Angel Oak High Yield Opportunities Fund Quarterly Review

June 30, 2020

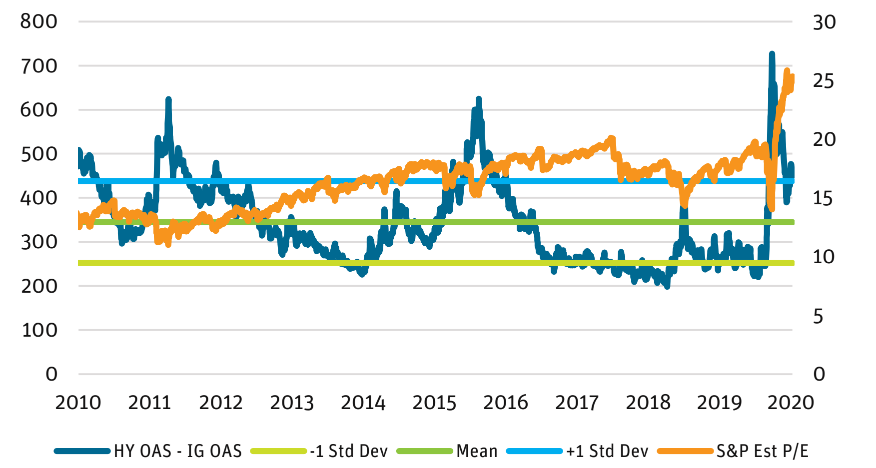
Angel Oak
CAPITAL ADVISORS

Quarter in Review

- High yield valuations and performance rebounded sharply in the second quarter, reflecting the optimism surrounding a reopening of the economy combined with massive monetary and fiscal support.
- Although success containing the spread of the coronavirus varies by state, progress for the nation as a whole is moving in a positive direction. Despite the recent rise in the absolute number of new cases, positivity, hospitalizations, and fatality rate have all declined significantly. In states where the number of virus cases has recently accelerated, slowing the pace of their economic reopening and implementing steps to contain the spread of the virus, the outlook should continue to improve, underpinning expectations of a continued rebound in economic activity.
- The support from the Federal Reserve has been unprecedented. In addition to cutting the Federal Funds rate to zero and expanding its balance sheet by $2.8T to $7.1T in less than three months, more importantly for corporate credit, the Fed launched the Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility, enabling it to purchase up to $500B and $250B respectively.
- The speed and magnitude of the fiscal response has been unprecedented as well, with the passage of more than $2.6T in federal relief, which has gone to support taxpayers, small businesses, hospitals, and airlines, and to mitigate a rise in unemployment. However, with the economy expected to take years to reach pre-pandemic levels, Congressional Budget Office estimates for unemployment declining to only 10.5% by year-end, and Center of Budget and Policy Priorities estimates of state budget shortfalls totaling more than $615B over the next three fiscal years, additional support will be needed to prevent another leg down.
- Investors have recognized the potential impact of the monetary and fiscal response with inflows to high-yield funds totaling approximately $46B since the beginning of April, contributing to a 70% retracement of high-yield spread widening from February 21 through March 23, and a reopening of the capital markets in which June set a new record for high-yield bond issuance of more than $58B.

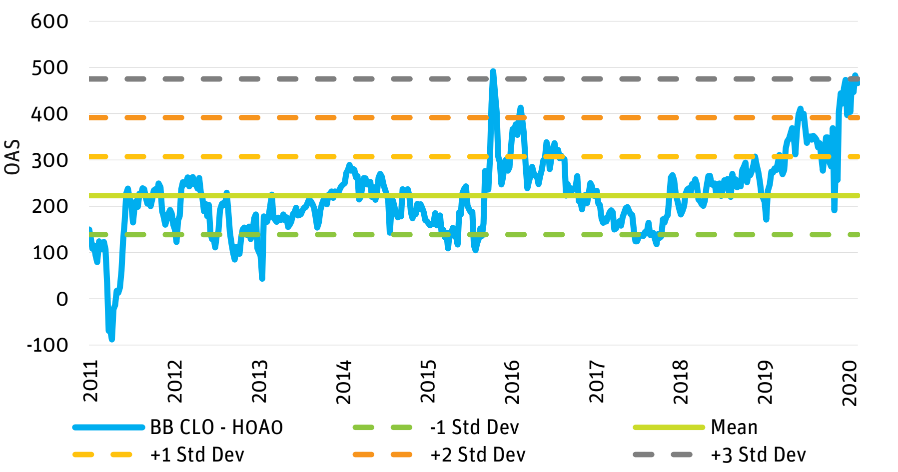
Benchmark Performance	3/31/20	6/30/20	Quarterly Change (bps)
2-Year Treasury	0.25	0.15	-10
5-Year Treasury	0.38	0.29	-9
10-Year Treasury	0.67	0.66	-1
UST 3M/10Y Spread	55	51	-4
Oil	20.48	39.27	+9,175
Iron Ore	88.02	102.95	+1,696
VIX	53.54	30.43	-4,316
S&P 500 Total Return Index	5,269	6,352	+2,054
Bloomberg Barc U.S. Corp IG Index OAS	272	150	-122
Bloomberg Barc U.S. Corp HY Index OAS	880	626	-254

High Yield Attractive vs. Investment Grade and Equities



Source: Bloomberg Barclays U.S. High Yield Index, S&P 500 est. P/E from Bloomberg as of 6/30/20.

