Aquila Narragansett Tax-Free Income Fund

PODCAST TRANSCRIPT

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Interviewer:
Hello, everyone. Welcome to this installment of our Aquila Group of Funds podcasts. I'm your host, Matthew DiMaggio. Today, we'll be discussing the municipal markets with Jeff Hanna, Portfolio Manager of Aquila Narragansett Tax-Free Income Fund. Thanks for joining us again, Jeff.

Jeff Hanna:
Glad to be here, Matt. Thank you.

Interviewer:
Fantastic. So, it's no secret that last year 2022 was a challenging period for fixed income markets, but hopefully the worst is behind us. I want you to zero in on municipals though. In your view, tell us how 2023 is shaping up so far.

Jeff Hanna:
Actually, 2023 is shaping up to be pretty positive for municipals. As you know, 2022 was challenging, but municipals actually held their own. So far in 2023, spreads have initially widened out a little bit, but have come back in. And there are a couple of factors for that. One certainly is lack of supply. So, I think that's certainly been something weighing on people's minds. But the municipal market relative to all the volatility and the general fixed income markets, particularly in the U.S. Treasury market, actually held in pretty well.

Interviewer:
Really looking forward to seeing how the remainder of the year plays out. Thank you for the overview so far. As we look at municipals today, what would you say are really the leading factors driving the muni market?

Jeff Hanna:
Certainly, the Federal Reserve (the "Fed") and interest rates for sure, right? Because with the Fed's tightening, continued tightening, certainly those impacts from the Fed. And again, the Treasury markets do pretty much drive all fixed income markets. So, I'd say those are definitely among the key factors, and key drivers. Inflation clearly is at the top of mind for the Fed, and top of mind for folks, particularly those folks who invest in municipal bonds. I think seasonal trends are also part of that. We have a decrease in municipal bond issuance. We have a move to alternative investments. We do have some disintermediation going on, particularly in the short end of the market.

So, I think from that standpoint, those are really three key drivers. Secondarily, I think economic growth and pending recession, as everyone's been talking about has some impact. But I think less so than the first three drivers. And credit fundamentals are still relatively strong for states and municipalities, although I think that's probably peaking. And clearly, supply and demand. There's obviously more demand out there than supply. It more recently has kept spreads tightening quite a bit on municipals. But again, relative to the move we've seen in the Treasury markets, I think that adjustment has been actually beneficial for municipals, as I believe they look a little bit better relative to Treasuries.

Interviewer:
And really, really such an interesting time in the municipal markets. You touched on interest rates, Jeff. Municipal bonds, of course, aren't immune to the changes in the rate environment, and really so much has taken place on the yield curve in the last year or so. So, as you look at the yield curve currently, do you see any value opportunities or attractive risk adjusted returns anywhere?

Jeff Hanna:
Yeah, I think so. I think part of that has to do with where the Fed decides at some point to pivot. So, from a duration or a maturity standpoint, clearly, I think there's value on the longer end of the curve. What's interesting to note is, historically, there are very few periods of time where you see an inversion in municipal rates. And we actually have seen that, and it tends to be in the shorter end. When you look at two, three, four years, and even out to five years, there's a little bit of an inversion in that yield curve, but it starts to steepen out as you get toward the longer end.

So, once you get beyond 10 years, there's a fairly steep incline. And I think there's definitely some value there. Credit quality, as I mentioned—I think we may be at the peak there, but there really hasn't been much in the way of concerns over that. And I think over the next couple of years, we should be fine. The municipal-to-Treasury ratio more recently has been bouncing on the historically low-rate levels or low-percentage levels, but we've more recently seen that back off a little bit. So, munis look a little more attractive on a relative basis.

Interviewer:
Thanks, Jeff. I want to shift gears a bit and talk about Rhode Island. What are the latest developments impacting the local economy and the State, or the municipalities themselves?

Jeff Hanna:
I think from that standpoint, the economy here looks pretty good. Unemployment is at historically low levels. And I think we have seen some increase in the participation rates here in Rhode Island and folks working, folks that live in the state. The ARPA (American Rescue Plan Act) funds that we've received have been very well-managed and have not been spent like they have in the number of other states. Tax receipts have continued to increase. Part of that is we've also seen spending decrease. But I think that figure is going to start to top out as far as the tax receipts.

Unemployment is at all-time lows, and that's actually been positive from the State's standpoint. And I think the State's actually started to focus more on the blue economy. And what I mean by that, or what is meant by that, is that you have a number of industries that are driven, as we are The Ocean State, by those related or folks who make their living or use the ocean for those purposes, whether it's staging the wind turbines for offshore power. There's also a number of initiatives related to the science field here as well, in Providence in particular. And I think there's a lot of other good momentum that the economy has here in Rhode Island that will keep us moving in the right direction.

Interviewer:
Great insight on Rhode Island, Jeff. I have just one more question for you. Given what you've shared today, what would you say are the key takeaways from the conversation?

Jeff Hanna:
Well, I think some of the key points in the conversation here really is that Rhode Island is actually looking pretty good. We're in pretty good economic shape. I will say supply of bonds has been very difficult. There's been one issue in the last five months. And then if you're looking at where Rhode Island is nationally, issuance, municipal issuance on a year-to-date basis is off about 20%. Rhode Island is off even a little bit more than that. I'll expect issuance may start to pick up as we get a little bit closer to the end of the second quarter.

Again, it's important to note that you need to keep an eye on what's going on around the State. The yield curve certainly presents some challenges, but it also presents some opportunities. And there's definitely value to be found within and along the yield curve. And I think also that realizing where the value is with respect to Treasuries. Again, with a lot of disintermediation, particularly lately with what's been going on in the banking and financial world, folks have to take a step back, realize where the value is, and then execute.

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

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