Semper MBS Total Return Fund Quarterly Conference Call
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Chairperson: Greg Parsons, CEO, Semper Capital Management, L.P.

Disclosures:

Diversification does not guarantee a profit or protect from loss in a declining market.

Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling 855-736-7799. Short term performance, in particular, is not a good indication of the fund's future performance, and an investment should not be made based solely on returns. Gross Expense Ratio: Institutional 3.68%, Investor 3.83%. Certain terms used in the call are defined at the end of the transcript.

Operator: Ladies and gentlemen, thank you for standing by. At this time I would like to welcome everyone to the Semper MBS Total Return Fund Quarterly Call. The views expressed on this call are the current views of the participants and are not intended as a forecast or as investment recommendations. Any information provided with respect to the fund is as of the dates described and is subject to change at any time. Performance data quoted represents past performance and is not a guarantee of future results. After the speakers' remarks, there will be a question and answer session. I would now like to turn the call over to Mr. Greg Parsons, Semper Capital Management.

Greg Parsons: A quick thank you to everyone for finding some time to join us on this call. We look forward to speaking with everyone briefly today and opening up for questions. My name is Greg Parsons, CEO of Semper Capital Management and I'm joined on this call by Tom Mandel, co-founder and senior managing director of the firm.

We look forward to spending a few minutes updating you or introducing you to the Semper MBS Total Return Mutual Fund, a mortgage-centric mutual fund we launched in the summer of 2013.

We'll divide the call into three parts. I'll give a quick overview of the platform for those that are new to us, our story, our products. Tom will discuss our fund and many of the market dynamics that we are seeing. And then we'll open up the call to questions.

So again at the outset I'd like to take just a few minutes on Semper Capital, the firm as we believe our structure, size and skills add a distinct source of value to the fund offering. Semper is a fixed income boutique that currently manages approximately $1.3 billion of assets across the firm.

We're focused on opportunities in what we define as the structured credit space, residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS) and asset-backeds with over $1.1 billion of firm assets in some form of mortgage-centric investment strategy.

These strategies include absolute return strategies, total return strategies, index-based solutions, and we offer these strategies across multiple product formats to include institutional separate accounts, private funds and public funds.

We're privately owned and we actively invest alongside our clients ensuring alignment of interest in both the Total Return Fund as well as our other products. Founded in 1992, we've been providing our fixed-income expertise to a wide range of clients for over 20 years and a highly skilled investment team is supported by robust institutional platform that leverages strong human capital and puts a big emphasis on operations, compliance and risk management.

Before turning it over to Tom and talk about the product and the opportunities we see, I'll close with some high-level comments as it pertains to our thoughts on the opportunity.

First and foremost, we continue to see opportunities to drive value on both an absolute and relative basis within the credit sensitive portions of the structured credit universe. The size, fragmentation and inefficiencies that continue to exist within the roughly trillion dollars of addressable opportunity continue to provide a solid foundation for attractive risk-adjusted returns.

We also believe the combination of our team, their skills, experience and capabilities meshed with the structural positioning of our firm allow us to be extremely nimble and opportunistic which enable us to better exploit the opportunities that exist in this space.

So, I'll turn the call over to Tom talk about more of the fund specifics.

Tom Mandel: Hello, Happy New Year. Thanks again for joining us today. For those of you who don't know me, as Greg mentioned, I'm a co-founder of the firm and I am a member of the senior investment team and excited to have the opportunity to talk to you a little bit about our fund that is focused on mortgage-backed securities (MBS).

So, first just a little bit of background on the fund, I think this is the third call we’ve had talking about it. The fund is now about one and a half years old. We have just completed our first full calendar year. The timing was good when we launched, we talked about it the last couple of calls. We launched the fund in the midst of some of the volatility that was created by the Fed's initial QE taper talk and frankly that opportunity has continued.

Again, the fund invests primarily in mortgages and currently we’re invested primarily in legacy non-agency, RMBS as well as non-agency CMBS. U.S. Bancorp is our fund administrator and custodian and they really provide us with great operational support in every way.

Another key fact, we continue to do a lot of work to make the fund available to our investors. We continue to be added on to more platforms and in fact over the next few weeks we will be on both the UBS and the Fidelity platforms in addition to some of the platforms we are already on: LPL, Lincoln, Schwab, Pershing, TD and so on. And we keep this list of available platforms on our website in case you have any questions at any point.

Let me touch on performance for just a minute. Again, having completed our first calendar year, for calendar year 2014 the performance for the institutional share class SEMMX was 9.33 percent and annualized performance since inception back in July 22 of 2013 through the end of this year was 12.7 percent. Again, that's annualized return for the Institutional share class.

[Note: Performance for the 2014 calendar year for the Investor (Retail) Share Class (SEMPX) was 12.41 percent and annualized performance since inception on July 22, 2013 through the end of this year for the Investor (Retail) Share Class was 8.99 percent.] This performance has come during what has continued to be a very interesting environment over this eighteen-month period. We've had a few bouts of significant volatility in the capital markets as all of you know. Starting again with the volatile rates that we saw in the first couple of months in the summer of 2013 until tapering got pushed back. We had a handful of other events, and then most recently we had the dramatic volatility in October and then again this week. Although, it looks like the stock market is now back pretty close to its record levels.

