SHELTON CAPITAL MANAGEMENT

Shelton Tactical Credit Fund

Quarterly
Commentary
As of March 31, 2024

Market Commentary

The first quarter didn't go exactly as bond traders were expecting and probably, hoping. A few hot inflation reports helped pare 2024 rate cut expectations from almost 175bp at the start of January to less than 75bp at the end of March. Treasury yields have risen 30-45bp across the curve so far this year. Despite the end-2023 excitement not yet coming to fruition, there's still reason for optimism. Regardless of whether the inflation flare ups we saw in January and February repeat in the months ahead, the Fed communication suggests a willingness to cut rates later this year.

Rates moved sharply higher in January, rallied hard at the end of the month, ripped still higher throughout February, rallied again in early March, before rising to intra-quarter highs mid-month and settling down a bit into quarter-end. In a reversal of Q4 2023, duration went from being friend to enemy (again). The cause behind the reacceleration in yields was stronger than expected economic data, which brought into question the timing and cumulative amount of rate cuts in 2024. As we mentioned last quarter, whether the last mile of inflation progress is quick or challenging will be a driver of 2024 performance.

Fourth quarter GDP decelerated from the roaring 4.9% in Q3 to a still heady 3.4% in Q4, and Q1 is currently tracking to a 2.8% figure according to the Atlanta Fed GDPNow Forecast. This is above trend growth, which, on one hand has not yet fully absorbed the boost from the massive easing of financial conditions over the past five months and on the other hand, may have not yet felt the drag from monetary policies with long, lag effects.

The Fed left rates unchanged at both meetings, while communicating that rate cuts will likely be appropriate at some point later in the year.

At quarter end, markets are now pricing in less than three cuts in 2024, while the FOMC dot plots indicate three. This is yet another reversal, where the market is anticipating fewer cuts than Fed projections. Whether the first cut comes in June, July or September will impact the front end of the yield curve, although it shouldn't create massive volatility in the intermediate and longer portions of the yield curve. While we had been concerned the Fed would wait too long to start cutting, we now believe they should wait longer. Their behavior has driven the dramatic loosening of financial conditions, which when combined with the rise in energy and other commodity prices, and the multitude of new kinks in global supply chains (Red Sea, Panama Canal, Port of Baltimore, etc), creates risks that inflation could stubbornly refuse to decline, if not start to reaccelerate. If this does materialize, then waiting longer just might create volatility in the intermediate and longer portions of the yield curve.

In Q1 2024, the Fund generated returns of +1.97% (DEBIX) and +1.90% (DEBTX). Below is a table of returns for the Fund, various relevant indices, and the Non-traditional Bond category. Performance in the quarter was strong across the board, exceeding all relevant indices and the Morningstar Non-traditional Bond Category as well. Even more notable is the fact that the Fund achieved these results despite being higher in average credit quality than the HY index, and longer in duration than the Non-traditional bond category. We attribute this to our credit selection and ability to find unique uncorrelated investments, our interest rate hedges, and our dynamic and tactical adjustments to the portfolio as macroeconomic and single-name data evolves. Our longer-term performance remains very strong and is a testament to our ability to overcome the vagaries of the rates markets and the occasional idiosyncratic hiccups by stringing together significantly more idiosyncratic winners than losers over time. In December, the fund reached its 10-year anniversary, and the performance of the Fund since inception stands very tall relative to peers, indices, and the Nontraditional Bond category.

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Portfolio Management

Peter Higgins
Head of Fixed Income & Sr. Portfolio Manager

Peter Higgins has over 25 years of experience in fixed income investing, most notably as Partner and Lead Portfolio Manager at both Ares Management and BlueBay Asset Management. Previously, Peter specialized in global leveraged finance at investment banks such as Deutsche Bank AG, Goldman Sachs & Co. and Credit Suisse in both London, England, and New York City. Peter earned a bachelor's degree in Economics-Political Science from Columbia University.

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.

William Mock
Portfolio Manager

William Mock has 25 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 nine 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.

	1Q24	YTD	1YR	3YR	5YR	10YR
Shelton Tactical Credit Fund (DEBIX)	1.97%	1.97%	7.26%	0.70%	2.76%	2.94%
Bloomberg U.S. Aggregate Bond Index	-0.78%	-0.78%	1.70%	-2.45%	0.36%	1.54%
Bloomberg U.S. Investment Grade Corporate Bond Index	-0.40%	-0.40%	4.43%	-1.87%	1.52%	2.61%
Bloomberg U.S. High Yield Corporate Bond Index	1.47%	1.47%	11.15%	2.19%	4.20%	4.44%
Bloomberg U.S. Investment Grade Municipal Bond Index	-0.39%	-0.39%	3.13%	-0.41%	1.59%	2.66%
Bloomberg U.S. High Yield Municipal Bond Index	1.51%	1.51%	7.91%	0.55%	3.02%	4.55%
Morningstar Nontraditional Bond Fund Category	1.76%	1.76%	7.05%	0.95%	2.07%	1.90%

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.

