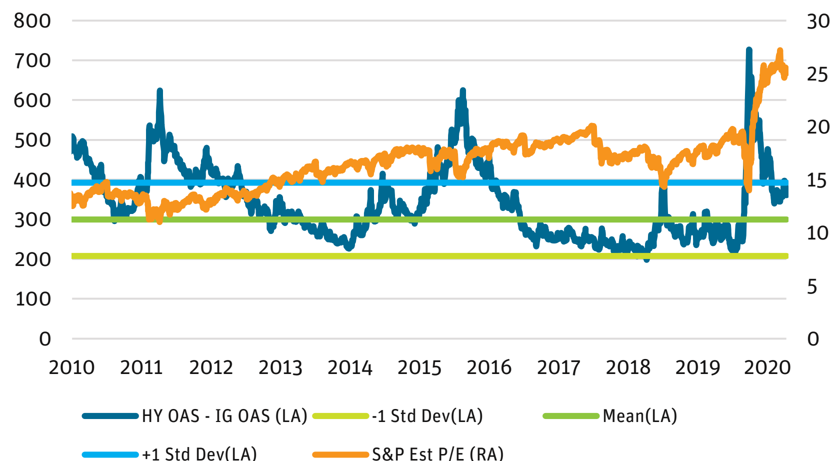
Angel Oak High Yield Opportunities Fund Quarterly Review

September 30, 2020

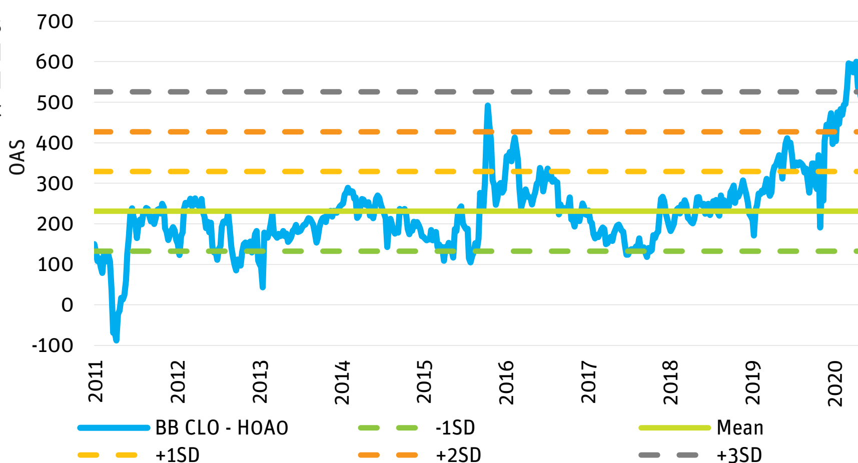
Quarter in Review

- Despite the expiration of enhanced unemployment benefits at the end of July, and little if any progress toward an additional fiscal relief package to date, risk markets, including high yield, have continued to gain as the economy continued to improve from trough levels with continued supportive monetary policy from the Federal Reserve.
- Although expectations had been lowered substantially, the second-quarter earnings season was resoundingly strong, with the exception of energy and utilities, with approximately 66% of the S&P 500 reporting better-than-expected sales and almost 85% beating earnings estimates.
- Similarly, the Citi Economic Surprise Index has been in record territory since mid-June, as the unprecedented size and speed of the fiscal response supported aggregated demand.
- The Federal Reserve is focused on average inflation, with the intention of leaving rates unchanged through 2023. Additionally, the Federal Reserve has extended the duration of its primary and secondary corporate credit facilities through the end of the year.
- The GS U.S. Financial Conditions Index also reflects the improvement in the economy, easy monetary policy, and asset valuations, and it indicates some of the loosest financial conditions in 20 years.
- High-yield mutual fund inflows reflect the optimism and the demand for yield, with approximately $6.5B of net inflows during the quarter. Issuers also took advantage of the demand, setting a single-month issuance record in June. September was the largest September ever on record and the third-largest month ever, and the annual issuance record was broken in September with three months still left in the year.
- Aside from a rise in cases in July, progress against the virus continues. Testing has increased, positivity is near its lows, hospitalizations have fallen to near lows, and the rate of fatalities continues to decline. Vigilance is paramount as we enter flu and holiday season if we want to avoid rollbacks of reopening actions and economic setbacks ahead of production of a vaccine.

