



# Aquila Churchill Tax-Free Fund of Kentucky

## PODCAST TRANSCRIPT

### Q3 2021

**Interviewer:**

Hello, everyone. Welcome to another Aquila Group of Funds podcast. I'm your host, Matthew DiMaggio. Joining me today is Royden Durham, Portfolio Manager of the Aquila Churchill Tax-Free Fund of Kentucky. We'll be discussing Kentucky's post-stimulus economic situation, infrastructure, municipal spreads, and rates. Welcome, Roy.

**Royden Durham:**

Thank you very much, Matt.

**Interviewer:**

Roy, we are about five or six months down the road from the American Rescue Plan Stimulus package. How is Kentucky faring in the economic recovery?

**Royden Durham:**

Well Matt, Kentucky during the pandemic has chocked up large surpluses, recording a revenue number for fiscal year ended June 30 in general revenue, up over 10%. This allowed the government to add about \$1 billion to the rainy-day fund, which stands at about \$1.5 billion. And that's a very meaningful number in a state with a total budget of only \$12 billion. State revenue, by the way, is up 8.4% for the first fiscal month of the year ending July 31. Two CARES Fund allocations I see are of the Sherman Minton bridge, which is being rebuilt in Louisville, and several hundred million to education. They're still haggling over the Brent Spence Bridge project in Cincinnati, which is a fight basically between Ohio and Kentucky.

**Interviewer:**

So, Roy, I want to touch on demand. Demand is high across all municipal segments with the relative supply being somewhat moderate. How does that affect the municipal market, and do we expect demand continuing at these levels?

**Royden Durham:**

Well, Kentucky issuance is down 25% latest numbers at the end of July from the bond buyer. The other supply problem is, much of the major issues have been brought as taxable issues to refund tax-free issues. In Kentucky, since there had been a yield gap to the national market, the yield gap has dried up since, as one broker put it, "They've discovered Kentucky." Our credit is improved in the eyes of the national rating agencies, I believe, primarily due to the state's revenue performance over almost two years of a pandemic, and fully funding the annual state pension deficit. So, this has helped dry up the offerings in the secondary market too, since portfolio managers will sell their higher yielding paper last. I really have no idea whether muni demand can be sustained at this pace. If the three and a half-trillion dollar bill with a tax hike fails, my guess is demand would dry up.

**Interviewer:**

Thanks, Roy. Municipal credit spreads are at incredibly narrow levels. What does that tell us about the mindset of investors?

**Royden Durham:**

Yes, spreads are very tight. In the day-to-day trading, have me passing on single-A and lower-rated hospital paper in Kentucky, primarily because I own enough, and I just can't really believe how tight the spreads are. This had me pass on buying some single A-rated Appalachian hospitals in the 13-year range, with a spread of 54 basis points and a 4% coupon. Normally, this should be in the 90 to 115 basis points spread range. Because of the demand, this is what is happening. It has investors reaching for yield anywhere they can find it. A lesson learned from past experience has me buying high-grades, AA and better, if I can find them. They tend to hold value better in weaker markets. Also, a 3% coupon in a down-market will hold up better than a 2% due to diminimus, the tax implications for taking a capital gain.

**Interviewer:**

Thank you for the insight. What are your expectations for the rest of 2021 and heading into 2022 around rates and inflation. And lastly, could you tell us how you have the portfolio position currently?

**Royden Durham:**

The only rationale for a 5.4% year-over-year inflation rate, and a 185 30-year bond is overwhelming demand. This shows up in dollar demand and foreign buyers of the U.S. dollar and U.S. treasuries. With a 10-year German bond at minus 47 basis points, and a U.S. 10-year at a 126, what do you think the German postal unions pensions options are? I believe that the Japanese postal union is actually one of the largest owners of U.S. treasury debt as indicative of this situation. Any growth in worldwide economies or something like the burgeoning inflation in the UK could change this situation quickly. In any event, it seems to me the Fed is erring to the inflationary side, and several of the even liberal Fed governors are concerned.

**Interviewer:**

Thanks, Roy.

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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.

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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.

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. The acronym PERS, stands for Public Employee Retirement System. The acronym PERA, stands for Public Employees' Retirement Association. CARES Act Stands for Coronavirus Aid, Relief, and Economic Security Act.

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.