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Tax-Free Muni ETF Can Ride Muni “Renaissance”

Tax season is just around the corner, and government dues could well be on investors’ minds — almost as much as the Fed’s ongoing interest rate hikes and the recession they could induce. Suffice to say, there are a lot of open questions in the market right now. But one source of positivity, municipal bonds, could be worth looking at for tax-free yields as bonds resurge, available in a tax-free muni ETF like the American Century Diversified Municipal Bond ETF (TAXF B).

What’s behind this muni bond “renaissance” on the horizon? Municipal bonds offer significant value compared to other fixed income securities, strong from a credit perspective with appealing spreads versus comparable U.S. Treasurys. That stability could help especially if the aforementioned Fed-induced recession comes to pass.

Municipal bond ETFs in the muni national intermediate category on YCharts have taken in \$1.6 billion in net inflows over the last month, returning 1.3% in that time — that’s better than the 1% return from corporate bond ETFs according to the database or the 0.5% return for ultrashort bonds. Add in the tax benefits, and the case grows yet more.

The investment case for municipal bonds also benefits from municipalities being flush with cash with strong revenues, which will likely limit new issue supply, providing a “technical tailwind” for market performance in the first quarter of 2023.

TAXF itself charges 29 basis points for its active management approach. The tax-free muni ETF combines investment-grade and high-yield municipal bonds in order to provide current income, a strategy that’s paid off recently — the ETF has outperformed the ETF Database Category Average and Factset Segment Average over the last month, returning 2.2%. The strategy allocates up to 35% of its portfolio to riskier municipal offerings, depending on conditions in the market.

Municipal bonds are just one part of the overall bond landscape that is driving so much attention right now — but they are a powerful tool given their value, yields, and tax free nature. For those investors on the lookout for an appropriate tax-free muni ETF, TAXF may be one strategy to watch in the weeks ahead.

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