ANHAX | ANHIX | ANHCX

Angel Oak High Yield Opportunities Fund Quarterly Review

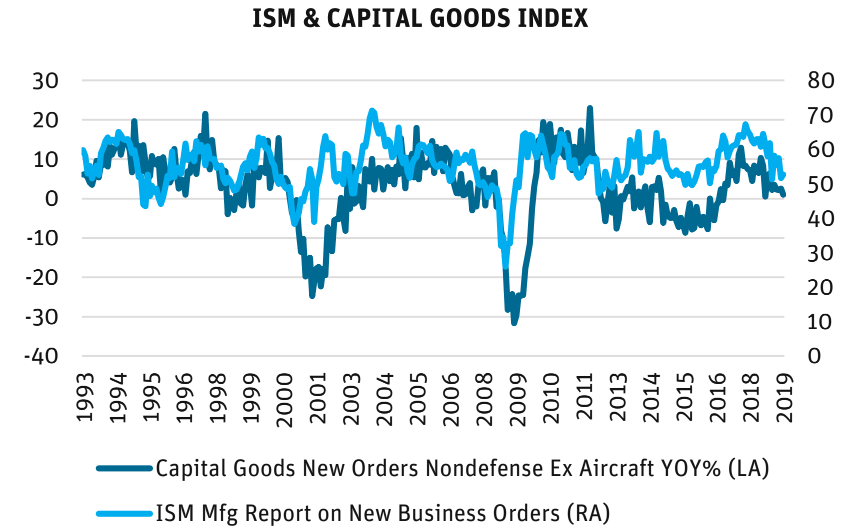
June 30, 2019

Angel Oak
CAPITAL ADVISORS

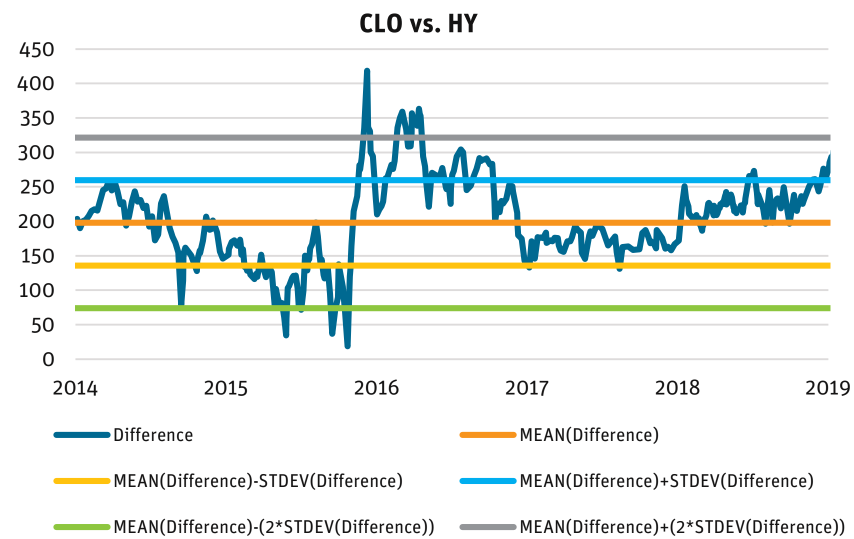
Quarter in Review

- The second quarter was essentially all about trade. A trade agreement with China appeared to be all but a done deal. Then out of nowhere, in early May, tariffs on Chinese imports were raised from 10% to 25% on $200 billion of imports, tariffs of 25% were being threatened on an additional $300 billion of imports, companies were being blacklisted, and each side was blaming the other for the deal falling apart. The deadline for the administration to act on the Commerce Department's findings that the U.S. was harmed by auto imports from Europe and Japan was looming. These findings resulted from an investigation under Section 232 of the Trade and Expansion Act. Additionally, Mexico was being threatened with tariffs starting at 5% and rising to 25% by October 1 for not doing enough to mitigate illegal immigration into the U.S. from Central America.
- Global manufacturing surveys deteriorated, reflecting current views on business activity around orders, production, and employment. The weakness of the manufacturing surveys raised doubts about the outlook for business capital expenditures and hiring. The cautiousness was warranted given the uncertainty regarding global supply chains and rising costs. Monthly job creation declined sharply with the four-month moving average falling to 127K, the lowest since mid-2012, possibly reflecting business cautiousness or the lack of qualified candidates with unemployment at historic lows. U.S. Treasury rates rallied 40 to 50 basis points, reflecting the increasing likelihood of slowing economic activity.
