Aquila Tax-Free Fund For Utah

PODCAST TRANSCRIPT

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Interviewer:
Hello everyone. Thank you for joining us for this Aquila Group of Funds podcast. I'll be your host, Matthew DiMaggio. Joining me today is JT Thompson, the Portfolio Manager of the Aquila Tax-Free Fund For Utah. We'll be discussing the current municipal bond market as well as the local Utah economy. Welcome, JT, and thank you for being on the podcast.

JT Thompson:
Thanks, Matt. I enjoy these opportunities.

Interviewer:
Great, let's jump right in. Let's start off with the story, not only muni markets, but all the markets for the start of 2022. That would be the Fed and interest rates as they look to tackle inflation. We've seen how the municipal markets, and really all markets sold off on the news of rate hikes. What do we expect from the municipal market for the rest of the year in anticipation of rising interest rates relative to other fixed income markets and other markets in general? And also how has Aquila positioned accordingly?

JT Thompson:
Well, Matt, obviously the Fed has really wanted to telegraph any type of movements that they are going to do in interest rates. They don't want a repeat of '93 and '94 where the bond market was surprised and created more volatility. So, they're definitely telegraphing at least 25 basis points in March. Some people are talking 50 basis points because they feel the Fed's behind the curve. The real question out there is, never before in history has there been quantitative easing at the rate the Fed has done over the past two years. Their balance sheets have grown from $4 trillion to just under $9 trillion, and now they're trying to figure out how do you drain that money off without really affecting the economy.

It's going to be a little difficult because, do they raise rates, but yet have an accommodative balance sheet? And, therefore, rates stay, even though the Fed funds rates are rising? That the yield curve flattens a little bit, but rates stay where they are? Or do they, as they raise rates, also drain the balance sheet? It's very interesting.

Prior to them starting to pay interest on deposits, the reverse repo is where banks and money market funds put their excess reserves to the Federal Reserve. The Federal Reserve has been paying interest on those deposits. Normally in the normal course of business, you see about one to four billion in reverse repos with the Fed. As of today, there was $1.6 trillion. There is plenty of cash out there. Banks have excess reserves. They can get paid by sending it to the Fed. So, there are a lot of different tools that the Fed can use, but I think because they're telegraphing the market, the market has been building in these rate increases over the last couple of months.

Interviewer:
Thank you, JT. So, there's some sentiment from our advisor universe asking what makes municipal bonds compelling at this moment. Clients are hearing about the potential rate increases and are asking their advisors to guide them. How do we help advisors discussing the asset class with investors answer that question?

JT Thompson:
Well, first off, especially in these times when not only are interest rates rising so the bond market is down, and the stock market is down. You have geopolitical risks all over the place. Everybody needs to have a good, balanced portfolio. And part of that balanced portfolio is fixed income. Now, within that fixed income piece of your investment portfolio, you should probably have some type of investment that has less risk.

The municipal bond historical default rate is minuscule because, normally, all municipal bonds are secured by a revenue stream. They aren't like the government that just issues and hopes tax revenues come in, and if there's a shortfall, then they issue more. For investors to buy a municipal bond, they want to see how exactly each maturity is going to get paid off and what the revenue stream is. And right now, as the Fed starts raising interest rates and are less accommodative, that means the risk on trade is not there. And you will start seeing credit spreads widen as there is more risk. Everybody's been investing, figuring the Fed put because the Fed has been in buying. Now they have quit buying bonds and the question is, what do they do with the balance sheet?

So, if you want less risk and a fixed return, then in your fixed income portion, it would be wise to have munis.

Interviewer:
Thank you, JT. We talk in great detail here at Aquila with regard to managing locally and the idea that, because we have a footprint in our states, we are better situated to tackle the state's municipal environment. In the past, you've had great insight on the Utah market. So, I want to ask, what are you seeing on the ground that someone looking at the market from a national perspective may miss?

JT Thompson:
Here in Utah, the elephant in the room that you have to pay attention to is The Church of Jesus Christ of Latter-day Saints. With 60-plus percent of the population in Utah members of that Church, they have sway. The Church has its own welfare program, and they tell members go to family first, come to the Church second, and as a last resort for help, go to the government. So, when you have a huge population that is focused on family and church, the cost to the state for a lot of the welfare programs, the social programs have been absorbed by the Church.

Also, the state constitution—you have to have a balanced budget, period. So, you're less likely to incur a lot of debt because you need to balance the budget. If something goes awry, then you're going to have to let people go and most people hate firing people. So, the uniqueness of a dominant religion here in Utah, somebody outside doesn't really understand how the networking works in Utah, and will completely miss that.

Interviewer:
Powerful information, JT. Staying at the state level, but more on the macro side, what are we seeing of note on the state economy?

JT Thompson:
Well, last year we had a net in-migration of over 75,000 in the State of Utah. So, Utah is growing, a lot of residents from California are moving here, and people from Oregon and Washington are moving into the state. So, housing has exploded. There's not enough housing. When you're talking about a population of about three million, 75,000 new households are a lot of people coming into a small economy. Somewhere like New York, you just absorb it. It doesn't do anything. But in Utah, it's significant.

Also, because we have a lot of national parks close by to major population centers of California, Las Vegas and Phoenix, the national parks had record visitation last year, which helped out the economy here in Utah. Also ski days were close to record amounts. So as far as tourism goes in Utah, the pandemic has been very beneficial.

Interviewer:
JT, thank you for your time today as always. And for your insight in the local Utah market, as well as the broader municipal bond landscape. And finally, thank you to all of our listeners.

Thank you for listening to this podcast. The opinions shared are those of the portfolio managers and do not necessarily reflect those of the Investment Adviser or Sub-Adviser of the Fund.

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The Fund seeks to provide a high level of income exempt from state and federal income tax as is consistent with capital preservation. Past performance does not guarantee future results. For certain investors, some dividends may be subject to federal and state income taxes, including the alternative minimum tax referred to as AMT. Please consult your tax professional.

Independent rating services such as Standard & Poor's, Moody's and Fitch assign ratings which generally range from AAA highest to D lowest, to indicate the creditworthiness of underlying bonds in the portfolio. Where the independent rating services differ in the rating assigned to an issue or do not provide a rating for an issue, the highest available rating is used in calculating allocations by rating. Pre-refunded or escrowed bonds are issued to retire or regain an outstanding bond issue at a specific call date. Until the call date, the proceeds of the bond issuance are typically placed in a trust and invested in U.S. treasury bonds or state and local government securities.

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 principal of an issue is expected to be paid.

A credit spread is a 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 above an applicable threshold amount. The acronym PERS, stands for Public Employee Retirement System. The acronym PERA, 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. 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.

The 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.

Reverse repos refer to the Federal Reserve's Reverse Repurchase Plan authorized by the Federal Open Market Committee (FOMC) to support effective monetary policy implementation and smooth market functioning by helping maintain the federal funds rate within the FOMC's target range.

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