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Angel Oak Financials Income Fund Quarterly Review

September 30, 2019

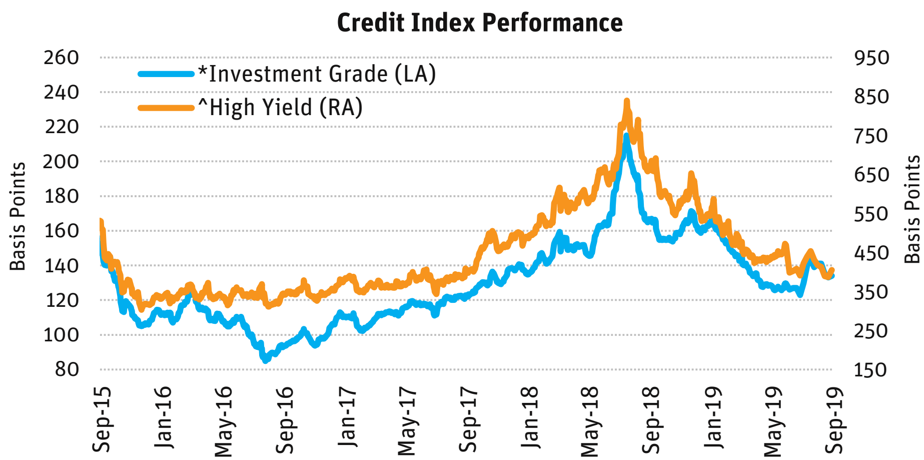
Angel Oak
CAPITAL ADVISORS

Quarter in Review

- U.S. risk assets were volatile in the third quarter as trade tensions with China continued to dominate headlines as both countries announced new rounds of tariffs. Despite geopolitical headwinds, the S&P 500 increased 1.70% while the Nasdaq Composite Index increased 0.18% in the third quarter.
- For the first time since 2007, the Federal Open Market Committee (FOMC) cut the fed funds target rate by 25 basis points, to a range of 2.0%-2.25% in July. The FOMC cut the target range again in September by 25 basis points on concerns of weakening growth in both the U.S. and global markets. The target range currently stands at 1.75%-2.00% at quarter end. Despite two cuts in 2019, investors still expect 1 or 2 additional cuts in the target range by the end of 2019. U.S. Treasury yields fell sharply in 2019, benefiting both equities and U.S. fixed income. Year-to-date, the S&P 500 returned 20.56%, the Bloomberg Barclays IG Corporate returned 12.9%, and the Bloomberg Barclays High Yield returned 11.5%. For Q3, the Bloomberg Barclays IG Corporate Index remained unchanged at 115 OAS, while the HY equivalent tightened by 3 basis points to 373 OAS. U.S. Treasury yields fell across the curve, bull flattening the 2s10s spread by 21 basis points to 0.04%. The 10-year Treasury yield decreased 34 basis points to finish the quarter at 1.66%. 1M LIBOR fell 38 basis points to 2.02%, while 3M LIBOR decreased 23 basis points to 2.09%. The secured overnight financing rate decreased 15 basis points to 2.35% at quarter end.
- Structured credit returns were positive in the third 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 1.5%, with positive excess returns for both Alt-A and Option ARM sectors of 1.2%. U.S. collateralized loan obligations (CLOs) were up 0.9%. CLOs generated positive excess returns of 0.5% for AAA- through A-rated tranches and 0.2% for BBB-rated tranches. CLO BB-rated tranches produced negative excess returns of 0.4% due to weakness in leveraged loan markets. Commercial mortgage-backed securities (CMBS) benefited from tighter spreads, posting positive excess returns of 0.7% for AA- through BBB-rated tranches. The asset-backed securities (ABS) sector posted a positive return of 0.8%, driven by spread tightening in floating rate ABS. While most structured spread sectors posted positive returns year-to-date, credit risk transfer (CRT) B1 and CLO BB tranches generated the highest positive excess returns of 12.8% and 6.7%, respectively.
- The ISM Manufacturing Index fell below 50, the demarcation line between expansion and contraction, for both August and September. The September reading of 47.8 was the lowest level since June 2009. New orders and new export components of the survey are at the lowest levels since 2009. While manufacturing data was weak, the U.S. labor market continues to remain healthy. Nonfarm payrolls rose +136k in September, marginally below expectations of +145k. The headline unemployment rate fell to a 50-year low, to 3.5%, as the labor force participation rate increased 0.3% to 63.2% from the previous quarter.
- On the housing front, the S&P CoreLogic 20 City Home Price Index rose 2.0% through July. Housing starts increased 12.2% month-over-month in August to an annualized pace of 1.36 million, the fastest pace since mid-2007. Existing home sales rose 1.29% month-over-month to a 5.49 million annualized pace. Falling financing costs and rates have contributed to an overall increase in affordability.

