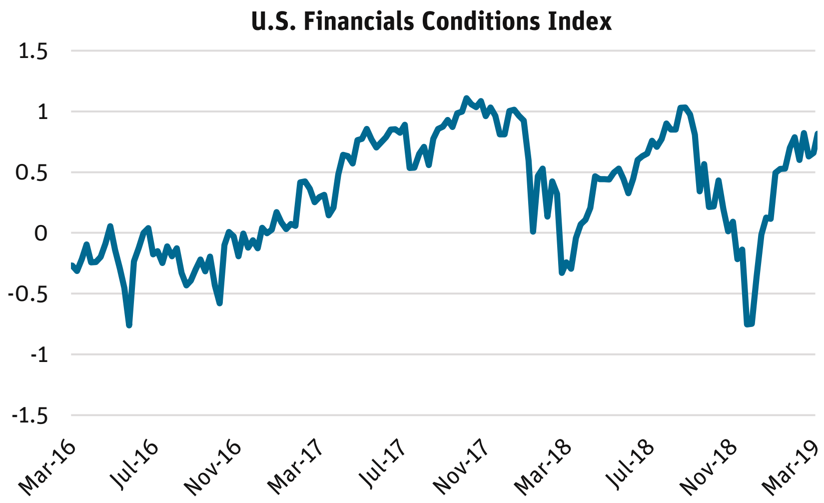
March 31, 2019

Angel Oak
CAPITAL ADVISORS

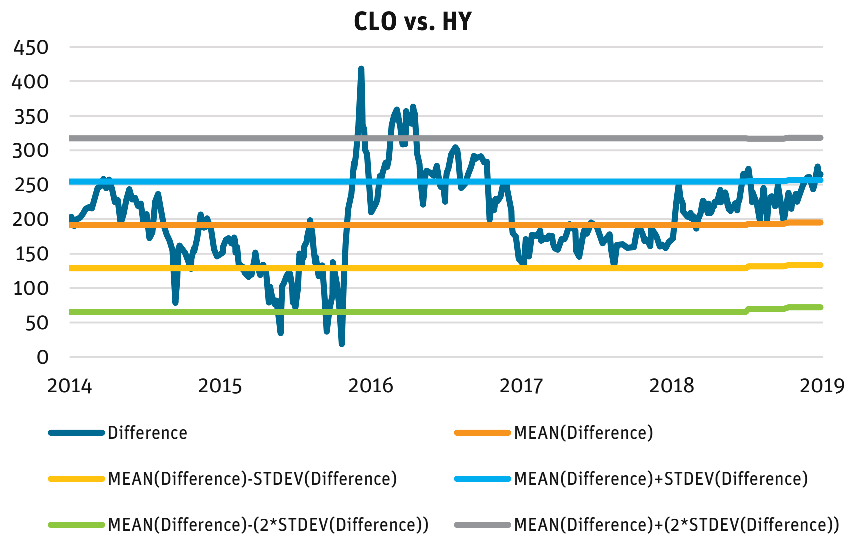
Quarter in Review

- Following the Federal Reserve-induced volatility of the fourth quarter, high yield rebounded sharply to start the year. The Bloomberg Barclays U.S. Corporate High Yield Index returned 7.26%, the best first quarter return since 2003, and the best quarterly return since the third quarter of 2009. The spread tightening was ignited by the Federal Reserve's abrupt reversal from tightening monetary policy to holding monetary policy constant in response to the rapid and material tightening of financial conditions in the fourth quarter.
- Between the Federal Reserve tightening monetary policy, the longest government shutdown in history, the negative impact from tariffs associated with the trade dispute with China, fading impact from the tax cuts, and uncertainty associated with Brexit, global growth is slowing and so far U.S. economic growth has deteriorated only slightly. Unemployment remains low, wages are rising, and inflation remains muted.
- With the deterioration in financial conditions in the fourth quarter stemming from the Federal Reserve's comments on the neutral rate and the balance sheet runoff, the Federal Reserve has acknowledged the lack of inflation and taken immediate action to pause any further tightening of monetary policy. The dot plot from the recent Federal Open Market Committee meeting removed the two potential interest rate hikes for 2019, and the Federal Reserve will end the runoff of the balance sheet in September, which is earlier than anyone had anticipated. These actions recognize that the U.S. is not an island, and the deterioration of global growth could negatively impact the U.S. economy, especially if the Federal Reserve had continued on the existing path.
- Despite the rebound in financial asset valuations and the improvement in financial conditions, sentiment indices such as the ISM surveys and their component indices remain subdued relative to levels at the end of the third quarter. That said, they are significantly more expansionary than survey results in Europe and China. Positive sentiment generally precedes a pick-up in capital spending, which is necessary for productivity improvement.
- With the Federal Reserve on hold, investors' fears of rising rates diminished, as evidenced by $13.3B of positive inflows into high yield funds in the quarter. Positive technicals are further supported by a continued decline in supply, with year-to-date, new-issue volume down $7.3B, or 10%, from last year, which follows a 43% decline in new-issuance volume for the full year 2018 as opposed to 2017.
- Fourth quarter earnings season was generally positive, still with a significant percentage of companies beating estimates, but less so than in earlier quarters. Expectations are for earnings growth to slow in 2019 from the double-digit pace of 2018, however, into the mid-to-high-single-digits range as we lap the impact from the tax cuts.

