A Changing Landscape Within Cash and Enhanced Cash Strategies

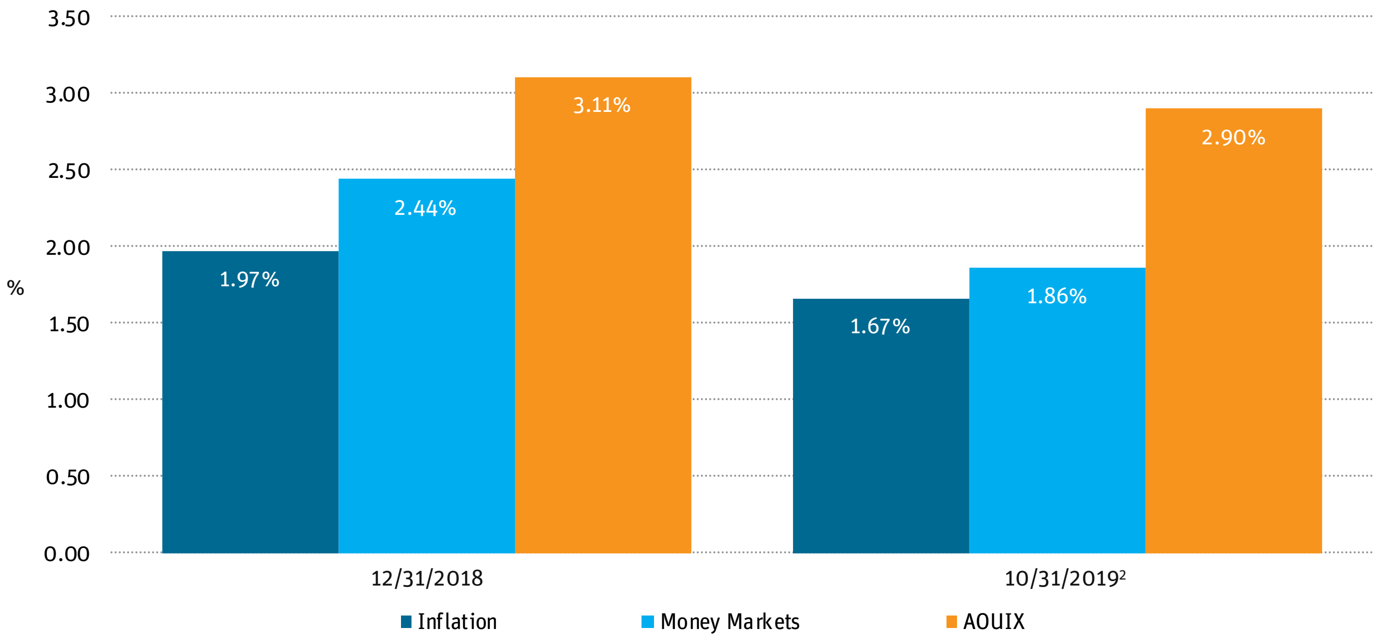
Q4 2019

Short duration investing is a dynamic space. In today's market environment, we favor allocations to structured credit to potentially benefit portfolio income while limiting expected price volatility. We believe credit selection is critical at this point in the economic cycle. Strategies with a more defensive posture should benefit risk-adjusted returns over the long-term. Our key reasons are as follows:

- Given the recent rate cuts from the Federal Open Market Committee (FOMC), we believe investors should look outside traditional money market funds to find yields higher than inflation.
- Within the short duration landscape, we believe structured credit is more attractive on a risk-adjusted basis versus corporate credit.
- For short duration allocations, we maintain an overweight to structured credit relative to corporate credit in an effort to limit potential price volatility.

Investors should note recent developments in both interest rates and U.S. credit fundamentals while evaluating their fixed income portfolios at year-end. The expected path of interest rates reversed course sharply in early 2019, leading the FOMC to cut their target rate three times. Consequently, these actions drove down yields on traditional money markets and ultrashort strategies. Given this backdrop, clients should revisit their short duration allocations as finding income within cash and enhanced cash strategies has become more difficult over the past twelve months. Current yields in many strategies may not maintain purchasing power, as inflation rates[1] are very similar to money market yields. However, there are still opportunities to find attractive yields higher than inflation within enhanced cash strategies (Figure 1).

FIGURE 1: YIELD VS. INFLATION



Sources: Bloomberg, Bureau of Economic Analysis, U.S. Board of Governors of the Federal Reserve System (FRB).
[1]Consumer Price Index.
[2]CPI YoY as of 9/30/19. U.S. Money Market yield and AOUIX SEC yield as of 10/31/19.

