SHELTON CAPITAL MANAGEMENT

Fixed Income

Quarterly Commentary
As of June 30, 2022

Market Commentary

The second quarter of 2022 continued the punishing trend for fixed income markets. What began in Q1 primarily as a rise in interest rates as inflation raged, transitioned to another phase where rates continued climbing but were compounded by significant spread widening. The Russian invasion of Ukraine was a seminal event, as already-strained supply chains were pushed to the breaking point and commodity prices surged. Markets began to price-in the much higher rates that would be required to chill demand and restore price stability. The Federal Reserve was slow to react, as they have been for much of the recovery phase of the pandemic, necessitating a more rapid increase in forward interest rate guidance. Eventually, broader markets came to understand how severely the economy would need to slow in order to bring down these runaway prices and risk premia began to reflect at least a moderate recession.

The Fed began the rate hike cycle with a modest 25 basis point increase in March, but belatedly realized the medicine necessary and raised 50 basis points in May and 75 basis points in June. Forward expectations have fluctuated from pricing in 10 or more hikes by mid-2023, to now already beginning to predict rate cuts by Q2 2023 and further easing for the remainder of the year. 10yr US Treasury yields began the quarter at 2.34%, reached an intra-quarter high of 3.48% in mid-June, and finished at 3.02% as quarter-end rebalancing and other technical factors compounded the recession narrative. Our hedges continue to protect the portfolio against significant upside moves in rates in a dynamic but cost-effective manner.

We reacted by reducing lower credit quality issuers that we do not believe are recession resilient and adding longer-duration high quality investment grade municipal bonds. This had the added effect of increasing the duration of the portfolio, as we believed intermediate and longer-term interest rates would soon peak and start to decline.

As we have written previously, we are certainly proud of the outperformance of the Fund during the post-pandemic recovery phase of the last two years, and of our ability to pivot and protect investors' capital during the most recent challenging market conditions. We don't have the mandate of a global macro fund making big bets on broad economic policy - we run a total return bond fund with the mandate to make dynamic tactical adjustments to duration, credit quality, net exposure and allocations between corporate and municipal bonds in order to provide compelling risk-adjusted returns and lower correlation versus traditional fixed income markets.

In Q2, the Fund generated returns of -5.75% (DEBIX) and -5.83% (DEBTX).

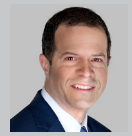
Description	Returns 2Q2022	YTD 2022
Shelton Tactical Credit Fund (DEBIX)	-5.75%	-8.68%
Bloomberg Barclays U.S. Aggregate Bond Index	-4.69%	-10.35%
Bloomberg Barclays U.S. Investment Grade Corporate Bond Index	-7.26%	-14.39%
Bloomberg Barclays U.S. High Yield Corporate Bond Index	-9.83%	-14.19%
Bloomberg Barclays U.S. Investment Grade Municipal Bond Index	-2.94%	-8.98%
Bloomberg Barclays U.S. High Yield Municipal Bond Index	-5.61%	-11.77%
Morningstar Nontraditional Bond Fund Category	-4.24%	-6.69%

Performance figures represent past performance and are not a guarantee of future results. The investment return and the 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 may be lower or higher than the performance data quoted. For more current month-end Fund performance information, please call our office at (800) 955-9988.

Portfolio weightings were modestly lower in high yield corporate bonds as we found increasing opportunities in municipal bonds and short positions. Long corporate and municipal bond positions were detractors from performance, particularly the lower rated credit segment. There was very little notable single-name outperformance, as most risk assets traded in lockstep with minimal idiosyncratic movement. We expect this will change going forward. Fortunately, we avoided many of the single-name implosions; issuers that missed earnings badly, called off corporate transactions, or otherwise disappointed their investors were punished. Interest rate hedges were significant contributors to returns, and corporate short positions were solid positive contributors as well. The primary detractors from overall performance were lower credit quality bonds where recession fears drove significant spread widening, and certain longer-duration bonds where the rate move overwhelmed idiosyncratic spread performance.

Portfolio Management

Jeffrey Rosenkranz
Portfolio Manager



Jeffrey Rosenkranz has 25 years of experience investing in the credit markets, with an emphasis in high yield, distressed debt, and special situations and has worked at firms including Cedar Ridge Partners, LLC, Durham Asset Management, Cooperstown Capital Management and Ernst & Young LLP. He holds an MBA from the Stern School of Business at New York University and a B.A. from Duke University. He is also a Certified Public Accountant.