We've had a very mixed bag of domestic economic results during this period. We had a negative first quarter GDP a year ago. We've had much stronger growth in the last half but there has been a continuation of disinflation talk.

We continue to see generally weak global growth especially in Europe, and at the same time there has been continuations of the accommodative monetary policies globally and we expect more to come out of the Eurozone. But critical to us, we have continued to see for the last few years now, solid and moderating U.S. housing market. The key there remains the fact that the credit fundamentals continue to improve.

Home prices continue to rise although now, home price appreciation going forward looks like it will be in the mid-single digits which we think is healthy. And the commercial real estate market continues to be strong as well.

In the financial markets we've really seen a mixed bag of performance of risky assets. And we had new record highs in stocks for much of last year and again now. We are now seeing a significantly higher yield however in high-yield corporate market.

So in the midst of all of this uncertainty and mixed-bag of information we have seen legacy RMBS and CMBS continue to perform well. Prices rose for the first half of last year and were basically pretty solid for the second half of last year. And I think we've seen a continuation, so far early this year, of that strength.

Barclays PLC recently reported that subprime paper returned about 12 percent last year so another strong year and strong relative to many other fixed-income asset classes. And again, we continue to see improving credit fundamentals leading to cash flow quality increases across most of these legacy sub-sectors.

We basically now have a 10 year history of these cash flows and prepayment history and average lives continue to decline.

We have seen an end to forced selling and even now when we see large bid lists which are appearing from time-to-time from the agencies, from banks, from insurance companies - even from overseas - they've been extremely well bid, a real source of – a real way to look at liquidity in this marketplace. And frankly we continue to see these bonds being held in stronger and stronger hands.

Technical strength in this marketplace continues. The supply has declined, call it 10 percent a year, but it's still more than large enough and frankly the market today for legacy RMBS is still as large as it was back in 2004 before that spike in issuances we saw in 2005 to 2006.

Next I'll briefly talk about the current composition and structure of the fund. I'm happy to answer specific questions later and of course I would refer you to the fact sheets that many of you received through e-mails and that are available on our website. In fact, the December fact sheet is available starting today.

We continue to be extremely well diversified with over 200 securities and these securities are allocated across more than 30 micro sectors or sub-sectors in this legacy market. We're very diversified in terms of underlying collateral in myriad ways.

For example, we own – a significant portion what we own participates in upside price optionality to both commercial and residential real estate markets

and a portion of the bonds that we own are purchased for their very strong stability and return profiles, given their expectation for cash flows.
Sector allocation: not a significant change from the end of the last quarter. At the end of December we had about a 64 percent allocation to non-agency RMBS, about 4 percent allocation to agencies, about a 20 percent allocation to CMBS, 7 percent allocation to asset-backeds and about a 5 percent allocation to cash, which again is an appropriate level of cash for liquidity purposes.

One comment in the legacy RMBS space, the allocation to Subprime is a little bit higher and allocation to Prime is a little bit lower than it was a quarter ago. And frankly that's because we've taken advantage of some significant price rises in some of the Prime paper and in the Subprime paper, again, given the strengthening fundamentals in many of these micro sectors we've seen the opportunity to add to positions in seasoned Subprime mezzanine paper. And we're buying these bonds essentially in the eighties and the low nineties.

In terms of interest rate sensitivity, duration of the fund is about 2.2 years at the end of the year. That's just a little bit lower than what we were at the end of September. But the empirical interest rate sensitivity continues to be lower than that. As we continue to see the opportunity for increasing prepayments, resulting from credit quality improvement of borrowers and underlying mortgages.

The duration of the prime sector positions is about three years, up just a little bit from two and a half at the end of September. Again, that's really reflection of the bonds that we've sold. The duration of the Alt-A positions we have continues to be about three years. Subprime subsector duration is still about 2.2 years. CMBS duration is just a little bit lower, just under two years, so again, not a material difference.

The average dollar price of the portfolio today is about 90 and that's unchanged from a quarter ago. So no material changes for the subsectors. The average dollar price of our Prime bonds is 88. For the Alt-As also 88, and Subprime about 87. CMBS average dollar price is a little bit higher at about 92.

A few of the other key characteristics, one of the very important metrics and continuous topic of our risk management activities is our target for liquidity. We're currently targeting liquidity in the fund of about 40 percent in a day, about 50 percent in a week, 70 percent in two weeks with the opportunity to liquidate 100 percent of the securities within a month, if necessary. And this liquidity is further supported with the line of credit that we have with U.S. Bancorp in case of redemptions.

The portfolio continues to be extremely well-seasoned. About 40 percent of the positions are pre-2005. That seasoning is even greater for Subprime - that number is about 60 percent before 2005. We still have 60 to 65 percent of our positions are senior and as I described a little bit in our last call, we also own a number of mezzanine classes that are behaving as senior bonds because of their significant seasoning and the pay downs of some of the senior classes above them. We still have a great deal of floating rate exposure. About 55 percent of the portfolio is floating rate paper and turnover continues to be about 10 percent a month.

