Semper MBS Total Return Fund Quarterly Conference Call

January 7, 2016, 11:30 a.m., E.T.

Chairperson: Greg Parsons, CEO, Semper Capital Management, L.P.

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.

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.

Barclays US MBS Index: Covers agency mortgage-backed pass-through securities - both fixed-rate and hybrid ARM - issued by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). Pool aggregates must have at least $250 million outstanding with a weighted average maturity of at least 1 year. One cannot invest directly in an index.

Barclays U.S. Aggregate Index: Represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. One cannot invest directly in an index.

Correlation: Statistic measure of how two securities move in relation to each other.

SEC Yield: A standard yield calculation developed by the Securities and Exchange Commission (SEC) that is based on the most recent 30-day period covered by a fund's filings with the SEC. The yield figure reflects the dividends and interest earned during the period, after the deduction of the fund's expenses.

Unsubsidized SEC Yield: 4.67%

Diversification does not guarantee a profit or protect against a loss in declining markets. Fund holdings and/or sector allocations are subject to change at any time and are not recommendations to buy or sell any security.

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 express on this call are the current views of the participants and are not intended as a forecast or as an investment recommendation. Any information provided with respect to the fund is as of the dates described and then subject to change at any time.

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.

After the speakers remarks, there will be a question and answer session. To ask a question, please press star and then the number one on your telephone keypad. To withdraw your question at any time, please press the pound key. I would now like to turn the call over to Mr. Greg Parsons of Semper Capital Management.

Greg Parsons: Good morning. Thank you for joining us on our quarterly call. For existing clients or partners of the firm, great to have you with us, and for those new to Semper, a big welcome.

I'm Greg Parson, CEO Semper Capital Management and I'm joined on the call by Tom Mandel, a Co-Founder of the firm and Senior Member of the Investment Team. Tom and I will spend 15 to 20 minutes providing an update on the Total Return Fund, a mortgage centric mutual fund that we launched in mid-2013. We'll divide the call into three parts. I'll give a quick update on the platform. Tom will provide an update on the fund and outlook on the markets and then we'll open up to questions.

So for those that are new to Semper, we're a privately owned fixed income boutique that currently manages approximately $1.3 billion of assets across the firm. We focus almost exclusive in opportunities in the structured credit space, residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS) and asset-backed securities (ABS). Our strategies include absolute return, total return, index based solutions and are offered across multiple products managed to include institutional separate accounts, private funds and public funds. I'm happy to state that the Semper MBS Total Return Fund is now one of our largest offerings and is rapidly becoming a cornerstone of our business having crossed over $480 million of assets.

Founded in 1992, we've been providing our fixed income expertise to a wide range of clients for over 20 years, our highly skilled investment team is supported by a robust institutional platform that places a strong emphasis on human capital, operations, compliance and risk management. And as a distinction, we believe that our firm structure, size, and skill set add distinct value to the fund offering. Before turning it over to Tom to talk about the portfolio and the opportunities we continue to see in the mortgage space, let me add some high level comments as it pertains to the opportunity.

First, and frankly most important, we continue to see opportunities to drive value on both an absolutely and relative basis within the credit sensitive portion of the structure credit universe. The size, fragmentation, inefficiencies that continue to exist within what is roughly $700 billion of addressable opportunity continue to provide a solid foundation for attractive risk adjusted returns. This has only been enhanced by the market dynamics that we saw last year and continue to see with spreads widening while overall credit quality continues to improve. We also believed the combination of our investment team, their skills, experience, and capabilities meshed with structural positioning of our firm allows us to be quite nimble and opportunistic and better exploit opportunities that exist within the space.

The senior investment team averages well over 20 years of experience managing this asset class and as volatility remains high and the economic and monetary policy cycle slowly moves forward, we believe this experience is paramount.

As the universe of Legacy RMBS continues to season and the overall credit quality of the residential real estate space continues to improve, we see growing opportunities for a smaller yet institutional quality structured credit research driven firm like Semper to invest in the attractively valued securities and mortgage assets that either not on the radar screen or fallen off the radar screen of large money managers.

