Aquila Churchill Tax-Free Fund of Kentucky

PORTFOLIO MANAGER COMMENTARY
Q4 2023

AQUILA® GROUP OF FUNDS

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Municipal Bond Market Overview

After continued weakness in the month of October, the municipal bond market staged a powerful rally in November and December during the quarter ending 12/31/23. The 10-year AAA yield, as measured by Bloomberg, declined 119 basis points, from 3.45% on September 30 to 2.26% at the end of the quarter. This resulted in an overall decline in this benchmark yield of 19 basis points for the 1-year period ending 12/31/23, when yields began the year at 2.45%. The market demonstrated a sharp turnaround during the fourth quarter. Following a jump in the 10-year AAA yield, to 3.65% at the end of October 2023, the market began a recovery in November, which picked up steam in December. This delivered the strongest quarterly performance for the municipal bond market since 1986, according to Bloomberg. The Bloomberg Municipal Bond: Quality Intermediate Index posted a positive return of 5.86% for the quarter, which enabled it to record a positive total return for the year of 4.64%.

The municipal bond market also outpaced the U.S. Treasury bond market by a wide margin, as the yield on the 10-year U.S. Treasury bond declined only 70 basis points. This outperformance was largely mirrored across the entire 1-30-year yield curve, reducing the ratio of municipal bond yields to U.S. Treasury bond yields. During the fourth quarter, this 10-year ratio declined from 74% to 58%, while the 30-year ratio declined from 93% to 83%. Although this outperformance has diminished some of the "cheapness" which had surfaced in municipal bond values last fall, the taxable equivalent yields of municipal bonds at the end of the quarter remained attractive relative to recent inflation readings that have remained below 4%. This still leaves municipal bonds in what appears to be a position to offer better risk-adjusted return prospects than other corners of the taxable investment-grade fixed income markets.

While investors have remained focused primarily on interest rate increases in 2023, and intentions in 2024 of the Federal Reserve and Chairman Jerome Powell, the continuation of the trend of inflation below 4% since last June has begun to provide a supportive tone to the municipal bond market. Coinciding with the drop in market yields was a surge in new municipal issuance during the past quarter. Nationally, issuance totaled $105.5 billion, a robust 39% increase over the $75.5 billion issued in the fourth quarter of 2022. For the year, issuance in 2023 totaled $379.9 billion, a modest 2.9% decline from the $391.3 billion issued in 2022, according to data from *The Bond Buyer.*

The credit quality of municipalities has demonstrated resilience in the face of recession concerns and the wake of the latest U.S. government downgrade last August by Fitch Ratings (from AAA to AA+). A barometer of this was the upgrade of the Metropolitan Transportation Authority ("MTA"), one of the most economically-sensitive New York issuers in the national municipal bond market. The upgrade of the MTA in October by S&P Global Ratings (from BBB+ to A-) reflects how the essential nature of important municipal services (in this case, mass transit in the nation's largest city) is important to credit quality. The upgrade is also a result of the impact municipalities derived from the significant intergovernmental transfers made by the U.S. government to power the COVID-related economic recovery. This included the $6 trillion in CARES Act packages passed in 2020, and the $1.9 trillion American Rescue Plan passed in February 2021.

Kentucky Municipal Bond Market and Local Economy

At the end of December 2023, Kentucky finished the year with new bond issuance rising 12.2% for the year. This compares to a contraction of 2.8% nationally. And this is particularly noteworthy when you consider that Kentucky's new bond issuance at the end of June was down 55.9%, according to *The Bond Buyer*.

New issue supply in the fourth quarter of 2023 provided the Fund opportunities to participate in various new issue county school deals. The purchases included the Counties of Anderson, Christian and Adair. We also purchased some of the Kentucky State Property new issue deal as well. The county school sector was approximately 22% of the total portfolio as of 12/31/23, which is considerably more in line with Kentucky's overall issuance, and generally higher than past allocation percentages.

A significant bond rally began on 11/1/23, when market observers decided that the next Federal Reserve move would be to lower interest rates. That, of course, remains to be seen, although it did provide a boost in bond prices during the fourth quarter. By any measure, it was a major move for fixed income, including municipal bonds.

