Aquila Churchill Tax-Free Fund of Kentucky

PODCAST TRANSCRIPT

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Interviewer:

Thank you for joining us for another Aquila Group of Funds podcast. I will be your host, Matthew DiMaggio. Today we're joined by Royden Durham, Lead Portfolio Manager of Aquila Churchill Tax-Free Fund of Kentucky. Thank you for being here today, Roy.

Royden Durham:

Hi, Matt. How are you doing today?

Interviewer:

Doing fantastic myself. We, of course, have a few questions for you, so I wanted to start with a popular topic. The Fed's monetary tightening cycle here is, certainly from our perspective, a little unique. What's your take on how the economy and the markets look at this point relative to the tightening?

Royden Durham:

Well, Matt, since the 1st of January of 2023, the Federal Reserve [the "Fed"] has tightened, raised rates four times, and then paused at the June and September Federal Open Market Committee meetings. The upper band [of the Fed's target rate] is now 5.5% percent as of October 11, and it was reflective of the 5.55% yield on the six-month Treasury Bill, and the 4.74% yield on the 30-year Treasury Bond.

Inflation seems to be moderating, but the Fed is sticking with their mantra of keeping rates "higher for longer." The CPI [Consumer Price Index] year-over-year in August was 3.7%, June, the GDP [Gross Domestic Product] was 2.4% year-over-year, and October unemployment comes in at 3.8%, which is still very close to historic lows.

Generally, I would say no recession is on the horizon, and inflation tends to be sticky. With falling commodity prices, gold down, oil declining recently from about $94 a barrel to today at about $85, it's possible that a faltering Chinese economy could be bailing us out.

Also, recently, the dollar continues to be strong against the Euro, Pound and Yen. This generally is reflective of our higher interest rates versus theirs. If Germany's ongoing recession is any indicator, they may have to even lower their rates more, which would strengthen the Dollar yet again.

Interviewer:

Interesting stuff there, Roy. And it seems all fixed income at this point is in a different position with the changing macroeconomic landscape. And at this point, how do you see municipal bonds?

Royden Durham:

Well, the municipal market's reaction has been that we have the highest yields in 10 years. With the AAA Municipal Scale [as measured by Bloomberg], it's yielding a 3.51% [as of 10/11/23]. That same scale in July of 2020 was just over a half a percent, or 63 basis points. On July 1, the percentage of U.S. Treasury yield versus the 10-year AAA scale, was at approximately 66%, while today, it's gone up to about 74%. It's movement in the right direction, even though we have a bear market, but still richer than the 80%–85% we see historically.

Interviewer:

So, from our perspective, it seems the national municipal supply has begun to pick up a little bit here in the fourth quarter of 2023. How does supply in Kentucky, more specifically, compare?

Royden Durham:

So, through the end of September, Kentucky issuance is down 30%, according to The Bond Buyer. Nationally, issuance is down 12.9%. This has created challenges that dovetail with the odd ladle-shape of the yield curve. Since size in the short-end tends to be relatively small in Kentucky, competitive deals make it difficult to "barbell" the portfolio to avoid the dip from the 2–11 years in the yield curve. The portfolio does have shorter effective duration bonds, like $4 million Jefferson County School District bonds that are currently callable, and have had their premium amortized of the 7/1/23 call, with a final maturity in 2026—originally at a 2.9% yield. So, that bond is helping the portfolio with its current 4% yield until it either matures or is called.

Also, some things are just undervalued by our estimation. An A1-rated Anderson County School came in with a maturity date of 2032 and a 4.125% coupon. Seemed like a bargain at the time. The tide is turning on issuance, as we have a $300 million Louisville/Jefferson County Metropolitan Sewer District, and a $144 million Kentucky State Property issue on the calendar this week and next week. Over the summer, we were happy to diversify the portfolio with several school revenue bonds that came to market like Kenton, Dyer, Bullitt and Christian counties.

Interviewer:

And continuing on the topic of Kentucky, if you will, what are some of the latest developments that are impacting Kentucky's local economy or its municipalities?

Royden Durham:

Kentucky continues to be on sort of a roll. General revenues for the State through the end of August, with a fiscal year beginning July 1, is up 7.4%, and road taxes up even more at 9.7%. Even with these great revenue numbers, the State did not meet its goal for exceeding appropriations by 1% for the 2024 year, and as a result, the income tax rate in Kentucky will remain at 4% through 2025.

There are three Kentucky road projects in the works that should spawn new issuance. They are the Brent Spence Bridge Project, which is to be completed by 2029 at a cost of $3.6 billion, which includes federal, state and Ohio monies, along with Kentucky.

A second project, which Kentucky has allocated $265 million to is the I-69 Bridge in Evansville, Indiana, connecting with Henderson, Kentucky. Some public private funding may be used on this project, which mirrors the East End Louisville Bridge of several years ago.

The last of the three is the Mountain Parkway, which needs an additional $400 million to complete. Each of these projects is ripe for some sort of Kentucky municipal issuance, I feel.

Interviewer:

Roy, for one last question, can you share how Aquila Churchill Tax-Free Fund of Kentucky is being positioned?

Royden Durham:

Sure, Matt. The Fund has improved its AA rating bonds, from 32% in April to 63% currently of the portfolio, as a result of the May and June upgrades by Fitch and Standard & Poor's. If we end this cycle in a recession, this would help insulate the portfolio from credit concerns and help prop up our bond prices where concerns of lower-rated bonds filter down through the market. The slightly more than a 7.5-year weighted average maturity, the modified duration of 4.5 years tends to be helpful in a bear bond market. Our maturity ladder and effective duration bonds are callable, which seeks to enable us to take advantage of the higher yields as they roll off and mature over the next few years.

Interviewer:

That's all today for this Aquila Group of Funds podcast. Thank you again for joining us, Roy.

Royden Durham:

Thank you, Matt.

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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.

Information regarding holdings is subject to change and is not necessarily representative of the entire portfolio. A complete list of the Fund's current holdings, including percentage allocation, is available on our website and by contacting Aquila Group of Funds. The following securities referenced were portfolio holdings of Aquila Churchill Tax-Free Fund of Kentucky, represented as a percentage of the Fund's total portfolio, as of 9/30/23: Jefferson County School District Finance Corp.: 7.80%; Kenton County School District Finance Corp.: 1.78%; Christian County School District Finance Corp.: 1.20%; Anderson County School District Finance Corp.: 0.65%; and Bullitt County School District Finance Corp.: 0.43%.

For certain investors, some dividends may be subject to federal and state income taxes, including the alternative minimum tax referred to as AMT. And 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 investment income, or a taxpayer's modified adjusted gross income above an applicable threshold amount. Please consult your tax professional.

Independent rating services such as Standard & Poor's, Moody's, and Fitch assign ratings which generally range from AAA highest to D lowest, to indicate the creditworthiness 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. Pre-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 a security in response to a change in interest rates. Effective duration also takes 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 principal of an issue is expected to be paid.

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.

The Municipal Market Data ("MMD") yield curve is generally considered the most widely-referenced yield curve in the municipal bond market, consisting of AAA-rated general obligation bonds.

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