ANFIX | ANFLX | AFLCX

# Angel Oak Financials Income Fund Quarterly Review

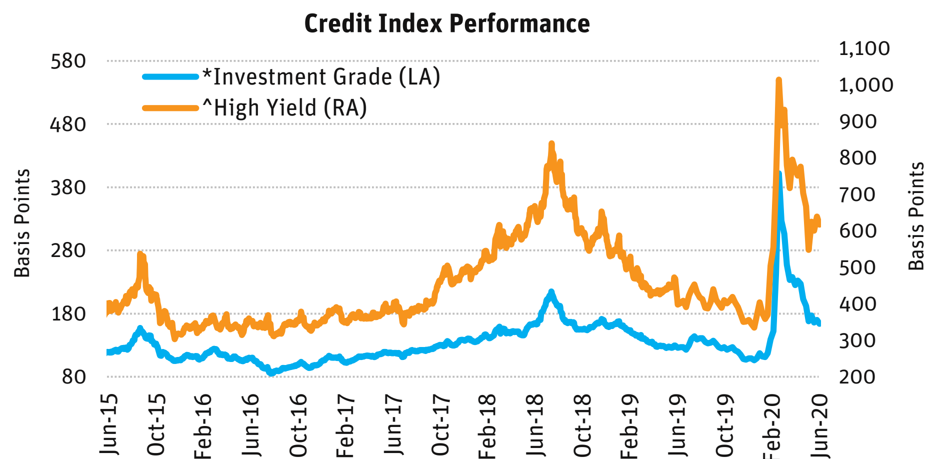
June 30, 2020

# Quarter in Review

- U.S. risk assets bounced back in the second quarter on positive news of declining cases of COVID-19 and the reopening of the U.S. economy. The S&P 500 was up 20.5%, and corporate spreads tightened, with investment grade and high yield spreads tightening 122 and 254 basis points, respectively.
- Structured credit returns were positive in the second quarter, as investor demand outweighed supply. Legacy non-agency residential mortgage-backed securities (RMBS) posted positive returns of approximately 10.1%, with positive excess returns of approximately 9.9%. Non-QM generated positive returns of 4.1%, with positive excess return of 3.6%. Collateralized loan obligations (CLOs) as a cohort produced excess return of 7.1%. Commercial mortgage-backed securities (CMBS) posted a positive excess return of 3.5%. The asset-backed securities (ABS) sector returned 4.2% on the quarter, with positive excess return of 3.6%.
- The Federal Open Market Committee (FOMC) maintained its target range of 0.00% to 0.25% in the second quarter after slashing rates twice in the first quarter. The FOMC noted it "is committed to using its full range of tools to support the U.S. economy in this challenging time, thereby promoting its maximum employment and price stability goals." The committee also expressed its commitment to continue to provide policy accommodation by announcing that it "will increase its holding of Treasury securities and agency residential and commercial mortgage-backed securities at least at the current pace." The highly anticipated Term Asset-Backed Securities Loan Facility (TALF) went into effect in June. Market participants view the TALF 2.0 program as more of a backstop to AAA-rated structured credit spreads, as most sectors trade inside financing costs by the end of Q2.
- Economic data on the quarter was better than expected. While the unemployment rate increased during the quarter to 11.1% from 4.4%, many participants estimated the figure to be close to 20% due to policymakers' decision to shut down the U.S. economy. More recently, the unemployment rate has seen two months of decline as many states begin their reopening process, after reaching an all-time high of 14.7% in April 2020. Both headline Institute for Supply Management (ISM) figures surprised to the upside in June. The ISM Manufacturing Index increased to 52.6 in June from the recent low of 41.5 in April, while the ISM Non-Manufacturing increased to 57.1 in June from 41.8, the recent low in April. Both indices came in above the key level of 50, indicating an expansionary move for both manufacturing and service sectors for the U.S. economy.

| Benchmark Performance | 6/30/20 | 3/31/20 | Quarterly Change (bps) |
|---|---|---|---|
| 1-Month LIBOR | 0.17 | 0.98 | -81 |
| 3-Month LIBOR | 0.30 | 1.43 | -113 |
| 2-Year Treasury | 0.15 | 0.25 | -10 |
| 5-Year Treasury | 0.29 | 0.38 | -9 |
| 10-Year Treasury | 0.66 | 0.67 | -1 |
| 30-Year Treasury | 1.41 | 1.32 | +9 |
| 2s/10s Curve | 0.51 | 0.42 | +9 |
| 2s/30s Curve | 1.26 | 1.08 | +18 |
| S&P 500 Total Return Index | 6,352 | 5,269 | +2,054 |
| IG Corporate OAS* | 150 | 272 | -122 |
| HY Corporate OAS^ | 626 | 880 | -254 |

Sources: Bloomberg and Yieldbook as of 6/30/20.




