Aquila Tax-Free Fund For Utah
Podcast Transcript December, 2019

Matthew DiMaggio:
Welcome to another Aquila Group of Funds podcast. This is your host, Matthew DiMaggio. Today we are speaking with JT Thompson, portfolio manager of Aquila Tax-free Fund For Utah. Thanks for joining us today, JT.

JT Thompson:
Thanks Matt.

Matthew DiMaggio:
Let's get started. I would like to briefly get your thoughts on a few topics from 2019 and then talk about the coming year. Since 2016 we have seen periods where muni investors have stayed on the sidelines notably from concern over tax reform and also duration risk when the Fed was increasing rates, but 2019 has turned out to be a pretty monumental year for the asset class. What would you say contributed to what will likely be record inflows by year end and have you seen that trend in Utah specifically?

JT Thompson:
Yes Matt. We have seen the inflows in the state of Utah. I think stability in interest rates has had an enormous effect on the fixed income market, and in particular, I think municipal issuers have had strong balance sheet and has made that part of the fixed income market very attractive.

Matthew DiMaggio:
Moving on JT, at the end of November, national municipal issuance was up 18% year over year and many of this year's deals were over-subscribed, but I noticed Utah's issuance was down almost 7% from the same time period. Has issuance affected the funds percentage of Utah holdings? And has your local presence been beneficial when accessing the primary and secondary markets?

JT Thompson:
The 7% decline in issuance has not had an effect on our Utah holdings. We're still hovering around 70% of the portfolio in Utah holdings. The ability to meet with the public finance bankers who represent issuers helps us leverage those relationships to get really good allocations on new issuance, but even better than that Matt, is we are able to see smaller issues that most people are not looking at, we're able to work with the public finance bankers to structure the debt at the advantage for not only our investors but the issuers.

Matthew DiMaggio:
Also building on that, JT, we've seen a noteworthy increase in AMT and taxable muni issuance across the markets. Have you found value in AMT this year and also will you give us your thoughts on what is driving the increase in taxable issuance?

JT Thompson:
Yeah, Matt, alternative minimum tax value has decreased since the tax reform, as fewer investors are subject to the alternative minimum tax. Although there is a pickup in yield in buying AMT bonds and it's a way of getting a little better yield without sacrificing credit ratings. As far as taxable municipal bond issuance in the state of Utah, it's up hundreds of millions of dollars and let me kind of give you an idea of what a taxable municipal is. The IRS issues certification for double tax exemption. If you can't get that certification, you can issue what they call a taxable municipal bond, where federally the interest is taxable, but in the state it's tax exempt. Now, most issuers lately with the lower interest rates have used taxable municipal bonds to refinance outstanding tax exempt debt, and that way they're able to lower their debt service costs and with that really help their balance sheets become very strong.

Matthew DiMaggio:
Thank you for the clarity on that. I think it's been pretty big topic for 2019. So let's touch on rates for a second. After increasing rates four times in 2018 the Fed reverse course this year and reduced target rate by 75 basis points in three consecutive meetings. Would you say the market has started to price in recessionary conditions? And what are your thoughts on the credit markets?

JT Thompson:
I don't think the credit markets have been building in a recession. The federal reserve, and just recently, has made it clear that they are on the sidelines until there is a clear vision of which way the economy is moving. I don't think that a good number or a bad number here and there will spur the Fed to react. They mentioned that they seem to be staying put for 2020 and I think unless you see a movement in the economy one way or the other, that we will trade in this narrow range for the majority of 2020.

Matthew DiMaggio:
And on a similar note, munis tend to be sensitive to credit spreads and other markets. What are you watching globally? Also do you see trade tensions, global growth, and an election year impacting your market and the funds? And are there any other risks that you're watching?

JT Thompson:
Matt, definitely election year with an administration that is negotiating trade treaties is going to have an effect on the markets. I think that some of those that are running against the current president that have more socialistic views could create volatility in the market. I did think that global interest rates, with a lot of countries having negative interest rates, are a magnet that seems to keep our interest rates low, even though outstanding debt continues to increase. I kind of look that this is going to be through the 2020 and not until election that we'll see markets move one way or the other.

Matthew DiMaggio:
Okay. Let's talk about pensions for a second. Always an important topic. Last year Barron's called the estimated $1 trillion in unfunded pension liabilities, the ticking time bomb in the municipal bond market. What is the pension situation in Utah, and are you concerned about it having an effect on the local municipal market?

JT Thompson:
Luckily for Utah, years ago Utah went to a defined contribution pension plan. In the state of Utah constitutionally you have to have a balanced budget, and when markets fluctuated you could have an over reach, or even a short fall in your pension funds and therefore you don't have a balanced budget. So they went with the defined contribution plan, which basically is 10% of a person's salary is put into a fund and that funds their pension obligation. So in Utah we are not concerned about pension liabilities. The unfunded portion of pensions is very, very small before the new law came in. As we know like in Detroit and other areas, you see a municipal default and the focus is to affect the pension plans to reduce pension obligations. That will not be happening in Utah or any of the local municipalities.

Matthew DiMaggio:
On the retirement side, we are seeing a large demographic shift with baby boomers moving into retirement and business insider recently ranked Utah in the top 10 places currently attracting retirees. Do you see this shift changing municipal demand and the fixed income market in general?

JT Thompson:
For retirees, quality fixed income is always in style, because you need a flow of funds to live off of if you're retired and so fixed income, the older you get usually you have a larger percentage in fixed income. Municipal debt tax-free, especially double tax free debt, in the fixed income sector is very attractive because it allows investors to invest in the local economy to help infrastructure in their hometown, in their County, in their state, and it is always been a major investment vehicle for individuals. The majority of all municipal debt is owned by individuals.

Matthew DiMaggio:
Thank you for your time today, JT.

JT Thompson:
You're welcome, Matt.

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