

Bond Case Briefs

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Municipal Bonds Still Key in the Retirement Income Puzzle.

In spite of this year's challenging fixed income environment, bonds remain vital portfolio components for retirement investors. How the bonds are deployed in retirees' portfolios is meaningful as well.

For investors with tax-advantaged accounts, embracing a taxable bond fund makes sense, but for those with the bulk of their assets in a taxable account, municipal bonds and funds are practical ideas due to the tax benefits associated with the asset class.

"Municipal bonds, which are issued by state and local governments, offer tax advantages to investors in higher tax brackets," writes Morningstar's Susan Dziubinski. "So even though a muni-bond fund's yield may look shrimpy when you compare it against the yield on a similar quality and similar term taxable-bond fund, that muni fund's yield doesn't reflect the tax advantages that may apply to you."

The tax benefits offered by municipal bonds could take on added importance if Congress is successful in passing the White House's proposed capital gains tax hike.

While it remains to be seen what happens on that front, it's clear the outlook for municipal bonds is solid. State and local finances were pinched at the height of the coronavirus pandemic, but the punishment was never as severe as originally feared. Plus, the federal government stepped up to support state finances, effectively reducing muni default risk.

With credit risk of minimal concern over the near- to medium-term, investors considering municipal bond funds still need to make rate risk part of the evaluation equation. Muni funds with longer durations could be susceptible to spikes in long-term interest rates.

"If there is in fact a tax advantage for you, you can begin the search for a muni-bond fund with the term and interest-rate sensitivity that meets your time horizon and appetite for risk," adds Dziubinski.

Morningstar has "gold" ratings on nine municipal bond funds, one of which is an ETF - the Vanguard Tax-Exempt Bond ETF (VTEB).

VTEB, which follows the Standard & Poor's National AMT-Free Municipal Bond Index, holds nearly 5,800 bonds with an average duration of 5.2 years. It's also cost-effective. With an annual fee of just 0.06%, or \$6 on a \$10,000 investment, VTEB is one of the least expensive funds in its category.

ETF TRENDS

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