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Active Muni ETFs Are Rapidly Gaining Traction.

In terms of population, the universe of actively managed municipal bond exchange traded funds is growing at a prodigious pace. That makes sense because there are multiple reasons why the combination of municipal bonds and active management can reward investors.

The ALPS Intermediate Municipal Bond ETF (MNBD) is one of the established names in the active muni ETF patch. MNBD, which turned two years old in May, attempts to beat the Bloomberg Municipal Bond 1-15 Year Blend Index. Admittedly, year-to-date isn't the best measuring stick of muni bond ETF performance. That's because this is a long-term asset class. Still, that doesn't diminish the point that MNBD is beating the widely followed ICE AMT-Free US National Municipal Index by a 2-to-1 margin this year.

Advisors know some perks can be accrued when munis meet active management. These include superior flexibility when it comes to managing credit and interest rate risk as well as the ability of active managers to more readily identify valuation opportunities than can muni indexes. Some other points in favor of MNBD should be considered.

MNBD Hidden Advantages

While municipal bonds are a massive corner of the broader fixed income market, some issues with this form of debt make indexing challenging.

"Municipal bonds are a highly illiquid and fragmented market. This makes indexing difficult and creates more opportunities for active managers than more liquid markets. This favorable arena is reflected in assets; 87% of all muni fund assets are in funds where managers choose the bonds rather than mimic and index," notes Morningstar's Gabe Alpert.

That's not to say passive muni ETFs are "bad" products. Instead, municipal bonds' liquidity, or lack thereof, highlights potential advantages with actively managed funds such as MNBD.

Another reason active management makes sense with municipal debt is because these bonds take various forms. This includes general obligation, revenue, and enhancement program bonds, among others. Each subsection of the muni space brings with it opportunities and risks. That can be viewed as further confirmation of the potency of active management. It could also bode well for the long-term adoption of ETFs such as MNBD.

"As demand for ETFs grew, firms launched muni-bond ETFs. Due to the difficulty of launching active ETFs until a regulatory change in 2019, before then, there were only 19 of these funds. Between 2019 and 2024, an average of 7.5 active muni ETFs were listed each year. This is compared with an average of 3.5 index muni ETFs. Flows have followed, with 60% of 2024 flows to muni ETFs going to active funds despite making up only 15% of assets," concludes Alpert.

etftrends.com

by Todd Shriber

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