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Bonds Could Bounce Back — Consider Munis as a Way to Play Rebound.

As fixed income investors know, 2022 has been unkind to bonds. The double-digit year-to-date loss by the Bloomberg US Aggregate Bond Index confirms as much.

Even with that ominous data point and the likelihood the Federal Reserve will raise interest rates again at its next meeting, some market observers are bullish on bonds, including municipal debt. That could be a sign that exchange traded funds, including the VanEck Muni Allocation ETF (MAAX), are worth considering.

"Our preferred strategy is to gradually increase duration of bonds in portfolios at these higher yields. However, we favor higher-credit-quality core bonds, such as Treasuries and investment-grade corporate and investment-grade municipal bonds," according to Charles Schwab research. "In most cycles, yields tend to converge near the peak of the federal funds rate for the cycle. In the 3% region, yields have already discounted Fed tightening beyond the neutral rate."

An attractive point regarding MAAX is that its 20 holdings are other ETFs or closed-end municipal bond funds, meaning the VanEck ETF spans a variety of durations and credit profiles. As such, MAAX's income profile, as highlighted by a 30-day SEC yield of 2.91%, exceeds those offered by many dedicated investment-grade ETFs in this category.

"After years of low yields that drove investors to allocate more to risky investments, income investors can find attractive yields in higher credit quality fixed income. Investment-grade corporate and municipal bonds are offering higher yields than we have seen in several years, and can help investors earn income without excessive risk-taking," added Schwab.

The actively managed MAAX, which turned three years old in May, does feature some high yield exposure, but the ETF's overall credit quality is strong, as 68.51% of its holdings carry investment-grade ratings compared to just 9.66% with junk grades, according to issuer data.

Given that compelling credit breakdown and an impressive yield, MAAX is a credible idea for income investors as the third quarter comes to a close.

"Overall, we look for returns in the second half of the year to be better for fixed income investors now that the market has reset interest rates higher. However, we still look for volatility to remain high as central banks shift away from their easy-money policies," concluded Schwab.

ETF TRENDS

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