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Why Boring Municipal Bonds are Exciting for Investors.

As interest rates have risen in recent months and bond prices have fallen, fixed income investors have found few safe places to hide.

But there is one corner of the bond market that can provide at least relative safety, and yet – strangely – many bond investors appear to be avoiding it. I'm referring to municipal bonds, debt issued by a governmental unit other than Uncle Sam.

I can almost see your eyes glaze over. Please, not another boring discussion of "munis," as these bonds are known. Why can't we focus on exciting investment topics such as the next iPhone or Amazon takeover target?

But sometimes you can be handsomely rewarded for focusing on the boring. You very well may be leaving money on the table if you are skipping munis in favor of taxable bonds. If not leaving money on the table is boring, I'll take boring any day.

How much you're leaving on the table is not immediately obvious, however, and that's one reason why munis don't receive the attention they deserve. You must go through several tax-rate calculations that, though quite straightforward, keep munis off the radar screens of investors who focus only on munis' stated – rather than implicit – yields.

Indeed, many investors are not even sure which tax bracket they're in, Jack Bowers told me. Bowers is editor of the "Fidelity Monitor & Insight" advisory newsletter, which is one of the few newsletters that my performance monitoring has shown to have beaten a simple stock index fund over the last 30 years.

You definitely should go to the trouble of finding out your tax bracket, however, since muni bonds' interest is exempt from federal income tax. Their interest is also exempt from state taxes if you live in the state where the munis were issued. On an after-tax basis, therefore, a municipal bond's yield can be much higher than that of comparable taxable bonds, even when the munis' yields are lower on a pretax basis.

Now is just such a time. Currently, for example, AAA-rated municipal bonds with 10 years left until maturity yield 2.49 percent, significantly lower than the 2.88 percent yield on the 10-year Treasury. But that muni yield becomes superior after you take taxes into account. An individual in the highest federal tax bracket – 37 percent – would keep only 1.81 percent of that Treasury's before-tax yield of 2.88 percent. The muni's yield is more than a half-percentage point higher, which can add up to a sizeable chunk of change over time.

Even if you're not in the highest tax bracket, munis still come out well ahead on an after-tax basis. If your federal tax rate is 24 percent – which kicks in for individuals with adjusted gross income above $82,501 – the 10-year Treasury's after-tax yield is 2.19 percent, still well below that of the 10-year muni.

To be sure, Bowers added, munis are somewhat riskier than U.S. Treasuries. So it’s to be expected that they should yield more on an after-tax basis. Still, even after taking their higher risk into account, Bowers believes munis are a better deal than taxable bonds for income-oriented investors.

One of the easiest ways to invest in munis is via an exchange-traded fund that owns a number of such bonds. The diversification across many different munis reduces your risk, and muni ETFs can be sold a lot more quickly and with less headache than an individual muni bond.

Two of the largest muni ETFs that own bonds with an average maturity in the five- to 10-year range are the iShares National AMT-Free Muni Bond ETF, with an expense ratio of just 0.07 percent, and the Vanguard Tax-Exempt Bond Index ETF, with a 0.09 percent expense ratio. Their current yields are 2.39 percent and 2.52 percent, respectively.

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