Semper MBS Total Return Fund Quarterly Conference Call

January 28, 2019, 4:00 p.m. ET

Chairperson: Greg Parsons, Chief Executive Officer

Definitions

Alt-A: A classification of mortgages where the risk profile falls between prime and subprime.

AUM: Assets Under Management.

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.

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.

Bloomberg Barclays Aggregate Index: The Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most U.S. traded investment grade bonds are represented. Municipal bonds, and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The index includes Treasury securities, Government agency bonds, Mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in U.S. One cannot invest directly in an index.

Bloomberg Barclays 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.

Bloomberg Barclays High-Yield Index: A rules-based, market-value-weighted index engineered to measure publicly issued non-investment grade USD fixed-rate, taxable and corporate bonds.

Borrowing facility: A facility is an agreement between a corporation and a public or private lender used for short-term borrowing.

Case-Shiller National Index: An index that measures the change in value of the U.S. residential housing market.

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

Coupon: The annual interest rate paid on a bond, expressed as a percentage of the face value.

Effective Duration: Calculation for bonds with cash flow variability. It takes into account that expected cash flows will fluctuate as interest rates change.

Empirical Duration: The calculation of a bond's duration based on historical data rather than a formula.

HPA: Home Price Appreciation.

LIBOR: A benchmark rate that some of the world's leading banks charge each other for short-term loans. It stands for Intercontinental Exchange London Interbank Offered Rate and serves as the first step to calculating interest rates on various loans throughout the world.

Liquidity: The degree to which an asset or security can be quickly bought or sold in the market without affecting the asset's price.

NAV: Net Asset Value, i.e. the value of the Fund's assets minus the value of its liabilities.

Par: The face value of a bond.

S&P 500: An index of 500 stocks seen as a leading indicator of U.S. equities and a reflection of the performance of the large cap universe, made up of companies selected by economists.

Standard Deviation: When applied to the annual rate of return of an investment, a statistical measurement that sheds light on the historical volatility of an investment.

Sharpe Ratio: The average return earned in excess of the risk-free rate per unit of volatility or total risk.

Spread Duration: The sensitivity of the price of a bond to a 100-basis point change to its option-adjusted spread.

Read more: http://www.investorwords.com/6677/spread_duration.html#ixzz5fbp0Om6D

Tranches: Pieces of debt or securities designed to divide risk or group characteristics in order to be marketable to different investors.

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

Credit Quality weights by rating are derived from the highest bond rating as determined by Standard & Poor's ("S&P"), Moody's or Fitch. Bond ratings are grades given to bonds that indicate their credit quality as determined by private independent rating services such as S&P, Moody's and Fitch. These firms evaluate a bond issuer's financial strength, or its ability to pay a bond's principal and interest in a timely fashion. Ratings are expressed as letters ranging from 'AAA', which is the highest grade, to 'D', which is the lowest grade. In limited situations when none of the three rating agencies have issued a formal rating, the Advisor will classify the security as nonrated.

Click here for the Semper MBS Total Return Fund Fact Sheet.

SEMMX Unsubsidized SEC Yield: 4.37% and Subsidized SEC Yield: 4.37% as of 12/31/2018

SEMPX Unsubsidized SEC Yield: 4.12% and Subsidized SEC Yield: 4.12% as of 12/31/2018

SEMOX Unsubsidized SEC Yield: 4.04% and Subsidized SEC Yield: 4.04% as of 12/31/2018

U.S. Bancorp Fund Services, LLC and Quasar Distributors, LLC are affiliated.

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.

Past performance does not guarantee future results.

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 these calls are the current views of the participants and are not intended as a forecast or as investment recommendations. Any information provided with respect to Fund is as of the dates described and is 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. I will now turn the call over to Greg Parsons of Semper Capital Management.

Greg Parsons: Good afternoon. I want to start off saying thank you for calling in today for our quarterly conference call for our MBS Total Return Fund. My name is Greg Parsons, CEO of Semper Capital Management, and I'm joined on today's call by Tom Mandel, Co-Founder of the Firm, our Chief Investment Officer and one of our Portfolio Managers.

