



# Angel Oak UltraShort Income Fund Quarterly Review

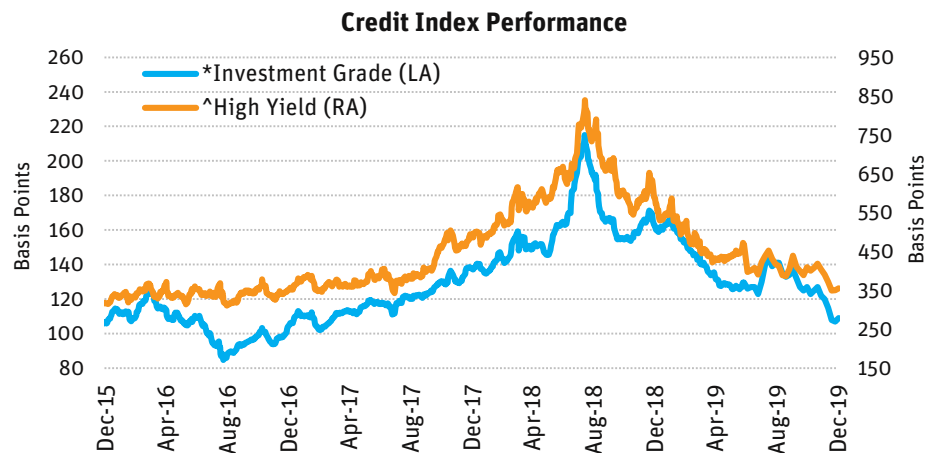
December 31, 2019

# Quarter in Review

- U.S. risk assets performed well in Q4 2019, a continuation of the significant price returns reached so far year-to-date. After a more volatile market environment in the third quarter, positive developments between the U.S. and China increased investor optimism. Expectations of a phase-one, partial trade agreement led to positive risk-asset returns for the final quarter of the year. The S&P 500 increased 9.07% while the Nasdaq Composite Index increased 12.49% in the fourth quarter. Credit spreads were tighter on the quarter while U.S. Treasury yields rose.
- As markets expected, the Federal Open Market Committee (FOMC) cut the Fed funds target rate by 25 points during their October meeting. This was the third rate cut for 2019, reducing the target rate range to 1.50%-1.75%. Short-term interest rates are now firmly in negative real rate territory. This reduction of the “risk-free” curve throughout 2019 fueled risk assets higher. The S&P 500 finished 2019 at all-time highs following one of the best total returns of the post-crisis period. Traditional fixed income benchmarks such as the Bloomberg Barclays U.S. Aggregate Bond Index (known as “the Agg”) had an exceptional year, primarily due to the significant amount of interest rate sensitivity in the composite. For 2019, the S&P 500 returned 31.49% while the Nasdaq Composite Index returned 36.74%. High yield and investment grade corporates returned 14.32% and 14.54%, respectively.
- Structured credit returns were positive in the fourth quarter. In particular, lower-rated tranches outperformed, benefiting from improved investor sentiment. Legacy non-agency residential mortgage-backed securities (RMBS) posted positive returns of approximately 1.5%, with positive excess returns of approximately 1.0%. Collateralized loan obligations (CLOs) generated positive excess return of 0.5% for AAA/AA tranches while lower-rated BBB and BB tranches posted positive excess return of 1.4% and 3.8%, respectively. Commercial mortgage-backed securities (CMBS) posted a positive excess return of 0.1% for AA- through BBB-rated tranches. The asset-backed securities (ABS) sector excess returns were flat on the quarter. For the year, credit risk transfer (CRT) B1 and CLO BB tranches generated the highest positive excess returns of 14.8% and 10.9%, respectively.
- On the housing front, the S&P 500 CoreLogic 20 City Home Price Index rose 2.3% through October. Existing home sales decreased 1.7%, to a 5.35M annualized pace, missing the market’s expectation of 5.44M in December. From a broader economic perspective, the U.S. consumer sector remains healthy, yet data within manufacturing activity is less rosy. For example, the ISM Manufacturing Index dropped to 47.2 in the final month of 2019. December’s reading was the fifth consecutive month of sub-50 results. Survey participants cited cautious optimism while only three industries reported growth, matching the worst performance since early 2009. The U.S. labor market continues to remain healthy despite weak manufacturing data. Nonfarm payrolls increased 145K in December, slightly below the market’s expectation of +160K. Unemployment remains at a 50-year low of 3.5%, and the labor force participation rate remained steady at its 63.2% from the previous quarter.

Benchmark Performance	12/31/19	9/30/19	Quarterly Change (bps)
1-Month LIBOR	1.78	2.02	-24
3-Month LIBOR	1.91	2.09	-18
2-Year Treasury	1.57	1.62	-5
5-Year Treasury	1.69	1.54	+15
10-Year Treasury	1.92	1.66	+26
30-Year Treasury	2.39	2.11	+28
2s/10s Curve	0.35	0.04	+31
2s/30s Curve	0.82	0.49	+33
S&P 500 Total Return Index	6,554	6,009	+907
IG Corporate OAS*	93	115	-22
HY Corporate OAS^	336	373	-37

Sources: Bloomberg and Yieldbook as of 12/31/19.



Source: Bloomberg as of 12/31/19.

\*Bloomberg Barclays U.S. Corporate Total Return Value Unhedged

^Bloomberg Barclays U.S. Corporate High Yield Total Return Index Value Unhedged



# Portfolio Performance

## Summary

The Fund was up 0.65% in the fourth quarter, outperforming the benchmark by 0.06%, which was up 0.59%. The Fund finished up 4.06% total return for 2019, outperforming the benchmark by 1.18% as the Bloomberg Barclays U.S. Treasury Bill 9–12 Month TR Index was up 2.88% over the same period.

