Angel Oak Capital Advisors Fourth Quarter Conference Call

February 4, 2014, 11:00 AM ET
Chairperson: Brian Smith (Mgmt.)

Important Disclosures:

The views expressed on this call are the views of the participants as of February 4, 2014, and are not intended as a forecast or as investment recommendations. Any information provided with respect to the Fund’s Portfolio Holdings, Sector Weightings, Number of Holdings, Performance and Expense Ratios is as of the dates described and are subject to change at any time. Performance data quoted represents past performance; past performance does not guarantee future results.

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<tr>
<th>Total Returns - As of 12/31/13</th>
<th>3 Month</th>
<th>YTD</th>
<th>1 Year</th>
<th>Since Inception</th>
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<tr>
<td>Multi-Strategy Income Fund – Class I</td>
<td>2.29%</td>
<td>4.12%</td>
<td>4.12%</td>
<td>13.19%</td>
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<tr>
<td>Multi-Strategy Income Fund – Class A</td>
<td>2.29%</td>
<td>3.87%</td>
<td>3.87%</td>
<td>13.02%</td>
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<tr>
<td>Multi-Strategy Income Fund – Class C</td>
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<td>3.06%</td>
<td>3.06%</td>
<td>12.17%</td>
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<tr>
<td>Barclays U.S. Aggregate Bond Index</td>
<td>-0.14%</td>
<td>-2.02%</td>
<td>-2.02%</td>
<td>2.72%</td>
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Expense ratio*:

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<th>Class A</th>
<th>Class C</th>
<th>Class I</th>
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<tr>
<td>Gross</td>
<td>1.86%</td>
<td>2.61%</td>
<td>1.61%</td>
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<tr>
<td>Net</td>
<td>1.26%</td>
<td>2.00%</td>
<td>0.99%</td>
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The A-class of the Angel Oak Multi-Strategy Income Fund incepted on June 28, 2011, while the institutional share class (ANGIX) and C-class (ANCX) incepted on August 16, 2012 and March 13, 2012 respectively. The returns of ANGIX and ANGCX shown for periods prior to their inception date (including returns since inception, which are since the investor class’ inception) include the returns of the fund’s older investor share class. These returns are adjusted to reflect the operating expenses of ANGIX and ANGCX. 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 for the Fund can be obtained by calling 888-685-2915.

*Gross expense ratios for the A Class, C Class and the Institutional Class are reported as of the 5/30/13 prospectus. The net expense ratios for the A Class, C Class and the Institutional Class are reported as of the 1/31/13 Annual Report and are referenced in the 5/30/13 prospectus. The Advisor has committed contractually to waive fees and/or reimburse expenses so that net annual fund operating expenses do not exceed certain levels through 8/31/14 and may be discontinued at any time by the Fund’s adviser after 8/31/14.

You should carefully consider the investment objectives, potential risks, management fees, and charges and expenses of the Fund before investing. The Fund’s prospectus contains this and other information about the Fund, and should be read carefully before investing. You may obtain a current copy of the Fund’s prospectus by calling 877-625-3042.
The value of some mortgage-backed securities may be particularly sensitive to changes in prevailing interest rates, and although the securities are generally supported by some form of government or private insurance, there is no assurance that private guarantors or insurers will meet their obligations.

There is no guarantee that this or any investment strategy will succeed; the strategy is not an indicator of future performance; and investment results may vary.

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**Barclays U.S. Aggregate Bond Index:** Barclays U.S. Aggregate Bond Index is 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. Please note that an investor cannot invest directly in the index; therefore its performance does not reflect a reduction for fees or expenses incurred in managing a portfolio.

**S&P 500 Index:** Includes 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.

**Effective Duration:** 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.

**Asset-Backed Security (ABS):** A financial security backed by a lease, loan or receivables against assets other than real estate and mortgage backed securities.

**Collateralized Loan Obligations (CLOs):** Securitized pools of leveraged bank loans that offer senior-secured positions and relatively high floating rate coupons, but with additional downside protection from defaults through subordination.

**Commercial Mortgage-Backed Securities (CMBS):** A type of mortgage-backed security that is secured by the loan on a commercial property rather than residential real estate. They are usually structured as multiple tranches similar to collateralized mortgage obligations.

**The S&P/Case-Shiller Home Price Indices:** The leading measures of U.S. residential real estate prices, tracking changes in the value of residential real estate both nationally as well as in 20 metropolitan regions.