Shelton Capital Management has contractually agreed to reimburse expenses incurred by the Fund to the extent that total annual fund operating expenses (excluding acquired fund fees and expenses, certain compliance costs, interest and broker expenses relating to investment strategies, taxes, and extraordinary expenses such as litigation or merger and reorganization expenses, for example) exceed 0.98% and 1.23% until May 1, 2024.

Fund Expenses - DEBIX (gross): 1.86% | DEBIX (net): 0.99%
DEBTX (gross): 2.11% | DEBTX (net): 1.24%

Portfolio weightings were higher in corporate bonds and lower in municipal bonds. We also did not have any credit short positions in acknowledgement of the significantly higher cost of carry and the need to carry positions longer given expectations for the delayed onset of a recession.

Corporate bond long positions were a strong contributor to performance overall, despite the move higher in rates, on account of strong credit analysis in selected lower rated credits, and event-driven gains in a few of our positions. Favorable credit selection also allowed us to avoid any major downside surprises. Longer duration, higher quality rate sensitive positions were a modest drag on overall performance, but the attractive yield on these quality IG borrowers should prove out over the course of the year as rates stabilize or even head lower. We continued to strike a good balance between prudent credit selection in single B and select CCC credits we believe are underappreciated by the market and rating agencies, while avoiding weaker single Bs and CCCs which could be severely punished in a downturn.

The borrowers in our portfolio reported solid Q4 earnings generally across the board and offered favorable yet prudent 2024 guidance as well, reinforcing our decision to upgrade the quality of the portfolio in the face of cost pressures and a potential Fed-induced economic slowdown. We enjoyed some single-name outperformance where better than expected earnings were applauded, credit improvement was recognized by the markets and rating agencies, or corporate transactions were announced. We expect this dispersion, where strong performance is rewarded, and poor performance is penalized, will accelerate going forward. Issuers that materially miss earnings, call off corporate transactions, or otherwise disappoint their investors will be severely punished. This kind of market is highly conducive to our strategy, when markets are generally rangebound or sideways and individual credit selection is rewarded or punished.

The Fund also benefitted from idiosyncratic gains across the capital structure for Pyxus. Interest rate hedges protected the portfolio from large moves in rates but were essentially breakeven overall given the wild swings in rates over the quarter.

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

Top 5 Contributors	**Top 5 Detractors**
Pyxus International Inc.	The Kraft Heinz Company
Talos Energy Inc.	Visa Inc.
Air Canada	Roche Holdings Inc.
Triton Water Holdings Inc.	AerCap Holdings NV
Cleveland-Cliffs Inc.	Sirius XM Holdings Inc.

Corporate Commentary

High yield corporate bonds began the quarter on the wrong foot, but quickly began a steady recovery which continued over the course of the quarter. Given the risk-on mentality, CCCs were the strongest performing cohort at +1.86%, followed by Bs (+1.06%) and BBs (+0.82%). We believe the massive outperformance of CCC-rated credits throughout much of 2023 and into Q1 2024, which correlated highly with equity markets, is unlikely to persist, and when the payback comes it could be harsh. Investment grade bonds followed a similar pattern, but at higher credit levels as the longer duration and interest rate sensitivity was a headwind, finishing at -1.57%. BBBs returned -0.83% versus single-As -1.32%, AAs at -1.92% and AAAs -2.98%. Investment grade funds had an overall quarterly inflow of $49.3 billion, while high yield saw an inflow of $4.9 billion. Investment grade new issuance was well ahead of this quarter last year, with supply totaling $560 billion, topping $428 billion in Q1 2023. High Yield issuance was $99 billion in Q1 versus $46 billion in Q1 2023. $9 billion of this was CCC debt, topping the $7 billion of CCC issuance in all of 2023, and an indication as to how wide-open the markets have been recently. Of the $99 billion issued, about 68% was for refinancing or repayment of debt, a trend we expect to continue as issuers peck away at the much publicized "wall of maturities."

