Aquila Tax-Free Trust of Arizona
Podcast Transcript May 8, 2019

Interviewer:
Hello. This is Matthew DiMaggio. Today, we are talking to Anthony Tanner, lead portfolio manager of the Aquila Tax-Free Trust of Arizona. Tony, thank you for joining us today.

Tony Tanner:
Good to be here, Matt.

Interviewer:
Let's lead right into our topics. On May 1st, Federal Reserve officials decided to hold rates study and stated that key economic activity had slowed during the first quarter. How have bond markets reacted to the announcement?

Tony Tanner:
Well, Matt, this Fed pivot had been mostly expected since the end of last year when growth forecasts for the economy were first being trimmed. And bond markets overall have been firm and responded favorably. The economic data has been moderating for the past few months and the economy is characterized right now by slowing but healthy growth. The forecast for GDP growth this year was reduced to 2.3% and to 1.9% for 2020, both of which were below 2018's growth rate of 2.9%.

The other important factor is that inflation remains subdued and below the Fed's self-described 2% target. The most recent measure of expected inflation that the Fed follows, - personal consumption expenditures-, only registered at 1.6%. This backdrop has been very supportive though to bond investors and bond returns.

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

Tony Tanner:
It very much has. As we first expected a few months ago when newspaper accounts of the impact of SALT were coming out, the SALT limitation did, in fact, drive up the tax bills of a lot of high-income earners. And this has placed a continued emphasis on the value of the muni tax exemption. It seems that the actual tax bite is very real, and that tangible tax bill has had a very discernible impact and has been a catalyst to municipal bond action. Almost to a much greater degree than the cheapness that we saw in the muni market back in the fall when muni yields were at or above those of taxable benchmarks. I think the key takeaway from this experience is that munis always have had, and delivered, the value of the tax exemption, not only in declining interest rate environments but also in rising yield environments as well.

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

Tony Tanner:
Well, nationally issuance has stabilized. Year to date through the end of April, total municipal bond issuance was up about 3% to $100

billion compared to $97 billion at this time last year. Here in Arizona, we've seen a 66% surge in issuance though to $1.8 billion up from only $1.1 billion a year ago. And most of this increase in issuance has occurred in the last two months. And I expect this to see this continue here in Arizona as municipalities capitalize on what is a very attractive cost of capital in funding important projects at both the state and local level. We're likely to see a healthy increase over the $4.3 billion in municipal bonds sold in Arizona last year. But I don't anticipate that we'll approach the almost $7 billion that were sold in 2017.

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

Tony Tanner:
Well, in general, the financial strength of municipal bond issuers continues to improve and continues the trend of healthy recovery from the credit crisis of 10 years ago. Upgrades continue to outpace downgrades in the municipal market both nationally and here in the state. And revenues at the state and local level are also continuing to climb, enabling many municipalities, nationally and in Arizona, to achieve healthy budget balances and to address things such as shoring up rainy day funds and appropriating revenues to areas of the state that are in need of attention. Here in Arizona, one of the things that I've noticed is that the state continues to have much higher above-average growth compared to national growth. In 2018, Arizona's economy, the GDP growth rate was 4% which ranked number fourth among the 50 states and actually placed it ahead of larger states such as California, Florida, and Texas. To me, another important positive development in the state's economy is that construction not only is a large contributor to job growth, it was actually the largest growth sector for jobs in 2018 adding almost 19,000 jobs. But now, the state is experiencing much healthier growth across all other employment sectors. And so, construction jobs now account for about 5.7% of jobs in the state which is pretty close to the national average of 4.8%. Back in 2006, the portion of jobs in the state accounted for by construction was almost double the national average, so Arizona's economy continues to grow and to diversify. In terms of sectors, last year, we began identifying some very tremendous values in Arizona's healthcare sector and that is now the largest sector in the portfolio. We actually prepared an extensive thought paper on the dynamic healthcare economy in the state that details both the inherent strengths of the healthcare economy as well as pointing out the value that we found in healthcare muni issues. This report was posted to our website in March and is a great reference to provide background on our holdings there. I think this exemplifies the benefit of combing a value awareness of the municipal fixed income market with the local portfolio management presence that Aquila has. And that allows us to observe and delve firsthand into developments in the state's economy such as what we observed in the healthcare market.

Interviewer:
Could you please tell us about your current strategy and the positioning in the Fund?

Tony Tanner:
Well, currently, we have endeavored to stabilize the Fund's income in an environment where municipal bond yields finished the year about 60 basis points lower than where they began and about 50 basis points lower than where they averaged; while at the same time, maintaining the Fund's very attractive interest rate and credit metrics. So, we have done that by continuing to broaden diversification across the maturity spectrum and trying to reallocate across cheaper portions of the yield curve and to avoid those segments of the yield curve that have gotten expensive with the renewed demand for munis this year. We think that that's the best approach towards maintaining the Fund's history of share price stability while retaining an attractive level of double tax-free income. And we do not anticipate any significant changes in the Fund's interest rate or credit risk profile going forward.

Interviewer:
Thank you very much, Tony. 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.