Semper MBS Total Return Fund Quarterly Conference Call

November 5, 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.

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

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.

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

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.

VIX: The CBOE Volatility Index, known by its ticker symbol VIX, is a popular measure of the stock market's expectation of volatility implied by S&P 500 index options, calculated and published by the Chicago Board Options Exchange.

M2s: A class of securities within CAS (Connecticut Avenue Securities) and STACR (Structured Agency Credit Risk) CRT deals.

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 10/31/18. 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 10/31/18 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 10/31/18 the Semper Short Duration Fund received a 5-Star Overall Morningstar Rating™ and 5-Star 3-Year Morningstar Rating™ among 144 ultrashort bond funds. The Fund received a 5-star rating for the 5-Year period out of 116 ultrashort bond funds. The rating is specific to SEMIX and SEMRX. The Overall Morningstar Ranking 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 6% out of 315 nontraditional bond funds, the top 19% out of 278 nontraditional bond funds, and 1% out of 171 nontraditional bond funds for the one, three, and five-year periods ending 10/31/2018, 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 (SEMIX) in the top 2% out of 185 ultrashort bond funds, the top 3% out of 144 ultrashort bond funds, and the top 1% out of 116 ultrashort bond funds for the one, three, and five-year periods ending 10/31/2018, 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 for 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 the investment will fluctuate so that an investor's shares when redeemed may be worth more or less than the original cost. Current performance of the Fund may be lower or higher than the performance quoted.

Performance data current to the most recent month end may be obtained by calling (855) 736-7799. After the speakers' remarks, there will be a question and answer session.

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

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

I'm joined on today's call by Tom Mandel, Co-founder of the Firm, Chief Investment Officer, and a portfolio manager within the investment team.

As we have traditionally done, Tom and I will spend about twenty minutes providing an update on the MBS Total Return Mutual Fund, a mortgage-focused mutual fund that we launched in mid-2013, and we'll break the call into three parts:

First, a quick update on Semper the Firm and the overall market. Second, Tom will provide an update on the Fund and an overview of our outlook, and finally, we'll open it up for questions.

For those that are new Semper, you know, 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). Our AUM (assets under management) has grown to approximately $3.2 billion, up a little bit more than $500 million over the last quarter.

We continue to manage assets across a wide 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, public funds.

We also now offer our mortgage skill set both here and in UCITS format for European or non-US investors. You know, I'm excited to say we have crossed another important milestone: the MBS Total Return Fund has just crossed $2 billion in AUM. The Fund is nearly doubled year-to-date, and we're pleased that the mortgage credit market continues allow us to capitalize on opportunities for our clients and partners creating the potential for continued out-performance.

If anything, you know, with the volatility we're seeing in market, opportunities to add value are better than they have been in some time. Speaking of volatility, you know, we've just come through a significant period of volatility that by many measures is probably the most significant period of uncertainty we've seen in the capital markets since early 2016. And just like during that time period, the MBS Total Return Fund has navigated this volatility quite successfully.

A few highlights over the past month, month-and-a-half: The equity markets were down about 7%; the VIX nearly doubled to 23; the 10-year treasury rose 10 basis points and we're now up 80 basis points year-to-date; the Bloomberg Barclays Index fell by almost 80 basis points; and the Bloomberg Barclays High Yield Index fell by 1.6%.

Despite all these metrics evidencing the volatility within market, the Fund's performance was positive as interest rates more than offset price action over the portfolio's mortgage securities. Continued strengthening in real state credit fundamentals and strong technical factors continue to work together to create strong support for this asset class in what was a strong risk-off environment.

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

The legacy non-agency market is now roughly $450 billion in size, and we continue to take advantage of our size, both the Firm and of the Fund, to take full advantage of opportunities in this market. Newly and at the same time, new-issue securities have continued to steadily increase and will total well over $70 billion this year.

The combination of opportunities within the legacy space and now the ever-emerging new-issue sector continues to be steady and provide opportunities. Our size, both at the Firm level and the Fund level, remains a strategic advantage, and is something we will continue to deliberately manage.

