

Buena Vista Investment Management, LLC

Creative Investment Solutions

MUNICIPAL BONDS PROVIDE ATTRACTIVE TAX FREE INCOME

By Joel Sullivan, Partner

In 2011 the Barclays Municipal Bond index had a total return of 10.7%. While experts don't expect such above average returns this year, they are still looking for total returns of 6-7%. It's because of these types of forecasts that PIMCO funds, which run the world's largest bond fund, boosted its holdings of U.S. municipal debt to the highest level in 5 years. This is also in stark contrast to a year ago when municipal bonds were getting a bad rap. States were having budget issues, Build America Bonds were being halted, and market analyst Meredith Whitney told 60 Minutes that there would be defaults totaling "hundreds of billions of dollars." Obviously, this did not come to pass. The default wave didn't materialize and munis staged an impressive rally as detailed above.

Total return figures of 6-7% are a combination of interest and price appreciation. If we just look at the interest paid, that figure ranges from 2 – 3% for investment grade. One to two percent higher for non- investment grade muni bonds. This interest is normally paid every 6 months to individual bond holders or quarterly from bond funds. One of the primary benefits of muni bonds is that they are free from federal tax. This means that for investors in the 28% bracket, a 3% rate is the equivalent of 4.2% taxable. If you're in the top rate of 35%, you would be earning a rate of 4.7% on a taxable equivalent basis.

According to Bloomberg news, municipal bonds is one investment where hiring a professional fund manager makes a ton of sense. Mutual fund companies have analysts to sort out the good investment-grade values, and you get the broad diversification that helps reduce default risk. There are a number of good funds out there. Morningstar research lists on their site several highly rated funds that yield from 3.35 to 4.25%.

With Federal Reserve Chairman Ben Bernanke announcing his intent to keep interest rates low until sometime in 2014, the higher yield from municipal bonds could be a very attractive place to be over the next year, or maybe longer.

Starting Friday, January 27 on WFHR at 10:30am we will be presenting our new radio show "Investment Insights from Buena Vista." Also please go to our website to stay up on our latest thoughts, buenavistainv.com

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