Angel Oak Financials Income Fund Quarterly Review

June 30, 2019

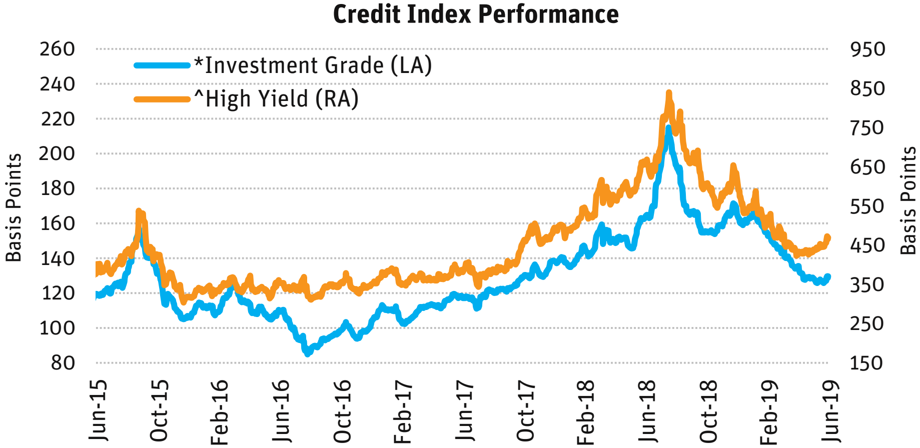
Angel Oak
CAPITAL ADVISORS

Quarter in Review

- U.S. risk assets were volatile in the second quarter as trade tensions with China and Mexico dominated the headlines; however, a more dovish Federal Open Market Committee (FOMC) sparked a rally in equities and credit in the last month of the quarter. The S&P 500 was up 4.30% while the NASDAQ Composite Index increased 3.88% in the second quarter. Corporate spreads benefited with the broader rally in risk assets.
- Following the sharp credit softness in the fourth quarter of 2018, FOMC Chairman Powell took a step back from his more hawkish sentiment, which created four rate hikes in 2018. The Fed reversal ignited a sharp rally in global assets for the first half of 2019. According to Bank of America Merrill Lynch Research, global stocks were up 15.5%, commodities rose 16.2%, HY corporates increased 9.3%, and IG corporates were up 7.7%. Falling interest rates throughout the first half of 2019 benefited both equities and U.S. fixed income. For Q2, the Bloomberg Barclays IG Corporate Index tightened 4 basis points to 115 OAS, while the HY equivalent tightened by 15 basis points to 371 OAS. U.S. Treasury yields fell across the curve, bull steepening the 2s10s spread by 11 basis points to 0.25%. The 10-year Treasury yield decreased 41 basis points to finish the quarter at 2.00%. 1M LIBOR fell 9 basis points to 2.40% while 3M LIBOR decreased 28 basis points to 2.32%.
- Structured credit returns were positive in the second quarter, especially for lower-rated tranches as long-duration assets benefited from the rate rally. Legacy non-agency residential mortgage-backed securities (RMBS) posted positive returns of approximately 2.7% in the second quarter, with positive excess returns for Alt-A and Option Arm of 2.0% and 2.2%, respectively. U.S. collateralized loan obligations (CLOs) were up 1.5% across the capital stack in the second quarter. CLOs generated positive excess returns of 0.7% to 1.1% for A and higher-rated tranches and 1.7%/2.3% for BBB/BB-rated tranches. Commercial mortgage-backed securities (CMBS) benefited from tighter spreads, posting positive excess returns of 0.5% for AA- through BBB-rated tranches. The asset-backed securities (ABS) sector posted a positive return of 1.6% for the quarter driven primarily by rates as the sector posted a 0.0% excess return. While most structured spread sectors posted positive returns year-to-date, Credit risk transfer (CRT) B1 and CLO BB generated the highest positive excess returns year to date at 7.4% and 7.1%, respectively.
- The FOMC looks to be following the rates market as the leadership is now signaling a potential rate cut in the third quarter, citing "global growth concerns" as the reason to "sustain" the expansion. The bond market is now pricing in 75 basis points of cuts by year-end and Fed Funds futures are implying an 80% probability of one cut and a 20% probability of two cuts in the July meeting. Inflation is currently running below the FOMC's long-term target, creating more room to cut rates. CORE PCE registered 1.6% year-over-year through June, 0.1% above market expectations of 1.5%.
- The U.S. labor market continues to remain healthy. Nonfarm payrolls rose 224k in June and have averaged +166k during the second quarter. The unemployment rate is currently running at 3.7%, with average hourly earnings continuing to rise at approximately 3.1% year-over-year.
- On the housing front, the S&P CoreLogic 20 City Index rose 2.54% through April. Housing starts fell 0.9% month-over-month in May to an annualized pace of 1.269MM. While new home sales declined 7.8% month-over-month, existing home sales increased 2.5% month-over-month.