Specific to the market conditions, two of the very important elements within this market, as we move in 2016 are the impact of potentially rising rates and an increased focus on liquidity. You know, relative to rates, the Fed made their first measured move in December and we believe they will continue to gradually raise their target interest rates over the next several quarters and the implication to the capital markets are important. Really, we believed that this sector, you know, mortgage sector at large is particularly attractive in terms of its relatively low sensitivity to rising rates. Second, liquidity has been a growing topic of concern across the fixed income marks of the last few years and it will continue to grow in importance. Risk management is very important part of our investment process and is integral at each state of our activities. Liquidity management and assessment is a key component of our risk management process.

I'll now turn the call over to Tom to talk a little about the portfolio and the markets.

Tom Mandel: Thank you all for taking time in to listen to our fund update and Happy New Year. We are still very excited by the growing interest in our fund and I look forward to spending a few minutes talking about the fund. I'm particularly proud to say that 2016 marks our firms 25th year as a registered investment advisor so we have now been around for a while.

If you're listening to us for the first time, I'm Tom Mandel and as Greg said, I'm a co-founder of the firm and also a member of the investment team. So, I will start with a quick review of the history of the fund. The fund started in July, late July 2013. We're now in our 30th month and as Greg stated, we've just crossed $480 million.

The fund has shown solid growth growing from about $150 million year ago but rest assured the fund remains small and nimble and has significant capacity to continue its same growth trajectory. The investment strategy of the fund is to invest primarily in mortgage securities, and our primary sector concentration as we've talked about in the past has been in legacy non-agency RMBS - residential mortgage back securities.

There haven't been any changes to any of the fund service providers. U.S. Bancorp. which is a leading bank in MBS custody is our fund administrator and custodian. The number of ways that you can invest in the fund including on broker dealer and clearing platforms that offer the fund continues to grow and we keep this list of available platforms on our mutual fund website, www.semperfunds.com, if anyone has any questions at any point about how to purchase the fund, either directly or through one of the platforms, please contact me or anybody at the firm. At this point, we're now approved on virtually all clearing platforms that your firms may utilize. The final operational update I would like to announce is that we have added an A share class. The ticker is SEMOX, so now we have three share classes including the institutional share class and an investor or a retail share class.

Before talking about performance and positioning, I'd like to reiterate Greg's point that risk management is an important part of the investment process and has never been more important than it is today. We believe we're very good at assessing mortgage credit risk. That's the risk we want to take and that we believe we're being paid for. However, there are a number of additional risks that we have to evaluate and manage everyday including liquidity risk, which of course as a major focus in the fixed income markets; macro or systemic risks for which we seek to keep correlations low, and then finally, interest rate risk. And we believe that this sector, this non-agency, this legacy non-agency sector lends itself to effectively mitigate in managing and manage many of these risks.

Allow me to provide a fund performance update next. So for the for the full calendar of year 2015, performance net of expenses for the institutional share class was 4.18 percent, that compares to 1.51 percent to the Barclays MBS index which is an excess return of 2.67 percent.

Annualized performance since inception for our fund again back in July 22nd of 2013 thru year end was 9.13 percent for the institutional class versus the Barclay's MBS index which returned 3.29 percent annualized during that period. And during the fourth quarter, performance ended up positive 0.39 percent net with the index at -10 basis points during the quarter. The fund’s total return has been positive or was positive for each month of the year despite the volatility we saw in credit spreads, interest rates and equity markets for much of the period. The primary source of performance during the year was interest income. Dividends on the fund totaled about 5 percent made up of interest income plus gains on monthly paydowns minus fund expenses.

Realized gains were fairly low for the full year and prices declined on average by about 1 percent over the course of the year with the small allocation we have to CMBS in the portfolio declining by a little bit over 2 percent over the course of the year, and non-agency RMBS declining by a little bit less than 1 percent on average. So this pause in the rise of prices which we had seen pretty consistently since the second quarter of 2009, in our view is a positive because it allows us to invest the new capital at higher loss adjusted yields to maturity at this stage.

