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Tax-Free Trust of Oregon

Aquila Tax-Free Trust of Oregon Podcast Transcript September 20, 2017

Interviewer:
Today we're talking to Chris Johns, portfolio manager of Aquila Tax Free Trust of Oregon. During the remainder of 2017 and into 2018, are you anticipating that we'll see additional rate increases from the Fed?

Chris Johns:
Well, the consensus right now is that we're expected to see one more 25 basis point rate hike this year, and that most likely will occur in December. This particular rate increase is widely-anticipated. The Fed has done a great job of being transparent about what their intentions are and so we don't expect that to be disruptive to the fixed income markets really at all, especially if you look at the last two increases in the Fed funds rate. The market knew they were coming and it was really no dramatic reaction. We saw rates on shorter-term securities go a little bit higher and those in the mid range and longer range really didn't change at all, and in some cases actually declined a little bit.

The one thing that could change that though is there has been some discussion about the impact of the hurricanes, and if that were to slow down economic activity it's possible that they might delay that first, or the next rather, increase in the Fed funds rate, but I think that's kind of unlikely. I would expect it to happen in December at this point.

Interviewer:
How might the unwinding of the Fed's balance sheet play out through either 2017 or into 2018?

Chris Johns:
Well, that's a really good question and it's hard to say because we've never had this big of a Fed balance sheet before and it's hard to predict exactly how the unwinding of that balance sheet is going to play out. But when you put it in perspective of what their original or their initial plans are, they have roughly $4.5 trillion dollars in securities on their balance sheet, which is a mix of US Treasury securities and mortgage-backed securities.

Now the original plan to begin to unwind that, which was actually announced today, is they're going to start with about $10 billion a month between Treasuries and mortgage backeds, and that will rise to $50 billion a month over the next 15 months. That may sound like a lot on the surface but it actually only represents about 3 percent of the total that they hold so it's actually a very slow and measured approach, and the Fed is doing that on purpose so that they don't disrupt the market. The one thing they're trying to do is not disrupt the market, so I think they're going to be very careful about it, and hopefully it will work the way they want it to.

But once again, with a $4.5 trillion balance sheet and they're beginning to unwind it, particularly when other foreign governments also have big balance sheets as well, if they start to unwind at the same time we do, it could add some uncertainty to that and for us that's probably going to lead to some slight upward bias in rates over the next year. But again, nothing really disruptive like we've seen in the past.

Interviewer:
Since the 2016 election there has been talk of an increased infrastructure spending by the Federal government. How might those plans be impacted, if at all, by the 2017 hurricane season?

Chris Johns:
Well, clearly there is going to have to be a lot of infrastructure spending to repair the damage of the hurricanes in Houston and in Florida. I think for us though the greater impact, or the impact that's more important to us, is that on the municipal bond market. For these hurricanes we've seen a $15 billion spending bill to begin to repair the damage of those hurricanes and that's not going to be in the form of

municipal bonds.

I mean, this is cash that will be injected into the system to start these repairs right away. I think longer-term, there could be some bonding for these projects, and I think that's what the goal was for infrastructure spending prior to the hurricanes. So I think, you know, we're going to see some more of that but it isn't necessarily going to be – the bonding won't necessarily be hurricane driven.

Interviewer:
The fund invests only in investment grade bonds. Beyond the rating what factors do you focus on when evaluating the credit quality of potential or existing fund holdings?

Chris Johns:
Well, there is a very wide range of factors that we look at, and what I would really want to emphasize here is that we do our own credit research for the holdings that we have or are thinking of adding to the portfolio. Everything starts in house. We don't look at the ratings from Standard & Poor's and Moody's and make our decision on that. That's really the last thing that we look at, so we do very in depth analysis that includes management interviews and ratio analysis of all of our holdings.

And the one thing that's really been important in the market this year, in our view, is that in this low interest rate environment we've seen credit spreads narrow pretty dramatically. Some of the riskier sectors – some of the lower rated bonds and sectors such as healthcare where there is a lot of uncertainty – we've really seen the difference between these lower-quality sectors and the higher-quality sectors narrow significantly to the point where we believe that we are not being paid appropriately for the risk of these riskier sectors. So we've really moved more towards the higher-quality end of the spectrum because risk hasn't really been priced correctly in our view.

Interviewer:
What are you anticipating in the way of new issuance in the fourth quarter of 2017?

Chris Johns:
In the state of Oregon we've had a very good year so far. We've had about $4.2 billion dollars issued year to date through the beginning of September here. And that's very near what we had all of 2016. This is driven by a great election season in November of '16 with bonds that came to market in the early part of this year. And then also in May of this year, in Oregon, we had a good slate of bond issues passed. So this has been a very good year so far. For the rest of the year, there's just a few smaller issuers that are going to come to market and then one big state issuance for some tax anticipation notes, which is just a short-term issuance – it's not something that we would normally buy.

So we think it's going to be a little quitter for the rest of the calendar year, and our expectation for Oregon is that we won't have quite as big a year in new issuance in 2018 as we have this year, just because we had so many bonds passed last year. So the supply is going to continue to be an issue in Oregon, and the demand is still very, very high for Oregon bonds. So that makes it sometimes a challenging environment.

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.