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Operator: Good morning. My name is [Ian], and I will be your conference operator today. At this time, I would like to welcome everyone to Angel Oak Capital Quarterly Investor Call.

All lines have been placed on mute to prevent any background noise. After the speakers’ remarks there will be a question-and-answer session. If you would like to ask a question during this time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question press the pound key. Thank you.

It is now my honor to introduce your host, Mr. Brian Smith. You may begin your conference, sir.

Brian Smith: Good morning, everyone, and thank you for joining us today for the Angel Oak Multi Strategy Income Fund year-end Update. My name is Brian Smith. I’m managing director here at Angel Oak Capital Advisors. Our goal for the call today is to update you on the fund, its performance and provide some insight on our investment thesis. Our speaker today is Brad Friedlander. Brad is the cofounder of

www.angeloakcapital.com
Angel Oak Capital Advisors and the head portfolio manager of the Angel Oak Multi Strategy Income Fund.

But before I hand it off to Brad, I’d like to give a brief summary on Angel Oak Capital, the mutual fund strategy and its performance. As a firm Angel Oak currently manages just over 3 billion in assets. Of that, 2 billion of assets are in the multi-strategy income fund with the rest comprising separately managed accounts and private funds. The main investment strategy for the multi-strategy income fund is to seek total return by investing in investment grade and non-investment grade structure credit, fixed income securities, that have an attractive income and/or capital appreciation opportunities.

Our team utilizes a top down strategy to identify under-valued assets and price dislocations combined with a bottoms up credit selection process. Today the fund’s allocation is presently 58 percent non-agency residential mortgage-backed securities, 18 percent in collateralized loan obligations, and 13 percent in commercial mortgage-backed securities with the remaining of the portfolio in liquid investments.

As of December 31, 2013, the Angel Oak Multi Strategy Income Fund institutional share class was up 4.12 percent for the year compared to the Barclays Aggregate Bond Index which was down 4.02. Since inception the Angel Oak Multi Strategy Income Fund institutional share class has returned 13.19 percent on annualized basis, while in comparison the Barclays Aggregate Bond Index was up 2.72 percent on an annualized basis over the same time period.

At this point I’d like to hand it over to Brad who will give us more in-depth view of the fund and with that, Brad, welcome.

Brad Friedlander: Great. Thanks Brian and thanks for everyone for joining us this morning. When we last left off in the fall, there was a pretty poor data ... economic data route that was tearing through most of the markets through September and October.

We felt that the market had just become too negative in general through that September and October time span and predictability the momentum shifted. It ushered in a strong finish to last year across most markets. Payroll figures, manufacturing numbers, consumer related data all inflected higher. It was a time of good vibrations ... a strong finish to equities in 2013.

It was time to usher in a new Fed Chair and that transition could not have gone any smoother. While the Fed really threaded the needle it was a strong tone that just entering the New Year and what a difference 30 days can make.
The equity markets are by no means in the midst of panic right now, but the air has been let out of the balloon some. Those hoping for a 5 to 10 percent pull back in equities, well, here we go. It serves as a reminder that those types of markets and all markets don’t only go in one direction.

You know leading to that has been data momentum that’s cooled of late. The payroll figures were just awful, 74,000 jobs added the most recent number. Expectations had been closer to 200,000. The durable goods figures have been lower; some of the other manufacturing figures ISM was lower. Much of that though can be related to cold weather story through most of December.

But really adding fuel to the fire has been some of the concern around the emerging markets. Slowdown in growth in China, important from a respective standpoint to think about a slowdown in China means growth slowing to about 7 percent to 7.5 percent, which I think many of us in the U.S. would actually envious of right now. But certainly that is a downward move if you think back to 2007, in China growth was at 14 percent.

So the question is looming. Is this systematic? Does this become much worse? And I think back and the way I tackle these types of situations is is this new? Is there something brand new that has entered the equation in the last few weeks that makes us more nervous in any way than we would have been several months back? Was much of this information not known in the third or fourth quarter? Absolutely it was.

But much of it came to a head in January. Was it new the China slowdown, the growth story slowdown in China? Not at all, it’s been a slowdown that we’ve been seeing that’s very gradual, and it’s been mostly since 2007 as I mentioned. But more recently it’s been measured you know in the press.

China, you know, as far as the dependence on China from a lot of multi national firms in the U.S., it comprises around 10 percent of revenue. So very important, but not certainly the most influential. But you have a year like last year where equities did quite well, what did emerging markets equities do last year.