Last, as the Fed continues on its path in moving from accommodative to neutral, the mortgage credit market remains extremely well-positioned within the fixed income landscape with respect to interest rates and price volatility. A large swath of securities in the non-agency RMBS sector and other securitized debt sectors have very low rate sensitivities, including floating-rate and other features limiting effective duration.

Volatility has also been low in many of these sectors and correlations to other fixed income assets and risk assets continues to be low, which was, once again, proven out in October.

While the Fund did have a little more price volatility this past month with NAV (net asset value) declining 4 basis points or about 35 basis points in price performance, we've now completed our 32nd consecutive month of positive net performance, and the Fund's dividend has continued to rise for much of this period.

In summary, given the positive performance year-to-date in the midst of volatility and the negative performance we're seeing in many fixed income sectors, we continue to believe that the mortgage credit sector continues to offer an extremely fairly straightforward, simple three-prong investment value proposition in a basket of highly liquid, senior, diversified securities, an advantaged yield profile with respect to rates, and extremely both structurally low, complemented by management, you know, low duration. And again, continues to be proven out, low correlation to other traditional risk assets.

All of these continue to make RMBS a great diversifier, a good anchor investment for a shorter duration strategy, and offers 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 its positioning.

Tom Mandel: Thank you and thanks everybody for listening. The Total Return Fund is well into its 6th year having crossed the 5-year mark back in July, and we continue to be pleased with performance, with our current positioning, and also with our outlook for the Fund and the sectors that make up the Fund, which again, are primarily non-agency mortgage credit.

The third quarter, which now seems like a very long time ago, was fairly positive for risk assets and negative for high-quality bonds. As Greg mentioned, the 10-year treasury note rose in yield, not only over last month, but in the prior quarter by about 20 basis points. And of course, we had another Fed hike in September, which the market seemed to take in stride at the time.

The Bloomberg Barclay's Aggregate Index, which is a measure of the overall IG or investment grade market, was flat in terms of performance during the quarter, while the

S&P was up by about 7%. Performance for the Fund was positive in each of the 3 months and has been positive each month including October since the first quarter ‘16.

We saw continued growth this quarter with assets increasing by about $200 million, and we ended the quarter at about $1.9 billion of AUM in the Fund, and as Greg said, we're crossing $2 billion today.

We continue to estimate that the Fund has limited capacity of about $3 billion, and we have made the decision to put a soft close in place when the Fund hits around $2¼ billion with $3 billion the outside target that we have in mind for the Fund.

Let me give you an update on performance: so, for the third quarter of 2018, the institutional class returned 1.01% net, an excess return of over 1% versus the benchmark index, which is the Bloomberg Barclays U. S. MBS Index.

Year-to-date through September, the institutional class returned 4.17%, an excess return of over 5% versus the index. The primary source of positive performance during the quarter was interest income with a contribution of about 1.3%.

Price declines reduced performance by around 20 basis points. These price declines were largely the result of price movement of many of the bonds that we own. They do have some duration, and partially the result of some very minor spread widening we saw in the highest quality portion of the newer-issue sectors as agencies, IG corporates, and IG CMBS all exhibited some widening.

For the month of October, the institutional class returned positive 11 basis points net. In contrast, the Barclays Bloomberg MBS Index returned negative 63 basis points, and the Aggregate Index returned negative 79 basis points. Those negative numbers being from a combination of yields rising as well as some spread widening.

For the portfolio, in October, interest income again, was the driver of positive performance with about 45 basis points positive contribution, and price declines were about 20 basis points.

These price declines were small, but they were fairly broad-based as we saw a very small softness in the bid side of many of these markets. In our view, it's a combination of market participants taking a step back because of the general market volatility that we saw, as well as investors starting to think about positioning for year-end.

