



# Angel Oak Strategic Credit Fund Quarterly Review

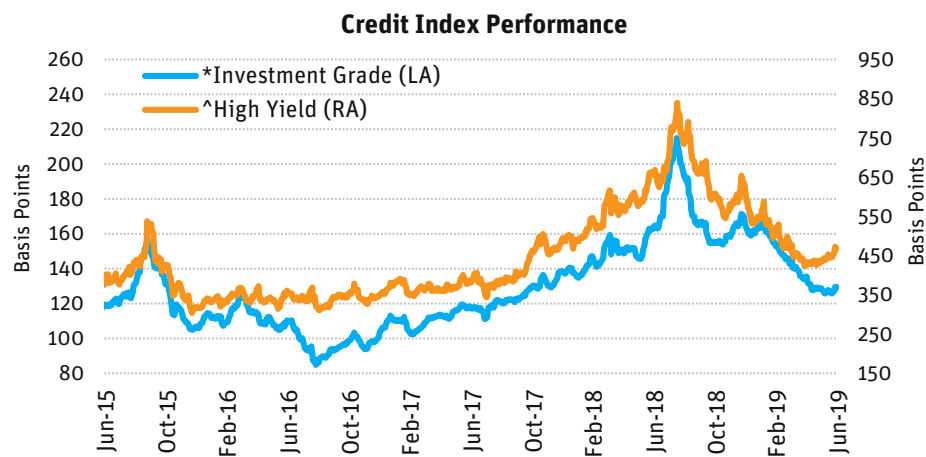
June 30, 2019

# 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.

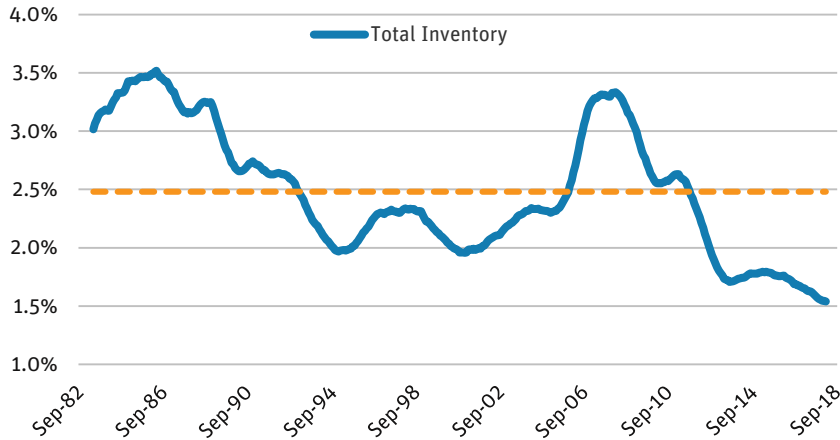
\*Bloomberg Barclays U.S. Corporate Total Return Value Unhedged