They were down roughly 5 percent. And we all know what the S&P did obviously. So in my view you need to take a look and take a step back and really see is this much of this new or is this more urgent than we’re being lead to believe.

Ironically and pointedly the IMF just on January 21st about 10 or 12 days ago just raised their global economy growth estimate from 3.6 percent across the globe to 3.7, as both the U.K. and more importantly the U.S. are accelerating from a growth standpoint.
So we're seeing some sense of synchronized growth across the developed world. Another example, 3M, a large conglomerate, says sales growth may double in the United States. They're also seeing strength in demand in Western Europe and even Japan. So I think a little bit back to that period where I think the fear level peaked, I think just about a week or so ago. And much of it I think unfortunately was related to Davos. And I would look a little bit more into that just from an intensity standpoint.

It really hit its heights as the thought leaders were gathering across the globe and thinking about what they were most concerned about, and I think a lot of that, a little bit of that fear bled to the press, bled to the media, and really added more fuel than I think the, than I think is really truly there. But the net of this though has been interest rates obviously haven't rallied significantly. Now they're 40 basis points and lower if you're looking at the 10 year.

This was a gift to so many traditional bond fund managers. And was right in the face of what many of us have read about the great rotation out of fixed income and into equities. So you've begun to see a nice little rally as far as traditional fixed income is concerned. But we think this may be relatively short lived. Most of us had called for the lows in rates to come in the first and second quarter of this year and think rates will gradually move higher as the data across the U.S. will eventually tip the scales in a more positive direction.

So how was this bleeding at all into the world of credit? How are the credit markets worried? It's generally holding in. You know, many of you are looking at high yield, high yield corporate bonds have widened, by my measure around 40 basis points. That's relatively in check if you compare that obviously to the sell-off we've seen across equities.

Compare that to the middle of last year, during May and June, taper tantrum last year where equities were off roughly 5 percent to 6 percent, high yield had actually widen 110 basis points by our measures. So you had a similar equity move in the middle of last year and high yield is actually only widened out about a third, give or take, compared to what we experienced last year.

That in my view is saying this is a very different, this is a high yield market. This is the credit markets in general really trying to infer some confidence, trying to stave off a lot of this fear. Now there is a limitation to that.

If we enter into a downward spiral and the markets enter a pure panic mode from an equity standpoint, then much of that cannot be contained, but I don't think that's the case here. I think you're seeing a pretty strong backbone on the part of most of the credit markets, high yield as an example, but even more so in Angel Oak's playground being structured credit markets.
Data tends to be streaky and you’re either part of a you know in the middle of downward spiral or that can go in the other direction as far as a virtuous circle is concerned. I think we’re probably not too far away from another turn from a data standpoint. A lot of this data has been weather related and I think the markets have been reading a little too deeply into it but it’s of course come at the same time you’ve a blow up in fear just related to developing economies, emerging markets, and China.

But Friday’s figure on the payroll, non-farm payroll comes out on Friday. That could be such an influential figure. Again it’s amazing how these Friday mornings just become so important to the markets, but the expectations is what I’d like to see.

Last month 200,000 jobs expected. There was a disappointment. This month 180,000 jobs expected. So that is the nice feedback loop of low expectations feeding its way into the system. And what it does is it opens the door, opens the window for an upside surprise, and that’s what we like to see.

So whether it happens this month or potentially next month we don’t think this is going to be particularly long lived from a negative data standpoint. And it should turn at some point. And I think we’ll see that also show itself in the face of in the form of a rate situation changing relatively soon.

What does the Fed do though? You know the Fed tries to quietly weed out a lot of this noise. There is a tremendous amount of noise in the system right now. That’s exactly what I think we should be doing as well … looking at fundamentals. Just focus on the hard data and just perspective is important. At the end of the fourth quarter last year, growth finished up for quarter around 3.2 percent, which is a strong number. It went out on a high note.

The Bloomberg Median forecast right now for GDP across this year and next year is 2.8 percent and 3.0 percent respectively. And so with that in mind I think the growth potential for 2014 is still likely to meet expectation, potentially even surprise to the upside.

We still have fewer fiscal headwinds than we did last year, which I think is very meaningful. But just refuse to believe that so much of the wealth impacts that have come from both housing, equity, as well as the equity market gains, stock market gains, cannot feel their way and weave their way into the system.

