WEEKEND INVESTOR

# A Discount on Muni Funds

*Fears on Interest Rates and Finances Have Held Down Prices*

By DAISY MAXEY

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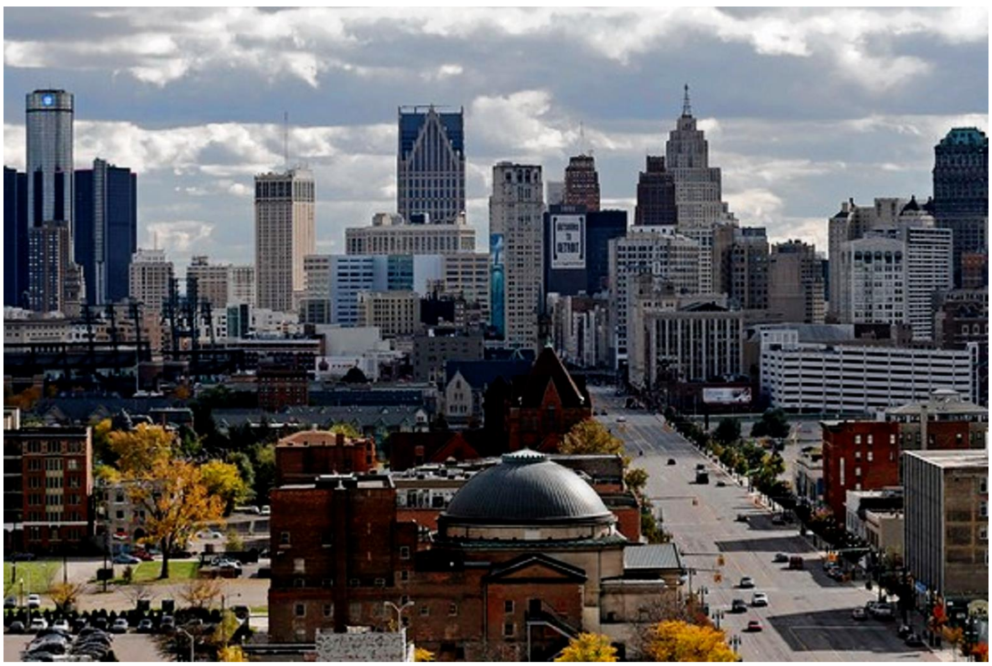


The municipal-bond market has been roiled by Detroit's bankruptcy filing in July. *Reuters*

Many closed-end funds that own municipal bonds can be bought at a discount to the value of their assets, an opportunity for investors who are willing to wager that interest rates don't soar and fiscal meltdowns such as the one in Detroit remain rare.

The funds issue a fixed number of shares that can be bought or sold on exchanges like stocks. In contrast to conventional mutual funds, closed-end funds can trade for more or less than the value of the underlying assets. The discount or premium depends on how investors view the risk of the investments held by the fund.

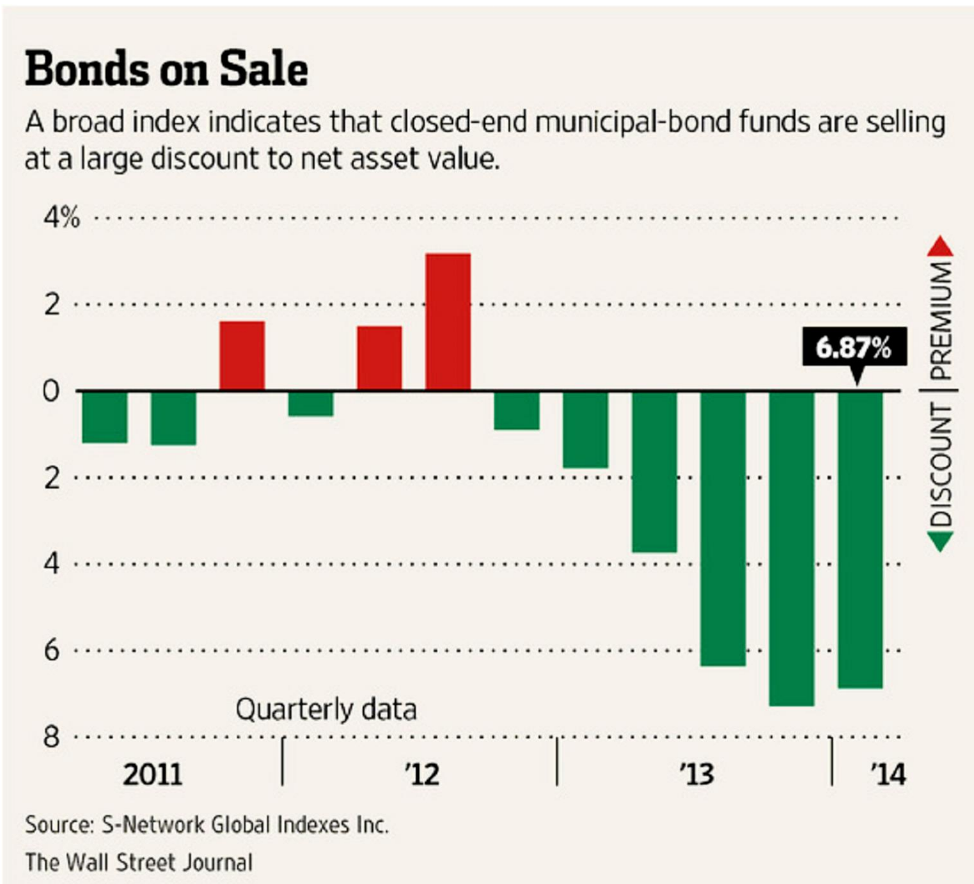
As of March 31, the discount on the S-Network Municipal Bond Closed-End Fund Index, which tracks 84 municipal-bond closed-end funds, was 6.87%, down from 7.29% at the end of December, according to S-Network Global Indexes, an index publisher based in New York.

