



AQUILA
GROUP OF FUNDS®

Tax-Free Trust of Arizona

Investment Commentary

January, 2012



Fund Facts

Portfolio Management

Todd Curtis

Inception Date

3/14/1986

Assets Under Management

\$299.3M (as of 12/31/11)

Number of Holdings

200 (as of 12/31/11)

Maturity Allocation (as of 12/31/11)



Credit Ratings ¹ (as of 12/31/11)

AAA/Aaa	11.38%
Pre-Ref/Esc	11.34%
AA/ Aa	42.82%
A/A	23.39%
BBB/Baa	8.70%
Non Rated	2.36%

¹ 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 credit worthiness of the underlying bonds in the portfolio. Where the independent rating services differ in the rating they assign 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/escrowed bonds are issued for the purpose of retiring or redeeming an outstanding bond issue at a specified call date. Until the call date, the proceeds from the bond issuance are typically placed in a trust and invested in US Treasury bonds or state and local government securities. Non-rated bonds are holdings that have not been rated by a nationally recognized statistical rating organization.

2011 Market Review

Last year brought many financial stories that were fodder for a media circus. The United States Government came within hours of defaulting, certain municipal governments now have higher credit ratings than the Federal Government and the Federal Open Market Committee reintroduced monetary policy from the 1960's in an attempt to spark economic growth. However, the most exaggerated story was a statement made by a banking analyst in 2010 claiming "hundreds of billions" of municipal bonds may default in 2011. Investors were unduly frightened by the unusual market volatility of a normally staid asset class, but the municipal credit based defaults proved significantly milder than suggested by the financial media's initial headlines. This "headline risk," has taken a toll on the municipal marketplace. Although distinct from credit risk, headline risk increased investor concerns, causing investors to exit the municipal market at an inopportune time as bond prices decreased and yields rose. Rising state revenues, meaningful expenditure reductions and attractive relative yields have overcome most fears and investors have returned to the municipal bond market.

Ironically, the impending default risk of the Federal Government proved less troublesome to the municipal market than the aforementioned headline risk. A last minute deal avoided a default, but the spectacle raised the eyebrows of citizens and investors questioning the ability of our Federal Government to make decisions about national debt and budgeting issues. The resulting effect on the municipal bond market is difficult to quantify since the event was spread over a long period of time and largely priced into the market by the time it ultimately unfolded. The resulting damage inflicted on the credit side was felt primarily by certain state and local governments dependent upon federal appropriations.

On August 5, 2011 Standard & Poor's downgraded the long-term sovereign credit rating of the United States for the first time. The rating was lowered one notch from AAA to AA+ and was largely attributed to the instability of American policymaking, specifically the partisan fight over raising the nation's debt ceiling. The market, in general, still views the nation in a triple-A light with Moody's Investors Service affirming its Aaa rating and Fitch Ratings maintained the Nation's sovereign debt at AAA. S&P analyzes state and local government credit quality independent of the Federal Government, placing certain state and local governments in higher ratings categories than the nation for the first time in history. The negligible reaction of the municipal bond market to S&P's downgrade demonstrates the resiliency of the municipal bond asset class. Furthermore, the effect on Arizona municipal bonds has been minor; the primary result being increased scrutiny of credits relying upon federal appropriations. Nevertheless, the downgrade of our Nation's credit rating reinforces the value of deep credit research and a disciplined approach to portfolio management.

The Federal Open Market Committee continues its efforts to reinvigorate the economy, this time with Operation Twist designed to lower yields on long-term bonds through the purchase of \$400 billion of longer-term Treasuries, and sale of \$400 billion of Treasuries that mature in three months to three years. The "twist" term refers to early 1960s-era operations wherein the central bank sold shorter-dated securities and bought longer-dated securities in an effort to drive down long-term rates and stimulate economic growth. The policy goal is to make home and business loans more attractive to encourage home purchases and business expansion. At the very least, we believe this policy will keep long-term rates on Treasuries low and have a corresponding effect on highly rated municipal bonds forcing investors who are seeking higher yields to look further out on the yield curve.



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Municipal Overview

Arizona's fiscal situation continues to improve, but the road to recovery remains long. Residential real estate prices are showing signs of hitting a bottom, but foreclosures continue to hold down housing values. With this, property tax revenue, which primarily supports cities, local school districts and special districts for water and fire, continues to show marginal declines. On a brighter note, Arizona's unemployment rate fell below 9% for the first time since early 2009 to 8.7% in November, matching the national rate for the month. The state's revenue situation is looking favorable. Arizona is expected to have a budget surplus for the first time in four years. Estimates show that the state closed FY 2011 with a \$600 million surplus, which can be primarily attributed to an additional 1% state sales tax. The additional tax is scheduled to expire in May of 2013, but discussions around extending it further are already underway. Lower than expected federal matching funds for Medicaid were fortunately offset by lower than anticipated Medicaid caseload growth for FY 2011. The minimal caseload growth, combined with improved revenue projections, also eliminated the large FY 2012 budget gap estimate. The state is expected to have a balanced budget in FY 2013 as well. The projected return to the state's FY 2007 peak revenue collections is FY 2016.

Arizona's Tax-free municipal bond issuance was down 32% for 2011 with only \$4.3 billion issued for the year compared to \$6.3 billion issued in 2010. We expect a marginal increase in issuance in 2012 to between \$4.5 billion and \$5.0 billion, but expect it to remain below recent years.

Portfolio Review

The Tax-Free Trust of Arizona experienced relatively steady performance in last year's municipal bond environment, and the Trust's portfolio quality remains strong. Assets under management have continued to grow steadily through the fourth quarter. The Trust's average maturity has been extended over the past few months as bonds have been called. We expect the maturity to remain somewhat longer than the benchmark as we take advantage of slightly higher yields on the longer end of the curve in the existing low rate environment. In the current market, we remain comfortable with Arizona issuers. The investment strategy of Tax-Free Trust of Arizona is focused on high-quality issues and an intermediate portfolio maturity. In our view, this strategy facilitates our pursuit of the objectives of providing as high a level of current income exempt from state and Federal income taxes, as is consistent with capital preservation.

Symbol and CUSIP

Class A	AZTFX	876931106	Class C	AZTCX	876931304	Class Y	AZTYX	876931205
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Before investing in the Trust, carefully read about and consider the investment objectives, risks, charges, expenses and other information found in the Trust prospectus. The prospectus is available from your financial advisor, and when you call 800-437-1020 or visit www.aquilafunds.com.

- NOT FDIC INSURED - NO BANK GUARANTEE - MAY LOSE VALUE -

- NOT NCUA INSURED -

For more information on this fund and the entire Aquila Group of Funds, please visit www.aquilafunds.com

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