CLO Credit Spread Differential History (CLO BB vs HY)



Source: Bank of America Merrill Lynch as of 6/30/20.

Portfolio Performance

Summary

- The Angel Oak High Yield Opportunities Fund returned 11.57% in the quarter ending June 30, 2020, outperforming the Bloomberg Barclays U.S. Corporate High Yield Index return of 10.18%.
- The sharp reversal from the first quarter reflects the financial markets' response to the massive monetary and fiscal support injected into the market compounded by progress on reopening the economy following progress containing the spread of the virus. After deteriorating to their worst reading since the financial crisis, financial conditions are back to levels that prevailed most of 2019. Similarly, after dipping to lows not seen since the financial crisis, the Citi Economic Surprise Index has jumped to all-time highs, reflecting the greater-than-expected rebound in economic activity as states reopen.
- With the economy already in recession, we maintained exposure to viable issuers in industries that had the greatest sensitivity to a rebound in economic activity following the monetary and fiscal fuel that was being injected into the economy, such as basic materials, capital goods, and consumer cyclicals. We also took advantage of opportunities in sectors and issuers that previously traded rich, but where now secured bonds with appropriate covenant packages at historically attractive levels are available.
- The spread on the Bloomberg Barclays U.S. Corporate High Yield Index tightened 254 basis points to 626 basis points, which despite the extensive spread tightening, remains 70 basis points wide of its long-term average and more than 300 basis points wide of its year-to-date tights. The BB category outperformed with a total return of 11.54%, with spread tightening of 198 basis points reflecting its longer duration. The B and CCC categories lagged from a total return perspective, returning 8.64% and 9.1%, respectively, despite spread tightening of 213 and 495 basis points, respectively.

				Annualized			
Net Total Returns as of 6/30/20	**3 Mo.**	**YTD**	**1 Yr.**	**3 Yr.**	**5 Yr.**	**10 Yr.**	**SI[1]**
Class I	11.57%	-5.32%	-1.51%	2.86%	4.75%	6.40%	8.11%
Class A at NAV	11.55%	-5.41%	-1.74%	2.60%	4.48%	6.15%	7.85%
Class A at MOP[2]	9.02%	-7.52%	-3.95%	1.84%	4.00%	5.90%	7.63%
BBgBarc U.S. Corporate High Yield TR USD	10.18%	-3.80%	0.03%	3.33%	4.79%	6.68%	10.19%

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 net expense ratios are reported as of the 1/31/20 Annual Report and are referenced in the 5/31/20 prospectus. 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	1.15%	0.90%
Net Expense Ratio^	0.90%	0.65%
SEC Yield (Subsidized)	5.82%	6.21%
SEC Yield (Unsubsidized)	5.59%	5.97%

FUND CHARACTERISTICS

Fund Assets (All Classes)	$68.9 mm
Number of Securities	169
Distribution	Monthly
Effective Duration	3.6
Average Coupon	6.35%
Average Yield-to-Worst (%)	7.17

FUND STATISTICS

(Since Inception)	Fund[3]	Index
Standard Deviation	7.2	8.2
Sharpe Ratio	1.1	1.2
Correlation to Index	0.9	1.0
Positive Months (%)	71.9	73.3
Negative Months (%)	28.1	26.7

[3]ANHIX

Performance Contribution

	% of Market Value*	Q2 2020** Contribution (bps)	YTD 2020** Contribution (bps)
Corporates	93.8	1,074	-164
CLOs	3.7	97	-181
Equities & ETFs	0.1	0	-147
Cash	2.4	0	1
Fund Expenses	-	-14	-40
Total	100.0	1,157	-532

*% of Market Value shown represents end of period market value. **Net and unaudited. Contribution is calculated using an internal model, thus, returns may vary from the Fund's total return.

Corporates:

- For the second quarter, the high-yield corporate bond allocation returned 12.12% and contributed 1,074 basis points to the total return of the Fund. The high-yield corporate bond allocation outperformed the Bloomberg Barclays U.S. Corporate High Yield Index return of 10.18% by 128 basis points.
- Consumer cyclical was the largest positive contributor to performance in the quarter, returning 15.63% compared to the benchmark, which returned 10.40%. The outperformance was almost entirely from selection. Of the significant positive contributors, the largest was a holding in a hospitality company that serves the energy industry in several of the most economic shale basins, as well as a holding in a tier-one auto parts supplier that is expected to benefit from the return to full production by the automotive original equipment manufacturers.
- Communications was the second-most significant positive contributor to performance in the quarter, returning 6.81% compared to the benchmark, which returned 4.64%. The outperformance was from a combination of allocation and selection. We were underweight communications during the quarter in which it underperformed the index returning 4.64% versus 10.18%, benefitting the portfolio. Additionally, the portfolio benefited from holdings in a television broadcaster that should benefit as the economy rebounds and the demand for advertising increases.
- Energy was the largest detractor from performance, returning 27.97% compared to the benchmark, which returned 40.02%. The underperformance was mostly attributable to selection with a large holding in a high-quality liquified natural gas exporter, lagging in an environment where the most speculative exploration and production issuers rebounded the most on the back of the OPEC+ production cut agreement. Additionally, a holding in a shallow water offshore drilling company materially contributed to the underperformance as demand for drilling will lag the rebound in commodity prices until excess inventories are reduced and supply matches demand.
- Cash was the only other material detractor from performance in a quarter in which essentially every sector generated a positive total return.