Benchmark Performance	12/31/18	3/31/19	Quarterly Change (bps)
2-Year Treasury	2.49	2.26	-23
5-Year Treasury	2.51	2.23	-28
10-Year Treasury	2.69	2.41	-28
UST 2s/10s Spread	31	1	-30
Oil	45.41	60.14	3,244
Iron Ore	70.58	82.06	1,627
VIX	25.42	13.71	-4,607
S&P 500 Total Return Index	4,984	5,665	+1,366
Bloomberg Barc U.S. Corp IG Index OAS	153	119	-34
Bloomberg Barc U.S. Corp HY Index OAS	526	391	-135



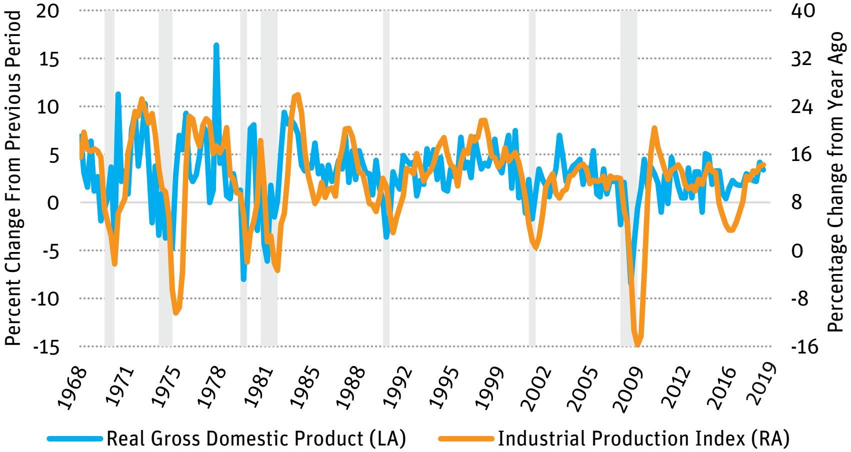
Source: Bloomberg of 3/31/19.



Source: Citigroup as of 3/31/19.

