Hawaiian Tax-Free Trust

PODCAST TRANSCRIPT

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Interviewer:

Hello everyone. Thank you for joining us for another installment of the Aquila Group of Funds podcasts. I'll be your host today, Matthew DiMaggio. Today we are accompanied by Reid Smith, Portfolio Manager of Hawaiian Tax-Free Trust. Thank you for being here with us today, Reid.

Reid Smith:

Thank you for having me.

Interviewer:

Fantastic. Jumping right in on a big topic, of course, in fixed income and the economy, which is the Federal Reserve (the "Fed"). The Fed decided to sit tight on short-term rates earlier this year, but it seems the sentiment might be the same here now in March. What are you thinking and how does it affect how you're managing the portfolio?

Reid Smith:

Sure. Well, first of all, we think the market has gotten ahead of itself in the prediction of upcoming Fed cuts to the federal funds rate. The Federal Reserve had predicted a 0.75% cut in 2024 according to their estimated dot plots, but that was in late December, and the market rallied and estimated 1.50% cuts starting in March—a very aggressive stand ahead of what the Fed had been communicating. That has proven to be too aggressive though. Economic numbers remain strong, especially in employment and inflation, and they have ticked higher in recent months. It now looks like a hold for longer without any potential reduction in the federal funds rate has been pushed back to possibly the latter part of the year.

Although we have seen the end of the increasing rate regime, we expect the steady-as-you-go trading range at this higher level until there are clear indications that inflation is dropping lower and staying closer to the Fed's target of 2%. The portfolio holds a lengthened maturity structure in the current environment to deliver a steady and durable Hawaiian tax-free dividend.

Interviewer:

Thanks, Reid, for shedding some light on an important topic.

I want to focus in now on municipal bonds, specifically. Something we watch is the Municipal-to- Treasury ratios, and they've been below average for some time. It seems the only part of the ratios, or the yield curve, that's close to its historical average is the long end. What's your take on what's going to have to happen for us to see a bigger change here?

Reid Smith:

Well, the municipal bond maturity curve is indeed very oddly-shaped. The front half of the curve is inverted, and the latter part of the curve is a traditional sloped structure that we would normally see with a bond curve. Like the U.S. maturity curve, it is high in the one-year area, then falls lower. Unlike the Treasury curve, the municipal curve rises after 10 years to exceed the yield in the one-year bond. After 15 years, it continues to rise there to 30 years. It looks like a check mark, with longer maturities being the most attractive. This is the same phenomena with a ratio of yields to U.S. treasury bonds—very low in shorter maturities and more normalized in longer maturities. To be frank, I'm not entirely sure why longer maturities offer such a striking relative value. It might be due to investor demand remaining focused on shorter maturities, but we're seeing strong value there in that part of the curve. This is consistent with the structure of the bonds held in the portfolio. We've been moving to this relative value opportunity with the Fund's investments for the past several months.

Interviewer:

Great take, Reid. Since the bottom of the market a few years ago, it's my observation that we haven't seen a confident municipal market. Would you agree with that and if not, what would you say about it?

Reid Smith:

Well, I would agree that we've experienced a substantial amount of volatility over the past two years, or a year and a half, due to the increases in federal funds rates and interest rates in general. But I think we're at an end of that now, where we're going to see things a little less volatile. For example, in the fourth quarter of 2023, we experienced a sharp pickup in new issue supply in September and October, and this cheapened the tax-exempt market. But in November and December, supply of municipals declined quickly, tightening up on availability of bonds. The market enjoyed a strong rally in December from a drop in supply, with a pickup in demand from seasonal coupon reinvestment and maturities.

Going into 2024, we witnessed consistent demand for municipal bonds from cash buyers and those that sought reinvestment after heavy tax loss selling in the latter part of 2023. We expect going forward a narrower range of bond prices with the Federal Reserve completing its tightening focus. The volatility should be reduced, and we should start seeing the benefit of the higher tax-exempt income from higher interest rates.

Interviewer:

Yes. And since you touched a little bit on supply and demand, that's a great segue into our next question.