Year-to-date through October, the institutional class returned 4.29% net versus a negative 1.70% for the MBS and negative 2.38% for the Aggregate Index. And since inception in July 2013, the institutional class has returned 6.83% annualized versus 1.97% for the MBS Index, which represents over 4.8% annualized excess return.

The trailing 12-month dividend distribution through the end of last month is 5.9%, and it has continued to drift higher. Standard deviation is currently running at about 1¼, and the Fund's Sharpe Ratio today is about 3.5.

Next, I'm going to provide a little bit of information about the portfolio's current composition. As of the end of October, the portfolio had an 87% allocation to non-agency RMBS of which 1% was prime, 14% was Alt-A, 17% subprime, 7% option ARMs, 11% in Jumbo 2.0s and RPLs, 18% in agency credit risk transfer or CRT, and 17% in SFR or single-family rental securitizations.

In CMBS, we had about a 6% allocation to non-agencies comprising of Freddie Mac multi-family deals totaling 4% and then another 2% in small balance commercial deals. We had a 5% allocation in a diverse group of ABS and 1% allocation to cash.

There've been a couple of shifts in allocation during this 4-month period since the end of June. First, non-agency MBS are up about 2%, and this is from an increase in agency credit risk transfer, again CRT bonds, an increase of 7%, and a reduction in subprime bonds totaling approximately 5%.

Our reallocation was really the result of a few different factors. First, we have continued to focus on maintaining very strong liquidity in the portfolio, which again, we think will set us apart when we do see a material reduction in liquidity across risk markets.

One of the basic tenets of our investment philosophy is to constantly undergo price discovery, and we found that we were able to sell a number of our subprime positions at strong valuations and as a result, we were willing to sell them, reducing the allocation.

And then separately, we felt that the CRT sector had become increasingly attractive during the period through the combination of some new-issue activity, some particularly attractive structures from both Freddie Mac and Fannie Mae, and our continued preference for quality and liquidity given how far lower quality cash flows have run in price, especially in the legacy space.

And then we added about a 2% position to our Freddie K allocation, and again these are non-government guaranteed multi-family securitizations with floating-rate features and good yields. The credit performance on this shelf has been very good and provides a good diversification to Resi.

New issue sectors including CRT, Jumbo 2.0, non-QM, RPL deals and SFR, today are a little over half of our MBS allocation. Generally speaking, these new-issues have more liquidity, they're actively traded by more dealers, and they're often securitized by loans made under stricter underwriting standards. And they offer some interesting structural differences relative to legacy paper.

This growing universe of bonds gives us more tools to make tactical decisions with respect to liquidity and rate sensitivity, and so on. As Greg mentioned, there will be $70 billion or more of issuance this year, which at this point is essentially the same as the size of the pay-downs that we're expecting in the legacy space.

Our cash balance remains very low. We continue to be comfortable holding less cash because of the overall improvement in liquidity for the sectors that we're investing in, particularly these new-issue sectors. Our overall tactical strategy remains the same as a quarter ago.

We believe it's still prudent to be taking less risk in anticipation of more volatility and the subsequent opportunities that we would expect to see. We continue to focus on higher-quality cash flows with more liquidity, less rate sensitivity, and we expect continued low correlations to other risk assets.

Well over half of our MBS positions are still in senior bonds. The Fund's correlation to the MBS Index is still running about 0.1. 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 maintain a pretty good level of trading activity extracting value in a number of ways. We've kept our total allocation to MBS with floating-rate coupons at about 75% of the portfolio. And as I've described in the past, some portion of these floaters, about a quarter, do have some model duration because of structural nuances in the bonds, but most of these are still trading with little or no empirical duration. These coupons have been rising in tandem with the increasing target Fed funds rate, which have provided a nice boost to portfolio yield.

The portfolio's loss-adjusted yield today is about 4.6%, which is up about 20 basis points from a quarter ago. And this, of course, is partially from the benefit of our floating-rate coupons stepping up, as well as some yield increases from the price movement we've seen.

