Semper Short Duration Fund Quarterly Conference Call

May 10, 2018, 11:30 a.m., E.T.

Chairperson: Tom Mandel, CIO, 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.

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.

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.

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

Par: Par value is face value of a bond.

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

LIBOR: London Interbank Offered Rate, a benchmark rate that some of the world's leading banks charge each other for short-term loans.

Standard Deviation: A measure of the dispersion of a set of data from its mean.

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 and Percentile Rankings reflect risk-adjusted performance as of 3/31//2018. 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. The Semper Short Duration Fund received a 5-Star Overall Morningstar Rating™ among 140 Ultrashort Bond Funds and a 5-Star Morningstar Rating™ for both the 3 and 5 year periods among 140 and 107 Ultrashort Bond Funds, respectively. These ratings are 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. As of 3/31/2018 SEMIX ranked in the top 3% over the 1 year period among 178 ultrashort bond funds, the top 2% over the 3 year period among 140 ultrashort bond funds, and the top 1% over the 5 year period among 107 ultrashort bond funds. **Morningstar Percentile Ranking** compares a fund's Morningstar risk and return scores with all the funds in the same Category, where 1% = Best and 100% = Worst

Past performance does not guarantee future results.

SEMIX Unsubsidized SEC Yield: 2.31% and Subsidized SEC Yield: 2.61% as of 3/31/2018

SEMRX Unsubsidized SEC Yield: 2.07% and Subsidized SEC Yield: 2.37% as of 3/31/2018

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.

Operator: Ladies and gentlemen, thank you for standing by. At this time, I would like to welcome everyone to the Semper Short Duration 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 performance quoted. Performance data current to the most recent month end may be obtained by calling 855-736-7799.

After the speaker's remarks will be a question-and-answer session.

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

Tom Mandel: Thanks very much. I'd like to start off by saying thank you all for calling in for today's quarterly conference call for our Short Duration Fund. I am Tom Mandel, Co-Founder of Semper Capital Management and a senior member of the investment team. I am alone on today's call, and Greg Parsons sends along his apologies for not being able to participate on the call today.

My plan is to keep the call short and I will be pleased to answer any questions you may have, following my overview and, of course, Greg and I always welcome follow up questions at any time, so please contact us.

I'll start with Firm highlights for anyone new to Semper. As many of you know, we're a privately-owned asset management platform, focusing our efforts on opportunities within the structured credit space and, specifically, RMBS ("Residential Mortgage-Backed Securities"), CMBS ("Commercial Mortgage-Backed Securities"), and ABS ("Asset-Backed Securities"). And for over 25 years, that has included a focus on the short end of the curve.

In early March, our Firm's AUM crossed $2 billion. And today, we're close to $2.4 billion. We manage a combination of public funds, private funds, and institutional separate accounts across four strategies.

First, the short and ultra-short duration, which is today's topic. Second, total return. Third, absolute return. And then, finally, an active index-based strategy.

And each of these strategies is based on our core competency in structured credit. The growth that we've have seen this year-to-date has been distributed across all of our products and we strongly believe that our distinctive positioning within the universe of fixed-income investing has allowed and will allow us to continue to capitalize on opportunities for our clients and our partners.

Very importantly, we believe that being a small-niche boutique manager focused on mortgage credit gives us a competitive advantage in this world of extremely large broad-based bond managers.

And we think that our short duration strategy is particularly well-positioned to provide continuing opportunity for attractive risk-adjusted returns in today's economic and market conditions. We believe that the greatest likelihood is for short and intermediate interest rates to continue to rise for some time with continued curve flattening.

We also think that price volatility for risk assets will rise. And in our view, the types of bonds we're investing in are best suited to minimize price volatility from these rate and volatility moves, while benefiting from these rising rates through higher coupons and yield.

And even at today's levels, with most non-agency MBS and other structured credit sectors at or close to post-crisis tights, 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.

We launched the Short Duration Fund back in December of 2010, and we've now got more than a seven-year track record managing the portfolio, and we've extended our string of consecutive years of positive net performance to seven years.

Despite a fairly significant rise in the front into the curve over the last couple of years, the Fed has now increased their target fund rate six times and the 2-year Treasury yield is, as of today, above 2.50, up over 60 basis points year-to-date.

Many of you have heard Greg and me talk at length about continuing value in mortgage credit and how mortgage credit can add value to a total return portfolio. We're confident that the sector and related structured credit sectors form the basis for an equally attractive short duration fixed income strategy.

In the interest the time, I'm going to focus on a higher level overview, but again, I would welcome any questions either at the end of this call or later at your convenience.

The Fund invests in structured credit with low interest rate sensitivity in the following asset classes – agency MBS, including pass-throughs and CMOs ("Collateralized Mortgage Obligation"); legacy, non-agency RMBS, including prime, Alt-A and subprime bonds; newer-issue or next-generation non-agency paper, including agency credit risk transfers, securitizations, jumbo private-label securitizations, and re-performers.

