

Market Overview

The first quarter of 2026 unfolded in two distinct acts. January and February delivered strong gains across international developed markets, driven by AI-related hardware investment, improving global growth expectations, and continued U.S. dollar weakness. Then, in the final days of February, U.S. and Israeli military strikes against Iran led to the eventual closure of the Strait of Hormuz and triggered the worst monthly decline for global equities since the pandemic era — reversing most of the quarter’s early gains in a matter of weeks.

The STOXX Europe 600 fell 9.7% in March — its largest monthly decline since 2022 — and the DAX dropped 12.4%, as Europe’s energy import dependence and LNG exposure amplified the shock. For the full quarter, the STOXX 600 finished down 3.1%, with Germany’s DAX declining 9.1% and France’s CAC 40 off 6.1%. The UK’s FTSE 100 proved more resilient, ending the quarter up 1.3%, supported by its energy sector composition. Japan’s Nikkei was down 2.4% for the quarter, as early gains from strong AI hardware momentum and Prime Minister Takaichi’s landslide election victory in February were offset by the oil shock’s pressure on the yen and Japanese manufacturing costs.¹

Within international small caps specifically, the quarter reinforced two themes: First, the AI hardware and infrastructure investment cycle continued to generate outsized performance in select names — particularly across Japan, Taiwan, and Northern Europe — through February. Second, and more painfully, the energy shock of March exposed small-cap vulnerability to macro shocks: smaller companies have less financial flexibility to absorb input cost spikes, and they tend to sell off more sharply in risk-off environments. The MSCI World ex-USA Small Cap Index finished the quarter down -1.6%.

The Iran Shock: What It Meant for International Developed Markets

The Iran conflict carried several distinct channels of impact for developed international equity investors. The closure of the Strait of Hormuz removed approximately 20 million barrels per day of crude and refined products from global trade. European natural gas prices surged to their highest levels since January 2023, amplified by Iranian strikes on Qatar’s Ras Laffan facility that wiped out roughly 17% of global LNG capacity — an outsized hit for a continent that had pivoted heavily toward LNG imports following the Russia-Ukraine conflict. The result was a rapid shift from a market expecting ECB rate cuts to one pricing in potential hikes, with Bund yields pushing close to 3% and gilt yields approaching 5%.²

For Japan, the yen — which had shown strength through early February — weakened under the weight of the oil shock, touching near 160 per dollar at points and prompting intervention warnings from authorities. Japan’s status as one of the most oil-import-dependent economies in the developed world meant that the energy shock had direct implications for corporate margins, particularly in manufacturing and transportation. The Bank of Japan held rates at 0.75% but signaled readiness to act if inflation forecasts materialized.

Amid this, a few regions showed relative resilience. The UK benefited from its energy-sector composition. Australia, with its domestic energy resources and commodity exposure, held up better than continental peers. Canada, similarly, was partially insulated by its energy independence.

Fund Performance

The Shelton International Select Equity Fund returned 1.30% in the first quarter of 2026, compared to -0.37% for the MSCI World ex-USA Small Cap Index. However, due to timing differences in the calculation of index and mutual fund performance, we believe that the actual performance during the quarter was lower than the reported number.

Both stock selection and factor positioning detracted from relative returns in Q1. Stock selection cost approximately -74 basis points, while factor exposures — country, industry, and style positioning in aggregate — added a further -7 basis points. In a quarter defined by a sharp,

Portfolio Managers

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¹All returns in USD. Sources: Bloomberg

²Source: Bloomberg

³Source: Bloomberg

⁴Details on the effect of timing on performance calculation: The MSCI World ex-US Small Cap Index is calculated at market close on the last day of the quarter. Mutual fund and ETF net asset values (NAVs), however, are calculated later in the evening — and if overseas markets have already opened by that time, the price changes in those markets must be reflected in the NAV calculation.

On April 1, 2026, the MSCI World ex-US Small Cap Index rose 3.64%, with the majority of that gain occurring in the early hours of trading — before U.S. NAVs were finalized on the evening of March 31. As a result, both the Fund and the iShares MSCI EAFE Small Cap (which tracks a similar index to our benchmark and is subject to the same NAV calculation requirements) captured a portion of April 1’s index return in their March 31 NAVs.

The iShares ETF reported a quarterly return of 1.14% for Q1 2026. Because our fund’s return was similar to the ETF’s, we believe our performance would have been about 1% behind our benchmark for the quarter.

Fund Performance cont.

macro-driven shock, most of the relative underperformance traces to individual stock performance rather than structural positioning, though country exposure amplified the drag.

On the factor side, industry positioning was a meaningful bright spot: our exposure to chemicals (+46 bps), communications equipment (+38 bps), IT services (+17 bps), and professional services (+16 bps) was additive. The performance of momentum stocks was the primary style headwind (-43 bps), as the sharp reversal in March punished positions that had appreciated most through February.

The most significant factor drag came from country positioning. Japan was the largest country headwind at -44 basis points, reflecting both the yen's weakness and the oil shock's outsized impact on Japanese manufacturing margins. Australia (-17 bps) and the UK (-14 bps) also detracted at the country level despite reasonable individual stock performance — in both cases a reflection of benchmark composition differences rather than poor security selection within those markets.