Benchmark Performance	6/30/19	3/31/19	Quarterly Change (bps)
1-Month LIBOR	2.40	2.49	-0.09
3-Month LIBOR	2.32	2.60	-0.28
2-Year Treasury	1.75	2.26	-0.51
5-Year Treasury	1.77	2.23	-0.46
10-Year Treasury	2.00	2.41	-0.41
30-Year Treasury	2.53	2.81	-0.28
2s/10s Curve	0.25	0.14	0.11
2s/30s Curve	0.77	0.55	0.22
S&P 500 Total Return Index	5,908	5,665	+430
IG Corporate OAS*	115	119	-4
HY Corporate OAS^	376	391	-15

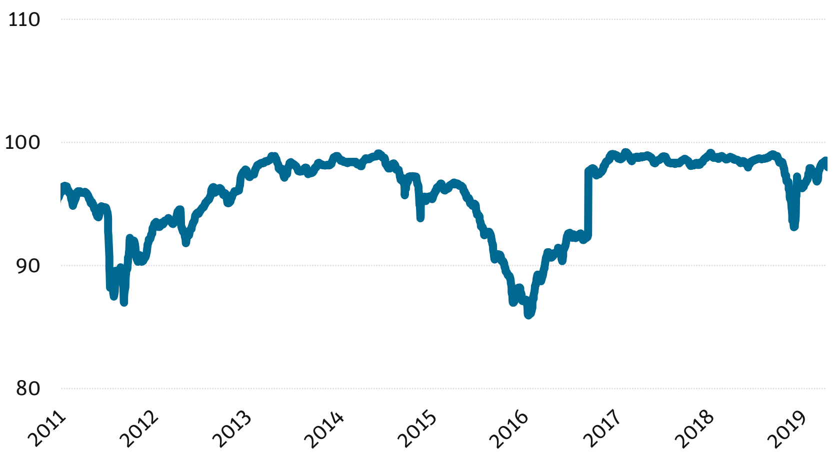
Sources: Bloomberg and Yieldbook as of 6/30/19.



Source: Bloomberg as of 6/30/19.
*Bloomberg Barclays U.S. Corporate Total Return Value Unhedged
^Bloomberg Barclays U.S. Corporate High Yield Total Return Index Value Unhedged

