Shelton Tactical Credit Fund

Quarterly
Commentary
As of March 31, 2025

Market Commentary

"Boy – that escalated quickly…. I mean that really got out of hand fast." Ron Burgundy, Anchorman

Interest rates started 2025 moving higher in anticipation of pro-growth policy and continuing inflation. This quickly gave way to concerns around slowing economic growth, and 10-year rates moved from an intra-quarter high of 4.79% on January 14th to 4.21% at quarter end. The Fed held rates steady in January and March, choosing to wait for more data on the balance of risks between 'stag' and 'flation'. The updated Summary of Economic Projections at the December FOMC meeting illustrated that the Fed was shifting 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, and this wide range of potential outcomes warrants caution, dexterity, and active management.[1]

GDP decelerated modestly from 3.1% in Q3 to 2.4% in Q4. As of March 31st, Q1 was tracking to a negative 2.8% figure according to the Atlanta Fed GDPNow Forecast, and even with an adjustment for transfers of gold, the figure would still be negative. The cumulative effect of higher rates still had not dented economic activity, but what the Fed could not do, the uncertainty around trade policy had taken care of. Businesses and consumers have paused activity while awaiting more clarity on the rules of the road ahead. The key question now is whether enough visibility emerges soon enough to prevent a deeper and longer downturn.[1]

At quarter end, markets are pricing 3 cuts in 2025, and another one plus 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 hard data points 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 had still been deteriorating. At the same time, the Fed indicated that while slower growth would ordinarily prompt an easing response, they are hamstrung due to the uncertainty of trade policy and its potential effect on inflation.

In Q1 2025, the Fund posted returns of +1.35% (DEBIX) and +1.24% (DEBTX). Below is a table of returns for the Fund, various relevant indices, and the Morningstar Non-traditional Bond category. Performance in the quarter could be characterized as down the middle of the fairway – exceeding the Morningstar Non-Traditional Bond Category and High Yield bonds, while trailing more rate-sensitive indices like the Agg and Investment Grade bonds. Our positioning was somewhat cautious, expecting uncertainty and volatility, and our relative performance adjusted for the average creditworthiness of the portfolio (BBB-/BB+), was favorable. 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.

1 Bloomberg

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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.

	1Q25	YTD	1YR	3YR	5YR	10YR
Shelton Tactical Credit Fund (DEBIX)	1.35%	1.35%	5.28%	2.79%	6.81%	3.02%
Bloomberg U.S. Aggregate Bond Index	2.78%	2.78%	4.88%	0.52%	-0.40%	1.46%
Bloomberg U.S. Investment Grade Corporate Bond Index	2.31%	2.31%	4.90%	1.14%	1.51%	2.43%
Bloomberg U.S. High Yield Corporate Bond Index	1.00%	1.00%	7.69%	4.98%	7.29%	5.01%
Bloomberg U.S. Investment Grade Municipal Bond Index	-0.22%	-0.22%	1.22%	1.53%	1.07%	2.12%
Morningstar Non-traditional Bond Fund Category	1.24%	1.24%	5.41%	3.25%	4.02%	2.37%

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. Although we appreciate the all-in high yields for corporate bonds, spreads are still relatively tight by historical standards and uncertainties abound, so we maintained our portfolio hedge on the IG CDX index during the quarter.

Corporate bond long positions were the primary positive contributor to performance overall during the quarter. At the ratings level, our higher credit quality, more rate-sensitive positions were strong positive contributors as rates declined but their higher quality provided spread resiliency, while our lower quality bonds generally declined as growth concerns increased. Favorable credit selection allowed us to avoid any major 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 Q4 earnings generally across the board and offered favorable yet prudent 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) JBS Foods, which advanced plans for listing their shares in the United States; ii) Sun Communities, which announced the surprise divestiture of its Safe Harbor marinas division at a strong valuation; and iii) GEO Group, whose outlook improved alongside immigration policy. AMC bonds declined as the first quarter box office trailed expectations, which we expect to reverse as the film slate improves significantly over the balance of the year.

The top 5 contributors and detractors for the quarter (12/31/24 - 3/31/25) are listed below:

Top Contributors	Top Detractors
Pyxus International, Inc.	AMC Entertainment Holdings Inc.
JBS USA Food Co	PetSmart Inc.
Visa Inc.	Rise Baking Company
Roche Holding AG	Guitar Center Inc.
Warner Music Group	Bausch Health Companies Inc.