- The volatility of returns on high yield corporate credit during the quarter reflected the unexpected negative headlines on trade, with May's negative return of 1.19% almost wiping out April's positive return of 1.42%. The Bloomberg Barclays U.S. Corporate High Yield Index rebounded to finish the quarter with a positive return of 2.50%. This reflected the increasing expectations of additional monetary policy stimulus from the Federal Reserve to mitigate the negative impacts around trade and extend the economic expansion. Currently, the market is pricing in approximately three 25 basis points rate cuts by year end. Additionally, with the S&P 500 at all-time highs and credit spreads recapturing the widening from May, financial conditions are positive and capital access readily available.
- Flows into high yield mutual funds during the quarter reflected the volatility around trade headlines. Strong inflows through April shifted to outflows totaling approximately $4 billion in May. The direction of flows shifted again following the June Federal Open Market Committee meeting, where the chairman commented to the effect that if the uncertainty resulting from the disruption around trade continued to weigh on the outlook, it could justify additional monetary policy accommodation. Inflows for June totaled approximately $2 billion, highlighting the expectation that corporate credit should perform well in an environment of declining interest rates and positive, albeit low, economic growth.

Benchmark Performance	3/31/19	6/30/19	Quarterly Change (bps)
2-Year Treasury	2.26	1.75	-51
5-Year Treasury	2.23	1.77	-46
10-Year Treasury	2.41	2.00	-41
UST 2s/10s Spread	1	-9	-10
Oil	60.19	58.13	-342
Iron Ore	85.70	109.18	2740
VIX	13.71	15.08	999
S&P 500 Total Return Index	5,665	5,908	430
Bloomberg Barc U.S. Corp IG Index OAS	119	115	-4
Bloomberg Barc U.S. Corp HY Index OAS	391	376	-15



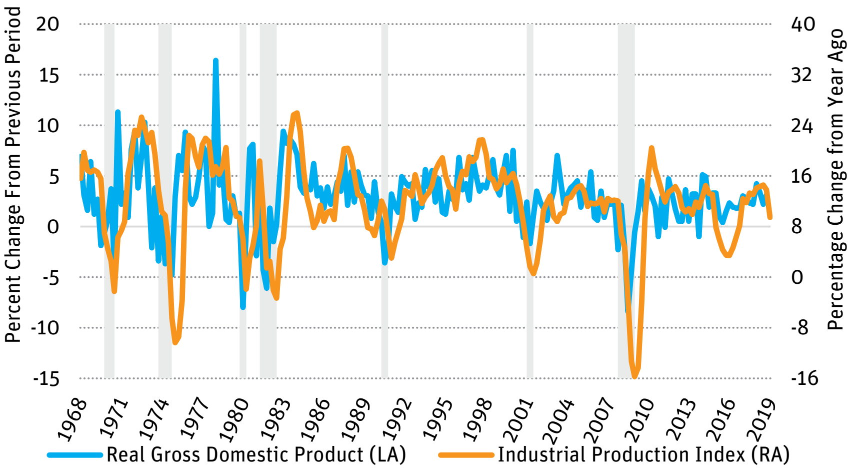
Source: Bloomberg of 5/31/19.



Source: Citigroup as of 6/30/19.

