Semper MBS Total Return Fund Quarterly Conference Call
March 26, 2015, 11:30 am, E.T.
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. Liquidity Risk:. Low or lack of trading volume may make it difficult to sell securities held by the Fund at quoted market prices.

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.

Empirical Duration: The ex post interest rate sensitivity of a bond.

Basis Points: A unit of measure that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument.

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 of the current views of the participants and are not intended as a forecast or as investment recommendation. Any information provided with respect to the fund is of the dates described and is subject to change at any time. Performance data quoted represents past performance and is not guarantee of future results.

After the speakers' remarks, there will be a question and answer session. I will now turn the call over to Greg Parsons with Semper Capital Management, please go ahead.

Greg Parsons: Well, I want to say thank you to all for attending our quarterly call. Tom Mandel and I look forward to spending a few minutes updating or introducing you to the Semper MBS Total Return Mutual Fund, a mortgage centric mutual fund that we launched in the summer of 2013. My name is Greg Parsons, CEO, Semper Capital Management joined on the call by Tom Mandel, co-founder and Senior Managing Director of the firm.

We'll divide the call into three parts. For those new to our product or new to Semper the platform, I will give a quick overview of Semper. Tom will discuss our fund and many of the market dynamics that we are currently seeing, and then we'll open up the call the questions.

So I'd like to take just a few minutes on Semper Capital, the firm as we believe our experience, structure and size add a distinct value to the fund offering. We're a fixed income boutique with a strong focus on structured credit that currently manages approximately $1.3 billion of assets across the firm, with $1.2 billion of those assets in some form of mortgage centric investment strategy. The strategies include absolute return, total return and index based solutions and are offered across multiple product formats to include institutional separate accounts, private funds and public funds.

We're a privately owned firm that actively invests alongside our clients ensuring alignment of interests for the total return fund as well as our other products. Founded in '92, we've been providing fixed-income expertise to a wide range of clients for over 20 years and our highly skilled investment team is supported by a robust institutional platform that leverages strong human capital and place a strong emphasis on operations, compliance and risk management.

Quickly before turning it over to Tom to talk about the Total Return Fund and the opportunities we see, I'll close with some high-level comments as it pertains to the opportunity.

First, 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 inefficiency, that exists within a roughly 900 billion dollars of addressable opportunity continue to provide a solid foundation for attractive risk-adjusted returns.

We also believe accommodation of our team, their skills, experience and capabilities within the space and the structural positioning of the firm allows us to be extremely nimble and opportunistic and to better exploit opportunities that exist within the space.

Specifically, as the universe of legacy residential mortgage-backed securities (RMBS) continues to season and the overall credit quality of the residential space continues to improve, we see continued and frankly growing opportunities for a smaller yet institutional quality structured credit research driven firm like Semper to invest in attractively valued securities which are not on the radar screen or have fallen off the radar screen of the large money managers.

Two critically important elements of this market as we forecast further in 2015 are the impact of interest rates and questions around liquidity. We believe the Fed is on the path of raising its target interest rate and the implications are important. We believe that this sector is particularly attractive in terms of its relatively low sensitivity to rising rates.

I'll now turn the call over to Tom talk about the fund.

Tom Mandel: Thanks very much. Hello. Thanks for joining us. Let me start out with just a bit of more history of the MBS Total Return Fund. As Greg mentioned, we started in 2013 in late July, so we're now about 20 months into the fund's history.

As I've mentioned before the timing was good when we launched and the opportunity just continued and by some measures, we believe the opportunities have even gotten better. The fund invests primarily in mortgage securities and currently we remain invested primarily in legacy, non-agency, RMBS, as well as commercial mortgage-backed securities (CMBS). U.S. Bancorp which is a leading bank in the MBS custody business is our fund administrator and our custodian and they provide us with very strong operational support.

We continue to work to make the fund available to investors in a broader way. We continue to get added on to more platforms; we're excited to say the fund is now available on both UBS and on Fidelity adding to the list which includes: LPL and Lincoln, Schwab, Pershing, TD, Vanguard, ScotTrade and a bunch more. We keep this list of available platforms on our mutual fund website and we'll give you that name later. As an aside, our new prospectus and SAI will also be available on the website within the next few days.

