JANUARY 2021

Semper Capital Management, L.P.
2021 Non-Agency RMBS Sector Outlook

Summary

The Non-Agency Mortgage-Backed Securities (RMBS) Sector is well positioned for strong performance moving into 2021 and we believe it offers both an extremely attractive absolute and relative value opportunity compared to other U.S. fixed income sectors. The price recovery for much of this sector, following March's pandemic-induced liquidity event across the capital markets, has lagged other momentum-driven and Fed-supported sectors. At the same time, the U.S. housing market which underpins RMBS has been one of the strongest performing sectors in the economy with headline data continuing to strengthen through 2020 year-end. This has created an increasingly attractive value proposition coming into the new year which sets up RMBS for a strong 2021.

The opportunity set is being driven by:

(1) Strong housing fundamentals
(2) High quality borrowers and mortgage loans
(3) Structurally attractive characteristics
(4) Favorable RMBS market technicals

The combination of a strong credit backdrop (reinforced by ever improving top down and bottom up metrics), an asset class in which the securities have structurally attractive features and favorably trending market technicals all contribute to the value we are seeing in the markets.

Recent activity in the space

Senior, investment grade bonds across most sub-sectors within RMBS have retraced much of their spread widening and price declines, but many pockets of mezzanine and subordinated paper remain much higher in yield and lower in price when compared to pre-pandemic levels. A number of factors have contributed to this phenomenon:

- Structural and credit complexity of many of these bonds and experience/data/cost barriers to entry
- Lack of direct Fed support, increasing perceived risk early in the pandemic
- Reduction in leverage utilized by a swath of RMBS market participants, led by mortgage REITs
- Tendency for Non-Agency RMBS price moves to lag momentum driven markets like corporate credit

In recent months, some of the RMBS sectors with higher levels of trading volume, most notably Agency Credit Risk Transfer bonds (CRT), have seen prices trending higher, and this strength has moved down the capital stack into both B1 and B2 subordinated tranches. The heightened interest in these bonds, which has driven prices as much as 20% to 30% higher in the final months of 2020, has in turn led to increasing interest in the mezzanine and subordinated structures of other RMBS profiles including Non-Qualified Mortgage securitizations (Non-QM), Jumbo 2.0, Reperforming Loan securitizations (RPLs) and Non-Performing Loan securitizations (NPLs).

The table below shows relative yield and spread data for a representative RMBS deal, highlighting the relative yield movements of tranches across the capital stack. This is a Non-Qualified Mortgage deal, AOMT 2019-5, issued in October 2019. The table shows each class/tranche in the deal, along with its level of credit enhancement (C/E) in February and then in November. C/E is a measure of how much collateral loss a bond can withstand before suffering principal loss. For example, C/E for the BBB rated M1 class increased from 10.7% to 13.3%, or close to 25%, during (and despite) this economic dislocation. Concurrently, our view of expected lifetime collateral losses has only marginally increased, a benefit of the very strong housing market and strong loan performance we have witnessed this year.

Bond Class	Tranche Type	Credit Rating	Credit Enhancement (February 2020)	Credit Enhancement (November 2020)	Yield Spread (February 29)	Yield Spread (November 30)
A1	Senior	AAA	38.9%	42.4%	80	80
A2	Senior	AA	32.5%	36.4%	95	120
A3	Senior	A	18.9%	23.5%	110	135
M1	IG Mezz	BBB	10.7%	13.3%	155	215
B1	BIG Mezz	BB	6.4%	8.0%	220	315
B2	BIG Mezz	B	2.4%	3.0%	315	450