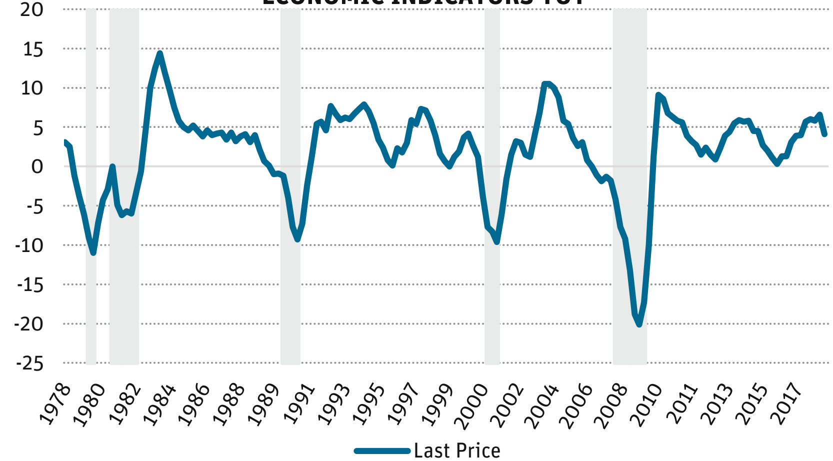
Fundamental Backdrop

INDUSTRIAL PRODUCTION AND GDP



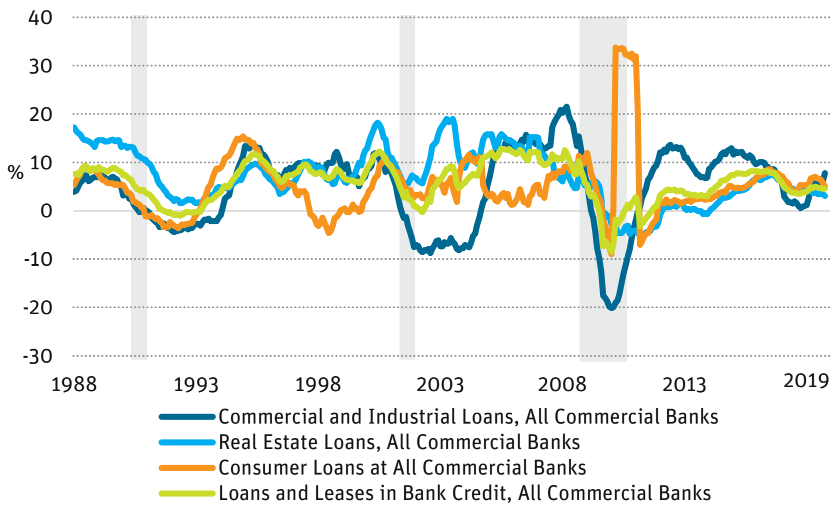
Source: FRED as of 1/31/19.

CONFERENCE BOARD U.S. LEADING INDEX TEN ECONOMIC INDICATORS YOY



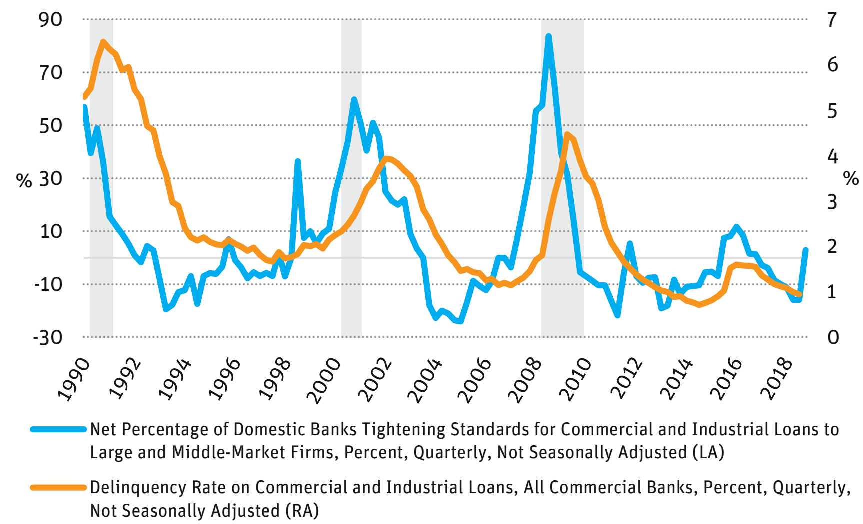
Source: S&P 500 as of 2/28/19.

BANK LOAN GROWTH



Source: FRED as of 1/31/19. Shaded gray bars represent periods of recession.

BANKS TIGHTENING STANDARDS C&I AND DELINQUENCY C&I



Source: FRED as of 12/31/18.

