Semper MBS Total Return Fund Quarterly Conference Call

March 29, 2018, 11:30 a.m., E.T.

Chairperson: Tom Mandel, Co-Founder and CIO, Semper Capital Management, L.P.

Definitions:

RMBS: Residential Mortgage-backed Securities

CMBS: Commercial Mortgage-backed Securities

ABS: Asset-backed Securities

HPA: Home Price Appreciation.

SFR: Single Family Rental Securitizations.

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 1-3 Year Government Index: The Index includes Treasury and Agency securities issued by the U.S. Government with a maturity from 1 up to (but not including) 3 years. This unmanaged Index contains only dollar-denominated, investment grade issues with at least $250 million par outstanding. One cannot invest directly in an index.

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.

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

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.

HAMP: The Home Affordable Modification Program (HAMP), a government program introduced in 2009 to respond to the subprime mortgage crisis.

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

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

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

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

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

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

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.

Par: The face value of a bond.

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

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.

Morningstar Proprietary Ratings reflect risk-adjusted performance as of 3/31/18. The Morningstar Rating™ for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history, without adjustment for sales loads. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating™ for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating™ metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. As of 3/31/18 the Semper Short Duration Fund received a 5-Star Overall Morningstar Rating™ and 5-Star 3-Year Morningstar Rating™ among 140 ultrashort bond funds. The Fund received a 5 star rating for the 5 year period out of 107 ultrashort bond funds. The rating is specific to SEMIX and SEMRX. The Overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its three-, five- and ten-year (if applicable) Morningstar Rating metrics. ©2017 Morningstar, Inc. All Rights Reserved. The information contained herein (1) is proprietary to Morningstar (2) may not be copied or distributed and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any sue of this information.

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.

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

Past performance does not guarantee future results.

Operator: Ladies and gentlemen, thank you for standing by. At this time, we'd 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. 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 speaker's remarks, there will be a question and answer session. To ask a question, please press star and the number one on your telephone keypad. To withdraw your question at any time, please press the pound key.

I would now turn the call over to Tom Mandel of Semper Capital Management.

Tom Mandel: I'd like to start off by saying thank you for calling in today for our quarterly conference call for the Semper MBS Total Return Fund. And I am Tom Mandel. I am Co-Founder of Semper Capital and a senior portfolio manager.

I am alone on today's call and Greg Parsons sends along his apologies for not being able to participate today.

I recognize this is a busy time for everyone, plus we have the holiday weekend, so I intend to keep my remarks short today. I'll be pleased to answer any questions you have following my overview. And, of course, Greg and I always welcome follow-up questions at any time from everybody.

Let me first start with Firm highlights. As many of you know, we're a privately-owned asset management platform focusing our efforts on opportunities within the structured credit space, specifically RMBS, CMBS, and ABS. Our firm AUM has now crossed $2 billion, and it's approaching $2.2 billion.

We manage a combination of public funds, private funds, and institutional separate accounts across four strategies which are: this total return strategy (what we're focused on today), absolute return, active index based, and short duration. Each strategy is based on our core competency in structured credit.

2018 has started off where 2017 left off. We continue to grow in a measured way and we continue to build on what we believe is a strong and institutional quality asset management platform. The Total Return Fund assets have grown about $220 million this quarter or about 20% to just under $1.4 billion today.

The growth has been steady and diversified and we believe we're positioned for similar growth in the coming months. We strongly believe that our distinctive positioning within the universe of fixed-income investing will allow us to continue to capitalize on opportunities for our clients and our partners. We estimate today that the Fund has another 1 ½ billion or so of incremental capacity from here.

Let me share some of our current thoughts about the markets. As we've been alluding to in our recent calls, we've been increasingly of the view that we could see heightened volatility in the yield curve and in risk assets. And while we still firmly believe that the residential real estate recovery will continue, we have believed that this market volatility could result in increased opportunities for active management and, in fact, it has.

That said, just like in the first quarter of 2016, the prices and spreads of the RMBS sectors that we invest in have largely remained steady. We believe this is because a growing number of investors recognize mortgage credit as an attractive sector offering the potential for solid yield with low rate sensitivity and low downside risk.

While we believe that this is true, this is also increasingly a space in which credit intensive, loan level and deal structure analysis is critical and that there will be winners and losers.

