SHELTON CAPITAL MANAGEMENT

Shelton Tactical Credit Fund

Quarterly Commentary
As of December 31, 2024

Market Commentary

We waited so long for this?

The Fed finally began the rate cut cycle in September with a 50 basis point double shot, followed by further 25 bp cuts in November and December. At the same time, longer term interest rates shot higher as concerns around a recurrence of inflation rose to the surface. The subsequent outcome of the election triggered additional worries about stronger growth, tariffs, and higher deficits, causing the curve to steepen even more. The updated Summary of Economic Projections at the December FOMC meeting illustrated that the Fed was shifting back away from labor market concern and back to a more balanced assessment of the risks of their dual mandate. As we will discuss in the outlook section, where we go from here could almost be anywhere, but at least we'll be starting from attractive all-in yields.

GDP moved slightly higher from 3.0% in Q2 to 3.1% in Q3. As of January 1st, Q4 is currently tracking to a 2.54% figure according to the Atlanta Fed GDPNow Forecast, after this estimate had been as high as 3.36% earlier in December. The cumulative effect of higher rates has yet to dent economic activity, and the series of rate cuts and expectations of further cuts that prevailed from August through October increased the enthusiasm for growth. The key question now is whether this significant move higher in longer term rates starts to bite and have an effect on business and consumer spending.

At year end, markets are pricing in less than two more cuts in 2025 and another one cut in 2026. The long end of the curve will also be impacted by philosophical issues like R* and the terminal rate, and by expectations around fiscal policy, deficit spending and budgetary restraint (or lack thereof). As 2025 progresses, we will get more clarity on fiscal policy, tariffs, immigration reform and other factors which will all bear upon inflation, employment, and growth.

Although the balance of risks has likely shifted back into an equilibrium between inflation and full employment after recent employment reports, the FOMC still has a very difficult task of ensuring inflation does not reappear or reaccelerate, while also protecting the labor market from further deterioration. Fed governors have spoken about how they do not want any further weakening of the labor markets from here. These things operate with a lag, so if all the cumulative tightening over the last several years is still impacting hiring and firing decisions, we won't know until later that the employment picture was still deteriorating. In addition, we now have the added uncertainties of geopolitical volatility under the new administration.

In Q4 2024, the Fund posted returns of -1.48% (DEBIX) and -1.53% (DEBTX). Below is a table of returns for the Fund, various relevant indices, and the Morningstar Non-traditional Bond category. While performance in the quarter was negative, relative performance versus indices, especially adjusted for the average creditworthiness of the portfolio (BBB-/BB+), was favorable. Full year performance significantly exceeds the Agg and the Investment Grade corporate and municipal bond indices, but slightly trailed the Nontraditional bond category. The Fund did trail the relevant high yield index, which was powered by very strong performance from the CCC cohort. Our crossover-rated positioning has been purposeful and diligent, which has allowed us to navigate the uncertainties of the rate cut cycle. 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 2023, the fund reached its 10-year anniversary, and the performance of the Fund since inception stands very tall relative to peers, relevant indices, and the Non-traditional 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 over 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 over 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 ten 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.

	4Q24	YTD	1YR	3YR	5YR	10YR
Shelton Tactical Credit Fund (DEBIX)	-1.48%	5.93%	5.93%	1.26%	3.32%	2.94%
Bloomberg U.S. Aggregate Bond Index	-3.06%	1.25%	1.25%	-2.41%	-0.33%	1.35%
Bloomberg U.S. Investment Grade Corporate Bond Index	-3.04%	2.13%	2.13%	-2.26%	0.30%	2.43%
Bloomberg U.S. High Yield Corporate Bond Index	0.17%	8.19%	8.19%	2.91%	4.21%	5.16%
Bloomberg U.S. Investment Grade Municipal Bond Index	-1.22%	1.05%	1.05%	-0.55%	0.99%	2.25%
Morningstar Nontraditional Bond Fund Category	0.15%	5.95%	5.95%	1.94%	2.13%	2.34%

Sources: Bloomberg; Morningstar Direct

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.

The Fund's Advisor, Shelton Capital Management (the "Advisor"), 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 (including commissions, mark-ups and mark-downs), leverage interest, other transactional expenses, annual account fees for margin accounts, taxes (such as income and foreign withholding taxes, stamp duty and deferred tax expenses), and extraordinary expenses such as litigation or merger and reorganization expenses, for example) exceed 0.98% and 1.23%, for the Institutional and Investor class shares, respectively, until May 1, 2025.