You know we’re going to see that in terms of money velocity still being a disappointment, but over time we do expect that to feed its way through. And not also to be under estimated is just the
energy, U.S. energy story, continuing to inspire strength. You’re seeing that through corporate
earnings in the U.S. Forecasts to rise this year by about 8.5 percent versus 5.2 percent last year.

Nearly 80 percent of companies that have reported earnings results so far this quarter, have topped
estimates. The press has made news of Apple and GE disappointing. Of course the cars you know
the auto manufacturers have also been a bit softer, GM, et cetera. But again I think much of that
can be attributed to weather.

But meanwhile on the jobs front unemployment has quietly marched down to 6.7 percent. So you’re
really beginning to get into that initial comfort zone that the Fed spoke so much about where they
many, many months ago spoke about beginning to feel comfortable and would feel more
comfortable about the economy to the point where they may even begin to remove stimulus, and to
a certain extent you’re seeing that through tapering.

So a lot I just mentioned. You know a few things here in the last few seconds but let’s tally some
of the good and bad, the pros and the cons. You know you have a bit of U.S. decoupling story.
Earnings are looking on the up still. GDP figures are strong. Unemployment marching lower. A
synchronized global growth story of developed countries across the world. Housing in the U.S., U.S.
energy story looking stronger. That’s all on the positive side.

Detracting from that you have more headline issues. Developing and emerging headlines from
China and Argentina, Turkey, et cetera. Still some fiscal headwinds in the U.S. and always the
potential for a blow up there. But again I think that’s more headline related and certainly a positive
versus last year. And then of late has been the softer data that has just been a bit softer as of late.

I think that’s something that will probably reverse itself as time progresses here. Then you have the
Fed stimulus removing a stimulus gradually through tapering. So the net of both those pros and
cons is much more of a decoupling story.

The U.S. and other developed nations across the world are overpowering and really offsetting a lot of
I think these headlines that we’re seeing. Just simply not as influential when it comes to an
emerging market story unless it becomes particularly systematic, which I lean against at this point.

So one of key points, positive points we just mentioned and so near and dear to our heart, let’s talk
about housing because that’s so important and critical to the upside potential of what we focus on
and having such a allocation to especially private label non-agency mortgage bonds ... bonds that are
tied to housing.
Housing remains still a bright spot in the economy. Had a very strong year again last year versus especially versus expectations. Expectations for home prices were not much better than mid-single digits and wrapped up last year somewhere between 11 and 13 percent depending upon which measure you’re looking at ... the Realtor Association or Core Logic or Case-Shiller. But another key point is that 98 percent of the zipcodes across the United States posted a year-over-year gain.

So just very, very, you know a ground swell of improvement all closely tied to a shrinking inventory story across the United States, which is going to benefit housing. Even with the Fed decision to start tapering and the pick up in rates, housing activity also remains strong. Price appreciation has buoyed home investors or excuse me homeowners out of their underwater mortgages. And that’s really what that has done is mobilized a lot of buyers, not so much specific in Angel Oaks story because we tend to focus on the best credits out there.

But what it is good for is that it’s broadly very, very good for the health of the housing market to have that lubrication in the housing market, the ability for borrowers that were stuck to then be in the money on their home, the ability to move, the ability to prepay. Frees up the system and you begin to see that in the form of home prices. Serious delinquencies continue to decline. Now a 35 percent drop in mortgage delinquencies since 2010.

And so we’re going to see that from a home price standpoint as well, improving the defaults coming down as well. That should also help recovery as well over time.

So while rising rates and housing prices have edged us off the highs, the question becomes what about housing affordability. Have we reach a point of frothiness or excess?

The Affordability Index, which has been measured since the ‘60s I believe, the 1960s, still remains at extraordinarily strong level ...near historical levels from an affordability standpoint. So even with the decline, if that index were to move say from 165 to 150, it would still mark the fifth most favorable year as far as home price affordability is concerned or home affordability is concerned. The fifth most favorable year in the last 40 years.

So we like what we’re seeing there. There is still good values out there. Rates obviously especially in the last several weeks have moved lower. And that can only be supportive. And then again where you want to challenge this is from a home price standpoint. How we’ve reached the point of excess or point of frothiness. Are we heading back to 2006 and 2007 and 2008?

Home prices still have a 23 percent move upwards before hitting that peak that we hit in April of 2006. So we think there is still a lot of ground to cover and homes prices still can continue to climb higher over a several year period before even reaching that peak that we once hit and then
surpassing that because these types of cycles can be particularly long especially if you add the influence of the Fed and how they’ve artificially extended the cycle to a certain extent.