With respect to duration, we're keeping it low, which is one primary reason that performance has been positive all year. Duration today is about 1.2 years. We are not seeing material interest rate-driven price movements in most of the portfolio, and we expect this to continue at least for the near term to intermediate term.

Other fixed income sectors, in our view, remain at risk from rising rates so we like our relative positioning. The portfolio spread duration remains at about 4 years.

The average dollar price of the portfolio is about 95 today, that's about a dollar higher than the end of the second quarter. This is largely from having more new-issue bonds as a portion of the overall portfolio. The average price of our legacy RMBS is in the mid-80s and our new-issues are about 100 on average.

The Fund remains long-only with no leverage, no hedges in place. We have no plans to change that. We remain really comfortable with the level of credit risk we're analyzing and taking in the portfolio, ultimately an important source of that performance that we have continued to generate. We also believe that we have an appropriate amount of liquidity in the portfolio, and remain confident that our limited rate risk will serve the portfolio well.

Our liquidity, as an aside, continues to be supported by our borrowing facility at US Bank Corp. US Bank Corp is our Fund custodian and administrator. We can use that for redemption purposes only, and of course, it's another source of liquidity in the portfolio.

We just went through quite a month, as everybody knows, with volatility spiking, risk assets underperforming, and the Fed still continuing on its path to a neutral monetary policy. Adding to that have been a bunch of other headlines, tariffs, elections, issues with Brexit, Italy's budget, etc.

In addition, there's been increased discussion about declining home affordability, rising mortgage rates, and a continue drag on growth in construction and sales in real estate. The fact is that our market remains largely immune to all this. Residential mortgage credit quality remains very strong. Incomes are rising, home prices continue to rise, and the job market continues to be strong. Remittance data that we review monthly remains strong.

Refinancing activity for subprime borrowers with adjustable rates continues to slowly increase in contrast to the rest of the mortgage market. So we are not seeing material impact from home affordability metrics today.

The credit quality of new-issue sectors also continues to improve overall, and we've witnessed a number of credit upgrades to our bonds as deals have continued to de-lever. We certainly saw some increase in correlations to risk assets last month, but still much less than in the first quarter of 2016.

As I mentioned, our NAV declined by 4 basis points during the month, which we believe is quite good relative to other risk assets. We estimate that about half of this price movement is from duration on the quarter of the portfolio that have fixed rates as well as a small number of floating-rate securities that exhibit some model duration. And then the other half is from widening in sympathy with moves in another risk assets. We saw this primarily in the new-issue sectors, particularly CRT and more specifically in M2s.

We've also seen a little softness across SFR, and even a little softness across legacy paper. Again, this is bid-side softness as much because the street and insurance companies, and hedge funds, and money managers are starting to position for year-end.

So looking at the last couple of months of the year and into the next year our views remain essentially unchanged despite this recent volatility. We expect the front-end of the curve to continue to rise. We believe there will be another Fed move in December and at least a couple more next year. The 10-year yield is near the top end of its recent range, and depending on election results and near-term economic trends; there may well be continued upward pressure on the intermediate part of the curve.

We think we'll see continued periods 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, very fragmented sector, and in fact, we're small and nimble, yet are very good at doing the work necessary to understand how these cash flows work, which puts us in great position. We continue to believe that floating-rate securities in the MBS space are appropriate to own, and that senior cash flows in general are most appropriate.

As of today, we still believe that traditional CMBS remains unattractive, given duration characteristics, refinancing risks, and we also believe that agency MBS are very much still at risk of significant under-performance, given their yield, their duration, and the fact that the Fed still owns 2 trillion of these agencies.

So we've positioned the portfolio to be the beneficiary of volatility should this risk-off scenario resume, and in the meantime, we own bonds with good carry, and in our view low downside price risk.

When we enter into the next risk-off environment, although we expect some positive correlation between RMBS and other risk assets, we believe these bonds will hold up much better just as we saw last month.