Projected Lifetime Collateral Loss Range: 1.0% to 2.5%

Source: Semper Capital

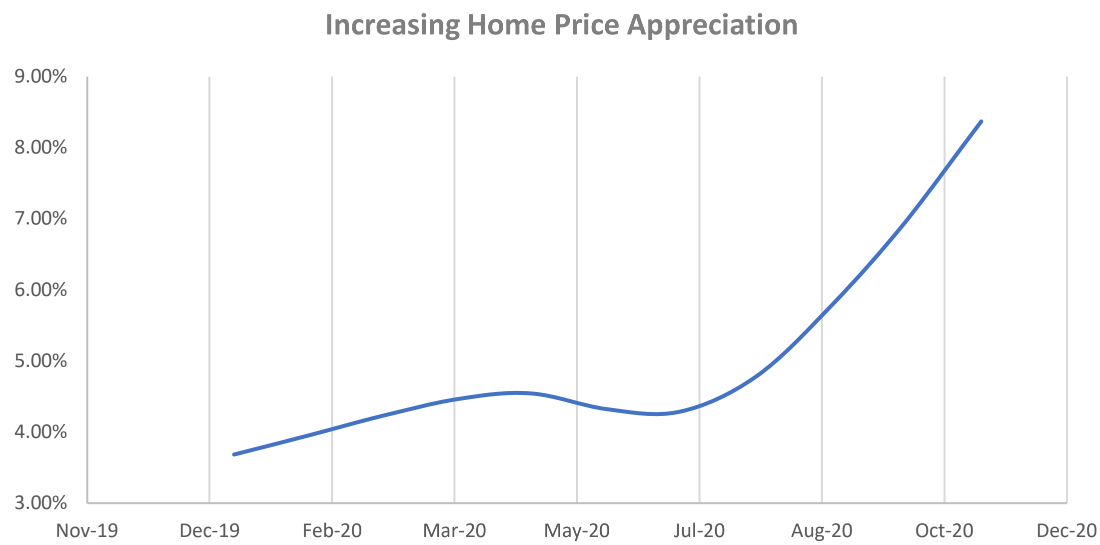
With a 1% to 1.5% drop in Treasury yields, swaps, and LIBOR since February, yields are lower for many of the highest rated tranches in RMBS deals although yield spreads remain close to or higher than February levels. In contrast, mezzanine and subordinated bond yields remain higher in most cases, reflecting much wider spreads despite strong credit fundamentals.

Multiple Tenets of Value

(1) Strong Housing Fundamentals

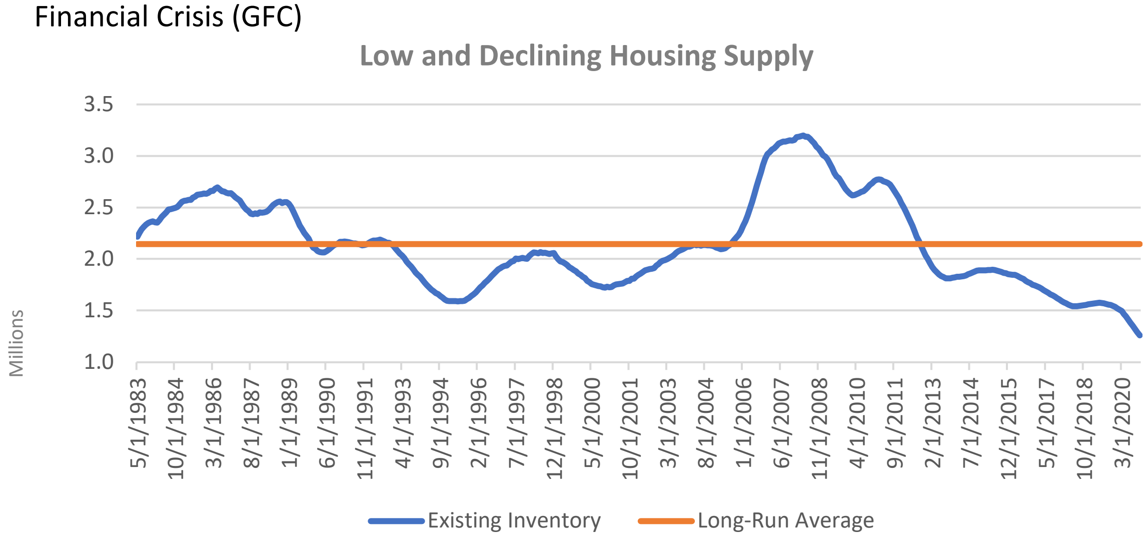
Housing has continued to be a pillar of the U.S. economy, far outperforming expectations throughout 2020, with impressive and growing demand for shelter. Pending home sales, purchase applications and new home sale metrics are currently up 20%, 19% and 20% respectively year-over-year (YoY) through October. The strong demand in housing has led to a further decline in housing supply, which was already at low levels going into 2020.

