Semper Short Duration Fund Quarterly Conference Call

September 13, 2018, 11:30 a.m., E.T.

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

Definitions:

Average coupon: The weighted-average gross interest rates of the pool of mortgages that underlie a mortgage-backed security (MBS) at the time the securities were issued.

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 8/31//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. 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 8/31/18 the Semper Short Duration Fund received a 5-Star Overall Morningstar Rating™ among 144 Ultrashort Bond Funds and a 5-Star Morningstar Rating™ for both the 3 and 5-year periods among 144 and 112 Ultrashort Bond Funds, respectively. As of 8/31/18 the Semper MBS Total Return Fund received a 5-Star Overall Morningstar Rating™ and a 4-Star 3-Year Morningstar Rating™ among 288 Non-Traditional Bond Funds, and a 5-Star 5-year Morningstar Rating among 178 Non-Traditional Bond Funds. Past performance does not guarantee future results.

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. Morningstar ranked the Semper Short Duration Fund in the top 5%, 3% and 1% out of 183, 144 and 112 Ultrashort Bond funds for the one and five-year periods ending 8/31/2018, respectively.

Past performance does not guarantee future results.

SEMIX Unsubsidized SEC Yield: 2.89% and Subsidized SEC Yield: 3.17% as of 6/30/2018

SEMRX Unsubsidized SEC Yield: 2.64% and Subsidized SEC Yield: 2.92% as of 6/30/2018

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 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 date described and is subject to change at any time. Performance data quoted represents past performance, past performance does not guarantee future results. The investment's return and principal value of an investment will fluctuate, and 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.

I will now turn the call over to Greg Parsons of Semper Capital Management.

Greg Parsons

Good morning everyone. I want to start off by saying thank you for calling in today for our quarterly conference call for the Semper Short Duration Fund. I'm Greg Parsons, the CEO of Semper Capital Management, and I'm joined on today's call by Tom Mandel, Co-Founder of the firm and a Senior Portfolio Manager and portfolio manager on this product.

Tom and I plan to spend about twenty minutes providing an update on the Semper Short Duration Fund, a securitized, debt-focused, ultra-short duration mutual fund we launched coming on eight years ago, and we'll break the call into three parts. First, a quick update on Semper and what we're seeing in the overall markets. Second, Tom will provide a detailed update on the Fund and an overview of our outlook. And third, we'll open it up to questions.

For those that don't know us, Semper Capital is a privately-owned asset management platform that focuses our efforts on opportunities within the structured credit space, specifically RMBS (residential mortgage-backed securities), CMBS (commercial mortgage-backed securities), and ABS (asset-backed securities). Now we've recently also launched a European presence, managing assets both here and abroad. Our AUM has grown to 3 billion from about 2 billion six months ago, across a range of structured credit strategies that include absolute return, total return, and index-based solutions; and our skill set is available across multiple product formats to include institutional separate accounts, private funds, and public funds.

We reached an important milestone in July, our MBS Total Return Fund crossed its five-year mark, and as of the end of August was the top-ranked fund in Morningstar's non-traditional bond fund universe. Across every metric our platform is the strongest it has ever been with respect to people, resources, and products; and we 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 a few of Semper's current thoughts related to the opportunity we're seeing in market. As a structured credit shop, we are focused on non-agency RMBS, along with CMBS, ABS, CLO (collateralized loan obligations), and agency opportunities, each of these sectors offers some great value for a short duration strategy with a lot of floating-rate, high-quality, and liquid structures. Most exciting in these sectors continue to be non-agency RMBS, where the majority of our time and energy is spent.

Despite much of the non-agency RMBS universe trading at close to or at post-crisis tights, we continue to see opportunities to drive value in the sector. The structure of the sector and strong technical factors continue to work together to create what we believe to be one of if not the best source risk adjusted returns in the fixed income market, hard stop.

With respect to credit fundamentals, home price appreciation has continued at very strong paces and continues to beat virtually all expectations. While we are starting to see weakness in some of the more expensive cities and states, overall, price increases remain the trend. Meanwhile, home affordability remains extremely attractive compared to historical levels, meaning that the average disposable income is still strong when compared to the cost of buying or financing a home.

Second, as the universe of these legacy assets continues to season and the overall credit quality of the residential real estate space continues to improve, we see growing opportunities for a nimble, opportunistic strategy to invest in attractively-valued real estate debt securities. The legacy non-agency RMBS market remains roughly 450 billion in size and we continue to believe that we're right-sized to take full advantage of this opportunity.

