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High Yield Muni Bonds Present New Opportunities.

With aggregate bond indexes flailing this year at the hands of rising interest rates, fixed income investors are understandably frustrated and wary about the asset class at large.

However, this year's turbulence could be giving way to opportunities in the bond market, including with municipal bonds. Some experts might argue that sentiment extends to high yield munis, which are accessible via exchange traded funds such as the VanEck High Yield Muni ETF (HYD A-) and the VanEck Short High Yield Muni ETF (SHYD C+).

Helped by its short duration, SHYD is outpacing the Bloomberg US Aggregate Bond Index this year. With yields elevated across the muni spectrum, both HYD and SHYD could be worthy of consideration by income investors.

"The yield on the Bloomberg U.S. Aggregate Bond Index stood at about 5.0% as of the end of October. Yields for the Bloomberg Municipal Bond Index edged up to 4.1%, while the high-yield municipal benchmark yielded 6.3%," noted Morningstar analyst Amy Arnott.

For its part, the $3 billion HYD sports a 30-day SEC yield of 4.81%, while SHYD features a 30-day SEC yield of 4.23% — impressive considering the ETF's effective duration of 4.46 years. On a standalone basis, these yields are impressive, but there's more to the story.

Historically, the higher a bond's starting yield is when an investor purchases it, the better the investor's odds are of positive outcomes. Second, the yields currently found in the municipal bond segment are unusual relative to historical norms.

"Munis haven't always offered such a generous yield advantage. As of December 2019, for example, the gap between taxable and tax-equivalent yields for funds in the muni-national intermediate category was only 3 basis points for investors in the 32% bracket and 10 basis points for investors in the 35% tax bracket. Investors in the top 37% bracket could eke out 20 additional basis points versus the average intermediate-term core bond fund," added Arnott.

Of course, "high-yield" could give some investors pause, but when it comes to HYD and SHYD the credit quality found within the ETFs isn't alarmingly "junky" and municipal bonds across the ratings spectrum are backed by strong fundamentals, indicating default rates are likely to remain low for the foreseeable future.

"With unemployment still running at historically low rates, state and local governments have also been collecting more revenue from income taxes and property taxes. Many municipalities have used this extra cash to build up their reserves, which should help cushion the blow if a weaker economy leads to lower tax revenue," wrote Arnott.

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