

# **Bond Case Briefs**

*Municipal Finance Law Since 1971*

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## **Income Investors Should Consider Incorporating a Muni ETF Strategy.**

As we dive into what people are missing — and what risks they might be accidentally taking — in traditional approaches, investors can consider an active exchange traded fund municipal bond strategy that looks across the entire market opportunity set instead of being tied to a benchmark's methodology.

In the recent webcast, [Hidden Income Your Munis Are Missing: An Expert Perspective](#), Joseph Gotelli, vice president and portfolio manager at American Century Investments, helped outline the current market environment. For instance, Congress is looking at up to \$9.4 trillion in U.S. fiscal spending since the start of COVID-19. New issuances of tax-exempt munis have been steadily declining over the years. More importantly, we are seeing increased interest for tax-exempt munis as a greater source of value for income-minded investors, especially as the Biden administration eyes higher tax rates to pay for the new government spending plans.

Looking at the municipal bond asset category, Gotelli also noted that munis offer diversification benefits for a traditional bond portfolio mix. Historically, munis have rarely defaulted, with Baa-rated corporates exhibiting three times more instances of defaults than Baa-rated munis.

Beyond the rate-risk outlook, Gotelli argued that municipal bond exposure can help further diversify an investor's fixed income portfolio through non-correlated returns. The low correlation to other asset classes makes the muni bond category important in a well-diversified portfolio. Investment-grade municipal bonds exhibit a trailing 10-year correlation of 0.73 to U.S. core bonds, 0.23 to U.S. high-yields, and 0.04 to U.S. equities.

The American Century Diversified Municipal Bond ETF (NYSEArca: TAXF) is an actively managed municipal bond fund that combines investments in thoroughly researched high-yield and investment-grade municipal bonds. Designed for investors seeking current income, the fund dynamically adjusts investment-grade and high-yield exposures based on prevailing market conditions.

TAXF incorporates a top-down and bottom-up selection process to improve risk management and create a well-diversified muni bond portfolio. For example, the ETF's management team takes a macroeconomic outlook that incorporates an economic outlook, duration, rates, and yield curve. The municipal market outlook incorporates sectors, yield curve, and municipal relative value vs. taxable fixed income. The fundamental credit analysis incorporates internal credit review, economic financial strength, debt analysis, assigned internal ratings, and credit committee reviews. The relative value discussion incorporates bond pricing review, portfolio fit, and structure security analysis. The risk budgeting process incorporates position sizing, risk model review, and expected return/tracking error projections. Lastly, the buy/sell order incorporates pre-trade compliance, portfolio managers transact, and best execution prices.

TAXF's management team also follows a fundamental credit analysis process that includes internal credit review; economic, financial strength, debt, and political risk analysis; assigned internal rating;

and surveillance of ongoing issuer exposures.

Matt Lewis, vice president and head of ETF implementation and capital markets at American Century Investments, also explained the benefits of the ETF structure as an investment tool that provides more efficient access to the municipal bond market.

Specifically, the on-screen liquidity or current bid/offer spread and size available to trade reflect trading activity that has already transpired and is visible in the secondary market, where ETFs are priced, traded, and settled like stocks. The non-displayed liquidity or market maker's ability to provide liquidity for larger trades reveals that with the assistance of a broker, this level of liquidity may be accessed. Additionally, the underlying basket or creation/redemption process represents how market makers can access the liquidity of the underlying securities to meet investors' demands.

"Our solutions cover a vast array of investment capabilities," Lewis said. "These capabilities allow us to respond to specific client needs and also provides flexibility to offer unique investment solutions. Our ability to deliver a variety of investment solutions has become increasingly important to the various types of clients we serve."

## ETF TRENDS

by MAX CHEN

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