Elevator Talk: Clayton Triick, Angel Oak UltraShort Income (AOUAX/AOUIX)

By David Snowball
Published September 1, 2019

Since the number of funds we can cover in-depth is smaller than the number of funds worthy of in-depth coverage, we've decided to offer one or two managers each month the opportunity to make a 200-word pitch to you. That's about the number of words a slightly manic elevator companion could share in a minute and a half. In each case, I've promised to offer a quick capsule of the fund and a link back to the fund's site. Other than that, they've got 200 words and precisely as much of your time and attention as you're willing to share. These aren't endorsements; they're opportunities to learn more.

Clayton Triick, CFA®

"We fill a void in the marketplace by offering access to structured credit, a distinctive and independent asset class."

Clayton Triick manages Angel Oak UltraShort Income which launched in April 2018. He joined **Angel Oak Capital Advisors** in 2011 as an expert in the residential mortgage-backed securities markets, which is a subset of the larger asset-backed securities market. Prior to joining Angel Oak, he was a portfolio manager for YieldQuest, a now defunct advisor whose internal dynamics were, he allows, "a bit challenging." Since joining Angel Oak, he has been co-manager on **Angel Oak Multi-Strategy Income** (ANGLX, $7.7 billion AUM, four stars from Morningstar) and lead manager on **Angel Oak UltraShort Income**.

Ultra-short funds are generally tools for cash management. They generally seek to provide returns higher than those available from insured vehicles such as deposit accounts or CDs with minimal volatility. Over the course of the current market cycle, running from October 2007 to now, the average ultra-short fund in the Lipper database returned 1.4% a year, suffered a maximum drawdown of just 1.7% during the market crisis and recovered from that fall within four months. Only a couple funds have returns above 2.0% a year over the end cycle. That's better than the average savings account, which pays 0.10% annually (the advertised high rates on online accounts are typically short-term marketing gimmicks), but nothing to brag to friends about. With no prospects for expecting "normal" interest rates in the foreseeable future, this remains a low drama corner of the market.

The problem with 1.4% returns is 2.0% inflation. As of August 2019, that's the Federal Reserve Open Market Committee's projection for household inflation, designated CPE, for the next five years or so. If those two numbers hold, ultra-short investors will encounter negative real growth in their investments; that is, the $10,000 you might invest in an ultra-short account in 2019 will buy **less** in five years than it would buy today.

The solution is to find income that's not interest-rate dependent, which means investing at least some part of the portfolio in something *other than* bonds. The willingness to look beyond the traditional bond market is often signaled by a fund's name: "Ultra Short Bond" in the name means a far more restricted investment universe than "Ultra Short Income." In both cases, the portfolio's average duration—a measure of interest rate sensitivity—is under one year but, in the latter case, the portfolio might hold a variety of income-producing securities that aren't exactly bonds.

The folks at Angel Oak believe they've found their solution to low interest rates: asset-backed securities. The "assets" behind ABS, as they're called, might be a home mortgage, a car loan or income from leasing a commercial building. The simplified version: banks and credit unions issue mortgages, but don't actually want to keep them on the books for the next 30 years, so they sell the mortgage to something called a **special purpose vehicle** (SPV). The special purpose vehicle bundles together lots of mortgages, which is called "securitizing" them, and sells those securities to general investors. The SPV will issue some securities backed by the lowest-risk borrowers, perhaps well-established affluent homeowners borrowing a relatively small amount for a relatively short period, and others that represent iffier borrowers who are paying higher rates for their loans.

Why might this be a good idea for investors? As DoubleLine, a prominent investor in asset-backed securities, points out, such securities have experienced:

- ✔ Lower duration (remember: interest-rate risk) than other investment grade bond sectors
- ✔ Lower volatility than other investment grade bond sectors
- ✔ Higher yields than US Treasuries
- ✔ Better relative performance during periods of rising rates than other investment grade bond sectors
- ✔ Lower correlations to equities than corporate credit. ("The Advantages of Mortgage-Backed Securities in Today's Environment," 2018).

Angel Oak UltraShort has only been around since April 2018 but has been an exemplary performer. The fund has recorded positive returns in 100% of its months, hence its maximum drawdown is … well, zero. It has produced substantial total returns from both income and a smidge of capital appreciation:

TOTAL RETURNS (as of 6/30/19)	2Q19	YTD	1 YEAR	INCEPTION
Class I	1.21%	2.29%	3.88%	3.69%
Class A	1.05%	2.18%	3.52%	3.44%
Index[2]	0.87%	1.69%	2.88%	2.65%

The fund ended its first full year of operation in the top 1% of its Morningstar peer group, substantially outpacing competitor funds from folks such as PIMCO and DoubleLine.