David Falk
Portfolio Manager

David Falk has over 30 years of broad-based fixed income experience as a trader, research analyst and investment banker for firms including Cedar Ridge Partners, LLC, Bear, Stearns & Co. Inc. and Lazard Freres with a focus on the municipal securities market. He is also a Portfolio Manager for the Green California Tax-Free Income Fund and fixed income managed accounts. He holds a Master of Regional Planning from the University of North Carolina at Chapel Hill and a B.A. from Northwestern University.

William Mock
Portfolio Manager

William Mock has 24 years of experience as a trader and portfolio manager of fixed income and derivatives portfolios, working at Citibank, Societe Generale, and TKI Capital prior to joining Shelton Capital in 2010. He is also lead portfolio manager of Shelton Capital's other municipal and government bond mutual funds. William holds a B.S. in Electrical Engineering from Kansas State University and an MBA from University of Chicago Booth School of Business.

Chris Walsh
Portfolio Analyst

Chris Walsh has over seven years of experience analyzing credit and equity markets. He has been with Shelton Capital since November 2016. Chris earned a B.A. in Economics, Villanova University.

Kyle Johnson
Fund Analyst

Kyle has been with Shelton Capital Management since July 2019. He has 10 years of industry experience and previously worked with OppenheimerFunds, ALPS, and an independent RIA. He has a B.S. in Finance with a certificate in Entrepreneurship from Florida State University and is also a CFA® charterholder.

The top 5 contributors and detractors for the quarter are listed below:

Top 5 Contributors	Top 5 Detractors
Wynn Las Vegas LLC (short)	Guitar Center Inc.
American Airlines Group Inc. (short)	Red Rocks Resorts, Inc.
Navient Corp. (short)	Triton Water Holdings Inc.
NY State Urban Development Corp	AerCap Holdings NV
CBL & Associates Properties, Inc.	PetSmart LLC

Corporate Commentary

As mentioned, the second quarter brought pain to fixed income products as yields continued their steep and volatile climb higher. Investment grade funds suffered an overall quarterly outflow of $76.4 billion and high yield posted an outflow of $2.7 billion. Investment grade new issuance remained disappointing, as supply totaled $276 billion, down 28% from last year, while High Yield issuance slowed to a trickle, with bond sales of only $25 billion, the lowest 2Q volume since at least 2006, putting the first half of the year down 76% from last year.

Despite this deterioration, corporate fundamentals continue to look quite solid. Leverage is below pre-covid levels and interest-coverage remains ample. What has become clear is the amount of refinancing that was done last year. Within the high yield universe, 79% of leveraged issuers have no bonds or loans coming due until at least 2025. Furthermore, amongst CCC issuers, only 16% of their respective capital structures mature before 2025 according to JP Morgan. This number was 38% going into 2021, revealing the aggressive terming-out that was accomplished last year while rates remained at recent lows. This should be very helpful in keeping default rates down in the next couple years.

This new debt has been repriced significantly however as CCCs have now posted losses for six straight months, marking the longest losing streak since December 2008. The chaos in the markets has frozen all transactions, putting a limit on some of the shareholder-friendly and bondholder-unfriendly activity seen towards the end of last year for the time being.

Performance in IG remained dismal, returning -7.2% in the second quarter and bringing year to date total return performance to -14.4%. High yield returns were -8.5%, the worst second quarter on record. CCC's have now lost -15.72% in the first half of the year, also a record. HY spreads ended the quarter at +570bps, off +288bps on the year, and now sit wider than the long-term average but still within the wides of past meltdowns such as in 2020, 2008, and even 2015.

The economic backdrop was largely more of the same in the second quarter as not much progress was made on the key issues that have beleaguered markets for some time now: rapidly rising inflation, large-scale supply chain breakdowns, highly volatile commodities, war in Ukraine, and an uncertain Fed. While hardly any signs of a slowing consumer were seen in the first quarter, some indications began to emerge in the second quarter. MBA mortgage applications dropped in June, suggesting higher rates and low supply could be taking a toll on the red-hot housing market. In addition, several large retailers including Target, Walmart, and Kohl's commented on inflation eating into sales for the quarter. These data points and broader expectations of demand destruction were also reflected in the price of oil, with WTI breaking months of increases and falling in June.

Credit markets are pricing in a moderate recession currently and tend to be jumpy in the summer months. However, even with some additional spread widening, the income being offered by the high yield market looks interesting. Much of the higher-rated bucket of BB credit, which generally comprises companies with lower leverage, substantial cash flow, and a favorable market position, is yielding 8%. This is likely to pique broader investor attention sooner rather than later especially if there are any downside surprises to the inflation picture.

