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# Kiplinger's Investing for Income

Strategies to Boost Your Cash Yield

## Unlocking the Mysteries of Closed-End Funds

In May 2020's letter, we wrote that Western Asset Investment Grade Income Fund (PAI) represented an opportunity to invest in a portfolio of quality securities and pay far less than market value. On April 10, the fund, which owns BBB-rated corporate bonds along with a touch of junk and emerging-markets debt, traded for $13.73 a share—7% below its net asset value at the time. Helped by its high duration of 8 as long-term interest rates plummeted, as well as vigorous bond markets and a dash of borrowed money, PAI shares rose to $15.67 on August 14, a 14.3% jump and barely less than the fund's revised NAV per share of $15.76. For the three months through August 14, PAI's total return on share price was 14.5%, which dwarfs the Bloomberg Barclays Aggregate Bond index's 2.0% rise and the 5.7% gain by VTC, the Vanguard Total Corporate Bond exchange-traded fund.

Wise trading and research helped stoke PAI's advance, but so did the fact that Western Asset Investment Grade is a closed-end fund. A CEF has a fixed number of shares that trade like shares of a stock. That means at times a CEF's price will soar relative to the aggregate value of the fund's holdings. That enabled this 14.5% three-month gain as PAI's 7% discount melted to almost zero. Of course, when market conditions are bad, the reverse can be true—but there's also a measure of safety because the closed-end structure inoculates managers from frantic redemption orders that force ETFs and, to a lesser degree, regular mutual funds to sell assets into a free-falling market. In March, PAI's shares lost 7.4%. That wasn't swell, but it was far from a disaster. The Vanguard ETF dropped 6.7%, and many individual bonds traded down 20% or more. Well-run closed-ends normally have more upside in rallies than downside in sell-offs.

> **Well-run CEFs normally have more upside in rallies than downside in sell-offs.**

Another distinction: Most CEFs pay larger monthly or quarterly distributions than ETFs and mutual funds. This results from leverage, or borrowing, which lets CEFs own more than $1 of stocks, bonds, real estate investment trusts or whatever for each $1 of shareholder capital. PAI is moderately leveraged, at 9%. Some CEFs go up to 40% leverage; the industry-wide average is 25%. Again, at the wrong time and in the wrong hands, this will magnify principal losses. But PAI's mild borrowing is just enough so it can distribute 4%, compared with the Vanguard ETF's 2.8%.

We raise this topic because the widening gap between CEF distributions and the yields of ETFs and standard funds means we see more-frequent inquiries about closed-ends, including from people who have never used them and do not understand their proclivities and quirks—such

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as having two ways to measure performance. We have several CEFs in the Kiplinger Income 25, and we occasionally point to overly discounted ones suitable for sniping. So, to help with any confusion, here's a user's guide and some perspective.

**A yield or a distribution?** Yield is investment income from actual securities. Distribution is the ratio of cash payments to share price. Because of leverage, the distribution will be higher (sometimes much higher) than what the fund's regular stocks and bonds yield. Sometimes a CEF will also include in its payouts some returned capital. That's technically not yield, although websites and even some fund literature sometimes call it that ("distribution yield" is a fallacy). Closed-End Fund Advisors, provider of the best CEF data, reports the average taxable-bond CEF distributes 8.7%; common stock distributes 8.1%; preferred stock, 7.4%; and municipal bonds, 4.4%. This puts more money in the shareholders' pockets in real time, which is a prime objective.

**Is that distribution reliable?** Most of the time, a CEF sets its fixed monthly payout rate and covers it from investment income and reasonable trading gains. If those come up short, the fund must cut the distribution or else return capital and thereby shrink the asset base (or both). Evidence that a fund's payout is covered can be found in the Statement of Operations in the annual or semiannual report. Compare net investment income with total distributions to shareholders. PAI now pays 60 cents a share per year; over the past five years, its net investment income was 62, 65, 68, 70 and 70 cents, so the distribution is honest. It can cover the occasional shortfall out of trading profits, which were $1.55 a share in 2019. Problems arise when CEFs promise a fat 12% distribution but cannot possibly earn that and must finagle. We avoid those.

