Federal Reserve Leaves Interest Rates Unchanged: Implications & Outlook

1. What is Angel Oak's view on today's Fed decision to not raise interest rates?

The Fed passed on an opportunity to take interest rates off of the current zero mark. To many market participants, a move today would have signaled a vote of confidence in the U.S. economy and removed some uncertainty out of the markets. However, the increased global volatility across Europe and China created a very difficult environment for the Fed to begin raising interest rates. Similar to 2013's "Taper Tantrum," when a sharp rise in longer-term Treasuries threatened the initial recovery in U.S. housing, a potential rise in rates too early this quarter could threaten a global economic recovery that is finally gaining momentum. If the global economic dust settles and market volatility declines over the next few months, the Fed may feel more confident to begin the normalization process.

Today's dovish Federal Open Market Committee ("FOMC") announcement left many investors wondering if the FOMC will ever raise its target rate, but we have to often remind ourselves and our investors that this is not a normal recovery. It was not a normal recession either. We are slowly healing from the effects of a failed banking system. In fact, this week marks the eighth anniversary of Lehman Brothers' failure.

It takes many years to recover from levered real estate bubbles, and in our view, we are headed in the right direction; but, the U.S. and other global developed markets are still reeling from the deflationary downdrafts of the credit crisis, globalization, and demographic shifts of the boomers. Core personal consumption expenditures ("PCE"), the Fed's preferred inflation gauge, is running at 1.3% year over year. Core PCE has been below their 2.0% target for nearly the entire post-crisis period. A 0% percent front-end and a $4 trillion balance sheet does run the risk of forming other asset bubbles, but we believe that risk is outweighed by the threat of dampening what little inflation and growth we are currently enjoying in the U.S. The FOMC cannot afford to threaten the inflationary recovery it has been able to generate with its historically accommodative monetary policy. With renewed global growth concerns, the FOMC politically may have a difficult time implementing additional tools if the U.S. growth picture worsens. As discussed in the June FOMC meeting, "another concern related to the risk of premature policy tightening was the limited ability of monetary policy to offset downside shocks to inflation and economic activity when the federal funds rate was near its effective lower bound." Investors unfortunately need to continue to position for very low risk-free rates in the U.S., particularly on the front-end, for many years to come.

2. What is the probability of the Fed raising rates in October or later this year?

After today's FOMC announcement, market participants are now only pricing in a modest 25% chance of tightening at the October meeting and a 52% chance at the December meeting. The October meeting does not have a subsequent press conference, and we have long been in the camp that when the FOMC does liftoff, it would prefer to have a press conference to tactfully deploy its longer-term dovish stance and underscore its attempt to stoke growth and inflation. Probabilities aside, what is important to glean from today's meeting (and many others of the post-crisis period) is that the Fed has been and will continue to deploy an all-out assault on deflation. The U.S. has been more successful than its peers in Europe and Japan, but the battle is real and the consequences of failure are significant. Until the FOMC and market participants see a significant pick-up in inflation and growth, they will remain very accommodative and committed to a sustainable inflationary recovery.

3. What is the future outlook for mortgage and structured credit asset classes?

An FOMC committed to ensuring a reflationary recovery and an improving U.S. economy should continue to provide tailwinds for our holdings. Our structured credit holdings have performed well this year amid spread widening across most credit-sensitive assets, and we attribute the outperformance to the following factors:

a. Improving housing fundamentals
b. Healthier consumers
c. Expanding credit guidelines
d. Significant structural credit enhancement of our holdings
e. High current income in predominantly floating rate securities at a discount

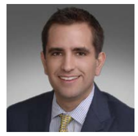
Our assets are not immune to credit spread widening, but as demonstrated in the post-crisis period, the structured credit exposure we target is less sensitive to short-term and long-term interest rate movements. As the liftoff debate rages on, we believe our funds are positioned to perform in both lower and higher-than-expected interest rate environments.

Sam Dunlap
Senior Portfolio Manager

Mr. Dunlap is a Managing Director at Angel Oak Capital Advisors where he serves as the Lead Portfolio Manager of the Financial Institutions Division (FID). FID manages assets of financial institutions such as banks and insurance companies.

Mr. Dunlap has 11 years of capital markets experience across multiple sectors of the fixed income markets. Prior to Angel Oak, Mr. Dunlap spent six years marketing and structuring interest rate derivatives with SunTrust Robinson Humphrey. His primary coverage was the Wealth and Investment Management line of business where he focused on both interest rate hedging products and interest rate linked structured notes. Mr. Dunlap's previous experience included two years at Wachovia in Charlotte, NC supporting the agency mortgage pass-through trading desk.

Mr. Dunlap received a B.A. in Economics from the University of Georgia.



Clayton Triick, CFA®
Portfolio Manager

Mr. Triick serves as a Portfolio Manager for Angel Oak Capital Advisors where he focuses on portfolio analytics and fixed income strategies for Angel Oak Capital. Mr. Triick manages specific strategies within the mutual funds, private funds, and SMA's for Angel Oak Capital, specifically within structured credit and non-agency mortgage bonds.

Mr. Triick has 7 years of investment experience across multiple sectors of fixed income. Prior to Angel Oak Capital, Mr. Triick worked for YieldQuest Advisors, LLC where he served on the investment committee focusing on investment strategy and also managed the closed-end fund exposure within their investment portfolios for individual clients and across the family of mutual funds.

Mr. Triick graduated with a degree in Finance from the Farmer School of Business at Miami University in Oxford, OH. He also holds the Chartered Financial Analyst (CFA®) designation.

→ Learn about Angel Oak Capital's innovative approach to structured credit investing: AngelOakCapital.com

Must be preceded or accompanied by a prospectus. To obtain an electronic copy of the prospectus, please visit www.angeloakcapital.com.

Past performance does not guarantee future results.

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