And importantly the loss adjusted yield to maturity - again, we look at yield to maturity in terms of loss adjusted and we're looking for and have expectations for future defaults in the collateral - remains about five and a half percent, so that's unchanged from the end of last quarter.

I'll spend a couple of minutes talking about our current views on the sectors. In terms of non-agency we believe that value continues to remain for a number of the legacy subsectors. The market continues to still be large enough for us, over $700 billion of legacy RMBS alone continues to be opaque, fragmented, again more seasoned, with 70,000 or more cusips, many of which are now 10 years old.

I mentioned season Subprime mezzanine paper being attractive, that's one area that we're certainly focused on.

We continue to be very interested in low loan count, low loan balance securities, which again are credit intensive and can offer some great premiums. We continue to like single family rental securitizations which are growing in size and interest.

And again as I mentioned, we do have more Subprime than we had three months ago and that really is providing us with more optionality to improving fundamentals that we continue to see.

Agencies, it's the same story for us. Although, negative extension risk or extension risk and negative convexity are a little bit reduced at this point we still think that they are almost priced to perfection. Yields are low, spreads are low. We think that they are at risk of widening.

CMBS, our view remains relatively unchanged. They've done extremely well on the whole. As the commercial real estate fundamentals continue to recover, demand and liquidity have certainly picked up and we continue to see a great opportunity to own both a combination of securities such as well seasoned subordinated bonds with good credit enhancement but still some optionality to improving fundamentals.

Going forward, our near term outlook is to keep our sector allocations relatively unchanged. So for the first part of 2015, we're looking to keep 60 to 65 percent of the portfolio invested in non-agencies, 20 to 25 percent in CMBS, and then call it 10 percent in the combination of cash and agency CMBS. We intend to keep duration short.

We think we're in a spot where we will avoid a great deal of the potential interest rate volatility that we're expecting. We plan on keeping liquidity high and we expect to keep our loss adjusted yield similar to where it is today.

In the non-agency space, we'll continue to seek out these less well-sponsored micro sectors like seasoned Subprime, and the low loan count types of deals.

CMBS, it'll be more of the same with a diversified basket of subs with good optionality and some low volatility securities as well with lots of excess coverage, even in worst case, loss scenarios. We will continue to have a bottom up focus on undervalued cash flows across the MBS and CMBS sectors. Security selection and credit worthiness is first and foremost for us.

So we remain confident that the structured credit market is here to stay. There will be – continue to be - opportunities for us to add value. We continue to see pockets of emerging sectors like the single family rental deals and credit risk transfer deals continue to grow and are becoming more interesting.

In our view we expect to see increased volatility again in 2015 and we firmly believe that the legacy RMBS and CMBS sectors position us well to generate, to have the opportunity to generate, attractive returns in this environment relative to some of the other fixed income sectors that one can invest in.

So I'd like to just end by inviting you to call us, e-mail me, visit us at any time. I look forward to continuing the conversation and answering any questions you may have, and now I'll pass it back to Greg.

Greg Parsons: Great. Thanks Tom. In closing, so you know the fund today is approximately $160 million of assets with a robust pipeline, up from $125 million last quarter. We remain excited about the opportunities we're seeing in the market that drive value and I want to personally thank those on the phone, who are already investors for their support to date and look forward to welcoming those who are on the phone evaluating opportunity for their attention and their diligence.

Our newest market commentary will shortly be up on our firm website, www.sempercap.com along with factsheets showing performance, allocations, and the fund statistics. We're making this call available replay and it will be on the website as soon as well.

At this stage we'll open up for questions from the participants.

Operator: To ask an audio question, please press star one on your telephone keypad that is star one to ask a question. We'll pause for just a moment to compile the Q&A roster.

Again, to ask an audio question, please press star one.

And there are no audio questions at this time, sir.

Greg Parsons: Great. Thanks again. We look forward to continuing the dialogue and again as Tom mentioned, please visit us any time in person and phone. Have a great day.

Operator: Thank you for joining today's conference call. You may now disconnect your line.

Definitions:

Cash Flow: Mortgages typically have required monthly interest and principal payments which are collected by servicers of mortgage-backed securities trusts, which in turn distribute these payments to MBS investors.

Duration: Measure of a bond or bond portfolio’s sensitivity to changes in interest rates. Generally, the longer the duration, the greater the price change relative to interest rate movements.

Yield To Maturity: Anticipated rate of return on a bond if held until the maturity date.

Loss Adjusted Yield-to-Maturity: Yield-to-Maturity for a mortgage-backed security after adjusting projected cash flows lower to reflect assumed credit losses on underlying mortgage loans.

Negative convexity: Convexity is the rate of change of a bond’s duration as interest rates rise or fall. The rate of change of duration for bonds with predictable cash flows increases as interest rates decline, enhancing the bond’s expected price appreciation as rates decline, and slightly mitigating the bond’s price decline as rates rise. However, callable bonds including mortgage-backed securities, which may have unpredictable cash flows, exhibit a rate of change in the opposite direction, or negative convexity, such that a bond’s price rise from declining rates is mitigated, while a bond’s price decline from rising rates is accentuated.