Corporate Commentary

Following a banner year for risk assets in 2024, lower-quality credit suffered in the first quarter. High yield spreads widened +60bps to end the quarter at +347. Higher quality, rate sensitive bonds were rewarded by the sharp rate reversal in late January, which overshadowed the move wider in spreads. Volatility in rates jumped sharply higher and has been a defining factor this year. By rating, dispersion appeared with BBs returning 1.49%, followed by single Bs 0.74% and CCCs -0.44%.

In investment grade, duration was again rewarded, with AAAs returning 2.93%, AAs 2.70%, single As 2.46%, and BBBs 2.22%. Investment grade funds had an overall quarterly outflow of $2.08 billion, and high yield funds had an inflow of $12.58 billion. New issuance for investment grade was a massive $561 billion, beating out $546 billion in Q1 '24. High yield new issuance was solid with companies bringing $68 billion in new supply although short of $86 billion in 1Q24. The market was open to all issuers, although less so for the riskier cohort, with just ~$2 billion in new issuance amongst CCCs, as compared to ~$4 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." Year to date, the sectors that brought the most in issuance were Consumer with $15 billion followed by Industrials with $13 billion, and TMT with $10 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 mixed guidance due to macro uncertainty. Leverage ticked lower for the first time in four quarters to 3.98x from 4.05x. Leverage is 0.22x 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 +6.2%, with the strongest gains in the Technology, Media, and Transportation sectors. Metals/Mining, Retail, and Energy saw the largest decline in EBITDA. Leverage for BB, B, and CCCs is 3.3x, 4.5x, and 7.2x versus the past decades' average of 3.5x, 5.0x, and 7.6x, respectively. Interest coverage ratios increased 0.08x to 4.74x off a 2.5 year low and remain above the historical average of 4.50x.[1,2,3]

The HY default rate ticked down by 44bp to 1.20%, which is down 142bp since a year ago. This represents the lowest default rate in over two and a half years, and for context, the 25-year HY default rate is 3.4%. Notably, leveraged loans are still seeing a significantly higher default rate, at 3.86%, which is above their long-term average of 3.0%, although it has come down 66bps from a recent four-year high. The spread of 266bp over HY narrowed as interest rates came down, benefiting loans, and moving off a high since 2000. With HY spreads widening in the quarter, markets started to price in more tangible chances of a recession. As yields moved higher to 7.75% in HY, the all-in yield picture is still meaningful although less generous than the 8-9% earlier in 2023.[2]

Municipal Commentary

The primary source of municipal market volatility in the quarter was the volatility in the benchmark US Treasury market, which rallied in January and February and steepened in March, pivoting around the 10-year. Tax-exempt municipal market rates moved higher in March across the curve. Investment grade municipals returned -0.22% for the quarter, lagging US Treasury returns (2.92%), which in turn lagged taxable municipal bonds (2.99%). The current market environment is extremely subject to headline risk in both directions around trade tariffs and the potential impact they may have on future economic activity and inflation. The table below shows the change in AAA municipal yields in basis points across the curve during the quarter.[1]

Maturity	January	February	March	Full Quarter
2 Years	-11	-15	9	-16
5 Years	-8	-18	22	-3
10 Years	-7	-18	33	8
30 Years	9	-4	35	39

Source: Bloomberg

From a relative value perspective, tax-exempt bonds are cheaper than they were at either the end of the prior quarter or a year ago but continue to be historically rich relative to Treasuries across the curve. AAA Muni/Treasury ratios moved slightly higher over the quarter, rising from 66% to 68% in 2 years, 66% to 73% in 5 years, 68% to 76% in 10 years and 81% to 93% in 30 years. Nominal municipal bond yields remain close to the highest yields of 2023, yields last seen in 2009 prior to the 2023 peaks.[1]

The municipal bond market will continue to take overall direction from US Treasury markets with relative value being dependent on market technicals. While fundamental macro analysis is currently overshadowed by news and rumors on tariffs, we still know that issuance levels will be impacted by yields, and flows will be impacted by the strength of the economy. Fund flows will dictate the degree to which new issuance continues to put upward pressure on ratios. History tells us that 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. We'll be closely attuned to the resolution or perpetuation of the nascent international trade war and the resultant economic and market impact. We will also be paying close attention to any potential changes to tax rules that could have an impact on the municipal bond market.[1, 2]

Outlook

We wrote last quarter about complacency and compression. Credit spreads were tight by historical standards, not offering compelling risk/reward given those conditions. Markets were anticipating pro-growth policy and stubborn inflation. What we have gotten so far has been uncertainty and volatility, which has caused economic activity to come to a screeching halt, as companies and consumers pause significant expenditures until the rules of the road are more clearly understood. At the same time, interest rates have been spiking, driven by both fundamental and technical factors. The fundamental drivers are tariff-induced inflation, and the potentially higher cost of re-shored production versus lower-cost production abroad. Technical factors include continued issuance of US Treasuries to support deficit spending, selling of US Treasuries by foreign countries (for liquidity or potentially for retaliation), and forced unwinding of leveraged hedge fund basis trade positions. In effect, the bond market is trying to police some of this fiscal and trade policy, sending warning signs that certain more extreme outcomes would not be palatable nor tolerable.

