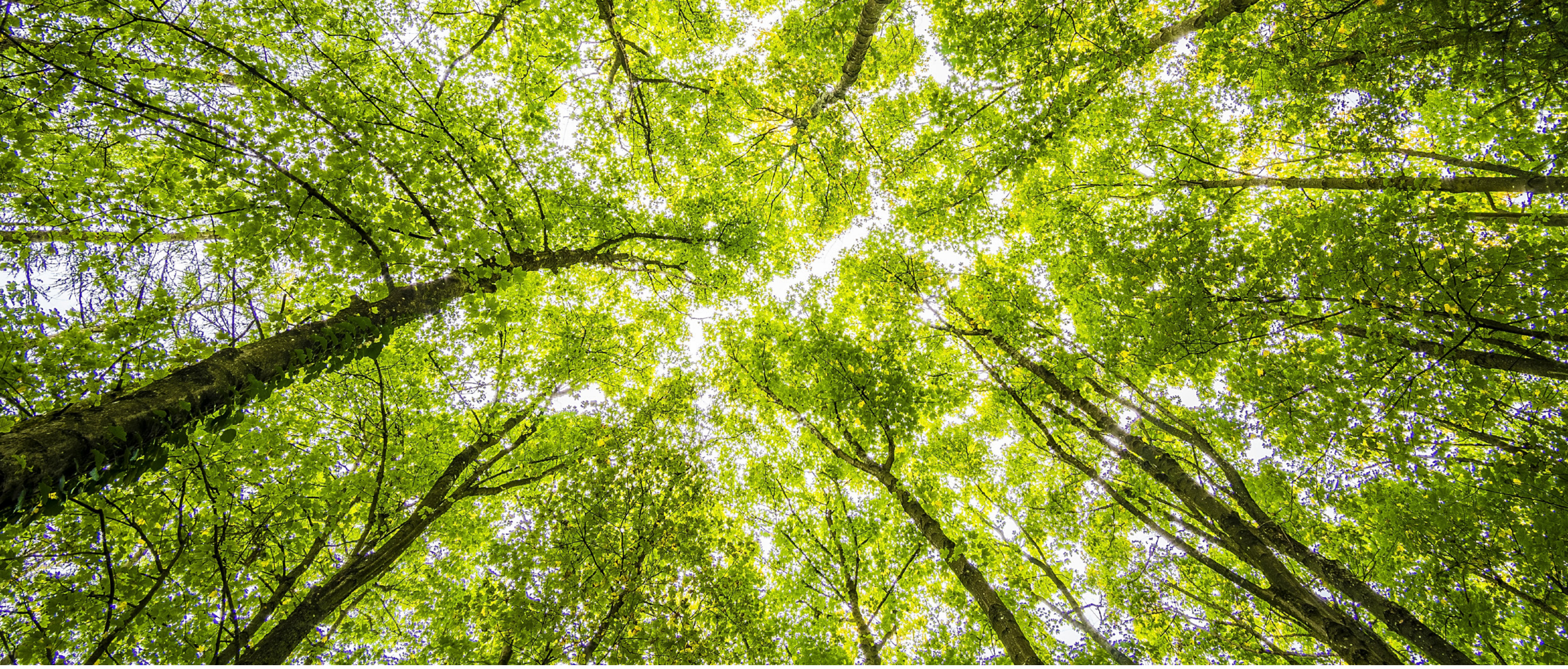


GREEN BONDS: INVESTOR DEMAND, ADVISOR EDGE

Conversation with George Gay, Peter Higgins and Bill Mock

GEORGE GAY, CEO, First Affirmative Financial Network – the leading advisor network serving the responsible investment community overseeing nearly $1B in AUM and advisement and working with 400+ specialist SRI advisors. He also produces and hosts the annual ESG for Impact Conference.

PETER HIGGINS, Head of Shelton's Fixed Income team with over 25 years of global leveraged finance experience across investment banking, capital markets, high yield trading/research, and portfolio management.