^Bloomberg Barclays U.S. Corporate High Yield Total Return Index Value Unhedged



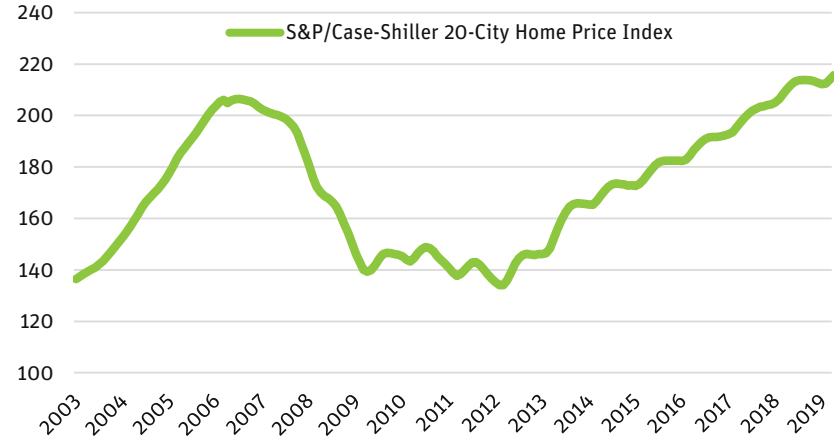
# Fundamentals = Scenario Improvement

**Single-Family Inventory as % of Total Households**



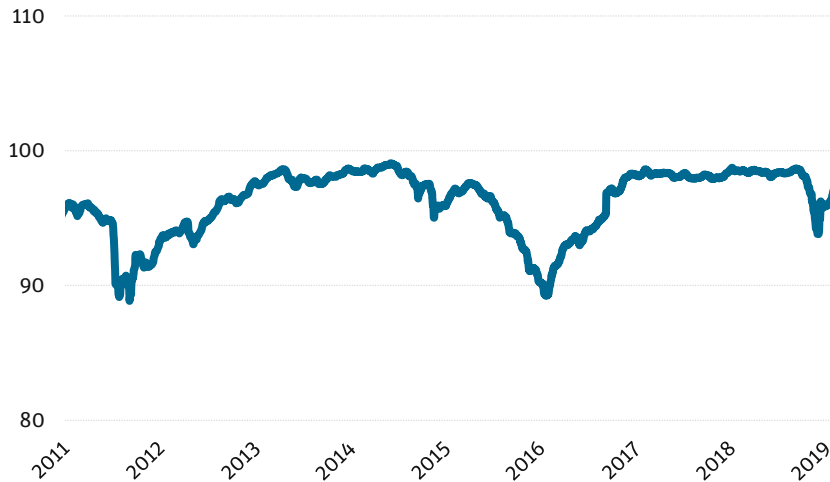
Source: Morgan Stanley as of 9/30/18.

**Home Prices Continue to Improve**



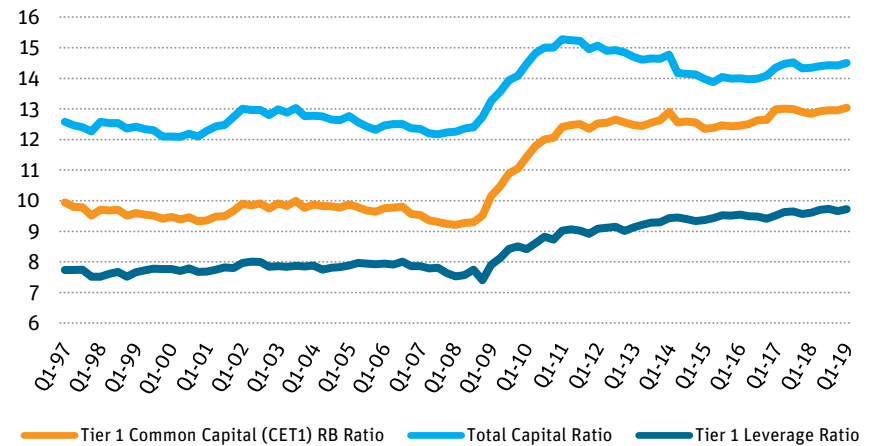
Source: Bloomberg as of 4/30/19.

**S&P Leveraged Loan 100 Index**



Source: Bloomberg as of 6/30/19.

**Bank Subordinated Debt**



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



# Portfolio Performance

## Summary

- The Fund was up 1.92% in the second quarter of 2019, underperforming the benchmark by 1.16%. The Bloomberg Barclays U.S. Aggregate Bond Index was up 3.08% over the same time period, as U.S. interest rates rallied throughout the quarter, driven by more accommodative language from the Fed and the anticipation of a mid-cycle rate cut.
- Duration positioning drove underperformance relative to the benchmark, as the Fund maintained its duration short of the benchmark. U.S. Treasury yields fell approximately 40 to 51 basis points across the curve. The continued decline in risk-free rates across the U.S. term structure in the second quarter was driven by the dovish rhetoric from the FOMC and the market's expectation of multiple rate cuts on the horizon. This fueled performance for traditional U.S. fixed-income benchmarks, notably the Bloomberg Barclays Aggregate, due to its high sensitivity to interest rates.
- All subsectors of the Fund produced positive returns on the quarter, driven by high current carry and modest spread tightening. Corporates were the best-performing subsector in the first quarter, producing a total return of approximately 441 basis points, contributing 75 basis points to Fund performance. RMBS produced a total return of approximately 212 basis points, contributing 85 basis points to Fund performance.

Net Total Returns as of 6/30/19	3 Mo.	YTD	1 Yr.	3 Yr.	SI <sup>1</sup>
Class I	1.92%	4.25%	5.64%	n/a	6.07%
Bloomberg Barclays U.S. Agg. Bond Index	3.08%	6.11%	7.87%	n/a	4.28%

*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. <sup>1</sup>The inception date of the Angel Oak Strategic Credit Fund Class I (ASCIX) was 12/26/17. <sup>^</sup>The Adviser has agreed to waive fees and may amend, extend, or discontinue this waiver at any time without notice.*

## FUND INFORMATION AS OF 6/30/19

	Class I
Gross Expense Ratio	7.99%
Net Expense Ratio <sup>^</sup>	0.75%
SEC Yield (Subsidized)	6.66%
SEC Yield (Unsubsidized)	2.12%

## FUND CHARACTERISTICS

Fund Assets (All Classes)	\$11.4 mm
Number of Securities	56
NAV	Daily
Dividend Frequency	Monthly
Liquidity Provisions	Quarterly
Floating Rate (%)	43.7

## FUND STATISTICS

(Since Inception)	Fund <sup>2</sup>	Index
Standard Deviation	2.5	3.4
Sharpe Ratio	2.3	0.9
Correlation to Index	0.0	1.0
Positive Months (%)	83.3	61.1
Negative Months (%)	16.7	38.9

<sup>2</sup>ASCIX



# Sector Attribution

		Q2 2019*	YTD 2019*
	% of Market Value	Attribution (%)	Attribution (%)
Residential Mortgage Credit	36.1	0.96	1.83
Commercial Mortgage Credit	10.0	0.18	0.25
CLOs	20.8	0.63	1.08
Corporates	11.1	0.25	1.01
ABS	18.6	0.02	0.31
Cash	3.4	0.04	0.11
Fund Expenses	-	-0.17	-0.34
Total	100.0	1.92	4.25

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.

