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Muni Bond and Other ETFs Are Trading at Big Discounts. Here's Why, and What to Do.

Municipal bond exchange-traded fund investors probably had no clue what hit them on Monday. Muni bonds are supposed to be staid, steady-eddy investments, and are largely owned by high-ne--worth retail investors seeking tax-free income. Because they tend to be particularly buy-and-hold investments, they can be illiquid. And that can be a big problem, as some investors found out this week.

On March 16, the bonds in the $1 billion SPDR Nuveen Bloomberg Barclays High Yield Municipal Bond ETF (ticker: HYMB) portfolio fell 0.7%—pretty good, considering the stock market's 12% loss. But the ETF itself plummeted 9.5%, far more than the bonds themselves fell.

The truth is, when markets become volatile, many ETFs, especially those invested in illiquid market sectors, behave more like closed-end funds, trading at premiums and discounts to their underlying portfolio values or net asset values (NAVs) to use a Wall Street term. This can happen in supposedly safe investments, like the $14 billion Pimco Enhanced Short Maturity Active ETF (MINT). Pimco's MINT has long been thought of as an alternative to a money market fund; it invests in similar securities that yield a bit more. But MINT was trading at a 0.39% discount—the equivalent of "breaking the buck," a sacrosanct imperative of money funds. In more egregious cases, such as In the SPDR Nuveen ETF's case, the price dislocation was so bad it ended the day trading at $45.84 a share—an 18.6% discount to its $56.34 NAV, according to Morningstar Direct. That is dramatic in any case, but especially for a large ETF that rarely had a discount of more than 1 percentage point in the past three years.

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