Other firms have noticed, and reacted to, the advantages of this asset class. Those range from Vanguard's $10 billion **Vanguard Mortgage Backed Income Securities Index Fund** (VMBSX) to a bunch of DoubleLine's 18 funds. Nonetheless, the combination of ultrashort duration and a securitized portfolio remains rare. Here are Clayton's 300 words on why you should add AOUAX to your due-diligence list:

> *Ultrashort duration funds may offer various benefits to a broader fixed-income portfolio. In the current environment, the U.S. yield curve is inverted. Investors can find attractive income at the front end of the yield curve over and above intermediate-duration assets. Furthermore, the introduction of high-quality structured credit tends to dampen price volatility during times of stress. This unique attribute with respect to market risk can be beneficial to an investor's entire portfolio.*

We believe investors should be looking for opportunities within assets that improve in quality over time. This fund targets short-term investments that have powerful "de-levering" characteristics; i.e., as they approach maturity, their credit risk is at their lowest point as credit protection is at their maximum point. This is in direct contrast to traditional corporate credit, which tends to carry more of a binary credit risk.

This relative performance diversion was most evident between the Angel Oak UltraShort Income Fund and its peer group in Q4 2018, as NAV volatility was minimal compared with corporate credit-focused ultrashort duration funds.

Before launching the strategy in 2018, we realized there were very few specific mutual fund offerings that focused primarily on structured credit for investors. The addition of our ultrashort strategy has filled this void in the fund marketplace.

The Angel Oak UltraShort Income Fund seeks to provide current income while aiming to minimize price volatility and maintain liquidity. For portfolio construction, we take a top-down approach, which helps provide the fund with superior income within the ultrashort landscape while minimizing volatility.

Currently, the ultrashort income fund features a distribution yield of approximately 3%. The potential opportunities in the short duration space provide potential for additional price return, thus enhancing total return above the yield.

Angel Oak Ultra-Short has a $1000 minimum initial investment on its no-load "A" shares, and $1 million for the institutional share class. Expenses are capped at 0.50% on the "A" shares and 0.25% for institutional shares after substantial expense waivers which are in effect through May, 2020. The fund has gathered about $265 million in assets since its April 2018 launch. Here's the fund's homepage. Folks who would like to hear directly from Mr. Triick might enjoy a three-minute video, released in August 2019, discussing the fund.

Bloomberg Barclays 9-12 Month U.S. Treasury Bill Index: Measures the performance of U.S. Treasury bills, notes, and bonds with a remaining maturity between 9-12 months. The index does not include trading and management costs.

Correlation: A statistical measure of how two securities move in relation to another.

Distribution Yield: The distribution yield is calculated by annualizing actual dividends distributed for the monthly period ended on the date shown and dividing by the net asset value on the last business day for the same period. The yield does not include long-or short-term capital gains distributions.

Maximum Drawdown: Defined as the peak-to-trough decline of an investment during a specific period.

It is not possible to invest directly in an index.

While the fund is no-load, management and other expenses still apply. Please refer to the prospectus for more information.

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.*

Mutual fund investing involves risk; principal loss is possible. 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. 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.

Fund Information (as of 6/30/19)

	A Shares	I Shares
Gross Exp Ratio*	0.95%	0.78%
Net Exp Ratio*	0.50%	0.25%
30-Day SEC Yield subsidized	2.86%	3.18%
30-Day SEC Yield unsubsidized	2.50%	2.81%

*Gross expense ratios are reported as of the 5/31/19 prospectus. The net expense ratios are reported as of the 1/31/19 Annual Report and are referenced in the 5/31/19 prospectus. The Adviser has contractually agreed to waive fees through 5/31/20.

Morningstar Rankings represent a fund's total-return percentile rank relative to all funds that have the same Morningstar Category. The highest percentile rank is 1 and the lowest is 100. It is based on Morningstar total return, which includes both income and capital gains or losses and is not adjusted for sales charges or redemption fees. Morningstar ranked the Fund (AOUIX) in the top 1% of 198 UltraShort Bond Funds for the one-year period ending 8/31/19, respectively.

As of 6/30/19, the Angel Oak Multi-Strategy Income Fund (ANGLX) received a Morningstar rating based on risk-adjusted returns of 4 stars overall, 4 stars for the three-year period and 4 stars for the five-year period among 303, 303, and 240 multisector bond funds, respectively. The Morningstar Rating™ for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating™ for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating™ metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.

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