- Positive home price growth is expected to continue in 2021, with home prices nationally now 8.41% higher than a year ago through October according to Case Shiller, and the expectation is for price appreciation to remain positive in 2021 with Wall Street research analysts projecting an average base case HPA over 3% for the year (based on an average of projections from Morgan Stanley, Nomura, Citi, BAML, Goldman Sachs, and JPM)



Source: S&P CoreLogic

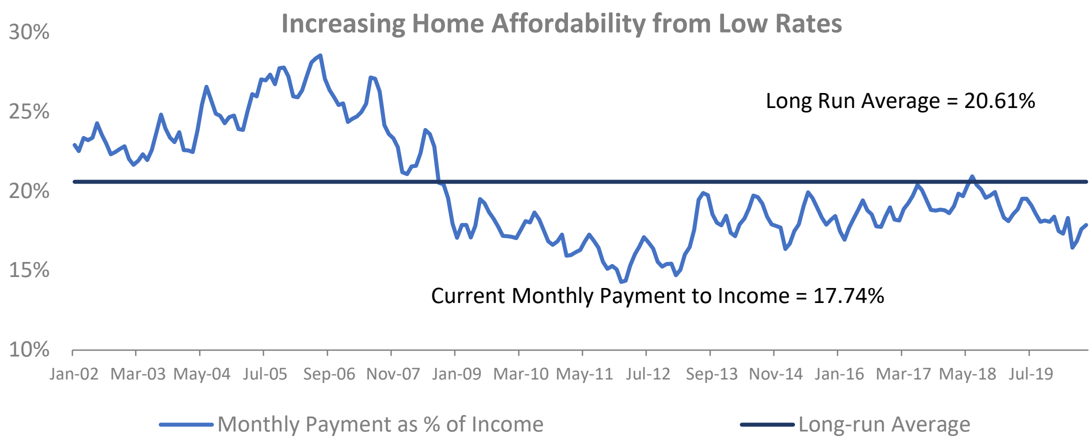
- Historically low housing supply – currently under 3 months versus an historical norm of more than double that amount - and continued strong demand at levels last seen prior to the Great Financial Crisis (GFC)



Source: Morgan Stanley Research

- Housing construction has remained well below pre-GFC levels, further limiting supply

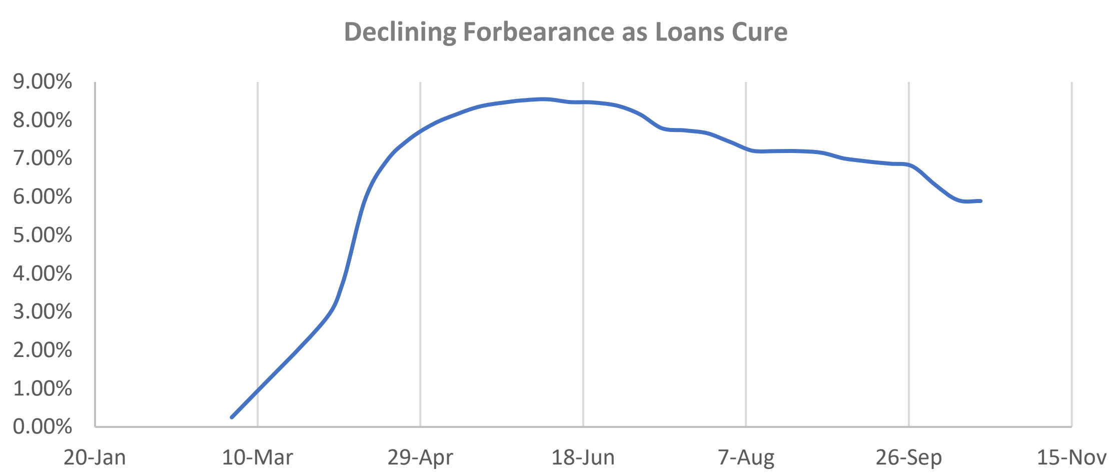
- Demand is being fueled by a longer-term demographic shift toward higher household formation rates, attractive home affordability driven by historically low mortgage rates, and a pandemic-led change in housing preferences nationally



