Semper MBS Total Return Fund Quarterly Conference Call

July 19, 2018, 11:30 a.m., E.T.

Chairperson: Greg Parsons, Chief Executive Officer

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 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.

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.

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.

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 7/31/18. For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating™ based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each 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. As of 7/31/18 the Semper MBS Total Return Fund received a 5-Star Overall Morningstar Rating™ and a 4-Star 3-Year Morningstar Rating™ out of 278 nontraditional bond funds and a 5-Star 5-Year Morningstar Rating™ among 171 nontraditional bond funds. As of 7/31/18 the Semper Short Duration Fund received a 5-Star Overall Morningstar Rating™ and 5-Star 3-Year Morningstar Rating™ among 143 ultrashort bond funds. The Fund received a 5-star rating for the 5-Year period out of 111 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. 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. Morningstar ranked the Semper MBS Total Return Fund (SEMMX) in the top 7% out of 323 nontraditional bond funds, the top 16% out of 278 nontraditional bond funds, and 1% out of 171 nontraditional bond funds for the one, three, and five-year periods ending 7/31/2018, respectively. Morningstar Rankings represent a fund's total-return percentile rank relative to all funds that have the same Morningstar Category. The highest percentile rank is 1 and the lowest is 100. It is based on Morningstar total return, which includes both income and capital gains or losses and is not adjusted for sales charges or redemption fees. Morningstar ranked the Semper Short Duration Fund in the top 2% and 1% out of 184 and 109 Ultrashort Bond funds for the one and five-year periods ending 6/30/2018, respectively.

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, I would 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 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: Well, good morning, everyone. I want to start off saying thank you for calling in today for our quarterly update call on the Semper MBS Total Return Fund. My name is Greg Parsons. I'm the CEO of Semper Capital Management and I'm joined on today's call by

Tom Mandel, Co-founder, CIO and a Senior Portfolio Manager within the investment team.

Tom and I will spend about 20 minutes giving everyone an update on the Semper MBS Total Return Mutual Fund, a mortgage-focused mutual fund that we launched in mid - 2013. I will break the call into three parts.

First, a quick update on Semper, the platform, and what we're seeing in the overall markets. Second, Tom will go deep on the portfolio itself and give an overview of our forward-looking outlook. And the third final piece, we'll open up for any questions.

So, Semper Capital, we are a privately-owned asset management platform that focuses all of our investment efforts on opportunities within the structured credit space, specifically RMBS (residential mortgage-backed securities), CMBS (commercial mortgage-backed securities), ABS (asset-backed securities), and targeted portions of the high-yield market.

Our AUM is approximately $2.8 billion, having grown about $800 million year-to-date across the range of structured credit strategies that include absolute return, total return and index-based solutions.

Our skill set is also available across multiple product formats to include institutional separate accounts, private funds and a series of public funds, both here and in Europe.

We just hit an important milestone this week or actually will hit it next week. The MBS Total Return Fund hits its five-year mark since its launch middle of next week, something we're extremely proud of. The Fund has grown about 50 percent year-to-date and has approximately $1.8 billion of assets.

Our platform is the strongest it has ever been with respect to people, resources and products. And we continue to believe our distinctive positioning within the universe of fixed income investing will allow us to continue to capitalize on opportunities for our clients and partners.

Let me share some of Semper's current thoughts related to the opportunity we continue to see in market. Most of the non-agency RMBS-related credit sectors continue to trade at or close to post-crisis tights.

But even at today's levels, we continue to see opportunities to drive value on an absolute and relative basis within the credit-sensitive portions of the structured credit universe.

Strengthening real estate credit fundamentals, the structure of the market and continued strength, the technical factors, continue to work together to create what we believe is one of, if not the best source risk-adjusted returns in the fixed income landscape, hard stop.

With respect to credit fundamentals, home price appreciation is continued at quite strong pace, continues to beat virtually all expectations, but home affordability remains extremely attractive, compared to historical levels of affordability.

Second, as the universe of these legacy assets continues to season, and the overall credit quality of residential real asset space continues to improve, we continue to see opportunities for a nimble opportunistic strategy to invest in attractively valued real estate debt securities.

Of note and of increasing importance, the emergence of what we define as kind of the next-gen mortgage credit opportunity starting to augment opportunities that we've traditionally seen in the legacy markets.

The legacy non-agency RMBS market is now, roughly, $450 billion in size and we continue to believe that we are right sized to take full advantage of opportunities within this market. At the same time, new issuance has continued to steadily increase and will total, approximately, $75 billion to $100 billion of outstanding opportunity set by the end of this year.

The combination of legacy and new issue opportunities, for the first time in a long time, has kind of the total addressable market, in terms of opportunity set at equilibrium, at roughly $550 billion of addressable market. Again, our size both at the firm level and at the fund level allow us to take distinct advantage of opportunities that many of our competitive set can't effectively or efficiently access.

