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Angel Oak Multi-Strategy Income Fund Quarterly Review

September 30, 2019

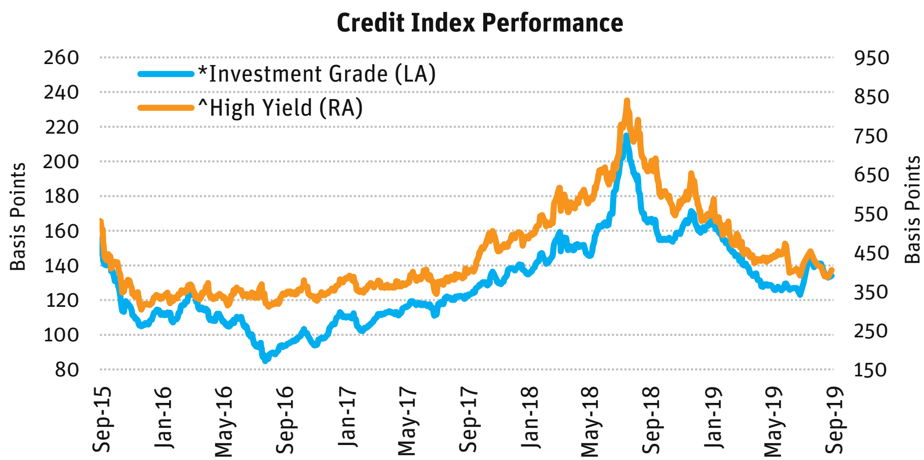
Angel Oak
CAPITAL ADVISORS

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.

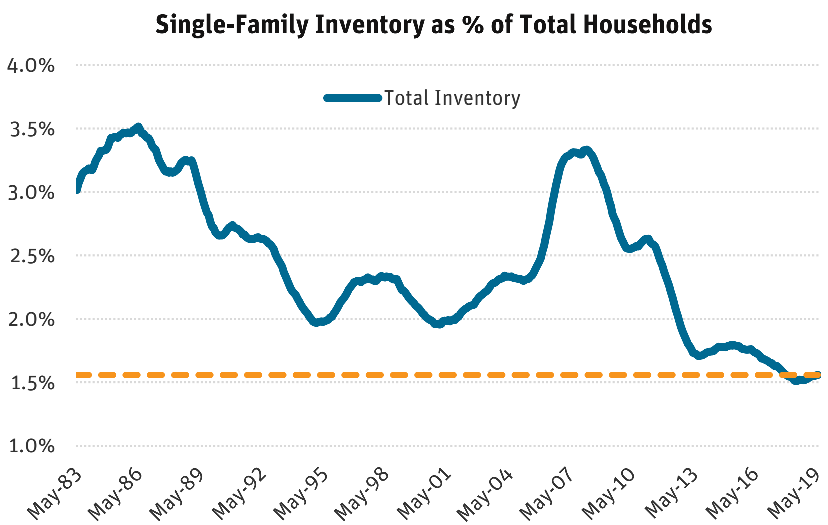
Benchmark Performance	9/30/19	6/30/19	Quarterly Change (bps)
1-Month LIBOR	2.02	2.40	-0.38
3-Month LIBOR	2.09	2.32	-0.23
2-Year Treasury	1.62	1.75	-0.13
5-Year Treasury	1.54	1.77	-0.23
10-Year Treasury	1.66	2.00	-0.34
30-Year Treasury	2.11	2.53	-0.42
2s/10s Curve	0.04	0.25	-0.21
2s/30s Curve	0.49	0.77	-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.

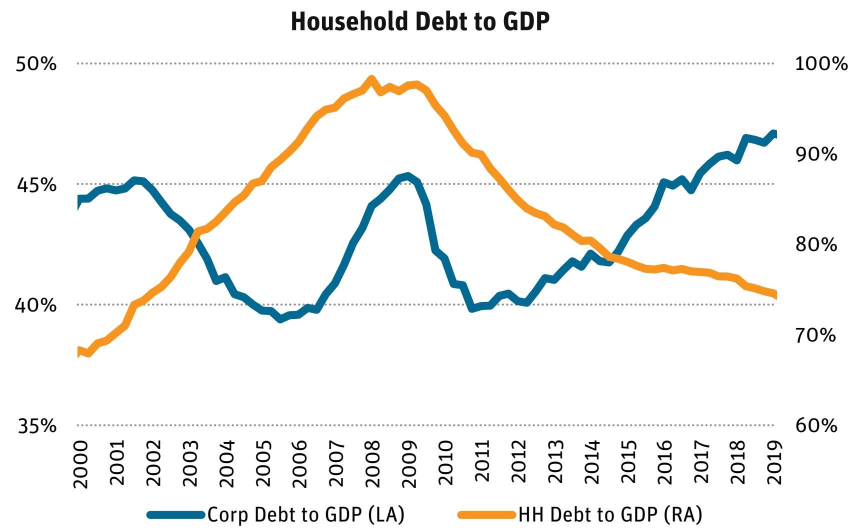


Source: Bloomberg as of 9/30/19.
*Bloomberg Barclays U.S. Corporate Total Return Value Unhedged
^Bloomberg Barclays U.S. Corporate High Yield Total Return Index Value Unhedged