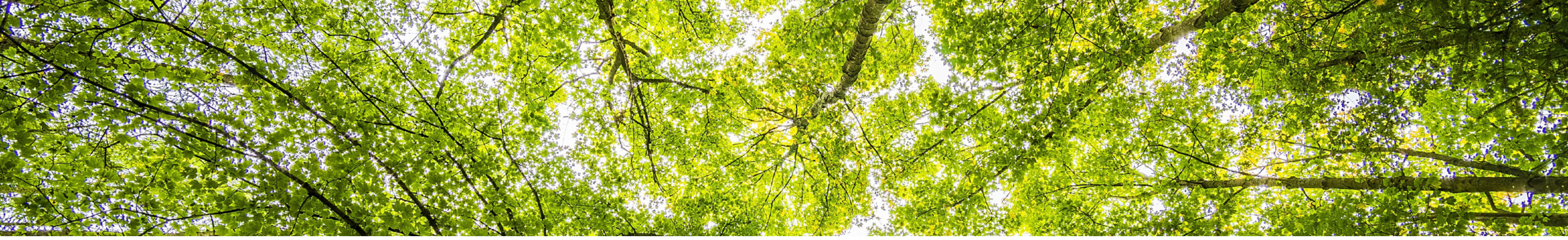
BILL MOCK, lead member of the portfolio management team for Shelton's Fixed Income and Money Market funds with 25 years of experience as a trader and portfolio manager of fixed income and derivatives portfolios.

ESG investing and investing with a purpose are growing priorities for today's investors and advisors need to be prepared to address these changing investor preferences. Shelton Capital Management is an experienced Green Bond manager utilizing an actively managed approach to fixed income portfolios which seeks to generate total investment returns through income and capital price appreciation. The firm manages mutual funds and SMA strategies for clients seeking an ESG, green, or sustainable focus.

Our managers employ a thorough top-down and bottom-up research approach based on soundly developed views of economic and business cycles as well as interest rate and credit cycles. The firm's unique approach to portfolio construction aims to generate differentiated above-market returns that are uncorrelated to market benchmarks. It is also applied directly to ESG and impact investing in the US fixed income markets. Utilizing ESG factors in fixed income investing may generate unique uncorrelated returns and can help create desired social impact objectives.

May 2023

SHELTON CAPITAL MANAGEMENT



GREEN BONDS: INVESTOR DEMAND, ADVISOR EDGE

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So, how is Shelton defining green bonds and ESG these days?

MR. MOCK: We have our own internal criteria, but overall, we align with the industry. Green bonds are thought of as those issues whose proceeds are used on projects or activities that have a tangible environmental benefit. Similarly, social bonds have tangible socioeconomic benefits. Sustainable bonds are basically a combination of the two – an issue that has both social and environmental benefits.

Do you consider corporate green bonds and municipal green bonds to be separate categories?

MR. HIGGINS: We look at available green and social bonds across the entire credit spectrum. Tax-exempts are generally strong investment-grade municipals. Taxables, whether corporate or municipal, typically have a much broader range of credit.

MR. MOCK: We should say that corporate bonds that are ESG-related are new relative to municipal issues. A lot of the corporate issuers in this space are what I would call “old economy” businesses that aren’t generally thought of as being green or social. We have to do a fair amount of work to understand the use of proceeds of the issue and whether it fits our in-house criteria.

Do you have a sense of the size of the green bond market now?

MR. MOCK: It’s impossible to accurately capture the size of the space since there are a lot of bonds trading in the secondary market that were issued long before anything was labeled green that would otherwise meet the criteria and the fact that there isn’t a single universally agreed upon taxonomy.

What we can say with certainty, though, is that the green market is growing.

The Climate Bonds Initiative estimates the U.S. dollar-denominated green bond market to be over $2 trillion and just over $3.5 trillion dollars when you add in social and sustainable bonds.

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>
> **- BILL MOCK**
> SHELTON CAPITAL MANAGEMENT

There’s been some notable commotion in the ESG equity market around who’s in and who’s out. Do you have to think about whether a credit might be good one year but may not fit the bill the next?

