Angel Oak
CAPITAL ADVISORS

Fed Repricing Creates Short Duration Opportunities

4Q 2021

Favor Reinvestment Opportunity over Interest Rate Risk

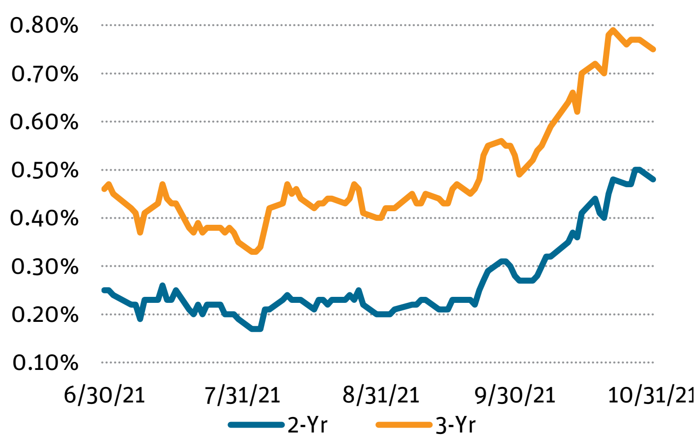
October finally brought the sharp repricing, or "un-anchoring," of the front end. The 2-year Treasury yield finished October just below 0.50% while the 3-year ended near 0.75%, both increasing over 20 basis points in a single month (Figure 1). With this repricing, many short duration strategies are lower from a price return perspective. Using Morningstar category returns as a proxy, we see negative total returns for both the Short-Term Bond Category and the Ultrashort Bond Category (Figure 2).

Prior to October, the front end remained anchored well below 0.50% as the outlook for an increase in the Fed funds' target rate was more than two years into the future. Using history as a guide, the last time the Federal Open Market Committee (FOMC) began its interest rate hiking campaign, short-term Treasury yields started increasing about two years prior to the first actual tightening. With the FOMC implying rate increases during calendar year 2023, it was time for the short end to move higher.

Our prior portfolio positioning for the Angel Oak UltraShort Income Fund (AOUIX) was duration risk over reinvestment risk, which benefited from the peak in the Fed funds target rate in late 2018 through mid-2020. Looking forward, we believe the opportunity set has flipped. As interest rates gradually move higher, investors should look for enhanced return while limiting interest rate risk. In fixed income strategy terms, investors should favor reinvestment opportunity over interest rate risk.

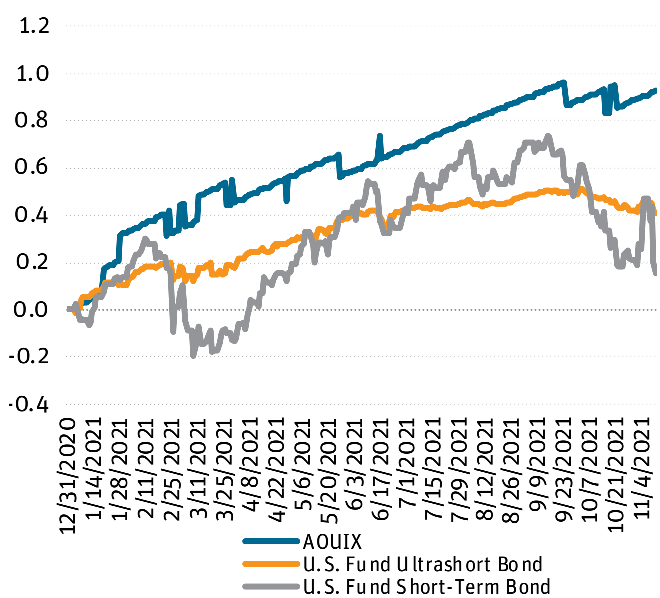
So, which assets should investors target to favor reinvestment opportunities over interest rate risk? Shorter duration cash flows that receive principal each month instead of a bullet, longer duration asset. Amortizing cashflows within many areas of structured credit, particularly RMBS and ABS, provide this positive reinvestment opportunity, effectively creating a short duration ladder portfolio.

FIGURE 1: U.S. TREASURY YIELD CURVE RATES



Source: U.S. Department of the Treasury as of 10/31/21.

FIGURE 2: AOUIX PERFORMANCE VS. BENCHMARKS



Source: Morningstar Direct as of 10/31/21.

Structured credit, particularly RMBS and ABS, tends to be structured as shorter duration investments that receive amortization principal payments over the bond's life. This return of principal each month provides the ability for investors to reinvest as interest rates, or spreads, move higher into an FOMC hiking cycle. We believe active management within these asset classes can provide a better risk/return profile than just traditional Treasuries and corporates.

TOTAL RETURNS (AS OF 9/30/21)	3Q21	YTD	1 YEAR	3 YEAR	SI[1]
AOUIX	0.20%	0.89%	1.51%	2.55%	2.63%
AOUAX	0.14%	0.70%	1.27%	2.23%	2.35%
Morningstar Short-Term Bond Category	0.10%	0.52%	1.58%	3.08%	2.85%
Morningstar Ultrashort Term Bond Category	0.06%	0.49%	0.84%	1.75%	1.81%
Bloomberg 9-12 Month U.S. Treasury Bill Index	0.03%	0.12%	0.17%	1.80%	1.80%

[1]The inception date of the Angel Oak UltraShort Income Fund I Class (AOUIX) was 4/2/18, while the inception of the A Class (AOUAX) was 4/30/18. The returns of AOUAX shown for periods prior to the inception date include the returns of AOUIX and are adjusted to reflect the operating expenses of AOUAX.

DEFINITIONS

ABS: Asset-backed security.

Basis Point (bps): One hundredth of one percent and is used to denote the percentage change in a financial instrument.

Bloomberg 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.

Cash Flow: Periodic coupons received by the bondholder during their holding period.

Morningstar Short-Term Bond Category: Represents an average of all funds in the Morningstar Short-Term Bond Category. Short-term bond portfolios invest primarily in corporate and other investment-grade U.S. fixed-income issues and have durations of one to 3.5 years (or, if duration is unavailable, average effective maturities of one to four years).

Morningstar Ultrashort Bond Category: Represents an average of all of the funds in the Morningstar Ultrashort Bond Category. Ultrashort bond portfolios invest primarily in investment-grade U.S. fixed-income issues and have durations typically of less than one year.

RMBS: Residential mortgage-backed securities.

Opinions expressed are as of 10/31/2021 and are subject to change at any time, are not guaranteed, and should not be considered investment advice.

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 do higher-rated securities. 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.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Angel Oak Mutual Funds. This and other important information about each Fund is contained in the Prospectus or Summary Prospectus for each Fund, which can be obtained by calling 855-751-4324 or visiting www.angeloakcapital.com. The Prospectus or Summary Prospectus should be read carefully before investing.