Key Contributors

Lynas Rare Earths was the top individual stock contributor with a return of 78.5% in the quarter. Lynas is an Australian mining company and one of the few scaled rare earth producers with processing facilities outside China — a strategic position that carries increasing significance as governments and manufacturers seek to diversify critical mineral supply chains. After a difficult end to 2025, when unexpected production disruptions weighed on the stock, investor focus in Q1 shifted decisively back to the structural scarcity of rare earth supply outside China — a theme that only intensified as the Iran conflict raised broader questions about commodity supply chain resilience. We maintained our position through the earlier volatility, and it was rewarded in Q1.

Amada Co. returned 16.6% for the quarter. The Japanese precision machinery and laser systems manufacturer benefited from strong order activity driven by the continued buildout of AI-related manufacturing capacity — factory automation, precision fabrication, and sheet metal processing demand all showed resilience through February.

Vermilion Energy added performance to the portfolio, returning +66.3%. The Canadian oil and gas producer was a direct beneficiary of the energy shock — Brent crude rose more than 43% in March alone — and Vermilion's diversified production base across Europe, North America, and Australia positioned it to benefit across geographies. This was a case where a position held for its cash flow and dividend characteristics became an unexpected portfolio hedge in a period of sharp energy price dislocation.

Keller Group and Ericsson also contributed meaningfully. Keller, the UK-listed geotechnical engineering firm, continued to benefit from elevated infrastructure activity across its European and North American project pipeline. Ericsson's exposure to the ongoing global network buildout — particularly 5G and AI-adjacent infrastructure investment — drove its +15.2% return.

Key Detractors

Konica Minolta declined by -24.9%. The Japanese office technology and healthcare imaging company faced a confluence of pressures: continued structural headwinds from declining print volumes, cautious enterprise technology spending, and the oil shock's effect on Japanese manufacturing cost structures. Konica Minolta has been navigating a multi-year transition toward healthcare and industrial precision imaging, but the pace of that transition remains a source of investor uncertainty.

Gamma Communications returned -24.7% in the quarter. The UK-listed business telecommunications provider sold off sharply in the risk-off March environment, amplified by concerns that its enterprise client base may face margin pressure as energy costs rise. The stock had been a strong performer in 2025 on the strength of its cloud communications growth, and we view the Q1 decline as partly an unwinding of that prior momentum rather than a fundamental deterioration.

De'Longhi fell by 19.4%. The Italian premium appliance maker is exposed to European consumer discretionary spending, which deteriorated sharply in March as energy cost concerns weighed on household confidence. The ECB's hawkish pivot — markets moved from pricing rate cuts to pricing potential hikes — was a meaningful headwind for a consumer-facing European company at this valuation level.

Charter Hall Group declined during the quarter, returning -21.7%. The Australian real estate fund manager had been a strong performer in 2025, supported by a guidance upgrade, active property acquisition activity, and improving sentiment toward Australian real assets. In Q1, rising long bond yields globally — driven by the oil-shock-induced repricing of central bank expectations — weighed mechanically on real estate investment trust valuations. We view Charter Hall's Q1 decline as primarily a rates-driven re-rating rather than a reflection of any change in its underlying business trajectory.

Sumitomo Pharma fell by 11.8%. The Japanese pharmaceutical company has built a compelling position in oncology, with its flagship drug Orgovyx generating strong commercial results. In Q1, investor sentiment softened as the market reassessed the pace of growth in that franchise and the timeline for broader pipeline contributions.

1Q 2026 Shelton International Select Equity Fund Commentary

Outlook

The case for international developed small-cap equities entering Q2 2026 is more nuanced than it was entering Q1, but we believe the structural opportunity remains intact — and in some respects, the March selloff has made it more compelling from a valuation standpoint.

The macro headwinds are real. The Iran conflict and Strait of Hormuz disruption have injected meaningful uncertainty into the European growth and inflation outlook, prompting a sharp reversal in central bank expectations from easing to potential tightening. Energy-import-dependent economies — much of continental Europe and Japan — face genuine margin and consumption headwinds if elevated energy prices persist. For smaller companies, which have less ability to pass through costs rapidly and more limited access to capital markets in volatile periods, these dynamics create near-term risk.

But the structural tailwinds underpinning the international small-cap opportunity set have not reversed. The AI-driven capital expenditure cycle continues to generate real demand for precision manufacturing, networking infrastructure, industrial automation, and specialty materials — all areas where the international small-cap universe offers significant exposure at valuations well below their U.S. counterparts. Japan's governance reform story, Europe's defense and infrastructure spending program, and Australia's resource and infrastructure exposure all represent durable, multi-year investment theses that one quarter's geopolitical shock does not diminish.

We are managing the portfolio with this duality in mind: attentive to near-term energy cost and demand risks, particularly within European consumer-facing and manufacturing-intensive positions, while maintaining our conviction in the structural growth stories that we believe will drive relative performance over a full investment cycle. Disciplined stock selection and active risk management — the same principles that guided us through the volatility of 2025 — remain the core of our approach.

Sources: Bloomberg, MSCI, J.P. Morgan, StreetAccount, Morningstar, Shelton Capital Management internal attribution. Fund performance is preliminary and unaudited. Benchmark: MSCI World ex-USA Small Cap Index. Past performance is not indicative of future results.

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