MR. MOCK: As bond managers, we have the advantage of knowing specifically how the proceeds of the issue will be spent. So, we endeavor to make sure that that use of proceeds is going to either tangibly benefit the environment or the socioeconomic welfare. An issue, in other words, that we'd be comfortable defending the ESG bona fides going forward.

Meanwhile, various states are passing or considering legislation regarding the use of ESG criteria for state money. There are political implications, of course, but do you see it impacting your ability to do your job as well?

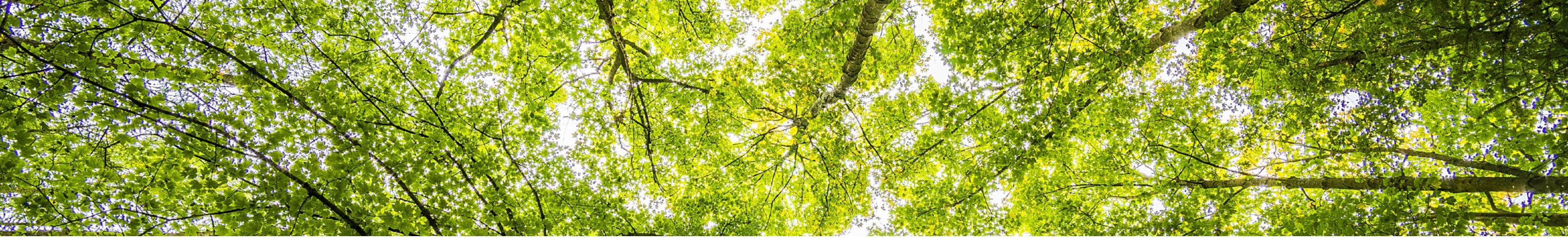
MR. MOCK: We see this as more noise than anything. Our job as portfolio managers is to identify material data. You may strip out "ESG" or "green" or "ethical" or any of the different taxonomies, but the underlying use of proceeds is going to be the same. We can still identify conservation bonds, mass transit bonds, bonds that make water systems more efficient.

MR. HIGGINS: On the supply side, however, the rhetoric is loud and I’d have to think municipality treasurers and corporate CFOs will take it to heart. They're going to be

GSS+ scorecard

	Green	Social	Sustainability*	Transition	SLB
Total size of market (cumulative)	USD2.2tn	USD653.6bn	USD682.0bn	USD12.5bn	USD204.2bn
Number of issuers	2,457	772	507	39	336
Number of countries	85	49	57	12	50
Number of currencies	49	42	41	7	21

Source: Sustainable Debt Global State of the Market 2022 Climate Bonds Initiative.
**To avoid double counting, deals with multiple labels were classified as sustainability bonds*



extra careful that the use of proceeds is in fact used for the purposes that have been set forth, or the public scrutiny will come back to haunt them later.

Congress passed the Inflation Reduction Act last year with $369 billion tagged for climate-related activities. Do you expect this to have an impact on the supply side of the green market?

MR. MOCK: Absolutely. This piece of legislation represents the single-largest act toward addressing climate change the U.S. government has ever made. The result should be a massive stimulus to wind, solar, and energy storage, as well as production tax credits to other producers of renewable energy. So, yes, we think this will help to light a fire, so to speak, and we'll have more supply on both the corporate and the municipal issuance sides.

MR. HIGGINS: Any time the government intervenes and establishes regulations, there will be change. Oftentimes, that change will need capital.

As we look at converting to renewable energy, there are big issues with the grid and bigger issues with the source of materials. What's your sense of the opportunities and difficulties in this space?

MR. MOCK: Clearly, there's going to be an enormous opportunity if we're to even approach the current goals. The electrical grid is already failing when stressed and needs to grow substantially to meet stated carbon neutrality goals at the local, state and federal levels. But right now, these are goals with a lot of unanswered questions, such as reducing the carbon impact of the current supply chain for solar panels, electric vehicles, batteries, etc.

Who are going to be the issuers?