OPPORTUNITIES IN SHORT DURATION STRUCTURED CREDIT

Short duration structured products can potentially improve portfolio income while limiting price volatility (Figure 3). ABS and RMBS, in particular, exhibit favorable characteristics for short duration investing. Price stability tends to increase as structured credit bonds approach maturity. This positive dynamic is driven by two key factors:

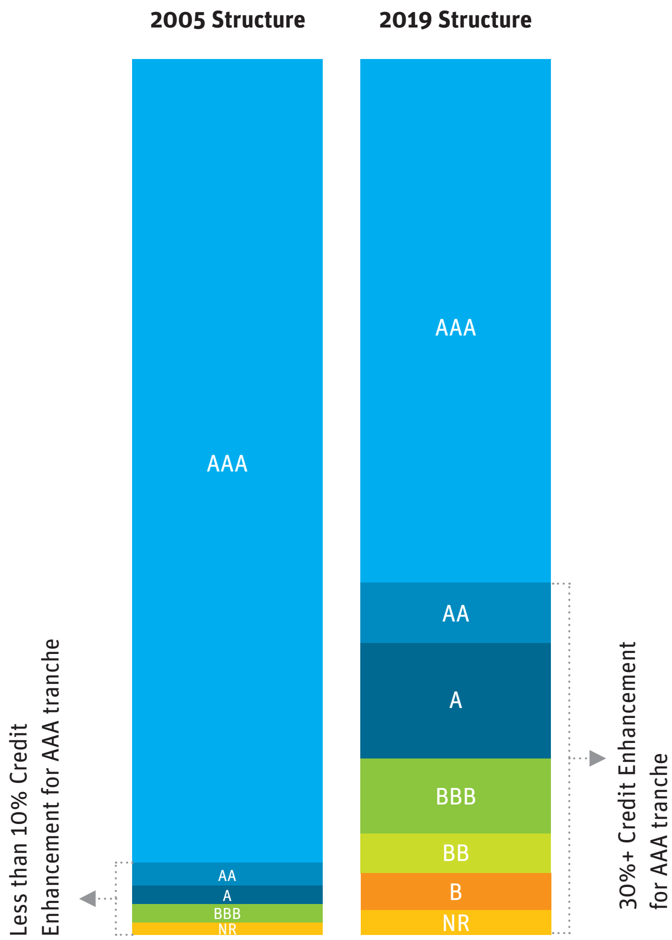
1. Shorter maturity bonds tend to have lower market risk given lower credit and interest rate risk (lower duration).
2. Credit protection increases as the underlying collateral amortizes and pays off.

Amortization increases credit support for senior and mezzanine bonds each month, improving credit quality over time. Individual tranches tend to be upgraded as credit enhancement increases and the probability of default decreases, increasing the potential for positive total returns as market risk premiums tighten. Finally, structured credit products are rarely available in ETFs and other passive strategies, making these assets more difficult to access for retail investors and less correlated with ETF fund flows.

IMPROVEMENT TO OVERALL INTEGRITY OF SECURITIZED MARKETS

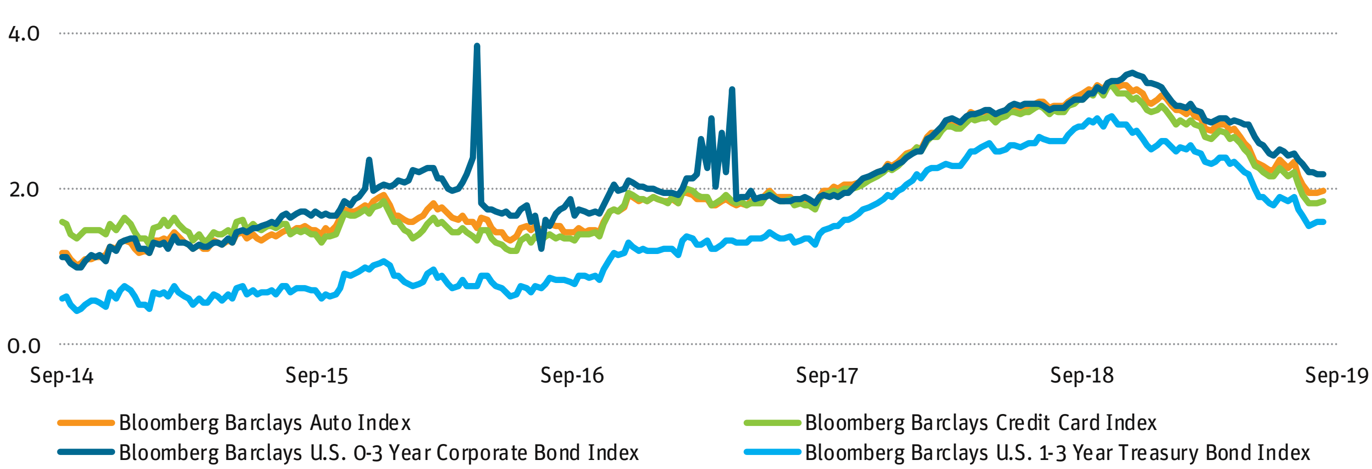
There have been significant changes in the underlying market dynamics with respect to the structured products marketplace in the post-crisis era. First, bond investors demand increased transparency into underlying collateral fundamentals and the simplification of securitized structures. Second, rating agencies have tended to be more cautious and conservative in their modeling assumptions given the effects of the financial crisis; in our view, rating agencies are too onerous especially in their loss assumptions for mortgage and consumer credit. Third, Dodd-Frank increased the regulatory requirements with respect to U.S. structured credit. The most significant requirement was risk retention; effectively aligning the incentives between issuers and bond investors. In our view, the result of risk retention shifted incentives from an "originate to sell" to an "originate to retain" model. Sponsors of new issue deals within ABS, CMBS, and RMBS must retain some "skin in the game," improving the overall integrity of the securitized marketplace. Finally, credit enhancement increased within many areas of structured credit compared to pre-crisis levels (Figure 2).

