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Thought For the Month

“Volatility – The Steps We Take To Control It”

As we have continuously pointed out, changes in interest rates dictated by the Federal Reserve Board will be reflected in changes in the share value of fixed-income securities such as those in which the bond funds in the Aquilasm Group of Funds invests. When interest rates go up, the share value will go down. And, conversely, when interest rates go down, the share value will go up. While we cannot control interest rates or their effect upon the market, we can, and do, use various investment management techniques to dampen the swings that can occur in your fund's share value.

To the maximum extent possible, we strive to make certain that there are no “surprises” with any of the securities in each fund's portfolio. To help limit the degree of uncertainty, our knowledgeable locally-based portfolio manager constructs the portfolio with high quality and intermediate maturity in mind.

When dealing with investments, we firmly believe that stability equates to quality. Therefore, for protection of investors' capital, each of the funds intentionally limits, by prospectus, its investments to the four highest credit ratings - AAA, AA, A, and BBB. (In the case of our Rhode Island Fund, 100% of its investments are AAA rated.) And, in practice, the portfolios have a substantial portion of their investments in the top two categories – AAA and AA. These high credit ratings mark those municipal issues which are deemed to have significant cash flow strength to pay interest when due on a timely basis and to redeem the bonds at maturity, in good times and bad.

Another technique we use in the construction of the overall portfolio to help keep a stable share price is a laddering of maturity levels with the various municipal securities that we purchase. As you probably are aware, shorter-term maturity bonds tend to have very little price fluctuation, but produce a lesser rate. Conversely, longer-term maturity bonds, while producing a higher return level, have much higher price volatility. This higher price volatility reflects the risks associated with the unpredictability of future events and the potential interest rate changes over the extended life of the municipal bond.

Through utilizing a blend of maturities – both shorter-term and longer-term - each fund in the Aquila Group attempts to provide a satisfactory level of return without subjecting the share price to excessive swings as interest rates increase and decrease. In this way, we feel that we take the best that each investment has to offer – gaining stability from the shorter-term maturities and higher yields from the longer-term maturities.

With more than 15 years of experience utilizing these techniques, Aquila believes that it has successfully developed a proven formula that mitigates the volatility that will inevitably occur. Take a look at any of the Aquila funds' share price records over its lifetime and you will see that although there have been some ups and downs, these movements have been quite minor in nature – despite interest rate fluctuations. And, that is just what our strategy is intended to do.

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