Source: Morgan Stanley Research

(2) High Quality Borrowers and Mortgage Loans

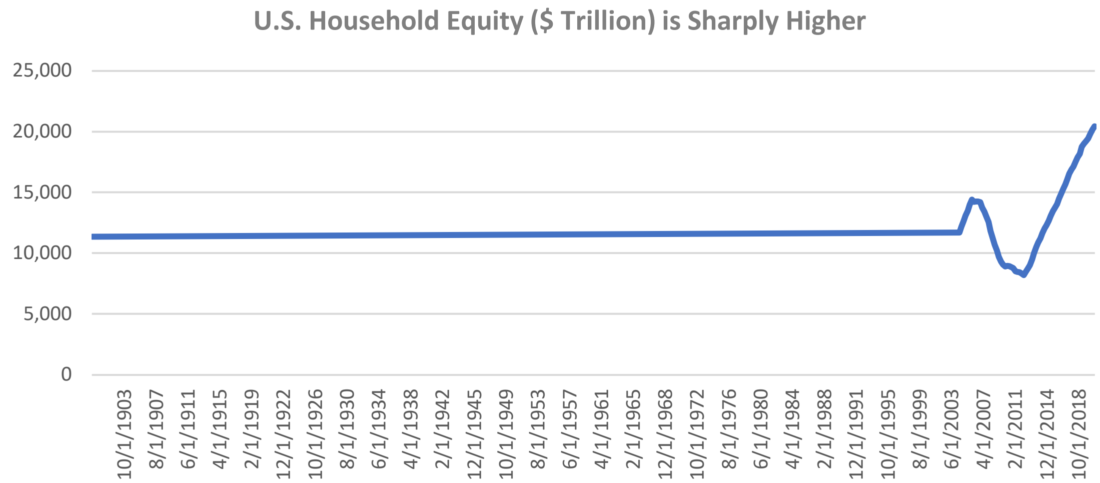
Mortgage borrowers drastically outperformed the initial pandemic forecasts for forbearance take-up and delinquency. Most collateral experienced all-in levels of forbearance below even the initial bull case forbearance range. Additionally, since April, over 50% of the loans that have entered forbearance have subsequently cured or paid in full.



Source: Morgan Stanley Research

Across all RMBS sub-sectors, mortgage credit quality remains high. Newer loans have been underwritten with much stronger regulatory and industry standards post 2008. Additionally, outstanding legacy loans have improved in quality as borrowers have built equity through HPA and amortization, and weaker loans have since defaulted and/or liquidated.

Home equity, which has the strongest negative correlation to default probability, is at record high levels nationally. Loan-to-value ratios (LTV) for legacy bonds are generally as low as 50% on average, while next generation bond LTVs generally range from 50% to 80%.



Source: Morgan Stanley Research

Low mortgage rates have led to a record level of borrowers refinancing. These high rates of prepayment in conjunction with low levels of default, have led to significantly shorter mortgage bonds with much higher levels of credit enhancement. This is expected to lead to accelerated credit upgrades, spread tightening, and price appreciation, especially in mezzanine and subordinate profiles. While approximately 7 million loans were refinanced in 2020, an extremely high number in historical context, another 20 million may be eligible for refinancing in 2021.

(3) RMBS are Structurally Attractive

RMBS securities are often attractive for several structural reasons. First, many "next generation" deal structures – bonds issued in the last few years – are designed to delever quickly as monthly principal payments (from prepays and amortization) pay down senior bonds and leave more credit support for the deal's remaining bonds. This often leads to credit ratings increases and spread tightening over time as credit support improves. This "roll down effect" also reduces interest rate sensitivity as bonds get closer to their principal windows. The fact that these bonds are normally fully amortizing provides a structural advantage versus CLOs (during their investment period), CMBS, high yield and investment grade corporate bonds, which generally must be refinanced at maturity – this refinancing risk can have negative implications in a rising rate or recessionary environment.

We expect these pillars of credit support to remain strong next year.

