



# Aquila Tax-Free Trust of Arizona

## PODCAST TRANSCRIPT

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**Interviewer:**

Hello, thank you for being with us on this installment of the Aquila Group of Funds Podcast. I'll be your host today, Phil Felice. I'm the Director of Internal Sales here at Aquila Group of Funds. And joining me is Tony Tanner, Portfolio Manager of Aquila Tax-Free Trust of Arizona. As we are known to do, we'll be discussing all matters regarding the municipal bond markets and touching on the local Arizona economy. So, let's start off. Welcome Tony, and thanks for sitting down with us. Welcome, Tony, and thank you for sitting down with us.

**Tony Tanner:**

Good morning, Phil. Thanks for having me aboard again this morning.

**Interviewer:**

Yes, always great to have you. And I say, let's start broadly with the current assessment of the municipal bond market. How would you describe the present state of the municipal market?

**Tony Tanner:**

Well, in describing it here in the middle of October, following the most recent upward move in market yields both in the Treasury market and the municipal market, I would say the best way to describe the present state is that it's somewhat unsettled.

**Interviewer:**

And so, within that, Tony, what would you say are the key factors driving the municipal bond market?

**Tony Tanner:**

Well, Phil, I think the best way to answer that question would be to first talk about what's not driving municipal bonds right now. I would say that supply/demand dynamics are fairly good and in balance. Issuance is down modestly this year with the higher interest rate environment. And so, the municipal market is not having any significant challenges with absorbing supply. Trading in the secondary market has been very brisk and robust. And so, liquidity, I find to be particularly good in light of the fluctuations in the market. Credit fundamentals generally remain strong. So, those are things that really aren't creating any worries or driving municipal bonds.

The thing that's primarily driving municipal bonds and the fixed income markets in general are inflation concerns and the Federal Reserve's monetary policy. And to that, one of the things I would point out is that since the end of May, we've now had four consecutive months where the Consumer Price Index has been reported below 4%, which compared to the same time a year ago where we were consistently reporting inflation between 7% and 8%. I do think that the Fed's monetary policy has to some degree broken the inflation fever and brought it down from those high single digits to something more manageable in the 3% to 4% range. That's still a little higher than I guess the Federal Reserve wants and it's keeping investors nervous.

And so, the other thing is again, with Fed policy and, in particular, the downgrade of the U.S. credit rating back earlier this summer, that's going to create, I think, a period of rates staying somewhat elevated, partly because the benchmark Treasury is no longer the pristine AAA it was. And so, there's a lot more for investors to consider. But I would say that this break in the inflation fever into the 3% to 4% range is welcome, especially in relation to where tax-free market yields have found themselves here in October.

**Interviewer:**

So, you brought up inflation compared to a year ago. Let's stay on that and add some context and perspective to the market. How do you view the current market, say, like last year at this time, or even during previous market cycles?

**Tony Tanner:**

One of the ways I look at it is through both a recent and long-term perspective. If you go back to late-summer/early-fall in 2021, we were still in a period where the highest quality 10-year municipal yields were only in the 1% to 2% range, which is somewhat problematic when you know that the long-run rate of inflation has always sort of been around 2%. And so, it was an environment where it was really difficult to attain what are considered to be real yields that help protect purchasing power. Today, even though the inflation rate is higher, the environment for market yields is decidedly more favorable, with 3% and 4% high-quality municipal yields prevalent. And so, within the context of long-run inflation considerations, there's some real value to the yields that appear to be emerging. In a forward-looking perspective, the ingredients for income investing, I think, have become more favorable than we've seen in the last two to five years.

**Interviewer:**

So, a lot of interesting stuff there, Tony, to unpack. But I do want to switch gears and focus a little bit on the Fund's investment strategy. And I want to talk a little bit about what goes into evaluating the municipal market, the bonds held in the portfolio, and identifying new opportunities in managing risk. If you could speak a little bit about just day-to-day investment strategy.

**Tony Tanner:**

Well, That's a good question, Phil. And the operative word there is managing risks. It's important when you are managing an investment vehicle that has the capacity to attain broad diversification, that you are indeed thoughtfully managing and engaging risk, and not necessarily simply avoiding it. And so here at Aquila Group of Funds, not only in Arizona but across our product line, we engage in very deliberate active management, again within the higher-quality, intermediate space. But even within those relatively conservative vantage points, we're finding relatively attractive values.