MR. MOCK: There will surely be municipal and corporate utilities, where the use of proceeds qualifies them for municipal tax-exempt treatment. There will be new technology companies seeking corporate financing for the next generations of technology. As referenced earlier, a lot of the cutting-edge development and R&D spending is being done by legacy firms not historically thought of as ESG proponents.

How will the upward trend in interest rates affect the demand and the availability of green bonds?

MR. MOCK: 2022 was a historically rough year for fixed income. I'd suggest that for investors sitting on the sidelines, now is a great time to look at fixed income investing in general, and social or green bonds specifically if that's an investor's interest. You can actually earn a tangible rate of return on your fixed income investments while doing good.

MR. HIGGINS: Today's yields are nearly three times higher than they were at the end of 2021. Investors have ample time to wade back into the water here and clip attractive yields. The same goes for those green and social bonds in the investment-grade and corporate spaces where yields are above 5%.

But there are two parts to the equation. On the supply side, issuers will be spending more on their interest payments in this new interest rate environment. So, if there's a new project for them to pursue, they need to ensure that the return on their investment capital is still attractive. The demand is certainly there. We'll have to see if the supply comes.

Green bond market scorecard

	2022	2021	Change YOY
Size of market	USD487.1bn	USD582.4bn	↓ -16%
Number of issuers	741	976	↓ -24%
Average size of instrument	USD140m	USD124.6m	↑ 12%
Number of countries	51	62	↓ -18%
Number of currencies	33	35	↓ -6%

Social bond market scorecard

	2022	2021	Change YOY
Size of market	USD130.3bn	USD219.5bn	↓ -41%
Number of issuers	153	183	↓ -16%
Average size of instrument	USD55.2m	USD90.5m	↓ -39%
Number of countries	27	30	↓ -10%
Number of currencies	24	27	↓ -11%

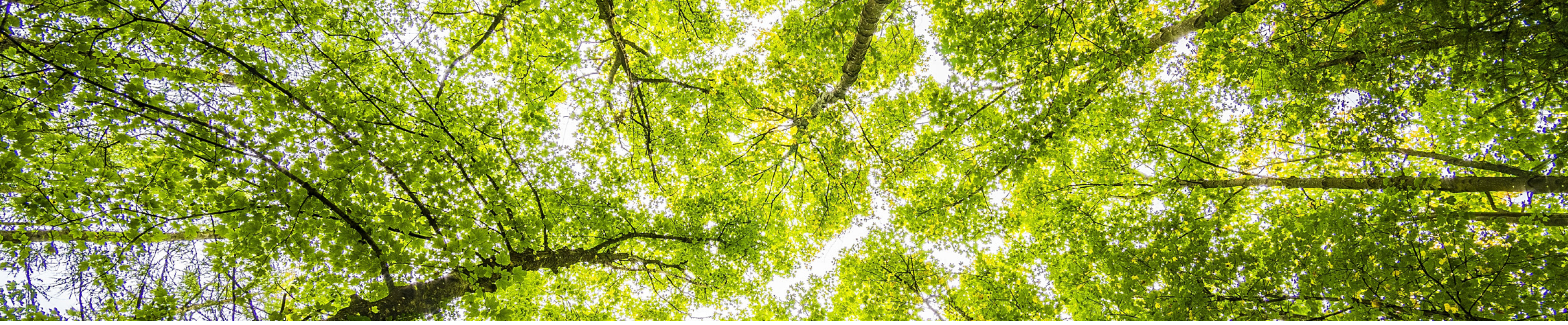
Sustainability bond market scorecard

	2022	2021	Change YOY
Size of market	USD161.3bn	USD204.1bn	↓ -21%
Number of issuers	206	262	↓ -21%
Average size of instrument	USD131.9m	USD176.1m	↓ -25%
Number of countries	36	47	↓ -23%
Number of currencies	28	31	↓ -10%

Sustainability-linked bond market scorecard

	2022	2021	Change YOY
Size of market	USD76.4bn	USD112.1bn	↓ -32%
Number of issuers	142	190	↓ -25%
Average size of instrument	USD372.6m	USD437.9m	↓ -15%
Number of countries	35	36	↓ -3%
Number of currencies	16	18	↓ -11%

Source: Sustainable Debt Global State of the Market 2022 Climate Bonds Initiative.