Today, we will spend about 20 minutes providing an update on the Semper MBS Total Return Mutual Fund, a mortgage-focused mutual fund that we launched in mid-2013. And we will break the call, as we always do, into three parts.

First, a quick update on Semper and what we're seeing the overall markets. Second, Tom will provide a more detailed update on the Fund and an overview of our outlook, and last, we will open it up to questions. For context, and any new prospect or party on the phone that isn't familiar with Semper, we are a privately-owned asset management platform that focuses our efforts on opportunities within the structured credit space with a particular focus on mortgage-backed securities including RMBS (residential mortgage-backed securities) and CMBS (commercial mortgage-backed securities). We are active both here in the US and in Europe with distribution of our product set.

Our Firm AUM is currently about $3.2 billion, and these assets are managed across a range of structured credit products to include mutual funds, private funds, and separately managed accounts.

Our MBS Total Return Fund ended the year just under $2 billion. We're proud of the performance we delivered in what were increasingly challenged markets over the course of 2018 and more importantly, we're pleased that the mortgage credit market continues to provide opportunities for us to capitalize on the potential for continued outperformance for our clients.

Some quick thoughts on the market you know, we've just come through and frankly probably are still in a period of significant volatility by any measure, and frankly the most significant period of uncertainty we've seen in the capital markets since probably early 2016. As it did in the period in 2016, the MBS Total Return Fund navigated volatility extremely successfully.

Some quick reference points for context: you know over the 4th quarter, the S&P fell about 13.5%. Over that time period, the Bloomberg Barclays High Yield Credit Index fell a little more than 4.5%. Ten-year treasuries moved from a 3% yield in early October to a high of 3.25% on November 8th and then fell to 2.55% by January 3rd.

These numbers are in the context of an ever-increasing amount of uncertainty at a macro level. Whether it's questions on tariffs, government paralysis here and abroad, slowing growth in China, frankly no growth in Germany, Brexit uncertainty, you know the list of macro factors increasing the risk profile and volatility profile of the markets at large goes on and on. In the context of this increasing uncertainty, our sector and our Fund continue to perform against our stated mandate.

There are number of factors that continue to support our excitement in the space. The first, continued strengthening real estate credit fundamentals: while home price appreciation might be slowing, it is still forecast to be solid single digits over 2019. The technicals in the RMBS market continue to be extremely favorable for active, nimble management. Continued improvement of the overall credit quality of the residential real estate space as assets continue to season: despite many headlines about home sales, home starts, home affordability, slowing home prices in certain markets, the credit metrics for the loans supporting our bonds continue to show improvement. And lastly, the growing emergence and value of many of the next generation sectors like agency credit risk transfer or single family rental securitizations continue to improve and give us access to increasing opportunity.

Last, our size both at the Firm level and at the Fund level is still, we believe, a distinct competitive advantage allowing us to take advantage of many opportunities our competitive set just can't efficiently access.

In summary, more than ever, we believe that the mortgage credit sector continues to offer value in the form of higher yield, lower duration, and low correlation to other fixed income or other risk assets. All of these continue to make mortgage credit a great complement to other fixed income and risk assets, and the sector continues to offer the potential for higher risk-adjusted total return. I'll now turn the call over to Tom to talk more specifically about the Fund and its positioning.

Tom Mandel: Thank you for joining our call today. I'll be brief with our update and I look forward to answering any questions that you may have at the end of the call. The Total Return Fund is well into its 6th year having crossed the 5-year mark last July. We continue to be pleased with performance, with our current positioning, and with our outlook for the Fund and the sectors that comprise the Fund.

The 4th quarter was certainly an interesting one, with the first significant bout of risk-off sentiment that we've seen since the beginning of 2016, as Greg mentioned. Treasury yields dropped a lot, about 70 basis points from peak to trough, although they in fact rose for the first half of the quarter. All risk assets were challenged and as Greg highlighted, he highlighted some of the performance of some of these markets.

