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Interviewer:
Today we're talking to Royden Durham, portfolio manager of Aquila Churchill Tax-Free Fund of Kentucky. On May 1st, Federal Reserve officials decided to hold rates steady and stated that key economic activity had slowed during the first quarter. How have bond markets reacted to the announcement?

Royden Durham:
Well in general, the market has reacted positively – higher prices, lower yields. My general feeling is that the Fed is bracketing GDP and the CPI. So if the GDP is above 2.5%, which it currently is, coming in at 3.2% the other day and, the CPI is above 2.0%, which on a year over year basis it is not at 1.9%, then the Fed will feel obliged to at least consider a discount rate hike. Currently, they are indicating that they don't see it, but that 3.2% growth number in the first quarter, in which we had some dreadful winter weather which normally slows things down, must really have them, the Fed, in a quandary.

Interviewer:
Americans recently filed their first tax returns with the state and local tax, or SALT, deduction caps in place. Do you think that change in the tax law had an impact on the municipal bond market?

Royden Durham:
I really do. We have not seen spreads this tight in terms of relationships to Treasury yields in probably 15 years. One-year munis are trading at 65% of the Treasury curve, while 10-year maturities are trading at about 73% of the Treasury curve. Two years ago those both would have been about 100% or close to it. The average is closer to 80% over the long-term. I would definitely say SALT has been one of the factors that has brought us to, what I would consider, an extreme.

Interviewer:
How has new issue supply year to date changed versus 2017 and 2018? And what are you anticipating over the remainder of this year?

Royden Durham:
So, supply in 2017 in Kentucky, which was the last year for advanced refundings or refunding a bond prior to its call date, supply was enormous in 2017 because of that. Kentucky in 2018 bucked the trend of lower issuance and supply and the supply rose a deceiving 45%, while the national declined about 25%, matching the advanced refunding totals from the prior year. The reason for the deceiving supply in Kentucky in 2018 rests on the fact that $5 billion of issuance consisted of four issues totaling $3.5 billion. Those four issues were all gas bonds, and I would not participate due to the structure of the issues and the credit. The other $1.5 billion issued by Kentucky would have had issuance down over 40%, which was more in line with the national issuance. So far this year we're down around 50%, keeping us on parity with the $1.5 billion issuance of last year. Make no mistake about it, supply is tight coming off last year and lack thereof this year. This has made it very, very difficult finding yield and something worth buying, if you ask me.

Interviewer:
We've seen generally positive economic indicators in recent months. How would you assess the financial strength of municipal bond issuers in general, and are there particular sectors that you find attractive?

Royden Durham:
Sure. Kentucky as we know has been on a roller coaster ride credit wise, with the Legislature, Governor and Courts handling of all of our pension system problems. Revenues are rising and even in some surprising areas like road revenues, statewide. I bring this up because over the past several years the legislative budget on road revenue has always been a negative, but has surprised on the upside. Other parts of the economy of the state show positive revenue possibilities as well, with expansions by Nucor in Brandenburg, Kentucky and several of the auto manufacturers like Toyota, as well as considerable growth in the logistics and distribution hubs. Kentucky has a AA3 rating from Moody's with a stable bias. Moody's is particularly happy with the legislative funding levels the state has made towards the pension system over the past two years. So, Kentucky State Property Bonds with wide spreads in comparison of the market, garner national buyers in a market of very tight spreads. And this seems to have trickled down or carry over to the smaller issuers, as we are seeing syndicates by small Kentucky school bond issuers who have never purchased a Kentucky issue in the past. Specifically, a firm out of Atlanta called IFS Securities. So, to answer the question, turnpike bonds and school revenue bonds have my attention.

Interviewer:
Would you please describe your current strategy and the positioning of the Fund?

Royden Durham:
Kentucky, having experienced credit pressures brought on by the underfunding of the state pension system has had us position the fund with a shorter duration than my competitors. With the downgrades we have weathered price erosion better, but have sacrificed yield in the interim. Our objective is as an intermediate fund, and right now we're on the shorter side of that range. When there's a clear path toward a pension fix and interest rate direction, then we would consider an extension modestly to our duration, which would enhance the current yield.

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.