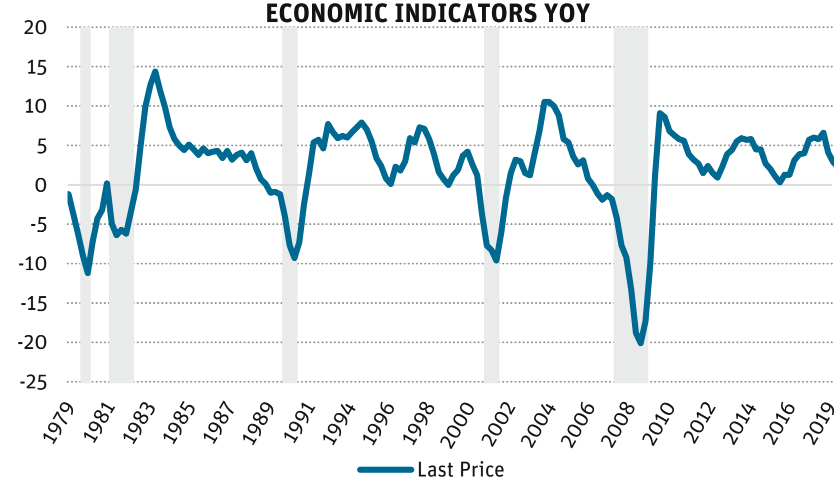
Fundamental Backdrop

INDUSTRIAL PRODUCTION AND GDP



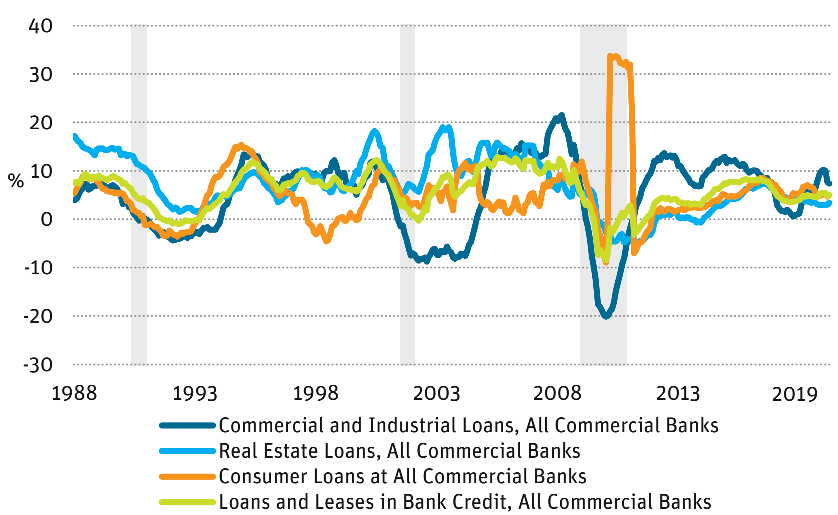
Source: FRED as of 4/30/19.

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



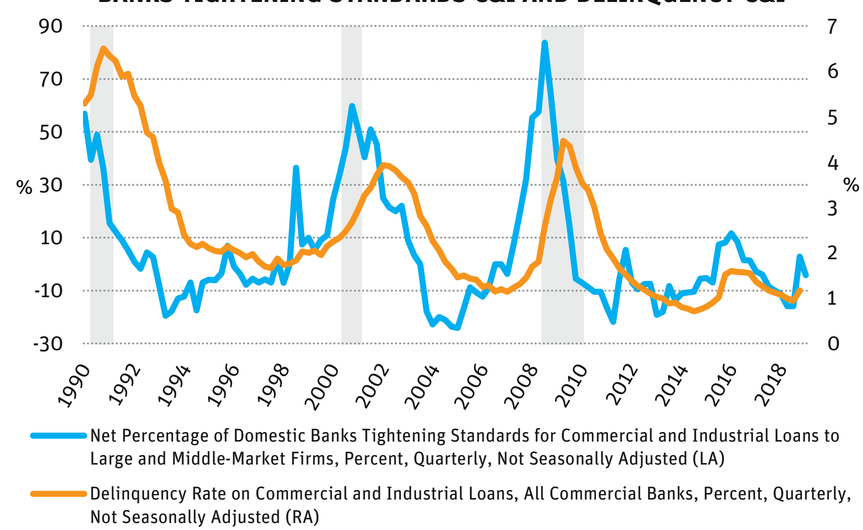
Source: S&P 500 as of 5/31/19.