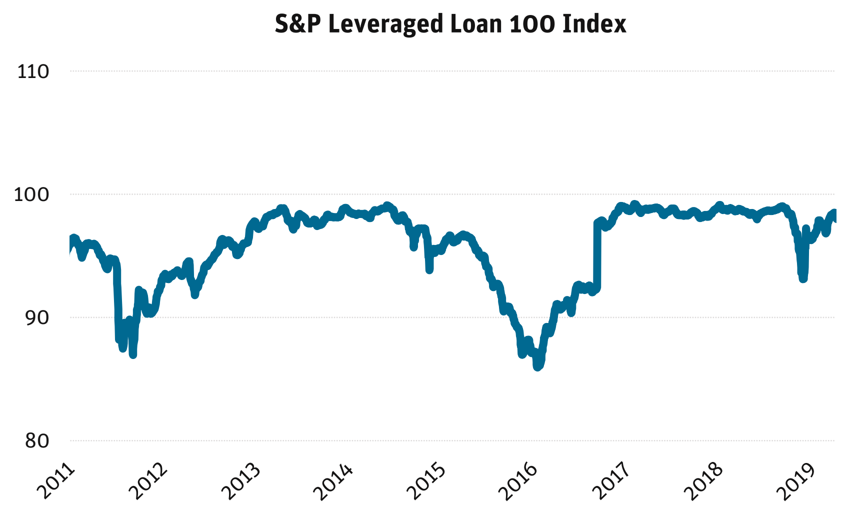
Benchmark Performance	9/30/19	6/30/19	Quarterly Change (bps)
1-Month LIBOR	2.02	2.40	-0.38
3-Month LIBOR	2.09	2.32	-0.23
2-Year Treasury	1.62	1.75	-0.13
5-Year Treasury	1.54	1.77	-0.23
10-Year Treasury	1.66	2.00	-0.34
30-Year Treasury	2.11	2.53	-0.42
2s/10s Curve	0.04	0.25	-0.21
2s/30s Curve	0.49	0.77	-0.28
S&P 500 Total Return Index	6,009	5,908	+170
IG Corporate OAS*	115	115	0
HY Corporate OAS^	373	376	-3

Sources: Bloomberg and Yieldbook as of 9/30/19.

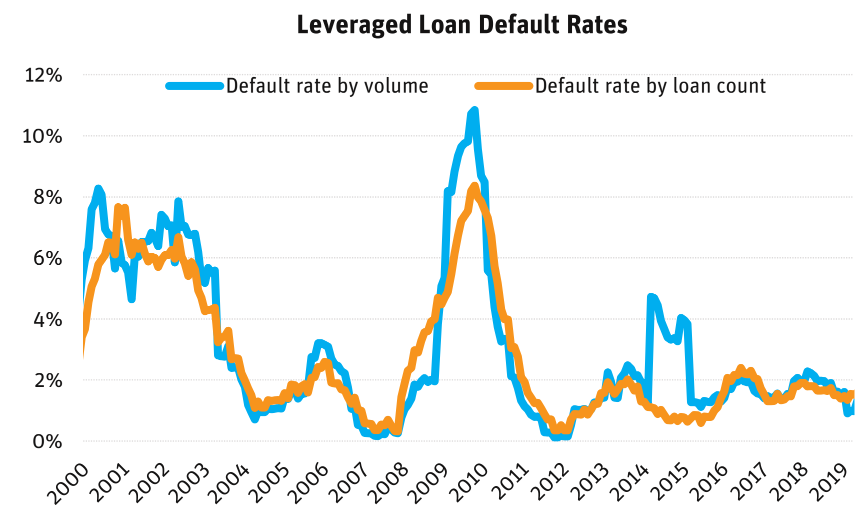


Source: Bloomberg as of 9/30/19.
*Bloomberg Barclays U.S. Corporate Total Return Value Unhedged
^Bloomberg Barclays U.S. Corporate High Yield Total Return Index Value Unhedged

