

AQUILA GROUP OF FUNDS
PORTFOLIO MANAGER COMMENTARY
October 27, 2008

An Exceptional Week in Municipal Bond Markets

I'm nearly speechless – and for those of you who know me well, that is quite a statement! The turnaround in the municipal bond market that we have witnessed over the past several trading days has been rewarding to watch, and to participate in as well.

The recent rally in the municipal bond market was stimulated by accommodative moves from the Fed and the Treasury - both literally “flooding” the street with available funds that would enable investors to get out of illiquid money market instruments and other longer-term, less marketable paper. This resulted in short-term rates – especially LIBOR - taking a nose dive. Among other things, this also allowed dealers easier/cheaper access to funds that could be used to finance inventory positions of new and secondary issues. Crossover buyers (those who usually buy in the taxable market) saw tremendous value in municipal bonds versus Treasuries and comparable corporate credits. And, whether viewed as good news or bad news, it has allowed arbitrageurs and other leveraged buyers back into the fray with lower short-term rates and still relatively high longer-term yields. These factors led to the heightened activity we saw during the week of October 20 to 24. Municipal bonds were selling like popular toys on Christmas Eve. Retail buyers led the way (as usual) and institutional buyers (sometimes viewed as the “smart money”) soon followed.

As the attached yield curve illustrates, there were significant historic moves last week in the normally docile municipal bond market. Particularly notable was the basis point change in the longer municipal maturities. As a rule of thumb on a longer bond, 10 basis points of yield is roughly equivalent to 1 point in price, i.e. a variation of 98 cents on the dollar to 99 cents on the dollar. As you can see, even with the significant market moves in the week of October 20th, municipal bonds still represent uncommon value versus taxable alternatives. With taxable equivalent yield spreads still ranging between 200 and 300 basis points, and with yields that are more than 100% of comparable maturity Treasuries, municipal bonds remain an extraordinary bargain.

While I remain optimistic – particularly with the Dow working its way through 8,000, oil at \$64 and Treasuries continuing their upward price move – a major concern is the possible flood of new issue supply that had been slated to come to market over the past few weeks, but was placed on hold. As municipal bond market conditions dramatically improved, so did the probability of these previously postponed issues coming to market. If (and it's a big “If”) this wave of new issues can move through the system in an orderly fashion – i.e. selling throughout the week, rather than all selling on a single day – I think the demand we have seen will accommodate the massive supply scheduled to come to market. Inflation, at present, is a “no show”. Supply, and how the market handles it, is our main concern at present.