Third, our sectors, from a fundamental standpoint remain extremely well-positioned within the fixed income landscape, with respect to credit fundamentals, rates and price volatility.

A large swath of securities in the non-agency RMBS sector continues to have extremely low rate sensitivities, including floating rate and other features limiting effective duration. Volatility continues to be low in many of these sectors and correlations to other fixed income assets and general global risk-off attributes remains extremely low.

We're quite proud of performance year-to-date. For the first six months, they continue to support the thesis that the sector and our product offer an attractive yield, combined with low duration and extremely low volatility.

Net performance for the Fund's institutional class has averaged 42 basis points per month over the last five months with an extremely tight interval of performance ranging from 36 basis points to 48 basis points.

While the equity markets have done OK this year, we're seen some volatility in high yield, emerging markets, other portions of fixed income, our Fund and sector have been immune to this volatility.

The Bloomberg Barclays Agg Index, the proxy for overall domestic bond market is down approximately 1.6 percent year-to-date with four out of the last six months being negative.

The Bloomberg Barclays MBS Index, our Fund's benchmark index, is down approximate 95 basis points year-to-date, largely the result of duration exposure with three out of the last six months being negative.

In summary, given the positive performance year-to-date, in the midst of this volatility, negative performance we've seen in many fixed income sectors, we believe that the mortgage credit sector continues to offer higher yield, lower duration, low correlation plus the opportunity for risk mitigation, based on the continued strengthening of credit fundamentals.

All of these factors combine to make RMBS a great diversifier, a good anchor investment within the shorter duration context, and the sector continues to offer the potential for a higher risk-adjusted return.

I'll now turn the call over to Tom to talk more specifically about the Fund and its positioning.

Tom Mandel: Thank you. As Greg mentioned, the Total Return Fund has its five-year anniversary next Monday which we are extremely pleased with. And we're also pleased with performance year-to-date. We're pleased with how the Fund is currently positioned, and we also feel good about our outlook for the Fund and for the sectors that comprise the Fund.

We saw continued growth this quarter, as Greg alluded to, assets increased by about $350 million, ending the quarter at greater than $1.7 billion.

So, we continue to estimate that the Fund has limited capacity of about $3 billion and so we are beginning internal discussions about a soft close next year, which is probably a little over $1 billion from here.

The Fund's primary investment strategy remains the same, that is investing in mortgage securities. We have a target minimum of 80 percent and our primary sector concentration to this date continues to be non-agency RMBS.

The second quarter was a fairly solid quarter for most risk assets in the U.S. There were an awful lot of headlines that could have been very disruptive like tariffs and trade wars and inflation and Fed action. But securitized products held in very well, especially legacy securities.

The Fed raised their target Fed funds rate again in June, second time this year, and again the market took it in stride. The 10-year treasury rose by about 15 bps (basis points) during the quarter, ending the quarter at a yield of about 2.86%, and is now up about 45 basis points year-to-date.

And meanwhile the two-year treasury, which of course is much more sensitive to Fed policy, started the quarter at just about 2 and a quarter and ended at about 2.53%. So as a result, the two to 10-year spread has continued to narrow to about 33 basis points to the end of the quarter versus 50 at the end of last year.

And so far in July, the 10-year has essentially been unchanged, very little movement, while the two-year has drifted higher by another 10 basis points.

Let me provide a brief update on performance. For the second quarter of 2018, our institutional share class returned positive 1.42 percent net, which is in excess return of 118 basis points over the benchmark index. Year-to-date through June 30, the institutional class returned 3.14 percent, which is in excess return of over 4 percent versus the index. For the last one year, the institutional class net performance was 5.83 percent.

At this point, the Fund's total rate of return has been positive for the last 28 months, and for 57 out of 59 months or over 95 percent of the time in contrast to the index performance, which has been positive less than two-thirds of the time.

The primary sources of positive performance during the quarter – it sounds a lot like last quarter – was interest income with a contribution of about one percent, and also price appreciation of about 40 basis points. And that price appreciation occurred primarily in the subprime and Alt-A subsectors.

The annualized dividend for this last three months is approximately 5.6 percent, which represents an uptick versus last year's dividend, which was 5 and quarter for the full year.

Standard deviation of performance is currently about one and a quarter. So, volatility continues be very low and the Fund's Sharpe ratio is currently about 3 and a half.

Turning to composition and structure of the Fund, let me start by talking about current sector weightings.

At the end of June, the portfolio had about an 85 percent allocation to non-agency RMBS and this represents about a 50-50 split between legacy non-agencies and new issue, or next-gen, securities that Greg alluded to.

