

Hawaiian Tax-Free Trust

PORTFOLIO MANAGER COMMENTARY

Q2 2024



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Municipal Bond Market Overview

During the second quarter of 2024, interest rates fluctuated within a trading range. Early on, the market experienced a decline, as attention shifted to sustained economic strength, dismissing earlier expectations of an imminent rate cut by the Federal Reserve (the “Fed”) from 2023. However, a bond market recovery began in June, driven by weakening retail sales, employment data, and softer inflation statistics. This rally extended into July, as forecasters adjusted expectations for Federal Reserve accommodation—now anticipated for late 2024.

While recent economic data supports a more favorable outlook, it remains premature to anticipate significant changes before the November U.S. presidential election. Although a modest reduction in short-term rates could occur, with a possible cut projected for Q4, substantial uncertainty remains regarding the Fed’s inflation targets. Greater clarity on U.S. fiscal policy and potential shifts in government leadership will likely emerge by 2025, providing a clearer picture for future rate adjustments.

Hawaii Municipal Bond Market and Economy

By the end of the most recent quarter, the municipal market experienced a slight decline, mirroring the trend in taxable securities, as yields rose marginally. Diminished expectations for Federal Reserve rate cuts weighed on the market, while new issue supply exerted upward pressure on tax-exempt bond yields. The Bloomberg Municipal Index and the Bloomberg Hawaii Index fell by -0.02% and -0.14%, respectively. Municipals underperformed compared to U.S. Treasury bonds in the second quarter, with the ratio of Bloomberg BVAL “AAA” tax-exempt yields increasing to 68% from 59% at the start of the quarter due to higher new issue supply. This ratio indicates the tax savings breakeven against taxable bonds.

National municipal issuance surged by 40% compared to the previous year, testing market liquidity, and contributing to higher rates and decreased bond prices, including those in Hawaii. Interestingly, Hawaii saw lower issuance during the quarter but still experienced a rise in bond yields. According to Bloomberg, the national 10-year “AAA” municipal yield increased from 2.5% to 2.8%, while the Hawaiian 10-year yield rose from 2.7% to 3.0%. The higher yield on Hawaiian bonds relative to national municipals presents a potential value opportunity. For income-focused investors seeking tax-free dividends, a Hawaii-only mutual fund portfolio, such as the locally-managed Hawaiian Tax-Free Trust, remains a strong investment option.

During the second quarter, economic indicators for the State of Hawaii showed some signs of slowing. While the Hawaiian economy had been robustly advancing since the end of the pandemic, the fires on Maui have begun to impact visitor numbers to the island. Overall visitor counts to the State declined by 2.5% in the first quarter of 2024, with Maui experiencing a significant 24% drop, based on data from the State of Hawaii Department of Business, Economic Development & Tourism through April.

Despite the downturn in visitor numbers, there is positive news in the construction sector. Infrastructure improvements are driving growth across the islands. As noted in our Q1 commentary, significant investment in infrastructure is planned over the next five years, including the redevelopment of critical water, wastewater, and port facilities, as well as rebuilding efforts on Maui. This investment is expected to provide much-needed relief and create jobs for local residents. Currently, unemployment stands at 3.0%, and the Hawaiian economy added 2,600 jobs in the first quarter of 2024, marking a 6.9% increase. However, Maui County continues to face challenges, with civilian employment falling by 7.4% due to its high dependence on tourism.

In the second quarter of 2024, the State’s GDP grew by 4.5%, contributing to a 0.7% increase for the entire year. Despite the mixed results, we remain optimistic about the Hawaiian economy from a bondholder’s perspective. As the Maui fires fade into the past, the focus will shift to recovery and rebuilding. The process will be gradual, but once liability claims are resolved and community plans are developed for a culturally sensitive new Lahaina, we anticipate a positive trajectory. We will continue to closely monitor Maui County’s recovery, but the overall credit outlook remains strong.

Fund Strategy and Outlook

Looking ahead, we anticipate that the Federal Reserve will maintain current interest rates for the foreseeable future, with a potential modest reduction later in 2024. We expect economic growth to slow in the coming quarters, while inflationary pressures are likely to continue easing, although some persistence remains. It remains uncertain whether the Fed can achieve its inflation targets without triggering a recession. Despite this, our outlook suggests a generally favorable environment for investment-grade municipal bonds.

In response, we have strategically extended your Fund's average maturity to capitalize on current elevated interest rates. We believe this approach will enhance the Fund's potential for future returns and support continued generation of double tax-exempt income distributions. The Fund's relative performance can be attributed to its greater exposure to longer-maturity bonds, which fared better compared to shorter intermediate bonds during the quarter.

As of 6/30/24, the Fund's portfolio was strategically overweighted in recently-issued essential service water bonds, such as those from the Honolulu City & County Board of Water Supply, as well as Honolulu City & County Wastewater System Revenue. This positioning contributed to the Fund's performance relative to the local benchmark, which had a heavier allocation to General Obligation bonds. With higher yields now generally available, the Fund capitalized on new issues, benefiting shareholders with increased double tax-exempt Hawaii income. The portfolio management team continues to prioritize essential service revenue bonds for their diversification benefits and credit strength.

For specific information about fund characteristics, holdings and performance please see the Fund Fact Sheet on our website at www.hawaiiantaxfreetrust.com.

Fund Facts as of 6/30/2024

Lead Portfolio Manager REID SMITH	Inception Date 2/20/1985	Total Investments \$449.4M	Number of Holdings 163
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This information is general in nature and is not intended to provide investment, accounting, tax or legal advice. It is not intended to represent a recommendation or solicitation related to any particular investment, security or industry sector. The opinions shared are those of the portfolio manager and do not necessarily reflect those of Asset Management Group of the Bank of Hawaii, Investment Adviser for Hawaiian Tax-Free Trust, the Bank of New York Mellon, which serves as the Trust's Administrator/Business Manager.

Information regarding holdings is subject to change and is not necessarily representative of the entire portfolio. Securities of the issuers referenced were portfolio holdings of Hawaiian Tax-Free Trust during the second quarter of 2024. Following is a listing of the issuers, represented as a percentage of the Fund's total portfolio as of 6/30/24: Honolulu City & County Board of Water Supply: 5.29%; and Honolulu City & County Wastewater System Revenue: 17.63%.

Independent rating services (such as S&P Global Ratings, Moody's Investors Services and Fitch Ratings) 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.

A credit spread or a yield spread is the difference between the quoted rates of return on two different investments, usually of different credit qualities but similar maturities.

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 Bloomberg Municipal Bond Index covers the U.S. dollar-denominated, long-term tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds. The Bloomberg Hawaii Index is an unmanaged index composed of a broad range of municipal bonds of issuers in the State of Hawaii. Indices are unmanaged and are not available for direct investment. Past performance does not guarantee future results.

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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 credit quality of the issuer, borrower, counterparty, or collateral, adverse tax or legislative changes, court decisions, market or economic conditions. State-specific fund performance could be more volatile than that of funds with greater geographic diversification.

Before investing in the Fund, carefully read about and consider the investment objectives, risks, charges, expenses and other information found in the Fund prospectus. The prospectus is available from your financial advisor, and when you call 800-437-1000 or visit www.hawaiiantaxfreetrust.com.