In tandem with this healthy refinancing, the balance sheets of HY issuers appear to be in good shape in the aggregate. The level of leverage ticked down from 3.97x to 3.89x and is still well-below where it was pre-pandemic and the long-term average of 4.32x, while interest coverage metrics declined to 5.02x, an eight-quarter low although still quite strong. Additionally, there has been a healthy cohort of issuers moving up to investment grade, keeping a limit on total HY supply and thus providing a minor technical tailwind. In the loan market, flows were strong, which allowed borrowers to take advantage of this strength, driving a surge in repricing transactions.

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Corporate Commentary (continued)

The default rate increased slightly from 2.53% to 2.59% (1.99% a year ago), and remains very low by historical standards, for now. Spreads tightened -34bp in the quarter to +331bp, which still feels low for a pre-recessionary period and is even tight compared to non-recessionary averages, but the elevated all-in yields are a powerful draw for investors. The pain which the Fed inflicted during this hiking cycle will cause dislocations and dispersion and will provide attractive entry points at all-in yields close to double digits.

We plan to continue to search for names that have been neglected or miscategorized by the market, and as always apply a contrarian mindset in trading. With rates having risen quite a bit since their issuance, many higher quality (generally longer duration) names are trading at steep dollar price discounts to par. We like the safety here with the added optionality to the upside if there is some sort of event leading to a takeout at par.

We have fully taken advantage of our tactical mandate and agility 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

For the full quarter, the Bloomberg Municipal Bond Index (-0.39%) beat the Bloomberg US Treasury Index (-0.96%). Yields rose across the curve as it became evident that inflation wasn't abating at a rate that would allow the Federal Reserve to cut rates as rapidly as the market had previously expected. The muni market yields moved higher with US Treasuries; the table below shows the change in AAA municipal yields in basis points across the curve during the quarter.

Maturity	October	November	December	Full Quarter
2 Years	23	9	18	49
5 Years	18	8	5	31
10 Years	19	7	-2	25
30 Years	21	8	3	33

From a relative value perspective, little has changed as the tax-exempt bonds continue to be historically rich relative to Treasuries across the curve. AAA Muni/Treasury ratios ended the quarter slightly higher than they began at 65%, 60%, 60% and 86% in the 2-, 5-, 10-, and 30-year maturities. Many analysts had expected a positive net supply with higher new issuance to put upward pressure on ratios in 2024. With $83.4 billion in YTD new issuance, $9.9 billion in fund inflows have bolstered reinvestment dollars to provide support and keep the ratios at very rich historical levels.

Until the new issue supply significantly exceeds reinvestment and fund flows, we anticipate the tax-exempt bond market will remain rich on a ratio basis, but the primary driver of municipal yields will be the US Treasury curve. Market participants will continue to parse economic inflation data and Federal Reserve speakers for clues to the timing and magnitude of monetary policy changes that could continue to push rates higher or be the catalyst for a bond rally.

Outlook

The Atlanta Fed GDPNow Forecast for Q1 currently sits at 2.8%, which would mark a deceleration from Q4 but would still be considered above trend growth. We expect GDP to continue to decelerate in 2024, hindered by the continued lagged impact of higher rates, withering contribution from fiscal stimulus, and rising consumer debt balances. Rate cuts beginning in June, July or September may gyrate the bond market within a relatively narrow range, although if rates aren't cut at all, then yields may break-out of this range. We plan to continue to be tactical and trade around the volatility to enhance returns. The philosophical debates around term premium required to hold longer dated bonds and the real-world impact of rising supply of treasury bond issuance will determine the shape of the yield curve and performance for intermediate and longer dated fixed income. Of course, microeconomic fundamentals and corporate earnings will be the key to changes in credit spreads, but supply and demand technicals will also factor into corporate bond performance as well. We believe that real interest rates are unnecessarily high and will come down as the economy slows, offsetting concerns about a rising supply of treasuries. Furthermore, since we do not expect corporate earnings to reach their CY '24 estimates amidst a slowing economy, equities seem vulnerable and the appeal of bonds as a safer fixed income return should counterbalance the mania for term premium.

The Fed has allowed financial conditions to ease significantly over the last 5 months. Whether recent strong economic data proves to be anomalous or not will be the key near-term driver of rates. The FOMC is in data-dependent mode, not wanting to wait too long to start rate cuts and tip the economy into an unnecessary recession, while also being terrified of allowing inflation to re-accelerate. This is why recent commentary signals a possible delay in the first rate cut. As we have written countless times, because the Fed is more comfortable running the playbook of re-stimulating an economy out of a recession rather than trying to re-conquer entrenched inflation, they should err on the side of making sure inflation is well on the way to being vanquished before cutting rates. While 25bp isn't material in and of itself, the symbolism around that first cut will likely unleash animal spirits in the equity and bond markets. It also will likely trigger a wave of fund flows out of short duration fixed income into intermediate and longer duration bonds.

