Hawaiian Tax-Free Trust

PODCAST TRANSCRIPT

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Interviewer:

Aloha. Thank you for listening to this installment of the Aquila Group of Funds Podcast. I'll be your host today, Phil Felice, the Director of Internal Sales. Joining me today from Bank of Hawaii is Reid Smith. He's the Vice President and Director of Fixed Income at the Bank of Hawaii, as well as the Lead Portfolio Manager of the Hawaiian Tax-Free Trust. As always, we're here to discuss the municipal bond market, as well as the local Hawaii economy. Reid, thank you for joining us today, and thank you for being on.

Reid Smith:

I appreciate the opportunity to be able to share some information today about Hawaiian Tax-Free Trust.

Interviewer:

So, let's dive right in. It's fair to say it was a quarter in Hawaii unlike any other, that I know the people of the islands have experienced. So, why don't we begin with discussing the wildfires that occurred in Maui. Some time has passed, so can you provide the latest update on the potential effects that they've had on Hawaii bonds in your view, both for a short- and long-term perspective?

Reid Smith:

This summer, Maui County suffered a terrible and tragic natural disaster. Wildfires destroyed numerous buildings across the island of Maui, devastating the town of Lahaina and taking precious lives. Although it is a difficult and traumatic time for the community, "Maui Strong" resonates to rebuild homes, businesses, and infrastructure. In the long term, Maui will be rebuilt, but in a unique way, consistent with the needs of the residents and culture of the islands. Although it'll never be the same, during the next several years, we believe Maui will experience an economic renaissance, as the island returns to the beautiful destination which it's known and loved for around the world.

As for the impact on the Trust's portfolio, we believe that Maui County credit remains solid, with the first call on property tax revenues from Maui, Molokai, and Lanai. Through the third quarter-end, there have been no downgrades on Maui County credit, and the market trading generally remains at normal levels.

Hawaiian Tax-Free Trust does not hold bonds directly issued by Hawaiian Electric Industries or Hawaiian Electric Company. However, the Trust historically held an allocation in bonds issued by the State of Hawaii Department of Budget and Finance for the benefit of and guaranteed by Hawaiian Electric Company. These loans were not obligations of the State of Hawaii or any subdivision of the state or counties. All exposure to the State of Hawaii Budget and Finance, Hawaiian Electric Bonds are supported by discrete loans from three underlying subsidiaries located on Oahu, Maui and Hawaii, with a wrapped guarantee from Hawaiian Electric Company for all the debt.

The portfolio allocation to these bonds was reduced approximately 60% since the Maui fires. The bonds still held in the Trust have no or limited underlying loans attributable to Maui Electric. For further information regarding Hawaiian Tax-Free Trust's portfolio holdings, please refer to Aquila Group of Fund's website at www.aquilafunds.com. For additional information, please also refer to "Maui Wildfires and the Potential Impact."

Interviewer:

Thank you for that color on the incident, Reid. Let's now talk about things from more of a macro perspective and for a current assessment of the municipal market. How would you describe the present state of the municipal market?

Reid Smith:

Well, our current assessment of the Hawaii municipal bond market is opportunistic. Rates have been pushed higher from the activity of the Federal Reserve to tighten monetary policy back to a more normalized rate environment. After many years of sub-inflation returns from the high-quality fixed income investments, we now have yields providing a measurable and potentially durable return in excess of the rate of inflation. The Federal Reserve has signaled a reduction in further rate increases and recently has actually not even raised rates for the past two meetings that they've had. And they intend on maintaining the current rate environment for a longer period, slowly to push inflation lower. The Federal Reserve mantra seems to fit the current forecast of "higher for longer."

Interviewer:

So, along with all of that, because I know you kind of think it's threefold, what are the key factors currently driving the municipal market as you see them?

Reid Smith:

Exactly. Three factors converge to unsettle the market leading to the opportunity of higher yields. First, the economy remains strong and with improved employment. Second, we saw investor selling and municipal mutual funds increasing the available supply in the secondary market. And third, the municipal market entered its normal increased fall seasonal new bond issuance. With the economy humming along, increases in the amount of bonds available in the primary and secondary markets, yields have increased. We believe it has set the stage for the availability of Hawaiian municipal bonds at attractive yields, both in terms of absolute and relative value.

Interviewer:

Great, thank you. And to provide some context to that and some perspective, how do you view the current market, compared to, say this time last year or even during previous market cycles?

Reid Smith:

Well, looking back to last year, the market had forecasted a recession by the end of 2023. The yield curve shape factored in several cuts in the short-term interest rate of the fourth quarter. Well, here we are and no slowdown in sight. Still, the forecasters are looking for a downturn in the economy in late 2024. Even the Federal Reserve is concerned and is beginning to taper the future increases to keep rates stable and watch the data on the economy and inflation. Now is the time to focus on stability or sustainability of income. With the current rate environment fighting inflation, investing in longer term bonds allows the opportunity to look for current higher yields for a greater period of time.