**Return on price or on NAV?** Do you recall we mentioned two ways to compute performance? One is return on share price, which includes discounts and premiums; it measures what becomes of your real money in real life. The second is return on NAV, which reports the portfolio's results before market trading waggles the CEF's share price. To compare a CEF with an ETF or a regular fund, a purist will insist that you use return on NAV. But that is not entirely fair, because the market should reward superior trading and analysis with narrower discounts or rising premiums. According to Closed-End Fund Advisors, return on price over 20 years has consistently beaten return on NAV by 1% a year, after expenses. We think this is because active management pays off in the end. One of our favorite comparisons is to pit PFD (Flaherty & Crumrine Preferred Income) against PFF (the iShares index ETF). PFD presumably has a handicap because of its higher expenses. But the score shows it has been no contest, whether looking at this year, last year or the past 10 years, during which PFD's annualized return on price of 10.8% and on NAV of 10.6% doubled the index fund's 5.2% annualized gain. Another actively managed preferred CEF, Cohen & Steers Select Preferred & Income (PSF), is comparable to PFD.

**About those expense ratios.** A curmudgeon might note that PFF's annual expenses are 0.46%, while Flaherty & Crumrine's are 2.94% and Cohen & Steers's are 2.48%. But for a CEF, this ratio includes the interest cost of the fund's leverage, so a fair comparison shows that ETFs have a narrower fee advantage. The barely leveraged Western Asset corporate bond fund, PAI, has total expenses of 0.85%. So, expenses are not a reason to eschew closed-ends. Many times, you get what you pay for, in investments as elsewhere. Next month, we will showcase CEFs in every category.

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# Late Summer and Early Fall Blues

September and October hoover up a disproportionate share of financial disasters. There was 1929, of course, and 1987 and 2008, but also the Panic of 1907 and the 1998 collapse of a notorious $4.6 billion hedge fund called Long-Term Capital Management. This is consistent with reading in early August that investment adviser and author A. Gary Shilling, who accurately foretold the end of high inflation decades ago, predicted U.S. stocks shall commence a 30%-to-40% drop starting in precisely seven weeks. That would put the Dow Jones industrial average's next catastrophe at about September 28.

We are not superstitious, and Shilling's alarm clock relies heavily on his theory that when U.S. bond yields crater, signifying gathering economic distress, it takes seven weeks for stock indexes to get the ominous message. Shilling, as well as others, further avers that if shares of Amazon, Apple, Facebook, Google and Microsoft were to suffer a simultaneous correction, the smallest 100 components of the S&P 500 would need to leap 90% to offset the decline, which is impossible. Our short-term view is much less dire. We posit there will be a correction—a 10% to 20% drop—before long. But before getting overly worried, we'd like the answers to two critical questions: What sparks the sell-off, and when? Normal trading losses and profit-taking? No sweat. Slightly higher inflation and interest rates? Okay. Weak earnings? We get that. It would take a combination of deepening collapses in business conditions, jobs, health and confidence to usher in another and costlier crash.

Shilling is no permabear, and as we get closer to this red zone of risk, the news is mixed, and not all negative. The COVID economy has winners and losers. Manufacturing, housing and even auto sales are trending upward, along with digital and communications enterprises. Travel, restaurants, much of retail and related commercial real estate are in bad and worsening shape. Banks are still well-capitalized, although cash dividends are frozen and earnings prospects limited by low interest rates. The financial markets have no precedent for digesting this combo because the causes of past recessions—oil shocks, stagflation, rampant bank failures and choking, 1970s-style interest rates—are nowhere in view. So, before you mark September 28 as the next Black Monday, consider the variables that may or may not interrupt or reverse the summer's bullishness. Bad or even discouraging news on the following would reward anticipatory de-risking:

**Skipped rents and mortgages.** So far, government stimulus and accumulated savings are fending off mass non-payments. But Wall Street is nervous that if rampant evictions and foreclosures ensue and the COVID caseload and unemployment stay high or rise, it will not only be harmful for public health and social order but also tarnish lenders' and property owners' balance sheets and income statements.

**Legislative politics.** A breakdown between Congress and/or the White House that prevents any relief before the election would also stab the bull. The markets will not be appeased by partial measures such as temporary tax cuts.

**Municipal finances.** Illinois could be busted to a junk credit rating. The idea of a large U.S. state as the credit equivalent of an emerging market will provoke some panic. Illinois will not default, but a junk rating would spread headline risk about municipals in general. It is possible that buying opportunities will arise for those with cash and guts, but not immediately.

**Third-quarter earnings.** Stocks and corporate bonds recovered after troughing in March as evidence spread that second-quarter profits would not be as dismal as first predicted. That proved true: S&P 500 earnings from April to June dropped, but not by the dreaded 50% or more, despite the 32.9% annualized plunge in gross domestic product. Third-quarter profit and economic reports begin arriving in October. Traders' reaction will be brutal if the results are awful.