FIGURE 2: CAPITAL STRUCTURE COMPARISON BETWEEN LEGACY NON-AGENCY RMBS & NON-QM



As of 10/31/19.

FIGURE 3: ABS SECTORS EXHIBIT LESS VOLATILITY THAN CORPORATES



Source: Bloomberg as of 9/30/19.

CLAYTON TRIICK, CFA®
Senior Portfolio Manager

Clayton is a Senior Portfolio Manager at Angel Oak Capital and serves as a Portfolio Manager for the UltraShort Income Fund, the Multi-Strategy Income Fund and the Multi-Strategy Income UCITS Fund. He is a Portfolio Manager within the non-agency and agency residential mortgage-backed securities markets and focuses on cross asset fund allocation and interest rate risk management of Angel Oak's funds and institutional separately managed accounts.

SAM DUNLAP
Senior Portfolio Manager

Sam is a Managing Director and Senior Portfolio Manager at Angel Oak Capital and serves as a Portfolio Manager for the Angel Oak Multi-Strategy Income Fund and the Angel Oak Multi-Strategy Income UCITS Fund. He is also responsible for managing the separately managed accounts for Angel Oak clients, primarily depository institutions, and focuses on building and managing strategies within the residential mortgage-backed securities market as well as managing the interest rate risk exposure across the Angel Oak Funds and managed accounts.

COLIN MCBURNETTE
Senior Portfolio Manager

Colin is a Senior Portfolio Manager at Angel Oak Capital and serves as a Portfolio Manager for the Multi-Strategy Income Fund, the UltraShort Income Fund, the Strategic Credit Fund, and the Strategic Mortgage Income Fund. He also focuses on security and portfolio analytics and is responsible for building and managing strategies within the residential mortgage-backed securities market.

Performance (as of 9/30/19)	3 Months	YTD	1 Year	Since Inception[3]
AOUIX	1.07%	3.39%	4.15%	3.79%

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.
[3]The inception date of the Angel Oak UltraShort Income Fund I Class (AOUIX) was 4/2/18. The gross expense ratio of AOUIX is 0.78%.

ABS: Asset-backed security.
CMBS: Commercial mortgage-backed security.
RMBS: Residential mortgage-backed security.
Bloomberg Barclays Auto Index: Comprised of primarily investment grade tranches of U.S. Dollar-denominated, auto ABS securities. ABS securities must have a remaining average life of at least one year.
Bloomberg Barclays Credit Card Index: Comprised of primarily investment grade tranches of U.S. Dollar-denominated, credit card ABS securities, both bank and retail credit card master trusts. ABS securities must have a remaining average life of at least one year.
Bloomberg Barclays U.S. 0-3 Year Corporate Bond Index: Contains fixed-rate, investment-grade U.S. Dollar-denominated bonds from industrial, utility and financial issuers only.
Bloomberg Barclays U.S. 1-3 Year Treasury Bond Index: Measures the performance of the U.S. government bond market and includes public obligations of the U.S. Treasury with a maturity between 1 and up to (but not including) 3 years.
Consumer Price Index (CPI): An index that measures the changes in the price of a certain collection of goods and services bought by consumers in an effort to measure inflation.
Duration: Measures a portfolio's sensitivity to changes in interest rates. Generally, the longer the duration, the greater the price change relative to interest rate movements.
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.

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.

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.

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