So with the higher level of volatility across the risk markets during the 2015 calendar year including high yield corporate bonds and equities, we view this performance in the non-agency RMBS sector as being pretty good. Going into 2016, we've got a lot of the same concerns as we had last year including the trajectory of the Fed’s interest rate moves, global growth or growth deceleration led by China, commodity prices and their implications for emerging markets as well as for the Middle East and of course market liquidity. The Fed currently is stating that they expect to raise their target Fed Funds rate four times this year. Market consensus is for it to happen fewer times than that and while it’s far from certain that intermediate or the long term interest rates will move much, at a minimum we certainly expect the two year treasury to continue moving higher. The two year rose from about 60 basis points of beginning of last year to a little bit over 1 percent at year end and is now falling back slightly below 1 percent, while the 10 year rose from about 2.15 percent to about 2 1/4 at year end, back of course to 2.15 as of now. We do expect bond liquidity to remain at lower levels although importantly, we believed that this liquidity will remain sufficient for our investment strategy and we do think they'll be significant volatility across all risk markets over the course of the year. However, with all of those uncertainties that we're facing, the critical factor for our mutual fund and for our investment activities remains mortgage credit. This is the risk that we're willing to take and that we're able to analyze well in our view. The credit quality of the pool of mortgages underlying these securities that we purchase depends to a great extent on loan-to-value and homeowners' financial strength. Both of these measures largely continue to improve.

According to the numbers that we've looked at including Case-Shiller and CoreLogic, home prices have risen over 5 percent over the last year which is higher than the market expectations were going into 2015 and market projections for 2016 are nearly as strong. So that results in a continued rise in home equity with hundreds of thousands of homes continuing to flip from negative equity to positive equity each quarter. The last quarter, that number was something like 800,000 homeowners moving back to positive home equity.

Of course, employment has continued to rise which again is a key ingredient to homeowners' financial strength. And as housing gets healthier, the credit quality of the bonds that we are investing in continues to improve on the whole. So as a result, in the midst of all the volatility and uncertainty that we've seen in the capital markets, the legacy RMBS sector has continued to show more resiliency than many of these other fixed income sectors, in addition to the continued fundamental credit improvement of course. Market technicals are also improving from a continued reduction in supply which is running at about 10 percent a year in combination with continued interest from a diverse range of institutional investors.

Next, I will briefly describe its current portfolio composition and structure. For additional details, again, please either contact me at any point or go to the funds website where we keep a lot of current statistics available.

The fund remains extremely well-diversified in terms of the number of securities. We continue to be diversified across sectors, sub-sectors, diversified across vintages, geography, types of borrowers, the yield curve and more. At the end of December, the allocation to non-agency RMBS was about 50 percent and about 40 percent of that 50 percent were in prime bonds, another 30 percent in Alt A and then 40 percent in sub-prime. Agency CMBS allocation was about 5 percent, Non-agency CMBS about 21 percent, ABS as a whole, a 10 percent allocation, cash 5 percent and then finally agency MBS, we had an 8 percent allocation.

Over the last four to five months of the year, we reduced our allocation to RMBS where we had an RMBS allocation of roughly 60 percent, we reduced it to 50 percent which was primarily accomplished through cash inflows based on our expectation that we'd be seeing some increasingly attractive investment opportunities developing out of the modest weakening that we've seen in the legacy RMBS sector widening spreads, some increased liquidation activities by some hedge funds and so on. So having a somewhat higher allocation to cash as well as agency MBS provided us with the dry powder and potentially higher liquidity profile that we thought was appropriate going into year end.

From an interest rate risk standpoint, the duration of the portfolio remains approximately two years with our observation that prices have moved even less than duration would suggest because of the stable nature of these cash flows. We continue to calculate durations assuming low prepayments such as if interest rate increases are significantly more than what we expect and they're significant enough to have an impact on prepayments that will already be baked into our duration numbers. We've continued to monitor the effect of prices on prices and performance of our securities from changes in interest rates since inception and as I talked about in the past couple of calls, during the few bouts of rising rates we have seen, prices in our portfolio have remained stable and performance has remained relatively stable.

Performance has been positive each month of the last year, in fact has been positive in each month since the launch of the fund.

The average dollar price of the portfolio remains roughly unchanged from a quarter ago at about 88 and that's about 1 percent lower than a year ago. The average price of the agency book is a little over a hundred and for the CMBS that we own, it's a little under a hundred versus the Legacy RMBS portion of the portfolio which has an average dollar price of about 85. And by the way, the average dollar price for the Subprime bonds we own is about 90. So, we have continued to invest in RMBS at prices of 10 percent to 20 percent below par, which is a major contrast to the agency MBS market which has an average price of still close to 105.