All this said, it would take a combination of the events above for stocks, real estate, and U.S. corporate and municipal bonds all to lose major principal again before year's end. There is a lot of cash on the sidelines, and plenty of investors are still fearful of missing out. Some interpret what might be the start of slightly higher inflation as better for stocks than debt. And if you're curious why presidential politics is not on this list, it's because there's no reason to expect immediately actionable tax-code revisions or other changes, whatever the outcome. Even as the voting date nears, the coronavirus and Congress are the key stories to watch.

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# Surpluses or Shortages? Does It Matter?

For years, investment returns have been boosted by an invisible hand: too many people and institutions, both foreign and domestic, vying to own the same scarce securities and pouring in more and more new money. One widely quoted reference notes that the 2,800 companies listed on the New York Stock Exchange are half the number that existed not that many years ago. The count of publicly traded U.S. utilities, after mergers and privatizations, is now down to 40, from 57 in 2010. That helped turn electrics from dull bond stand-ins to vibrant, must-own income-and-growth securities. Today's total of Standard & Poor's Dividend Aristocrats, 65, is little changed from the 56 available in 2005, but trading volume has exploded, and dividend investing has morphed into a wildly popular wealth-building strategy. We call it BHCG, for buy, hold, collect and grow, an engine powered by corporate America's trend toward bigger and bigger dividend raises and payouts, frequently pushing your yield on original cost near 10%.

As Americans ponder the fate of the bull market that dates to 1982, this concentration has a worrisome aspect: We are all in thrall to an ever-more-limited list of names in fewer industries. Hundreds of gigantic exchange-traded funds and other index funds contain this same bag of stuff. If market sentiment sours for longer than a few days, as we saw this winter, the losses will be sweeping and frightening, and there will be nowhere to seek shelter except yield-free cash.

Hence, one of our missions is to find high-income-paying categories sufficiently obscure that not all of the best selections have been picked over and bullied to extreme prices by the mob. Before the energy industry fell apart, this described master limited partnerships. Today, these include non-energy preferred stocks, taxable municipal bonds and unconventional real estate investment trusts that own data farms, cell-phone towers, digital advertising media and farmland. Each can yield, on new money, twice what the usual-suspect large-capitalization dividend stocks do and considerably more than high-grade bonds. The drawback is that these are not nearly as liquid as, say, AT&T, Exxon or government-backed debt, and they cannot easily survive scandals or market accidents. So, and this may sound counterintuitive, we want to see a slew of new offerings to take the pressure off the chosen few. And there are signs.

We are especially happy to see a boom in the creation of taxable municipals. Last year, the market added $63 billion worth of them—16% of all new munis. In 2020, while the issuance of all munis is up 15%, taxable-muni volume is climbing faster than tax-free volume; it might reach 25% of new issues. Yet that hasn't fazed the two best-known taxable-muni funds, **Invesco Taxable Municipal ETF** (BAB, price $33.34, yield 3.3%, year-to-date return 7.7%) and BBN, the leveraged closed-end **BlackRock Taxable Municipal Trust** (price $25.18, distribution 5.3%, return 7.8%). The greater supply means managers can be more selective. And the yield is slightly better than you'll get from investment-grade corporate indexes; with new money, the yield is sweet compared with the 2.1% to maturity on the S&P 500 bond index. Quality is fine; familiar tax-free borrowers add a taxable series to their calendars for buyers who don't need the personal tax exemption.

We're also seeing a lot of new preferred stock. The $34 billion issued in the first seven months of 2020 equals the full-year amount from 2019. This stands to be the biggest year for new preferreds since 2008. If you get a shot at a closed-end preferred fund trading at or below its net asset value, pretend you're a cat presented with a plate of fresh salmon. It won't last long, and there will be a crowd.

## Timely Tactic of the Month

Signs that European and Asian economies are improving while our economic outlook remains cloudy leave us curious why **Vanguard International Dividend Growth ETF (VIGI, price $71.22, yield 1.8%, year-to-date return 12.4%)** has not caught fire until now, with a 7% return in the past 30 days. The fund is not handicapped by dividend-slashers like BP and Shell. Also, many foreign companies decide what they will pay not by precedent but based on year-end results and the outlook for the next. December's quarterly dividend, normally the biggest, could be much improved from 2019.