We also look at the health of the borrowers. Mortgage payments as a portion of income now stands about 19.8 percent. That’s well below the long-term average of 24 percent, so 19 percent versus 24 percent. These consumers are in better shape, borrowers are in better shape, and they’re not reaching and stretching like they once had. You’re seeing that in the form of tighter credit, really still across the U.S.

Also looking at housing, homebuilder confidence remains extraordinarily high, 56 is the last measure on the NAHB figure. Foreclosures, delinquencies, inventories all dropping. So we would expect strong demand to continue, especially as you’re seeing that shadow inventory that was so looming a few years ago continuing to drop. The current inventory level of homes, existing homes across the U.S. is 1.86 million.

If you take into account sales figures that’s about four months of supply and that’s versus about a year worth of supply that we hit during the worse of the housing crisis. Shadow inventory that I just spoke about also continuing to drop, that’s about 2.3 million homes.

So how do we position the funds and how do we take advantage of some of the opportunities that we’re seeing, the fundamental improvements that we’re seeing in housing right now. We’ll just talk quickly about duration because obviously we’ve had a lot of interest rate moves and duration is just so critical when you’re looking at fixed income funds and the exposures there.

The effective duration of the fund right now stands at about 1.5 percent. And investors can see this in the form of the NAV of the fund. If you just watch the fund empirically over the last several weeks is as rates spike and they’ve rallied again, not a lot of reaction in the fund like Angel Oaks ... much more reactive to credit. It becomes a very clear credit decision on the part of our investors rather than so much an interest rates story.

That helps when rates rise and we think that’s the larger story over the next several years as far as fixed income is concerned. But that certainly goes both ways and if you look at the rally that we’ve seen over the last several weeks, the last couple of weeks, traditional bonds have absolutely rallied. Many of them, many bond funds have been bailed out by the rally.

And certainly we had to give up some of that but the net of it is still a fund that’s outperformed by roughly, outperformed by roughly, we’re sitting at about 1.85 percent year-to-date as far as returns are concerned in the multi-strategy income funds.
Now the fund from a low duration standpoint, a lot of that is coming naturally. We're now 70 percent roughly floating rate assets or adjustable rate mortgages.

On top of that though we're also able to be very selective in picking many fixed rate assets that became particularly attractive towards the end of last year, and we're able to hedge out any intrinsic duration that was there or hedge out as much of that duration as possible and make a credit decision, something we think behooves the funds.

We're still not convinced of a better value proposition right now than non-agencies across fixed income really because of fundamental story that I just outlined a few seconds ago ... the tailwind in housing. We continue to emphasize our exposure there. And really the upside potential that we think is there. These are discounted assets, let's not forget that, which is such a rarity right now as far as fixed income is concerned.

We're actively bidding in the markets. We’ve been extraordinarily active especially this morning. This morning marked the end of what we’ve been speaking about really since really last year. The Dutch government auctioned off a large portion of the portfolio that was part of the bailout of an ING portfolio, part of the bailout package. They were advised to sell a multi billion-dollar package and this morning marked the last batch of that 2.1 billion incurred face. Angel Oak was active in that list, and we’re happy to have won a couple of pieces.

And really what we like seeing here and I’ve spoken about this cautiously is the influence of supply. That’s what you need to be worried about when times are very concerning in these markets. It tends to be more about supply. It tends to be supply-oriented. I’m not worried about supply right now. We’ve seen that in the face, in the form of the ING list that came out and is now gone. Fannie and Freddie have slowly and gradually sold pieces into the marketplace.

There are still a very few large pockets of supply that I would consider shadow supply or looming supply that’s out there that can in any way you know dampen the tone in the market right now. It’s been a very gradual story, a letting out of supply into strength.

Again I mentioned non-agencies the fund, in the fund right now are still priced around 90 cents on the dollar. So we’re very much still a discounted buyer essentially being called back at PAR every month as we see prepayment.

The refinance activity in the fund in 2013 basically doubled from 2012 levels. So a real significant move there. This is a testament to our investment process. How we look at and emphasis bonds that are showing strength from a borrower’s standpoint, older vintage, in a better position from an equity standpoint.
That is really just a key, we're just beginning to see the beginnings of a wave in refinance activity in our view in the adjustable rate positions within the fund. I think that's a two to three year story that's going to be very gradual.