Benchmark Performance	6/30/20	9/30/20	Quarterly Change (bps)
2-Year Treasury	0.15	0.13	-2
5-Year Treasury	0.29	0.28	-1
10-Year Treasury	0.66	0.68	2
UST 3M/10Y Spread	51	58	7
Oil	39.27	40.22	+242
Iron Ore	102.95	123.98	+2,043
VIX	30.43	26.37	-1,334
S&P 500 Total Return Index	6,352	6,919	+893
Bloomberg Barc U.S. Corp IG Index OAS	150	136	-14
Bloomberg Barc U.S. Corp HY Index OAS	626	517	-109



Source: Bloomberg Barclays U.S. High Yield Index, S&P 500 est. P/E from Bloomberg as of 9/30/20.



Source: Bank of America Merrill Lynch as of 9/30/20.

Portfolio Performance

Summary

- The Angel Oak High Yield Opportunities Fund returned 4.23% in the quarter ending September 30, 2020, slightly behind the Bloomberg Barclays U.S. Corporate High Yield Index return of 4.60%.
- The performance reflects the continued progress against the virus and the resulting economic recovery as the economy has gradually, albeit unevenly, reopened across the country. Over 11.4 million of the 22.2 million jobs lost in the recession have been recovered, and the unemployment rate has declined from a peak of 14.7% to 7.9%. Manufacturing also continues to improve, with the ISM Manufacturing PMI rebounding to 55.4 for September, the highest reading since late 2018.
- Easy monetary policy has been and continues to be a driver of financial asset performance. The Federal Reserve balance sheet has grown to more than $7 trillion and represents approximately 34% of GDP, leaving significantly more room to increase quantitative easing if necessary, to offset the lack of fiscal stimulus and to maintain functioning markets relative to a country like Japan, where the central bank balance sheet represents 130% of GDP, or the European Union, where the central bank represents almost 59% of GDP. The Federal Reserve has committed to keeping rates at essentially zero through 2023 in support of its goal of average inflation targeting, which would require inflation to run above 2% before they would consider raising rates.
- In the context of continued progress against the virus, economic recovery, and easy monetary policy, the spread on the Bloomberg Barclays U.S. Corporate High Yield Index tightened 105 basis points to 521 basis points, which is essentially in line with its long-term average. And despite tightening 359 basis points over the past two quarters, high-yield credit spreads are still 185 basis points wider year-to-date. In contrast to the second quarter, the CCC category outperformed, with a total return of 7.35% and a spread tightening of 245 basis points, reflecting the market's conviction in the recovery and the reach for yield as credit spreads tighten. The B category was essentially in line with the benchmark, returning 4.35% and a spread tightening of 99 basis points. The BB category lagged, returning 4.02% with a spread tightening of 75 basis points.

				Annualized			
Net Total Returns as of 9/30/20	**3 Mo.**	**YTD**	**1 Yr.**	**3 Yr.**	**5 Yr.**	**10 Yr.**	**SI[1]**
Class I	4.23%	-1.31%	1.61%	3.64%	6.39%	6.14%	8.31%
Class A at NAV	4.14%	-1.49%	1.36%	3.38%	6.12%	5.88%	8.05%
Class A at MOP[2]	1.81%	-3.69%	-0.94%	2.58%	5.65%	5.64%	7.84%
BBgBarc U.S. Corporate High Yield Index	4.60%	0.62%	3.25%	4.21%	6.79%	6.47%	10.39%

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 9/30/20

	Class A	Class I
Gross Expense Ratio	1.15%	0.90%
Net Expense Ratio^	0.90%	0.65%
SEC Yield (Subsidized)	4.91%	5.28%
SEC Yield (Unsubsidized)	4.68%	5.05%

FUND CHARACTERISTICS

Fund Assets (All Classes)	$70.8 mm
Number of Securities	175
Distribution	Monthly
Effective Duration	3.3
Average Coupon	6.30%
Average Yield-to-Worst	6.38%

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 (%)	71.7	73.2
Negative Months (%)	28.3	26.8

[3]ANHIX

Performance Contribution

	% of Market Value*	Q3 2020** Contribution (bps)	YTD 2020** Contribution (bps)
Corporates	97.3	429	161
CLOs	1.7	11	-129
Equities & ETFs	0.1	0	-116
Cash and Equivalents	0.9	0	1
Fund Expenses	-	-17	-49
Total	100.0	423	-133

