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Tax-Free Trust
of Arizona

Aquila Tax-Free Trust of Arizona
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Interviewer:
Today we're talking to Tony Tanner, portfolio manager of Aquila Tax-Free Trust of Arizona. At mid-year, we typically see an increase in municipal bond maturities and calls. How would you describe the supply of municipal bonds currently and what are you anticipating over the remainder of the year?

Tony Tanner:
Well, the supply of municipal bonds within Arizona has been fairly scarce during the summertime. And, in general in the muni market, the degree of what's called negative net issuance, where the amount of maturities and call proceeds exceeds new bonds, has been particularly heightened. The estimates were around $140 billion of negative net new issuance this year, versus historically being around $70 or $80 billion. So, the lack of bonds in Arizona has been fairly acute.

I will tell you that we have had very good success, though, mining the secondary market for bond opportunities and have been using the lack of bonds in the new issue market to our advantage to prune holdings that we feel are over-valued or no longer offered a benefit to the fund.

Interviewer:
We've continued to see positive economic indicators in the first half. Are municipal bond issuers seeing improvements in tax collections and other revenue sources?

Tony:
Yes, and the credit front has been decidedly good and positive. Upgrades have been exceeding downgrades by a factor of about four to one, and in general municipal receipts have continued to be on an upswing. I know that here in Arizona some of our largest issuers that derive their revenues from a very broad range of varying excise taxes continue to see healthy year-over-year growth in those receipts. And that's a trend that's continued for several years.

Interviewer:
Based on comments from the Federal Reserve, it seems as though we can anticipate one or two additional increases in the Fed Funds rate during 2018. How has the municipal bond market been trading and where are the yield curve do you see value?

Tony:
Well, the muni market and the fixed income markets in general have been what I would say very tranquil in the last four or five months. Ever since the 10-year Treasury yield first touched 3 percent, we've been fairly range-bound. And that's for a variety of reasons. While we've seen stronger economic growth, concerns around tariffs and trade wars are really keeping a lid on outsized growth expectations and inflation expectations. So it's been a bit of a Goldilocks environment. Short and intermediate yields have increased markedly since the onset of the Fed's campaign at the end of 2015, and we're now finding very good values in that intermediate 10 to 15-year part of the curve, where you're getting a real yield above the rate of inflation, and not having to take a meaningful amount of interest rate risk.

The other thing that we're observing is that despite the increase in short and intermediate muni bond yields over the course of the last two years, the municipal bond yield curve remains very steep, especially compared to the US Treasury curve. The spread between 2 and 30-year munis is around close to 1.5 percentage points, where it's maybe 40 or 50 basis points in the Treasury market. So investors still get paid very well to extend from apparent safety of very short bonds that still offer yields below the rate of inflation.

Interviewer:
The Supreme Court recently determined that states could require retailers to collect sales tax on internet transactions. Do you anticipate that sales tax receipts from the decision will be significant for the state?

Tony:
They're unlikely to be significant for the state solely because a majority of the tax revenues and sales tax revenues that are derived in the state take place from activity that occurs within the state. There's less of a reliance on generating sales taxes on goods that are bought by out-of-state consumers as opposed to states where the economy hinges more on manufacturing and production of consumer goods.

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.

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