The bond market overall generated negative performance for the first 10 months of 2018, but then rebounded with the decline in rates as duration assets rallied significantly. The Bloomberg Barclays Aggregate Index, representative of the total domestic fixed income market, ended up returning one basis point for the full year and our benchmark index, the Bloomberg Barclays MBS index, ended up 2.08% for the quarter and positive 99 basis points for the full year.

We had our first negative month since 2016 Q1, with the institutional class declining 27 basis points for the 4th quarter. We also had some redemption activity. The Fund started and ended the quarter with $1.9 billion of assets and peaked in early November at $2 billion. So, we had a little less than 5% redemptions, most of which occurred in November, and which were absolutely not a concern given the liquidity of the Fund. The broad market weakness that we saw in the late '18 felt different than the weakness we encountered in late '15 through early '16. Additionally, our portfolio was positioned differently, with more quality and more liquidity and our shallow drawdown bears that out.

Spreads in the non-agency sector, broadly speaking, saw spread widening of anywhere from 10 basis points to as much as 50 basis points in some instances. We remained very active during the period, with about $1 billion of trades in the Fund during the quarter, both buys and sells. As I've described in the past, we believe it's really important to remain active for price discovery—we learn a tremendous amount about our portfolio and underlying securities and the market every day.

During November and December, we bid on a number of bonds, trying to take advantage of mispricings in our sector as equities and corporate credit fell sharply, but we ended up being the cover bid for most of what we tried to buy. The bottom line is that the mortgage credit sector was actually much stronger than many people probably thought.

As I have mentioned previously, it's really important to our Fund shareholders that we keep the Fund small and nimble to maximize the value of opportunities we see in the mortgage credit market. So, we have made the decision to put a soft close in place when the Fund hits about $2.25 billion, with $3 billion of current AUM being the outside target in mind.

Let me provide you with an update on performance. As I mentioned for the 4th quarter of '18, the institutional class returned -0.27% or negative 27 basis points. For the full calendar year, the institutional class returned 3.89% versus 0.99% or 99 basis points for the Bloomberg Barclays MBS Index, an excess return of just shy of 3%. Since inception of the Fund in July '13, the institutional class has returned 6.54% annualized versus 2.42% for the MBS Index, representing over 4% of annualized excess return.

The primary source of positive performance during the quarter was interest income, with a contribution of about 1.25%. Price declines reduced performance by a similar 120 basis points. Most of the sectors that we invest in exhibited some spread widening and our limited spread duration helped to keep this low, so again we witnessed some positive, albeit low, correlation to other risk assets with limited price movements.

The trailing 12-month dividend distribution rate was 5.9%, and it has continued to drift higher. The standard deviation for the trailing 3 years is currently running at 1.3 and the Fund's Sharpe Ratio is currently about 2.5.

Now here is the current composition and structure the Fund as of December 31st: in terms of the sector weightings, non-agency RMBS totaled about 91% of the portfolio.

This includes legacy or pre-crisis sectors including prime at 2%, Alt-A at 14%, subprime at 16%, and option ARMs totaling 6%, and this 91% also includes next-generation bonds, which we like to call Next Gen, including NPL (non-performing loans), RPL (re-performing loans), and jumbo 2.0 bonds totaling 13%, CRT, or credit risk transfer bonds, totaling 21%, and SFR, or single family rentals, totaling 18%.

The portfolio held no agency CMBS or agency RMBS at the end of the year. Non-agency CMBS totaled 5%, asset-backeds 1% and cash about 3%. Allocations were fairly consistent throughout the quarter although we did increase the CRT exposure by about 3% which is offset by small reductions in ABS and CMBS. So, at this point about 2/3rd of our non-agency RMBS exposure is in Next Gen, or the newer-issues sectors, and about 1/3rd is in legacy or pre-crisis paper.

Within CMBS, we own two types securities: number one, we have a 3% allocation to Freddie K multifamily housing securitizations, which again are non-government guaranteed Freddie issuance, and a 2% allocation to small balance commercial securitizations.