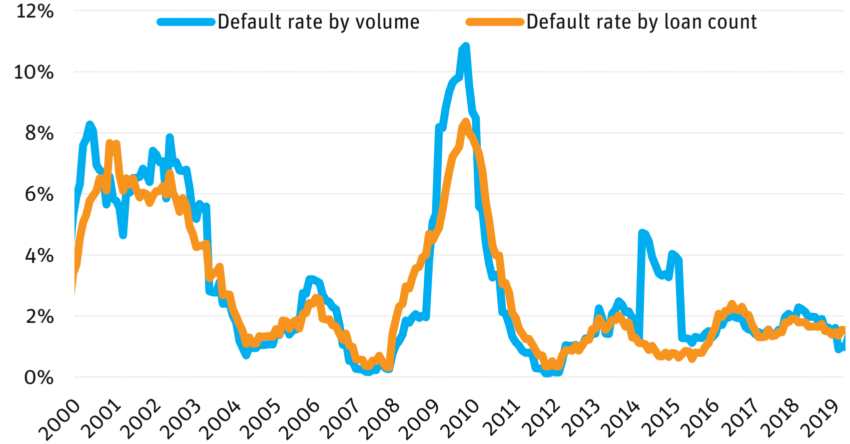
Fundamental Backdrop

S&P Leveraged Loan 100 Index



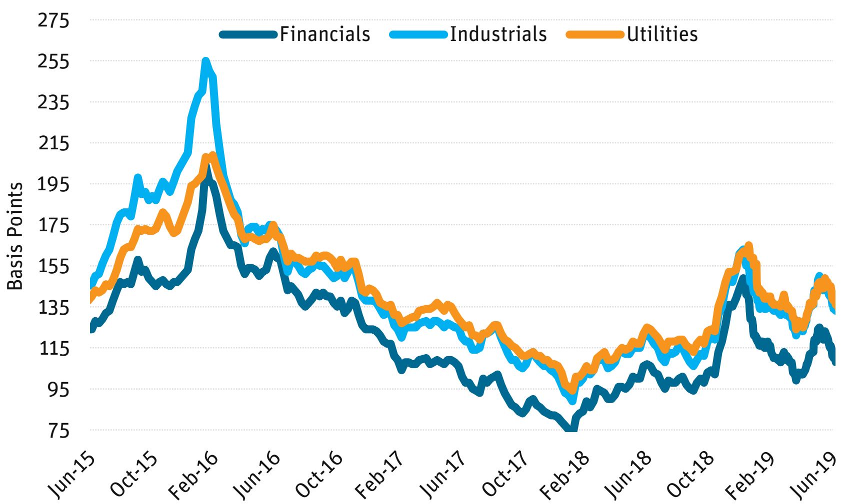
Source: Bloomberg as of 6/30/19.

Leveraged Loan Default Rates



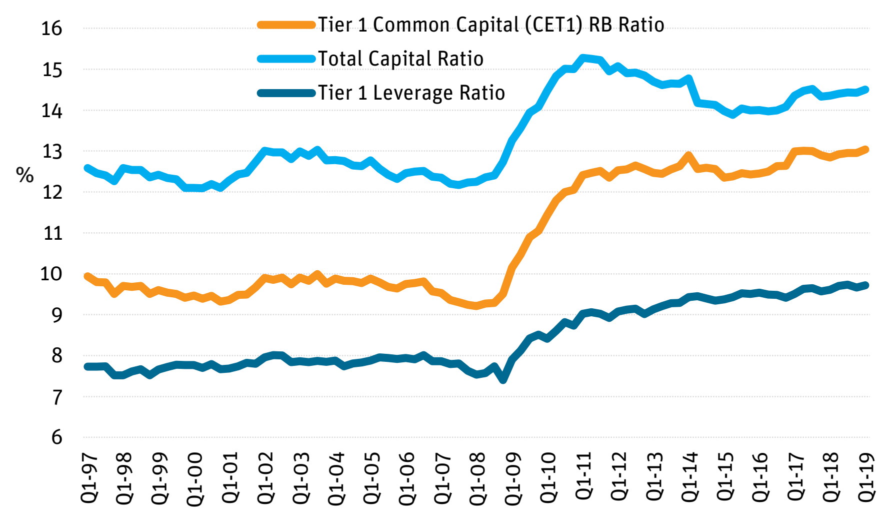
Source: Deutsche Bank as of 6/30/19.

Investment Grade Sector Performance



Source: RCA, Morgan Stanley as of 6/30/19.

Bank Subordinated Debt



Source: S&P Global Market Intelligence as of 3/31/19.

Portfolio Performance

Summary

- The Class I share was up 2.37% during the second quarter, underperforming the benchmark by approximately 71 basis points, as the Bloomberg Barclays U.S. Aggregate Bond Index was up 3.08% over the same period. The Fund's underperformance was a function of the shorter-duration positioning versus the benchmark, as rates rallied over the quarter.
- The corporate and equity allocations were the top performers for the quarter, as they were up with a total return of 2.25% and 0.18%, respectively. The corporate allocation benefited from price gains in non-bank financials, senior bank debt, and subordinated bank debt. The corporate allocation continued its consistent performance, with a total return of 3.61% for the year.

				Annualized	
Net Total Returns as of 6/30/19	**3 Mo.**	**YTD**	**1 Yr.**	**3 Yr.**	**SI[1]**
Class I	2.37%	3.86%	5.77%	5.91%	3.56%
Class A at NAV	2.30%	3.73%	5.50%	5.66%	3.33%
Class A at MOP[2]	-0.05%	1.44%	3.09%	4.87%	2.83%
Bloomberg Barclays U.S. Agg. Bond Index	3.08%	6.11%	7.87%	2.31%	2.93%

Performance quoted is past performance and is no guarantee of future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data shown. Current performance for the most recent month-end can be obtained by calling 855-751-4324 or by visiting www.angeloakcapital.com. [1]The inception date of both the Angel Oak Financials Income Fund A and I Class (ANFLX and ANFIX) was 11/3/14. [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 6/30/19

