Aquila Churchill Tax-Free Fund of Kentucky

PODCAST TRANSCRIPT

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Interviewer:
Hello, everyone. Welcome to this installment of our Aquila Group of Funds podcast. I'm your host, Matthew DiMaggio. Today, we'll be discussing the municipal markets with Royden Durham, Portfolio Manager of Aquila Churchill Tax-Free Fund of Kentucky. Thank you for joining us today, Royden.

Royden Durham:
Thanks, Matt.

Interviewer:
So, Royden, it's no secret that 2022 was a challenging period for the fixed income markets, but hopefully the worst is behind us. Zeroing in on municipals though, in your view, how is 2023 shaping up so far?

Royden Durham:
Well, the 2022 market performance was a real Jekyll and Hyde affair, with a downdraft beginning the year and ending by the end of April. From that point, we rallied with some bumps along the way, particularly in October. Basically, the Federal Reserve (the "Fed") raised the federal funds rate (the interest rate that banks charge each other to borrow or lend excess reserves overnight) last year, and I think the MMD (Municipal Market Data) 10-year yield curve ended January 30, 2023 at 219 basis points, and closed on July 29, 2022 at 223 basis points, virtually unchanged over the six/seven-month period. Of course, things have become more volatile since the end of January.

Interviewer:
Thanks, Royden. Looking forward to seeing how the remainder of the year plays out. So, as we look at the municipal bond market today, what would you say are the leading factors driving the market?

Royden Durham:
So, Federal Reserve Chairman Powell has been adamant that the Fed will raise rates higher and for a longer period, but some inflation trends, lower and robust jobs reports have tugged the Fed in two different directions. At the February Federal Open Market Committee ("FOMC") meeting, most analysts thought the Fed would raise rate 50 basis points, but a week before the economic numbers, they changed and the Fed raised rates by only 25 basis points. Two weeks later, Powell's stern testimony before Congress had the Fed raising 50 basis points at the March 22 FOMC meeting. But now with bank failures looming, we're talking about 25 basis points and tightening ending by the third quarter of this year. It's really a moving target with volatility thrown in. Amazingly, the muni market has been less affected and less volatile than the Treasury market, but that's come at a cost of the Municipal-to-Treasury ratios. Currently, that ratio is about 67%, the U.S. Treasury to AAA muni scale in the 10-year maturity. The median valuation for the 10-year over the past seven years is about 92%.

Interviewer:
Really such an interesting time in that Federal funds cycle. Since we're on the topic of interest rates, municipal bonds, of course, are not immune to changes in the rate environment, and so much has taken place on the yield curve there. So, as you look at the yield curve currently, where do you see value, potential opportunities or any attractive risk-adjusted returns?

Royden Durham:
So, Kentucky supplies really dried up over the first quarter of 2023, down through the end of February, according to *The Bond Buyer* by 80%. Well, the national issuance is only down 28%. Not that that's good. This has driven spread relationships narrower for Kentucky paper, since the usual higher spreads of Kentucky paper garner much national attention. Occasionally, secondary paper in the highly volatile market has presented some buying opportunity, but dries up quickly. Some year-to-year new issuance, with maturities in the 9- 14-year range have some allure for us. This is longer than the saucer-shape for the first time, or a cup-inverted yield curve we're experiencing in the sector.

Interviewer:
And thank you for being specific, drilling down to Kentucky. If we could, let's talk about Kentucky a little bit more. What are the latest developments impacting the local economy and/or the municipalities themselves?

Royden Durham:
So, the big news, which garnered national attention over the quarter, has been the funding of the Brent Spence Bridge in Cincinnati. The project will be funded by $1.6 billion in federal funds, and commences this year and wraps up in 2029. The entire project is supposed to cost about $3 billion, and have no idea what costs are allocated to Ohio versus Kentucky. One would think that the Ohio access will cost more, but really don't know. Since funding for the Louisville Bridges came through the Kentucky Asset and Liability Agency, my guess is that that'll be the entity that handles the funding. By the way, Kentucky General Fund revenues, when adjusted for an offshore gambling settlement in 2022, are up 8.8% through the end of January. The fiscal year, by the way, begins on July 1, and the legislature has cut Kentucky State income taxes by another half a percent for 2024, as a result of revenues meeting the statutory financial goals outlined in the fiscal year 2023 legislation.

In other economic news through the State, the Kentucky Small Business Credit Initiative is releasing $117 million over the next 10 years to support venture capital projects in Kentucky. The funding is provided to help businesses that were affected by the shutdown experience during the COVID-19 pandemic. Also, Kentucky's unemployment rate as of December 2022 was 3.9%, the historical record low. The national unemployment rate in December 2022 was 3.5%. Kentucky also placed second nationally in economic projects per capita in 2022. Envision Automotive Energy Supply Corporation, Ford Motor and Novellas Corporation were all recognized with 2023 outstanding corporate and community economic impact awards from a trade magazine called Trade and Industry Development. So, the Ford Super Duty plant will cost about $700 million. That has a huge economic impact. The Novellas Corporation, which is a recycling center for batteries, will cost $365 million, and Envision is building a $2 billion electric vehicle battery plant.

Interviewer:
Fantastic insight on Kentucky. Really appreciate that, Royden. I just have one more question for you. Given all that you've shared today, what would you say are the key takeaways from this conversation?

Royden Durham:
The Fund's aproach over the past year, using its tenets of local management, high-quality and intermediate-term maturity, drove our performance from a total return perspective. Value in the Kentucky market does exist but it is increasingly hard to uncover. And Kentucky is on a roll from an economic, legislative and labor perspective, with lower state taxes, increased economic projects, and a 3.9% unemployment rate.

Interviewer:
Those are all the questions I have for you today, Royden. Thank you again, and thank you to all our listeners.

Royden Durham:
Been a pleasure, Matt.

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A credit spread is a difference in yield between two bonds of similar maturity, but different credit quality. Taxable equivalent yield is the return that is required on a taxable investment to make it equal to the return on a tax-exempt investment.

Yield is expressed as a percentage based on the invested amount, current market value, or face value of the security, and includes the interest earned or dividends received from holding a particular security. The yield ratio represents the comparison of the expected yield of one bond to the expected yield of another. A yield ratio is important when deciding whether to invest in one bond or another. Generally, the higher yield is considered better.

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