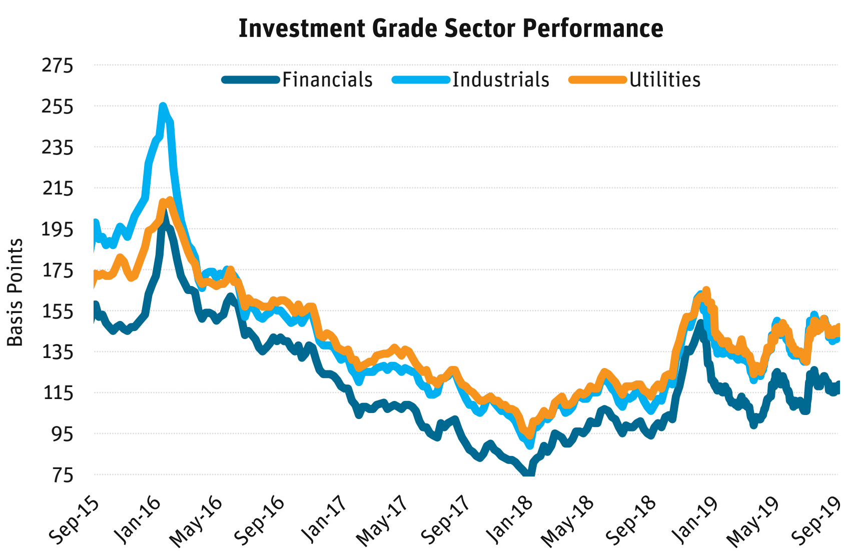
Fundamental Backdrop



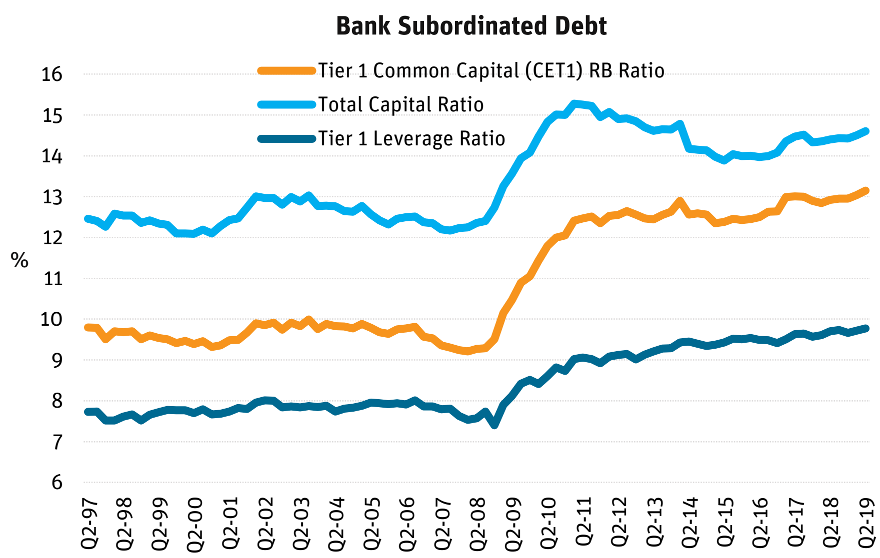
Source: Bloomberg as of 9/30/19.



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



Source: RCA, Morgan Stanley as of 9/30/19.



Source: S&P Global Market Intelligence as of 6/30/19.

Portfolio Performance

Summary

- The Class I share was up 1.46% during the third quarter, underperforming the benchmark by approximately 0.81%, as the Bloomberg Barclays U.S. Aggregate Bond Index was up 2.27% 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. However, when compared to the Morningstar Short-Term Bond category, the Class I share significantly outperformed, since the Fund has a similar duration to the category but higher yield profile.
- The Fund also outperformed the Bloomberg Barclays U.S. Aggregate 3-5 Year Index, the index which is most similar to the Fund in terms of duration, by 0.19%.

