Aquila Tax-Free Fund For Utah

PODCAST TRANSCRIPT

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Interviewer:
Hello everyone. Welcome to another Aquila Group of Funds podcast. I'm your host, Matthew DiMaggio. Today we are joined by JT Thompson, Lead Portfolio Manager of Aquila Tax-Free Fund For Utah. We will be discussing the current municipal environment, both broadly and on the state level. Thanks for sitting with us today, JT.

JT Thompson:
Thank you, Matt. Look forward to this.

Interviewer:
Great. And just to start, this year, so much has happened in the fixed income market and really beyond. Can you speak to how the municipal bond market has transformed this year?

JT Thompson:
Well, Matt, municipal prices have been dragged down by higher Treasury interest rates. But in the municipal markets, demand has remained strong. And in so far this year, across the country, issuance is down about 16%. Here in Utah, it's down nearly 19%. If you start looking at how municipal bonds trade relative to U.S. Treasuries, it gives you a feel of the strength of the municipal market. According to published statistics, the five-year AAA municipal bond is currently trading at 76% of the five-year Treasury. And since our portfolio duration is generally in the five-year range, that's why I'm using that. Over the last year, the high was 91% of the U.S. Treasury for the AAA municipals. The mean is 64%. So, we have seen relative strength. And as investors are looking for tax-free income, the municipal market has remained strong.

Interviewer:
Great coverage, JT. Thank you. So the headline topic for fixed income this year has really been interest rates and inflation. Of course, it's not possible to say exactly what the Federal Reserve ("the Fed") is going to do going forward, but give us your thoughts on their current position.

JT Thompson:
Well, as we all know, the Fed is aggressive in raising rates. They said that they're going to stay aggressive going forward. Just recently, the November Consumer Price Index and Producer Price Index numbers indicated a slowing of the inflation rate, and the fixed income markets responded positively to that. I think we can expect the Fed to continue to increase the federal funds rate. The fed funds rate mainly affects short-term rates, and usually mortgage rates more so, as we've seen an inverted yield curve. One thing that the Fed has done is put the income back into fixed income. A year ago, you were lucky on a AAA 10-year municipal bond to get over 1%. Today, you may be getting over 3% on that same AAA 10-year municipal bond.

Interviewer:
So, in a year with such uncommon circumstances, I believe it's understandable for investors to be a bit turned around at this point. Can you address what the key market drivers are that are currently at play?

JT Thompson:
I think paralysis. I think investors in both fixed income and equities have seen the volatility and drop in prices, and they're afraid or concerned about losses. But one of the things that they're overlooking are the opportunity costs of just sitting on the sidelines. As I mentioned above, right now, you're starting to get some decent returns on a AAA 10-year municipal bond that's double tax-free (income generated by municipal bonds is typically exempt from federal income tax, and may also be exempt from state and local income tax, depending on whether you are a resident of the state in which the bonds are issued). And taking advantage of those opportunities, I think going forward, I wouldn't jump into the deep end of the pool. But as you see opportunities to start investing, it may be a good sign.

Interviewer:
Yes, an interesting take there on the investor mindset. I want to talk now about credit strength and the municipal bond market, both at the national level, and if you feel there ae any details at the Utah level. And that's for anybody who may be concerned about the state of the economy. How would you assess the condition of our credits here in the country?

JT Thompson:
I think when you look at upgrades versus downgrades, credits across the country are stable, if not firm. Credits in bonds that are rated, Utah-rated bonds appear to be strong. Utah has a constitutional amendment that they need to have a balanced budget. So, issuers in Utah are very hesitant to issue a lot of debt because they have to balance their budget. The State is very protective

of their AAA rating and look at it very carefully, and it wants to guard that AAA rating. The last few years, the economy here in Utah has been very strong, and the State on capital projects has been using “pay as you go.” The Treasurer just came out and said, “Well, if we see a downturn in the economy, we may have to issue bonds for capital projects.” Utah will only issue bonds with a final maturity out to 15 years. They’ve always said, “Look, if we can’t pay it in 15 years, then we’re not going to issue debt”, where most states will go 30-40 years. But that’s just the conservative nature of the State of Utah and is why the credits here are fairly strong. There have been some bonds issued that were for infrastructure, what we call “dirt bonds,” or developers putting in infrastructure and hoping to sell the properties. Those are not rated. They’re more risky, but they don’t fall into the way most of the issuers in Utah are.

Interviewer:
Great stuff, JT. And I just want to close out today’s podcast, if you will, by covering the Utah Fund’s strategy and outlook.

JT Thompson:
We’ve always felt that a high-quality, intermediate-term fund help mitigate volatility in the markets. By having high-quality holdings, that gives us the liquidity. The intermediate sector allows us to, again, mitigate some of the volatility that comes along.
As we go forward, we’re going to look at opportunities in that intermediate sector as they come along, and again, stick to the higher-quality issuers and focus a lot on Utah credits. Most of the investors in the Fund, they prefer to have a high percentage of Utah credits. As we know, we do have reciprocal states, and we will buy from those states when we believe it is advantageous for the investors.

Interviewer:
And with that, that is all for today’s podcast. JT, thanks again for taking the time to discuss the municipal bond market with us.

JT Thompson:
Thanks, Matt.