	Class A	Class I
Gross Expense Ratio	1.43%	1.18%
Net Expense Ratio^	0.94%	0.69%
SEC Yield (Subsidized)	3.70%	4.03%
SEC Yield (Unsubsidized)	3.31%	3.64%

FUND CHARACTERISTICS

Fund Assets (All Classes)	$209.7 mm
Number of Securities	107
Distribution	Monthly
Effective Duration	3.3
Average Price (Portfolio)	$102.9

FUND STATISTICS

(Since Inception)	Fund[3]	Index
Standard Deviation	3.7	3.8
Sharpe Ratio	1.0	0.8
Correlation to Index	0.1	1.0
Positive Months (%)	78.2	60.0
Negative Months (%)	21.8	40.0

[3]ANFIX

Sector Attribution

		Q2 2019*	YTD 2019*
	% of Market Value	Attribution (%)	Attribution (%)
Corporates	92.9	2.25	3.61
CLOs	0.9	0.04	0.15
ABS	0.0	0.01	0.01
Equity	3.2	0.18	0.34
Cash	3.0	0.06	0.09
Credit Hedges	-	0.00	0.00
Fund Expenses	-	-0.17	-0.34
Total	100.0	2.37	3.86

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.

Corporates

- The market faces a more challenging interest rate environment going forward, with market participants expecting two to three Fed Funds rate cuts by year-end. The yield curve inverted in March and 3M LIBOR declined 18 basis points in the second quarter.
- We expect bank earnings growth to decelerate under the current interest environment and outlook, and expect negative EPS revisions going forward. We expect modest net interest margin (NIM) compression in 2019, and higher compression in 2020. Loan growth is tracking mid-single-digit range for large banks and high-single digits for smaller community banks.
- From an equities perspective, we expect outperformance will be opportunistic and story-driven going forward, following modest outperformance by the large banks in the first half of the year. Operating leverage will be a key lever for alpha generation, but is more difficult to achieve in a declining rate environment. Valuation looks attractive on current estimates, but we think EPS estimates will decline by 3% to 5% on average.
- Credit conditions are still incredibly favorable, with no signs of systemic deterioration. We expect modest normalization over the next few years. Strong credit quality trends support a positive outlook for bank debt.
- Core profitability remains strong and capital levels continue to increase. Profitability provides a sizeable cushion for any unexpected credit quality deterioration along with flexibility to return capital (buybacks/dividends) and/or to seek inorganic growth opportunities.

CLOs

- CLOs had a total return of -27 basis points in June, contributing 0 basis points to the Fund, bringing the year-to-date total return to 713 basis points, contributing 15 basis points to the Fund. The Fund continues to maintain its CLO exposure by selectively adding high-coupon BBs at relatively wide spreads, given our belief that these are the most attractive tranches on a risk-adjusted basis.

ABS

- The Fund exited flow credit card names at the front end of the curve as they served as placeholders for new issue opportunities in the corporate sector.

Definitions

EPS: Earnings per share.
Alpha: Measures the difference between a fund's actual returns and its expected performance, given its level of risk (as measured by beta). A positive alpha figure indicates the fund has performed better than its beta would predict. In contrast, a negative alpha indicates a fund has underperformed, given the expectations established by the fund's beta.
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.
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 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.
Total Capital Ratio: The percentage of a bank's capital to its risk-weighted assets.
Tier 1 Leverage Ratio: The relationship between a banking organization's core capital and its total assets.
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 decrease when interest rates rise. This risk is usually greater for longer-term debt securities. Investments in lower-rated and nonrated securities present a greater risk of loss to principal and interest than higher-rated securities do. 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 lead to losses that are greater than the amount invested. The Fund may make short sales of securities, which involves the risk that losses may exceed the original amount invested. The Fund may use leverage, which may exaggerate the effect of any increase or decrease in the value of securities in the Fund's portfolio or the Fund's net asset value, and therefore may increase the volatility of the Fund. Investments in foreign securities involve greater volatility and political, economic, and currency risks and differences in accounting methods. These risks are increased for emerging markets. Investments in fixed-income instruments typically decrease in value when interest rates rise. The Fund will incur higher and duplicative costs when it invests in mutual funds, ETFs, and other investment companies. There is also the risk that the Fund may suffer losses due to the investment practices of the underlying funds. For more information on these risks and other risks of the Fund, please see the Prospectus.

Effective 12/16/18, the Angel Oak Flexible Income Fund changed its name to the Angel Oak Financials Income Fund.

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 6/30/19 and are subject to change at any time, are not guaranteed, and should not be considered investment advice.

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