Next, touching on performance for a moment. So we, again, the two year mark is now in sight. For calendar 2014, the fund returned 9.33 percent net for the institutional share class. 2015 year to date, the institutional class has returned about 1.5 percent in line of our expectations. Annualized performance since inception back on July 22 of '13 through the end of the last calendar quarter, December 31st was 12.7 percent for the institutional share class. And this performance has occurred during what continues to be an interesting market and economic environment over this past couple of years. We've continued to see some bouts of fairly material volatility in the capital markets driven by a couple of things including diverging global economies, diverging currencies and interest rates. And also by the Fed trying to determine how to best replace their dry powder, you know, first by the tapering that occurred last year, and second by raising their target fed funds rate most likely this year. We have had continuing improvement in the U.S. housing market which is critical of course to both the economy as well as to the MBS markets broadly. And the key there remains to the improving credit fundamentals. We continue to see mid–single digit home price appreciation on average, along with strong rents nationally. And we continue to see improvement in the commercial real estate valuations.

In the financial markets we've also seen a mixed bag of performance of risky assets despite volatility however, a number of the markets are still near record highs as of now. You know, in the midst of this Legacy RMBS and CMBS have continued to do well. Prices ground higher for much of last year, spreads continue to contract for much of the period and it’s been steady if not exciting so far this year. By all measures, the Legacy market was one of the top performing asset classes of last year and it started out 2015 well. Prices in many cases are at or near their highest since back in 2005–2006.

We've seen continuing improvement in the credit fundamentals leading to cash flow quality increases. Bonds continued to be increasingly seasoned which continues to reduce uncertainty for investors, decrease unknowns. We now have 10 years of history for a number of these bonds and consistent with that, declining average life.

We have not seen forced selling in some time. We continue to see a reasonable number of large bid lists from banks, insurance companies and from overseas and they have been extremely well bid. We believe that these bonds continue to get held in stronger and stronger hands.

Technically the market – the RMBS market continues to strengthen as well as we continue to see a reduction in supply of about 10 percent a year but as Greg mentioned at $900 billion I believe RMBS and CMBS it is still more than large enough and in fact, just as large as the market was back in 2004 so we still see plenty of opportunity there. And we see demand continuing as institutional investors continue to look for yield as well as looking to replace cash flows that get paid down.

So let me next briefly describe the current composition and structure of the fund. And again, I'm happy to answer specific questions later and of course, our website has the most current fact sheets which go out monthly and have updated information.

The fund remains well diversified in terms of securities, We have over 200 securities across multiple sectors. The sector allocations have not changed materially since our last call three months ago. We still have about a 65 percent allocation to non-agency RMBS, and that consist of Prime, Alt-A and Subprime. We have a little bit more Subprime than Prime and a little bit more Prime than Alt-A.

And our slight preference for Subprime at this point is really many-fold. It's a combination of yields that we're getting in that space, the low interest rate sensitivity for much of the Subprime market as well as still having some good positive optionality to improving real estate markets.

In the non-agency CMBS space, our allocation is a little bit lower worth 18 percent versus 20 percent three months ago. In general, CMBS have continued to do well. We've certainly seen a couple of subordinated securities– a little bit of volatility.

In terms the most liquid portion of portfolio, we continue to have about a 10 percent allocation to agency MBS and cash, again consistent with what we've done over the past couple of quarters and where we think we need to be.

Duration is about 2.3 years with empirical interest rate sensitivity even a little bit lower than that. And by the way, with the short duration we've had very little exposure to the part of the yield curve that has benefitted from the decline in longer rates. So with about a two year duration, we're obviously – the interest rate sensitivity is similar to a two year treasury – two year treasury yields have actually risen quite a bit over this past year as the 10 year has rallied.

The average dollar price of the portfolio is about $90, that's consistent with a quarter ago and that's versus a cost of about $88. And that $90 price is fairly similar across each of our major subsectors. There are still large portions of the legacy markets trading in the 70's and even lower. So this average dollar price of $90 provide some sense of the relative quality of the cash flows that we're investing in.

One of the benefits of investing in cash flows below par of course is that, if prepayments do strengthen for these borrowers, the timing and value of these cash flows improves significantly as prepayments increase. Other characteristics: one of the most critical metrics that we talked about continuously as to the investment team and risk committee is liquidity. So our target of liquidity currently is 20 percent in a day, 50 percent in a week and close to a hundred percent in a month. In other words, we believe, we can liquidate those securities, in those percentage of our portfolio at current valuations given current market conditions.