At the same time, new issue has continued to increase and will total over 70 billion this calendar year. The combination of legacy, and now new-issue sectors, continues to remain constant and provides plenty of opportunity for us to drive value. Our size, both at the firm level and at the Fund level, allows us to take advantage of opportunities our competitive set, frankly, just can't efficiently access.

Third. Our sectors remain extremely well-positioned within the fixed income landscape with respect to interest rates and price volatility. A large swath in securities in the non-agency RMBS sector and other securitized debt sectors have low duration and low rate sensitivity, including floating-rate or other features limiting effective duration. Volatility, or lack thereof, continues to be low in many of these sectors, and correlations to other fixed income asset classes remains low.

In our view, these securitized debt offerings remain a good alternative to corporate credit and other fixed income sectors. We believe that the mortgage credit sector continues to offer higher yield, lower duration, low correlation to other fixed income and risk assets from continued improvement of real estate credit fundamentals, economic, and wage growth. All of these continue to make RMBS a great diversifier, a good anchor investment for a shorter duration strategy, and the sector continues to offer the potential for higher risk-adjusted total returns.

I'll now turn the call over to Tom to talk more specifically about the fund and our outlook.

Tom Mandel Thank you all for joining our call today, I look forward to providing an update for our Short Duration Fund. We launched the Fund back in December of 2010, and we now have about a 7 2/3-year track record managing the portfolio. And in fact, we've been managing short duration portfolios and portfolios on the front end of the curve since 1993. Despite the name of the Fund, please think of this as an ultra-short strategy.

As you will hear, we're keeping duration or rate sensitivity very short to in a range of about one-third to one-half year, which is quite a bit shorter than most short duration funds. The bottom line for us is that we believe that a portfolio of securitized debt instruments made up of mortgages, both non-agency and agency, along with CMBS, ABS and other structured investments can make for a very solid portfolio.

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 just as confident that this sector and related structured credits sectors form the basis for a very attractive ultra-short duration fixed income strategy.

So the Fund invests in structured credit with low rate sensitivity including agency mortgage-backed securities, including pass-throughs and CMOs (collateralized mortgage obligations); legacy non-agency RMBS, including prime, sub-prime, and Alt-A bonds; newer issue or next generation non-agency paper, including agency credit risk transfer, securitizations, re-performers, and jumbo private label securitizations, agency multi-family securitizations, single asset/single borrower CMBS, single-family rental securitizations, as well as a number of ABS structures along with AAA-rated CLO tranches.

So, this universe that we invest in is in fairly sharp contrast to many of the short duration or ultra-short duration funds that have a tendency to invest either in government securities or in corporate credit. And we seek to manage the fund to an overall investment-grade credit quality, along with interest rate risk or effective duration under a half a year, and with a yield that's significantly higher than short maturity government securities can offer.

The Fund provides daily liquidity, there are no fees or limitations associated with the time of your purchases or redemptions, we do provide liquidity. The fund has two classes: SEMIX, which is the institutional share class; and SEMRX, which is the investor share class which has a 25-basis point 12b-1 fee, there are no other front-end or trailing fees. The Fund is approved to purchase on many dealer platforms and, of course, can be purchased directly as well.

Morningstar has our fund in their ultra-short bond fund universe, which today has over 200 funds, of which 112 have been open for at least 5 years. For the trailing one, three, and five-year periods, the Fund continues to be ranked in the top 5% of the universe based on performance through August 31st; in fact, for the trailing 5-year period it is the top-ranked fund based on performance.

Performance year-to-date through August 31st was 1.73% for the institutional class versus 37 basis points for its primary benchmark index, the Bloomberg Barclays 1-3 Year Government Index, for an excess return of over 1.3%. Annualized performance from inception back in December of 2010 through the end of August, was 2.52% for the institutional class versus the index return of 72 basis points, which is an excess return of about 180 basis points per year over this nearly 8-year period.

The Fund’s total rate of return has now been positive for each month this year and, in fact, it's been positive for each of the last 30 months, and that's a period in which the 2-year Treasury has risen by over 200 basis points to about 2 3/4 today. The primary source of performance for the last quarter, once again, was interest income generating about 80 basis points during this 3-month period.

While we do actively manage the portfolio, since most of the securities are relatively short and high-quality, we really don't see much price movement. In fact, the Fund share price or NAV, has varied by only 1 basis point so far this year. The Fund pays a monthly dividend, the 12-month dividend rate as of August 31st was 2.65% while the indicative yield based on August’s dividend is even higher, 2.94%.