Fund Expenses - DEBIX (gross): 1.62% | DEBIX (net): 0.99%
DEBTX (gross): 1.87% | DEBTX (net): 1.24%

Portfolio weightings were higher in corporate bonds and lower in municipal bonds. We also did not have any cash 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. Although we appreciate the all-in high yields for corporate bonds, spreads are tight and uncertainties abound, so we maintained our portfolio hedge on the IG CDX index during the quarter. When interest rates declined on expectations for significant additional rate cuts, and rate volatility was subdued, we added back rate hedges, which served us well late in the quarter.

Corporate bond long positions were a drag on performance overall during the quarter. At the ratings level, our single B and CCC positions were strong positive contributors, and our higher quality longer duration bonds suffered as interest rates increased sharply and the curve steepened. Favorable credit selection allowed us to avoid any major downside surprises. 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 Q3 earnings generally across the board and offered favorable yet prudent Q4 and initial 2025 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 benefitted from idiosyncratic gains in i) BlueTriton Brands, which completed its merger with Primo Brands; ii) AMC Entertainment and Cinemark, which rose on strong film box office results; and iii) GEO Group, which rose sharply on expectations for increased revenue under the incoming Trump administration.

The top 5 contributors and detractors for the quarter (9/30/24 - 12/31/24) are listed below:

Top Contributors	**Top Detractors**
The GEO Group, Inc.	The Kraft Heinz Company
Pyxus International, Inc. Term Loans	Visa Inc.
AMC Entertainment Holdings, Inc.	Roche Holding AG
Transocean Ltd.	JPMorgan Chase & Co.
Talos Energy	KLA Corporation

Corporate Commentary

The lower the quality, the better the return proved to be the overall theme in corporate credit. High yield spreads started the year at +333bp, peaked at +381bp in August, reached the tights of +253bp in November, before finishing the year at +287bp. Higher quality, rate sensitive bonds were punished by the sharp move higher in rates, while lower quality bonds clipped their higher coupons and were unimpeded by credit risk, as spreads tightened in the risk-on environment. How long CCCs can continue to outperform is the key question.

In investment grade, duration was punished throughout the year, with long bonds returning -1.95% vs. intermediate maturity bonds achieving +4.22% annual gains. Ironically and correlated with longer duration, highest quality bonds suffered the most in Q4 '24 with AAA's returning -5.88%, AA's -3.94%, single A's -3.31%, and BBB's -2.58%. Investment grade funds had an overall quarterly inflow of $35.7 billion, and high yield funds had an inflow of $3.3 billion. New issuance for investment grade was a massive $258 billion, beating out the $228 billion this quarter last year. High yield new issuance was also very strong with companies bringing $65 billion in new supply as compared to $42 billion in 4Q23. The market was open to all issuers, with CCC's bringing ~$4 billion in new issuance, versus ~$1 billion this quarter last year. Refinancing or repayment of debt continued to be the most common use of proceeds, accounting for 80% of YTD issuance, the highest since 2000 and a trend we expect to continue as issuers peck away at the much publicized "wall of maturities." For the year, the sectors that brought the most in issuance were Financials with $62 billion followed by Consumer with $59 billion.[1, 2]

1 Bloomberg
2 CreditSights

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Corporate Commentary (continued)

The balance sheets of HY issuers continue to appear in good shape, amid some downward guidance revisions. Leverage ticked higher to 4.05x. Leverage is 0.29x higher than 1Q23's record low, although still well below the long-term average of 4.31x, and well below the peak in 1Q21 at 5.92x. EBITDA expanded from a year ago at a pace of +1.2%, with the strongest gains in the Technology, Media, and Healthcare sectors. Metals/Mining, Retail, and Transportation saw the largest declines in EBITDA. Leverage for BB, B, and CCCs is 3.4x, 4.7x, and 6.8x versus the past decades' average of 3.5x, 5.0x, and 7.6x, respectively. Interest coverage ratios decreased -0.23x to 4.66x but are still above the historical average of 4.50x.

