Aquila Tax-Free Fund of Colorado

PORTFOLIO MANAGER COMMENTARY

Q1 2022

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Municipal Bond Market Overview

Municipal rates shifted higher over the first quarter of 2022, particularly in the 1- to 5-year range of the yield curve. This move in rates was spurred on by the Federal Reserve ("the Fed"), with the municipal market reflecting its anticipation of a series of interest rate hikes, as the Fed raised the Federal Funds rate for the first time since 2018. Overall, the yield curve is now flatter, with adjustments on the longer-end of the yield curve less severe, as the market continues to incorporate a transitory view of inflation.

Although yields have risen from their lows, rates remain well below current inflation levels. Last summer's consensus for the inflation outlook was for a peak around year-end to the first quarter of 2022. However, the consensus did not anticipate the economic impact of the events in Ukraine. Supply chains have recovered some, but the Russia-Ukraine conflict continues to pressure commodities and energy prices.

Bond yields, while higher, continue to be relatively low particularly when compared to recent inflation releases. The result is that real rates, incorporating the impact of inflation, are actually negative. Thus, the current outlook for additional rate hikes seems reasonable and likely. The Treasury yield curve may have recently inverted, but the municipal yield curve remains upwardly sloped. Recent movements between the two asset classes have resulted in favorable Muni/Treasury ratios, with 10-year munis yielding over 90% of Treasuries. We anticipate that municipal bond yields will continue to increase as the Fed pursues its path towards higher interest rates in an attempt to dampen inflation.

As interest rates ramp-up, existing positions of callable bonds may experience fewer calls going forward. Market participants believe this may result in greater demand for callable holdings. In addition, taxable muni yields have risen in parallel with Treasury yields, which has rendered many taxable muni refundings "uneconomical." As a result, year-to-date taxable muni issuance is approximately 40% of last year's issuance over the same period.

The municipal bond market experienced significant outflows during the first quarter. As investors have pulled back from the market, elevated secondary market trading activity has created the opportunity to capture higher yields at the portfolio level, which we are closely monitoring.

Colorado Municipal Bond Market and Economy

Colorado's economy has reached and exceeded pre-pandemic levels in most industries, as spending on services, which were hit hardest during the pandemic, rose to 99.5% of spending compared to the fourth quarter of 2019. Retail sales continue to be at record highs, up 17.3% in 2021, as sales of motor vehicles and parts were up approximately $4.6 billion, contributing to 20% of retail sales growth—even with the continued supply shortages and production delays. The fastest growing sectors in 2021 were clothing stores, gas stations, and sporting goods and hobby stores that were the most negatively impacted during the recession. According to the New York Federal Reserve Survey of Consumer Expectations, year-ahead household spending expectations remain strong.

According to the Colorado Secretary of State's Office, over 40,400 businesses dissolved during 2021, an increase of 7.7% from 2020. However, new business filings increased through the end of the year, which is encouraging. The U.S. Bureau of Labor Statistics reported that the State's unemployment rate was 4.0% in February, which continues to decline, and is the lowest it's been since February 2020. Colorado's labor force participation rate improved to 68.5% in January, the third highest in the nation. As of January, Colorado has gained 98.4% of the jobs it lost since the pandemic began.

According to the Colorado Legislative Council (CLC), March 2022 economic forecast, Colorado's revenue is projected to increase by $1.7 billion in 2022, as individual and corporate income taxes, and sales tax revenues, exceeded expectations due to strong consumer and business activity. Colorado's 2021 General Fund revenues are $14.3 billion, up 11.2% from fiscal year 2020. General Fund revenues are expected to increase 11.6% in fiscal year 2022, and 0.6% in fiscal year 2023, to $16.1 billion. Consumer spending rebounded in 2021 and returned to pre-pandemic growth rates in the second half of the year. The labor market continues to recover as some sectors struggle to find workers.

Colorado tax-exempt, non-AMT issuance in the first quarter decreased approximately 13%—$2.2 billion, compared to $2.5 billion for the first quarter of 2021. We suspect that the majority of issuance this year will be in the form of new money general obligation bonds issued by school districts, which issued $504.5 million of general obligation bonds throughout Q1. School districts and municipalities have $270 million and $374 million, respectively in general obligation bonds authorization remaining from the November 2021 election.

Specific to Aquila Tax-Free Fund of Colorado, over 44% of the portfolio's holdings are allocated to general obligation bonds, which rely upon property taxes for repayment. We do not anticipate immediate, material credit risks for these holdings given the stability of the property tax-funded revenue model, and a lack of exposure to significant coronavirus-related expenditure increases for most of these bonds. Property tax collections in Colorado have been robust over the past year and property values have continued to appreciate.

Fund Strategy and Outlook

With a relatively flat yield curve and tight credit spreads, we remain cautious in our selection of municipal bonds. We have been taking advantage of the higher interest rate environment by initiating security swaps structured to reduce lower-yielding securities and replace them with higher-yielding securities in the 10- to 15-year maturity range. Given the current slope of the yield curve, we believe this can be accomplished without adding meaningful extension risk to our target portfolio duration of 4.5-4.75 years. With Fed policy pointing toward additional rate hikes and more aggressive tightening, we continue to resist the temptation to meaningfully extend duration. However, should the yield curve steepen, we would consider slightly lengthening duration to take advantage of higher rates.

Credit research remains the cornerstone of our investment approach, with vigilant monitoring of pandemic-affected issuers and sectors. Under our overall defensive portfolio strategy, the Fund holds approximately 92% AA or higher credit quality, due to currently narrow credit spreads in the municipal market. As the economy recovers, we have expanded our effort to evaluate currently under-represented sectors and bonds with attractive structures or relative spreads. These focuses present an opportunity to capture incremental yield while diversifying risk. Furthermore, these sectors present an opportunity to increase exposure to holdings with yields commensurate to, or exceeding, potential volatility.

As credit spreads tightened during 2021, investors seemed willing to assume greater credit risk to replace legacy yields on maturing high-grade bonds. Although we have recently experienced some spread-widening, we view credit risk as not being sufficiently rewarded, particularly for longer maturities. For this reason, we continue to maintain a heightened exposure to pre-refunded bonds as a source of liquidity and current yield. Our exposure to pre-refunded bonds remains elevated, due to municipalities refunding existing issues in this still relatively low-rate environment to achieve debt service savings.

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 3/31/2022

PORTFOLIO MANAGER	INCEPTION DATE	TOTAL INVESTMENTS	NUMBER OF HOLDINGS
CHRIS JOHNS CREDIT ANALYST VASILIOS GERASOPOULOS	5/21/1987	$233.3M	136

Information regarding holdings is subject to change and is not necessarily representative of the entire portfolio. 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 credit quality of the issuer, borrower, counterparty, or collateral, adverse tax or legislative changes, court decisions, market or economic conditions. Fund performance could be more volatile than that of funds with greater geographic diversification.

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 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.

A credit spread or a yield 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.

The Bloomberg U.S. Treasury Bond Index measures the performance of the U.S. Treasury bond market, using market capitalization weighting and a standard rule-based inclusion methodology. Indices are unmanaged and are not available for direct investment.

Before investing in the 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 professional, and when you call 800-437-1020 or visit www.aquilafunds.com.