BANK LOAN GROWTH



Source: FRED as of 4/30/19. Shaded gray bars represent periods of recession.

BANKS TIGHTENING STANDARDS C&I AND DELINQUENCY C&I



Source: FRED as of 3/31/19.

Portfolio Performance

Summary

- The Angel Oak High Yield Opportunities Fund returned 2.26% in the quarter ending June 30, 2019, slightly behind the Bloomberg Barclays U.S. Corporate High Yield Index return of 2.50%.
- The positive returns mask the volatility from the unexpected and unpredictable headlines around trade during the period. Overall, credit spreads on the Bloomberg Barclays U.S. Corporate High Yield Index tightened 15 basis points in the quarter from 391 basis points to finish at 376 basis points. However, the path to get there was 33 basis points of tightening in April, 75 basis points of widening in May triggered by the negative trade headlines, and 56 basis points of tightening in June following statements from the Federal Reserve that they were ready to cut rates to mitigate the negative effects of the uncertainty caused by the trade disruption to extend the economic expansion.
- Within the high yield universe, there is currently a bias for quality that is reflected in the changes in credit spread levels as well as total returns. The higher-quality BB category tightened 8 basis points and returned 3.08% for the quarter, outperforming both the B and CCC categories on both metrics. The B category tightened 2 basis points and returned 2.66%, while the higher-risk CCC category widened 10 basis points and returned just 0.29%. The current preference for higher-quality issuers potentially reflects the "reach for yield" by normally investment-grade investors in this environment of low and declining rates and low but positive economic growth. Traditional high yield investors are favoring higher-quality, lower-risk issuers, acknowledging the fact that more speculative, higher-leveraged issuers are more susceptible to financial stress given the increased costs and disruption from a shifting global supply chain combined with slower growth.
- The collateralized loan obligation (CLO) allocation outperformed in the quarter, returning 2.64% compared to the Bloomberg Barclays U.S. Corporate High Yield Index return of 2.50%. The outperformance reflects their higher yield and specific characteristics resulting in a consistent, lower-volatility contribution to performance.

Net Total Returns as of 6/30/19	3 Mo.	YTD	1 Yr.	3 Yr.	5 Yr.	10 Yr.	SI[1]
Class I	2.26%	9.60%	6.87%	7.77%	4.93%	8.33%	9.10%
Class A at NAV	2.19%	9.43%	6.59%	7.51%	4.67%	8.07%	8.84%
Class A at MOP[2]	-0.13%	7.00%	4.18%	6.69%	4.19%	7.82%	8.60%
BBgBarc U.S. Corporate High Yield TR USD	2.50%	9.94%	7.48%	7.52%	4.70%	9.24%	11.24%

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 6/30/19

	Class A	Class I
Gross Expense Ratio	1.25%	1.00%
Net Expense Ratio^	0.90%	0.65%
SEC Yield (Subsidized)	5.38%	5.78%
SEC Yield (Unsubsidized)	5.08%	5.48%

FUND CHARACTERISTICS

Fund Assets (All Classes)	$69.4 mm
Number of Securities	131
Distribution	Monthly
Effective Duration	3.4
Average Coupon	6.30
Average Yield-to-Worst (%)	5.68

FUND STATISTICS

(Since Inception)	Fund[3]	Index
Standard Deviation	5.7	7.4
Sharpe Ratio	1.5	1.5
Correlation to Index	0.9	1.0
Positive Months (%)	72.4	72.4
Negative Months (%)	27.6	27.6

[3]ANHIX

Sector Attribution

		Q2 2019*	YTD 2019*
	% of Market Value	Attribution (%)	Attribution (%)
Corporates	83.2	2.16	9.14
CLOs	7.6	0.22	0.70
Equities & ETFs	0.1	0.00	0.00
Cash	9.1	0.04	0.08
Fund Expenses	-	-0.16	-0.32
Total	100.0	2.26	9.60

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

Corporates:

