Aquila Tax-Free Fund of Colorado

PORTFOLIO MANAGER COMMENTARY

Q4 2023

A Shares: **COTFX**	C Shares: **COTCX**	Y Shares: **COTYX**

Municipal Bond Market Overview

After continued weakness in the month of October, the municipal bond market staged a powerful rally in November and December during the quarter ending 12/31/23. The 10-year AAA yield, as measured by Bloomberg, declined 119 basis points, from 3.45% on September 30 to 2.26% at the end of the quarter. This resulted in an overall decline in this benchmark yield of 19 basis points for the 1-year period ending 12/31/23, when yields began the year at 2.45%. The market demonstrated a sharp turnaround during the fourth quarter. Following a jump in the 10-year AAA yield, to 3.65% at the end of October 2023, the market began a recovery in November, which picked up steam in December. This delivered the strongest quarterly performance for the municipal bond market since 1986, according to Bloomberg. The Bloomberg Municipal Bond: Quality Intermediate Index posted a positive return of 5.86% for the quarter, which enabled it to record a positive total return for the year of 4.64%.

The municipal bond market also outpaced the U.S. Treasury bond market by a wide margin, as the yield on the 10-year U.S. Treasury bond declined only 70 basis points. This outperformance was largely mirrored across the entire 1-30-year yield curve, reducing the ratio of municipal bond yields to U.S. Treasury bond yields. During the fourth quarter, this 10-year ratio declined from 74% to 58%, while the 30-year ratio declined from 93% to 83%. Although this outperformance has diminished some of the "cheapness" which had surfaced in municipal bond values last fall, the taxable equivalent yields of municipal bonds at the end of the quarter remained attractive relative to recent inflation readings that have remained below 4%. This still leaves municipal bonds in what appears to be a position to offer better risk-adjusted return prospects than other corners of the taxable investment-grade fixed income markets.

While investors have remained focused primarily on interest rate increases in 2023, and intentions in 2024 of the Federal Reserve (the "Fed") and Chairman Jerome Powell, the continuation of the trend of inflation below 4% since last June has begun to provide a supportive tone to the municipal bond market. Coinciding with the drop in market yields was a surge in new municipal issuance during the past quarter. Nationally, issuance totaled $105.5 billion, a robust 39% increase over the $75.5 billion issued in the fourth quarter of 2022. For the year, issuance in 2023 totaled $379.9 billion, a modest 2.9% decline from the $391.3 billion issued in 2022, according to data from *The Bond Buyer.*

The credit quality of municipalities has demonstrated resilience in the face of recession concerns and the wake of the latest U.S. government downgrade last August by Fitch Ratings (from AAA to AA+). A barometer of this was the upgrade of the Metropolitan Transportation Authority ("MTA"), one of the most economically-sensitive New York issuers in the national municipal bond market. The upgrade of the MTA in October by S&P Global Ratings (from BBB+ to A-) reflects how the essential nature of important municipal services (in this case, mass transit in the nation's largest city) is important to credit quality. The upgrade is also a result of the impact municipalities derived from the significant intergovernmental transfers made by the U.S. government to power the COVID-related economic recovery. This included the $6 trillion in CARES Act packages passed in 2020, and the $1.9 trillion American Rescue Plan passed in February 2021.

Colorado Municipal Bond Market and Economy

Colorado's economy continues to expand with a strong labor market and continued consumer spending, despite rising prices and higher borrowing costs. With faster income growth and lower unemployment rates, balanced with higher inflation, Colorado's economy is generally expected to modestly outperform the U.S. economy through 2025. Below are a few of the latest key economic indicators for the State:

- The U.S. Bureau of Labor Statistics reported that Colorado's monthly unemployment rate remained at 3.3% in November of 2023.
- The labor force participation rate held steady at 68.9% in July, the fourth highest in the nation.
- The largest job gains were in the Government, Leisure & Hospitality, and Accommodation & Food Services sectors, which were the hardest hit industries during the pandemic and have been slower to recover.
- Colorado's household financials remain strong, as the tight labor market has kept wages and salaries elevated above historical trends. As the Fed continued to raise interest rates, homeowners appeared unmotivated to sell, as higher mortgage rates and affordability lowered the demand for housing.

