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Angel Oak High Yield Opportunities Fund Quarterly Review

September 30, 2019

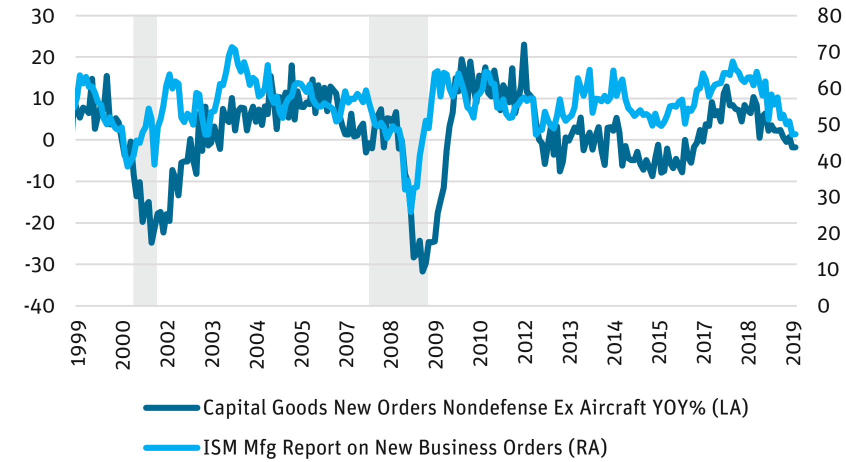
Angel Oak
CAPITAL ADVISORS

Quarter in Review

- The trade war with China continued to be a drag on the economy in the third quarter, with the continued escalation blamed for deterioration in the economic data, specifically manufacturing, leading the Federal Reserve to move from a pause to cutting rates.
- After trade negotiations unraveled in the second quarter, just ahead of the G20 meeting, President Trump and President Xi agreed to resume negotiations. The first meeting, in late July, was cut short with little to no progress achieved, and as a result, Trump announced a tariff of 10% on $300B of imports not already subject to tariffs, effective September 1 ($125B) and December 15 ($175B). In response to China's retaliatory tariffs announced August 23, Trump announced the increase in the tariff rate from 10% to 25% on the $300B, and raised the tariff rate from 25% to 30% on the $250B already subject to tariffs effective October 15. On the prospect of a partial trade agreement coming out of the early October meetings, the October 15th tariff increase was suspended pending an agreement.
- Select U.S. economic data began to deteriorate in the quarter – specifically, manufacturing-related data as represented by the Institute for Supply Management (ISM) surveys. The ISM Manufacturing survey fell below 50, the demarcation line between expansion and contraction, for both August and September. The September reading of 47.8 was the lowest since June 2009. The new orders and new export orders components of the survey are at the lowest levels since 2009. The employment component also deteriorated sharply, falling below 50 in both August and September. Additionally, the business fixed investment component of GDP has weakened and was a negative contributor to second quarter GDP.
- In response, the Federal Reserve cut rates in July for the first time since 2007. The Federal Reserve chairman's response to questions during the press conference, that this wasn't the beginning of an easing cycle, contributed to a sell-off in risk assets and spread widening in August. Despite the volatility during the quarter, credit spreads were 4 basis points tighter and the Bloomberg Barclays U.S. Corporate High Yield Index returned 1.33% for the period.
- With the backdrop of weakening growth in the U.S. combined with low inflation, and the absence of any fiscal stimulus, investors' expectations are for additional interest rate cuts from the Federal Reserve to mitigate the negative impact from the trade war and support financial asset valuations. In that context, investor demand for income continues to be strong, with inflows into high-yield mutual funds totaling over $3B in the quarter, bringing the total year-to-date to over $15B.

