Investment Commentary

December, 2018

AQUILA® GROUP OF FUNDS

AQUILA® Tax-Free Fund of Colorado

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

Municipal Market

In December, we forecasted yields to end the year higher; however, yields did not remain at those levels for very long due to volatility stemming from a sell-off in the stock market. Treasuries and high-quality bond yields tend to decline in a flight-to-quality when the stock market sells off, and this past month was no exception. Although we have seen some minor inversion to the Treasury bond yield curve, we do not expect any inversion within the municipal bond yield curve. Instead, we expect to see significant flattening in areas, though the curve should remain positively sloped. Over the next year, we project a slight upward bias in interest rates, short and medium rates up and longer rates flat, with the Fed exercising caution if the yield curve shows signs of inverting.

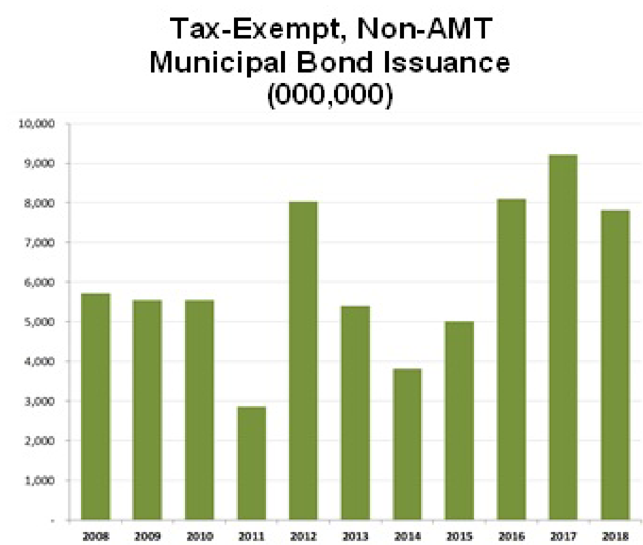
As a result of the flight-to-quality, the municipal market has also experienced widening of credit spreads (the difference in yield between BBB rated bonds and AAA rated bonds) over the past quarter. Although credit spreads remain tight, buyers are requiring increased compensation for taking credit risk. According to Bloomberg data, the difference in yield between 10-year BBB rated municipal bonds and 10-year AAA rated municipal bonds has increased from 0.66% in mid-October to 0.93% at the end of December.

Municipal credit continues to show overall strength, as municipal defaults remain uncommon. The extended economic expansion has provided local governments with the opportunity to build reserves and make adjustments to staffing levels. The expansion has also lifted property values, which has resulted in significant increases to local property taxes and development fees from new construction.

Nevertheless, specific credit concerns persist. Economic growth is beginning to soften, as home price growth has slowed to 2016 levels and job growth is hampered by record low unemployment levels in many states. Many issuers continue to contend with escalating pension burdens. We expect pension funding levels to continue to disappoint as a result of poor equity returns over the past year, during a period of generally growing pension liabilities. In addition, we have concerns regarding uncertainty stemming from the partial federal government shutdown and the potential impact of an extended shutdown. Although most local governments are not heavily reliant upon federal sources, healthcare, higher education and transportation are all more susceptible to federal funding disruptions.

Colorado Economy

Colorado's economy continues to rank as one of the best in the nation. The U.S. Bureau of Labor Statistics reports that the State's unemployment rate rose 0.1% to 3.3% in November. According to the Colorado Legislative Council's (CLC) December 2018 economic forecast, Colorado's economy will continue to grow, but at a slower pace, due to the impact of tax reform, higher interest rates, continued employment growth and moderate increases in consumer spending. Colorado's 2018 general fund revenues are $11.7 billion, up 14.2% from fiscal year 2017. This represents the fastest growth rate in the general fund since fiscal year 1998. Statewide economic growth has been widespread across most industries, with professional, scientific, and technical services and information technology posting the strongest growth.



Source: Bloomberg and Kirkpatrick Pettis Capital Management

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However, inflationary pressures, a tight labor market, rising home prices and an aging population are expected to constrain economic growth in Colorado. International trade policy and tariffs continue to cloud the economy and could put upward pressure on consumer prices.

Overall, 2018 was a strong year for issuance in Colorado, despite being the first year after the elimination of advance refundings. January 2018 started the year with $830 million in issuance, picking up where 2017 left off, but then slowed down through the rest of the first half of the year. The second half of the year accounted for approximately 62% of issuance. Issuance over the year was highlighted by several transactions, in which the Fund participated, including: $375 million Poudre School District General Obligation Bonds, $326 million Jefferson County School District General Obligation Bonds and $94 million Colorado Building Excellent Schools Today.

We expect the majority of issuance in 2019 will be in the form of new money general obligation bonds issued by school districts, especially during the first half of the year. This issuance will be largely driven by the November 2018 general election, during which voters approved $1.6 billion in general obligation bonds across the State compared to the November 2017 election, which saw only $1.3 billion of issuance approved. Voters rejected all statewide tax ballot measures for transportation and schools. The majority of the bonds approved were for school districts making capital improvements to existing facilities and construction of new facilities. Notable projects include $567 million for Jefferson County School District, $298 million for Littleton Public Schools and $250 million for Douglas County School District. In addition, voters approved $80 million for street improvements in Arvada, $33 million for capital improvements in Longmont, $8 million for affordable housing in Telluride and $3 million for sanitation in Fleming.

Fund Strategy

Currently, the Aquila Tax-Free Fund of Colorado is postured defensively. As of 12/31/18, the Fund a 6.85 year average maturity, an effective duration of 4.2 years and over 17% of the portfolio was allocated to pre-refunded bonds that are backed by U.S. Treasury securities. In addition, over 87% of the portfolio was rated in the AA category or higher. Over the next year we expect the portfolio will continue to maintain its allocation to high quality, intermediate maturity, liquid bonds with the objective of maximizing yield while maintaining credit quality and limiting interest rate volatility exposure. The portfolio may experience a slight lengthening of maturity and duration as pre-refunded bonds mature and proceeds reinvested in the 10 to 13 year maturity range. We believe our defensive strategy will weather the rapidly changing interest rate and credit environments well. We will closely monitor the shape of the yield curve and credit spreads before making adjustments to the portfolio and only extend when longer intermediate maturities or lower investment grade credits provide greater value. For specific information about fund characteristics, holdings and performance, please see the Fund Fact Sheet on our website at www.aquilafunds.com.

Portfolio Manager	Inception Date	Assets Under Management	Number of Holdings
Chris Johns	6/16/1986	$260.3M (as of 12/31/18)	133 (as of 12/31/18)
Credit Analyst			
Vasilios Gerasopoulos			