Portfolio Performance

Summary

- The Angel Oak High Yield Opportunities Fund returned 7.18% in the quarter ending March 31, 2019, slightly behind the Bloomberg Barclays U.S. Corporate High Yield Index return of 7.26%.
- Underpinning the strong return performance was the rapid tightening of credit spreads during the quarter. From the recent peak of 537 basis points on January 3, 2019, the spread on the Bloomberg Barclays U.S. Corporate High Yield Index tightened to 391 basis points to finish the quarter, recapturing approximately 62% of the spread widening induced by the Federal Reserve in the fourth quarter.
- Fears of impending recession implied by the inversion of the three-month/ten-year yield curve were brushed aside, with investors interpreting the Federal Reserve's actions as supportive in the attempt to continue and extend the economic expansion.
- Credit spreads tightened aggressively across all rating categories and, as would be expected, more aggressively within CCCs than with BBs. The BB category tightened 119 basis points, the B category tightened 144 basis points, and the CCC category tightened 187 basis points. That said, in terms of total return, CCCs actually underperformed higher-rated categories, returning 7.15%. BBs, benefiting from their longer duration as well as tighter spreads, returned 7.21%.
- The collateralized loan obligation (CLO) allocation underperformed in the quarter, returning 5.54% compared to the Bloomberg Barclays U.S. Corporate High Yield Index return of 7.26%. Although the allocation underperformed for the quarter, it has a higher yield than the corporate bond allocation and could provide a hedge against rising interest rates, such as in 2018 when the allocation outperformed by more than 600 basis points.

Net Total Returns as of 3/31/19	3 Mo.	YTD	1 Yr.	3 Yr.	5 Yr.	SI[1]
Class I	7.18%	7.18%	5.08%	8.75%	5.05%	9.09%
Class A at NAV	7.08%	7.08%	4.81%	8.50%	4.77%	8.83%
Class A at MOP[2]	4.71%	4.71%	2.46%	7.67%	4.30%	8.58%
BBgBarc U.S. Corporate High Yield TR USD	7.26%	7.26%	5.93%	8.56%	4.68%	11.26%

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 High Yield Opportunities Fund I Class (ANHIX) was 3/31/09, while the inception date of the A Class (ANHAX) was 7/31/12. The returns of ANHAX shown for periods prior to the inception date include the returns of ANHIX and are adjusted to reflect any applicable sales charges and the higher annual operating expense of Class A. [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	1.28%	1.03%
Net Expense Ratio^	0.90%	0.65%
SEC Yield (Subsidized)	5.64%	6.04%
SEC Yield (Unsubsidized)	5.38%	5.78%

FUND CHARACTERISTICS

Fund Assets (All Classes)	$64.3 mm
Number of Securities	128
Distribution	Monthly
Effective Duration	3.5
Average Coupon	6.69
Average Yield-to-Worst (%)	6.28

FUND STATISTICS

(Since Inception)	Fund[3]	Index
Standard Deviation	5.7	7.5
Sharpe Ratio	1.5	1.5
Correlation to Index	0.9	1.0
Positive Months (%)	72.5	72.5
Negative Months (%)	27.5	27.5

[3]ANHIX

Sector Attribution

		Q1 2019*	YTD 2019*
	% of Market Value	Attribution (%)	Attribution (%)
Corporates	84.3	6.83	6.83
CLOs	9.3	0.46	0.46
Equities & ETFs	0.1	0.00	0.00
Cash	6.3	0.04	0.04
Fund Expenses	-	-0.16	-0.16
Total	100.0	7.18	7.18

*Net and unaudited. Attribution is calculated using an internal model, thus, returns may vary from the Fund's total return.

Corporates:

- For the first quarter, the high yield corporate bond allocation returned 7.89% and contributed 683 basis points to the total return of the Fund. The high yield corporate bond allocation outperformed the Bloomberg Barclays U.S. Corporate High Yield Index return of 7.26% by 83 basis points.
- Energy was the sector with the largest positive contribution to quarterly performance, returning 10.97% compared to the benchmark, which returned 8.31%. Almost all the performance attribution was from selection, with more than half from two holdings: one in a shallow water offshore drilling company and another in a specialty hydrocarbon products company. Both of these are benefiting from the 41.41% rebound in crude oil prices compared to their low in December.
- Cash was the largest detractor from performance, accounting for 61 basis points of negative attribution.
- The financial services sector was the next-largest detractor from quarterly performance, returning 3.92% compared to the benchmark, which returned 8.04%. More than half the negative attribution is due to a holding that is currently callable, capping the upside appreciation potential.

CLOs:

- After a quick rebound from year-end wides in January, the CLO market traded sideways for the remainder of Q1. Consistent loan fund outflows and a backlog of new-issue activity were large headwinds preventing further spread tightening. Additionally, as the Treasury curve inverted, floating rate bonds became less sought-after, putting more pressure on demand.