(4) *Favorable RMBS Market Technicals*

- RMBS new issuance halted in the spring as a result of the pandemic and market volatility. While it resumed through the summer and fall, new issue supply for 2020 was roughly 40% lower than initial projections

- Higher borrower prepayment and issuer call activity combined with this supply disruption led to negative net issuance in the RMBS space for all of 2020

- The lower levels of supply and faster paydown of bonds adds an important tailwind to further price appreciation in 2021

RMBS Relative Value vs Other Risk Assets and Fixed Income

RMBS has generally been attractive from a risk-adjusted relative value standpoint since the GFC, with higher current yield and greater total return opportunities than IG and HY corporate credit. Reasons include the persistent structural complexity premium, smaller size of the sector, over-the-counter nature of the sector, and barriers to entry into the sector including the importance of sector specific expertise.

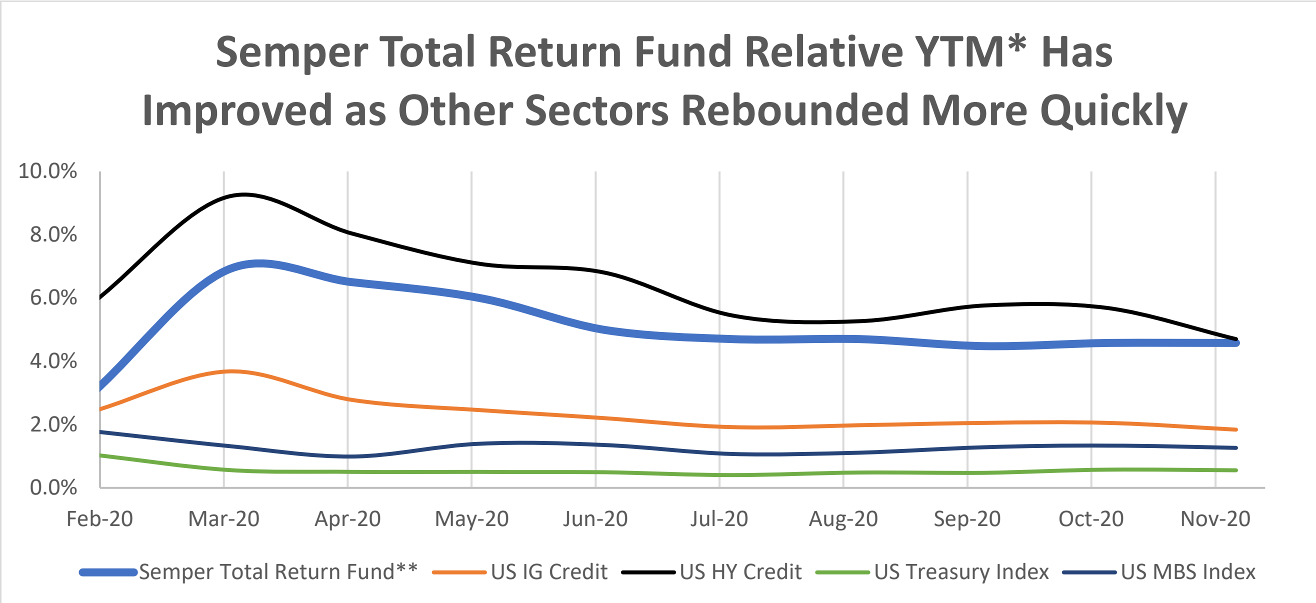
During the severe liquidity-driven economic and market dislocation in March, RMBS prices fell as much or more than other risk assets, and then failed to recover as quickly for the reasons highlighted earlier. The below table and graph highlights how RMBS yields (loss adjusted) remain higher relative to the yields (nominal or gross) for other asset classes since the onset of the pandemic. Our view is that the strong structural and collateral fundamentals are undervalued as a result of this persistent price dislocation.

Sector	YTM* (November 30)	YTM* (March 31)	YTM* (February 29)
Semper MBS Total Return Fund*	4.6%	6.9%	3.1%
US IG Credit	1.8%	3.7%	2.5%
US HY Credit	4.7%	9.2%	5.9%
US Treasury Index	0.6%	0.6%	1.0%
US MBS Index	1.3%	1.3%	1.8%

* The RMBS Sector is represented by the Semper MBS Total Return Fund. YTM is based on a range of Semper scenario analyses reflecting different economic, real estate, and RMBS market factors. There is no guarantee this will be achieved.

