# Shelton International Select Equity Fund

QUARTERLY
Commentary
As of December 31, 2023

## Market Commentary

International equity markets posted solid returns in 2023, albeit not quite as strong as US markets. Given the degree of economic uncertainty in the year, the more cyclical, less growth-oriented composition of non-US equity markets explains much of the difference in performance. Valuation spreads between international and US markets remain near historical highs, and the potential for international outperformance in the near future remains high.

A big headwind for international markets has been their proximity to multiple crises around the world. The war between Russia and Ukraine looks to be headed to a quagmire, with support beginning to wane from the West, and the Middle East has erupted in conflict centered around the Israel-Palestine conflict, affecting shipping lines and potentially oil prices. In Asia, while open conflict has not occurred, saber-rattling between Taiwan and China has catalyzed a trade war as Western nations shift trading relationships away from the Far East and back home or to closer, friendlier partners.

For much of the past several decades such crises have been buying opportunities, and these may prove to be so as well. For the moment these trends have been inflationary, propping up producer costs around the world, be they from commodity, manufacturing or transport.

While the inflation picture on the supply front looks murky, most Western nations have successfully managed inflationary forces on the demand side. The Federal Reserve signaled in the fourth quarter that rate hikes are likely over, and markets have looked forward to when rate cuts may begin. Europe and the UK have been a quarter or two behind the US with rate cuts expected to begin in the summer and fall.

Meanwhile on the other end of the world, great change is stirring the markets of a longtime dormant economic power. Japan is grappling with inflation as well. While a peak of 4.3% inflation might not sound like much to the rest of Western economies, to an economy embroiled in deflation for decades it is a welcome relief. If these levels show resilience, the conversation continues whether the Bank of Japan will relax the grip it has had on the yield curve for the past 7-8 years and let rates rise.

Such a rise would and has had a dramatic effect on the market. Changes in the difference between the US and Japanese interest rates is the primary driver of capital flows between the two countries, and if Japanese rates continue to climb, the dollar will weaken.

Even more interesting is what is going on in the Japanese equity market. In 2024 we will see increasing effects of a reform program initiated by the Tokyo Stock Exchange. The TSE has mandated that firm improve their book value and return on capital or jeopardize their listing on the exchange. Japanese firms have lagged behind their global peers in these measures thanks to a great deal of cross-holdings and general neglect of shareholder interest. These reforms will bring change to those practices, and potentially better returns for investors in Japanese equities.

**Performance**

The Shelton International Select Equity Fund (SISEX) returned 9.95% (net) in the fourth quarter of 2023, outperforming the MSCI All-Country World ex-US Index return of 9.75% by 0.2%. For the year, the fund returned 13.97% (net), compared to a return of 15.62% for the benchmark.

Stock selection remained strong during the quarter but was offset by some of the country and sector exposures in the portfolio. Emerging Markets, an overweight for the portfolio, did not keep up with developed markets during the quarter.

Deutsche Post, parent company of DHL returned 16.4% last quarter. The firm is a beneficiary of lower inflation, and management compounded that benefit by improving their business mix, focusing on the higher quality express delivery and eCommerce segments.

Kia Motors (000270 KS) is an emerging market position that did produce returns, up 29.5% in USD. Kia finished out the year strong after Hyundai (Parent Company of Kia) sold its plant in Russia which had suspended operations since March 2022 due to the war with Ukraine. Though the sale was at a loss of about $200M, investors seemed to appreciate that the uncertainty about the future of the plant was put behind them.

Another strong position was Associated British Foods (ABF LN). Solid third quarter results featuring improved margins, especially for the Primark brand, topped off with a 500 million pound buyback program propelled the stock up 21.8% in USD.

Ping An Insurance (2318 HK) was a negative contributor, down 21% in USD for the quarter. With the Shanghai CSI 300 stock index down 11.8% last year, and down 40% from its peak in 2021, many insurance companies in China have experienced weak performance in their investment portfolios.

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## Portfolio Managers

**Derek Izuel, CFA**

Derek Izuel, CFA is Chief Investment Officer and a Portfolio Manager of the International Strategies. He has over 24 years of portfolio management experience at Invesco, HighMark Capital and Vitruvian Capital. Derek earned his MBA from the Ross School of Business at the University of Michigan and a B.S. in Computer Science from the University of California at Berkley.

**Justin Sheetz, CFA**

Justin Sheetz, CFA is a Portfolio Manager of the International Strategies. His experience includes 12 years as an Investment Strategist at Blackrock/BGI's Scientific Active Equity Group, 3 years as VP and Equity Analyst at HighMark Capital and 3 years as partner at Vitruvian Capital.

**Tony Jacoby, CFA**

Tony Jacoby, CFA is an Equity Analyst of the International Select Equity Fund. He has a B.A. in Economics from the University of Colorado Boulder and is currently pursuing an M.S. in Applied Mathematics with an Applied Probability concentration at the University of Colorado.

Denso (6902 JT), the Japanese automotive parts manufacturer was down 6% in USD in the fourth quarter. In response to the Tokyo Stock Exchange mandated reforms Toyota has been selling down their cross holding in Denso. At the same time, Denso is one of the firms best positioned to improve their ROIC and book value to accommodate these reforms.

Wuxi Biologics (2269 HK) was down 35% in USD in the fourth quarter. The Hong Kong based biotech firm experienced funding shortfalls that forced them to cut back on their product pipeline, while at the same time suffered delays in some ongoing projects due to regulatory changes.



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