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# Kiplinger's 25 for Income

Another month on the plus side, despite official news that the second-quarter economy contracted at an annual rate of 39% and despite spreading dividend cuts and freezes. Only six selections slid in price, half being the energy trio of Magellan, Suburban and Valero. Suburban chopped its quarterly dividend in half, so the yield is no longer more than 15%, but its price declined by a less-than-expected 4.2%. The gainers were propelled by low (and falling) interest rates, a bounce by oversold real estate investment trusts, and perfervid buying of yield champs such as junk bonds and preferred stocks. Evidently, neither the economic shock nor political drama can blunt the pursuit of 3%-to-8% yields when the return on cash and short-term bonds is invisible. Hence Annaly tacked on 7%, Digital Realty 6.6% and Realty Income 4.1%. Plus, all six fixed-income closed-end funds and ETFs rose between 1.8% and 4%. And, except for Suburban, we had no new distribution or dividend cuts. Where you see a slightly lower current yield, it is because the share price or net asset value is advancing faster than the distribution. We will not complain about that.

| **Utility stocks** | | **Price** | **Yield** | **Frequency** |
|---|---|---|---|---|
| American Electric Power (AEP) | Traditional electric company serving 11 eastern and southern states | $82.95 | 3.4% | quarterly |
| AT&T (T) | Wireless-service giant that grew out of the former SBC | 30.01 | 6.9 | quarterly |
| American Water (AWK) | Largest investor-owned water utility, serving 16 states | 145.31 | 1.5 | quarterly |
| National Grid (NGG) | British national gas and electric utility that also operates in New York and New England | 58.35 | 5.3 | semiannually |
| Xcel Energy (XEL) | Central states electric system that emphasizes wind energy | 70.73 | 2.4 | quarterly |
| **High-yielding open-end bond funds** | | | | |
| Dodge & Cox Global Bond (DODLX) | A mix of domestic and foreign corporate bonds, mostly denominated in U.S. dollars | $11.80 | 3.2% | quarterly |
| DoubleLine Total Return (DLTNX) | Income fund that makes the most of mortgage securities | 10.72 | 3.3 | monthly |
| Fidelity Capital & Income (FAGIX) | Creative and aggressive junk bond fund | 9.98 | 4.0 | monthly |
| Fidelity New Markets Income (FNMIX) | Impressive emerging-markets bond fund | 14.63 | 4.2 | monthly |
| Hotchkis & Wiley High Yield (HWHAX) | Boutique high-yield fund that concentrates on small companies | 10.53 | 5.4 | monthly |
| Loomis Sayles Bond (LSBRX) | Go-anywhere investment-grade bond fund | 13.18 | 2.6 | monthly |
| **Closed-end mutual funds and ETFs** | | | | |
| AllianceBernstein Global High Income (AWF) | High-yield corporate bonds and government bonds from emerging markets | $10.71 | 7.3% | monthly |
| *BNY Mellon Municipal Bond Infrastructure (DMB)* | *A leveraged closed-end fund that likes transportation and hospital bonds* | *13.91* | *4.6* | *monthly* |
| Eaton Vance Floating-Rate Income Trust (EFT) | One of the oldest floating-rate loan funds, with a team of five veteran managers | 11.84 | 5.9 | monthly |
| iShares U.S. Preferred ETF (PFF) | This exchange-traded index fund spreads your money in more than 301 preferred stocks | 36.37 | 5.5 | monthly |
| *Nuveen Municipal Value (NUV)* | *This non-leveraged closed-end is an alternative to the Dreyfus Infrastructure fund* | *10.65* | *3.5* | *monthly* |
| Pimco Corporate & Income Strategy (PCN) | An unusual mixture of high-yield corporate, muni and foreign bonds | 15.99 | 8.4 | monthly |
| **Real estate investment trusts** | | | | |
| Annaly Capital Management (NLY) | Borrows cheaply to reinvest in government-guaranteed mortgage securities | $7.51 | 11.2% | quarterly |
| Digital Realty Trust (DLR) | Developer and operator of data centers in the U.S., Canada, Europe and Asia | 153.32 | 2.9 | quarterly |
| Realty Income (O) | Landlord to chain stores and restaurants, also known for 600 straight monthly dividends | 61.01 | 4.6 | monthly |
| Welltower (WELL) | Develops and owns assisted-living facilities, hospitals and medical labs | 56.75 | 4.3 | quarterly |
| **Energy investments and partnerships** | | | | |
| Brookfield Infrastructure Partners (BIP)* | Owns toll highways, ports and transmission lines | $44.39 | 4.4% | quarterly |
| Magellan Midstream Partners (MMP)* | One of the largest pipeline carriers of gasoline, diesel and chemicals | 41.39 | 9.9 | quarterly |
| Suburban Propane Partners (SPH)* | Propane distributor normally yields substantially more than junk bonds | 13.72 | 8.7 | quarterly |
| Valero Energy (VLO) | World's largest independent refiner, known for large dividend increases | 54.46 | 7.1 | quarterly |