According to the Colorado Legislative Council's December 2023 economic forecast, the State's 2023 general fund revenues are estimated to be $18.0 billion, up 1.7% from fiscal year 2022. General fund revenues are forecast to decrease 2.7% in fiscal year 2024, and increase 6.0% in fiscal year 2025 to finish at $19.6 billion. The State's unaudited general fund reserves ended 2023 at $2.4 billion, $431.5 million above the statutory required 15.0% reserve. On 9/1/23, the State Controller certified a TABOR surplus of $3.57 billion for fiscal year 2023. The TABOR (Taxpayer's Bill of Rights) Amendment, which was approved by voters in 1992, limits the amount of revenue the State of Colorado can retain and spend. The Controller's certification also indicated an outstanding refund obligation of $114.4 million, for a total TABOR refund of $3.68 billion in fiscal year 2024. Sales tax revenues are projected to increase 5.2% from fiscal year 2022, and are expected to grow 2.5% in fiscal year 2024, as labor conditions soften and household finances start to constrain, due to price increases and spending down excess savings.

Colorado tax-exempt, non-AMT, municipal bond issuance in 2023 decreased approximately 43%, totaling $5.1 billion. This compared to the $8.9 billion of municipal bond issuance in 2022. In addition, Colorado has experienced a significant amount of maturities and calls from issuers and demand remains robust, with new issues and secondary offerings continuing to price aggressively.

As of 12/31/23, approximately 44% of Aquila Tax-Free Fund of Colorado's municipal bond holdings were allocated to general obligation bonds, which rely upon property taxes for repayment. We do not see any material immediate credit risks for these types of credits given the stability of the property tax-funded revenue model. Property tax collections in Colorado have been robust over the past year and property values have generally continued to appreciate.

Fund Strategy and Outlook

Given the current shape of the municipal yield curve and current market volatility, we remain cautious in our selection of municipal bonds. Our portfolio positioning of shorter duration, higher credit quality, and higher average coupons has been relatively advantageous during current dynamic market conditions, which include volatile daily changes. Furthermore, in recent months, proceeds have been reinvested in the 15-year maturity range to take advantage of the steeper slope in the yield curve, and a greater percentage of Treasury yields in that portion of the curve.

Credit research remains the cornerstone of our strategy, with vigilant monitoring of both issuers and sectors. Under our overall defensive portfolio strategy, credit quality remains high, with approximately 88% of the portfolio rated AA or higher (as of 12/31/23). Although we have observed wider spreads for certain credits, we are only selectively taking risk where we find risk being rewarded by the market.

Furthermore, we have expanded our effort to evaluate currently under-represented sectors and bonds with attractive structures or relative spreads. We believe these under-represented sectors present an opportunity to increase exposure to holdings with yields commensurate to, or exceeding, potential volatility. As a result, we feel these opportunities present an opportunity to capture incremental yield while helping to diversifying associated risk.

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 12/31/2023

CO-PORTFOLIO MANAGERS	INCEPTION DATE	TOTAL INVESTMENTS	NUMBER OF HOLDINGS
TIMOTHY ILTZ VASILIOS GERASOPOULOS ROYDEN DURHAM	5/21/1987	$141.1M	83

This information is general in nature and is not intended to provide investment, accounting, tax or legal advice, nor is it intended to represent a recommendation or solicitation related to any particular investment, security or industry sector. The opinions shared are those of the portfolio managers and do not necessarily reflect those of the Investment Adviser of the Fund. 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.

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-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.

The Bloomberg Municipal Bond: Quality Intermediate Index tracks the performance of municipal bonds with remaining maturities between 2 and 12 years and a minimum credit rating of A3. Indices are unmanaged and are not available for direct investment.

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. State-specific fund performance could be more volatile than that of 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 prospectus. The prospectus is available from your financial professional, and when you call 800-437-1020 or visit www.aquilafunds.com.