From a quality standpoint in the fund, delinquencies are now down about 10 percent from where they were from 2012 to 2013, so again a nice continued decline in delinquencies.

Best performers from an attribution standpoint, we became very bullish on option ARMs in the middle of last year. And we're gradually, so over the course of the year we're beginning to take down a more significant position really towards the middle of last year. We were rewarded with that. Really one of the best performers were option ARM assets. And really outperformed both Alt-A and Prime. So it's an area we continue to like.

We may sell selectively here and there in the short run, but we think over the long haul, there will still be a scarcity effect as far as what we determine to be money good assets that are available at a significant discount. And I think that there is a real tangible aspect to that that the market will grab a hold of over time here.

Also over the fourth quarter beside the options ARMs that we really had mostly through the middle of last year, towards the end of last year we began a focus a lot more on what we call credit base fixed rates. So fixed rate assets that were in some way the market was impairing, but we're offering significant coupons, which again from a scarcity standpoint are just very rare breeds.

Assets that were offering coupons between 6 and 7 percent, the market was discounting significantly available in the ‘80s, 10 to 30 point discounts below PAR, again looked really attractive to us. And that’s an area we added significant amount to towards the end of last year and that's been rewarded as well as you've seen this rate rally through the beginning of this first quarter. So that's an area that we've also continue to add to.

Many of these positions will add value for different reasons. We continue to hold a large floating rate position. And again we find many assets that may make sense more from an income standpoint or a coupon standpoint potentially with limited upside, but then we offset that with many positions that we think will have potentially a lower income in the short run, but offer much more significant upside going forward, and that is the balance we make in the portfolio.

Away from fixed income, or excuse me away from housing, you know CLOs is an area that’s a market we’ve spoken, a sector we’ve spoken about so often over the last several quarters. We’ve added incrementally to that somewhere around 18 percent right now is where we stand. We like that for
all the same reasons, floating rates, secured assets. We think they're a superior alternative to both high yield and even their bank loan cousins.

So it's an area we continue to be, have strong feelings about, more potentially from an income standpoint, slightly less upside in our view versus a non-agencies or CMBS, but it's an area we think again makes a ton of sense from a floating rate standpoint.

Another fourth quarter story for us was the addition of CMBS, which we were able to take advantage of for a couple of reasons. One, the yield curve steepened up. The ten year very quickly moved suddenly showing a 305 on the 10-year in the fourth quarter. Really began to look much more attractive to us from a steep yield curve standpoint.

But also not just a steepness of the treasury curve, but also the steepness of what they call the credit curve, meaning that if you were able to take just a couple of notches degree more credit risk, that you were rewarded that much more handsomely from a spread standpoint.

CMBS was that we were targeting in the A minus to BBB minus area with spreads that were 200 to 400 basis points over treasuries ... mostly targeting new issue, look extraordinarily attractive to us. So that's an area that we've picked up our allocation on.

We were incubating that sector through most of 2013 and then it begun to take a little bit more of a constructive view there as time progresses, especially in the new issue market. You're seeing more and more a gradual refinancing story and you're seeing that kind of show its head in the face of, in the form of new issue.

So we've increased that credit allocation to CMBS to about 4 percent or 5 percent. We also hold a number of AAA assets in the CMBS market.

So kind of wrapping things up a bit. You know the tone is still very stable in the face of a negative tone in the equity markets. High yield feeling it a bit. The tone is still strong, still stable across structured credit. It's never immune completely to a lot of noise that's out there that we're seeing out there, but it certainly in our view have a stronger backbone.

I think Friday's payroll figure will be very important to watch, critical to watch from that standpoint just to see, will this market continue to take a step lower across the broader macro markets. Our feeling is that over time that will reverse whether it's this month or next month payroll figure. We don't think this negative data route will be long lived.
We remain focused on scouring the market for opportunities, especially in non-agencies. This morning we were again successful in finding a few positions that were coming off of liquidation lists from a bailout of ING from the Dutch government during the crisis.

We’re not as interest rate focused as most fixed income. Again we’re much more agnostic. You’re going to see the good and the bad of that, but I think over the long haul we would much rather be agnostic to rate rises over time than be beholden to a rate rally that we’ve seen in the last couple of weeks in the treasury markets.

So that’s something that we want to do is make this as much as a credit decision on the part of our investors and clear credit decision on their part as possible.