## RMBS

- NA RMBS had a total return of 259 basis points in the second quarter, contributing 96 basis points to Fund performance. Pricing disparity between deals continues to be most profound at new issue, creating opportunities to pick up bonds with strong total return potential. The Fund continues to be overweight Non-QM, though the rate rally has created opportunities in the expanded prime and prime jumbo spaces.
- After a slow May, the new-issue market picked back up in June, with almost \$13 billion coming to market across 27 deals. RPL and CRT dominated the new-issue landscape, accounting for 68% of the issuance. Non-QM had the third-largest share, contributing approximately 15% to issuance. Two first-time issuers, including one in Non-QM, priced deals during the month.

## CLO

- CLOs returned 288 basis point in the second quarter, contributing 63 basis points to Fund performance. The focus remained on defensive-natured, seasoned bonds closer to the reinvestment period end date rather than the standard five-year reinvest/two-year non-call structure. The Fund has also looked to target discount bonds with upside from potential corporate actions.

## CORPORATES

- The Fund's corporate allocation had a total return of 192 basis points in the second quarter, contributing 25 basis points to Fund performance, driven primarily by income.

## CMBS

- CMBS produced a total return of 221 basis points on the quarter, contributing 18 basis points to Fund performance. Generic spreads for the quarter were mixed across the credit structure. For example, AAAs and BBBs tightened by 3 and 15 basis points to 85 and 330 basis points, respectively, while AA widened by 5 basis points to 135, and single A remained flat at 175.

## ABS

- The Fund's largest allocation shift throughout the quarter was toward ABS. As credit spreads in other areas of the market continued to grind tighter, relative value in ABS became increasingly apparent. The growth in the allocation came from both the marketplace lending and auto subsectors of the market. For the quarter, the allocation had a total return of 117 basis points, contributing 2 basis points to Fund performance. Approximately 41% of the sector's return was driven by price appreciation, the largest such ratio of any sector in the second quarter.



# Definitions

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**QM:** Qualified mortgage.

**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

**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.

**Tier 1 Leverage Ratio:** The relationship between a banking organization's core capital and its total assets.

**Total Capital Ratio:** The percentage of a bank's capital to its risk-weighted 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

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Mutual fund investing involves risk; principal loss is possible. The Fund's shares will not be listed on an exchange in the foreseeable future, if at all. The Fund's derivative investments have risks, including the imperfect correlation between the value of such instruments and the underlying asset, rate, or index, which creates the possibility that the loss on such instruments may be greater than the gain in the value of the underlying asset, rate, or index; the loss of principal; the possible default of the other party to the transaction; and illiquidity of the derivative investments. The Fund may invest in illiquid securities and restricted securities. Investments in restricted securities could have the effect of increasing the amount of the Fund's assets invested in illiquid securities if qualified institutional buyers are unwilling to purchase these securities. The Fund will be subject to risks associated with adverse political and economic developments in foreign countries, including seizure or nationalization of foreign deposits, the imposition of economic sanctions, different legal systems and laws relating to bankruptcy and creditors' rights, and the potential inability to enforce legal judgments, all of which could cause the Fund to lose money on its investments in non-U.S. securities. Changes in interest rates generally will cause the value of fixed-income instruments held by the Fund to vary inversely to such changes. Below-investment-grade instruments are commonly referred to as "junk" or high-yield instruments, and are regarded as predominantly speculative with respect to the issuer's capacity to pay interest and repay principal. Lower-grade instruments may be particularly susceptible to economic downturns. The price paid by the Fund for asset-backed securities, including CLOs; the yield the Fund expects to receive from such securities; and the average life of such securities are based on a number of factors, including the anticipated rate of prepayment of the underlying assets. Mortgage-backed securities are subject to the general risks associated with investing in real estate securities; that is, they may lose value if the value of the underlying real estate to which a pool of mortgages relates declines. For more information on these risks and other risks of the Fund, please see the Prospectus.

*Must be preceded or accompanied by a current prospectus. To obtain an electronic copy of the prospectus, please visit [www.angeloakcapital.com](http://www.angeloakcapital.com).*

It is not possible to invest directly in an index.

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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