In terms of other characteristics, one critical metric and an ongoing very important focus of our risk managing activities is liquidity. We maintain targets for our liquidity or the portion of the portfolio that we believe we can sell at current fair value at a point in time. Right now our targets are 10 percent, in a one day time frame, 50 percent in a two week time frame and close to 100 percent in one month. And as of today, we continue to believe that we can liquidate securities in current conditions in line with these targets. Also, we continue to have a borrowing facility from U.S. Bank Corp. equal to about 20 percent of the fund size available for redemption purposes which obviously is another strong source of liquidity.

So I've mentioned earlier that much of the universe has been outstanding for quite some time, so about 60 percent of the assets that we own have more than ten years seasoning so that they're vintage 2005 and earlier. The number is even higher for Subprime which of course is important because the more seasoned those bonds become, the more information we have about how these borrowers act, because the underwriting standards are higher and of course because credit enhancement continues to improve with most of the structures.

60 percent of the RMBS are floaters and so the extent that borrowers in fact are stronger from a credit standpoint and can withstand rise in mortgage rates, our bonds have additional price protection from rising rates. We also believed that as these floating rate mortgages do reset to higher rates that will be another source of increased prepayments.

Portfolio turnover continues to be about 100 percent annualized. We continue to be very comfortable with our trading activity. And importantly, we believed that our size which of course is small compared to other fund managers remains a significant advantage in this marketplace. We have not and don't expect to utilize leverage or to incur the cost of hedging. First, we're very comfortable to doing the credit work to understand and assume the credit risk of the bonds we're investing in. And second, we think that the rate risk of portfolio is low as I mentioned earlier. The portfolio's loss adjusted yield to maturity currently is about 5.5 percent for the overall portfolio, and a little bit higher, about 6 percent for the legacy RMBS portion of portfolio. The SEC yield by the way for the institutional share class as of November 30th was 4.6 percent. So our loss adjusted yield to maturity is based on our expectation for future underlying mortgage loan defaults which we believe is conservative.

I'll share a couple of views on sectors. So the non-agency space we continue to see a lot of opportunity perhaps even modestly better opportunities given the price activity over 2015.

Legacy RMBS prepayments continued to rise in 2015 by as much as 50 percent. We think this trend will continue into 2016 increasing the opportunity for near team realized gains.

Liquidity of course remains critical as this asset class slowly pays down and individual deals continue to get smaller, but again, we view this as a competitive advantage for us.

The market in our view is absolutely still large enough for us to find value in over $700 billion in legacy RMBS alone and more fragmented and seasoned than ever. In contrast, the corporate high yield market is in the same order of magnitude - that's got about $1.2 billion amount outstanding.

Cash flow credit quality in this non-agency RMBS space continues to get better, interest rates continues to decline. And as I mentioned before, technicals are also improving as the market shrinks slowly and steadily. We believed that demand from (money managers) will continue. We believe demand from insurance companies will persist or even grow. So even though only 5 percent of this market is investment grade rated, about 70 percent of this legacy market is rated NAIC-1 meaning that they're eligible for purchase by these insurance companies.

We continue to find market sectors offering attractive complexity premiums without a lot of sponsorship which again is an opportunity for us to generate higher returns if we're willing, and able to do the work, which we are.

In the CMBS space, we're cautious and we expect to remain vigilant for sometime given the recent supply-driven widening of spreads on some of the more commonly traded securities of as much as 300 basis points wider, so we are cautious about CMBS. The agency space in general we continue to believe that on the whole this sector, continues to be fully valued, if not rich, with lower yields relative to the level of interest rate risk that one assumes, this probably will change over time, but for now, the primary value added is liquidity that this sector offers.

And then finally, new and emerging sectors where we continue to focus on newer opportunities including the government agencies' credit risk transfer deals which are showing up more commonly now in the daily press. Non-prime deals, non-performing loan transactions and so on. They're all very deal and collateral specific but offer some terrific opportunities. We've read that issuance for these sectors should be over $50 billion this year so it continue to grow. As Greg articulated, we believed we're well positioned within the space as a small yet credit research intensive shop. We can focus on some of these less well sponsored opportunities.

Over the near term, we expect to maintain our current allocations fairly consistently with the largest allocation remaining to non-agency RMBS as well as having a meaningful allocation to cash and near cash assets. We look to keep the duration of portfolio short and to maintain sufficient liquidity. We continue to focus on portions in the market in which we believed we have a competitive advantage but also focusing on growing value in this emerging sectors that I just mentioned briefly.