So, within that 80 – 85 percent, there's about a two percent allocation to prime bonds, so a very small allocation, given that most of those do tend to be fixed rate. Alt-A exposure is about 14 percent, subprime about 21 percent.

The Alt-A exposure is materially higher than it was a quarter ago, which I'll talk about in a moment. Option ARM exposure was 8 percent, essentially the same as last quarter. NPL/RPL 2.0 next-gen paper about 10 percent, same as last quarter. CRTs made up 11 percent (CRTs are agency credit risk transfer securities). That's down from last quarter, which I'll talk about again in a moment. And single-family rental securitizations or SFR, which we're lumping in the non-agency RMBS sector for these purposes, was up about 3 percent to 17 percent.

Our exposure to non-agency CMBS remains quite small, about a 4 percent allocation, which is basically half small balance commercial deals and half Freddie Mac multi-family securitizations.

And then we have a 5 percent allocation to asset-backs and that's cut to about one half versus the prior quarter which again I'll mention in a second. And cash was just slightly positive at the end of the quarter.

So, a few sector data points that I'd like to highlight, I mentioned that RMBS was up and that's from a combination of a higher allocation to what we are classifying as Alt-A paper.

These are legacy Alt-A, and in some cases, subprime loans that had not previously been securitized, but they've been around, obviously, since pre-crisis. And they have recently been put into a series of new securitizations. These deals have a very good combination of – number one, structure; number two, loan-level credit quality; and number three, yield.

These are all floating rate bonds with average lives of under two years and a loss-adjusted yield of about 5 percent. So, all in all, a very attractive group of assets we've been able to add.

We also added, as I mentioned, a few percent in single-family rental securitizations, which we continue to believe are one of the undervalued sectors in the non-agency space.

This is one sector, in fact, where investment grade paper has actually widened slightly, in sympathy with movements in high-grade CMBS and corporates year-to-date.

We reduced our ABS exposure during the quarter. We're simply not seeing good relative value there, and the fact is that most of these are short maturity fixed-rate bonds, with exposure to the two and three-year parts of the curve. That is not appealing to us currently, given our expectation for more curve flattening.

New issue sectors, as I mentioned, which include agency credit risk transfer, NPL/RPLs, new non-agency originations, and single-family rental securitizations, are about 40 percent of the portfolio or about half of the total non-agency RMBS portion today.

So, generally speaking, these newer sectors have more liquidity, they're actively traded by more dealers, they're often securitized by loans made under stricter underwriting standards and offer some structural differentiation in contrast to the legacy paper that we own.

This growing universe of bonds gives us more tools to make tactical decisions with respect to liquidity, with respect to rate sensitivity, quality, exposure to real estate credit fundamentals, call risk, et cetera.

And as Greg mentioned, there is going to be $75 billion or more issuance this year, which is essentially equal to the amount of the legacy bonds that are – that are paying down at this point.

As I mentioned, our cash balance remains very low, and a little bit of that is timing. But we continue to be very comfortable holding less cash because of the overall improvement and liquidity for the securities in the portfolio that we currently have invested in, particularly these new issue sectors.

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

We're continuing to focus on higher quality cash flows with more liquidity, less rate sensitivity, and we expect continued low correlation of the risk assets. The majority of our RMBS positions are senior bonds. The Fund's correlation to the Bloomberg Barclays MBS Index, in fact, is only about 0.1 today.

We're still seeing 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.

We've kept our allocation to MBS with floating rate coupons at about a 75 percent total allocation. As I've described in the past, some portion of these floaters, currently about a quarter, have some model duration. This is because of structural nuances in the bonds: caps on coupons, modifications of some of the underlying loans, et cetera.

But most of these continue to trade with, essentially, no empirical duration. And, these floating rate coupons have been rising in tandem with the increase in the Fed's target Fed funds rate and providing a nice boost to portfolio yield, as well as providing a boost to the portfolio's dividend.

Our portfolio's loss-adjusted yield today is about 4.5 percent, which is about one quarter of a percent higher than a quarter ago. Again, this is partially from the benefit of our floating coupons stepping up.

In terms of duration, we continue to keep duration low which, of course, is one very important reason why performance is positive this year. Duration today about is 1.15 years. We still are not seeing material interest rate-driven price movements in most of our portfolio even with securities that have model duration and we expect this lack of sensitivity to continue.

Other fixed income sectors, in our view, remain a risk from rising rates and we like our relative positioning. And the portfolio spread duration today is approximately 4 years, essentially the same as it was a quarter ago.

The average dollar price of the overall portfolio is 94, which is the same as it was last quarter. The average price of our legacy RMBS is in the high 80s and for the new issues, about – just about par on average.

Our turnover for the last quarter has been a little lower, still averaging well over 150 percent annualized. And even in the middle of the summer, we're still seeing some very good opportunities to actively manage the portfolio.