Over this past quarter, we have continued the trend of adding quality and liquidity. Overall, we currently believe that there's better relative value within the CRT and SFR new-issue sectors relative to legacy paper. Of course, first, we like the liquidity. We also like the underlying credit quality and performance of the loans and importantly, these structures generally delever quickly, resulting in upgrade opportunities. In fact, in the first couple weeks of January, we have had several of our CRT positions upgraded from below investment grade to investment grade.

But that said, we certainly continue to see some opportunity in the legacy space, including the optionality of prepays. Even as rates rose through most of the year, we continued to see modest growth in prepayment activity for most of our subprime deals. The Total Return Fund’s average dollar price for the subprime bonds we own is 82.

In terms of other characteristics, the portfolio's overall effective model duration is 1 year, which is down from 1.3 years a quarter ago. Duration drifted lower for a number of our securities primarily as rates declined. About 75% of the portfolio consists of mortgage securities with floating rate features. We remain comfortable with this yield curve positioning, and so far this month Treasury yields have in fact risen a bit after last quarter's sharp drop.

The portfolio's yield to maturity declined from about 4.5% to 4.4% during the quarter. Yields rose some from spread widening, but declined from lower absolute yield levels and also declined from our continued move towards higher quality and more liquid securities as we continue to seek to have more dry powder ready to take advantage of some great buying opportunities that we expected, and still expect, to arise. The portfolio's average coupon rose to 4.1%, which is mostly a reflection of a growing new-issue allocation and also coupon resets.

The average dollar price of the overall portfolio declined by a little less than 1% to 94, and the average dollar price of the legacy non-agency RMBS we own is about 80, while the average dollar price of our new-issue bonds is close to par. The portfolio's spread duration remains at about 4 years. And importantly, the Fund remains long-only with no leverage or hedges in place.

So, we are clearly still in a period of uncertainty despite this year's relatively strong start in equities and corporates. There's a lot we don't know, with respect to the direction of rates, the economy, and risk assets. Chairman Powell and the Fed have clearly come across as being more dovish this month, which has given the market some comfort that they won't act without economic data to support their decisions. They won't raise rates or change their balance sheet run-off at this week's meeting, but we certainly need to pay attention to their policy statement.

With respect to the partial shutdown, the government has reopened at least for the next three weeks, but clearly there's now a lot of data reporting that's behind schedule. Treasury yields have drifted up a bit this month as I mentioned, and most spreads are marginally tighter. Despite strength in corporates, we don't think that that market is out of the woods. We think we're at a point in the cycle where the consumer is in better shape than corporate America, and we think that trend will continue. All of the credit trends that we look at for mortgage borrowers continue to show improvement. Delinquencies, defaults, severities are generally still going down.

Home price appreciation is slowing to what is a more sustainable level of 3 to 4% and home affordability has actually gotten a bit better. We don't expect material changes in defaults or other pressures in the real estate market from the shutdown and while the new SALT, or state and local tax deduction, limitations will affect higher-priced areas, and we have been seeing that, these tend to be much stronger loans from a credit standpoint. None of this should have a material impact on what we are investing in the near or intermediate term.

As the Fund grows, we have the ability to continue investing in senior, collateralized bonds that are supported by solid quality of the underlying borrowers and collateral and from structural credit enhancement. Further, the liquidity of these sectors we're investing in remains good and in large part, these sectors are immune to global macro events. We continue to see increased refi activity from our legacy subprime borrowers, which once again is a positive sign for us.

Looking forward, we expect to primarily own non-agency RMBS for the near-term, and we definitely remain cautious on both traditional CMBS as well as agency MBS. Our primary goals remain to minimize downside volatility, to maintain liquidity. and within those constructs provide good current yield. We think the portfolio's structure allows us to continue to do that. We continue to focus on quality and liquidity in these sectors to ensure appropriate asset/liability matching to minimize this downside volatility, and also to be prepared to take advantage of any additional significant opportunistic offerings that we see.

