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Municipal Bond Mutual Fund Performance and Active Share.

Abstract

This article evaluates the performance of actively managed US open-end municipal bond mutual funds between 1999 and 2020. Fund classifications span national short, intermediate, and long-term, as well as high-yield and single-state portfolios. An initial investigation reveals that municipal securities manifest characteristics of a distinct asset class. Performance measures include benchmark-adjusted returns and single- and multifactor pricing models. During the sample period, only 8% of funds generated returns that beat their benchmark indexes, and 29% produced positive excess returns (alpha) based on a four-factor pricing model. Longer-maturity funds generally performed better than short-maturity funds. Based on portfolio performance, managers specializing in single-state issues do not manifest unique knowledge or insight. Active share for the aggregate sample was 25%, implying an active expense ratio exceeding 3% and annualized active alpha below −3%. The evidence overall suggests that active management of municipal bond portfolios is not a value-enhancing activity.

Key Findings

■ Municipal bonds possess several characteristics that satisfy traditional criteria qualifying them as a distinct asset class. In this first evaluation of the performance of actively managed open-end municipal security mutual funds, the authors find that the vast majority of funds underperform their benchmark indexes. They also document significant underperformance when accounting for four fixed-income market systematic risk factors.

■ The performance results vary by fund type, with short-term funds underperforming more acutely than intermediate- or long-term funds. Single-state funds are among the worst performers, suggesting that managers do not possess unique insight about the issuer domicile and its securities.

■ Portfolio active share for muni bond funds is about 25% (similar to what extant work finds for equity funds), which implies an annualized active expense ratio of about 3% (similar to fees charged by some hedge funds).

Read the full article.

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