Net Performance as of 12/31/20	1 Year	5 Years	Inception (7/22/13)
SEMMX	-7.14%	2.12%	4.37%

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. Periods longer than 1 year are annualized.



*The YTM for the Fund is loss adjusted while other sector YTM are nominal
**RMBS sector is represented by the Semper Total Return Fund. YTM based on a range of Semper scenario analyses reflecting different economic, real estate, and RMBS market factors. There is no guarantee this will be achieved.
See disclaimers for more info on the above
Source is ICE for BAML US/HY Credit indices. Source is Bloomberg (Bloomberg Barclays Aggregate Index) for US Treasury/MBS Index

RMBS Opportunities in 2021

- **Agency Credit Risk Transfer:** Backed by high quality pools of agency borrowers (with average FICO scores in the mid 700 range and mid 30s debt to income ratios (DTI), these bonds offer investors opportunities to access mortgage credit and express credit views of housing and loan performance. The collateral has continued to outperform initial expectations related to the pandemic and continues to benefit from programs designed by the FHFA and GSEs relating to forbearance and loss mitigation. Subordinated B1 and B2 profiles currently yield between 4-7% with mezzanine bonds yielding in the 3% range. Many prices remain at a discount to par, and the sector's significant liquidity affords active management opportunities

- **Non-Qualified Mortgages:** Although these borrowers don't qualify for agency purchase and are not as high quality as prime jumbo loans, the average quality of these borrowers is very high relative to that of pre-financial crisis borrowers. Mezzanine bonds currently yield about 4-5% with 3 – 5 year durations, and collateral enhancement well in excess of worst case loss scenarios. These bonds have delevered much more than loss expectations have increased. Prices have the opportunity to appreciate another several percent if spreads revert to early 2020 levels

- **Prime Jumbo 2.0:** Backed by the highest credit quality borrowers in RMBS, deals had muted forbearance take-up rates at the height of the pandemic. Strong performance along with rapid prepays are leading to credit enhancement buildup, future upgrade opportunities, and spread tightening on jumbo mezzanine profiles, supporting near term price appreciation

- **Non-Performing Loan Securitizations:** NPLs, especially those collateralized largely by REO properties, have benefited from robust 2020 HPA growth, limited new issue supply, and improving credit fundamentals. NPL issuers continue selling re-performing loans and REOs out of existing structures rapidly delevering these structures. Subordinate bonds remain below par, and currently yield in excess of 5% expected yield. We expect price appreciation from early calls or spread tightening

- **Mezzanine Tranches of Single-Family Rental Securitizations:** The SFR sector has been one of the strongest performing sectors fundamentally since March driven by high quality tenants, a long term demographic demand for single family rentals, and sophisticated SFR operators. Rental collections and revenue growth during the pandemic have remained in line with or better than previous periods, while SFR collateral has benefited from levels of HPA higher than the national average. Mezzanine profiles in the sector currently yield 3-5+%

- **Fannie Mae and Freddie Mac Multifamily Securitizations:** GSE deals have seen continued low delinquencies rates and rental collections have remained well above initial pandemic expectations. In our view these securities have always been fundamentally mispriced, given historical performance, strong collateral underwriting, and experienced property sponsors. Similar to CRT, assistance programs offered during the pandemic have aided the few borrowers who faced disruption. We believe this sector will continue to offer strong total return, strong fundamentals can be accessed via securities with discount dollar prices, intermediate to long spread duration, and material upside to spread tightening and collateral prepayments

Looking Ahead

We expect further credit spreads contraction and price increases across RMBS sectors in 2021 as a result of continuing fundamental strengthening combined with reduced uncertainty by way of vaccinations, post-election stimulus, and continued curing of pandemic related delinquencies. We expect mezzanine and subordinated profiles to perform best as we recapture last year's lagged price recovery. This will likely result in attractive performance relative to other fixed income sectors that have already fully recovered to pre-pandemic levels and beyond, in many cases without the fundamental credit support that RMBS enjoys today.

Today's housing and RMBS markets are vastly stronger across any range of metrics, and we expect valuations to increasingly be reflective of this strength leading to our expectation that RMBS will be a leading performer from a risk-adjusted basis in 2021.

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