We invest in agency multi-family securitizations, a form of CMBS. We invest in single-family rental securitizations, and we invest in a number of ABS structures, along with the AAA-rated seasoned senior CLO ("Collateralized Loan Obligation") tranches. This universe that we invest in is in fairly sharp contrast to many other short duration or ultra-short duration funds, that often tend to invest in either government securities or in corporate credit.

We seek to manage the Fund to have a portfolio with an overall investment grade credit quality. So while we do find value in below-investment grade or non-rated securities, especially in legacy non-agency MBS, that allocation is limited. We manage the portfolio to have minimal interest rate risk or effective duration. In this environment, we're generally targeting duration of a half a year or even less. And we manage the Fund to have a significant yield advantage over other short maturity securities and cash alternatives.

The Fund provides daily liquidity and there are no fees or limitations of any sort associated with the timing of purchases or redemptions. The Fund has two share classes: an institutional class plus an investor share class with a 12b-1 fee, and the Fund is approved for purchase on many dealer platforms in addition to being available for purchase directly.

The Short Duration Fund is in Morningstar's Ultra-short Bond Fund universe. And for the trailing one-year, three-year, and five-year periods through the end of March, it's ranked in the top 5% of performers. And, it's got a 5-star Morningstar Overall Rating™.

Let me share some performance data, and our website provides daily NAV updates and monthly performance, along with a great deal more. So the Fund's performance year-to-date through April 30th was positive 0.73% for the institutional class versus a negative 0.32% for the primary benchmark index, which is the Bloomberg Barclays 1-3 year Government Index, for an excess return of a little over 1%.

Annualized from inception in December of 2010 through April 30th, performance was 2.5% for the institutional class versus an index return of 0.66%, an excess return of over 1.8% annualized.

The Fund's total rate of return has been positive each month this year, and in fact it's been positive for each of the last 26 months, a period during which the two-year treasury has risen by over 160 basis points.

The primary source of performance in the first quarter of '18 was interest income generating about 80 basis points adjusted for expenses, or over 3% annualized.

Realized and unrealized gains were just slightly negative, the result of our small agency exposure. And while we do actively manage the portfolio, because most of the securities are relatively short and high quality, we generally do not see a lot of price movement.

Then looking at attribution by sector, we saw that non-agencies, CMBS, ABS, and the AAA-rated CLOs all contributed to positive performance during the quarter. Only agency MBS had a negative contribution to performance.

The Fund pays a monthly dividend, and the 12-month dividend rate as of April 30th was 2.48%.

Now I'll provide some additional information about composition and structure of the Fund.

At the sector level, as of April 30th, the portfolio consisted of 12% in government-guaranteed paper, 37% in non-agency RMBS, 12% in CMBS, 16% in a diversified grouping of ABS, and 21%, again, in AAA-rated senior CLO tranches, with 2% in cash equivalents.

The two primary changes in the sector allocations year to date are number one, an increase in investment grade non-agency RMBS; and number two, an increase in CLOs.

The increased relative attractiveness of the CLOs is in large part due to the fact that their coupon resets above 3-month LIBOR rather than 1-month LIBOR, and the spread between the two measures has increased to about 40 basis points this year, making the yield of 3-month LIBOR securities that much more attractive. Over 40% of the portfolio is invested in securities with direct residential real estate credit exposure and the entire portfolio is either supported with mortgages or other assets securitizing the bonds or is government guaranteed. And we don't own any corporates or other unsecured paper.

During our last few MBS Total Return calls, we've talked about agency credit risk transfer securitizations or CRT, along with single-family rental securitizations or SFR, as well as some other next-generation RMBS. This area is equally important for the short duration fund, which now has approximately three quarters of its residential real estate credit exposure in these new issue securities.

The bonds that we own tend to be investment grade, liquid, supported by a number of primary dealers, and are based on new collateral with strong underwriting. These securities help to support the portfolio's quality and, very importantly, its liquidity, and provide us with some new and exciting opportunities to add value through active management, so these subsectors have rapidly become a key constituent in our portfolio.

Another investment characteristic that our two mutual fund's share in common is the value of voluntary prepayments for discount securities. The Short Duration Fund's average dollar price for the subprime bonds that we own is approximately 97.

Over the last couple years, we have seen a growing percentage of subprime borrower prepayments, which is a positive for the timing of cash flows and Fund performance, and we expect this to continue even the short rates continue to rise.

The average credit quality of the bonds in the Fund is BBB, and 90% of the portfolio is in investment grade securities. The portfolio's effective duration as of the end of April was 0.3 years, down from one half year at end of December, and this low rate sensitivity is coming from two sources.

First, many of the securities that we own have very short final maturities or average lives, along with fairly active amortization schedules. And at this point, 75% of the portfolio now consists of securities (mostly mortgage securities) that have floating rate features.

So as the Fed raises their target fund's rate and LIBOR and other reference rates rise in concert, the coupons on these securities rise as well. This raises the yield of the securities and it supports their prices and, of course, the Fund's NAV.