Circling back to liquidity for a moment: while we do believe that the level of liquidity of the bonds in the Fund is appropriate today, we do continue to maintain the borrowing facility from the US Bancorp, our Fund custodian and administrator, which we can only use for redemption purposes, should we choose.

To summarize, we believe we're positioned appropriately for this environment, which includes clearly the prospect for continued volatility in yields and in risk assets. We'll continue to maintain the portfolio's low duration, we'll continue to maintain appropriate liquidity, and we'll actively take advantage of relative value across legacy and new-issue sectors.

We will continue to buy and trade opportunistically as the market permits, and if last month's volatility returns, we're confident that opportunities to buy high quality and liquid cash flows at attractive yields will continue to improve, and in turn, enhance the opportunity for increased performance. We're really confident that our small size and ability to be nimble is increasingly valuable. While, we are slowly and steadily growing, that nimbleness is 100% intact.

Thank you and I will pass it back to Greg.

Greg Parsons: Thanks, Tom. You know, obviously, great traction and great success with the Fund and beyond our continuing success with MBS Total Return Fund, we have a lot that we're proud over the last 12 months. For the second year in a row, Semper was recognized in the 2018 Pensions & Investments Best Places to Work in Money Management Awards.

We were also named by the US Chamber of Commerce Foundation as a Best Corporate Steward, Small and Middle Market Business in their 2018 Corporate Citizenship Awards for our philanthropic efforts.

We continue to support many activities that support our nation's warriors and heroes and expect to further expand on that this year. It's an area that I am personally very passionate about, and all the employees at Semper are passionate about, and would love the opportunity to speak with any of you on the phone about what more we can do together.

Again, we remain very excited about the MBS Total Return Fund performance, growth, and its pipeline, and we are more excited than ever about the opportunities we are seeing in market to drive value, from both legacy and new-issue RMBS, as well as other structured credit sectors. I'd like to thank those on the phone, who are already investors, for your support to date, and now we'll open it up to questions.

Operator: At this time, I would like to remind everyone, in order to ask a question, press star and the number 1 on your telephone keypad. Again, star 1 on your telephone keypad. We will pause for just a moment to compile the question-and-answer roster. Again, if you would like to ask a question, press star 1 on your telephone keypad. Your first question comes from the line of Chad Adams from UBS, your line is now open.

Chad Adams: Hi, guys. Thanks for, you know, providing us with the call today. My main question centers on, you know, we all have liquidity until we don't and you know, spread duration is fine until it isn't, and I feel a little bit like Quint in "Jaws" when the reel just started to go a little bit to where like it hasn't gone to hell just yet.

I think we still have run way there, but as those conditions continue to evolve down the line you know, as recession risk begin to rise and obviously the consumer's in a better position than the corporation for right now, what type of changes would you foresee in the Fund, or would it be more of a "ride it out" and be a liquidity provider approach?

Tom Mandel: Hey Chad, thanks for the question. I would say that, you know, one of the things that we're most excited about, being mortgage managers, is that we have a tremendous amount of flexibility. Today, the opportunity clearly is in a combination of both legacy and new-issue securities. If, over time, you know, we believe that liquidity is becoming more of an issue, and we have the ability to own more senior, new-issue paper, in particular CRT and SFR paper, which is really quite liquid, and we think it would hold on to its liquidity and narrow bid-asks much longer potentially than legacy paper would or subordinate paper would, but even importantly again as mortgage managers, we ultimately have the ability to tap that $6 trillion agency MBS market, which we do not like today because yields are low, duration is long and the Fed still owns a third of the market on its balance sheet, but ultimately agencies are a great source of liquidity and quality.

Chad Adams: Thank you very much.

Tom Mandel: Thank you.

Operator: Again, participants if you would like to ask a question, press star 1 on your telephone keypad. There are no further questions at this time for Semper; you may now continue.

Greg Parsons: Well, again thank you so much for the support and interest to date. We're always available for questions, dial direct, or **www.sempercap.com.**

Thanks again for the time.

Operator: This concludes today's conference call. Thank you all for joining. You may now disconnect.