The HY default rate ticked down slightly by 17bp to 1.64%, which is down 141bp since year end 2023. This represents the lowest default rate in over two years, and for context, the 25-year HY default rate is 3.4%. Notably, leveraged loans are seeing a significantly higher default rate, at 4.49%, which is above their long-term average of 3.0%, and a nearly four year high. This spread of 285bp over HY is the highest since 2000 as the effects of higher-for-longer policies sink in. HY spreads tightened some in the quarter from +340bp to +318bp, and still remain relatively tight especially if there is a chance of a recession. As yields moved higher to 7.5% in HY, the all-in yield picture is still meaningful although less generous than the 8-9% earlier in 2023.[2]

Municipal Commentary

Municipal markets followed the US Treasury market, with a substantial selloff over Q4 that began in mid-September, partially retraced in November and resumed in December. The move to higher yields had a negative impact on performance with investment grade municipals returning -1.22% for the quarter, beating US Treasury returns (-3.14%), which in turn outperformed taxable municipal bonds (-3.57%). The Treasury curve shift to higher yields was driven by persistent inflation, concerns both before and after the election about the potential inflationary impact of a new Trump administration's policies, and the FOMC taking a more hawkish stance. The table below shows the change in AAA municipal yields in basis points across the curve during the quarter.[1]

Maturity	October	November	December	Full Quarter
2 Years	30	-11	24	43
5 Years	37	-13	29	53
10 Years	41	-21	30	50
30 Years	32	-34	35	32

Source: Bloomberg

From a relative value perspective, tax-exempt bonds are cheaper than a year ago at all but the 30-year tenor but continue to be historically rich relative to Treasuries across the curve. AAA Muni/Treasury ratios moved slightly higher at 2 and 5 years and slightly lower at 10 and 30 years over the quarter, rising from 63% to 66% in the 2 year and 63% to 64% in the 5 year, while falling from 66% to 65% in the 10 year and 80% to 75% in the 30 year. Though lower than Q4 2023's high yields, nominal rates in municipal bonds remain close to the highest yields in the last decade. Municipal Fund flows were approximately $40 billion for the year in 2024, with 23 consecutive weeks of inflows in the latter half of the year.

The municipal bond market will continue to take overall direction from US Treasury markets with relative value being dependent on market technicals. We're seeing projected reinvestment capital of around $400 billion and projected issuance of about $450 billion for 2025. Fund flows will dictate whether or not the projected net supply puts upward pressure on ratios. If the economy remains strong, capital flows will trend to riskier sectors and poor municipal flows could result in rising ratios. Should the economy exhibit signs of weakness, the credit quality of municipal bonds relative to corporates has historically driven strong flows to the municipal market which will support strong relative value and lower ratios.[1, 2]

Outlook

When almost all the sell-side forecasts are tightly grouped within a narrow band, complacency abounds. 10-year U.S. Treasury yield forecasts within a sideways to higher range are the product of mild at best progress on inflation, coupled with inflationary pressures from tariff, immigration, and other fiscal policies under the new administration. These are valid concerns. However, when seemingly everyone thinks rates are stuck higher for longer and future government action can only be inflationary, we look for reasons to be contrarian.

Firstly, the recent surge in long-term rates is a problem for many consumers and businesses. Many of them believed that rates were going lower and were optimistic. Perhaps this allowed consumers to continue spending beyond their means in Q3/Q4 (as evidenced by further declines in excess savings, and spending below income levels). The continued strength in retail sales has been led by the wealthy with cracks forming under the surface, including credit utilization and delinquencies on the rise. Maybe businesses retained employees or added more and made plans to increase capital investment in 2025. The cost of capital for most people and businesses is priced off of longer-term rates, not Fed Funds, and money has gotten a lot more expensive over the last few months. Financial conditions have tightened as a result. At some point, presumably this would put the brakes on spending.

Secondly, the amount of tariffs and how they will be structured is uncertain. If they are targeted towards certain countries or certain products, the impact would be less than if they were broad-based. There is some debate as to whether tariffs are even inflationary at all, as they provide a 1-time boost to prices, but not a continuing expectation of future price increases, so they are a step higher in prices but not a persistent inflation threat. Also, if the retaliatory response crimps demand for exports, it could also favorably affect the supply / demand balance and ease pricing pressures domestically. Let's see whether tariffs are initiated as negotiating tools, or permanent, and then make a more reasoned assessment.

Thirdly, action on immigration could also have a varied impact, depending on the amount and structure. The incoming administration is cognizant that the US labor force depends on immigrant labor, especially in certain industries, and is unlikely to disrupt corporate workforces on a widespread basis. If immigration is more targeted, it should not lead to widespread wages and price inflation. Also, removing people from the country would also remove aggregate demand for goods and services, in a counterbalancing impact.