*% 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 third quarter, the high-yield corporate bond allocation returned 4.61% and contributed 429 basis points to the total return of the Fund, performing in line with the Bloomberg Barclays U.S. Corporate High Yield Index return of 4.60%.
- Despite the underweight, communications was the largest positive contributor to performance in the quarter, returning 4.65%, compared to the benchmark, which returned 3.46%. The outperformance was broad-based and predominantly driven by selection. The primary theme was outperformance of advertising-exposed issuers relative to less economically sensitive cable and telecommunications issuers.
- Insurance was the second most significant positive contributor to performance in the quarter, returning 6.35% compared to the benchmark, which returned 3.69%. Similar to communications, the strong performance of our holdings overcame our underweight relative to the benchmark. Among the largest contributors was a mortgage insurance issuer that is part of a larger insurance entity that is being acquired.
- Energy was the largest detractor from performance, returning -0.09% compared with the benchmark, which returned 2.89%. The underperformance was entirely attributable to selection, with a holding in a refiner underperforming on continued weakness in demand for fuel—particularly jet fuel, as airline traffic remains 70% below prior year levels—as well as a holding in a shallow-water offshore drilling company facing weak demand for drilling, which 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:

- CLOs continued their rally from the lows in March as the longer-term view for loans improved. Defaults decreased, and CCC buckets improved, as an increase in loan prices allowed managers to rotate out of weaker collateral into cleaner credits. This also led to improved overcollateralization ratios. The shorter-duration focus of the Fund's exposure performed in line with the rest of the market rally as trading normalized. With CLO liabilities now at levels that are more conducive to new issue creation, the primary market has been actively producing deals that have been absorbed by market participants with a healthy appetite to put money to work.

Sector Exposure

	Weighted Avg. Price	% of Market Value		% Change	OAS		Bps Change	Yield-to-Worst		Bps Change
		6/30/20	9/30/20		6/30/20	9/30/20		6/30/20	9/30/20	
Corporates	100.35	93.8	97.3	3.5	682	595	-87	7.23	6.31	-92
CLOs	80.34	3.7	1.7	-2.0	1,010	1,396	386	10.45	14.34	389
Equities & ETFs	11.50	0.1	0.1	0.0	N/A	N/A	N/A	N/A	N/A	N/A
Cash and Equivalents	100.00	2.4	0.9	-1.5	N/A	N/A	N/A	N/A	N/A	N/A
Total	99.93	100.0	100.0		677	603	-74	7.17	6.38	-79

Corporates:

- While the economy continues to recover from the plunge in economic activity in the second quarter, the pace of improvement has slowed. Initially, the recovery was supported by the combination of massive monetary policy response from the Federal Reserve and unprecedented fiscal response from Congress. However, the fiscal support has mostly been exhausted, and an additional relief package before the election looks increasingly unlikely. However, regardless of who wins the election, we do expect additional fiscal support after the election.
- The Federal Reserve has committed to keeping rates at essentially zero through at least the end of 2023 in pursuit of its average inflation target. The Federal Reserve also has the capacity to offset the lack of fiscal response to some degree through additional quantitative easing to keep longer-term rates from rising, as well as the recently extended corporate credit facilities to maintain liquid and functioning financial markets.
- In the context of a gradually recovering economy, lower for longer interest rates, and Federal Reserve quantitative easing, high-yield corporate spread valuations look relatively attractive. Unlike equities, high-yield credit spread valuations are essentially at their long-term average as opposed to cycle peaks. High-yield spreads are also attractive relative to investment grade, with the overall spread pickup versus investment grade at historical averages and BBs almost one standard deviation cheaper than BBB corporates. Additionally, in the event of a Democratic sweep leading to a massive fiscal spending spree and rising interest rates, high yield has a duration approximately 60% shorter than investment-grade corporates.
- Although there is no getting past the fact that the pandemic and the response to the pandemic from a permitted business activity perspective have generally negatively impacted revenue and cost structures, high-yield corporates have been proactive, raising liquidity and taking advantage of lower borrowing costs and market conditions to refinance near-term maturities.
- We continue to emphasize industrial over service sectors, favoring sectors and issuers that can more easily and cost-effectively adapt to new distancing requirements as well as where demand is less sensitive to regulations regarding capacity utilization and often deemed essential.
- With the expiration and depletion of fiscal support, and the unlikely probability of an additional relief package ahead of the election, we remain vigilant with regard to signs of weakening economic conditions, especially with regard to consumers and employment, potentially triggered by a rise in virus cases as we head into holiday and flu season and leading to a reversal of reopening progress.

CLOs:

- The Fund remains focused on maintaining an exposure to shorter and cleaner BB CLO. As secondary trading and new issuance have come back to create a healthy, active marketplace, the largest near-term catalyst for market instability is the U.S. presidential election in November.

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.
Goldman Sachs Financial Conditions Index: A weighted sum of a short-term bond yield, a long-term corporate yield, the exchange rate, and a stock market variable.
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 9/30/20 and are subject to change at any time, are not guaranteed, and should not be considered investment advice.

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