Relative value changes over time as well and that’s why you’ve begun to see these moves in the funds. You’ve seen those changes. We were once 80 percent non-agencies, and now we’re much closer to say 60 percent. CMBS allocation has changed. CLO allocation has grown.

That relative value proposition is going to change and we would like to continue to make those moves over time as we see that dynamic shift. And so we’re going to see that continue happen. And we would expect that.

So we’re very opportunistic. We’re still extraordinarily nimble. We’ve had a lot of opportunity to pick up value in the last several weeks and even in the last couple of weeks or so into this treasury rally we’ve been able to find some particularly strong values.

So really for us it’s about idea generation. It’s about what investors do as rates eventually rise. Transitioning to a Fed that’s less accommodative than it is now. I think the Fed is going to continue to be very supportive, very stimulative in short run, but that dynamic can change.

I think they’re going to be extraordinarily data dependent, almost robotic in nature in responding to the data that they’re seeing right now. Much less emotional than I think the market is reading into right now.

So with that, we’ll head over and probably take some questions at this point.

Brian Smith: Yes. Thanks Brad. Operator, if you would please open up the lines for questions and while we wait, we’ll go ahead and answer a couple that have been e-mailed to us.

Brad Friedlander: Sure.
Brian Smith: Brad, first question is the fund buying any new issue non-agency mortgage-backed securities and if so, which issuers are the favorites?

Brad Friedlander: Right, so the question is surrounding new issue non-agencies, just for a bit of a background as well. The new issue market was a little bit of a disappointment last year ... roughly 15 billion in supply. You saw just the dynamic change from a business model standpoint.

The arb where most originators and servicers would prefer to hold loans rather than securitize last year, and I thought you began to see that dynamic change. You saw less origination that was originally expected. Still at that point I would expect it to continue to see a gradual improvement over time.

We were very sour on the new issue market I would say in the spring of last year ... probably made some negative statements in the press about it just because I felt that the value proposition was not there versus the legacy non-agencies, those vintage securities that we focus on from 2003 generally to 2005.

I thought that a 200 to 300-basis point in richness compared to what we focus on was just not that attractive. That value proposition changed in the middle of last year during the taper tantrum.

When the markets leaked wider in general that also cheapened up the new issue market and so we were able to take advantage of that. You're seeing, the question surrounds are there any you know particular originators that we're focused on. We look at them all. We, you're seeing quality from a number of them. We were purchasers you know of the Redwood Trust Securitizations and Sequoia Securitization.

Credit Suisse did a deal as well from a correspondence side. JP Morgan has issued a number of quality deals. So we've been participants in many of those as that market has cheapened up. And then more recently it's begun tightening again so I'm not as enamored with it as I was say in the second and third quarter of last year ... would be the quick answer.

We're finding more value in the legacy paper that we're focused on. You can pick up still 200-300 basis points in yield on a very, very similar credit. And if anything what I like about the new issue market again is price discovery.

What it's doing is showing what a market is willing to pay for high quality asset. And right now it's 200 to 300 basis points tighter in spread, lower in yield than what we're focused on. And what we think we're buying is still very similar credit on a risk-adjusted basis.
Brian Smith: Second question Brad, your views on second lien paper and whether there is any exposure in the portfolio either directly or via collateralized loan obligation.

Brad Friedlander: Almost de minimis exposure to second lien. Second lien is in residential space will find themselves in a lot of subprime deals. They may make up you know broadly speaking between 3 and say 8 percent of a lot of subprime deals.

Again as a reminder we're not focused on subprime. We hold no subprime securities in the fund currently, but with a focus on prime and near prime Alt-A deals, we don't have real second lien exposure there in residential.

Not so much a story either on the CLO side. CLOs may have a very, very small allocation. It may be roughly say 2 percent of a loan basket that has been securitized in a CLO deal, so not a lot of exposure there. It's important to remember from a perspective standpoint that even a second lien would have still obviously a secured asset. The recoveries may at the end of the day be somewhat lower. But if we were ever to find significant second lien exposure we have no direct exposure at all in the funds. We're not buying second lien loans.

Good question though. But if we were ever to be focused there at all it would be on a higher quality issuer, high quality loans in general and potentially go down in the capital structure. But again that's not a story as you know currently.

Brian Smith: Operator, are there any questions for Brad?

Operator: Again to ask an audio question, please press star one on your telephone keypad. If you have a question you wish to ask please press star one. Our first question comes from the line of Sasan Faiz from Morton Capital Management.