The potential to buy at a discount is one reason some investors are drawn to closed-end funds. In addition, investors often want the income the funds can generate. Many of the funds use borrowed money to increase their holdings, which typically results in higher yields.

### *Not for Everyone*

Closed-end funds aren't usually suited to short-term investors, because the discounts can persist and even widen. The use of borrowed money also can make share prices more volatile, by magnifying a fund's gains or losses.

The municipal-bond market has been roiled by Detroit's bankruptcy filing in July and Puerto Rico's fiscal problems, which include a hefty debt of roughly 70 billion.




In addition, municipal-bond prices have taken a hit since May, when Ben Bernanke, then-chairman of the Federal Reserve, said the central bank could begin slowing its asset-purchase program. Mr. Bernanke's statement led many investors to sell bonds, pushing down prices and driving up yields, which move in the opposite direction.

But some experts believe investors are selling bonds indiscriminately and note that yields on municipal bonds have historically been less sensitive to rising rates than Treasurys.

Fears that interest rates will rise further are damping demand for closed-end funds that hold municipal bonds, says Patrick Galley, chief investment officer at RiverNorth Capital Management, a Chicago-based investment firm that manages 2.1 billion.

### *A Buying Opportunity*

Nonetheless, he says, "for those investors who have muni-bond exposure or other fixed-income-like exposure, this is a great time to invest" in the funds, because of the current discounts. Discounts will narrow as interest rates stabilie or perhaps even as they rise, "taking some air out of the fear in fixed income," Mr. Galley says.

Investors who own municipal bonds in a mutual fund, for example, might want to consider selling and buying that same exposure at a discount through a closed-end fund, says Mr. Galley, who bought shares in the funds for his clients late last year and earlier this year.

Paul Winter, president of Five Seasons Financial Planning in Salt ake City, bought a number of municipal-bond closed-end funds last year, focusing on those with lower leverage ratios, and he says he hasn't sold any of them yet.

"It seemed like a great opportunity to rebalance clients out of stocks and into bonds," he says.

Among the funds he holds are Western Asset Municipal igh Income Fund, Invesco Municipal Income Opportunities Trust and Eaton Vance National Municipal Opportunities Trust, which traded at discounts of 9.79%, 6.43% and 10.1%, respectively, as of April 1, according to Chicago-based investment-research firm Morningstar.

Mr. Winter, whose firm manages 36 million, says he is reluctant to add to his holdings at current prices. But, he adds, "I'm still closer to being a buyer on weakness than a seller on strength."

### *The Risk of Leverage*

Closed-end funds aren't appropriate for the most conservative investors, says Mariana Bush, who heads the closed-end fund research group at Wells Fargo Advisors.

Most of funds will suffer the additional volatility that comes with leverage, she says. And it may take some time for the discounts to narrow, a process that likely would be driven by the market feeling more comfortable about interest-rate risk, she adds.

Nonetheless, Nicholas aVerghetta, a principal at NCM Capital Management, says he has been adding to his municipal-bond closed-end fund holdings over the past six months.

"There is interest-rate and leverage risk, but the 6% plus in tax-free income is compensating us for that risk," says Mr. aVerghetta, whose Ramsey, N.J., firm manages 82 million.

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