Aquila Churchill Tax-Free Fund of Kentucky

PODCAST TRANSCRIPT

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Interviewer:
Hello, everyone. Thank you for joining us for this Aquila Group of Funds podcast. I'll be your host, Matthew DiMaggio. Joining me today is Royden Durham, the Portfolio Manager of the Aquila Churchill Tax-Free Fund of Kentucky. We'll be discussing the current municipal bond markets as well as the local Kentucky economy. Welcome, Roy. And thank you for being on the podcast.

Royden Durham:
Hi, Matt. How are you today?

Interviewer:
Doing well. Let's jump right in. So how do you see the Federal Reserve handling this year's rate hikes? And how do you believe that it will affect the municipal bond market?

Royden Durham:
Well, Matt, the Fed has announced that it will start ratcheting up rates beginning next month, March. The question is by how much and when. It seems to be a foregone conclusion that it will come in increments of a quarter percent each move. Some are now doubling up and say the March move will be a half a percent, which I think would be wise. The Fed is way behind the curve, and there is too much money sloshing around the Western world. The Fed has $8.9 trillion in securities, treasuries and mortgages on their balance sheet. In 2007, they had $870 billion. In 2008, it went to $2.2 trillion, and then to $4.4 trillion by 2016. At the end of 2019, it was $3.7 trillion. So, it dropped slightly by the end of the Trump term. The growth is obviously a reaction of the COVID outbreak, but has seemingly gone way too far since we are now booking 7% or more annualized inflation. Goldman Sachs says there will be seven rate rises this year. Everyone else is four or five rate hike moves. As far as we know, the Fed's hand will be forced to sell off some of the securities at some point. So big picture-wise, municipals will be competing with what the Fed has to sell off, or the old term is "crowding out".

Interviewer:
Roy, in this rising rate environment, why is the municipal sector a compelling story?

Royden Durham:
Well, tax-free versus taxable, tax-free always seems better. So, in Kentucky, we have triple tax-free income versus corporates, and double tax-free income versus treasuries. That's federal, state, and ad valorem taxes. A very low default rate on municipals also makes them a great long-term investment. This very low default rate has attracted foreign buyers over the last decade that don't even reap the benefits of the tax-free income. It's not uncommon even in the Kentucky market, to see foreign market legal language incorporated in new prospectuses. This adds to the demand for municipal debt, which typically reduces borrowing costs. As a percentage yield of treasuries, Kentucky's munis have been trading below historic norms over the last 12 months. This is one reason that munis have performed so well, up until just recently, over the past year.

Interviewer:
Touching more on Kentucky, Roy, what dynamics at the state level do you see helping Kentucky over the long-term or short-term? And how will this affect the state's credit rating?

Royden Durham:
Kentucky in general is on a roll. Logistics, auto plants, battery plants, Prime Air, and technology startups popping up everywhere to support these industries. I've lived here my whole life and have never seen anything like it. The state will run one and a half to two billion surplus this year out of a budget of $12 billion. About $200 million of that will go to support tornado victims of the December 10th outbreak. Generally speaking, the Republican dominated Congress since 2011 has not begun new projects and is paying the actuarial contributions to the state under the underfunded pension funds. S&P has had the lowest credit ranking on the state, and on January 28th, announced that they moved Kentucky off credit "stable" to credit "positive". Some of this can be attributed to the federal money the state has received. But in actuality, that's under COVID. But in actuality, the revenue growth of over 12% for January and over 15% year-to-date with a fiscal year beginning July 1st is remarkable at this stage of the economic cycle.

Interviewer:
For my last question, Roy, it is actually a two-part question. With the "Build Back Better" ("BBB") plan sidelined, do you believe that demand for tax-free income will be diminished? And secondly, what does the supply outlook for municipal bonds look like in the state this year?

Royden Durham:
Well, Matt, with a growing Kentucky economy, which is supporting well-paying jobs—as an example, Prime Air is trying to hire 900 pilots—the appetite for a municipal income pool should be growing. Despite the "BBB" not raising income tax rates, job inflation salaries will help push higher wage earners into higher brackets. With companies raising wages to hold onto the employees because of the labor market, that will support those higher wages in moving people into higher brackets. This should support demand for municipals. This coupled with Aquila's trademark goal of high quality and intermediate maturity should help investors moderate risk in this rising rate environment. At this point on the forward Kentucky calendar, deals are few and far between. There is, however, a meeting soon on a new Kentucky state property deal that should settle in early April.

Interviewer:
Great, Roy. Thank you. And thanks for joining us on this podcast today. And thank you as well to all the listeners.

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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 weighted average life, also referred to as weighted average maturity, is a reflection of the quickness with which the

principal of an issue is expected to be paid.

A credit spread is a difference in yield between two bonds of similar maturity, but different credit quality.

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Yield refers to the earnings generated and realized on an investment over a specific period. Yield is expressed as a percentage based on the invested amount, current market value, or face value of the security, and includes the interest earned or dividends received from holding a particular security.

The yield ratio represents the comparison of the expected yield of one bond to the expected yield of another. A yield ratio is important when deciding whether to invest in one bond or another. Generally, the higher yield is considered better.