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Muni Carnage Could Create Opportunity.

Municipal bonds and the related exchange traded funds are languishing as interest rates rise, but a silver lining could materialize.

While the first four months of 2022 have been rough on munis, some market observers believe that rare opportunity could avail itself in this corner of the bond market. That could be a boon for an array of exchange traded funds, including the VanEck Vectors Muni Allocation ETF (MAAX).

"Relative to other fixed income investments, muni yields are attractive, too. One common metric to analyze the relative attractiveness of the muni market is the municipals over bonds (MOB) spread," says Cooper Howard of Charles Schwab. "It's a ratio of the yield on a AAA muni to that of a Treasury before considering the tax benefits that munis offer. Since the start of the year, the MOB spreads for most maturities have been steadily climbing and are now above their five-year averages."

MAAX is a relevant consideration in terms of finding opportunity and value with muni bonds because the ETF's 19 holdings are other ETFs and closed-end funds spread across varying credit qualities and durations.

Current MAAX components include the VanEck Vectors Long Muni ETF (MLN), the VanEck Vectors High Yield Muni ETF (HYD), and the VanEck Vectors Short High Yield Muni ETF (SHYD).

"Although prices have fallen, it's largely due to rising interest rates and not credit concerns. As a result, we believe the risk of defaults in the muni market remains low," adds Howard. "The ongoing economic recovery, combined with the multiple rounds of federal aid, have helped bolster most state and local governments' finances. Tax revenues have surged and rainy day funds (a pool of money a state can use under certain circumstances) are also at record highs, according to the National Association of State Budget Officers. Generally, states have used rainy day funds to help counteract the negative impact of declining revenues."

Translation: With prices down, yields up, and state and local finances mostly sturdy, some high-yield muni exposure could be warranted. With HYD, SHYD and other holdings, MAAX offers those credit opportunities, and the ETF sports a 30-day SEC yield of 2.74% — confirmation that investors are compensated for credit risk.

To that end, 68% of MAAX's holdings carry investment-grade ratings, while only 9.58% have junk grades, indicating that credit risk is minimal with this fund.

ETF TRENDS

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