Sasan Faiz: Brad, this is Sasan at Morton Capital. Thanks again for the great work last year and I just had a quick question on the non-agency breakdown. It's seems like about a year ago maybe you were about 68 percent in prime and 32 percent in Alt-A.

Right now you're more evenly divided with maybe 48 percent in prime and maybe 52 percent in Alt-A. Can you elaborate a little bit the rationale kind of moving the non-agency breakdown in favor of Alt-A here?

Brad Friedlander: Yes. Great question, thanks Sasan. You know I would say the biggest difference would be the value proposition that we found in option ARMs. It's really about upside potential. And I think there will be really a limited supply as time progresses, a window closing of what we would deem to be money good assets that are trading at significant discounts.
And there is just a limited supply of that in the marketplace. That reared its head last year. The way to take advantage of that was really two ways significantly last year. One was through subprime adding a lot of subprime exposure because there were certainly some money good assets that were at a discount, but also through option ARMs. And we found that to be a superior way just because we believe the price volatility is significantly lower there.

So that explains kind of the difference there. It’s a mid-year shift in more Alt-A, a bit more option ARM, but what I would say, from an ultimate risk, a terminal risk, risk of principal over the long haul, is actually lower with many of the option ARM securities. The only difference would be is that potentially they are a bit more volatile from a price standpoint. But that really kind of explains the differences.

It was a mid-year shift, a mid-year you know value shift that we began to see in option ARMs towards the middle of last year began to look a lot more attractive to us. And especially with some of the liquidations that we saw Lloyd’s Bank out of the U.K. So we began to see that in other pockets as well.

And it ended up being really one of the top performing subsectors last year. So we’re glad we did it.

Sasan Faiz: Also on the value proposition of CLOs, do you think about 20 percent of so that’s as high as you would go on CLOs in the portfolio or do you think that can continue to grow? And can you comment also on the liquidity of the CLO market? How liquid are they? How are you diversifying issuers or issues that you’re buying in? What tranches you are focusing on more?

Brad Friedlander: Yes. CLOs you know still look very attractive to us. The spreads are still at this point extraordinarily attractive. BBBs in the 400 to 450 area, over 600 spread in the BBs as well. Those tend to be the sweet spots for us just because of the ability to still sustain a significant blow, you know a multiple of what we experienced through the economic crisis where default rates across those types of credits had peaked around 10 percent on an annual basis. You could sustain a series of years like that and still be protected from a principal standpoint.

So CLOs in our view still make a lot of sense. They offer a very attractive floating rate coupon that we think makes a lot of sense. Compare that to say floating rate, just the broad bank loans themselves that may have those have floors that may not eventually, as rates eventually rise they’re not capturing on a one for one basis, the eventual moves in coupon and rate movement.

You know the CLOs are pure floaters and will benefit from immediately from the rate rise. So we feel very good about those. We think spreads can continue to tighten. We think on the balance though they’re not significantly discount assets.
You know there is still, you know, a mid 90s discount. So what I kind of hinted to during the call earlier was really around you’re using different sectors for different reasons.

And housing related assets at significant you know residential MBS at a more significant discount represents more upside potentially slightly less coupon, a little less floating rate than the CLO market.

CLOs is a little bit more coupon oriented, floating rate, but also with the potential to tighten, but potentially a little less price return focused and a little bit more coupon focused.

A great question as well as far as liquidity is concerned. The fund is about 18 percent allocated to CLOs. I think that’s the right figure right now. We’ve meet as an investment Committee often speaking about the right figure there.

And I think that’s the right number from us especially when you balance it out with the opportunities we’re seeing in residential, where opportunities we’re seeing in commercial MBS as well, as well as the ABS markets.

Some of esoteric ABS markets that are also have some liquidity, you know some liquidity constraints there as well.

But we think 20 percent a right number. Significantly more than 20 percent in CLOs I think is something you want to be cautious of in a (40-Act) mutual fund. But it’s an area that we’re still constructive on, but again I think that’s the right figure.

Sasan Faiz: All right. Thanks again for your great work.

Brad Friedlander: Thank you.

Operator: Again to ask an audio question please press star one. At this time you have no further audio questions.

Brian Smith: Well, on behalf of Angel Oak and Brad Friedlander, we would like to thank you for joining our year-end quarterly call, and we will look forward to speaking with you again in the future. Thank you.

Operator: This does conclude today’s conference call. You may now disconnect. Presenters please stay on the line.