How Well Does Your Bond Fund Handle Stress?
By David Falk, Fixed Income Portfolio Manager

Selecting a bond fund for your client's portfolio is not easy. Advisors must determine what role a fund plays within the portfolio and how it fits together with other holdings to achieve the client's objectives. What is the client's risk profile? And how important is income relative to capital appreciation?

Advisors often rely on their firm's gatekeepers and other investment allocators that employ a variety of factors in selecting bond funds for their models and clients. These factors include, among others: fund size, fees and expenses, experience of the fund management team, risk profile and, of course, performance track record. These items – which are both quantitative and qualitative -- certainly are an important part of any robust diligence process. But we believe evaluating **how a bond fund performs through stressful market conditions is one of the most important factors to consider.**

The markets and investors have been through extremely stressful times over the past two and a half years. From January 1, 2020, to June 30, 2022 (the "Stressful Period"), we have experienced some extremely difficult market challenges, as summarized below:

---COVID-19 Pandemic, lockdowns, vaccine roll-out and economic reopening
--- Massive fiscal stimulus
--- Russian invasion of Ukraine
--- Supply chain disruptions
--- Commodity price volatility
--- Rapid and robust inflation
--- Secular change from long-term, low-interest rate environment to Fed tightening
--- Growth slowdown and beginning of recession

Designing a Stress Test
Actual performance of different bond funds during the Stressful Period are comparable and provide an important input to the fund selection process. Some of the most popular bond funds (by assets and Google searches) reside in Morningstar's Intermediate Core Plus category. Intermediate Core Plus funds invest primarily in investment-grade U.S. fixed-income issues including government, corporate, and securitized debt, but generally have flexibility to also hold corporate high yield, bank loan, emerging-markets debt, and non-U.S. currency exposures. We will use the Morningstar Intermediate Core Plus category as a proxy for popular bond funds.

As part of our analysis, we will also look at the Shelton Tactical Credit Fund (Ticker: DEBIX), a $38 million fund which is included in Morningstar's Nontraditional Bond Category. This category includes a wide variety of credit investment strategies. DEBIX seeks current income and capital appreciation, employing long positions in high grade and high yield corporate and municipal bonds, short positions in corporate bonds and cost-effective strategies to manage interest rate risk.

In addition, we will look at the Bloomberg US Aggregate Bond Index as a benchmark.

Examining Total Return and Upside/Downside Capture
Two tools that are useful for evaluating and comparing how well different funds managed through the "Stressful Period" are: **Total Return** and **Upside/Downside Capture**.

Stressful Period 1/1/20 to 6/30/22						
	Cumulative Return %	**Annual Equivalent Return %**	**Upside Capture Ratio**	**Downside Capture Ratio**	**6/30/2022 Modified Duration**	**6/30/2022 Current Yield %**
Shelton Tactical Credit Fund (DEBIX)	3.55	1.41	151.05	88.33	6.65	5.93
Intermediate Core Plus Category	-4.42	-1.79	119.01	109.47	6.52	3.66
Bloomberg US Aggregate Bond Index	-5.11	-2.07	100.00	100.00		

Source: Morningstar

Average Annual Returns	2Q22	YTD	1YR	3YR	5YR	Inception
DEBIX	-5.75%	-8.68%	-8.78%	1.03%	1.73%	3.19%
DEBTX	-5.83%	-8.74%	-9.03%	0.78%	1.50%	2.94%
Bloomberg US Aggregate Bond Index	-4.69%	-10.35%	-10.29%	-0.93%	0.88%	1.82%

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.

In the table above we see that DEBIX delivered a positive return of 3.55% compared to the Intermediate Core Plus Category which returned -4.42% during the Stressful Period. We also see that DEBIX outperformed the benchmark by 866 basis points during this period. In addition to investment return, upside/downside capture ratios are another useful tool for stress test analysis. An upside capture ratio **over 100** shows that a fund has outperformed the applicable benchmark during periods of positive returns for the benchmark. A downside capture ratio **below 100** shows that a fund loses less during periods of negative returns compared to the benchmark. While the Intermediate Core Plus category and DEBIX both have upside capture ratios greater than 100, the DEBIX ratio exceeds the Intermediate Core Plus category by more than 30%. Furthermore, DEBIX demonstrated an impressive downside capture ratio well below 100 at 88.33 while the Intermediate Core Plus had a downside capture ratio of 109.47 meaning that it underperformed the benchmark during the Stressful Period.

We can learn a couple of important lessons from this stress test that can help enhance the fixed income fund selection process:

--- Bigger is not always better. While the popular funds may be very large in terms of assets under management, they did not appear to navigate the Stressful Period very well. However, DEBIX weathered the storm much better. **In stressful market environments, smaller funds can more quickly make meaningful tactical adjustments in asset class, credit quality, and duration than larger funds.**

--- As noted above, the popular funds all reside in the Intermediate Core Plus category, while DEBIX lies in the Nontraditional Bond category. **To the extent possible, especially in challenging market environments, try not to be limited by categories in the fund selection process. Sometimes coloring outside the lines can produce a better result.**

BOTTOM LINE: Remember that while some funds may not show up on your normal screening process for several reasons, size, or category label, they can still add meaningful value to your client's portfolios – particularly during difficult market environments -- so keep looking under those rocks.

David Falk is a portfolio manager of Shelton Capital Management's fixed income team. Click here to learn more about DEBIX and Shelton's other fixed income solutions.

Important Information

It is possible to lose money by investing in a fund. Past performance does not guarantee future results. ***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. Mutual fund investing involves risk, including possible loss of principal.***

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.

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