Here's some updated information about the composition of the portfolio. At the sector level as of August 31st, the portfolio consisted of a 6% allocation to government-guaranteed paper, both Treasuries and agencies, 25% allocation to non-agency RMBS, virtually all of that is in the newer issue space, about a 5% allocation to legacy paper. A 25% allocation to CMBS, half of that consists of single-family rental securitization bonds, and then another 5%, small-balance commercial securitizations, which we've talked about a little bit the past.

We have a 20% allocation to asset-backed securities, which is made up of a number of different kinds of both traditional and esoteric asset-backed securitizations. And then we have about a 22% allocation to AAA-rated senior CLO tranches along with a 2% balance in cash.

The sector weightings have not changed materially over last quarter, we continue to have an extremely well-diversified portfolio across these different securitized debt sectors, and we continue to focus on floating-rate structures with both good liquidity and good credit quality. We're most excited currently about our non-agency exposure and also our exposure to the AAA CLOs.

In addition to the really strong structural credit enhancement and liquidity, we like these CLOs in large part due to the fact that their coupons typically reset above 3-month LIBOR rather than the 1-month LIBOR, the spread between these two measures still remains wider than historically at about 20 basis points, so we're picking up incremental yield by owning those CLOs.

Over half 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 securitized in the bonds or is government guaranteed. And again, we don't own corporates, we don't own unsecured paper.

We talk more and more often about the next generation of non-agencies, including credit risk transfer securitizations or CRT, single-family rentals or SFR, Jumbo 2.0, among others. This is equally important for the Short Duration Fund, which now has about 2/3 of its real estate credit exposure in these new-issue securitizations.

The bonds that we own here are generally investment grade, they are liquid, they are supported by a number of primary dealers, and they're based on new collateral with strong underwriting characteristics. These securities help support the portfolio's quality, and importantly its liquidity, as well as providing us with some new and some really interesting opportunities to add value through active management. These sub-sectors have rapidly become a very key and important constituent in our Short Duration portfolio.

Over the last quarter we did add a couple of interesting new structures. First, we added a few private re-securitizations, collateralized with the legacy bonds supported by sub-prime and Alt-A loans, which in turn are characterized by very attractive LTVs (loan-to-value ratio) averaging around 65%. A number of them have been modified, about 70%, and rapidly improving fundamentals overall. These are fixed-rate deals, they have key rate duration in the 4 to 5-year part of the curve, which helps us to avoid that part of the curve that we believe is most susceptible to continued flattening so we're trying to avoid that 2 to 3-year part of the curve to the extent we can.

We also added a few investment grade mortgage insurance credit risk transfer securitizations, and these offer an interesting distinction versus the agency CRT deals we've been buying for the last couple of years and continue to buy. And these insurance transactions were actually being paid by mortgage insurance payments owned by some of the major insurance players in the mortgage space. This is yet another example of a nascent smaller sector offering of 20 or 30 basis points of incremental yield, which can be taken advantage of by early adopters. And we take a lot of pride in the fact that our small, nimble, yet credit-intensive approach allows us to take advantage of these kinds of opportunities.

One of the key opportunities we continue to see in the legacy space is optionality of prepays, we have talked about that before. Another investment characteristic that our two mutual funds share in common is the value of voluntary prepayments for discounts securities. This Fund's average dollar price for the sub-prime bonds we hold is about 94.

And over the last couple of years we've continued to see a growing percentage of the sub-prime borrowers prepaying in this sector, a positive for the timing in cash flows and for fund performance. And we expect this to continue, especially as short rates continue to rise.

The average credit quality the bonds in the portfolio is BBB. 85% of the portfolio is investment grade, and much of the remaining 15% is in securities with no rating, and many of those have investment grade comparable quality.

The portfolio’s effective duration is 0.3 years, same as a quarter ago. This rate sensitivity is coming from two sources. First, many of these securities have short final maturities, or average lives, and have active amortization schedules. And second, close to 75% of the portfolio consists of securities, again, mostly mortgage securities that have floating-rate features.

So as the Fed raises their target funds rate and as the 1 and 3-month LIBOR and other reference rates rise in concert, the coupons on the securities rise as well. So, this has been a real boost for the portfolio’s yield and its average coupon, and it's really helped support the prices of these bonds, and of course, the Fund's NAV.

The portfolio's yield-to-maturity, which has been benefitting from this rise in the reference rate for these coupons as well as for the upper slope of the forward curve, has risen from about 2.9% at the beginning the year to about 3.5% today. The portfolio’s average coupon, at the same time, has risen from about 3.1 to 3.5%. The portfolio has an overall average dollar price of just under par, and the average dollar price of the legacy non-agencies that we own is in the mid-90s.

