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## **Defined Maturity ETFs: A Robust Solution For Fixed-Income Investors**

One of the most aggressive interest rate hiking cycles in U.S. history has a way of getting people's attention.

From March 2022 to July 2023, the Federal Open Market Committee aggressively lifted the federal funds target rate by a whopping 5.25%. Combating inflation was and continues to be the focus. However, many conservative fixed-income investors instantly became unintended collateral damage.

Many broadly diversified index ETFs such the Vanguard Total Bond Market ETF (BND) fell by a staggering amount for conservative bond investors accustomed to an era of low volatility. In case you forgot, BND fell more than 16% and has yet to recapture its 2022 level.

What went wrong?

BND, like many plain vanilla index ETFs, is drenched with duration risk. And when interest rates are skyrocketing, these types of seemingly conservative bond ETFs are going to behave in a not so conservative manner by falling sharply, as history has proven.

As such, the ETF industry's solution to the problem is something called "defined maturity" bond funds.

The benefit of this approach is that advisors can execute bond laddering in an ETF wrapper. Defined maturity bond ETFs hold a portfolio of bonds that all mature in the same year, which is known as the fund's "target maturity year."

One of the oldest iterations of this hyper-focused maturity bond ETF are the BulletShares lineup from Invesco. The company offers target maturity funds for corporate and municipal bonds covering 2024 to 2033. BlackRock also offers its version of defined maturity bond funds within its iShares lineup.

With under \$35 billion in assets, defined maturity bond ETFs are still tiny compared to other ETF categories.

Unlike traditional bond funds that continuously buy and sell bonds to maintain a diversified portfolio indefinitely, single-year bond ETFs have a fixed termination date. The bonds held inside the ETF are held until they mature, according to a specific year. When the bonds finally hit maturity, the fund will liquidate and return the principal to the shareholders.

Defined maturity ETFs are arguably a better, easier way to manage interest rate risk because the impact of fluctuating rates has muted impact on bonds nearing redemption. This can help make an investor's bond portfolio less volatile.

Diversification is another big advantage.

Laddering bonds from single corporations or municipalities might help to navigate rate risk, but it unfortunately concentrates a bond investor's credit risk with single issuers. An unexpected credit event or default could quickly cause unwanted damage.

In contrast, a defined maturity bond ETF typically invests in a diversified basket of bonds, which might include corporate, municipal or government bonds, all with maturities aligning with the fund's target year. This provides broader, diversified bond exposure in a single fund, while still maintaining a specific maturity date.

How might advisors deploy these types of ETFs?

One potential solution is they can be used as part of a bond laddering strategy. This is accomplished by investing in several different ETFs with staggered maturity dates to provide regular income over several years. Another solution is to use them for targeting specific financial goals that align with the fund's maturity date, like a planned retirement or paying for college education.

In the end, single-year bond ETFs offer a unique combination of predictable maturities, regular income and a robust fixed income strategy less credit and interest rate risk.

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