



# Aquila Tax-Free Trust of Oregon

## PODCAST TRANSCRIPT

March 2022



### **Interviewer:**

Hello everyone. Thank you for listening in to the Aquila Group of Funds podcast. I'll be your host, Phil Felice. Joining me today are Chris Johns and Tim Iltz. They are the Portfolio Management Team of Aquila Tax-Free Trust of Oregon. We'll be discussing the ever-timely municipal bond market, as well as the local Oregon economy. Welcome, Chris. Welcome, Tim. And thank you both for being on the podcast.

### **Chris Johns:**

Thanks, Phil.

### **Tim Iltz:**

Thanks, Phil.

### **Interviewer:**

Let's start off with the story, not only in municipal markets, but all markets for the start of 2022: The Fed and interest rates, as they look to tackle inflation. We've seen how the muni markets, and really all markets, sold off on the news of rate hikes. What do we expect from the muni markets for the rest of the year in an anticipated rising rate environment relative to other fixed income markets? And then, even relative to other markets in general? How does Aquila position accordingly?

### **Chris Johns:**

Well, that observation is correct, Phil. For the first part of this year, most of the interest rate news has been focused around hawkish decisions that the Federal Reserve is making. They've mentioned that they were going to begin to reduce the amount of securities they're purchasing in the open market, which they're going to start here at the beginning of March. They've also talked about allowing the securities that they own to run off their balance sheet. So, a balance sheet shrinking. And then the third thing where they've actually talked about the liftoff of starting to increase short-term interest rates. So, the combination of all three of those things led to higher interest rates in the first couple of months of this year, depending on which maturity range you're looking at in the Treasuries—anywhere from 50 to 70 basis points higher in a fairly short period of time because of all that. This is driven largely by the inflation numbers that you mentioned. We're seeing inflation virtually everywhere, in food prices, commodity prices, car prices, and home prices. Everything is experiencing inflation right now as we recover from the COVID pandemic, and there's still some supply chain disruptions that cause difficulty in getting products through the system and, hence, higher prices. So, between inflation and higher interest rates, that's really been the story so far this year. That's all being tempered by geopolitical events, with Russia and Ukraine, where interest rates have come back down a little bit because of concerns about what's going on internationally. And so, interest rates have come down a little bit. It remains to be seen if the Federal Reserve will react to these geopolitical concerns and slow down their hawkish policies that they've talked about at the beginning of this year. So, that remains to be seen.

We believe that interest rates will continue to edge upwards for most of the rest of this year, both for treasuries and for munis. And we believe that at some point, we'll start to see a little bit larger increases in interest rates on the longer end. So far, most of the interest rate increases have been in the 3–10-year range. And we think that the longer end of the curve could go up a little bit more from where they are today. For our Fund, we have a duration of about four and a half years, average maturity of around seven years and high credit quality. We've been anticipating higher interest rates for some time. And so, we've built a fairly defensive portfolio with limited interest rate risk exposure, and very limited credit risk exposure.

### **Interviewer:**

Great. Thanks for that, Chris. And with all that in mind, there is sentiment from our advisor universe and they're asking what makes munis compelling now. Their clients are hearing about potential rate increases, and they're asking their advisors to guide them. How do we help investors or even advisors discussing the asset class with investors? Answer that question of: "What makes munis compelling now?"

### **Chris Johns:**

Well, the first thing I would say is that there has been an adjustment in municipal bond interest rates relative to U.S. Treasury rates. For a lot of last year, and even at the beginning of 2022, muni rates had not really kept up with Treasury rates. But, recently they have caught up. So right now, the municipal/treasury ratio—in other words, the percent that muni yields are of corresponding

maturity U.S. Treasury yields— are more normal. In some cases, actually a little high. The five-year range muni yields are 77% of treasuries, 10-year range, about 86% of treasuries, and in the 30-year range, about 80% of treasuries. And I would say that's in the normal range, maybe even slightly above normal. So, the valuation of munis is good.

The next thing I would say is, that historically, in a rising interest rate environment, munis tend to be a little less volatile. And the primary reason for that is the tax-exempt nature of it. Having that tax benefit generally makes interest rates on munis a little less volatile than they would be on U.S. Treasuries. And then for us, with our limited interest rate risk exposure and high credit quality, that's the type of portfolio that we would anticipate would be a little less volatile in a rising interest rate environment

**Interviewer:**

We talk in great detail here at Aquila in regard to being local, and the idea that because of our footprint in a State like Oregon, we are better situated to tackle the State's muni environment. So, we want to switch gears and move it over to Tim. You always do a great job answering this question, so we want to ask you, what are you seeing on the ground that someone looking at your market from a national perspective may miss?

**Tim Iltz:**

Tax-exempt muni issuance in the State of Oregon has been fairly strong this year. Over the first couple of months, we've seen issuance up 40% versus the same time period last year. This compares to a decrease nationally of about 8½%. I know the demand remains strong in the Oregon market with new issues, many times oversubscribed. One of the things I think is notable that we've seen is that with higher interest rates, we've seen a significant drop in taxable issuance for the first time since the tax cuts and jobs act eliminated tax-exempt for fundings. These are bonds that are issued by governments to pay off existing debt with new debt, similar to how a homeowner might refinance their mortgage. In Oregon, over the past couple years, issuance has been about 50% taxable. And so, what's notable is that over the first couple months of this year, we've only seen two deals totaling about \$15 million, versus \$380 million last year. I attribute this largely to the increase in interest rates.

**Interviewer:**

So, let's stay at the State level, but let's look at it from a macro perspective. Anything to note about the state economy, whether it's employment, tourism, housing? Anything that anyone listening to this podcast that would stand out?

**Tim Iltz:**

The Oregon economy continues to be strong, and I would note that all primary revenue instruments in the State are outperforming pre-pandemic expectations. One of the big concerns right now that we have for the Oregon economy is supply constraint. One area that I would highlight is labor—labor constraints. And I note labor because that runs through everything, from goods to services. Particularly as we're talking about an economy that's transitioning to more of a service-related economy. I would note too that Oregon added a record number of jobs last year. But even so, labor supply remains tight, and this is leading to wage growth. From the State's perspective, this is largely a positive thing. Higher wages in the State, and this leads to greater withholdings. The concern though is inflation. And, while higher wages translate to better revenues for the State, it could potentially limit growth down the road.

**Interviewer:**

Chris, Tim, thank you as always for your time today, and for the insights—not only on the Oregon market, but the broader municipal bond landscape. We always do appreciate your time.

**Chris Johns:**

Thanks, Phil.

**Tim Iltz:**

You're welcome.

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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.