- For the second quarter, the high yield bond allocation returned 2.30% and contributed 216 basis points to the total return of the Fund. The high yield corporate bond allocation slightly underperformed the Bloomberg Barclays U.S. Corporate High Yield Index return of 2.50% by 20 basis points.
- For the second consecutive quarter, energy was the sector with the largest positive contribution to quarterly performance, returning 2.72% compared to the benchmark, which returned a negative 0.92%. This is despite the 2.8% decline in crude oil prices during the period. Almost all the performance attribution was from issuer selection with positive contribution widespread among issuers. The one standout positive contributor was our holding in a shallow-water offshore drilling company where management continues to act conservatively with regard to the balance sheet and has issued equity to finance 100% of the cost of recent drilling rig acquisitions.
- Cash was the largest detractor from performance, accounting for 24 basis points of negative attribution.
- The communications and capital goods sectors were also detractors from quarterly performance. The communications sector returned 2.83% compared to the benchmark, which returned 3.87%. The underperformance was almost entirely due to allocation, reflecting our underweight to the sector of 7.65%, compared to the benchmark weight of 20.01%. The capital goods sector returned 0.78% compared to the benchmark, which returned 2.88%. The negative attribution is entirely due to one holding in a printing machine manufacturer and distributor that had a combination of operating issues and an unexpected slowdown in sales.

CLOs:

- CLOs saw positive attribution to the Fund in Q2 largely due to income as spreads were range bound, tightening slightly in April and May before slightly widening in June. The short duration BB profile that the Fund targets remained well supported by market participants.

Sector Exposure

	Weighted Avg. Price	% of Market Value		% Change	Option Adjusted Spread		Bps Change	Yield-to-Worst		Bps Change
		3/31/19	6/30/19		3/31/19	6/30/19		3/31/19	6/30/19	
Corporates	102.41	84.3	83.2	-1.1	382	390	8	6.40	5.95	-45
CLOs	99.36	9.3	7.6	-1.7	662	758	96	9.55	9.52	-3
Equities & ETFs	14.00	0.1	0.1	0.0	N/A	N/A	N/A	N/A	N/A	N/A
Cash	100.00	6.3	9.1	2.8	N/A	N/A	N/A	N/A	N/A	N/A
Total	101.87	100.0	100.0		383	382	-1	6.28	5.68	-60

Corporates:

- With inflation stubbornly low, the outlook is for the Federal Reserve to take action with additional monetary policy accommodation to preserve and extend the economic expansion, if necessary. With the drag on growth from tariffs, growth is expected to be positive but slow to the 1.5%-2% range, down from more than 2%. Low inflation, low interest rates, and slow growth make an attractive environment for corporate credit.
- Access to capital is positive, with equities at all-time highs and credit spreads tightened back to near year-to-date lows. The consumer appears healthy, with household debt levels continuing to decline relative to disposable income, unemployment at 3.6%, and wages increasing at 3.1% year-over-year. After plunging at year end due to the decline in financial markets and the government shutdown, retail sales have rebounded, although only to the level of early 2018.
- Recently, JPM raised the full-year return forecast for high yield to 12%; CS raised theirs to 13%.
- That said, we are cognizant of the risks associated with potential widening and escalation of the trade disputes and the uncertainty and anxiety this is causing business leaders. With that in mind, we will continue to emphasize risk and reward and manage the allocation to cyclically sensitive issuers when the trade-off is no longer attractive to the portfolio. This approach also captures the reality and politics of the situation and how quickly an agreement could be reached that would provide a boost to growth prospects.

CLOs:

- The broader CLO market sold off into the end of Q2 as the anticipation of rate cuts hurt investor demand for floating rate bonds. Ample supply remains as the secondary market continues to see sizable activity coupled with an uptick in the new issue pipeline. As many 2017 vintage deals exit their non-call period, 2H 2019 should see a decent amount of refinancing activity providing sufficient opportunities for investors focused on seasoned profiles.

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.
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.
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).
MSCI USA Capital Goods Index: An index designed to capture the large and mid-cap segments of the U.S. equity market.
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 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. 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 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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