Real estate fundamentals continue to improve. The just-released Case-Shiller National Index shows year-over-year home price appreciation of a little over 6% which obviously is still very strong. And so far it's been largely indifferent to the tax overhaul from a few months back.

Home affordability remains good compared to historical affordability levels, meaning that average disposable income is relatively high compared to the cost of buying and financing a home. Clearly, there are some very strong differences regionally, but overall, the picture remains bright and supportive to our sector.

The structure of the market and strong market technicals continue to work together to create what we still believe to be one of, if not, the best source of risk-adjusted return in the fixed income markets.

As you know, the legacy non-agency RMBS market continues to slowly contract with current estimates now at a little under 500 billion. But, very importantly, the new issue sectors continue to expand. Issuance may hit as much as $100 billion this year and our view continues to be that Semper Capital is the right size to take maximum advantage of the opportunities in this market.

We've been believers that the likelihood of continued upward pressure on front-end yields, that were as a result of continued Fed action to reverse their extremely accommodative positioning over the last several years, through both rate hikes and through gradual reduction in the balance sheet, was essentially certain – definitely going to happen. And we believe that the recent tax overhaul and spending bill add to that likelihood.

That brings us to probably the favorite characteristic of our sector, which again we've been talking about for quite some time now, which is a high proportion of floating rate paper that makes up this 500 billion or so of mortgage credit.

These are not bank loans or corporate credits. These are mortgage-backed securities with coupons that reset higher as Fed action pushes LIBOR rates higher. This opportunity for increasing yields with stable bond prices across many scenarios offers the potential for a distinct advantage relative to most fixed income strategies.

The Fund’s first quarter performance helps to make this case. The combination of tax reform legislation, some hint of inflation, expectations for continued increase and tapering by a number of the western central banks, and a reasonable earnings season has led to rising expectations for three, or potentially even four Fed tightenings this year and potentially again next year and, of course, the Fed moved last week as expected.

Equities have shown volatility not seen for some time for a whole host of reasons, including rates. And we’ve seen the treasury curve rising this quarter as well as flattening some more.

The 10-year is up from 2.40% at the beginning of the year to about two and three quarters today although it briefly hit 2.95 in late February. This 20 basis point decline over the last three weeks or so in the 10-year, of course, you know, begs other questions.

The aggregate index, a proxy for the overall domestic bond market, is down 1.67% in total performance through yesterday. The Bloomberg-Barclays MBS Index, which is our Fund’s benchmark index, is down 1.34 % year to date. And over this time period, our Fund’s institutional class from December 31st through yesterday has returned a positive 1.74%.

Annualized from inception back in July 22nd of ’13 through December 31st to last quarter end, performance was 7.1% for the institutional share class versus the MBS Index return of 2.74%, an excess return of about 4.4% per year on average. Annualized performance from inception through yesterday, March 28th, for the institutional class was 7.17%.

So the Fund’s total rate of return has been positive for the last 24 months, now for 53 the last 55 months, which is more than 95% of the time, in contrast to the index, which has been positive about two-thirds of the time. The primary source of positive performance during this first quarter ending today has again been interest income with the contribution of about 1.25%.

The share price for the institutional class began the year at 10.66. It’s been as low as 10.65, as high as 10.71 and it closed yesterday at 10.68. So, as you can see, volatility has remained low.

The monthly dividend year to date has been running at about a 6% annualized rate. That reflects not only continued strong interest income, but also some income from rep and warranty payouts that we have received so far this year.

Let me now talk about the composition and structure of the Fund briefly. So, currently, the Fund's allocation to non-agency RMBS is about 81%. And that is made up of an allocation to prime bonds of about 2% (that's down from about 10% a quarter ago) and that number has come down largely through a reduction of our fixed rates into more floating rate paper. Alt-A allocation 8%; subprime, 21%. And again, that's down from last quarter primarily as we have moved to further increase liquidity in the portfolio and also to realize some gains that we had built in in some of these bonds, many of them from sort of fulfilling the optionality of some of the rep and warranty opportunities that we had been seeing.

RPL 2.0 is now about 10% of the portfolio which is one of the newer issue sectors. Also new issue sector CRT, or agency credit risk transfer, makes up about 19% similar to last quarter. Single family rental securitizations have gone up to about a 14% allocation. This continues to be a sector that we like for a host of reasons.

