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Puerto Rican Muni Bond ETF Launches.

First-of-its-kind fund focuses on U.S. territory bonds.

X-Square Capital, a Puerto Rico-based advisory firm, debuted its Triple Tax-Exempt Municipal Bond ETF (ZTAX), which it says is the first bond fund focusing on triple-tax-exempt muni bonds from U.S. territories.

The fund, with an expense ratio of 1.1%, launched on May 19 and invests in muni bonds issued by U.S. territories, with typical allocation ranges being 65%-80% Puerto Rico, 10%-25% U.S. Virgin Islands and 5%-10% Guam. While other funds hold Puerto Rican bonds, this is the first fund to fully focus on bonds from U.S. territories.

Its price has slipped to $25 since it launched last week at $25.95.

Part of the bond's appeal stems from a 125-year-old law giving Puerto Ricans U.S. citizenship, and establishing that income from bonds issued by Puerto Rico would be exempt from local, state and federal taxes.

As yields rose in 2022, muni funds experienced record outflows of $122 billion. They also had their worst year since 1981, with the Bloomberg Municipal Bond Index dropping 8.5%, with high yield munis doing worse still, losing 13%.

This year may present an improved scenario, with expectations for a pause in interest rate increases. A looming recession may also bode well for the asset class, because muni bonds have historically gained in recessions.

Declining inflation may also boost fixed income assets.

The bonds were central to the debt crisis and bankruptcy that Puerto Rico underwent starting in 2015, when it announced it would be unable to pay its $123 billion debt, declaring bankruptcy in 2017 after the widespread damage to the island from hurricanes Irma and Maria.

Puerto Rico's economy is still suffering compared to the mainland U.S., with average incomes a fraction of the poorest U.S. state; however, the unemployment rate has fallen significantly and now stands at 6%, higher than the U.S. average but lower than much of the last decade when it was about twice the national average.

With the restructuring having concluded, the "post restructuring," bonds held by the fund are a bet on the future of Puerto Rico differing from its past decade.

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by Gabe Alpert

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Reviewed by: Lisa Barr

Edited by: Ron Day

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