Thomas Albright, Portfolio Manager
Aquila Investment Management

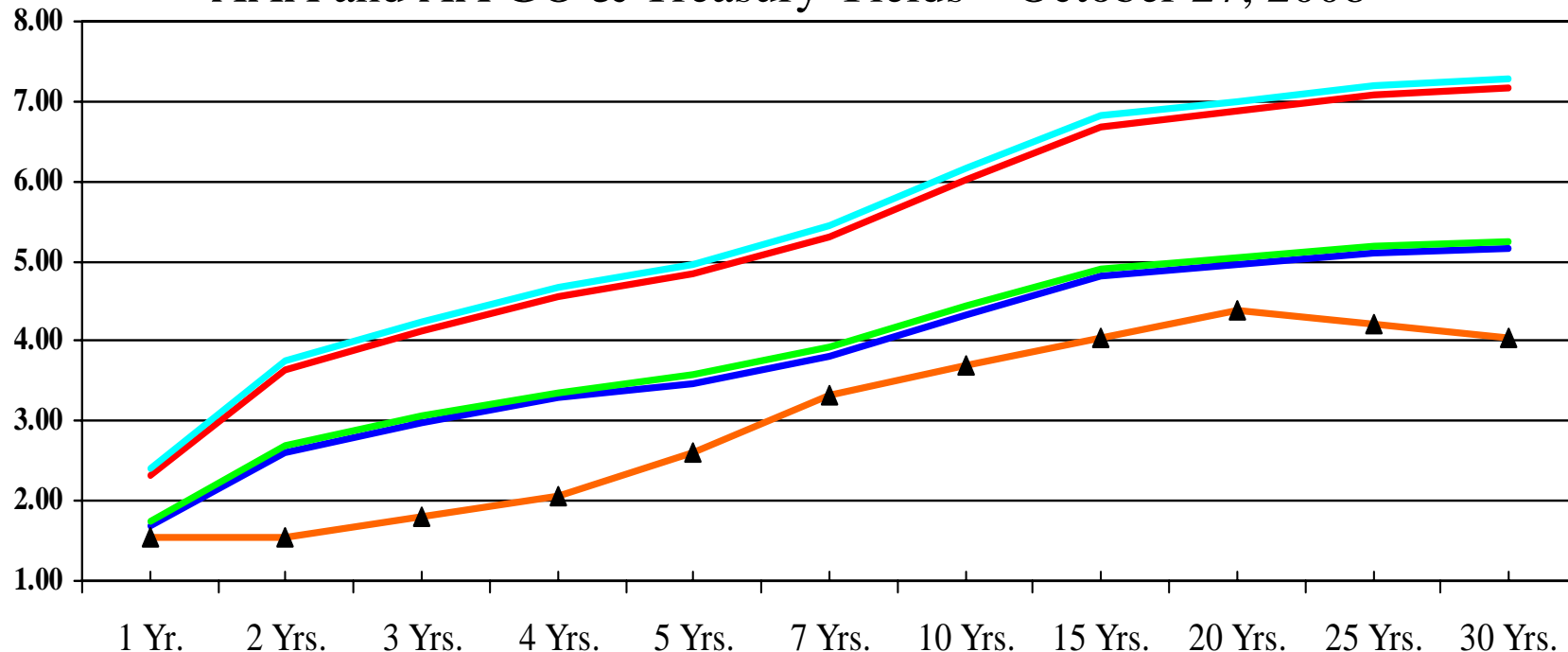
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AAA and AA GO & Treasury Yields – October 27, 2008



— AAA G. O.
 — AAA T.E.Y.
 — AA G. O.
 — AA T. E. Y
 ▲ US Tsy

Maturity	AAA G. O.	BP * Change	TEY @ 28%	AAA TEY Spread	% Treasury	AA G. O.	BP * Change	TEY @ 28%	AA TEY Spread	% Treasury	U. S. Treasury	BP * Change
1	1.68	-0.48	2.33	0.78	108.4	1.74	-0.48	2.42	0.87	112.3	1.55	0.20
2	2.61	-0.21	3.63	2.08	168.4	2.69	-0.24	3.74	2.19	173.5	1.55	-0.10
3	2.97	-0.26	4.13	2.34	165.9	3.06	-0.30	4.25	2.46	170.9	1.79	-0.15
4	3.29	-0.28	4.57	2.52	160.5	3.36	-0.35	4.67	2.62	163.9	2.05	-0.25
5	3.48	-0.30	4.83	2.22	133.3	3.58	-0.34	4.97	2.36	137.2	2.61	-0.24
7	3.82	-0.40	5.31	2.00	115.4	3.92	-0.45	5.44	2.13	118.4	3.31	-0.44
10	4.34	-0.52	6.03	2.33	117.3	4.44	-0.58	6.17	2.47	120.0	3.70	-0.28
15	4.81	-0.62	6.68	2.63	118.8	4.91	-0.66	6.82	2.77	121.2	4.05	-0.28
20	4.96	-0.76	6.89	2.50	113.0	5.05	-0.81	7.01	2.62	115.0	4.39	-0.28
25	5.09	-0.77	7.07	2.86	120.9	5.18	-0.81	7.19	2.98	123.0	4.21	-0.29
30	5.17	-0.75	7.18	3.14	128.0	5.24	-0.80	7.28	3.24	129.7	4.04	-0.29