The portfolio's yield to maturity, benefiting from this rise in the reference rate for the coupons and the upward slope with the forward curve has risen from approximately 2.9% at the start of the year to 3.4% today. The portfolio's average coupon during this time period has risen from 3.1% to 3.4%.

The portfolio, overall, has an average dollar price of just under par, with the average dollar price of the legacy non-agency RMBS that we own in the mid-90s. Volatility has remained low, and correlation to other asset classes has remained low as well.

For the three years ending April 30th, the annualized standard deviation of monthly returns is just over 0.5, and correlations versus several of the broader bond market indices that we track are all below 0.4. The Fund is long-only, no leverage or hedges in place, and we have no plans to change that.

So, given that we're positioned with a low interest rate sensitivity, high quality, and relatively high yield, let me highlight our current outlook.

We're expecting modest economic growth to persist through the year and beyond, supported by regulatory reform, supported by the benefits of the tax overhaul, and by deficit spending. We think that the actual negative impacts from potential trade restrictions are likely to be muted, although headline risks certainly could be greater.

And we believe that the greatest risk is for inflation to rise modestly above 2% this year, which we think will allow the Fed to address monetary policy more aggressively than currently priced in by the markets, and we think yields will likely continue to rise, again, with further flattening.

The investment grade, short-average life securitized debt sectors that we are investing in continue to perform well. The liquidity of the sectors and the performance of the underlying collateral continue to improve, largely immune to global macro events.

Home price appreciation continues to be well north of 5% nationally, and home affordability, while declining a bit in recent quarters, continues to remain better than historical averages.

We've continued to focus on owning higher quality and more liquid investments in these sectors to ensure appropriate asset liability matching, to minimize downside volatility, and to be prepared to take advantage of any significant opportunistic offerings that we see.

Importantly, we continue to believe that our number one risk is liquidity and our secondary focus remains the yield curve. We expect the bear flattening pattern to continue with two and possibly three more Fed rate moves this year, along with continued tapering.

Our approach in this environment is to own a significant allocation to floating-rate securities, which as I mentioned is currently about 75% of the portfolio. And the fixed-rate securities we own generally roll down the curve quickly.

This portfolio composition is helping prices to stay stable as rates rise and is increasing portfolio yield as LIBOR resets higher along with the target Fed funds rate.

Circling back to liquidity for just a moment, while we believe that the level of liquidity of the bonds in the fund is appropriate today, we do maintain a borrowing facility from U.S. Bancorp, our Fund custodian and administrator, which is equal to 20% of AUM for redemption purposes, which is one more strong source of liquidity in addition to the near-cash and cash positions that we own.

And just to summarize, we believe we are positioned appropriately for the environment that we're in, which includes the prospect for some volatility in yields and the potential for some volatility in risk assets. We'll continue to position the portfolio with low duration, with appropriate liquidity, and primarily investing in investment grade securities, all of which are supported by assets that we can evaluate like mortgages and commercial loans, with an objective of generating monthly returns that look a lot like the portfolio's yield net of expenses. And while doing this, also seeking to manage downside volatility, while at the same time continuing to buy and trade opportunistically as the market permits.

At this point, let me now open it up to questions please.

Operator: At this time, I would like to remind everyone in order to ask a question, please press star one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Again to ask a question, please press star one on your telephone keypad.

And as a final reminder, if you would like to ask a question, please press star one.

Tom Mandel: Great.

Operator: Your first question comes from Ryan Lange with Great Western Bank. Please, go ahead.

Ryan Lange: Good morning. I just wanted pick your brain on whether you think the bigger risk for some negative returns have come from the Fed raising rates much faster than the market is expecting or just the credit quality of the some of the structured securities?

Tom Mandel: I think that the greater risk for negative performance in this portfolio, frankly, would come from some sort of a risk-off trade that created some temporary illiquidity in the mortgage credit space.

We saw that a little bit in the first quarter of '16, which is when this portfolio had its last negative month, we were down 15, 20 basis points. And that was really just sort of broadened bid-ask spreads because of a decline in the liquidity.

I think that because the portfolio’s got about a 75% allocation of floating rates, we really don’t have a dramatic risk from the Fed moving more quickly. And I think given the quality of these securities, I think it would take a pretty dramatic downturn in economic activity or home price declines before we started to see that flow through to these underlying loan qualities. So I hope that answered your question.

Ryan Lange: Yes.

Tom Mandel: Thank you.

Operator: And there are no further questions. I know hand the call back over to you, Mr. Mandel.

Tom Mandel: Well, again, I want to thank everybody for taking the time to listen in. And I do want to encourage you to please call or email at any time, so we can talk about the portfolio in more detail. And I’d also encourage you to please check out our website because there is a lot of information that we’re maintaining, talking about the Short Duration portfolio and some of our thoughts on the market. So thank you again, everyone, for your time.

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