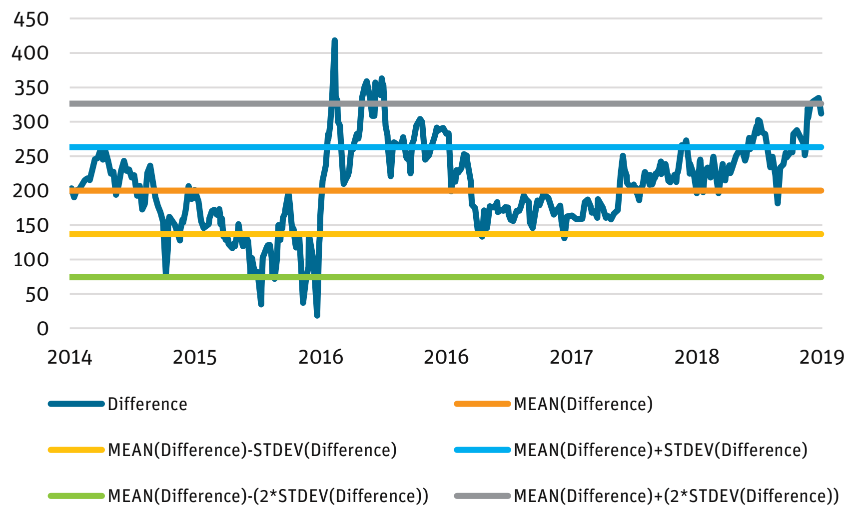
Benchmark Performance	6/30/19	9/30/19	Quarterly Change (bps)
2-Year Treasury	1.75	1.62	-13
5-Year Treasury	1.77	1.54	-23
10-Year Treasury	2.00	1.66	-34
UST 3M/10Y Spread	-9	-16	-7
Oil	58.47	54.07	-753
Iron Ore	109.18	42.91	-1490
VIX	15.08	16.24	+769
S&P 500 Total Return Index	5,908	6,009	+170
Bloomberg Barc U.S. Corp IG Index OAS	115	115	0
Bloomberg Barc U.S. Corp HY Index OAS	376	373	-3

ISM & CAPITAL GOODS INDEX



Source: Bloomberg as of 9/30/19. Shaded gray bars represent periods of recession.

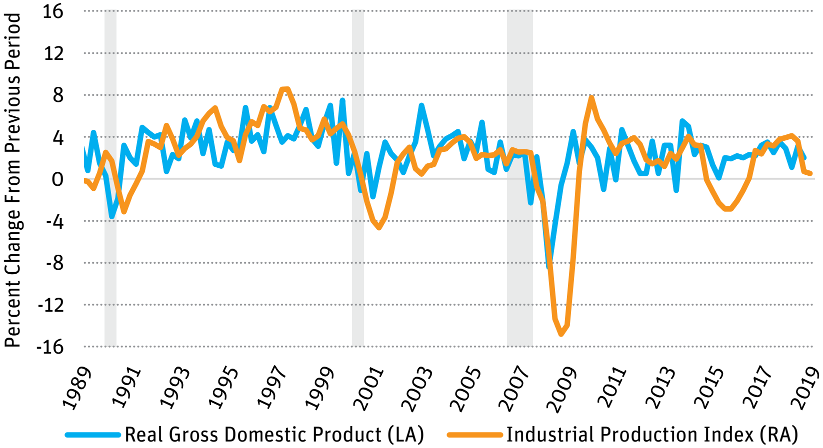
CLO BB vs. HY



Source: Citigroup as of 9/30/19.

