



# Aquila Tax-Free Fund of Colorado

## PODCAST TRANSCRIPT

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**Interviewer:**

Hello everyone. Thank you for listening to the Aquila Group of Funds podcast. I'll be your host today, Phil Felice. Joining me is Chris Johns, Portfolio Manager of Aquila Tax-Free Fund of Colorado. We'll be discussing the ever-timely municipal bond market, as well as the local Colorado economy. Welcome Chris, and thank you for being on the podcast.

**Chris Johns:**

Thanks, Phil.

**Interviewer:**

Let's start off with the story, not only in municipal markets, but all markets for the start of 2022: The Fed and interest rates, as they look to tackle inflation. We've seen how the muni markets, and really all markets, sold off on the news of rate hikes. What do we expect from the muni markets for the rest of the year in an anticipated rising rate environment relative to other fixed income markets? And then, even relative to other markets in general? And how does Aquila position accordingly?

**Chris Johns:**

Well, that observation is correct, Phil. For the first part of this year, most of the interest rate news has been focused around hawkish decisions that the Federal Reserve is making. They've mentioned that they were going to begin to reduce the amount of securities they're purchasing in the open market, which they're going to start here at the beginning of March. They've also talked about allowing the securities that they own to run off their balance sheet. So, a balance sheet shrinking. And then the third thing where they've actually talked about the liftoff of starting to increase short-term interest rates. So, the combination of all three of those things led to higher interest rates in the first couple of months of this year, depending on which maturity range you're looking at in the Treasuries—anywhere from 50 to 70 basis points higher in a fairly short period of time because of all that. This is driven largely by the inflation numbers that you mentioned. We're seeing inflation virtually everywhere, in food prices, commodity prices, car prices, and home prices. Everything is experiencing inflation right now as we recover from the COVID pandemic, and there's still some supply chain disruptions that cause difficulty in getting products through the system and, hence, higher prices. So, between inflation and higher interest rates, that's really been the story so far this year. That's all being tempered by geopolitical events, with Russia and Ukraine, where interest rates have come back down a little bit because of concerns about what's going on internationally. And so, interest rates have come down a little bit. It remains to be seen if the Federal Reserve will react to these geopolitical concerns and slow down their hawkish policies that they've talked about at the beginning of this year. So, that remains to be seen.

We believe that interest rates will continue to edge upwards for most of the rest of this year, both for treasuries and for munis. And we believe that at some point, we'll start to see a little bit larger increases in interest rates on the longer end. So far, most of the interest rate increases have been in the 3—10-year range. And we think that the longer end of the curve could go up a little bit more from where they are today. For our Fund, we have a duration of about four and a half years, average maturity of around seven years, and high credit quality. We've been anticipating higher interest rates for some time. And so, we've built a fairly defensive portfolio with limited interest rate risk exposure, and limited credit risk exposure.

**Interviewer:**

Great. Thanks for that, Chris. And with all that in mind, there is sentiment from our advisor universe and they're asking what makes munis compelling now. Their clients are hearing about potential rate increases, and are asking their advisors to guide them. How do we help investors, or even advisors discussing the asset class with investors? Answer that question of: "What makes munis compelling now?"

**Chris Johns:**

Well, the first thing I would say is that there has been an adjustment in municipal bond interest rates relative to U.S. Treasury rates. For a lot of last year, and even at the beginning of 2022, muni rates had not really kept up with Treasury rates. But recently, they have caught up. So, right now, the municipal/ treasury ratio—in other words, the percent that muni yields are of corresponding maturity U.S. Treasury yields—are more normal. In some cases, actually a little high. The five-year range muni yields are 77% of treasuries, 10-year range, about 86% of treasuries, and in the 30-year range, about 80% of treasuries. And I would say that's in the normal range, maybe even slightly above normal. So, the valuation of munis is good.

The next thing I would say is that, historically, in a rising interest rate environment, munis tend to be a little less volatile. And the primary reason for that is the tax-exempt nature of it. Having that tax benefit generally makes interest rates on munis a little less volatile than they would be on U.S. Treasuries. And then, for us, with our limited interest rate risk exposure and high credit quality, that's the type of portfolio that we would anticipate would be a little less volatile in a rising interest rate environment.

**Interviewer:**

Thank you, Chris. And so, switching gears a bit, we speak here at Aquila in great detail on being local, and the idea that because of our footprint in a State like Colorado, we are better situated to tackle the State's muni environment. You do a great job of this always. So, we want to ask, what are you seeing on the ground that someone looking at your market from a national perspective may miss?

**Chris Johns:**

For Colorado, it really is a distinct advantage. And the reason for that is that Colorado is just one of a few states that doesn't allow state general obligation debt. And so, the result of that is, we have many smaller stand-alone issuers in the State. There are thousands of issuers in the State of Colorado. And the Aquila Tax-Free Fund of Colorado has been around for more than 30 years. And as a result, we have really good credit files on most Colorado issuers, and we know what's going on with them. There are a lot of nuances in legislative developments, in economic developments, and even legal developments in a state like Colorado that has a very broad spectrum of credit quality issuers in the State. And so, being able to track all that and having the contacts that we have with not only the issuers themselves, but also with various government agencies, where we can get data from to track the credit strength of Colorado issuers. So, Colorado's really important to have those connections because there's so many issuers.

**Interviewer:**

So, let's stay at the state level, but let's look at it from a macro perspective. Anything to note at the State economy, whether it's employment, tourism, housing? Anything that anyone listening to this podcast that would stand out?

**Chris Johns:**

For Colorado, we've weathered the COVID storm remarkably well. The economy in Colorado is very strong. We've seen at the State level, the difference in General Fund revenues from 2020 to 2021 an increase of 10.7% in revenues. We've had record household savings, some of which has been drawn by the CARES Act, and by the American Rescue Plan. Another really strong area has been retail sales throughout the State of Colorado. Sales tax collections in virtually every corner of the state are at record levels. So, people have been spending money. And then the other big thing has been the real estate market. Residential real estate market has been on fire for a couple of years. The median selling price for a single-family home in Colorado is at a historic high of \$533,000 as of last November. And it's probably even gone up a little bit since then. So, that's important to us, because roughly 40% of our portfolio is backed by property taxes. So, that helps the credit quality of the portfolio. So, overall at the macro level, the state is doing very, very well.

**Interviewer:**

Chris, as always, thank you for your time today, and thank you for your insights, not only on the Colorado market, but the broader municipal bond landscape. We always appreciate it. Thanks for being here today.

**Chris Johns:**

You're welcome.

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