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Muni-Fund Investors Have Been Their Own Worst Enemies.

A more disciplined approach should lead to better results.

Municipal-bond fund investors have often been their own worst enemies, but they don’t have to be.

With holdings that help finance state and local governments and other essential projects like schools, water systems, bridges, and toll roads, muni funds might seem like a staid backwater of the fixed-income world. When it comes to investor behavior, though, they’ve often been prone to erratic cash flows that have ended up hurting investor returns (also known as dollar-weighted returns or internal rates of return).

In our annual “Mind the Gap” study, which estimates the gap between investors’ dollar-weighted returns and reported total returns, we found that in aggregate, the returns muni-fund investors earned for the trailing 10-year period ended Dec. 31, 2019, continued to fall short of reported total returns by a fairly wide margin. This gap has averaged about 1.1% per year over the past five 10-year periods. It improved slightly for the most recent 10-year period but still stood at 94 basis points per year, as shown in the chart below. That’s particularly painful given that returns on muni funds aren’t that high to begin with.

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by C. Arnott, CFA

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