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 was led by the wealthy with cracks forming under the surface, including credit utilization and delinquencies on the rise. Many 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 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 rate of tariffs and how they will ultimately be structured is uncertain. The initial salvo was across the board levies, with rates proportionate to the trade deficit with said countries. If the final outcomes 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 ultimately negotiating tools, or permanent, and then make a more reasoned assessment.

1 Bloomberg
2 JPMorgan
3 Creditsights

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Outlook (continued)

Thirdly, action on immigration could also have a varied impact, depending on the amount and structure. The new 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.

On the flip side, there are the potential positives of tax reform and de-regulation. Progress on extending tax cuts and perhaps even broadening them seems to be moving along, but the narrow Congressional majority is a challenge.

All these potential policies could be inflationary, or not. They could foster growth or be a negative shock as the initial indications suggest. 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 in the Republican party seem to be going along with the broader party as of now but could become emboldened and 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. Treasury Secretary Scott Bessent seems to understand the gravity of the situation, but it remains to be seen if his views will carry the day.

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 very unfavorable, and if this relationship normalizes, bonds could regain some of their attractiveness as a source of income and a haven from turbulence and volatility, especially if or when there is a correction in equities.

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 to 4.3% but remained in a narrow range and declined modestly back to 4.2%. Job openings in the JOLTS survey fell to a recent low of 7.10 million in September but have since risen a bit to 7.57 million. There were just 0.9 postings for each person seeking work, back to pre-pandemic levels, and the Quits rate has also declined to below pre-Covid levels, down to 1.6% in February. We recognize that all of this is backwards looking, and we need to wait a few months to get past the trade policy uncertainty 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 0.9%, consistent with inflation readings at or below 2%.

The Citi Economic Surprise index peaked in mid-November and declined steadily since, hitting recent lows of -15.4. The Atlanta Fed GDPNow Index sits at -2.416% as of writing, and even adjusted for gold transfers, the result would still be negative GDP for Q1. Personal income had been holding up adequately even in the face of inflation. The potential negative wealth effect from lower equity markets will likely crimp future demand. The US Economic Policy Index has recently hit all-time high levels, even exceeding COVID, 2008 and other periods of stress. This inevitably will be bad for the economy – with the salient question being how deep and long might the downturn be. Indicators of consumer confidence generally, or their views of the labor market more specifically, are reasons for caution. The quits rate has 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 unfavorable. However, we also recognize that sentiment could turn on a dime if policy changes, so positioning too far to one extreme or another would not be prudent.

The FOMC is now in a pause, the duration of which will depend on incoming data and incorporating the impact of future policy. Unless it is forced into immediate action with emergency rate cuts or the extraordinary measure of using its balance sheet to support the US Treasury market. We do not foresee the former but can see a scenario where the latter is required. And it would not be pretty.

Recent corporate commentary is concerning. Companies are withdrawing guidance until more clarity emerges. 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, and this has not changed. First-quarter earnings season may be too soon to understand the implications of policy change, and we expect this uncertainty to linger.

Given where all-in yields are now, we believe they are generally compensating investors for additional spread widening 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, even in a slowing growth environment; and some event-driven investments where that are not totally dependent on wide-open credit markets 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, into a slowing economy where rates decline and credit spreads widen, we would look to sell higher quality and rate sensitive bonds into that strength and add more credit risk at wider spreads, and perhaps that is how things play out, but there are more wildcards and uncertainty given much of this is being driven by policy, which can change abruptly, so we will be nimble and responsive. Periods of volatility and drawdowns have typically been opportunities to create outsized total returns and alpha out the other side, and we expect this time around to offer similar potential.

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.

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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 the fund. To obtain a prospectus, visit https://sheltonfunds.com/wp-content/uploads/2025/01/Prospectus-1.1.25.pdf or call (800) 955-9988. A prospectus should be read carefully before investing.

It is possible to lose money by investing in a fund. Past performance does not guarantee future results and current performance may be lower or higher than the performance data quoted.

Diversification does not assure a profit or protect against loss.

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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