Equity investors have always been able to customize their impact preferences. Are your fixed income clients starting to give you more guidance as to what they're looking for?

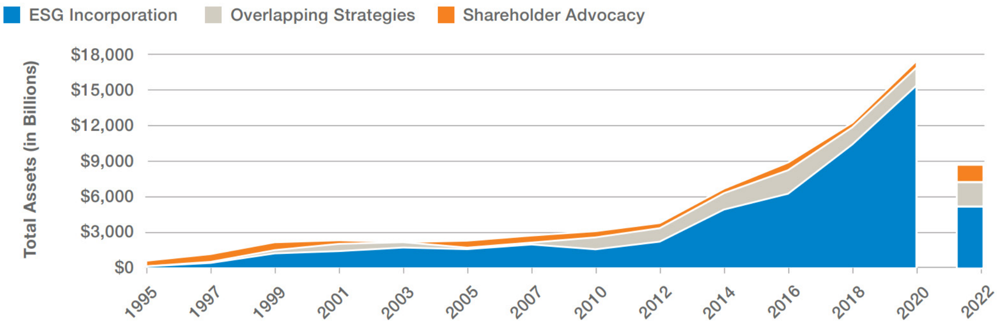
MR. MOCK: The quick answer is yes. A client can get very specific in defining what types of projects he or she would like to support with bonds. Even a conglomerate on the corporate side will have a narrowly defined use of proceeds before it can be considered to be a green or social bond. We can use that information to assess and customize portfolios. Money can't be used for just general purposes and still meet ESG criteria.

MR. HIGGINS: Our ability to do the fundamental analysis on these credits helps weed out the right use of proceeds from the wrong use of proceeds. And taking this a step further, I would say that just the composition of the investor base has changed over the last decade or so. Direct households still represent a very large proportion of municipal bond ownership, but the number is shrinking. There's been a modest growth in mutual funds, but the big difference has been separately managed accounts, which have tripled over the last decade. Individual investors today buying Fixed Income Securities with a defined use of proceeds, can have a lot of influence on what they buy, and in a more professionalized fashion of delivery.

"Individual investors today buying Fixed Income Securities with a defined use of proceeds, can have a lot of influence on what they buy, and in a more professionalized fashion of delivery."

- PETER HIGGINS
SHELTON CAPITAL MANAGEMENT

Sustainable Investing in the United States 1995-2022



Source: US SIF Foundation 2022 Report.
Note: Assets under management in 2022 represent US SIF's new modifired methodology.

We understand that nuclear power is something that people are considering again. What are your thoughts there?

MR. MOCK: Nuclear is probably going to grow over the next several decades due to new technologies. It is the ultimate source of reliable carbon neutral power, but there are valid investor concerns about nuclear waste storage and safety as memories of Fukushima and Chernobyl loom large. My personal experience is that due to these concerns most retail green bond investors don't currently support nuclear energy, which is fine. As we've said, we can tailor portfolios to the client.

Do you think the recent failures in the banking system will affect your business in any way?

MR. MOCK: We don't expect any major impact beyond short-term trading issues, though there is some concern that banks won't be as large a buyer of municipals over the long term.

What are you most optimistic about when you look to the future?

MR. MOCK: We believe the bonds we're investing in are not being issued because they're green or they're social. They're being issued because they make economic sense. So, regardless of the politics, regardless of the semantics and definitions, I think that this is a great place to be. These bonds make long-term economic sense, so as a capitalist, I believe the market will continue to grow.

MR. HIGGINS: Yield currently gives investors a much more attractive return profile. At the same time, investors are doing good for society. I think it's a win-win, and this economic backdrop provides a very good entry point for investors.

TO LEARN MORE ABOUT THE CONFERENCE:

https://www.firstaffirmative.com/esg-for-impact

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