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Income Investing

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October 13, 2016, 2:25 P.M. ET

Tough Week for Muni Closed-End Funds

By Amey Stone

Municipal bond closed-end funds are getting hit with a troika of headwinds this week. Not only are interest rates rising (which leads to falling share prices), but the municipal market is underperforming Treasuries for no obvious reason.

Plus, since this group of funds have outperformed for the past year, investors wary of rising rates may be looking to take profits. And since most employ leverage, any downtick gets compounded.

For example, the share price of the $3.6 billion **Nuveen AMT-Free Quality Muni Income** (NEA) has fallen from $14.25 to $13.80 since Monday. **Nuveen Enhanced AMT-Free Muni Credit Opportunities** (NVG), another large fund, is down 1.3% on Thursday alone to $15.07.

Barron's checked in with **Jim Robinson**, portfolio manager of **Robinson Tax Advantaged Income** (ROBAX), a fund that invests in muni CEFs, to see what he thinks is going. Here's what he wrote to us:

> The last couple of days is probably attributable to retail investors in tax-exempt CEFs getting spooked by higher yields; but, I'm at a loss to explain the underperformance of munis versus Treasuries over the past three months, particularly in a rising rate environment.

Even as rates bounced Thursday, municipal bond closed-end funds continued to sell off — most likely because of the lag from when individual investors start selling after institutions have inflicted some damage on a sector. Robinson explains:

> There's usually a lag effect between the Treasury market (institutional money) and the CEF market (mostly retail money). Trading volumes in tax-exempt CEFs have been way up the past couple days—yesterday volumes were 50-100% over average daily trading volumes and today they are 100-200% above average. Our Fund's weighted average discount is around 6% now —three months ago it was 1%.

He finds the underperformance of munis surprising given the turn the election has taken. On that topic he writes:

> The election is looking more and more like it could be a Democratic sweep—presumably that means that marginal tax rates for the highest earners are likely to go up. One would think that would be good for tax-exempt bond valuations relative to taxable bond valuations. So far that hasn't been the case—the effective yield for the muni index is up 0.4% over the past three months, whereas the effective yield for the Treasury index is up 0.35%. In general, one would expect muni yields to move at a beta versus Treasury yields of 1 minus the marginal tax rate

> (approximately 0.6). What's most surprising this time is that we haven't seen any muni market specific shock, like the Detroit bankruptcy in 2013, that would explain why munis are getting hit harder than Treasuries.