The Fund, of course, remains long-only, no leverage or hedges in place, and we do not plan on changing that. We're very comfortable with the level of credit risk that we're taking and analyzing which, ultimately, at the end of the day, is a very important source of the performance that we're generating.

We also believe that we have an appropriate amount of liquidity in the portfolio, and we remain confident that our limited interest rate risk will continue to serve the portfolio well. In terms of liquidity, we continue to have a borrowing facility from U.S. Bancorp, our Fund custodian and administrator, which is equal about 20 percent of AUM, which we can only use for redemption purposes. So that is one more very strong source of liquidity in the portfolio.

Looking forward from here, not only have our tactical strategies remained similar, but our views have not changed this year. We expect the front end of the curve to continue to rise with one and very likely two more Fed moves this year.

We certainly are not seeing signs of the intermediate part of the curve rising, but of course that can change quickly. For now, we believe the tenure will remain in a range.

We think we are going to see continued bouts of volatility in risk assets. And we think that will lead to some great opportunities to buy attractive bonds in our sectors, despite continued strength in credit fundamentals. And on that note, we continue to see home price appreciation in the 5-6 percent range.

We're operating in a very opaque, fragmented sector as we've talked about in the past, and the fact that we're small and can be nimble, yet are very good at doing the work necessary to understand how the cash flows underlying these non-agencies will change under different economic and market scenarios, puts us in a really good position.

We continue to believe that floating-rate securities in the MBS space are appropriate to own and we want to own a lot of them, and we think that senior cash flows in general are most appropriate.

We continue to believe that traditional CMBS remains unattractive, given their long-duration characteristics and very importantly, their reliance on refinancing loans. We still believe that Agency MBS are at risk of significant underperformance, given their low continued low yield, their long-durations, negative convexity, and the still $2 trillion of agencies that are sitting on the Fed balance sheet, which is still very early in the tapering process.

So, we have positioned the portfolio to be the beneficiary of volatility should this risk-off scenario develop. And in the meantime, we are seeking to own bonds with good carry, and in our view, with the low downside price risk.

If a risk-off scenario does develop, although we certainly would expect some positive correlation between RMBS and other risk assets, we think that these bonds will hold up better than other risk assets, probably better on a relative basis than they did back in the first quarter of '16.

So, in summary, we will continue to position the portfolio with relatively low duration, with higher liquidity, with limited spread duration, with the goal of targeting solid monthly returns, which we've done so far this year, largely from interest income, while managing downside volatility.

And at the same time, we'll continue to buy and trade opportunistically as the market permits. And again, I think it's really important to say this again and again, we're confident that our small size, and our ability to be nimble, is increasingly valuable. While we have been growing slowly and steadily, we think that nimbleness is 100 percent intact.

Greg, I will pass it back to you.

Greg Parsons: Thanks, Tom. Great update.

You know as many of you might know, we also have a quarterly call focused on the Semper Short Duration Fund. Given that that call isn’t until September, I'd like to provide a brief update.

The Fund also has a 5-star Morningstar rating and its performance for the trailing 1 and 5 years through June 30th is in the top three percent and one percent respectively for Morningstar's ultra-short-term bond fund universe, something we, again, are very proud of.

Performance through June 30th, year-to-date is 1.21 percent for the institutional class versus six basis points for its primary benchmark, an outperformance of 115 basis points in six months.

Performance has been positive every month since dating back to 2016. That Fund has also grown about 50 percent year-to-date and has a long runway to continue growing.

Within that product, we focus on investment grade mortgage securities along with CMBS and ABS, providing what we believe is a good source of low volatility, low correlated returns, built to have minimal interest rate exposure. Tom and I would be happy to speak with any of you about this if and when there is interest.

Again, we remain very excited about the MBS Total Return Fund's performance, growth and its pipeline. Frankly, we're more excited than ever about the opportunities we're seeing in market to drive distinct value within both the legacy and new issue RMBS sectors. And I'd like to thank those in the phone who are already clients and trusting us with your client's capital.

At this point, we'll open up the questions.

Operator: Thank you. Ladies and gentlemen on the phone lines, if you'd like to ask a question to our speakers, please hit star then the number one key on your touchtone telephone. If your question has been answered or you wish to remove yourself from the queue, you may hit the pound key.

May I ask that once you've asked your question to please mute your line to prevent any background noise from coming through. Again, that is star then one to ask a question. I'll wait a moment to see if any questions appear in the queue.

And again, that is star, then one to ask a question.

Speakers, I am showing no questions in the queue at this time.

Greg Parsons: Great. Well, again, thanks for everyone for finding some time to listen to the update. We're excited about things we're seeing and look forward to continuing to build relations on a go-forward basis. Thanks again for the time.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This does conclude your program and you may all disconnect. Everyone, have a great day.

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