Aquila Tax-Free Fund of Colorado

PORTFOLIO MANAGER COMMENTARY

Q1 2024

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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.

Colorado Municipal Bond Market and Economy

Colorado's economy continues to expand, with a strong labor market and consumer spending, despite rising prices. The State's general fund ended 2023 with a reserve of $2.4 billion, $431.2 million above the statutory required 15.0% reserve. According to the Colorado Legislative Council's (CLC) March 2024 economic forecast, the State's revenue is currently expected decrease by $382.4 million in 2024, due to the passage of Proposition 121. This legislation was passed at the November 2022 election to reduce Colorado's income tax rate from 4.55% to 4.40%. Colorado's 2023 general fund revenues finished the year at $18.0 billion, up 1.7% from fiscal year 2022. General fund revenues are forecast to drop 2.1% in fiscal year 2024, and increase 5.9% in fiscal year 2025, to finish at $18.7 billion.

Retail sales were up 0.9% in 2023 and are expected to grow 2.9% in 2024. The fastest growing sectors in 2023 were the food and beverage places sector, growing 6.2% and general merchandise stores, which grew 3.5%.

The State collected a TABOR surplus of $3.56 billion for fiscal year 2023, and is projecting a TABOR surplus of $1.82 billion in fiscal year 2024. Sales tax revenues are projected to increase 2.2% from fiscal year 2023 and expected to grow 3.5% in fiscal year 2025, as labor conditions soften and higher interest rates lead to tighter lending standards.

The U.S. Bureau of Labor Statistics reported the State's unemployment rate at 4.2% in February, the first month over 4.0%, since January 2022. However, Colorado's labor force participation rate improved to 68.1% in February, the fourth highest in the nation. The State's largest job gains were in the educational and health services and the government and construction sectors.

Colorado tax-exempt, non-AMT, issuance in the first quarter of 2024 increased approximately 120%—$2.6 billion, compared to $1.2 billion for the first quarter of 2023. 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.

Approximately 44% of the Fund's municipal bond holdings were allocated to general obligation bonds (as of 3/31/24), which rely upon property taxes for repayment. We do not see any material immediate credit risks for these 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 continued to appreciate.

Fund Strategy and Outlook

Given the current shape of the 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 with volatile daily changes. Furthermore, in recent months, proceeds have been reinvested in the 15-year maturity range to take advantage of the steeper slope and greater percentage of Treasury yields in that portion of the municipal yield 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 92% of the portfolio rated AA or higher (as of 3/31/24). Although we have observed wider spreads for certain credits, we are only selectively taking risk where we find risk rewarded. 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. We see these as 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 3/31/2024

CO-PORTFOLIO MANAGERS	INCEPTION DATE	TOTAL INVESTMENTS	NUMBER OF HOLDINGS
TIMOTHY ILTZ VASILIOS GERASOPOULOS ROYDEN DURHAM	5/21/1987	$134.6M	86

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.

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's prospectus. The prospectus is available from your financial professional, and when you call 800-437-1020 or visit www.aquilafunds.com.