Aquila Narragansett Tax-Free Income Fund

Podcast Transcript September, 2020

This is Candace Roane with Aquila Group of Funds. Today is September 2nd and I'm joined by Jeff Hanna, Portfolio Manager of Aquila Narragansett Tax Free Income Fund. Welcome, Jeff.

Jeff Hanna:
Good morning. Thank you.

Candace Roane:
Thank you for joining me today. We last spoke in April following the outbreak of the pandemic and the rather dramatic market events that occurred at the end of the first quarter. Can you tell us what has transpired in the municipal market since March?

Jeff Hanna:
Yes, well as we've seen here since then, the market certainly has rebounded very strongly to the levels, even higher and tighter than March. And certainly that happened mostly in April but markets continue to grind tighter.

We did see a bit of an increase in issuance, particularly in the taxable municipal bond markets. And demand still outstripping supply of tax exempt munis, particularly the result of the fear of changes more recently in tax laws post-election.

Candace Roane:
Focusing on the Fund, Aquila's municipal strategies have a relatively conservative investment mandate. How did that management style impact your shareholders' experience during the volatility this year?

Jeff Hanna:
Well, the Fund initially moved along with the national funds, which is typical during such turbulence. But the higher quality, well diversified portfolios, such as Narragansett Fund tended to hold up better than lower quality funds. The duration position that was more in line with the benchmark was helpful, particularly given the more recent curve steepening.

Candace Roane:
Shifting to more macro in the Fed, after offering no assistance during the previous financial crisis, the Fed has stepped in this year and offered some aid to municipal markets. What do you think is different this time? And can you give an update on how the Cares Act and the municipal liquidity facility have offered assistance to state and local governments?

Jeff Hanna:
Well, I think the pandemic certainly was not something we had ever seen and quite different from the financial market meltdown that we saw back in 2008, 2009. I mean, providing necessary liquidity to the markets and keeping the spigot flowing has allowed markets to continue functioning during these turbulent times.

And then the Fund certainly had been used to providing necessary care for those stricken with COVID and provided those institutions involved with support. And the Fed basically stepped in as a lender of last resort and again, providing this liquidity and that's something that continues to work for local state and local governments with respect to the facilities which have since expanded. The Fed has expanded those facilities to a greater degree than they were back in 2008, 2009.

Candace Roane:
Let's talk about defaults. Revenues have increased over 40% from their pre 2008 peak and municipalities appear to be resilient and prepared to sustain temporary revenue shortfalls. But there is some concern around muni default risk, do you consider that concern valid?

Jeff Hanna:
Well, I think that the right sizing of state and local governments is needed and for the most part achieved post financial crisis. Temporary interruptions can be handled at the state and local levels, but sustained impacts will stretch budgets and resources. Rhode Island has had a rainy day fund of about $200 million, but most is tapped to cover the recent budget shortfall.

And for the next fiscal year, the state is facing about a $515 million deficit, which is hoping comes in the form of additional federal stimulus. Otherwise, we could see a number of cuts here in the State, whether it be employee furloughs, layoffs and other types of programs that may take place, including perhaps increasing in fees at the state and local level.

The State is expected to increase its borrowing, given the large need and take advantage of the low rates while the credit ratings remain in good shape. And certainly, the concern around the municipal default risk, I think some of that is valid, certainly here in Rhode Island. For general obligations, bondholders get paid first, which I think is very important and it's something that's very important for bond holders to know.

Candace Roane:
Thanks for covering all of that. Let's get back to the Fed for one second. What do you expect going forward regarding stimulative monetary policy? The Fed has stated that rates will remain low for the foreseeable future. Do you expect them to take other measures like they have in the past with yield curve control?

Jeff Hanna:
Well, it's certainly difficult to control the yield curve. I mean, the Fed has done a fairly credible job in doing that. I mean, historically they've really just controlled short term interest rates, a little bit more difficult for long term interest rates, just because of the players in that market.

I do think we're lower for longer in here, which essentially means basically they've given up the ghost on inflation. They're not concerned about that or they'll let inflation rise. And the Fed's been fighting inflation now for about 12 years, and there's not much to fight there. I mean, if anything they've been trying to re-inflate, so they'd like to see a little bit of inflation in here. And that's just it's been very difficult to see that.

And I think again, we're still going to see the stimulation that we've had in the economy, both from the Fed and from the fiscal side of things. And until we start to see inflation ignite, the Fed's really going to let things go.

Candace Roane:
To wrap things up today, can you give us your outlook for the muni market as we head into the last few months of 2020? Are there any sectors that you're watching closely as we face a potential resurgence of COVID-19 and an election that could shake up Washington?

Jeff Hanna:
Yeah, so I think from the standpoint of that, certainly more recently we've seen municipal spreads widen a bit as the market, I think was really overdone. As a market attempts to digest the election and pandemic news, the focus will be on any tax-related changes and result in the credit impact on munis. And certainly there are sectors that we continue to watch and that we own, and really along the lines of convention center, airport, hospitals and the universities which we own, at least some of the universities here, are all being followed for potential downgrades.

But it's something that we continue. We're not all that concerned with what we own. I think we're in a good position on a lot of those. And I think the structure of those particular holdings, generally, at least compared to some of the other states, as far as convention centers and airports and hospitals, really are a little bit different than what we see in some of the other states across the country. So position wise, I feel pretty comfortable with the credits we own currently.

Candace Roane:
Jeff, as always thank you for joining me today and offering your valuable insights.

Jeff Hanna:
You're welcome. My pleasure.

Disclosure:

Thank you for listening to this podcast. Before investing in the Fund, carefully read about and consider the investment objectives, risks, charges, expenses and other information found in the Fund perspective. The prospectus is available from your financial advisor when you visit www.aquilafunds.com or call (800) 437-1020.

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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 principle of an issue is expected to be paid. A credit spread is the 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 in excess of an applicable threshold amount. The acronym PERS, P-E-R-S, stands for public employee retirement system. The acronym PERA, P-E-R-A, 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 of time. 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.

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.