We know that Fed policy operates with a lag, and because such a small percentage of mortgages, auto loans, and corporate borrowings have re-set at higher rates, the lags this time around might be even longer. Consumers have been the engine behind economic growth, but now they are dipping into their savings, as evidenced by the personal savings rate falling below pre-pandemic levels to 3.6%.

Much progress had been made on supply chains and bottlenecks, and delivery times in ISM surveys, in-stock positions from retailers, and moderating freight rates all corroborate this narrative. However, more recently hiccups from low water levels in the Panama Canal, Houthi rebel attacks in the Red Sea, and the collapse of the Francis Scott Key Bridge in Baltimore are causing disruptions that could reverse some of this progress. Oil prices have risen from $71.65 at year-end to over $83 per barrel at quarter end, and other commodity prices are also moving higher. This will not help the cause either.

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Outlook (continued)

Recent corporate commentary generally offered upbeat outlooks for 2024, however those companies focused on serving lower income cohorts are expressing more concern about the demand outlook given the disproportionate burden that inflation and higher rates have on these consumers. The ideal scenario is above trend growth without inflation, a very challenging proposition. Perhaps significant increases in productivity coupled with increased immigration will keep the labor market in check. However, given the lags in monetary policy, the Fed has an unenviable task of predicting if this is possible. Until we have more confidence as to which way we are headed, rates are likely to remain rangebound, with bouts of volatility. If the economy can sustain non-inflationary growth, rates will stay somewhat elevated and risk assets should perform well. However, if the economy slows due to the lagged effect of higher rates, or the Fed has to tap the brakes to achieve this objective, then equities and lower-quality fixed income have more downside. Given where all-in yields are now, we believe they are generally compensating investors 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 the lack of trading liquidity in that tier severely punishes mistakes.

We believe the sweet spots for future total returns are BBB, BB, and certain single-B corporate bonds we believe are stronger and more resilient than the market. CCC's are also screening a bit cheap on a relative value basis, and credit markets are somewhat open to these borrowers, but the credit analysis must be superb. Mathematically, even if spreads widen a few hundred basis points further, BBs at yields of 6.75% would still produce a breakeven return over the next 12 months. If rates go lower and/or the recession proves to be milder, then total returns could easily eclipse 10% over that period. In this scenario, we would make the tactical adjustment to add more credit risk to the portfolio. There are valid reasons to believe spread widening might stop short of previous recessions, as the index has a higher quality composition (more BBs, fewer CCCs), beginning all-in yields are higher than the onset of a typical recession, and the average dollar price of bonds is much lower and much closer to recovery rates. However, if spreads were to blow out to levels above +800 basis points that are often reached in severe recessions, total returns would likely be flat or even negative. Navigating these bouts of volatility by adjusting credit quality overall and selecting the right individual securities will be the keys to success, and we are confident in our ability to thrive in such an environment.

As always, we will be cognizant of valuations, while continuing to seek value and compelling risk/reward investments across fixed income products with a focus on the corporate and municipal bond markets.

IMPORTANT INFORMATION

Investors should consider a fund's investment objectives, risks, charges and expenses carefully before investing. The prospectus contains this and other information about a fund. To obtain a prospectus, visit www.sheltoncap.com or call (800) 955-9988. A prospectus should be read carefully before investing.

Credit-related instruments typically decrease in value when interest rates increase. Concentration in a small number of issuers increases the risk that one issuer could have a large adverse impact on the Fund's return. Borrowing and frequent trading could increase the Fund's operating expenses. High-yield bonds involve greater risk of default, and may be more volatile and less liquid, than investment grade securities. Subordinated and unsecured loans may be disproportionately affected by default and downgrade. Foreign investments may be adversely affected by currency fluctuations, lower liquidity, tax regulation, and political instability. Derivatives can be highly illiquid and difficult to unwind. The Fund's short positions may equal up to 100% of the Fund's net asset value. Short sales theoretically involve unlimited loss potential since the market price of securities sold short may continuously increase. The Bloomberg Barclay U.S. Aggregate Bond Index is an unmanaged index of the U.S. dollar-denominated investment grade fixed-rate taxable bond market. It includes government, corporate, mortgage-backed, and asset-backed debt securities with a maturity of at least 1 year. It is not possible to directly invest in an index.

Effective May 15, 2023, David Falk is no longer a portfolio manager of the Fund.

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