Aquila Tax-Free Fund of Colorado
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Interviewer:
Today we're talking to Chris Johns, Portfolio Manager of Aquila Tax-Free Fund of Colorado. At mid-year, we typically see an increase in municipal bond maturities and calls. How would you describe the supply of municipal bonds currently, and what are you anticipating over the remainder of the year?

Chris Johns:
Well, that's very true. I mean, traditionally we see most bond maturities and calls in the middle of the year; in the June, July and August frame. And we are going to experience that again this year, both nationally and in our state.

Year to date, nationally, we are down in new-issue supply somewhere between 20 and 25 percent from 2017. In Colorado, so far this year, we've had about $3 billion in new issuance, which is down significantly from last year. But if you look at it over, say, the last ten years, it's slightly above normal.

So in the big scheme of things, it hasn't been too bad in Colorado. We have elections in the fall and we'll know in August what is going to actually make it to the ballot for the November elections. And in recent years, Colorado voters have been very generous in terms of approving bond issues at the ballot box. So it remains to be seen. We could see some pickup in supply at the end of the year.

Interviewer:
Based on comments from the Federal Reserve, it seems as though we can anticipate one or two additional increases in the Fed funds rate during 2018. How has the municipal bond market been trading, and where on the yield curve do you see value?

Chris Johns:
Well, in the last three months or so, the municipal bond market has traded in a very narrow trading range. We haven't seen a lot of change in rates in the last three months or so. Interest rates on municipal bonds have not risen as much as Treasuries in the short part of the curve, and I would measure that by, say, five years and shorter.

I think that the curve right now – you get most of the value around ten years – that spot on the curve. You get about 80 percent of the yield of a 30-year bond at the 10-year mark, so that seems to be a pretty good value place; 10 to 12 years, in there.

Moving forward, I mean, as far as the Fed is concerned, we think it's kind of unlikely that they'll intentionally invert the yield curve. If they come up with a scheduled increase in the Federal Funds Rate, and it could invert the curve, they might wait. It sends a message that the economy may be weakening, and the Fed doesn't believe that. We don't believe that. So I think it's unlikely that they would do that intentionally.

Interviewer:
We've continued to see positive economic indicators in the first half. Are municipal bond issuers seeing improvements in tax collections and other revenue sources?

Chris Johns:
I would say so. Muni credit quality remains very strong as state and local tax collections of virtually all kinds are above pre-recession highs. In particular, real estate has been especially strong in our state, and helps tax-backed bonds. So credit quality remains strong.

Our one concern, though, about this is that – particularly in the real estate area – housing affordability becomes an issue. We've seen such great price increases it's difficult for people to buy homes these days. That could kind of level off the price appreciation that we've seen in real estate over the last couple of years.

Interviewer:
The Supreme Court recently determined that states could require retailers to collect sales tax on internet transactions. Do you anticipate that sales tax receipts from the decision will be significant for Colorado?

Chris Johns:
Yeah. Typically, additional sales tax collections from the internet is a credit positive. The interesting thing is how it will flow through to local issuers and other sales tax-backed issuers in the state. It remains to be seen how that works out.

In Colorado, with the population growth we've seen, strong economic – sales tax revenue is a very important revenue stream. And so we think this is, generally speaking, a credit positive for the state.

Interviewer:
Given the current market conditions and rate expectations, how have you positioned the portfolio?

Chris Johns:
We've been fairly consistent over the last year and a half to two years. We've become more defensive, for a couple of reasons. The first thing is we've seen the yield curve flatten that we've talked about many times. In other words, we don't get paid much higher interest rates to go further out the curve.

In addition to that, we've seen credit spreads narrow dramatically over the last couple of years. So in our view, risk is kind of mispriced right now. We don't believe that you're paid very much to take the additional risk of longer maturities or lower credit quality.

So our duration right now has been around four years or so. And we're going to kind of keep it there because we believe that the two main risks that face our shareholders are higher long-term rates and a widening credit spread. So we have AA average quality in our portfolio and fairly short duration relative to our guidelines.

The other thing that's important about our portfolio is that we have a big representation of pre-refunded bonds, which are Treasury-backed securities in the muni market that offer tremendous safety because they are backed by Treasuries. They offer good current yields; usually higher than what we can get in the current market conditions. And they also offer a lot of liquidity.

And we've held on to those for those three reasons, and that gives us a lot of flexibility if we get into market conditions that are a little bit more hostile and this part of the portfolio will provide us an opportunity to take advantage of higher rates, should they present themselves.

Interviewer:
Thank you very much. For those of you listening, before investing in the Fund, carefully read about and consider the investment objectives, risks, charges, expenses and other information found in the Fund prospectus, which is available on this site, from your financial advisor, and when you call 800-437-1020.

Thank you for listening to this podcast.