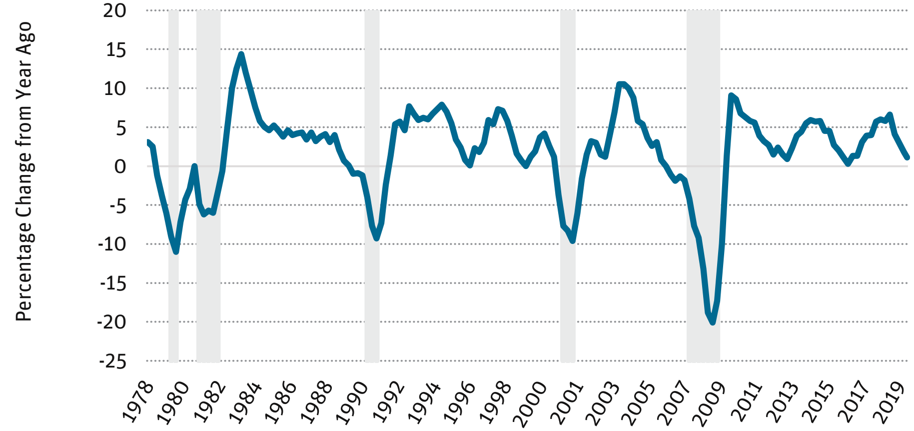
Fundamental Backdrop

INDUSTRIAL PRODUCTION AND GDP



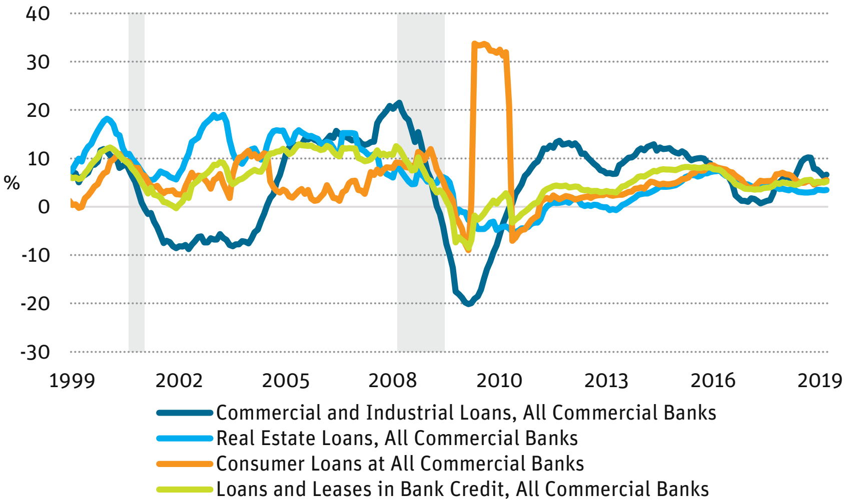
Source: FRED as of 7/31/19. Shaded gray bars represent periods of recession.

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



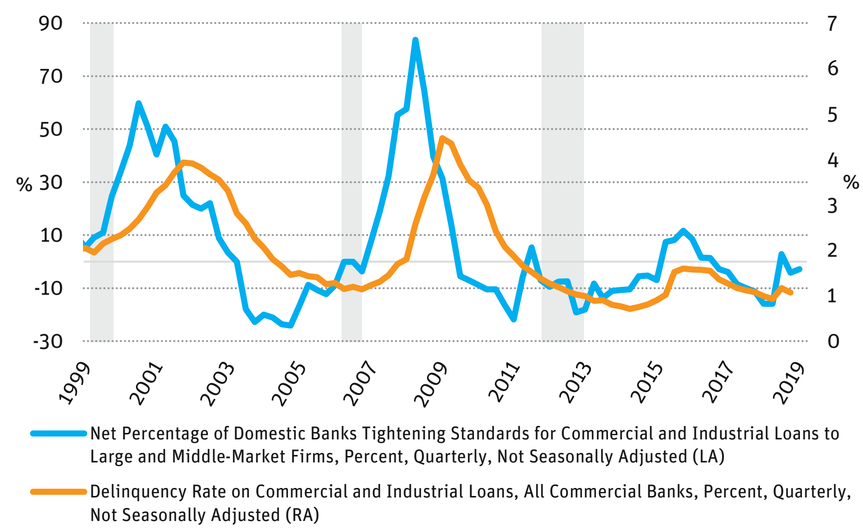
Source: Bloomberg as of 8/31/19. Shaded gray bars represent periods of recession.

BANK LOAN GROWTH



Source: FRED as of 7/31/19. Shaded gray bars represent periods of recession.

BANKS TIGHTENING STANDARDS C&I AND DELINQUENCY C&I



Source: FRED as of 6/30/19. Shaded gray bars represent periods of recession.