Volatility has remained very low and correlation to other asset classes has remained low as well. For the last three years annualized standard deviation of monthly returns is about 0.5. The correlations versus the broader market indices that we track are all below 0.4. The Fund remains long-only, we have no hedges in place, we have no plans to change that. And overall, we are positioned with low rate sensitivity, high-quality and relatively high yield. And let me just spend a minute highlighting our current outlook.

First. We expect the economic growth to persist beyond this year, supported by regulatory reforms, by the benefits of the tax overhaul we continue to see, and the deficit spending. We think that the actual negative impacts from potential trade restrictions that we keep hearing about in the press are likely to be muted, although certainly the headline risks could be greater.

We think the greatest risk right now is for inflation to rise a little bit above 2% this year, which would allow the Fed to reduce monetary policy accommodation even more aggressively than currently priced-in by the markets. And we feel very confident that yields on the front and will continue to rise with further curve flattening.

Today the spread between 2’s and 10's is down to about 20 basis points. So, we're not really confident in projecting the 10-year treasury yield, but we are confident in stating that the 2-year treasury yield and other short rates will be rising from here.

The investment grade short average life securitized sectors that we're investing and have continued to perform well. Liquidity in these sectors has been good, it has continued to improve, and performance has largely been immune to global macro events.

Home price appreciation has continued to rise in the 6% range, still higher than we are projecting, although we've certainly seen some pockets of softness in some higher cost cities and states with SALT (state and local tax) deduction limitations taking effect this year. And home affordability--Greg mentioned briefly--while declining in recent quarters remains better than historical averages, in our view, and is not a hindrance to refi activity.

So again, we've continued to focus on owning higher quality, more liquid investments in these sectors to ensure the appropriate asset liability matching of our daily liquidity fund and to minimize downside volatility, and also to be prepared to take advantage of any significant opportunistic offerings that we see and certainly hope to see.

Importantly, we continue to believe that our number one risk is liquidity and our secondary focus remains on the yield curve. We expect the bear flattening pattern to continue. We believe that we will see a rate hike later this month, it's essentially fully priced in and we believe that we're likely see one more in December. The Fed's tapering continues on track and they are moving towards their neutral policy stance.

Our approach in this environment continues to be to own a significant allocation to floating-rates to avoid the 2 to 3-year part of the curve to the extent that we can, and to own a little bit more duration with our 25% fixed-rate exposure creating just a bit of a barbell.

These fixed rate securities tend to roll down the curve fairly quickly, however. So, this portfolio composition is helping prices stay stable as rates rise and increasing portfolio yield as LIBOR resets along with the Fed fund's target rate moving up.

Moving back to liquidity for just a second. While we believe the level of liquidity of the bonds in the Fund is appropriate today, we do continue to maintain the borrowing facility from US Bancorp, which we can only use for redemption purposes if we choose to.

So, to summarize, we believe we're positioned well for the environment that we're in, including the prospect for some volatility in yields and the potential for some volatility in risk assets. We're going to keep our low duration, we're going to keep our high liquidity, we're going to keep our investment grade average quality; all of which are supported by assets that we can evaluate, like mortgages and commercial loans, with an objective of continuing to generate monthly returns that look a lot like the portfolio's yield net of expenses. While doing this we'll continue to manage the portfolios downside volatility, and at the same time looking to buy opportunistically as the market presents opportunities.

And back to Greg.

Greg Parsons Thanks Tom. If it's not obvious, we remain very excited about the short duration's current positioning and outlook for forward-looking continued performance, and frankly, expect to continue to drive this level of performance in the face of the rising rate environment.

The Fund has a 5-star Morningstar© rating. Performance has been solid and consistent in the Fund and continues to have a lot of capacity. We've seen nice inflows year-to-date, the fund recently effectively having doubled assets over the last 6 months and expect continued deliberate distribution and net inflows on a go-forward basis.

We'd be happy to speak to anyone on the call about the Fund in more detail, always available. So, thank you for time on the phone today, and we'll open it up for questions.

Operator At this time, we would like to take any questions that you may have for us today. In order to ask a question, please press star then the number one on your telephone keypad. Again, that's star one on your telephone keypad. We'll pause for a moment to compile the Q&A roster.

Again, if you would like to ask a question please press star then the number one on your telephone keypad.

There are no questions on the line. Presenters, you may proceed.

Greg Parsons Great. Thanks again. We appreciate the support. Thanks again for your time.

Operator Thank you again for joining us today. This concludes the conference, you may now disconnect. And have a great day.