Non-agency CMBS exposure continued to decline. It's down to about 4% and half of that is made up of Freddie Mac K multifamily deals and then the other half from small balance commercial deals, about a 10% allocation to a range of asset-backed securities and approximately 3% allocation to cash.

So let me talk for just a minute about what we're seeing currently in subprime. And again, we have reduced this allocation somewhat versus the end of the last quarter having taken advantage of some good selling opportunities.

Our allocation remains significant for a couple of continuing reasons: The first is the ongoing opportunity in the rep and warranty settlement trade that we've been talking about. Going into this year, we had bought a lot of bonds in the last half of last year to benefit from some of the rep and warranty payout activity that we were expecting, one being this JPMorgan $4.5 billion settlement that we were expecting to start seeing money back from early January and, in fact, the first billion dollars of that settlement came in January with more to come in the coming months.

So again, we've sold some of these bonds as the options to those rep and warranty payments that really become fully priced in. There's another Lehman Brothers settlement on the way, and there's a couple of others in the works.

And then, the second important trade in this subprime area is forbearance recoveries. Essentially, during the loan modifications as a part of HAMP and other programs over the past several years, borrowers, in some cases, were allowed to forbear a portion of their mortgages which, in many cases, had to then ultimately be taken as losses by our trusts.

But now, given the strong recovery that we've seen in real estate prices and in market, we're now seeing an increasing amount of these forborne amounts being recaptured by trusts and flowing through to various tranches depending on waterfalls to cash flow rules.

There continues to be a real lack of uniform information and we believe that through hard work we're able to identify opportunities for these recoveries.

New issue sectors, including agency credit risk transfer or CRT, RPL deals, new non-agency originations, and single family rentals now make up about 50% of our non-agency position.

These sectors, while still relatively small and in many cases still offering some new issue concessions and very strong liquidity, are becoming increasingly important to us and to the market.

In addition to the liquidity that they provide, many of them are floating rates, they're actively traded by more dealers, they're often securitized by loans made under stricter underwriting standards, and often have some very interesting structural characteristics relative to the legacy paper.

So this growing universe of bonds continues to give us more tools to make tactical decisions with respect to liquidity, rate sensitivity, quality, exposure to real estate credit fundamentals, call risk, etc.

And then, finally, our cash balance remains low. Today it's about 3%, but generally keeping even a little bit lower than that. So our comfort in holding less cash comes from the overall improvement of liquidity for the sectors we are investing in particularly the new issue RMBS sectors that I've just mentioned and, more specifically, senior classes of the agency credit risk transfer deals and the single family rental securitizations.

Our overall tactical strategy remains the same as a quarter ago. More than ever, we believe it's prudent to be taking less risk in anticipation of more volatility and subsequent opportunities that we fully expect to see.

We continue to focus on higher quality cash flows with more liquidity, less rate sensitivity, and we expect continued low correlation to other risk assets. In fact, some of the correlations that we've seen have actually been lower than they had been in prior quarters.

We've seen continued increasing opportunities to own bonds with upgrade potential and with upside optionality and other opportunities for relative value trades. This has allowed us to increase our trading activity extracting value in a number of ways.

So we further increased the portfolio's allocation of floating rate securities from roughly 70% a quarter ago to roughly 80% today. But again, some of these floaters, perhaps a quarter of them, have some model duration.

And this is because of some of the structural nuances in the bonds: caps on the coupons, caps on the underlying loan rates, modifications of some of the underlying loans, etc. But most of these are still trading with essentially no empirical duration which, of course, we're tracking very carefully.

So again, just to be clear, when I talk about floating rate securities, I am referring to MBS and CMBS generally with coupons resetting monthly above one-month LIBOR.

So although one-month LIBOR is lower than three-month LIBOR, about 40 basis points lower as of today, these coupons are able to reset more quickly and, therefore, there is less lag during this period of fairly steady rises in the Fed funds target rate. So this has been providing a boost to yield.

The portfolio's loss-adjusted yield, currently it's about 4.5% which is down from a quarter ago, but back really where it was a couple of quarters ago. And again, this is a reflection, number one, of our sale of some of the subprime positions we had purchased last year replacing them with some very senior and liquid new issue bonds, but then, partially offset by our floating rate coupons that are boosting the yield.