Source: Bloomberg as of 6/30/20.
*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 Class I share was down 0.78% during the second quarter, underperforming the benchmark by approximately 2.56% as the Bloomberg Barclays U.S. Aggregate 3-5 Year Index was up 1.78% over the same period. The Fund's underperformance was a function of credit spreads which did not rally in line with the market which exhibited a much stronger recovery over the quarter. The Fund's performance was also hurt by having a shorter-duration profile as rates continued to drop during the quarter.

| | | | | Annualized | | |
|---|---|---|---|---|---|---|
| **Net Total Returns as of 6/30/20** | **3 Mo.** | **YTD** | **1 Yr.** | **3 Yr.** | **5 Yr.** | **SI[1]** |
| Class I | -0.78% | -6.89% | -4.22% | 1.87% | 1.40% | 2.14% |
| Class A at NAV | -0.84% | -7.00% | -4.55% | 1.59% | 1.15% | 1.89% |
| Class A at MOP[2] | -3.04% | -9.10% | -6.72% | 0.81% | 0.68% | 1.48% |
| Bloomberg Barclays U.S. Agg. 3-5 Year Index | 1.78% | 4.64% | 6.54% | 4.09% | 3.22% | 3.11% |
| Bloomberg Barclays U.S. Agg. Bond Index | 2.90% | 6.14% | 8.74% | 5.32% | 4.30% | 3.94% |

*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. [1]The inception date of both the Angel Oak Financials Income Fund A and I Class (ANFLX and ANFIX) was 11/3/14. [2]Maximum Offering Price takes into account the 2.25% maximum initial sales charge. ^The Adviser has contractually agreed to waive fees through 5/31/21.*

## FUND INFORMATION AS OF 6/30/20

| | Class A | Class I |
|---|---|---|
| Gross Expense Ratio | 1.35% | 1.10% |
| Net Expense Ratio^ | 0.94% | 0.69% |
| SEC Yield (Subsidized) | 4.09% | 4.43% |
| SEC Yield (Unsubsidized) | 3.61% | 4.03% |

## FUND CHARACTERISTICS

| | |
|---|---|
| Fund Assets (All Classes) | $148.3 mm |
| Number of Securities | 93 |
| Distribution | Monthly |
| Effective Duration | 3.0 |
| Average Price (Portfolio) | $100.5 |

## FUND STATISTICS

| (Since Inception) | Fund[3] | Index[4] |
|---|---|---|
| Standard Deviation | 4.1 | 2.5 |
| Sharpe Ratio | 0.4 | 1.2 |
| Correlation to Index | 0.2 | 1.0 |
| Positive Months (%) | 77.6 | 64.2 |
| Negative Months (%) | 22.4 | 35.8 |

[3]ANFIX
[4]BBgBarc U.S. Agg 3-5 Yr Idx

# Performance Attribution

| | % of Market Value | Q2 2020[1] Contribution (%) | YTD 2020[1] Contribution (%) |
|---|---|---|---|
| Corporates | 96.9 | -0.81 | -5.45 |
| Equity | 2.3 | 0.23 | -1.09 |
| Cash | 0.8 | 0.00 | 0.02 |
| Fund Expenses[2] | - | -0.20 | -0.37 |
| Total | 100.0 | -0.78 | -6.89 |

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.
[1]Estimated returns, net of hedges, 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.

Market volatility in the financial debt space continued to decline in 2Q20 in the face of unprecedented government stimulus and support related to the COVID-19 pandemic. First-quarter earnings reports for publicly traded banks showed (1) a proactive approach to expected rising credit costs through significant reserve build and (2) that banks are the mechanism to facilitate and distribute government support to businesses and consumers, most notably evidenced by the Paycheck Protection Program (PPP) . Banks remain near all-time bests from capital, liquidity, and asset quality perspectives, putting them on strong footing to weather the pandemic. The strength of the banking system is evident in the fact that the Federal Reserve specifically excluded depository institutions from their corporate debt purchases as well as in the robustness of the primary issuance market.

The primary market saw a large rebound in issuance beginning at the end of April after shuttering from mid-March to mid-April. Over $3.4 billion of primary market issuance came to market in 48 deals between April 24 and June 30, more than the three-year average annual issuance between 2017 and 2019. The first half of 2020 ended with over $4.6 billion of issuance across 57 deals, and we expect full-year issuance could exceed $6 billion. Post-COVID-19 spreads have widened to an average of 528 basis points, from ~300 basis points before COVID-19 and ~370 basis points in 2019, driving a compelling investment opportunity in the current market environment. We expect spreads will normalize and go back down as we move through the post-COVID-19 supply, driving the potential for price appreciation and total return over time.

# Definitions

**Basis Point (bps):** One hundredth of one percent and is used to denote the percentage change in a financial instrument.
**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. Aggregate 3-5 Year Index:** An index that tracks bonds with 3-5 year maturities within the Bloomberg Barclays U.S. Aggregate Bond Index.
**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. Agg. 3-5 Year 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).
**ISM Non-Manufacturing Index:** An index based on surveys of more than 400 non-manufacturing firms' purchasing and supply executives by the Institute of 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.
**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 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.

# 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. The Fund may make short sales of securities, which involves the risk that losses may exceed the original amount invested. The Fund may use leverage, which may exaggerate the effect of any increase or decrease in the value of securities in the Fund's portfolio or the Fund's net asset value, and therefore may increase the volatility of the Fund. Investments in foreign securities involve greater volatility and political, economic, and currency risks and differences in accounting methods. These risks are increased for emerging markets. Investments in fixed-income instruments typically decrease in value when interest rates rise. The Fund will incur higher and duplicative costs when it invests in mutual funds, ETFs, and other investment companies. There is also the risk that the Fund may suffer losses due to the investment practices of the underlying funds. 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 6/30/20 and are subject to change at any time, are not guaranteed, and should not be considered investment advice.

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