Aquila Tax-Free Trust of Arizona

PORTFOLIO MANAGER COMMENTARY

Q1 2024

A Shares: **AZTFX**	C Shares: **AZTCX**	Y Shares: **AZTYX**

Municipal Bond Market Overview

At the end of December 2023, the Bloomberg 10-year AAA municipal yield was 2.28%. On that date, the relationship between the U.S. Treasury and AAA municipal curve for one-year was 55.80%, for 10 years 59.10%, and for 30 years was 85.80%. Over the course of the calendar quarter ending 3/31/24, the 10-year AAA municipal yield rose from 2.28% to 2.51%. The one-year U.S. Treasury/AAA municipal ratio increased from 55.80% to 64.50%, while the 10-year relationship moved up slightly from 59.10% to 59.80%, and the 30-year decreased from 85.80% to 84.80%. In general, from a historical perspective, and taking into consideration the "ladle" shape of the municipal yield curve, shorter bond maturities are currently considered to be expensive by the market, while the 30-year U.S. Treasury/AAA municipal relationship of 84.80% is closer to the five-year average of approximately 92%.

This municipal yield curve ladle shape expanded in the past quarter. Increased selling in one-year maturities, a common occurrence during first quarter tax season as investors raise cash for potential tax bills, led to a sharp rise in rates on the front-end of the municipal yield curve. Continued inflation worries led to greater selling in long maturities, which underperformed the intermediate portion of the curve. This "barbell" selling activity moved one-year and 17-year yields above 3% at the end of the first quarter, while yields on most intermediate maturities in-between 2 and 16 years remained below 3%.

Coinciding with the rise in market yields, municipal issuance increased nationally. Issuers seemed confident coming to market, as demand for municipal bonds continued to be strong. In the first three months of 2024, national issuance totaled $95 billion—a robust 19.5% year-over-year increase according to Bloomberg. Issuance in 2023 ultimately totaled $391.3 billion, a modest 1.1% increase from the $387.1 billion issued in 2022. Issuers have started to refund Build America Bonds ("BABs") through extraordinary redemption provisions, even in the face of investor challenges. Issuance is projected to eclipse $400 billion in 2024.

Despite the Federal Reserve's interest rate increases in 2022 and 2023, the labor market continues to charge forward. Although the labor market rebalanced last year, March payroll data from the Bureau of Labor Statistics indicate U.S. payrolls rose by the most in nearly a year, with employers adding 303,000 workers to their payrolls. Furthermore, the labor force participation rate rose from 62.5% to 62.7%, while the unemployment rate dropped from 3.9% to 3.8%. The March payroll report strengthens the argument being made that interest rates may remain higher for longer. Although the Federal Reserve previously indicated its plan to cut interest rates later this year, there doesn't appear to be a real hurry given recent economic strength. Furthermore, strong economic data in terms of consumer spending and real GDP growth raise the possibility of inflation rebounding in the quarters ahead.

Arizona Economy and Municipal Bond Market

Arizona municipal bond issuance in the first quarter declined 12.5% to $792 million. Although this ran counter to the overall increase in new issuance nationally (+23.8%), the forward calendar for new issues in the upcoming quarter has expanded rapidly. The market anticipates upwards of $1.5 billion in new issuance in the next three months.

The State's unemployment rate in February dropped from 4.2% to 4.1%, bucking the national rate, which rose from 3.7% to 3.9%. Job growth for the 12-month period ending February 2024 came in at 2.1%, with a total increase of 61,100 jobs. Along with continued population growth, Arizona's labor force continues to expand as well, with year-over-year growth of 2.3%.

The median home price in Maricopa County rose to $470,000 in January, which was an increase of 7.9% compared to a year earlier. The housing market in Arizona has demonstrated remarkable resilience despite the significantly higher mortgage rate environment compared to two years ago. Arizona home price values and valuations remain attractive compare to those of many regions from which Arizona is attracting new population and homebuyers. This has helped support the pace of home buying in the State.

State budget revenues have slowed primarily due to reduced Individual Income Tax ("IIT") collections. Overall fiscal year (ending 6/30/24) general fund revenues of $2.090 billion through the first two months were $129 million (-5.8%) below the enacted budget forecast. Among the primary components of budget revenues, Sales and Use tax collections in the first two months of the fiscal year totaled $1.264 billion—a 1.1% increase compared to the prior year, and a modest $49 million (-3.8%) below the enacted budget forecast. With the reduction in the state income tax rate to 2.5% that became effective at the start of 2023, year to date IIT collections of $830 million were $95.5 million below the enacted budget forecast.

Fund Strategy and Outlook

Aquila Tax-Free Trust of Arizona ended the fourth quarter of 2023 with an average final maturity of 8.74 years, and an effective duration of 5.04 years, while maintaining the majority of its holdings (85%) in the AA-rated and higher-credit quality categories. During the first quarter of 2024, those metrics were extended slightly to 9.27 years and 5.18 years, respectively, as we found good relative values in longer-maturity bonds whose valuations were attractive relative to benchmark taxable yields. Recent high-quality new issues sold during periods of market weakness during the quarter provided an opportunity to increase the Funds holdings of AA and higher-rated credits to 89% at the end of Q1.

With inflation remaining solidly above the Federal Reserve's 2% target, and market expectations for the Fed to delay interest rate cuts, we will likely maintain the average final maturity around 9 years, and effective duration near the midpoint of the Fund's desired range of 4-6 years. The persistent ladle shape of the municipal yield curve continues to dictate a preference towards a barbell maturity structure in the portfolio. This has translated to maintaining broad diversification across both maturity and bond structure. The Fund's average coupon of 4.47% (as of 3/31/24) reflected holdings across both premium bonds with coupons above 4% and select discount bonds with 3% and lower coupons.

For specific information about fund characteristics, holdings and performance please see the Fund Fact Sheet on our website at www.aquilafunds.com.

Fund Facts as of 3/31/2024

Lead Portfolio Manager	Inception Date	Total Investments	Number of Holdings
ANTHONY TANNER, CFA®	3/14/1986	$179.0M	93

Independent rating services (such as S&P Global Ratings, Moody's Investors Service and Fitch Ratings) assign ratings, which generally range from AAA (highest) to D (lowest), to indicate the credit worthiness of the underlying bonds in the portfolio. Where the independent rating services differ in the rating they assign to an issue, or do not provide a rating for an issue, the highest available rating is used in calculating allocations by rating. Municipal/Treasury Ratio compares the rates of municipal bonds with those of U.S. Treasury bonds in percentage terms.

Municipal-to-Treasury Ratio compares the rates of municipal bonds with those of U.S. Treasury bonds in percentage terms.

A credit spread or a yield spread is the difference between the quoted rates of return on two different investments, usually of different credit qualities but similar maturities.

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.