



Hawaiian Tax-Free Trust

PORTFOLIO MANAGER COMMENTARY

Q4 2022



A Shares: **HULAX**

C Shares: **HULCX**

F Shares: **HULFX**

Y Shares: **HULYX**

Municipal Bond Market Overview

In the fourth quarter of 2022, the municipal bond market exhibited a solid rally in price as yields fell lower. Over the period, inflation statistics began to taper in magnitude. Although still elevated above the Federal Reserve (the “Fed”) target of 2%, we expect a higher rate path may still be pending from the Fed. However, in the short term, progress in the reduction of the pace of inflation (as measured by the Consumer Price Index) has muted the need for additional aggressive policy increases. The Fed is forecasting a reduction in magnitude of future rate hikes and then pausing to see the effect. To be sure, this doesn’t reverse the focus on fighting inflation and doing what it takes to push price increases lower to meet the Fed target. In fact, Federal Reserve Chairman Jerome Powell has stated he intends to hold rates in this higher range longer than the market is expecting.

Currently, the market is generally expecting a slowing of the economy this year with a recession possible in the second half. The market appears to be anticipating a decline in the federal funds rate (the interest rate that banks charge each other to borrow or lend excess reserves overnight) by the end of 2023. Chairman Powell has publicly argued that the market has it wrong and rates will stay higher for longer.

While only time will tell who will be correct, the past year has been tough on bondholders. The Bloomberg Municipal Bond Index declined 8.5% in 2022. The Bloomberg Hawaii Index declined 6.9% for the same time period. On the flip side, bond yields have increased significantly from year-ago levels. Commensurately, this provides an opportunity for investors to earn a higher level of tax-exempt income.

Several factors played into a volatile 2022. First, according to Bloomberg, the municipal yield increased from 1.0% to 2.6% at the 10-year maturity level. Second, market issuers pulled back from bringing new debt to market, reducing supply as yields moved higher. For the one-year period, the supply of national new bond issuance fell by 21%, while Hawaiian issuance fell by 48%, as recorded in The Bond Buyer. Finally, according to Barclays, municipal bond mutual funds recorded \$122 billion in net cash outflows due to shareholder redemptions.

Hawaii Municipal Bond Market and Economy

The Hawaiian economy is doing relatively well. Tourism has rebounded from nagging weakness in Japanese travel. The State’s peak visitor count came for in the third quarter of 2019 at 2,657,783 in arrivals. As of the third quarter 2022, Hawaii visitors reached 2,452,123, very close to the pre-pandemic peak. During the same time, visitor expenditures increased from \$4.4 to \$5.1 billion. The daily hotel rate also increased from \$280 to \$378, even though occupancy dropped from 83% to 77%. As an additional piece of good news, the State of Hawaii unemployment rate dropped to 3.3% at the end of December, well underneath the national rate of 3.5%.

State finances remained solid. During the first three quarters of 2022, State General Fund tax revenue increased by 20.1% over the same period the prior year. For the third quarter, Transient Accommodation Tax (TAT) increased by 18.5% over the prior year. General Fund balances are robust and State finances are showing a nice come back from the pandemic shutdown.

On the negative side, the County of Maui was downgraded in December by Moody’s from Aa1 to Aa2 with a stable outlook. The rating service cited concerns with the reliance on tourism, moderately higher debt levels and low pension funding. However, the County still maintains a mid-Aa rating after the downgrade and a high AA+ from S&P.

During the first nine months of 2022, new municipal bond issuance in the local Hawaiian market fell 78% over the prior year. This reflects a large calendar of new bonds brought to market in Q3 2021. However, during the fourth quarter, the new issuance supply of Hawaiian bonds increased by \$709 million. As a result of this, year-to-date issuance has dropped by 48% for the full year. The higher rates muted State bond issuance.

Fund Outlook and Strategy

All in all, 2022 was a very eventful year for the municipal bond market. Throughout this period, we remained steadfast and determined to bring relative value to our shareholders—entering the year with shorter duration to dampen the effect of the rising interest rates and slowly moving the Trust’s average maturity longer during the year to reap the benefit of higher market yields.

Looking forward, we expect the Federal Reserve to slow the pace of increase in interest rates. We also expect a tapering of increases in 2023 as they monitor the impact of their aggressive policy shift in 2022. The unknown is the ultimate effect of higher interest rates on inflation or whether the economy will experience a sharp slowdown during the upcoming year. For now, the next six to nine months point towards a reduction in volatility in bond market with a wait-and-see approach. As we shift to a “higher for longer” regime in Fed-speak, we believe investors have the opportunity to benefit from potentially higher municipal bond yields and total returns.

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 12/31/2022

Portfolio Management Team REID SMITH STEPHEN DODGE	Inception Date 2/20/1985	Total Investments \$512.0M	Number of Holdings 217
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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 Standard & Poor’s, Moody’s and Fitch) 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.

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.

The Bloomberg Municipal Bond Index covers the U.S. dollar-denominated, long-term tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds. The Bloomberg Hawaii Index is an unmanaged index composed of a broad range of municipal bonds of issuers in the State of Hawaii. Indices are unmanaged and are not available for direct investment.

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Before investing in the Fund, carefully read about and consider the investment objectives, risks, charges, expenses and other information found in the Fund prospectus. The prospectus is available from your financial advisor, and when you call 800-437-1020 or visit www.aquilafunds.com.