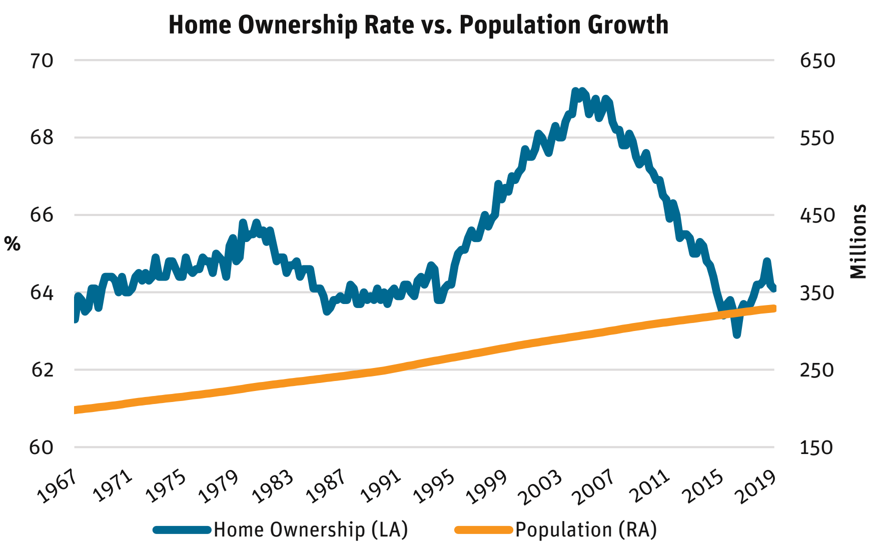
Fundamentals = Scenario Improvement



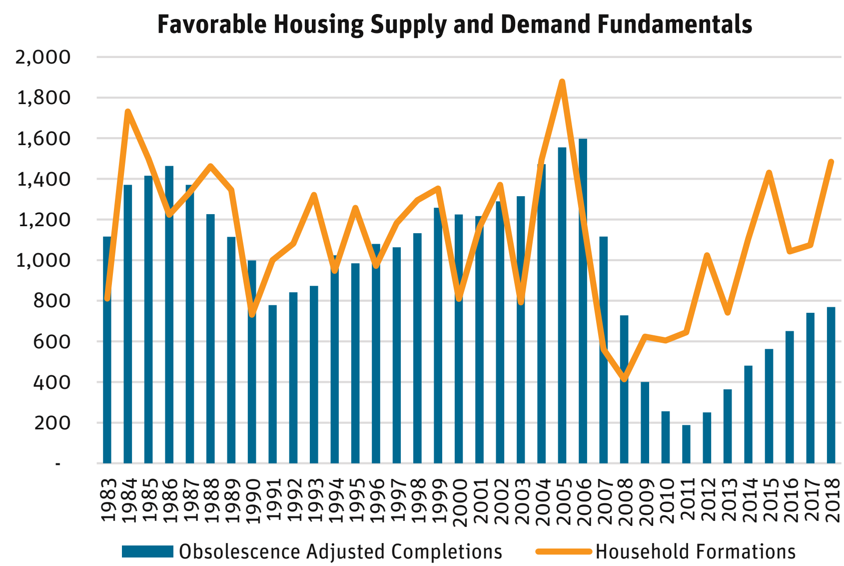
Source: Morgan Stanley as of 6/30/19.



Source: Federal Reserve, Bureau of Economic Analysis as of 6/30/19.



Source: Bloomberg as of 3/31/19.



Source: Morgan Stanley as of 12/31/18.

Portfolio Performance

Summary

The Fund was up 1.09% in the third quarter, underperforming the benchmark by 1.18%, which was up 2.27%. For 2019, the Fund is up 4.05% through September, underperforming the benchmark by 4.47%, as the Bloomberg Barclays U.S. Aggregate Bond Index was up 8.52% over the same period.