We think the portfolio is in line with those targets and we've had success and meeting expected routine redemption activities which I can talk about again a little bit later. So we do have some on–going proof of concept.

I mentioned earlier that much of the legacy universe has been outstanding for several years. So seasoning of the portfolio: more than 40 percent of what we own was issued before 2005 so again, 10 years or longer and it’s even a greater percentage for Subprime. 60 percent of our Subprime positions are over 10 years old. That's really important because we obviously get a growing data bank of information about how these borrowers and the securities act. 60 percent of our assets are senior in the cap structures, this of course is important.

The portfolio still has over 50 percent in floating rate notes. Turnover continues to be about10 percent a month. We think this is a reflection of our ability to identify value and to trade efficiently, and we also believe it’s a reflection of liquidity for a small nimble firm and a fund like ours. The gross loss adjusted yield maturity of the fund is about 5.5 percent today which is the same as it was a few months ago. (30 Day Sec Yield – SEMMX Subsidized: 4.84, Unsubsidized 4.79)

And performance: So we talked about performance earlier. In terms of performance attribution, the primary sources of this performance have been number one, interest income which contributed about 60 percent of our funds’ performance over the past year. Gains through trading - realized gains and we believe that our size provides us with the opportunity to be nimble and take advantage of trading opportunities. That trading has contributed about 20 percent of the fund performance. And then the other 20 percent of fund performance over the past year has come from price appreciation. We've seen all of our subsectors do fairly well. Our allocation to Alt-A longer cash flow bonds has done just a little bit better as they've had longer cash flows, longer durations and have benefitted from the credit group flattening over the past several months. And as I mentioned, CMBS in general has been helpful with slightly higher yields than our MBS positions, on average but we have had just a little bit of price noise in a couple of securities.

Let me talk about sectors for just a second, our view on sectors. Our view on the non-agency market overall is systematically the same as it was in the last quarter. We still believe that there's value available to us in many portions legacy RMBS market. You know, the market still remains large from our perspective with over $750 billion in legacy RMBS alone. It continues to be very fragmented, more seasoned than ever. More than 70,000 cusips which I believe I mentioned before.

Cash flow quality, cash flow credit quality continues to improve as interest rate sensitivity continues to decline. And the technicals as I mentioned before continue to improve as the market shrinks slowly and steadily. You know our primary job is to add value by identifying attractively price securities and we continue to find portions of this sector offering attractive complexity premiums, which offer the opportunity for higher returns for one who is willing and able to do this work, which we are.

Some of the interesting areas for us continued to included seasoned Alt–A and Subprime mez bonds which are still locked out and have solid amount of upside price optionality. Low loan count deals, some low loan balance deals and single family rental securitizations.

As Greg articulated, we believe we're well positioned within the space and as a small yet credit research intensive shop, you know, we can focus on less well sponsored opportunities. One example is with low loan count RMBS. So generally these are considered to be mortgages with fewer than a hundred underlying loans in contrast to new securitizations that will have anywhere from several hundreds to a couple of thousand loans. Of course, they didn't all start that way, so over time, many of these loans have paid off and or have defaulted. You know these deals are now smaller; they’re less well covered and less well sponsored. They’re smaller deals in the millions or tens of millions of dollars instead of hundreds of millions of dollars and we focus on finding and analyzing these low loan kinds of deals in looking for incremental value.

Because of their characteristics, they tend to be available at higher yields, everything else is equal, you know cheaper or higher in yield than comparable larger securities. So investing in just one these deals obviously would increase idiosyncratic risk with more variance in monthly pre–payment feeds, more variance in credit statistics, but investing in a large number of these makes them behave in the aggregate very much like a larger deal with higher return potential. So this is an example of a way that we believe that we can add value based on our size and nimbleness.

In terms of our near term expectations, we plan to keep 65 to 70 percent of the fund invested in non-agencies. Another 15 to 20 percent in CMBS and then we'll continue to keep 10 percent or so in cash and agency securities. We plan on keeping duration short where it is, keeping liquidity high and continuing to target an attractive loss adjusted yield.

