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The Risky Business of Chasing High-Yield Muni Bonds.

Investors are hungry for yield, and they appear to be satisfying that hunger with risky, high-yield municipal bond funds.

In fact, investors have poured $8 billion into funds that deal in high-yield muni bonds – or junk munis – this year, according to Refinitiv data. That's the most in nearly three decades.

"I would be worried about this," Scott Clemons, chief investment strategist at Brown Brothers Harriman, said on Yahoo Finance's "The First Trade."

"We're advising our clients to not chase yield. The trade-off of risk and return is just unappealing," Clemons said.

Even the largest Wall Street firms are hedging their bets. Goldman Sachs' $7.3 billion High Yield Municipal Fund, had about 62% of its assets in investment-grade securities by the end of April.

Falling Treasury yields, coupled with expectations for a possible interest rate cut from the Federal Reserve, have investors chasing higher returns in the lowest-rated and riskiest muni-bonds.

Liquidity, stability, income

So far, that bet has been paying off. According to FactSet data, high-yield munis are up 5.5% this year after outperforming stocks,Treasuries and corporate bonds in 2018.

Municipal bonds are also historically attractive to investors because they are one of the few remaining tax-shelters left.

The downside, though, is that if enough of these risky municipal projects default, those attractive yields will quickly reverse.

About 2.5% of non-investment-grade munis are currently in default, according to Municipal Market Analytics.

Clemons points out that fixed-income markets offer three main benefits to an investor's portfolio: liquidity, stability, and income.

"In this kind of interest-rate environment," Clemons said, "those benefits are fragmented. So you, as an investor, have to decide. If it's all about yield, you're going to have to give up some stability, maybe some liquidity. But if it's all about stability and liquidity, there's not a lot of yield attached to that."

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