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Angel Oak High Yield Opportunities Fund Quarterly Review

December 31, 2019

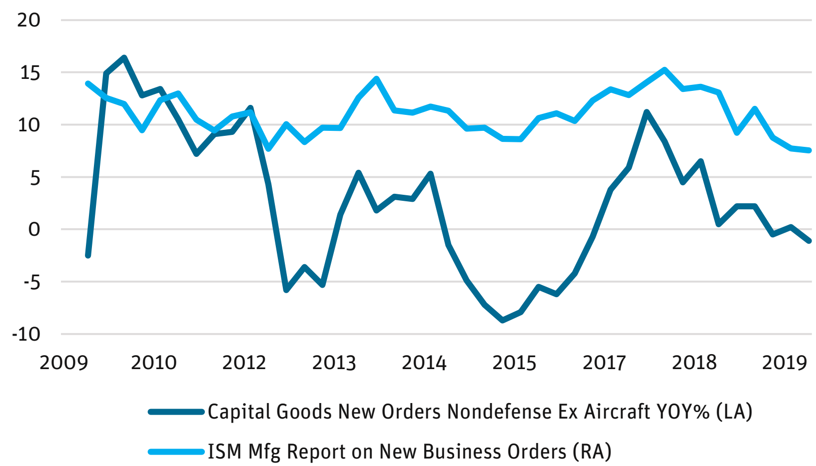
Angel Oak
CAPITAL ADVISORS

Quarter in Review

- Returns for the fourth quarter were driven by the prospect for a phase-one, partial trade agreement and comments from Federal Reserve Chairman Jerome Powell that after completion of the midcycle easing they are essentially on hold, not to mention the recent expansion of the balance sheet.
- After escalation of the trade war entering the fourth quarter, with threats of restrictions on capital flows and blacklisting of technology companies, the U.S. and China were able to agree to a phase-one, partial trade agreement. The details of the agreement have yet to be released, but in exchange for canceling announced but not-yet-implemented tariffs and cutting tariffs from 15% to 7.5% on $120 billion of imports, China has agreed to increase purchases of agricultural products, not to devalue the yuan, and take steps to open its financial sector and better protect U.S. intellectual property.
- The Federal Reserve completed their 75 basis points midcycle easing in the fourth quarter, reducing the Federal Funds rate to 1.50%, and indicated interest rates are appropriate to sustain the expansion. Chairman Powell further said that the economy and monetary policy were in a good place and it would take a significant sustained move up in inflation before he would consider raising interest rates. In addition to lower interest rates, returns were supported by the additional $410 billion of liquidity supplied by the Federal Reserve since the end of August, and that ballooned the Federal Reserve's balance sheet to $4.2 trillion, the highest since September 2018.
- Despite the progress toward a phase-one, partial trade agreement, manufacturing conditions continue to deteriorate, with the ISM Manufacturing PMI falling to 47.2 at the end of December, the lowest reading since June 2009. Industrial production measured on a year-over-year basis also deteriorated in the quarter, falling into negative territory, which almost never happens without a recession ensuing.
- In the context of progress toward a phase-one, partial trade agreement, easy monetary policy from the Federal Reserve, and low inflation, investors' optimism in the outlook for the economy and returns was reflected in their demand for high-yield fixed-rate assets, with inflows into high-yield mutual funds totaling approximately $3.3 billion in the quarter and approximately $18.5 billion for the year.