CLOs:

- The CLO allocation saw 26.19% total return, contributing 97 basis points to the Fund in Q2. Once liquidity came back to the structured products markets at the beginning of the quarter, the broad market dislocation gradually returned to a more normal trading environment. The defensive positioning of the BB holdings within the Fund, close to or out of the reinvestment period, outperformed longer-duration peers with collateral overallocated to industries impacted by COVID-19.

Sector Exposure

	Weighted Avg. Price	% of Market Value		% Change	Option Adjusted Spread		Bps Change	Yield-to-Worst		Bps Change
		3/31/20	6/30/20		3/31/20	6/30/20		3/31/20	6/30/20	
Corporates	97.51	87.4	93.8	6.4	945	682	-263	9.89	7.23	-266
CLOs	85.17	5.1	3.7	-1.4	1,863	1,010	-853	18.98	10.45	-853
Equities & ETFs	11.50	0.1	0.1	0.0	N/A	N/A	N/A	N/A	N/A	N/A
Cash	100.00	7.4	2.4	-5.0	N/A	N/A	N/A	N/A	N/A	N/A
Total	97.03	100.0	100.0		921	677	-244	9.61	7.17	-244

Corporates:

- The economy is currently in recession, and with any luck it will be the shortest recession in history given the quick response by the Federal Reserve and Congress providing unprecedented monetary and fiscal stimulus to support functioning capital markets and the real economy.
- Given the sudden onset and depth of the economic slowdown with a large portion of the nation in lockdown, all the recent traditional economic data looks positive as we bounce off the bottom as the economy gradually reopens. We are focusing on high-frequency data providing information on mobility, traffic, dining out, TSA data, etc. for early indications with regard to the consumer, which represents ~70% of U.S. GDP, and the direction and potential durability of the recovery.
- Currently, since we are coming out of a recession, we are emphasizing basic industries, consumer cyclicals, and capital goods that have the greatest leverage to a rebound in economic activity. We are also focusing on select issuers in hospitality, leisure, airlines, and retail, which were hardest hit by the economic shutdown, contingent on getting the right structure and value for issuers we expect to thrive as the economy rebounds.
- With the recent activation and purchases of corporate bonds by the Federal Reserve under the Secondary Market Corporate Credit Facility, the Federal Reserve has followed through on its commitment to ensure functioning capital markets and access to borrowers. Although it isn't specifically buying individual high-yield bonds, it is buying bonds of select fallen angels and high-yield ETFs in addition to individual qualifying investment grade corporate bonds that meet its criteria. This represents a new buyer in the market with potential buying capacity up to $250B, which will compress investment grade spreads, indirectly benefiting high-yield issuers as investors seek higher-yielding assets in an environment of zero rates and potential yield curve control.
- Despite our optimism regarding the eventual economic recovery, risks we are watching that could result in setbacks include passage of an additional relief package including support for state and local governments to avoid sharp budget cuts and layoffs, and a resurgence in virus outbreaks leading to reimplementation of restrictions on economic activity, not to mention volatility associated with what is expected to be a contentious presidential election season. As a result, we are emphasizing issuers we view as having the liquidity and balance sheet strength to survive an extended slowdown as well as benefit from a recovery.

CLOs:

- Going forward in the second half of 2020, the market is on firmer footing with both technical and fundamentals supporting a grind tighter into the summer months. The new issue market came back, secondary trading was more orderly, new funds were raised to take advantage of opportunistic levels, the leveraged loan market rallied, and stress scenarios became less harsh as more data unfolded. However, managers will still need to remain cautious of covenant breaches, default pickups, and ratings downgrades as the corporate landscape continues to develop.

Definitions

BBB CLO – HOAO: The difference of the Bank of America BBB CLO spread less than the Bank of America U.S. Corporate High Yield Index.
CLO: Collateralized loan obligation.
ETF: Exchange-traded fund.
HY OAS – IG OAS: The difference of the Bloomberg Barclays U.S. Corporate High Yield Index OAS less the Bloomberg Barclays U.S. Corporate Investment Grade Index OAS.
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.
Citi Economic Surprise Index: An index that measures the pace at which economic indicators are coming in ahead of or below consensus forecasts.
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.
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 (STDEV/SD): 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 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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