Aquila Churchill Tax-Free Fund of Kentucky
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Interviewer:
Today we're talking to Royden Durham, portfolio manager of Aquila Churchill Tax-Free Fund of Kentucky. Royden in spite of some volatility following the 2016 election, the municipal market has seen positive returns during 2017. What factors do you believe contributed to the earlier volatility and then to the recovery this year?

Royden Durham:
With the election of Donald Trump in November, 2016, the market was overcome by growth euphoria, I think. That precipitated the 4% drop in the bond market which stabilized by mid-December. Since then, the market has traded in roughly a 40 basis point band on the US Treasury ten-year; a 2.20% on the low side and about 2.6% on the high side.

The Trump euphoria has subsided to a degree, and returns generally are around one and a half to 2% year-to-date on intermediate bonds. So, anticipated higher growth rates, inflation hikes, and increased employment have not materialized, and widely-anticipated future Fed rate hikes seem to have been moved to the back burner.

Interviewer:
We've heard a lot about potential federal spending on infrastructure. How might that ultimately be implemented?

Royden Durham:
Well I believe more than likely it will be funded in a couple of different ways. One avenue would be through the Federal Highway Trust. Here in Kentucky, that would go a long way since we have over 300 bridges and overpasses that need immediate attention, according to a civil engineer inspection. These funds would be raised as a joint financing between the state of Kentucky and the federal government. An example is – most recently finished – the Abraham Lincoln Bridge completed in Louisville this past December.

Another avenue would be the P3 public-private partnerships financing used by Indiana on Louisville's other recently completed East End Bridge. This brings private investors, the contractors, and the state as an administrator together to complete a specific project. A municipal financing for these projects get a lowly rating as there is no historic information on tolls to pay the investors back. Once these deals become more prolific there's a good chance that the rating agencies will gain confidence and that could make them a great purchase currently.

Interviewer:
And from a relative value perspective how do municipal bonds look currently?

Royden Durham:
Well, as of May 18, the ten-year muni scale was about 92% of the ten-year Treasury. That is still cheap to the long-term historical relationship but expensive to recent experience of over 100%. Most lower-rated bond spreads have recently tightened as investors reach for yield. As a result, lower-rated bonds have become less attractive from a relative value standpoint. One important note is that foreign crossover fixed income investors are still attracted to US munis due to scant default ratios, raw yield and general market availability.

Interviewer:
What is your assessment of the Kentucky municipal market from a credit quality perspective?

Royden Durham:
Well as you know Kentucky has been on a downward spiral in terms of credit ratings due to its woefully underfunded pension system. A newly-ordered state government audit will be released next Monday, May 22, which will establish a roadmap for pension funding and new tax structure to be tackled in a special legislative session this summer.

This has given the widely issued Kentucky state property and building bonds a boost. They traded in the plus 95 basis point area in late January. That is close to 65 basis points currently for a 12-year maturity. So we have seen a boost in long-term confidence in Kentucky as a credit.

More recently with announcements from Catholic Health, which is also Kentucky One, and Baptist Hospital, we've experienced major down-grades and anticipate restructurings. The ACA and over-expansion by hospitals anticipating more Medicaid participants has wrought havoc with hospital revenues. And this just hasn't been limited to Kentucky.

Interviewer:
Thank you very much. For those of you listening before investing in the Fund, carefully read about and consider the investment objectives, risks, charges, expenses, and other information found in the Fund prospectus, which is available on this site, from your financial advisor, and when you call 800-437-1020. Thank you for listening to this podcast.