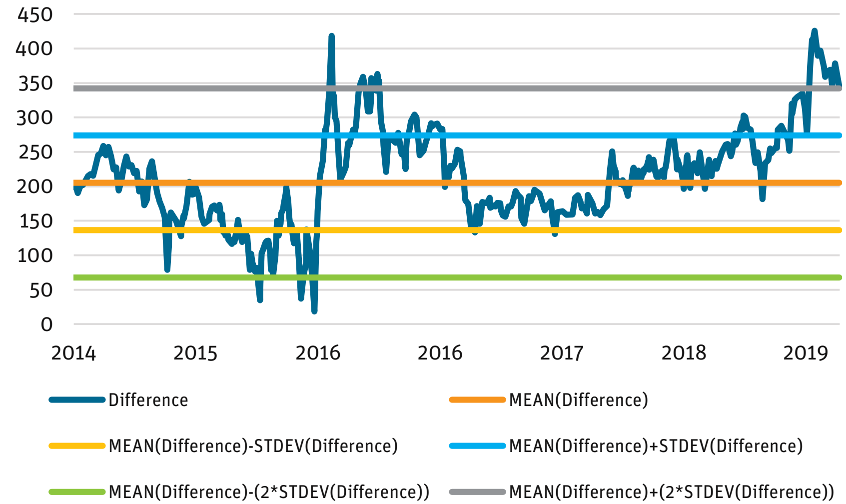
Benchmark Performance	9/30/19	12/31/19	Quarterly Change (bps)
2-Year Treasury	1.62	1.57	-5
5-Year Treasury	1.54	1.69	+15
10-Year Treasury	1.66	1.92	+26
UST 3M/10Y Spread	-16	36	+52
Oil	54.07	61.06	+1,293
Iron Ore	92.91	91.53	-149
VIX	16.24	13.78	-1,515
S&P 500 Total Return Index	6,009	6,554	+907
Bloomberg Barc U.S. Corp IG Index OAS	115	93	-22
Bloomberg Barc U.S. Corp HY Index OAS	373	336	-37

ISM & CAPITAL GOODS INDEX



Source: Bloomberg as of 12/31/19.

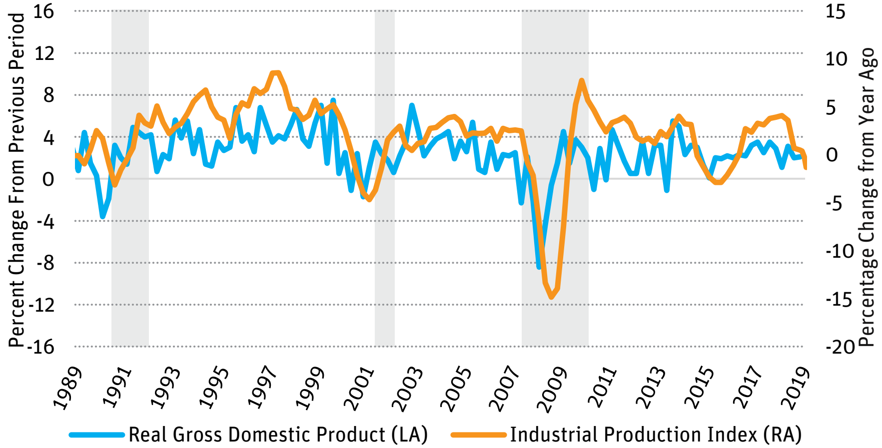
CLO BB vs. HY



Source: Citigroup as of 12/31/19.