Interviewer:

So, let's whittle down to Hawaiian Tax-Free Trust. And I want to ask you, as a Portfolio Manager of the Fund, can you talk a bit about the Fund's investment strategy? What goes into evaluating the municipal markets, bonds held in the portfolio, identifying new opportunities, managing risk—everything that goes into the day-to-day of managing Hawaiian Tax-Free Trust?

Reid Smith:

Actually, the interesting thing is the Hawaiian municipal market has provided remarkable opportunity. First, according to Bloomberg market data for the quarter ending September of 2023, the supply of new bond issuance increased at 190% in Hawaii, with $460 million in new issues. During the same time period, the 10-year Hawaii maturity rose from 2.7% to 3.8%. Hawaiian Tax-Free Trust has been participating recently in the lengthening of the average maturity of the portfolio to capitalize on both the availability of the Hawaiian double tax-exempt bonds, and to enhance income over a longer period of time.

Interviewer:

That's great stuff, Reid. You've covered a lot. You've shared some great insights. If you could briefly summarize a few key takeaways from our conversation for the listeners.

Reid Smith:

Sure. As I've already mentioned, the Hawaii municipal bond yields have risen to provide an attractive level of current income, which is enhanced by the tax exemption from federal and state income taxes. The Trust is diligently searching our Hawaiian bond opportunities in the national primary and secondary markets. We interface with over 35 different large and mid-size counterparties for broker- dealers across the country, competitively selecting top opportunities. We strive for best execution in assembling the portfolio to provide superior returns over time. At the end of the day, we tirelessly seek to maximize income and focus on stability of that income and principal invested. For over 35 years, Hawaiian Tax-Free Trust has been and still is managed by the same local portfolio advisor located within the state of Hawaii for the benefit of Hawaiian taxpayers. We know the local market and how to find the opportunities, and we believe this is a time of opportunity for investors.

Interviewer:

Great stuff, Reid. Thank you for joining us today and for the content. A lot to unpack on the municipal bond market and the local markets, and possibly where we might see things going from here. So, thank you. Mahalo for your time and have a great rest of your day, and a great rest of your year.

Reid Smith:

Thank you very much.

Thank you for listening to this podcast. The opinions shared are those of the portfolio manager and do not necessarily reflect those of the Investment Adviser or Administrator/Business Manager of the Fund.

Asset Management Group of the Bank of Hawaii is the Investment Adviser for Hawaiian Tax-Free Trust. Aquila Investment Management LLC serves as the Trust's Administrator/Business Manager.

Mutual fund investing involves risk. Loss of principal is possible. Investments in bonds may decline in value due to rising interest rates, a real or perceived decline in the credit quality of an issuer, borrower, counterparty, or collateral, adverse tax or legislative changes, court decisions, market or economic condition. Fund performance could be more volatile than that of the Fund's with greater geographic diversification. For more information on the entire Aquila Group of Funds, please visit www.aquilafunds.com.

The Fund seeks to provide a high level of income exempt from state and federal income tax, as is consistent with capital preservation. Past performance does not guarantee future results.

For certain investors, some dividends may be subject to federal and state income taxes, including the alternative minimum tax referred to as AMP. Please consult your tax professional.

Independent rating services such as Standard & Poor's. Moody's and Fitch assign ratings, which generally range from AAA, which is the highest to D, the lowest, to indicate the credit worthiness of underlying bonds in the portfolio. Where the independent rating services differ in the rating assigned to an issue or do not provide a rating for an issue, the highest available rating is used in calculating allocations by rating. Free refunded or escrowed bonds are issued to retire or regain an outstanding bond issue at a specific call date. Until the call date, the proceeds of the bond issuance are typically placed in a trust and invested in U.S. Treasury Bonds or state and local government securities.

Modified and effective duration both measure the value of the security in response to a change in interest rates. Effective duration is also taken into account, the effect of embedded options.

The weighted average life also referred to as weighted average maturity is a reflection of the quickness with which the principle of an issue is expected to be paid.

The 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.

For certain investors, net investment income tax known as NIIT may apply. NIIT is a 3.8% tax established by the Patient Protection and Affordable Care Act that applies to the lesser of the net amount income or a taxpayer's modified adjusted gross income above an applicable threshold amount.

Yield refers to earnings generated and realized on an investment over a specific period. Yield is expressed as a percentage based on the investment amount, current market value or phase value of the security, and includes the interest earned or dividend 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.

Before investing in a Fund, carefully read about and consider the investment objectives, risks, charges, expenses, and other information found in the Fund prospectus. The prospectus is available from your financial advisor, when you visit www.aquilafunds.com, or call (800) 437-1020.