You know in our view, there's a reasonable expectation for modestly higher interest rates certainly on the front end and certainly continued volatility. And we believe that this legacy sector remains the best position to generate attractive returns in a rising rate environment relative to other bond sectors based on a combination of yield, duration, fundamentals, upside optionality as well as technicals. And even if rates continue to stay where they are for a prolonged period, we believe equally strongly that our relative performance will be competitive.

As always let me reiterate my invitation to call, e-mail and visit us at anytime and pass it back to Greg.

Greg Parsons: Thanks Tom. Again, the fund today is approximately $480 million representing 20 percent growth over the past quarter with an extremely robust pipeline moving forward. We remain excited about the opportunities we are seeing in the market to drive value. And I want to thank those on the phone who are already investors for their support to date.

I'd like to mention once again that our mutual fund website www.semperfunds.com continues to add useful content for both our mutual funds and comments on the market including fact sheets, historical performance, statistics, conference call replays and more. Please check out the website, give us feedback.

We'll be making this call available for replay on our website soon. And now I think we'll open it up to questions.

Operator: As a reminder, if any participant has a question please press star one on your telephone keypad. We will pause for just a moment to compile the Q&A roster.

And your first question comes from the line of Chris Moe.

Chris Moe: Hi, I wanted to ask given what you said about the legacy market shrinking and becoming more seasoned. Are you concerned at all about the decreased liquidity in that market?

Tom Mandel: No, well we're very concerned and cognizant about it, but again as I mentioned that given the size of our firm, less than a $1.5 billion and the size of our fund at about $500 million, a little less than $500 million, we feel very confident that we'll continue to find outstanding opportunities in this sector. It is paying down at 10 or 15 percent a year. So, you know, even at that rate the market will remain at several hundred billion dollars in a few years coupled with the fact that the emerging sectors were projecting about $50 billion of growth this year, you know, that’s probably two thirds of the size of the legacy market paydown. So the total investable universe is not shrinking that much. We do think that if the larger funds begin to shy away from this sector because of their perception of liquidity issues, that this in fact will provide more opportunities for a fund our size to take advantage of investing in some of these less well sponsored portions of this market.

Chris Moe: Great, thank you.

Tom Mandel: Thank you.

Operator: Again if any participant has a question please press star one. Your next question comes from the line of John Smyth

John Smyth: I’ve noticed that data and price movement is pretty muted at times especially when markets in general move pretty wildly. Can you speak to that?

Tom Mandel: Certainly. Well the first thing I would say is that virtually all of the prices in our fund are priced by an independent pricing service which is IDC. And the pricing is handled by our administrator U.S. Bancorp. That said we certainly have seen more muted price action in the legacy RMBS space than in other fixed income sectors. And again we think it's a combination of a couple of things you know, one is improving credit fundamentals. Number two, increased seasoning and therefore shortening average lives and shortening interest rate sensitivity. So we think that, you know, those things combined with the attractive yield for many of these securities we believe that these are securities that tend to be sold less often. We think they're attractive securities and long term investors are buying them and holding them which certainly holds down the price volatility a little bit. But the bottom line is we think that these prices are really well – these bonds are really well supported at this point by the increasing credit fundamentals. So, we expect that low volatility of prices to persist.

John Smyth: OK.

Operator: You next question comes from the line of Scott Lasky.

Scott Lasky: Greeting. I'm just wondering, what kind of purchase yields do you see relative to you know, maturities these days, if you're trading the portfolio at 100 percent. What are you buying bonds at?

Tom Mandel: I'm sorry, what yields are we buying bonds at?

Scott Lasky: Yes.

Tom Mandel: Well, the average yield to maturity currently of our non-agency RMBS is around 6 percent and so that's pretty representative on average of where we're buying bonds. I mean, depending on the yield curve exposure, the credit quality, the liquidity of the underlying securities, I would say that the yields are ranging anywhere from 4 percent to 7 percent at this point.

Scott Lasky: That's great. Thanks.

Tom Mandel: Thank you.

Operator: Again, if any participant has a question, please press star one. And there are no further questions at this time.

Greg Parsons: Great. Well again, we appreciate the support for those that are in the fund, thank you. For those that are new to Semper, we look forward to building relationship and we want to thank everyone for the time this morning.

Operator: This concludes today's conference call. All participants may now disconnect.

END