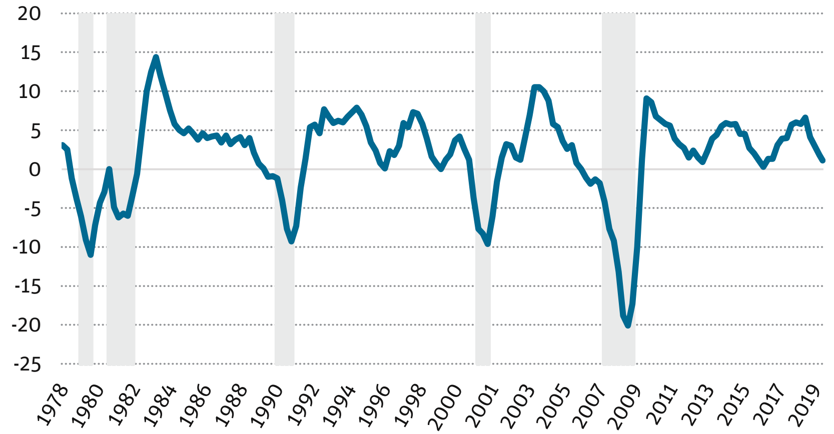
Fundamental Backdrop

INDUSTRIAL PRODUCTION AND GDP



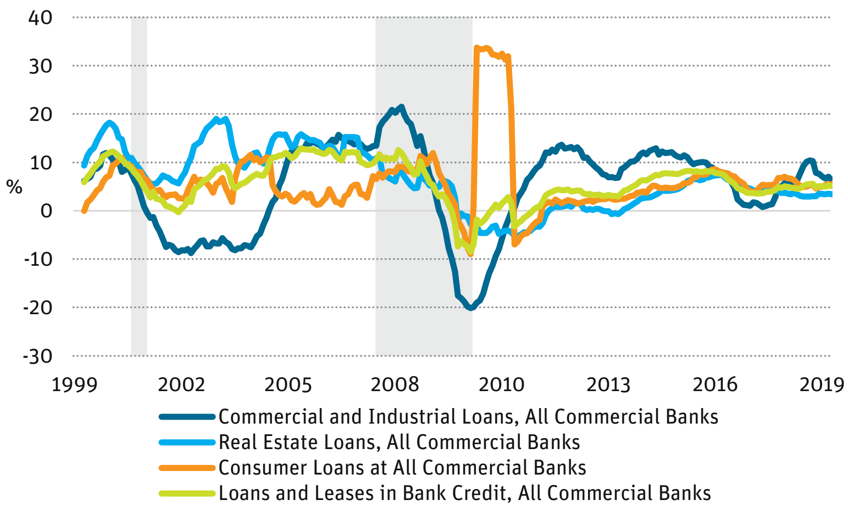
Source: FRED as of 7/31/19. Shaded gray bars represent periods of recession.

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



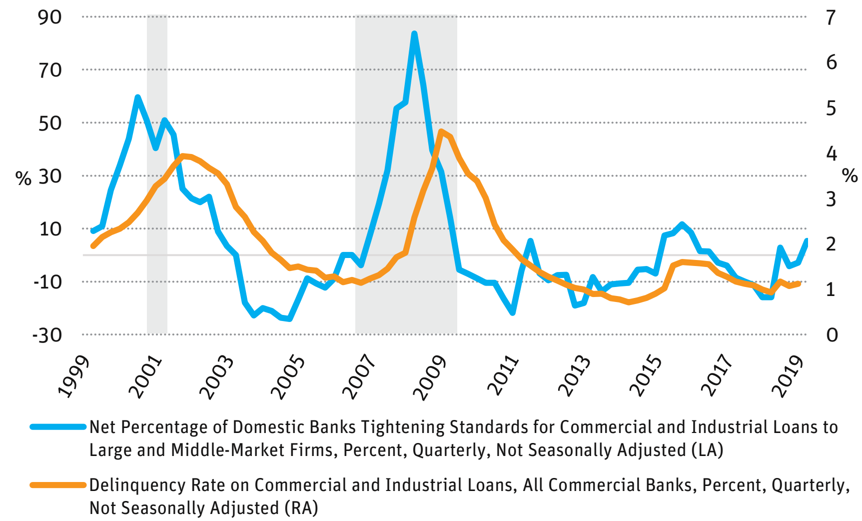
Source: Bloomberg as of 11/30/19. Shaded gray bars represent periods of recession.

BANK LOAN GROWTH



Source: FRED as of 10/31/19. Shaded gray bars represent periods of recession.