In terms of duration positioning, we're keeping duration low which is a primary reason that performance has been positive this quarter. Duration today is about one and a quarter years. We're still not seeing material interest rate price movements in most of our portfolio.

In our view, this low interest rate sensitivity that our fund has demonstrated adds to the attractive diversification that this sector can provide within a fixed income portfolio. And with rates still low and durations long in most fixed income sectors, any rising rates from here will have an increasingly negative impact on most of the bond market. And we do think that the mortgage credit sector can provide an important source of stability while generating current yield.

In terms of the average dollar price, the average dollar price of the portfolio today is about 94, which is up from last quarter largely from the decrease in legacy bonds and increase in newer issue bonds that we own as of today. The average dollar price for our legacy RMBS remains at about 85 and the new average dollar price for new issues is about 100 on average.

Our turnover continues to run at a little – at a little over 200% annualized. I talked about that a little bit earlier and we expect that to persist as we continue to take advantage of trading opportunities and move between some of the trades I've described with outside optionality and the more liquid newer issues like CRT and SFR.

The Fund, of course, remains long-only. No leverage or hedges in place and we again have no plans to change that. We remain very comfortable with the level of credit risk that we're taking in the portfolio, ultimately an important source of the performance that we have been generating.

We also believe that we continue to have an appropriate amount of liquidity in the portfolio and remain confident that our limited rate risk will continue to serve the portfolio well. And liquidity continues to be supported by the borrowing facility that we have from U.S. Bancorp, our Fund custodian and administrator, which is equal to 20% of AUM that we can use only for redemption purposes.

Looking forward from here, we believe that what we're seeing today will persist. We expect the front end to continue to rise, but we're less certain of what intermediate rates will do at least in the near term. For now, we think it will likely stay in a range.

We think we'll see continued bouts of volatility in risk assets and we think this will lead to some good opportunities to buy attractive bonds in our sectors despite the continued strength in credit fundamentals. We're operating in a very opaque fragmented sector and the fact that we're small and can be nimble, yet are experts at doing this necessary credit work, puts us in a good position.

We think that floating rate securities in the MBS space are the best structure to own and the senior cash flows will serve us well. Away from RMBS, we continue to believe that traditional CMBS remains unattractive overall given their long duration characteristics and, importantly, the reliance on refinancing loans.

We also still believe strongly that agency MBS are at risk of significant underperformance from here given their low yields and their long durations and really importantly the $2 trillion of agencies still sitting on the Fed balance sheet early in this tapering process. So we are solidly of the view that the legacy and new-issue non-agency RMBS sectors are the place to be.

We've positioned the portfolio to be the beneficiary of volatility. If a broader, deeper risk-off scenario does develop, although we do expect some positive correlation between RMBS and other risk assets, we believe these bonds will hold up much better, likely even better than they did back during the first quarter of 2016.

Within mortgage credit, of course, there is a range of spread duration, a measure of how much prices should change given changes in credit spreads, and we've actively kept ours on the shorter side at around four years.

So just to summarize, we'll continue to position the portfolio with a relatively low duration, higher liquidity, limited spread duration, with the goal of targeting solid monthly returns largely from interest income while managing downside volatility.

At the same time, we'll continue to buy and trade opportunistically as the market permits and we're confident that our small size and ability to be nimble is increasingly valuable.

So, in wrapping this up, let me thank those of you on the phone again who are already investors for your support so far. And, once again, let me thank everyone for participating.

If I can just add one small advertisement, we continue to add content to our mutual fund web site, semperfunds.com, and we invite you to visit. And you can also see information there about our other mutual fund, the Semper Short Duration Fund which is a five-star fund in Morningstar's Ultrashort Bond Fund category.

If there's anything that we can be providing you or telling you, of course, please let us know. And so, on that, let me please open it up to questions.

Operator: At this time, if you would like to ask a question, please press star, then the number one on your telephone keypad. Again, that is star, then the number one. We will pause for just a moment to compile the Q&A roster. And there are no questions on the phone line at this time.

Thomas Mandel: OK. Well, then, let me again thank everyone for participating and hope you all have a great holiday weekend. Thank you.

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

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