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Mom and Pop Buying Fewer Muni Bonds Directly as ETFs Heat Up.

- **Retail investors account for almost 75% of muni market's value**
- **Shift to managed accounts expected to continue in years ahead**

Mom and pop investors long have been staple retail buyers of state and local debt. Now that's changing as fewer and fewer are directly purchasing municipal bonds in the \$4 trillion market.

The value of bonds directly owned by households fell by \$18 billion in the fourth quarter of 2021, dropping to the lowest level since 2008, according to Federal Reserve data. Instead, those buyers are moving toward mutual funds and exchange traded funds, which have roughly doubled their muni holdings over the last decade.

Managed accounts offer buyers more liquidity and diversification, and their rise has put a spotlight on fund flow data as a key bellwether of the market's health. It also has homogenized the market by condensing individuals' investment strategies into the hands of account managers looking to beat a benchmark.

"When individual investors were the drivers of the market, every investor is different and you had this incredible diversity for buyers and sellers," said Patrick Luby, municipal strategist at CreditSights. "Munis will maintain their appeal to individual investors, but I think the way they access munis will continue to shift."

Together, direct and indirect retail account for almost three-quarters of the muni market's total value, dwarfing the holdings of insurance companies and U.S. banks, which each held about 12% in the fourth quarter.

As interest rates fell over the last few decades, the risk and reward tradeoff of buying individual bonds shifted, Luby said. Investors still ran the risk of losing principal, but smaller yields made mistakes more costly. It also become harder for financial advisers to squeeze out profits educating investors about individual deals.

Investors aren't necessarily selling individual bonds, but as their bonds mature, they're not putting as much money into new bonds. The Federal Reserve data isn't a perfect measure because it estimates households residually, or by subtracting all other reported holdings from the total market size. Still, it's one of the closest approximations of how much muni debt individuals hold directly.

"Mutual funds are becoming larger, over the last decade, their holdings pretty much doubled," said Mikhail Foux, head of municipal strategy at Barclays Plc. "Right now, they're the most important institutional player in the municipal space."

Foux expects the reallocation of retail muni holdings to continue, and pointed to a similar trajectory in the corporate market.

“There has been a lot of M&A activity in the mutual fund business and acquisitions of the separately managed account shops,” said Sweta Singh, portfolio manager at City Different Holdings LP. “Our market is getting more concentrated with bigger players, because there is bottom line pressure on margins.”

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