To summarize, we will continue to position the portfolio with relatively low duration, higher liquidity, limited spread duration, and with the goal of targeting solid monthly returns largely from interest income, while managing downside volatility. And at the same time, we will continue to buy and trade opportunistically as the market permits, and once again, we're confident that our size and our ability to be nimble is increasingly valuable. While we're slowly and steadily growing, that nimbleness is 100% intact.

Thanks again for your time, and let me pass it back to Greg.

Greg Parsons: Great Tom appreciate it. You know, in addition to our continued success with the MBS Total Return Fund, we have a lot that we're proud of. As many of you know, we are extremely deliberate in ensuring that not only are we extremely strong fiduciaries for our clients, but also that we are strong corporate citizens with respective to finding ways for our platform to give back to the community.

With Veterans Day less than a week away, we're focused on many of our activities to support our nation's warriors and their families. This year we'll celebrate our partnership with the Marine Corps Scholarship Foundation, the nation's oldest and largest provider of need-based scholarships to children of Marines and Navy corpsmen. Semper is proud to partner with the Marine Corps Scholarship Foundation with the establishment of the Semper Capital Management Scholarship. This scholarship allows us to honor the men and women in uniform by helping enable their children to attend college.

If any of you are able, please join us this Wednesday night at 6:00 pm, at our annual cocktail reception that we're hosting. You can call or email myself or Tom to get more information on the event.

Again, we remain very excited about the MBS Total Return Fund’s performance, growth, and the robust pipeline. And frankly, we're as excited as ever about opportunities we're seeing in market to continue to drive value from both legacy assets and, now, the ever emerging newer-issue sectors.

I'd like to thank those on the phone who are already investors for your support to date, and at this point, we'll open up the call the questions.

Operator: Ladies and gentlemen, if you would like to ask a question, please press star one on your telephone keypad. Again, that is star one and we'll pause for just a moment to compile the Q&A roster. And our first question is from Robert Culter, Peak Asset Management.

Robert Culter: Yes, hello thank you for the call, and I'm new looking at the fund. I'm an investment advisor. What - and I may come back with other questions - but what environment or circumstances would cause the fund to struggle?

Tom Mandel: Hi Robert, thanks for calling in. Definitely happy to give you as much information as you'd like offline. So our view is that there really are a couple of scenarios in which we would expect performance to decline.

The first situation would be a significant risk-off trade that led to a real reduction in liquidity across risk assets, and we saw that back in the first quarter of 2016 when we had a drawdown of about 1.7% peak to trough. And really that was really a mark-to-market event, no impact on cash flows or ultimate value and in fact, we were able to add cheaper securities as a result of that.

The second event, and I think really what theoretically should be most harmful to a mortgage credit strategy, is a very, very significant decline in mortgage credit fundamentals, which would come in the form of a significant downdraft in home prices, deterioration of the labor force, and the credit quality of homeowners.

We believe, however, that the market is liquid enough, and that we are nimble enough to stay well ahead of that. As a part of our continuous investment activities, we're doing a deep dive loan-level credit analysis with current remittance information every month.

So on a monthly basis we're getting to see any trends in homeowner credit quality. We're not seeing that now, and we think that if we did begin to see it, we'd have the ability to stay out of the way of any sort of pending problem.

Robert Culter: So sometime in the next two years, we will have a recession. How do you feel that the funds will do with that environment?

Tom Mandel We actively manage the portfolio. Turnover has averaged about 200% a year and the bottom line is that in the mortgage space, we have the ability to go up in quality, even so far as going into agency paper, which of course is full-faith in credit and performed extremely well back during the financial crisis.

So, you know, the key is staying ahead of this decline in credit quality. Certainly, there are a number of subordinated non-agency bonds that exist that will do very, very poorly in that scenario, but there are also, we believe, a lot of senior cash flows that will continue to perform well, you know, even under those kinds of economic outcomes.

Robert Culter Okay thank you.

Tom Mandel Thank you.

Operator Our next question is from John Bates, private investor.

