



Aquila Churchill Tax-Free Fund of Kentucky

PODCAST TRANSCRIPT

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**Interviewer:**

Hello, everyone. Welcome to another Aquila Group of Funds podcast. I'm your host Matthew DiMaggio. Joining me today is the portfolio manager of Aquila Churchill Tax Free Fund of Kentucky, Royden Durham. We'll be discussing recent events related to the municipal market, as well as Kentucky-specific topics. Welcome, Roy. And thank you for being here.

Royden Durham:

Good morning, Matt. I'm happy to be here on the podcast.

Interviewer:

The question I want to start off with Royden is quite direct. There are downturns in all markets given a long enough timeline, but we saw two things in the front half of this year. One, all markets experienced volatility in terms of price and yield. And two, some of the most severe and volatile municipal markets in 40 years. So, what would you say is different this time around?

Royden Durham:

The markets are reacting to high inflation numbers, exceeding 8%. With a 3% 30-year yield on the U.S. Treasury note, and an 8% inflation, that obviously makes no sense in context of the old inflation premium axiom of plus-1% to the inflation number— or in this case, 9%. Several other markets are acting counter to past trends. As an example, gold declining as bond yields and global unrest, specifically Ukraine tensions, are rising. As a point of reference, on June 14th of this year, the municipal bond market data ("MMD") curve—the "Bible" for pricing municipals—rose 25 basis points across the curve in one day. We thought that could be a record, but we're reminded that during the third week of March in 2020, the beginning of the pandemic outbreak, the MMD curve moved 50 basis points two days consecutively, or 1%. How quickly we forget pain. In general, what we are currently experiencing is a fixed income market front-running Fed rate hikes. This is standard procedure for fixed income in this environment.

Interviewer:

Interesting information, Royden. Now, what is the municipal market looking like in terms of relative value compared to Treasuries and the larger fixed income markets?

Royden Durham:

Well, Matt. The Treasury/Muni value ratios have been very volatile over the last 60-day period and, not uncommon, in a rising rate environment. As of June 16th, the five-year Treasury/Muni ratio was 69% versus 90% on May 18th. The ratio was 86% versus 90% on May 18th, and the 30-year 99% versus 104%. All significant moves, but particularly in the short-end of the market, as the Treasury yield curve flattens and inverts. So, Treasury yields are higher in seven years than 30 years. Watch the markets carefully, and pick your buying points carefully based on value. Market volatility is creating these buying opportunities. Basically, the muni market always has inherent value for the high-income earner. However, you can enhance returns by picking up inexpensive values in an oversold market.

Interviewer:

Good insight there. What are we seeing from an issuance standpoint heading into the second half of the year? Are you being presented with yields that are more appealing than what we saw coming into 2021?

Royden Durham:

Well, Matt. As rates rise, there's been less chance for refinancing any outstanding debt. As a result, issuance over the past couple of months has been lean here in Kentucky. The forward calendar isn't stellar either, with a \$78 million Jefferson County school bond issue, a \$50 million Boone County Duke Energy remarketing issue, and two \$10 million deals for Versailles and Pulaski County, as the big deals until the end of July. Jefferson is one of the most overused names in the State, so that limits the field even more. In the secondary market, most bid-wanted bonds seemed to be very long maturities. The shorter-end of the curve has ample yield vis-a-vis long maturities. So, the five-to-eleven-year part of the market has our attention at this moment. The spreads from year-to-year in this part of the curve also offer value from one year to the next, where longer does not, less basis points per year. So basically, why extend?

Interviewer:

Let's shift gears just a bit. We have been addressing the larger municipal market. At Aquila, we know that advisors and the clients of advisors look to us as the local subject matter expert. What are you seeing locally in terms of Kentucky's economic growth?

Royden Durham:

So, Matt. As you may remember, I've been very positive on growth in Kentucky, both in the spillover from Nashville and the incredible growth of logistics in the Louisville area. Louisville is now the second- largest freight airport in the U.S., and number four worldwide. In addition to this, Ford and SK Industries, which is a large battery producer out of Korea, are building a huge battery and EV (electric vehicle) plant near Glendale, Kentucky, slightly south of Elizabethtown. This one chink that seems to be in the armor is development in the area, is that online sales are slowing, and Amazon is trying to sublease space in some of their warehouses. This is on a national basis, and we're not really seeing or hearing that happened so far in Kentucky. In the same vein, the number two warehousing company, Duke Realty, just sold to the number one warehouse, Prologis Incorporated. None of this economic activity seems to be helping the supply of municipals issued in the State of Kentucky though. And general revenues for the State through the end of May are up 16%. Sales taxes and income taxes are the main suppliers of the high rate of increase. The State expects to end the fiscal year with a \$1.5 billion-\$2 billion surplus, which is the largest ever.

Interviewer:

Those are all the questions we have for you today, Royden. Thank you for joining us and providing great color on the markets, as usual.

Royden Durham:

Thank you, Matt.

Thank you for listening to this podcast. The opinions shared are those of the portfolio managers and do not necessarily reflect those of the Investment Adviser of the Fund. A complete list of the Fund's current holdings, including percentage allocation, is available on our website and by contacting Aquila Group of Funds.

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The Fund seeks to provide a high level of income exempt from state and federal income tax as is consistent with capital preservation. Past performance does not guarantee future results. For certain investors, some dividends may be subject to federal and state income taxes, including the alternative minimum tax referred to as AMT. Please consult your tax professional.

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 creditworthiness of underlying bonds in the portfolio. Where the independent rating services differ in the rating assigned to an issue or do not provide a rating for an issue, the highest available rating is used in calculating allocations by rating. Pre-refunded or escrowed bonds are issued to retire or regain an outstanding bond issue at a specific call date. Until the call date, the proceeds of the bond issuance are typically placed in a trust and invested in U.S. treasury bonds or state and local government securities.

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.

Taxable equivalent yield is the return that is required on a taxable investment to make it equal to the return on a tax-exempt investment.

For certain investors, net investment income tax, known as NIIT may apply. NIIT is a 3.8% tax established by the patient protection and affordable care act that applies to the lesser of, the net investment income, or a taxpayer's modified adjusted gross income above an applicable threshold amount.

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.