Aquila Tax-Free Fund For Utah

PODCAST TRANSCRIPT

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Interviewer:
Hello, everyone. Welcome to another Aquila Group of Funds podcast. I'm your host. Matthew DiMaggio. Joining me today is JT Thompson, portfolio manager of Aquila Tax-Free Fund for Utah. We'll be discussing Utah's post-stimulus economic situation, infrastructure, as well as municipal spreads and rates. Thank you for joining us today, JT.

JT Thompson:
Thank you, Matt. I look forward to our conversation.

Interviewer:
Let's jump right in. So, we're about six months down the road from the American Rescue Plan stimulus package. How is Utah faring in the economic recovery?

JT Thompson:
Utah is faring well. Forbes named it number one in GDP growth during the pandemic. Actually, during the pandemic, in the State, jobs grew during the pandemic. Construction boomed during COVID, and retail sales were already rising. So economically, the State faired very well. Their unemployment rate now is at 2.7%. It got as high as I think 4.8%, but has come down during the COVID. So, we're in good shape.

Interviewer:
Great to hear everything's going well, and thank you for the update. Let's talk about demand in the market for a moment. Demand is high across all municipal segments with a relative supply being somewhat moderate. How does that affect the municipal markets overall? And do we expect demand continuing at these levels?

JT Thompson:
Yes, obviously the municipal market has outperformed almost every other high fixed-income market that's out there. Anything with a higher yield is in demand. There was an article that came out yesterday. They have the 30-day supply calendar of $10 billion, but that's about $14 billion dollars short of how much in maturing bonds and interests that's coming due in thirty days. So, what you have is an enormous amount of cash coming into the market, even though the supply is a little bit higher, it still isn't enough to cover the demand out there. And as such, what you're seeing is a very, very limited secondary market. It used to be that when a big new issue came, let's say a New York issue, billion-dollar cow, California billion-dollar issuance. The people that bought that new issue had to sell something from their portfolio to pay for it. Well recently, with all the cash coming in from maturities and investors, nobody's had to sell anything to buy new deals. That's why the new deals are being oversubscribed, more orders than there are bonds and a very limited secondary market.

Interviewer:
Great information, JT. I want to touch a little bit more on supply. You mentioned supply already. But in regard to supply and infrastructure bill, we've all been reading about recently passed through the Senate and waiting a vote in the House. If it is passed, does the bill affects supply, and the municipal markets in general?

JT Thompson:
The real question, municipals are very unique in that the municipal market basically securitizes a revenue stream. And without seeing that revenue stream, it's going to be hard to issue bonds. Now Treasuries, they issue bonds to pay for deficits. Whatever, corporations for general corporate purposes and people look at well are their sales and their revenues there? But municipals, every buyer wants to see how they're going to get paid. And so even if the infrastructure bill gets passed, unless an issuer can show how the investor is going to get paid, it will be hard for them to issue a bond. So again, it's how are muni buyers going to get paid?

Interviewer:
Yes, interesting take and an important one. On the same topic of Washington, potential tax overhaul could be the next big story coming out of D.C. Is it too soon to start thinking in those terms? And how an increase in taxes could affect a municipal market?

JT Thompson:
It's a little early, Matt, to determine. But you have to invest some money in fixed income. Probably tax-free income is a good alternative in that it appears to pay for a lot of this. There will be some tax increases coming down the pipeline. What form? It's hard to say right now.

Interviewer:
Right. Of course.
Let's talk about municipal credit spreads. They're at an incredibly narrow level. So, we'd be remiss not to mention them, I think. And what does the narrow credit spreads tell you about the mindset of investors currently?

JT Thompson:
The mindset of investors is, I can take risks because the Fed's going to bail me out. And the huge demand for any type of return is pushing people into higher-risk investments. We've seen the Triple-B Minus spreads that are normally about one hundred fifty basis points over the MMD, to now where they're like sixty basis points over the MMD. People just, they want yield. And then they feel that if there's a double-dip recession, or if things slow down, that the Fed will just increase its balance sheet and help keep the economy going. And so, there are a lot of investors that are taking on a lot of risks.

Interviewer:
Yes, unusual circumstances and unique times, I agree. Shifting to your thoughts on rates and inflation. So, what are your expectations for the rest of 2021 heading into 2022 around rates and inflation? And then as a second part to that question, tell us how you have the portfolio positioned currently?

JT Thompson:
Because I don't have a model, I'm not an economist, it's hard for me to say exactly where I think interest rates are going to be. You read what economists and people that do have models. You listened to the Fed. It appears that maybe there will be some tapering towards the end of 2021, and into 2022. Although the Fed has not said they're going to raise rates in 2022, and they really would need to cut back their one hundred twenty billion quantitative easing before they raised rates. So, we're probably in an area that, again, the Fed has always said that data-dependent will decide based on what the data's telling us. Obviously, we have a strong labor market. There's a lot of jobs, a lot of help wanted signs. And a lot of businesses now, starting pay is $15 or more. So, the lack of workers is kind of a problem right now. So that higher pay and shortages could lead to a higher inflation that may not be transitory. So, again, without a model, I'm just parroting what a lot that I'm reading, a lot of what economists are saying out there. So, as a Fund Manager, what do I do? Right now, the Utah Fund is very liquid. And we're ready to take advantage of any market movements that could happen, any spike in interest rates that we're able to reinvest at a higher rate. Reinvestment risk is the biggest risk for a high-quality intermediate Fund. So that is what we're focused on, and just being able to respond with any positive market movement that will help the investors of the Fund. And we have the liquidity to do it.

Interviewer:
We appreciate the substantial insight. And thanks for joining us for this podcast, JT.

JT Thompson:
Thank you, Matt.

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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Mutual fund investing involves risk. Loss of principal is possible. Investments in bonds may decline in value due to rising interest rates, a real or perceived decline in the credit quality of the issuer, borrower, counterparty or collateral, adverse tax or legislative changes, court decisions, market or economic conditions. Fund performance could be more volatile than that of funds with greater geographic diversification.

Information regarding holdings is subject to change and is not necessarily a representative of the entire portfolio.

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.