John Bates Yes, my question has to do with Fed policy. If the economy remains strong over the next year, do you think risks to the Fund's performance are likely to increase due to actions by the Fed? And specifically I'm thinking about- or wondering about-the continuation of the reduction in the Fed's balance sheet, which is now at the, I think approximately $50 billion a month, and increasing the Fed funds rate towards the neutral rate, but could you speak about the reduction in the buying of MBS by the Fed due to the reduction in the balance sheet?

Tom Mandel Certainly. So, we believe that agency MBS which make up about 90% of this total mortgage market, or about $6 trillion. We believe they are at risk because of the fact that the Fed owns a third of that market or about $2 trillion.

We believe it makes a lot of sense to avoid those bonds until the Fed has gotten their balance sheet a lot smaller. Our portfolio today owns zero agency mortgage-backed securities. We have a 100% allocation to non-agencies. There are some non-agencies, in particular some of the triple-A rated, fixed-rate paper that certainly trade based on how agencies are trading. So if agencies underperformed, there is a swath of non-agency paper that will also underperform, even though it's very high credit quality.

We have positioned our portfolio to have about a 75% allocation to floating-rate securities, meaning that every time the Fed raises rates and Libor goes up, the coupon and then the yield of these bonds goes up. So really, we believe position the portfolio to avoid a great deal of that negative impact of interest rate rises, which is what's most likely to happen with this Fed policy.

So yeah, we think there's two potential problems with the Fed moving towards neutral: one being agency valuations, the second being the impact on bonds with duration, so we think we're avoiding both of those potential problems.

John Bates Appreciate the work you're doing there to keep the volatility and keep performance strong. The other question in my mind was there's two parts of what they're doing with the balance sheet and the other part is with treasuries. The increase in the buying of treasuries that's going on with the run-off of the balance sheet, do you think that that's contributing to the spread widening that you mentioned earlier?

Tom Mandel Well I think that just the general rise in rates and the expectation that there's got to be somebody out there that wants to buy $2 trillion of agencies that the Fed currently owns. I think that's contributing to the spread widening.

I just think there's so many factors involved. I'm pleased to say that we focus on mortgage credit and mortgages generally. So there are a lot of folks who have very strong opinions on all the different causes of spread widening across different risk assets.

John Bates Okay, thank you.

Tom Mandel Thank you.

Operator And our next question is from Mike Beam with Vision 4.

Mike Beam My question was answered as a part of one of the other questions so thanks.

Greg Parsons Great hearing from you Mike.

Tom Mandel Thanks Mike.

Operator My next question is from Robert Cutler with Peak Asset Management.

Robert Culter Yes, hi there thanks again and one other question, your consistent returns are very impressive. It seems that a bit of that is due to the high level of income that's generated.

Do you feel like you're reaching out on the credit quality to obtain that income, and would you scale that back if necessary?

Greg Parsons Bluntly, absolutely not, the strategic mandate of this portfolio is within the construct of a diverse, liquid appropriate set of securities to drive the strongest risk-adjusted return.

Effectively, folks should look at the loss-adjusted yield, and then expect us to add 100-200 basis points of value to actively manage the portfolio, right. Our strategic focus is to ensure liquidity and drive the strongest return with those two prioritizations.

So while there is a very strong level of income, and that has helped to buttress the Fund's performance from a volatility standpoint and buttress the Fund's performance in periods of uncertainty.

We are by no means stretching for yield, and we would expect the yield of the Fund to migrate up or down within a certain basket of risk assets based on what the market will offer.

Robert Culter Okay, thank you very much.

Operator And again, if anyone would like to ask a question, please press star one on your telephone keypad, and there are no other questions.

Greg Parsons Great, well again on behalf of myself, Tom, and the entire firm, we appreciate your time today. We appreciate for those that invested with us, appreciate the support. And for those new to the story, please do reach out if there is anything needed from us to turn you from prospects into partners and clients. Hope everyone has a great day and I appreciate the time, thank you very much.

Operator And this concludes today's conference call, you may now disconnect.

END