Dealers have been very cautious in the amount of capital they are willing to commit to supporting markets and providing liquidity. In fact, they have been net short HY bonds for much of the quarter. This dearth of liquidity has exacerbated price swings and contributed to volatility, particularly at the end of the quarter when spreads widened substantially. However, eventually the market will turn, and the combined effect of dealers needing to cover their net short position and build inventory, at the same time investors are gathering inflows and needing to put those dollars to work, will likely produce a turbocharged rally or series of rallies, even if they are short-lived. We fully intend to take advantage of our tactical mandate to trade around these bouts of volatility and enhance returns. We will continue to stay disciplined and opportunistic, identifying compelling opportunities in complex, out-of-favor, misunderstood credits, many of which are going through secular or regulatory changes or have cycles that are not aligned with the traditional economic cycle.

Municipal Commentary

Navigating the municipal market in the second quarter also presented a difficult challenge. While consumers continued to experience the personal impact of inflation at the grocery store and gas pump, they were additionally subjected to ongoing Fed speak between meetings along with daily political finger-pointing attempting to assign blame for rising prices. The municipal market direction was driven by investor views on inflation and the overall strength of the economy as well as the all-important technical levels of new issue supply and investor demand. Year-to-date outflows from tax-exempt municipal bond funds total $76 billion. This represents the largest and most rapid outflow cycle since flow data collection began in 1992. A reduced level of new issuance of municipal bonds continued in the second quarter. Year-to-date long-term issuance totals $218 billion – down approximately 11% compared to the first half of 2021. Much of this is explained by a $21 billion (60%) decrease in taxable municipal bond issuance as rising interest rates eliminated the ability for issuers to implement cost-saving taxable advance refunding issues.

Municipal yields ended the quarter higher across all maturities with AAA rates at 1.93% in 2 years (+15 bps), 2.27% in 5 years (+24 bps), 2.75% in 10 years (+52 bps) and 3.25% in 30 year (+65 bps). From a relative value perspective, AAA Muni/UST ratios richened across the curve ending the quarter at 65%, 74%, 91%, and 102% in the 2-, 5-, 10- and 30-year spots, respectively. But looking at quarterly endpoint data alone does not provide a full picture of the volatile nature of the municipal market during the quarter.

In the table below, the first three columns highlight the dynamics of three distinct market periods experienced during the second quarter while the fourth column summarizes yield changes over the entire quarterly period. The municipal market experienced a severe sell-off through mid-May, followed by an impressive rally through early June, followed by another sell-off through the end of the quarter.

Maturity	SELL-OFF 3/31/22 to 5/17/22	RALLY 5/17/22 to 6/3/22	SELL-OFF 6/3/22 to 6/30/22	FULL QUARTER 3/31/22 to 6/30/22
2 Years	+55	-52	+12	+15
5 Years	+66	-57	+15	+24
10 Years	+73	-51	+30	+52
30 Years	+75	-49	+39	+65

The initial sell-off was a result of ongoing investor inflation fears and concern over the degree and timing of the Fed's tightening activities designed to counter inflation. Retail investors addressed their fear of rising rates and falling asset values by continuing their exit from tax-exempt funds that began at the start of the year. These mutual fund redemptions required fund managers to sell positions to raise cash. This outsized selling pressure is evidenced by the daily par amount of Bid Wanted in Competition ("BWIC"). The daily average during the first sell-off period was $1.697 billion with a high of $2.499 billion occurring on May 11th. To put this amount of selling in perspective, consider that the average daily par amount of BWICs for calendar year 2021 was only $556 million. Municipal broker-dealers addressed the elevated selling by attempting to match sellers with offered bonds but were generally not inclined to take on a great deal of balance sheet risk themselves. As a result, bid-side yields for high-grade municipals increased and credit spreads for lower-rated municipal bonds widened. The sell-off continued until mid-May at which time municipal rates began to stabilize.

As municipal yields increased so did their attractiveness relative to taxable fixed income investments --- Treasury securities and corporate bonds. By May 20th the AAA Muni/Treasury ratio reached 105% in 10 years and 110% in 30 years and the AAA Muni/AA Corporate ratio hit 84% and 88% in the same spots. These municipal yield levels attracted "crossover investors" --- life insurance companies, taxable bond funds, bank portfolios and hedge funds. The absolute yield levels and after-tax yields were extremely compelling. Many of these investors were also comfortable buying longer-dated bonds and taking on duration. Crossover investors were also encouraged to buy in expectation of favorable technical factors as market analysts projected a potential $160 billion of municipal market reinvestment from interest payments, maturities, and redemption in June, July, and August. In addition, the higher yield levels were also attractive to individual retail investors --- as yields rose, prices of lower coupon bonds fell to discount levels. While the crossover investor and individual retail demand did not fully replace the tax-exempt mutual fund outflows, their marginal buying flipped the market in the opposite direction --- and the demand caused municipal yields to fall dramatically as shown in the second column in the above table. Municipals richened dramatically relative to Treasuries and corporates; by May 31st the AAA Muni/Treasury ratio had fallen to 88% and 95% and the AAA Muni/AA Corporate ratio fell to 71% and 78%.