1 Bloomberg
2 JPMorgan

Continues on page 4

Outlook (continued)

All these potential policies could be inflationary, or not. They could foster growth, or a negative shock. The reaction function from individuals and businesses, both here and abroad, could also go in a variety of directions. Enacting aggressive or controversial legislation is always a challenge but driving it through the narrowest majority in Congress in nearly 100 years may prove to be insurmountable. The fiscal hawks may demand spending offsets to any proposed legislation. Rather than runaway profligate fiscal spending, we could get restraint. Perhaps this would calm the bond vigilantes and narrow the term premium treasury investors demand to hold 30-year bonds.

Relative valuation between stocks and bonds is a further consideration. The equity risk premium (defined as the excess return that investing in the stock market provides over a risk-free rate) is unfavorable, and if this relationship normalizes, bonds will regain some of their attractiveness as a source of income and a safe haven from turbulence and volatility, especially if or when there is a correction in equities. If nothing else, we should expect volatility over the coming years.

We are not wholly convinced that any of these points above will definitively occur and are not advocating a 100% contrarian view. However, we do find it informative to understand both sides of these arguments, so that we can adjust our positioning accordingly. In the meantime, employing all the tactical tools at our disposal in the form of rate hedges, credit hedges, shorter or longer duration, higher or lower credit quality, and even going to more cash at times will all be available to us as we navigate the road ahead.

We thought that there were cracks forming in the labor market last fall. The unemployment rate rose from 3.4% to 4.3% but has since declined modestly back to 4.2%. Job openings in the JOLTS survey fell to a recent low of 7.37 million in September but have since risen two months in a row back to 8.1 million. There were just 1.1 postings for each person seeking work, back to pre-pandemic levels, and the quits rate has also normalized to pre-Covid levels, down to 1.6% in November. We may need to wait a few months to get past the distortions from natural disasters, rate cut hopes, and election hopes and dreams to see where companies' employment decisions are headed for a true read on the health of the labor market. Either way, wages should not be a source of future inflation, as the Employment Cost Index has fully normalized and sits at 0.8%, consistent with inflation readings at or below 2%.

The Citi Economic Surprise index peaked in mid-November and declined steadily through the year-end. The Atlanta Fed GDPNow Index sits at 2.73% as of writing, but we will keep an eye on revisions in coming weeks to see if late-quarter readings were slowing, consistent with the decline in the economic surprise index. Gross Domestic Income for 1H 2024 was revised higher a few months ago, from 1.3% to 3.2%, largely on account of faster compensation growth. This would suggest that consumer savings did not dwindle as much as the earlier belief. Combined with the wealth effect from equity markets rebounding to all-time highs, consumers should be confident in their ability to keep spending. Yet the quits rate has further declined to 1.6%, the lowest since April 2020, and other indicators on how individuals are feeling about the job market and their ability to find a new job if fired, or a higher paying job if they switch, are also in conflict with what should be positive consumer sentiment. Psychology suggests that even if consumers have excess savings, growing portfolios, lower inflation, and now lower interest rates, if they have doubts about the labor market, they will be more cautious.

The FOMC is now in a pause, the duration of which will depend on incoming data and incorporating the impact of future policy.

Recent corporate commentary generally offered upbeat outlooks for the balance of 2024 and into 2025, however those companies focused on serving lower and even middle-income cohorts have been expressing more concern about the demand outlook given the disproportionate burden that inflation and higher rates have on these types of consumers. Numerous automotive OEMs and parts suppliers have recently cut their outlooks substantially on account of demand weakness and bloated inventories. These companies tend to be bellwethers in terms of their predictive impact on other aspects of the economy.

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 had 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 threefold: high quality shorter duration BBB and BB corporate bonds; certain lower rated single-B and CCC corporate bonds that we believe are stronger and more resilient than the market and have an identifiable path to credit improvement; and some event-driven investments where the still-wide-open credit markets are available to facilitate the transactions to drive these catalysts. Considering rate uncertainty, higher rated investment grade bonds with duration sensitivity are a bit trickier. The recent backup in rates makes them more attractive again, as all-in yields are higher, and the new issue supply should be a bit more muted. Ordinarily, for a no-landing scenario we would make tactical adjustments to add more credit risk to the portfolio, but with spreads already very tight and CCCs having rallied 15.09% in 2024, we'll have to pick our spots rather than indiscriminately buy the entire cohort of lower rated bonds whose dispersion is abnormally high. There are valid reasons to believe spread widening might stop short of previous recessions, as the index has a better-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 quite 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.

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