Aquila Narragansett Tax-Free Income Fund

PODCAST TRANSCRIPT

March 2022

Interviewer:
Hello everyone. Thank you for joining us for this Aquila Group of Funds podcast. I'll be your host, Matthew DiMaggio. Today, we are speaking with Jeffrey Hanna, Portfolio Manager of Aquila Narragansett Tax-Free Income Fund. We'll be discussing the ever-timely municipal bond market, as well as the local Rhode Island economy. Welcome Jeff, and thank you for being on the podcast.

Jeff Hanna:
Great, thanks for having me.

Interviewer:
Let's start right off with a story that's not only affecting the municipal markets, but all of the markets for the start of 2022. That would be the Fed and interest rates, as they look to tackle inflation. So, we've seen how the municipal markets, and really all markets, sold off on the news of potential rate hikes. And what do we expect the municipal market for the rest of the year with anticipation for rising interest rates, relative to other fixed income, or other markets in general? And how would you say Aquila has positioned accordingly?

Jeff Hanna:
Well, I think anything that's credit-related has really given some ground in here. Spreads have remained fairly tight. We're starting to see that spreads moved a little bit wider. It's also interesting to note that there is a slow flow period, if you will—February to April—as people get ready for tax time. So, I think that has impacted the municipal market as well. And you also have inflationary pressures. So, a lot of this is dependent on the information that's coming out, the pressures that we're seeing in supply chain and inflation. Obviously, the Fed, I think, feels as though they've won the battle, if you will, or their dual mandate, on one side with full employment. And now, they're looking at stable prices. So, they appear to have gone all in, in fighting inflation, going forward, and have announced that they're expected to have rate hikes, and also shrinking their balance sheet. Which takes more securities, more treasuries, municipals to some degree, but mortgage back securities, again, out of the market—a natural buyer, if you will, or has been a natural buyer over the last number of years.

As far as positioning, the portfolio is positioned very well. It has been a little bit constrained by supply here within the State. But there are some secondary market issues out there. Anything that comes to market anew, we definitely are taking a look at. The portfolio is structured as such. We're probably a little bit longer duration than the benchmark. And while that may sound a little counterintuitive to where interest rates are going, because of the lack of supply, we want to make sure that the portfolio is basically shortening every month. So, regardless of what you have for a new supply, and when you don't have a great deal of new supply, you want to make sure that you're invested. And we do have maturities across the curve.

Interviewer:
Great color, Jeff. Moving on to the next question. There is sentiment from our advisor community asking what makes municipals compelling now. Clients are hearing about the potential rate increases that we're talking about, and are asking their advisors to give them guidance. How do we help those investors, or their advisors discussing the asset class, answer that question?

Jeff Hanna:
Well, I think from the standpoint of where interest rates are, just the anticipation of the Fed increasing rates, has moved the markets. So, a lot of that's already baked in. At this point, it's a matter of degree. Certainly, the yield curve has taken into account interest rate hikes. Obviously, the Fed's been very cognizant of the data, and is going to make additional moves, or a lack thereof, based on that data going forward. So, from that standpoint, I don't think it's necessarily something to fear. And I think a lot of investors don't realize that it's already in the numbers: already in the value of the bonds. I think from the standpoint of getting into the market, dipping a toe in the water is fine, reinvesting the dividends. And tax rates haven't changed. There was some talk about it last year, and that was anticipatory. Folks piled into munis, where we had spreads very, very tight near the end of the year. Since that hasn't changed, I think people stepped away a little bit and said, "Let's take a breather." Even with tax rates where they are, it still makes sense for municipal bonds to be part of a portfolio on a tax-equivalent basis.

Interviewer:
Thanks, Jeff. We talk in great detail here about Aquila with regard to managing locally. And the idea that, because of our footprint within our states, we are better situated to tackle the State's municipal environment. And you have great insight. So, we want to

ask, what are you seeing on the ground there in Rhode Island, that someone looking at your market from a national perspective, may miss?

Jeff Hanna:
Yes, we definitely focus at the local level. We know the specific credits and issuers. And I think what we bring here is relative value. So, from the standpoint, even though we're investing within the State, I think from the standpoint of where that comes in, where an issuer within the State, how that compares to national issuers, other issuers outside of Rhode Island. I think Rhode Island often, I don't want to give it away, are relative value here. But Rhode Island often gets overlooked, just because of the sheer size, or again, the smaller issuance size. If there's a larger issue, it tends to get a little more national attention. Smaller issues tend not to get that type of attention. But I think in general, again, depending on how the issue comes to market, there's some great value to be had in Rhode Island. And we're able to take advantage of that.

Interviewer:
And sticking to the State level, but maybe pulling it more to the macro sense, are we seeing anything of note at the Rhode Island state economy?

Jeff Hanna:
Well, I think everything seems to be moving in the right direction. We do have ARPA money, the funds here. We're being very thoughtful about how those monies are going to be used. A number of states have already spent some of that, or all of that money. And Rhode Island took a step back, and said, "We have this pool of funding, let's look back, and see what we need." And I think from that standpoint, providing much needed affordable housing, providing small businesses with some help, really an infrastructure. And I don't mean infrastructure from roads and bridges, like we're looking at on a national level. But looking at what can we do within the State with these funds to make Rhode Island a better place for all, and looking longer term. And that's something that's, I think, a very welcome approach.

Interviewer:
Absolutely, Jeff. For the last question, I wanted to discuss municipal demand, which has been strong for some time. We noticed demand for munis started to wane, as tax reform became less likely, which you just touched on in a prior question. Can you speak about that, and anything else that might be affecting demand at this time?

Jeff Hanna:
Sure. Yeah. I think with that, you're right. We did see spreads really tight going into the end of the year. Munis had a great year relative to other fixed income in 2021. But, also again, spreads had widened a little bit as we got into the beginning of the year. Some of that was due to a lack of tax reform, so to speak. But I also think that taxable bonds were relatively less expensive. And for those in lower tax brackets might have made more sense. But I also think that the market had gotten a little bit tired and you were starting to see things readjust. You did see, if you use munis as a percentage of treasuries, you did see those figures down into historically low numbers—in the mid-50s. Historically, they were considerably higher than that—I'd say probably 70 to 80%. So, you're starting to see that readjustment taking place in the first couple of months, along with concerns about the fundraising rates.

You did see individual investors step back a little bit, and just held cash as they were concerned about the markets going in the same direction. And what I mean by that is, interest rates were going higher, while equities were going down in value. So, the values are going down. Historically, stocks and bonds tend to go a little bit more in opposite directions. But for the first couple of months of the year, they went in the same direction, and folks weren't used to seeing that. Since that time, we've seen those markets going in their more traditional opposite directions. So, from that standpoint, I think from people getting additional demand back in the market, we'll see that. A lot of the deals that are coming are getting good demand. There's just not a great deal of supply at this point in time. But, as that supply continues, and again, it's still a little bit early in the year, but we'll start to see that ramp up in here. Particularly if rates, relatively speaking, are still at historically low levels.

Interviewer:
Interesting, Jeff. Thank you for your time today, and for your insights---not only on the Rhode Island market, but the broader municipal bond landscape. We, of course, always appreciate it.

Jeff Hanna:
Great. Thanks for having me. And always, great to talk to you guys.

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"ARPA" stands for the American Rescue Plan Act, which provides direct relief to cities, towns and villages in the United States stemming from the COVID-19 pandemic, as overseen by the U.S. Treasury Department.