BANKS TIGHTENING STANDARDS C&I AND DELINQUENCY C&I



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

Portfolio Performance

Summary

- The Angel Oak High Yield Opportunities Fund returned 2.96% in the quarter ending December 31, 2019, slightly outperforming the Bloomberg Barclays U.S. Corporate High Yield Index return of 2.61%. For the full year 2019, the Angel Oak High Yield Opportunities Fund returned 14.00%, slightly lagging the Bloomberg Barclays U.S. Corporate High Yield Index return of 14.32%.
- After initially widening 19 basis points in October on the back of trade war escalation, high-yield credit spreads narrowed sharply in November and December, with credit spreads 37 basis points tighter for the quarter. Credit spreads touched a low of 317 basis points during the quarter, not quite matching the post-crisis tight of 303 basis points from early October 2018, before finishing the year at 336 basis points.
- With the Federal Reserve on hold and expectations that the phase-one, partial trade agreement will lead to a pickup in economic activity, investors gravitated down the risk spectrum as the quarter progressed. The CCC-rated segment of the market, which represents more speculative issuers, tightened by an aggressive 110 basis points in December, after widening 79 basis points in October and 10 basis points in November, to finish the quarter 21 basis points tighter. The BB-rated category tightened 33 basis points, slightly less than the overall high-yield market. The single B-rated category tightened by 46 basis points and was the only category to tighten more than the market.
- The combination of progress on the phase-one, partial trade agreement and OPEC announcing it would cut production by an additional 500K barrels per day, contributed to a rally in crude oil prices which were up 12.93% in the quarter, and the performance of the Energy subsector. After being down as much as 3% prior to the OPEC meeting, the Energy subsector rallied 5.33% in December.
- The collateralized loan obligation (CLO) allocation slightly underperformed in the quarter, returning 2.17% compared with the Bloomberg Barclays U.S. Corporate High Yield Index return of 2.61%. Its positive performance in a declining interest rate environment reflects its higher yield and specific characteristics resulting in consistent, lower-volatility contribution to performance.

Net Total Returns as of 12/31/19	3 Mo.	YTD	1 Yr.	3 Yr.	5 Yr.	10 Yr.	SI[1]
Class I	2.96%	14.00%	14.00%	6.24%	6.63%	7.34%	9.05%
Class A at NAV	2.89%	13.67%	13.67%	5.99%	6.35%	7.08%	8.79%
Class A at MOP[2]	0.56%	11.15%	11.15%	5.19%	5.86%	6.84%	8.56%
BBgBarc U.S. Corporate High Yield TR USD	2.61%	14.32%	14.32%	6.37%	6.13%	7.57%	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 12/31/19

	Class A	Class I
Gross Expense Ratio	1.25%	1.00%
Net Expense Ratio^	0.90%	0.65%
SEC Yield (Subsidized)	4.29%	4.64%
SEC Yield (Unsubsidized)	4.09%	4.43%

FUND CHARACTERISTICS

Fund Assets (All Classes)	$73.0 mm
Number of Securities	152
Distribution	Monthly
Effective Duration	3.2
Average Coupon (%)	6.36
Average Yield-to-Worst (%)	5.01

FUND STATISTICS

(Since Inception)	Fund[3]	Index
Standard Deviation	5.6	7.3
Sharpe Ratio	1.5	1.5
Correlation to Index	0.9	1.0
Positive Months (%)	72.9	73.6
Negative Months (%)	27.1	26.4

[3]ANHIX

Sector Attribution

	% of Market Value	Q4 2019[1] Total Return (%)	Q4 2019[1] Attribution (%)	YTD 2019[1] Total Return (%)	YTD 2019[1] Attribution (%)
Corporates	89.7	3.32	2.96	15.69	13.67
CLOs	6.1	2.17	0.11	12.00	0.89
Equities & ETFs	2.8	1.53	0.04	-22.17	0.02
Cash	1.4	0.39	0.01	2.05	0.11
Fund Expenses[2]	-	-	-0.17	-	-0.68
Total	100.0	2.97	2.96	14.02	14.00

[1]Net and unaudited. Attribution is calculated using an internal model, thus, returns may vary from the Fund's total return. [2]Fund expenses include certain investment expenses, such as interest expense from borrowings and repurchase agreements, incurred directly by the Fund or indirectly through the Fund's investments in underlying Angel Oak Funds (if applicable), none of which are paid to Angel Oak.

Corporates:

- For the fourth quarter, the high-yield corporate bond allocation returned 3.32% and contributed 296 basis points to the total return of the F und. The high-yield corporate bond allocation outperformed the Bloomberg Barclays U.S. Corporate High Yield Index return of 2.61% by 71 basis points. For the full year, the high-yield corporate bond allocation returned 15.69%, outperforming the Bloomberg Barclays U.S. Corporate High Yield Index return of 14.32% by 137 basis points.
- Communications was the most significant positive contributor to performance in the quarter, returning 2.66% compared with the benchmark, which returned 1.74%. The outperformance was evenly split between allocation and selection. Given the risk-on environment, the communications sector, although generating a positive return, lagged the rest of the sectors, and when combined with our underweight position, contributed to the positive allocation effect. The positive selection effect was primarily driven by a holding in a Midwest telecommunications company that announced it was being acquired. Energy was also a significant positive contributor to performance, returning 4.29% compared with the benchmark, which returned 2.76%. The performance was entirely due to selection and driven by positions in an international shallow-water jackup rig operator that is benefiting from increased demand, resulting in higher utilization and day rates as well as a position in a Northeast-based natural gas liquids pipeline company with bonds that rallied in conjunction with higher commodity prices.
- Basic industry was the largest detractor from performance in the quarter, returning 1.88% compared with the benchmark, which returned 3.25%. The negative attribution was entirely due to selection and attributable to a holding in a chemical company that experienced an unplanned outage at one of its facilities and lower prices on methanol sales, which contributed to weaker-than-expected operating results.

CLOs:

- The Fund remained focused on maintaining its exposure to defensive, seasoned BB-rated profiles, that have already exited, or are less than a year and a quarter away from exiting the reinvestment period. The relatively higher credit enhancement and coupon for this type of bond should outperform its longer-duration peer in a negative credit environment.

Sector Exposure

	Weighted Avg. Price	% of Market Value		% Change	Option Adjusted Spread		Bps Change	Yield-to-Worst		Bps Change
		9/30/19	12/31/19		9/30/19	12/31/19		9/30/19	12/31/19	
Corporates	103.86	87.6	89.7	2.1	399	322	-77	5.78	5.01	-77
CLOs	98.06	6.3	6.1	-0.2	782	676	-106	9.74	8.51	-123
Equities	14.50	0.1	0.1	0.0	N/A	N/A	N/A	N/A	N/A	N/A
ETFs	98.74	0.0	2.7	2.7	N/A	N/A	N/A	N/A	N/A	N/A
Cash	100.00	6.0	1.4	-4.6	N/A	N/A	N/A	N/A	N/A	N/A
Total			100.0		399	330	-69	5.67	5.01	-66

Corporates:

- With a phase-one, partial trade agreement expected to be signed, combined with the Federal Reserve expressing that it is on hold regarding interest rate increases while also resuming balance sheet expansion, the base-case outlook is for economic growth and returns to be modestly positive for 2020, while inflation remains modest.
- Historically, modest but positive economic growth has been good for corporate credit. The lack of rapid growth reduces the opportunity for corporations to lever up, forcing them to maintain a semblance of financial discipline, leading to gradually improving credit metrics supporting improved valuations. High-yield credit spreads finished the year at 336 basis points, slightly wide of their post-crisis tight of 303 basis points at the beginning of October 2018 but significantly wider than the pre-crisis tight of 233 basis points in May 2007. Assuming modest economic growth and a slight steepening of the yield curve, high-yield corporate credit returns should reflect current yields in the middle-single digits.
- Despite the factors supporting positive economic growth and high-yield credit returns in 2020, the robust valuations of risk assets, whether they be credit or equity, heighten the sensitivity to disappointments. Areas we are focused on include the further deterioration in recent manufacturing surveys as well as the recent weakness in industrial production. In spite of the announced phase-one, partial trade agreement, the most recent ISM Manufacturing PMI survey fell further, to the lowest level since mid-2009, and the latest industrial production report measured on a year-over-year basis was negative, which historically is highly correlated with a recession. The weakness could reflect dissatisfaction with the magnitude of the tariff reductions in the phase-one, partial trade agreement, but are worth watching, especially if corporate earnings begin to come in lower than forecast.
- Given the combination of tight valuations and potential downside risk in the event of disappointing results, the emphasis is on the trade-off between risk/reward and on credit selection. With asymmetric risk increasing, we are focusing on avoiding issuers with event risk or dependent on things outside their control to maintain or improve their credit profiles aside from the level of general economic activity. 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.

CLOs:

- 2019 ended the year on a positive tone with the loan market rallying and perceived tail risk shrinking within CLOs. With the sector lagging broader risk market rallying, cash on the sidelines, and a renewed enthusiasm for the sector, we believe the market is set up to start the year on a bullish tone.

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).
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 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 12/31/19 and are subject to change at any time, are not guaranteed, and should not be considered investment advice.

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