The municipal market began another sell-off following a stronger than expected payrolls report on June 3rd. Expectations of more aggressive Fed tightening fueled continued tax-exempt mutual fund outflows. It seemed that much of the anticipated June reinvestment dollars were being held in reserve by mutual fund managers to cover investor redemptions rather than to make new investments. And crossover investors stepped to the sidelines again as municipals lost their relative shine. The third column in the above table shows the significant increase in yields for high-grade tax-exempts over the balance of June.

Where are we now? As of this writing, we seem to be at the beginning of another rally. Ratios have cheapened again to levels appealing to the marginal crossover buyer. Projected new issue supply appears manageable in the near-term and expectations continue for significant July and August reinvestment dollars to potentially create additional demand for municipals.

During the second quarter we added several high-grade municipal bonds to our portfolio in the water and sewer, transportation, general obligation, and health care sectors. While this added duration to our long positions, we are of the view that as the market shifts from a primary focus on inflation to one more concerned about declining economic growth and recession, the Fed will ultimately move from tightening to easing. When such a reversal occurs, longer duration assets should perform well, and portfolio valuations will benefit. Unfortunately, in the meantime, we anticipate that there will be continued ongoing municipal market volatility, as experienced in the recent quarter. We are doing our best to trade the market based on technical considerations and other factors and continue to employ cost-effective hedging strategies to manage the downside risk associated with longer duration and more interest rate sensitive positions.

With respect to municipal credit, it remains essential to continue to dive deep into each individual security considered for investment, but we can make a few general observations. First, the overall state of municipal credit is solid as the tailwinds of the economic reopening and significant Federal stimulus continue to provide support; larger tax collections, stronger balance sheets and larger rainy-day fund balances are reported by many States. Second, across the broader municipal market rating agency upgrades far exceed downgrades through the first half of 2022, but there are headwinds to consider. Some of the things on our mind include: (i) significant unfunded pension funds among many issuers, (ii) impact on state, local and other tax-backed revenue bonds due to weaker consumer demand in a recessionary economy, (iii) negative impact of a weaker housing market on local credits as mortgage rates rise, affordability declines, and housing values fall, (iv) continued weakness in transit credits as remote work remains entrenched through the economic reopening, and (v) growing challenges for health care and airline credits due to rising costs and labor supply challenges.

Outlook

Recent economic data and corporate commentary clearly indicates the onset of economic contraction. Unprecedented price increases in food, energy and broader goods and services, coupled with the wealth effect of lower asset prices is weighing heavily on consumer sentiment. The housing market should be the next shoe to drop, as affordability has declined at current mortgage rates. If home prices roll over, consumer confidence will take another hit, as it typically represents the largest asset of most households. How long and deep this impending recession might be is the next key question. Markets are pricing in at least a moderate one. If it turns out to be more severe, equities and lower-quality fixed income have more downside. However, in the case of fixed income, given where all-in yields are now, we believe investors are being adequately compensated for additional spread widening all the way down to the single-B rating tier. Below single-B you better get your credit analysis and downside protection correct, as mistakes are severely punished by the current lack of trading liquidity.

Second quarter earnings season should be very insightful as management teams give their read on current and future business conditions. Additionally, over the coming months we look for economic data to build a trend of slowing economic activity and lower inflation readings. Commodity prices are already signaling and the labor market

Outlook (continued)

should soon follow. This will allow the Fed to be less aggressive on forward guidance and actual rate hikes, which we believe could be a catalyst for a tightening of spreads.

We believe the sweet spots for future total returns are Investment Grade municipal bonds, and BBB, BB, and certain single-B corporate credits which we believe are stronger and more resilient than the market. Mathematically, even if corporate spreads widen a few hundred basis points further, BBs offering greater than 7% yield would still produce acceptable returns over the next 6 – 12 months. And if rates go lower and/or the recession proves to be milder, then capital appreciation would drive even greater total returns over that time period.

As always, we will be cognizant of valuations, while continuing to seek value and compelling risk/reward investments in the corporate and municipal bond markets.

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