Portfolio Performance

Summary

- The Angel Oak High Yield Opportunities Fund returned 1.02% in the quarter ending September 30, 2019, slightly behind the Bloomberg Barclays U.S. Corporate High Yield Index return of 1.33%.
- Credit spreads started the quarter modestly tighter in July, widened 22 basis points in August as the trade war escalated, and tightened 20 basis points in September as the Federal Reserve cut interest rates by another 25 basis points and it appeared trade negotiations would resume in October.
- As the demand for income remains strong but the economic environment continues to deteriorate, the outperformance of the higher-quality segment of the market within high yield continued in the third quarter. The higher-quality BB-rated category tightened 12 basis points and returned 2.03% for the quarter. The BB-rated category also benefited from the 20 basis point rally in interest rates, due to its greater duration and interest rate sensitivity. The single B-rated category also outperformed, tightening 15 basis points and returning 1.65% for the period. Reflecting investors' increasing risk aversion as the economy continues to slow, the more speculative CCC-rated category underperformed, with credit spreads widening 78 basis points and returning a negative 1.76% for the period.
- The collateralized loan obligation (CLO) allocation slightly underperformed in the quarter, returning 1.24% compared to the Bloomberg Barclays U.S. Corporate High Yield Index return of 1.33%. CLOs' positive performance in a declining interest rate environment reflects their higher yield and specific characteristics, resulting in consistent, lower-volatility contribution to performance.

Net Total Returns as of 9/30/19	3 Mo.	YTD	1 Yr.	3 Yr.	5 Yr.	10 Yr.	SI[1]
Class I	1.02%	10.72%	5.83%	6.22%	5.56%	7.42%	8.98%
Class A at NAV	0.96%	10.48%	5.65%	5.97%	5.28%	7.16%	8.72%
Class A at MOP[2]	-1.31%	8.03%	3.26%	5.17%	4.80%	6.92%	8.48%
BBgBarc U.S. Corporate High Yield TR USD	1.33%	11.41%	6.36%	6.07%	5.37%	7.94%	11.09%

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 9/30/19

	Class A	Class I
Gross Expense Ratio	1.25%	1.00%
Net Expense Ratio^	0.90%	0.65%
SEC Yield (Subsidized)	5.32%	5.70%
SEC Yield (Unsubsidized)	5.10%	5.48%

FUND CHARACTERISTICS

Fund Assets (All Classes)	$70.6 mm
Number of Securities	135
Distribution	Monthly
Effective Duration	3.3
Average Coupon (%)	6.38
Average Yield-to-Worst (%)	5.67

FUND STATISTICS

(Since Inception)	Fund[3]	Index
Standard Deviation	5.6	7.3
Sharpe Ratio	1.5	1.4
Correlation to Index	0.9	1.0
Positive Months (%)	73.0	73.0
Negative Months (%)	27.0	27.0

[3]ANHIX

Sector Attribution

	% of Market Value	Q3 2019* Total Return (%)	Q3 2019* Attribution (%)	YTD 2019* Total Return (%)	YTD 2019* Attribution (%)
Corporates	87.6	1.26	1.05	12.17	10.27
CLOs	6.3	1.24	0.08	9.68	0.75
Equities & ETFs	0.1	-	0.01	-	-0.03
Cash	6.0	-	0.02	-	0.10
Fund Expenses	-	-	-0.15	-	-0.37
Total	100.0	1.02	1.02	10.72	10.72

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

Corporates:

- For the third quarter, the high-yield corporate bond allocation returned 1.26% and contributed 105 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 1.33%, by 7 basis points, respectively.
- Consumer cyclical was the most significant positive contributor to performance in the quarter, returning 3.28% compared to the benchmark, which returned 2.33%. The outperformance was almost entirely due to selection and driven predominantly by holdings in homebuilders, offset partially by a holding in an auto parts manufacturer. Consumer non-cyclicals was also a significant positive contributor to performance, returning 3.45% compared to the benchmark, which returned 1.86%. Again, the outperformance was entirely due to selection and driven by a position in a consumer products company that manufactures battery and portable lighting products as well as a holding in a healthcare company specializing in post-acute care.
- Utilities and cash were the two largest detractors from performance, each accounting for 14 basis points of negative attribution. Utilities returned a negative 0.66% compared to the benchmark, which returned 1.91%. The negative attribution was predominantly due to selection and attributable to a holding in an independent power producer based in the Northeast, where mild weather contributed to lower demand, and the regularly scheduled capacity auction for 2022-2023 was delayed, which increased uncertainty regarding power pricing.

CLOs:

- The CLO allocation produced 1.24% total return in Q3 contributing 8 basis points to the fund. Prices were largely range bound but drifted slightly lower as spreads drifted wider on macro concerns surrounding global growth and international trade policy.

Sector Exposure

	Weighted Avg. Price	% of Market Value		% Change	Option Adjusted Spread		Bps Change	Yield-to-Worst		Bps Change
		6/30/19	9/30/19		6/30/19	9/30/19		6/30/19	9/30/19	
Corporates	102.50	83.2	87.6	4.4	390	399	9	5.95	5.78	-17
CLOs	98.07	7.6	6.3	-1.3	758	782	24	9.52	9.74	22
Equities & ETFs	15.50	0.1	0.1	0.0	N/A	N/A	N/A	N/A	N/A	N/A
Cash	100.00	9.1	6.0	-3.1	N/A	N/A	N/A	N/A	N/A	N/A
Total	101.98	100.0	100.0		382	399	17	5.68	5.67	-1

Corporates:

- With the prospect for a near-term resolution to the trade war uncertain, the outlook is for the economy to continue its gradual path to a lower level of economic activity, cushioned by the low level of unemployment, relatively healthy household balance sheets, and a Federal Reserve that appears, in the context of low inflation, ready to cut rates further to mitigate the impact of the trade war.
- Overall, high yield remains well bid with the credit spread valuations for the index at 402 basis points, only 56 basis points wider than the year-to-date tights and still more than 150 basis points inside the long-term average of 556 basis points. High yield is often looked to as an early indicator of potential weakness in the economy and risk assets. On the surface, valuations appear to signal that everything is generally okay. However, looking below the surface at the weakness in the more speculative CCC-rated category, the message is much different. Relative to the B- and BB-rated segments of the high-yield market, CCC credit spreads have widened to their widest level since early 2016. Investors may be desperate for income, potentially making the case for BBs, but have increasingly shied away from the more speculative issuers within the high-yield market.
- Manufacturing and capital investment data in the U.S. has deteriorated, catching up to the weakness seen globally as businesses pull back, reacting to the uncertainty caused by the trade war. Given the lack of fiscal support and in the context of low inflation, the Federal Reserve appears ready to cut interest rates to mitigate the impact of the trade war on the economy, maintain full employment, and extend the expansion. However, given the current demographic situation of an aging population and increased need for income from their savings and the current low level of interest rates, there are concerns about how effective additional interest rate cuts will be in stimulating business activity. For businesses, the issue is probably not the cost of capital, but certainty regarding supply chains and resolution of the trade war. Savers may save more to offset lower interest rates rather than take advantage of lower interest rates to spend, especially if they get nervous about the sustainability of the economic expansion and job security.
- We are not necessarily forecasting a recession in the near future, but growth will likely continue to slow. With this backdrop, the emphasis is on risk and reward, and at the margin we continue to increase exposure within the portfolio to less cyclical sectors and higher-quality issuers that should deliver more resilient financial performance in a slower growth environment, while not becoming overly conservative as to risk underperforming if a trade agreement is reached.

CLOs:

- The Fund remains focused on defensive BB-rated profiles, specifically bonds that are closer to the end of their reinvestment period if not already delevering or bonds with a high coupon, as these should outperform their longer-duration peers in a risk-off environment.

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).
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 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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