It seems like 2024 so far has shown elevated supply year-over-year. What will it take for the supply to really pop here in 2024? And secondly, do you think the demand side of the market will be able to support it?

Reid Smith:

Well, that's a good point. I mean, looking at the short-term period of 2024, you did see a pop, but we don't think that's a trend that we're going to see through 2024. Most of the municipal issuers are pretty well-funded right now coming out of the pandemic, and we don't see a significant pop in issuance in 2024. It should be an average year with approximately $400 billion in new issuance. To be sure, the seasonal supply and demand will be important for opportunistically purchasing. The high demand months of December, January, June, and July will lend to sparser supply of bonds. However, points of lumpier supply in the new issue market happen in spring and early fall.

Portfolio managers look for these seasonal periods of excess supply to offer opportunity to purchase new issue bonds, and swap from existing holdings to improve portfolio structure and return potential. Also, during these times, we look for ways of creating more durability or sustainability of the income flow. So, we would like to see bonds with long call features—longer maturities that we know the investor can receive an elevated level of interest for a longer period of time.

Interviewer:

So, while we're on the topic of supply, Reid, it may be important to mention that supply is generally documented or quoted on the national level. But the national supply numbers don't necessarily trickle down evenly to each state. So, can you speak to how Hawaii is looking for supply, more specifically?

Reid Smith:

Well, I'm sorry to disappoint you, but Hawaii should have a more normal year of supply—around $2 to $3 billion in issuance this year. Again, we see some ongoing needs for investment from bond issuance, but generally speaking, it's going to be a more normalized environment. We've already seen a new issue from the Honolulu Board of Water Supply in March, and it's important to note that there are substantial forward plans for infrastructure investment in State Counties. Airports, harbors, water and wastewater improvements over the next several years. So, that means the pipeline of new issuance is really going to be spread out over the next several years as Hawaii goes through a major infrastructure improvement cycle. This includes, of course, the rebuilding of Lahaina after the devastating fire of 2023. Many of these initiatives will be financed with support from local bond issuance.

Interviewer:

Great local coverage, Reid. Let's close out here by asking a question also about Hawaii. I'm interested in hearing if there's anything else happening in the state and local landscape that's worth noting.

Reid Smith:

Well, I've mentioned it, but certainly the most impactful event to hit our islands are the fires on Maui. Local Maui residents are recovering from an unbelievably devastating loss of life and property. For those that live on or visit the beautiful and friendly island, the rebuilding is a daunting issue for the entire state. The issue remains not if the island will be rebuilt, but the critical support for those that have suffered the loss of a loved one or a home. Lahaina is our first capital and a location of important historical value. The rebuilding will take time and resources.

Hawaiian Tax-Free Trust has been a critical resource for investment for over 35 years in the local community. The investment of the portfolio in bonds issued in Hawaii is facilitated by a partnership of a local Investment Adviser at the Bank of Hawaii and the Aquila Group of Funds. This is a concept that was first of its kind, founded in the 1980s by Aquila Group of Funds to support local community funding. Absolutely the most important resource are the investors in the Hawaiian Tax-Free Trust, who provide the funding of many projects across our state and through the purchase of tax-exempt bond issuance of local government entities. From infrastructure to essential service for our community, much has been accomplished. Again, with the County of Maui and the State of Hawaii, our shareholders through Hawaiian Tax-Free Trust stand ready to continue this mission of financial support for our island's future.

Interviewer:

And that sums up our podcast for today. Thank you everyone for listening. As always, thank you, Reid for joining us.

Reid Smith:

Thank you very much.

Thank you for listening to this podcast. The opinion shared are those of the portfolio manager and do not necessarily reflect those of the Investment Adviser of the Fund.

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 AMT. Please consult your tax professional.

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 Hawaiian Tax-Free Trust, represented as a percentage of the Fund's total portfolio, as of 12/31/23: Honolulu City & County Board of Water Supply: 5.96%.

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 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 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 principal 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.

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 face 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.

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 funds with greater geographic diversification.

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