Aquila Churchill Tax-Free Fund of Kentucky

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 am your host today, Matthew DiMaggio. Today we are accompanied by Royden Durham, Portfolio Manager of Aquila Churchill Tax-Free Fund of Kentucky. Thanks for being here today, Royden.

Royden Durham:

Morning, Matt.

Interviewer:

Good morning. So, to hit on a big topic here upfront, the Federal Reserve (the "Fed") decided to sit tight on short-term rates earlier this year. Seems like the sentiment might be continuing here moving through the year. What are you thinking and how does it affect how you're managing the portfolio?

Royden Durham:

Well, this may be a conspiracy theory, but I think the ECB (the European Central Bank) and the Federal Reserve are going to cut in concert either in May or June. May seems more likely with the U.S. election on November 8th, in my opinion. Really, most of the cuts are already baked in, and we are now ebbing and flowing between one statement by a central banker and another. They are jawboning, trying to keep inflation expectations at bay. We continue to buy in the 12–to–15-year range when money is available because that's the positive part of the curve that's sloping upward.

Interviewer:

Real thoughtful insight there, Royden, and thank you for that.

Talking about a topic that's typically big with municipal bond investors is the Municipal-to-Treasury ratio, which has been below average for some time. It seems the only part of the yield curve that's high at this point, or average, is the long end. So, what's your take on what's going to have to happen to see a change there?

Royden Durham:

On March 8th, a 10-year relationship in the curve, the Treasury bond to AAA municipal bond was about 58.9%. At 15 years, it's quite a bit cheaper, at 68% of the curve. At 20 years, it's 75%, and it's 84% at 30 years. We're happy at the 15-year area, which I indicated above, and sell when we get good bids on anything that is shorter. Two things are at work here, I believe. One is the SMA (separately managed accounts) industry is now around one to one and a half billion dollars, and their maturity range is the 5-to-10-year range laddered maturities. The other could be fixed income., with a huge increase in issuance primarily in the short treasury market.

Interviewer:

Great insight again, Royden. And since the bottom of the market a few years ago now, we haven't really seen a confident municipal market. What can you say about that?

Royden Durham:

Well, I take issue with that. Municipal bonds outperformed in the last quarter of 2023, with the biggest rally in the asset class since 1986. Supply was off last year by maybe 2% nationally, and demand so far in 2024 seems robust, although we've traded off the highest reach in very late December.

Interviewer:

Got it. And since you touched on supply, it may make sense to go down that avenue. I think since the start of the year here, we've seen a little bit of an elevated supply. What will it really take to pop in 2024 to get up some of those higher levels?

Royden Durham:

We don't see any drop in demand, and with the current supply ramping up here in the second week of March, the market could be tested. Interesting to note though, Lipper reports cash flows into municipal funds recently, something that's been lacking over the last couple of quarters.

Interviewer:

So, we talked about supply a little bit here on the national level, but of course, the national supply doesn't trickle down evenly to each state. So, curious how Kentucky is looking for supply.

Royden Durham:

So, last year, Matt, Kentucky supply on July 31 was down over 50%. By year-end it rallied, if you will, and it was up around 15% nationally, while supply was down 2%. So far in '24, just two months in, at the end of February, Kentucky issuance was up 436%, while national supply is up 27%. It will probably stay up too. Since we have a huge $650 million Kentucky state property and building deal, new money and some refunding money coming, I think it's going to be mid-April.

Interviewer:

Great to hear about Kentucky-specific supply. And while we're on the topic of Kentucky, is there anything interesting happening in the state and local landscape?

Royden Durham:

Well, as you probably know, the State did not make its numbers economically to reduce the state income tax by half a percent in 2025. We are cruising along at 4% for calendar years 2024 and 2025 for taxpayers, with a new projection to be released, I think for the 2026 number in October of this year. Otherwise, our Republican plurality, holding 80% in the legislature in Frankfort, is coming up with some novel legislation to thwart what they consider to be progressive overreach.

My personal favorite is Kentucky becoming a sanctuary state not to adhere to any of the EPA mandates, and the Federal Government mandates with regard to coal, natural gas and air pollution. All I can say is, not only will this go to the courts, but several of their other legislative efforts will also. Could be really interesting and surprising that it's not part of the national conversation.

Interviewer:

All right. Let's close here with our last question by speaking about Aquila Churchill Tax-Free Fund of Kentucky. Could you tell us about how the Fund is currently positioned and how you're managing in this environment?

Royden Durham:

Yes. Reviewing the Fund's metrics recently, I noticed from January 31, 2023–January 31, 2024 that our average maturity was 7.64 years in 2024 and 7.79 years in 2025. So, our modified duration on those dates was 4.10 years, and in 2024 it's 4.04 years. The effective duration was 4.27 years in 2023, and in 2024, it's 4.26 years. It amazes me how consistent it has been, which we believe helps mitigate large price swings even in turbulent markets. With a huge trade-off in the market in 2023 and the subsequent rally, we were really pleased how our local management, intermediate duration, and high-quality performed for our shareholders.

Interviewer:

Fantastic, Royden. And that sums up our podcast for today. Thank you, everyone, for listening and as always, thanks again for joining us, Royden.

Royden Durham:

Pleasure, Matt.

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 of the Fund.

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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 principle of an issue is expected to be paid.

Yield refers to the earnings generated and realized on an investment over a specific period. 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.

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