Primary contributors to Q3 performance were:

- Positive total returns in RMBS, CMBS, CLOs, ABS, and Corporates
- High allocation to RMBS, including legacy, Non-QM, and CRT
- Positive income returns north of the benchmark

Primary detractors were:

- Interest rate duration positioning short of the benchmark
- Focus on floating-rate bonds, given the decline in 1M and 3M LIBOR rates

				Annualized		
Net Total Returns as of 9/30/19	**3 Mo.**	**YTD**	**1 Yr.**	**3 Yr.**	**5 Yr.**	**SI[1]**
Class I	1.09%	4.05%	4.17%	4.87%	3.90%	6.92%
Class A at NAV	0.94%	3.76%	3.81%	4.56%	3.61%	6.68%
Class A at MOP[2]	-1.38%	1.46%	1.44%	3.76%	3.14%	6.39%
Bloomberg Barclays U.S. Agg. Bond Index	2.27%	8.52%	10.30%	2.92%	3.38%	3.37%

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 the Angel Oak Multi-Strategy Income Fund A Class (ANGLX) was 6/28/11, while the inception date of the Institutional Class (ANGIX) was 8/16/12. The returns of ANGIX shown for periods prior to the inception date include the returns of ANGLX and are adjusted to reflect the operating expenses of ANGIX. [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	1.37%	1.12%
Net Expense Ratio^	1.22%	0.97%
SEC Yield (Subsidized)	4.28%	4.64%
SEC Yield (Unsubsidized)	4.28%	4.64%

FUND CHARACTERISTICS

Fund Assets (All Classes)	$7.7bn
Number of Securities	3,386
Distribution	Monthly
Effective Duration	1.5
Average Price (Portfolio)	$92.0
Average Price (Legacy RMBS)	$87.1
Floating Rate (%)	65.7

FUND STATISTICS

(Since Inception)	Fund[3]	Index
Standard Deviation	3.1	3.8
Sharpe Ratio	3.0	1.1
Correlation to Index	0.1	1.0
Positive Months (%)	83.8	63.6
Negative Months (%)	16.2	36.4

[3]ANGIX

Sector Attribution

		Q3 2019*	YTD 2019*
	% of Market Value	Attribution (%)	Attribution (%)
RMBS	68.8	1.03	3.46
CMBS	9.1	0.08	0.39
CLOs	9.2	0.10	0.50
Corporates	5.9	0.11	0.40
ABS	5.7	0.06	0.16
Cash	1.3	0.01	0.03
Credit Hedges	-	0.00	0.00
Fund Expenses	-	-0.29	-0.87
Total	100.0	1.09	4.05

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.

RMBS

- NA RMBS had a total return of 141 basis points in the third quarter, contributing 103 basis points to Fund performance. Year-to-date, the sector generated a total return of 501 basis points, contributing 346 basis points to Fund performance. Spreads across the sector were largely range-bound during the quarter. The rate rally helped pull prices higher, while all in yields were lower. We expect to see the impact of the rate rally filter through legacy in the form of increased voluntary prepayment speeds in the coming months.
- The new-issue market picked back up in the third quarter, with almost $34 billion coming to market across 81 deals. Reperforming loans and Non-QM dominated the new-issue landscape, accounting for about half of the issuance. Non-QM continues to be a hot topic, with many new issuers coming to market and total issuance exceeding the entirety of 2018 volume.

CMBS

- CMBS returned 89 basis points in the third quarter, contributing 8 basis points to Fund performance net of hedges. Year-to-date, CMBS returned 530 basis points to Fund performance, contributing 39 basis points net of hedges. Generic spreads for the quarter were tighter for all tranches except for AAA. AAAs widened by 7 basis points to 92, while AAs tightened by 10 basis points to 125, single A tranches tightened by 20 basis points to 155, and BBBs by 40 basis points to 290. In new issue, $21.9 billion priced for the quarter, split between $14.3 billion of conduit, $3.8 billion of single asset/single borrower (SASB), and $3.9 billion of commercial real estate CLOs. Allocation within CMBS decreased slightly to 9.1% in the third quarter from 9.8% in the previous quarter. Over the quarter, the Fund's allocation to SASB has increased while reducing conduit allocation.

CLOs

- CLOs had a total return of 112 basis points in Q3, contributing 10 basis points to the Fund, bringing the year-to-date total return to 523 basis points, contributing 50 basis points to the Fund. The focus remained on defensive-natured, seasoned bonds closer to the reinvestment period end date as opposed to the standard five-year reinvest/two-year non-call structure. The Fund has also looked to target discount bonds with upside from potential corporate action.

ABS

- The ABS allocation returned 112 basis points in the third quarter, contributing 6 basis points to Fund performance. Year-to-date, ABS returned 448 basis points to Fund performance, contributing 16 basis points to the Fund. The Fund continued to focus on short, relatively attractive auto ABS higher up in the capital structure.
- Generic spreads were modestly tighter by approximately 2 to 5 basis points across the capital stack for both prime and subprime autos; however, floating rate cards widened by 5 basis points.

Definitions

ARM: Adjustable-rate mortgage.
Non-QM: Non-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.
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.
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 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.
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 higher and duplicative expenses when it invests in mutual funds, ETFs, and other investment companies. 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 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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