

# Hawaiian Tax-Free Trust

## Podcast Transcript March 2, 2018

---

**Interviewer:**

Today we're talking to Stephanie Nomura, portfolio manager of Hawaiian Tax-Free Trust. Tax reform legislation, The Tax Cuts and Jobs Act, was signed in December of 2017. What are the most significant impacts of that legislation on the municipal bond market?

**Stephanie Nomura:**

Hi Marie. Well, historically demand for municipal bonds has remained strong despite the changes in interest rates. In Hawaii, limiting the deduction for state and local taxes, also known as SALT, for income, sales, and property taxes to \$10,000, is equivalent to increasing the marginal tax rate for taxpayers. We expect, therefore, it should boost demand for tax-free bonds for middle to higher income residents.

Effective January 1st, 2018, which a lot of people don't realize, the state also increased its maximum tax rate to 11 percent, making the tax advantage of in-state bonds even more attractive. The federal tax rate was reduced from 39.6 percent to 37 percent and, at that level, the tax advantage of municipal bonds is still very attractive. By far the largest segment of muni bondholders has been individuals, based on market data.

It remains to be seen how all these lower corporate rates will affect demand for municipal bonds from that sector. Most companies have a tax rate lower than the previous ceiling, and the US Treasury Department calculated the average effective tax rate for companies was about 22 percent. So after the passage of the latest tax reform in 2017, there was a surge in issuance as issuers raced to the market to take advantage of existing tax laws regarding advanced refunding.

**Interviewer:**

Looking at the markets from a national perspective, what are your expectations regarding investor demand for municipal bonds and the supply of bonds available to meet that demand; and are there factors in Hawaii that impact local supply and demand expectations?

**Stephanie Nomura:**

Many of our local issuers have prefunded eligible issues over the last couple of years to take advantage of all these low interest rates. With the new tax law, prefunding existing debt will be much more restrictive, decreasing the supply of municipal bonds both locally and nationally. With our high personal tax rate, we still expect demand for tax exempt income to remain strong.

**Interviewer:**

You mentioned this earlier, but on January 1st, the state of Hawaii implemented three higher tax brackets for Hawaii residents; nine, ten, and eleven percent. Have you seen the effect of those rate changes on the market for local bonds?

**Stephanie Nomura:**

We definitely still expect tax exempt bonds to be even more of an attractive investment for local residents at those new rates.

**Interviewer:**

After nearly a decade of a very low Federal Funds rate, the Fed introduced several rate increases. How would you summarize the market activity you've seen related to changes in the yield curve and credit spreads?

---

*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 on this site, from your financial advisor, and when you call 800-437-1020.*

---

**Stephanie Nomura:**

Short-term muni rates have moved up about three quarters of a percentage for the three years ending December 31, 2017. This compares favorably to Treasury note rates that have increased by more than one percentage point and is indicative of a continued demand for short-dated muni bonds. While we hold only high-quality issuers in our fund, we observe that the continued low rate environment has resulted in some investors reaching out for higher yields available on lower quality bonds.

This demand has contracted the spread between high and low-quality bonds to historical lows, meaning investors are being compensated less for taking on additional credit risk.

**Interviewer:**

Given the high quality intermediate maturity profile of the Fund, how are you strategically navigating this market?

**Stephanie Nomura:**

We have continued to look for opportunities to add incremental yield to this portfolio, taking advantage of the significant number of advanced refundings. The recent state of Hawaii bond issuance in January was priced at a very attractive level, and we added some of those bonds to the portfolio.

**Interviewer:**

Speaking of navigation, how is Hawaii doing in terms of managing public employee pension funding?

**Stephanie Nomura:**

The state of Hawaii has taken proactive measures to improve the funding of its pension and OPED liabilities. The state has contributed more than the required amount in the fiscal years 2014 all the way through 2017, which will decrease future liabilities. The legislature also enacted higher employee pension fund contributions in 2017. The rating agencies cite the state's commitment to adjusting this long-term liability as a positive credit event. In fact, the state enjoys the second highest credit rating given by the various rating agencies and was upgraded by Moody's in 2016 to AA-1, which is one notch away from AAA.

**Interviewer:**

The president introduced his \$1.5 trillion infrastructure initiative on February 12th. How might the plan impact the municipal bond market?

**Stephanie Nomura:**

Well as you know, the plan as it will most likely be amended, so it's difficult to hypothesize on its impact. So I'm sorry, it's too early to speculate what's going to happen and how it's all going to turn out.

**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.

---

*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 on this site, from your financial advisor, and when you call 800-437-1020.*

---