### Primary contributors were:

- Positive total returns in RMBS, ABS, CMBS, and CLOs
- Overweight to RMBS and ABS relative to CMBS and CLOs, given outperformance of RMBS/ABS during the year
- Positive income returns north of the benchmark

### Primary detractors were:

- Duration short of the benchmark and interest rate hedge positioning
- Overweight to floating rate bonds

Net Total Returns as of 12/31/19	3 Mo.	YTD	1 Yr.	Annualized
				SI <sup>1</sup>
Class I	0.65%	4.06%	4.06%	3.62%
Class A	0.69%	3.82%	3.82%	3.38%
Bloomberg Barclays U.S. Treasury Bill 9-12 Month TR Index	0.59%	2.88%	2.88%	2.56%

*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](http://www.angeloakcapital.com). <sup>1</sup>The inception date of the Angel Oak UltraShort Income Fund I Class (AOUIX) was 4/2/18, while the inception date of the A Class (AOUAX) was 4/30/18. <sup>^</sup>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	0.95%	0.78%
Net Expense Ratio <sup>^</sup>	0.50%	0.25%
SEC Yield (Subsidized)	2.43%	2.74%
SEC Yield (Unsubsidized)	2.12%	2.42%

## FUND CHARACTERISTICS

Fund Assets (All Classes)	\$385.4 mm
Number of Securities	203
Distribution	Monthly
Effective Duration	0.7
Average Price (Portfolio)	\$100.7

## FUND STATISTICS

(Since Inception)	Fund <sup>2</sup>	Index
Standard Deviation	0.7	0.3
Sharpe Ratio	3.0	1.9
Correlation to Index	0.3	1.0
Positive Months (%)	100.0	100.0
Negative Months (%)	0.0	0.0

<sup>2</sup>AOUIX



# Sector Attribution

		Q4 2019 <sup>1</sup>	YTD 2019 <sup>1</sup>
	% of Market Value	Attribution (%)	Attribution (%)
ABS	44.5	0.35	1.80
RMBS	31.5	0.24	1.84
CMBS	3.4	0.03	0.12
CLOs	6.9	0.04	0.31
Cash	8.5	0.02	0.14
Corporates	0.7	0.00	0.04
Credit Hedges	-	0.00	0.00
Agency/Government & Muni.	4.6	0.03	0.09
Fund Expenses <sup>2</sup>	-0.03	-0.06	-0.27
<b>Total</b>	<b>100.0</b>	<b>0.65</b>	<b>4.07</b>

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.

<sup>1</sup>Estimated returns, net of hedges, and unaudited. Attribution is calculated using an internal model, thus, returns may vary from the Fund's total return. <sup>2</sup>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.

## RMBS

- The NA RMBS allocation produced a total return of 72 basis points in the fourth quarter, contributing 24 basis points to Fund performance and bringing the 2019 total return to 516 basis points, contributing 184 basis points to the Fund. Hybrid bonds led outperformance in the Fund, driven by a combination of price appreciation and current income, as the rate rally helped drive bond prices higher. NPL, CRT, and investor loan-backed bonds also performed well in Q4. The Fund continues to favor investment grade-rated Non-QM and prime jumbo front pays. The Fund has also looked to buy 2019 vintage CRT M2s given the fast prepayment speed of these high GWAC profiles building rapid credit enhancement while paying down quickly.

## ABS

- The ABS allocation produced a total return of 79 basis points in the fourth quarter, contributing 35 basis points to the Fund, bringing the 2019 total return to 594 basis points, contributing 180 basis points to the Fund. Generic spreads were modestly tighter by approximately 3 to 5 basis points across the capital stack for both prime and subprime auto ABS. Credit card ABS tightened by approximately 5 to 10 basis points during the quarter. The average duration and weighted average life (WAL) of the ABS allocation decreased quarter-over-quarter. Purchases during the quarter focused on shorter-duration profiles among a diversified mix of consumer, credit card, and auto ABS. Issuance volume for 2019 was \$241 billion; auto and credit card ABS made up the majority of issuance, with approximately 62% of new-issue supply.

## CMBS

- CMBS returned 72 basis points in the fourth quarter, contributing 3 basis points to Fund performance net of hedges. For the full year, CMBS returned 377 basis points to Fund performance, contributing 12 basis points net of hedges. Within CMBS, the portfolio is predominately composed of floating-rate agency CMBS bonds backed by multifamily properties and single asset/single borrower (SASB) tranches. The Fund continues to look for short-duration floating SASB and agency CMBS bonds.

## CLOs

- CLOs had a total return of 72 basis points in the fourth quarter, contributing 4 basis points to the Fund, bringing 2019 total return to 358 basis points, contributing 31 basis points to the Fund. The allocation to CLOs is focused on seasoned AAA-rated tranches with <3 (WAL) (to worst) and short-duration X tranches in the new-issue market. The Fund continues to target wide, short X notes, along with seasoned front-pay bonds that have passed the end of the reinvestment period.



# Definitions

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**GWAC:** Government-wide acquisition contract.

**NPL:** Non-performing loans.

**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 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.

**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.

**Weighted Average Life (WAL):** Average length of time that each dollar of unpaid principal on a loan, a mortgage or an amortizing bond remains outstanding.



# Disclosures

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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.

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](http://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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