Sector Exposure

	Weighted Avg. Price	% of Market Value		% Change	Option Adjusted Spread		Bps Change	Yield-to-Worst		Bps Change
		12/31/18	3/31/19		12/31/18	3/31/19		12/31/18	3/31/19	
Corporates	101.31	83.4	84.3	0.9	557	382	-175	8.16	6.40	-176
CLOs	99.20	6.9	9.3	2.4	741	662	-79	10.21	9.55	-66
Equities & ETFs	12.75	0.2	0.1	-0.1	N/A	N/A	N/A	N/A	N/A	N/A
Cash	100.00	9.5	6.3	-3.2	N/A	N/A	N/A	N/A	N/A	N/A
Total	100.94	100.0	100.0		516	383	-133	7.51	6.28	-123

Corporates:

- The Federal Reserve has acknowledged the severe tightening of financial conditions and confirmed that monetary tightening acts with a lag of 12-18 months has moved quickly to take the possibility of any rate hikes off the table for 2019, and has ended the tightening associated with the runoff of the balance sheet by the end of September. Thus, it's possible the Federal Reserve has acted quickly enough to protect the gains in employment and wages, and to extend the economic expansion in the U.S.
- As inflation remains persistently below the Federal Reserve's target of 2%, combined with increasing discussion of inflation over the cycle to make up for periods of below-target inflation, it's apparent that inflation has moved down the priority list. The focus now is on maintaining employment and economic growth as global growth continues to slow and the stimulus from the tax cuts begins to fade.
- In response to the Federal Reserve's move, interest rates have declined, with the 10-year U.S. Treasury down 28 basis points in the quarter, to 2.41%, which should benefit interest-rate-sensitive sectors of the economy such as housing and autos.
- The tariffs associated with the trade dispute with China continue to be a drag on economic growth. There appears to be progress toward an agreement, although the details have yet to be agreed upon. The protection against forced transfer of intellectual property and enforcement would appear to be equally contentious. Despite the disruption due to the trade dispute with China, the U.S. is better positioned, with ~13% of the economy based on exports.
- According to JPM's latest report for high yield corporate credit fundamentals, in aggregate, high yield credit profiles have been improving for ten consecutive quarters. Leverage is at a six-year low of 3.98x.
- Although credit spreads have tightened from their recent wides, the combination of supportive monetary policy and the continued improvement in high-yield credit profiles in aggregate underpins our positive outlook. That said, we are not expecting credit spreads to tighten aggressively from here back to the post-crisis tights of 303 basis points reached on October 3, 2018. The yield on the Bloomberg Barclays U.S. Corporate High Yield Index is currently 6.43%.
- In this context we continue to favor our overweights to fundamentally sound issuers generating positive free cash flow and prioritizing balance sheet strength in interest-rate-sensitive sectors such as basic industries, consumer cyclicals, and capital goods.

CLOs:

- While the default environment remains subdued, the Fund will continue to look for opportunities in BB-rated bonds with high coupons or discounts with upside from call optionality.

Definitions

Average Coupon: Equal to the total interest payments of an issue divided by bond year dollars.
Average Yield-to-Worst: The lowest potential yield that can be received on a bond without the issuer actually defaulting.
Basis Points (bps): One hundredth of one percent and is used to denote the percentage change in a financial instrument.
Bloomberg Barclays U.S. Corporate High Yield 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 specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.
CBOE SPX Volatility Index (VIX): A key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices.
Chicago Fed's National Financial Conditions Index (NFCI): An index that provides a comprehensive weekly update on U.S. financial conditions in money markets, debt and equity markets and the traditional and "shadow" banking systems.
Correlation: A statistical measure of how two securities move in relation to another. Index used for comparison is the Bloomberg Barclays U.S. Corporate High Yield 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.
Free Cash Flow: A financial performance calculation that measures how much operating cash flows exceed capital expenditures.
Industrial Production Index: An economic indicator that measures real output for all facilities located in the United States manufacturing, mining, and electric, and gas utilities (excluding those in U.S. territories).
ISM Manufacturing Index: An index that is based on surveys of more than 300 manufacturing firms by the Institute for Supply Management (ISM).
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).
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 a U.S. Treasury bond 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 decrease 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 result in losing more than the amount invested. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods. For more information on these risks and other risks of the Fund, please see the Prospectus.

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 3/31/19 and are subject to change at any time, are not guaranteed, and should not be considered investment advice.

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