				Annualized	
Net Total Returns as of 9/30/19	**3 Mo.**	**YTD**	**1 Yr.**	**3 Yr.**	**SI[1]**
Class I	1.46%	5.38%	6.78%	5.29%	3.68%
Class A at NAV	1.29%	5.06%	6.51%	5.04%	3.43%
Class A at MOP[2]	-1.01%	2.75%	4.16%	4.23%	2.95%
Bloomberg Barclays U.S. Agg. 3-5 Year Index	1.27%	5.76%	7.71%	2.29%	2.53%
Bloomberg Barclays U.S. Agg. Bond Index	2.27%	8.52%	10.30%	2.92%	3.25%
Morningstar Short-Term Bond Category	0.72%	3.95%	4.41%	2.00%	1.73%

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 9/30/19

	Class A	Class I
Gross Expense Ratio	1.43%	1.18%
Net Expense Ratio^	0.94%	0.69%
SEC Yield (Subsidized)	3.94%	4.29%
SEC Yield (Unsubsidized)	3.56%	3.90%

FUND CHARACTERISTICS

Fund Assets (All Classes)	$233.9 mm
Number of Securities	121
Distribution	Monthly
Effective Duration	3.2
Average Price (Portfolio)	$102.0

FUND STATISTICS

(Since Inception)	Fund[3]	Index[4]
Standard Deviation	3.6	3.8
Sharpe Ratio	1.1	0.9
Correlation to Index	0.2	1.0
Positive Months (%)	79.3	60.3
Negative Months (%)	20.7	39.7

[3]ANFIX
[4] BBgBarc U.S. Agg 3-5 Yr Idx

Sector Attribution

		Q3 2019*	YTD 2019*
	% of Market Value	Attribution (%)	Attribution (%)
Corporates	93.6	1.63	5.25
CLOs	0.8	-0.01	0.16
ABS	0.0	0.00	0.03
Equity	3.4	0.00	0.34
Cash	2.2	0.02	0.10
Credit Hedges	-	0.00	0.00
Fund Expenses	-	-0.18	-0.50
Total	100.0	1.46	5.38

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

- Corporates benefited from a robust quarter of primary market issuance across banks and non-bank financials. We added attractive yielding investment grade subordinated debt in the community bank sector and selectively increased non-bank financials exposure, primarily in investment-grade senior debt in the insurance sector.
- We continue to have high conviction on the banking sector from a debt perspective, given our outlook for continued strong credit performance. Asset quality for the sector remains pristine; we see continued modest improvement in non-performing assets and stable net charge-off trends. We are mindful of episodic credit events that may impact specific institutions from an equity valuation perspective but see no signs of systemic credit deterioration that may impact the broader bank debt market.
- While we expect top-line growth to slow for the banks in the face of a more challenging interest rate environment and expected future Fed funds rate cuts, banks have levers to partially offset slowing earnings growth: 1) higher mortgage banking revenues as refinancings increase, 2) cost control, and 3) lower interest-bearing deposit costs.
- Mergers & Acquisitions activity, a positive for bank debt performance, has increased in 2019 relative to 2015-2018 levels. The consolidation rate for the industry is running at 5.6% compared with an average of ~5% the prior 4 years. We expect further acceleration in M&A through 2020 as banks search for meaningful efficiencies and cost savings in the face of a tougher earnings and rate environment.
- Third-quarter earnings results to date (largely money center and large regional banks) show supportive sequential quarter trends on average: 1) lower credit costs, 2) stronger deposit growth, 3) lower interest-bearing deposit costs, 4) higher fee income, and 5) better expense management.

CLOs

- CLOs had a total return of –15 basis points in the third quarter, contributing –1 basis point to the Fund, bringing the year-to-date total return to 559 basis points, contributing 16 basis points to the Fund. The Fund continues to maintain its CLO exposure of defensive profiles by targeting short, high-coupon BBs, given our belief that these are more insulated from their longer-duration counterparts that see increased price volatility.

Definitions

ARM: Adjustable-rate 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. Aggregate 3-5 Year Index: An index that tracks bonds with 3-5 year maturities within the Bloomberg Barclays U.S. Aggregate Bond Index.
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.
Correlation: A statistical measure of how two securities move in relation to another. Index used for comparison is the Bloomberg Barclays U.S. Agg. 3-5 Year 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.
ISM Manufacturing Index: An index that is based on surveys of more than 300 manufacturing firms by the Institute for Supply Management (ISM).
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 Leveraged Loan 100 Index: A capitalization-weighted syndicated loan index based upon market weightings, spreads and interest payments.
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.
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 9/30/19 and are subject to change at any time, are not guaranteed, and should not be considered investment advice.

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