And we will continue to focus on the portions of the market in which we believe we have a strong competitive advantage. We remain confident that this structured credit market is here to stay. We continue to see growth in emerging portions of this market again, like single family rental deals, credit risk transfer deals by the Agencies and so on.

You know, in our view, this sector can currently continue to generate attractive yields in total rate return as it has and we believe that this sector is well positioned to do this even if rates do start to rise. So just in conclusion, as I hopefully remember to say whenever we have these calls this is my invitation for you to call me, to email me, to visit us at any time, so I can talk more about the fund; and let me pass it back to Greg.

Greg Parsons: Great. Thanks Tom. A great review of the portfolio. So again in closing we're proud of the fact the fund today approximately $175 million of assets with an extremely robust pipeline on a go forward basis, up from approximately $160 million a quarter ago.

We remain excited about the opportunities we're seeing in the market that drive value and I want to thank those on the phone, who are already investors for their support to date. I'm also pleased to say, that our new fund website is up and running. And you'll find our most current fact sheets, performance statistics, conference call replay, etc. posted there. We're making this call available for replay on our website soon.

At this point, we'll open it up to questions.

Operator: At this time if you would like to ask a question, please press star followed by the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Tom Mandel: Thank you.

Operator: And our first question comes from the line of (Andrew Dean).

(Andrew Dean): Yes. You mentioned duration earlier; can you talk more about how you are positioned for interest rates and specifically how the fund has done during recent periods of interest rate moves?

Tom Mandel: Certainly, so as I mentioned, you know, we've been keeping duration in a range of two to two and a half years. About 40 percent of the fund has a duration of under two years about 80 percent under four years. I mentioned earlier that over half of the portfolio is invested in floating rate securities which act as if they have very short duration, as long as credit spreads remain unchanged. And from a fundamental standpoint, we believe that the improvement in credit quality of much of what we own will do a great deal to counter interest rate risk should rates go up. You know, basically, as rates eventually rise in an environment of a strengthening economy and housing market we believe we'll continue to see credit quality improvements. We think that will result in refinancing picking up as home equity continues to improve for many of these borrowers who had negative home equity for a number of years, as more of these borrowers get better jobs and perhaps move to other locations. And as credit availability slowly improves, we think that will help as well.

So the bonds that we buy in the 70's or 80's or low 90's to the extent we get more of that principal back at 100, that shortens the interest rate sensitivities of the bonds. I would say that so far the fund has had very low correlation to changes in interest rates. I think there have been six months where interest rates have risen, six calendar months with interest rates rising since the launch of the fund. We've had positive performance in each one of those from a combination of improving credit quality and low duration. So just talking about the last few, in February of this year, the five year treasury rose 35 basis points and our performance was over a percent. Last December the five year treasury rose about 15 basis points, our fund returned 43 basis points. And similarly, last July, the five year rose 15 basis points and the fund returned about 84 basis points. So far these securities have demonstrated that they have very little empirical duration.

(Andrew Dean): Thank you.

Tom Mandel: Thank you.

Operator: And as a reminder, that's star one, to ask a question. Your next question comes from the line of (Ethan Ruby).

(Ethan Ruby): Hi guys, thank you for your time. I'm curious to see what factors you guys are tracking for specific threats to these funds. In other words what are the kind of canary in the mine combination of factors that you guys see as the biggest risk to the overall success of this investment strategy?

Tom Mandel: Well, I would say that the biggest long term risk would be a systemic decline in real estate values - clearly the ability for home owners to pre–pay their mortgages is critical. So that's one risk. I think our view however, is that home prices, real estate prices in general you know, remain attractive having come down a third from where they were at the peak of the market back in 2006, so we think that a lot of that irrational exuberance is out of the real estate market so frankly, we just don't see that as a major problem. And of course, the ability to borrow today is much more difficult than it was before so we think that these legacy securities having been around for many years and we've seen how they perform we think they are going to be in pretty good shape. So we don't see a major correction in real estate prices but certainly that would be a concern. Secondly, perhaps the more realistic near term risk is a material flight to liquidity or quality in the capital markets. So if something happens globally and the stock market goes down 20 percent, you know, that will hurt the pricing of all risk sectors. In the sectors we invest in we could easily see the bid side for bonds coming down and that would have a near term negative impact on performance for this bond. But that would not necessarily have any impact on yield from the cash flows of these securities.