As reported in September 2023, Louisville, Kentucky topped the national job market growth at 2.5%, according to payroll and Human Resource platform, Gusto. This was followed by Virginia Beach, Virginia (1.5%), Indianapolis, Indiana (1.1%), Richmond, Virginia (1.1%) and Cincinnati, Ohio (1.0%). Louisville salaries also grew at a high rate over the one-month period of September 2023, which was the third-fastest of the cities detailed in the Gusto report, at 11%. Louisville's unemployment rate in September was 3.7%.

The main event for Kentucky in the first quarter of 2024 will be the bi-annual legislative session. The re-elected governor, Andy Beshear, faces what is generally viewed as a veto-proof Republican legislature in both houses. Some major bills filed in the first few days of the session are changes to the currency and bullion taxability (to non-taxable), relaxing some planning and zoning requirements, and restricting the Council of Post-Secondary Education to tuition increases of no more than 5% (or 7% for out-of-state students). Governor Beshear's proposals regarding Universal Pre-K and across-the-board raises for teachers seem to be non-starters with the Republican legislators. The legislators seem to favor pumping more money into infrastructure, higher pay for state police, and extra support for the areas affected by the tornados and floods experienced over the past couple of years. One high priority for the conservative legislators seems to be financing (not in the State's Constitution) charter schools, and a school choice program, which has been recently shot down by the courts.

In Beshear's proposed budget, coupled with $1.2 billion in 2024-2025 and $1.2 billion 2025-2026 in federal funds, is financing and interest to complete the I-69 Ohio River Crossing and the Mountain Parkway. The total package allocated by the budget is $300 million, plus the re-issuance of $150 million Grant Anticipation Revenue Vehicle Bonds (GARVEEs), federal-backed road trust municipal bonds that are maturing on the Louisville Crossings Project. The Brent Spence Bridge Project allocation of funding is restricted to interest only, as the viable project plan is seemingly still in the making.

Fund Outlook and Strategy

We believe Aquila Churchill Tax-Free Fund of Kentucky's weighted average maturity of approximately 7.7 years and modified duration of 4.1 years (as of 12/31/23), has the portfolio well- positioned given the current market situation, with the continued inverted/dipped municipal yield curve. Our attention is still focused on the short-end of the curve—specifically, 1–2-year maturities, and roughly 13-year maturity portion of the yield curve, that we believe present opportunities for a positive increase in yield. Conditions are always subject to change and we continue to monitor things closely through our disciplined, locally-based strategic approach.

The Fund's credit sector allocation over the past year increased to 61% AA as of year-end, a result of two credit rating upgrades for Kentucky in 2023—one in May (to AA) by Fitch Ratings, and another in June (to A+) by S&P Global Ratings. In our opinion, this helps further insulate the portfolio from a credit perspective.

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 12/31/2023

Lead Portfolio Manager	Inception Date	Total Investments	Number of Holdings
ROYDEN DURHAM	5/21/1987	$157.1M	130

This information is general in nature and is not intended to provide investment, accounting, tax or legal advice, nor is it intended to represent a recommendation or solicitation related to any particular investment, security or industry sector. The opinions shared are those of the portfolio manager and do not necessarily reflect those of the Investment Adviser of the Fund.

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 S&P Global Ratings, Moody's Investors Service and Fitch Ratings) 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.

Municipal-to-Treasury Ratio compares the rates of municipal bonds with those of U.S. Treasury bonds in percentage terms.

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: Quality Intermediate Index tracks the performance of municipal bonds with remaining maturities between 2 and 12 years and a minimum credit rating of A3. Indices are unmanaged and are not available for direct investment.

Mutual fund investing involves risk; loss of principal is possible. Investments in bonds may decline in value due to rising interest rates, a real or perceived decline in credit quality of the issuer, borrower, counterparty, or collateral, adverse tax or legislative changes, court decisions, market or economic conditions. State-specific fund performance could be more volatile than that of funds with greater geographic diversification.

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 professional, and when you call 800-437-1020 or visit www.aquilafunds.com.