And then, of course, the taxable equivalent yield. If you were in a 33% tax bracket, it would put you closer to 6%. And so, that's a favorable environment for our disciplined, high-quality, intermediate approach. And we are very carefully looking at the shape of the yield curve to identify and obtain value there. Sometimes it's important to avoid having too much in fully-valued sectors of the curve. And so, we think having broad maturity diversification is important, as well as broad coupon diversification now that there's a wide variety of coupons and market yields out there from which to choose. Again, being locally-based helps us out a lot because we can see, "on the ground," certain sectors and issuers where these values are amplified, whether it be local school districts or higher education bonds. We're finding this to be a very favorable time for Aquila's careful approach to these obviously tumultuous markets.

**Interviewer:**

As we always do, and we always talk about, what are some of the latest developments impacting Arizona's local economy and the municipalities?

**Tony Tanner:**

Phil, I want to touch upon a couple of important trends that are somewhat below the waterline in terms of attention, but are really what are driving the local economy. The first is what I'm going to call the migration of wealth and decision-makers to the State. I came upon a couple of interesting studies recently that really characterized this. The first was a study of IRS income figures, and it showed that in the last five years, over 200,000 tax-filers, with a combined Adjusted Gross Income of \$22 billion, have net relocated to the State. That's third in the nation behind only Texas and Florida. And it's really interesting to compare that to Texas, because on a per capita basis, that amounts to about \$3,000 of additional wealth income per capita. In Texas, the \$30 billion they received was only about \$1,000 per capita. So, the State of Arizona is clearly becoming wealthier, but not just from retirees.

The Hoover Institute came out with a really good study last year about California company headquarter relocations. And in that study, it showed that among 350 California headquarter relocations from 2018 to 2021, Arizona attracted the fifth-largest number of those headquarters—21, trailing only, Texas, Tennessee, Nevada and Florida. And so, decisionmakers that really impact the quality of jobs are also moving here. And so, that's a really important trend of the State.

The second trend that I'm seeing, which again kind of flies under the radar screen, has to do with the quality of education in the State. And one of the interesting outcomes from the pandemic showed just how resilient Arizona's higher education system is. From the outset of the pandemic to September of 2022, I believe Arizona was one of only eight states to achieve public university enrollment increases. And with Arizona State University standing as a well-recognized innovation leader, that's a really important component of what's going on with the economy.

Interestingly, is the growth of the increase in the workforce education in the State. The commercial real estate entity, CBRE Group, just put out a study that showed that Arizona ranked third in the nation over the last five years in terms of the increase in residents in their thirties with a college degree. And that increase was 32%. And so, we're becoming a very highly-educated workforce, which is very important when you look at how the State has evolved into what I call the nation's "smart manufacturing hub." We're seeing very strong employment figures in the semiconductor and other related industries. One of the interesting things that I saw in a recent study showed that within the Phoenix area, there are over 140,000 jobs related to semiconductors and precision electronic components. That compares very favorably to a place like San Jose, with an employment of 180,000.

And I would say the final trend that's really helping affect the State is continued growth in healthcare and a pretty resilient real estate market. Housing prices have moved actually fairly sideways since the beginning of 2022. And we're seeing healthy construction growth in multifamily residences. So, overall, a really good tone to the economy supported by a variety of important industry sectors.

**Interviewer:**

So, we covered a lot there. We talked about the macro, we talked about the Fund strategy, and then we took a look at Arizona itself. So, can you briefly summarize maybe a few takeaways for our listeners and what those items would be?

**Tony Tanner:**

Sure. I'll kind of go in reverse order. What's going on "on the ground" here in Arizona in the economy is a confluence of really important trends around high-quality manufacturing, and grid stability, given that we have very few outside disruptions to our power grids. And it's reminding me a lot of what you had seen in Silicon Valley in the mid to late-'70s, when the confluence of a lot of research within the personal computer industry was developing. And so, I think it provides a real good outlook for growth in the economy, and innovation in the economy.

Also, in terms of what we're seeing within the municipal bond market itself, it's really a great time to stick to quality investment yields, and even the highest-quality sectors are very attractive relative to inflation. And it's also a great time to engage your financial advisor and professional managers in the municipal bond asset class to help sift through where the best values are and how to take advantage of those values.

**Interviewer:**

Thank you, Tony. And as always, it's great to hear your perspective on all of these items. Have a great rest of your year, and it's a lot for us to consider as we come here on the tail-end of 2023, looking into 2024. Thanks, Tony.

**Tony Tanner:**

Thanks Phil, and thanks for letting me share some of this valuable information with our audience.

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