(Ethan Ruby): OK. Thank you. And then based on the flip side, if the market did start to correct significantly at what point in time are you guys starting to take action to mitigate those – the impact it would have on this portfolio.

Tom Mandel: Well, you know, we're constantly evaluating relative value and credit risk so I think that we would hopefully – again, being a small shop which hopefully can be more nimble we think that if prices were to begin declining, given that our fund is the size that it is we think it would be easier for us to reposition into other securities and/or cash if we felt that was really important. Perhaps though, I would look at it from the flipside that if bonds were to become more attractively priced, it would be an opportunity for us to purchase securities at lower prices and better yields.

(Ethan Ruby): OK. Thank you very much. Appreciate it.

Tom Mandel: Thank you.

Operator: And our final question is from line of (Alexandra Hill).

Tom Mandel: Hi.

(Alexandra Hill): Hi team, thanks for the time, as always. Given that the fund is relatively new, can you talk about your redemption activity so far and if the liquidity has been as expected.

Tom Mandel: Certainly, so as I mentioned before, liquidity is one, if not the key, risk management considerations in managing this fund. And as our fund has gained some history you know we've certainly seen some redemption activity and we believe it’s a healthy level. We've had no issues in meeting these redemptions, while maintaining our target sector allocations.

Over the last several months, we've had redemptions of as much as call it 10 percent of fund assets in any one month and so liquidity has been as expected so far. Also, as I talked about earlier we really look at liquidity in a couple of different ways. First we are targeting an amount of liquidity over time so a percentage of the portfolio that we believe we can liquidate in a day, in a week, in a month at fair value.

Obviously that is constantly revaluated given current market conditions. And then secondly, we look at the cost of selling X percent of the fund in a certain time frame. So if we had to sell 50 percent of the portfolio in two days, what would be the implication? Obviously there would be some cost associated with that, given bid ask spreads.

So whenever we buy a bond, we are essentially giving it a liquidity score and we're constantly updating that. We also can assess liquidity through market observations. So for example, looking at the strength of large bid lists that hit the market periodically. So even during periods of less trading, you know, we've seen significant interest and strong levels on those bid lists over the last several months.

Another way to look at it is the firmness of offered size that we see during flights to liquidity and quality across the risk spectrum. So last fall, we had a period where trading declined significantly across all risk sectors - not just MBS. And in the RMBS space, what we saw was, you know, bonds were bid back but the offered size didn't budge. So that really gave us a good sense of ultimate liquidity.

And then, we also look at trading activity market wide. So over the past year trading activity in non–agencies has averaged over a billion dollars a day which is pretty good relative to the size of the market. And I should just add that, in closing, in terms of liquidity we have a 20 percent line of credit with U.S. Bank, our custodian, in place for redemptions that further supports our liquidity.

So again, if we have a large redemption today and we don't want to sell bonds, we have that 20 percent facility in place.

(Alexandra Hill): Understood Tom. Very helpful. Thank you.

Operator: OK. And there are no further questions. I'll not turn over the presentation back over to you. OK. Sorry, one moment, we do have a question from the line of (Tim Ross).

OK. Hi, (Mr. Ross), your line is open, please unmute.

(Tim Ross): Hi Tom, thank you.

Tom Mandel: OK.

(Tim Ross): Tom, could you provide the breakdown between CMOs and passthroughs in the portfolio. And then to the earlier point from others asking the questions around liquidity, what would you say would be the optimal fund size bearing in mind the other assets with the firm.

Tom Mandel: Answering the second question first. You know, we believe that this fund can easily be about $2 billion in order for us to continue to add value in the way that we do. Obviously, we have a ways to go to get there but we feel very confident in that size and we think what we've seen other mutual funds do is also consistent with that view.

In terms of the allocation between passthroughs and CMOs, I will circle back with you. Certainly the majority of the bonds in the RMBS space in the non–agency RBS space are tranched, so most of them are CMO structures.

But I will follow with the specific response if that's OK.

(Tim Ross): OK. Thank you.

Tom Mandel: Thank you very much. Thank you for listening in.

Operator: There are no further audio questions.

Greg Parsons: Great. Well, again, for those that are supporters invested to date, we appreciate the support, for those that this is an introduction to Semper and our fund. We look forward to building relationship and want to thank everyone for their time this morning.

Operator: And this concludes today's conference call. You may now disconnect.

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