Funds in italics pay tax-exempt income. Investments with an asterisk (*) are partnerships. Prices and yields as of August 14, 2020. SOURCES: Fund companies, Morningstar Inc., Yahoo.

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# Ask Jeff

Readers are invited to send questions about income investments to jkosnett@kiplinger.com. I'll answer you personally if there's no space here for a published reply.

**Dear Jeff:**
**I know this is controversial, but what should I think about doing with my investments if the apparent loser of the presidential election refuses to concede and chaos ensues? Buy Swiss francs? Yen? Gold? Treasuries and Ginnie Maes? Or what?**
**David**

Dear David:
I'm not biting yet on such trouble. Election results often prove to be just another short-term financial variable, and the markets continue with their usual focus on economic data, the Federal Reserve, relative valuations and, this year, the pandemic's progress and lasting impact. Do not divest successful and appropriate investments, foreign or domestic, unless you have other reasons to rebalance or you prefer to trim risk. As for hideouts such as Swiss francs, there are not nearly enough of them to supplant the dollar as the reserve currency. The Treasury's full faith and credit should retain its brand value. The dollar is sliding a bit against Japan's yen and the euro, but those exchange rates have just returned to roughly where they began 2020, so I am puzzled by headlines and commentaries about the suddenly suffering dollar. Besides, if Treasury yields bump up some more, that should firm up the exchange rates.

**Dear Jeff:**
**My investment adviser has discretion to make trades for my account and just bought high-yield bond funds from Fidelity, Vanguard and Federated. I am nervous because I am 75 and retired, and I cannot afford a big loss. Should I ask to reverse these trades?**
**Jeet**

Dear Jeet:
Generally, high-yield bond funds are moderately risky, but not crazy. The income continues uninterrupted this year despite the economic downturn. And by "big loss," it depends whether your definition is a transitory 5% or a calamitous 25 cents on the dollar. That size loss has not struck BB-rated corporate bonds in ages, except during the credit crisis of late 2008. So, unless the adviser transferred a whopping 20% or more of your bond allocation, I would not object—though I would discuss it and request a consultation next time as a courtesy.

**Dear Jeff:**
**I invested in Healthpeak Properties (PEAK), a senior housing and medical-property REIT, for income and because I thought it was a stable industry. I have lost a chunk this year, so what is your take?**
**Marjorie**

Dear Marjorie:
PEAK is not as famous as Alexandria, Ventas or Welltower. But it is often the case that in boom times, midsize REITs can outperform giants in their subsectors. PEAK has had its moments. And its year-to-date loss of 17%, even after losing nearly half of its value at one point, is narrower than most of its competitors' losses. Healthpeak wisely invests about one-third of its assets in biotechnology offices and laboratories, which is an advantage over Ventas and Welltower. But the majority of PEAK's assets are in assisted living, nursing care and medical offices, which were out of favor and then further afflicted by the coronavirus and its pox on occupancy and expenses. At best, PEAK is an average performer in a subpar REIT category.

**Dear Jeff:**
**What does it mean when you say an investment is taxed at the qualified rate instead of the ordinary rate? How do I know which tax liability to expect?**
**Marcia**

Dear Marcia:
This term refers to whether an income distribution, such as from a common or preferred stock or a closed-end fund, "qualifies" for the lower capital gains tax rate or if instead you must regard it as "nonqualified" regular income, with a maximum marginal rate of 37%. Generally, if the entity distributing the cash is not taxed, such as a real estate investment trust, expect to pay ordinary income tax rates instead of the qualified 15% or 20% rate applicable to payouts from many banks' and industrial companies' preferred shares. If a company is distributing capital gains, those are also taxed at the lower rate.

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# What's New in Cash

**Early words on the election.** A direct quote from market watchers at Deutsche Bank Research: "Predictable elections have historically been nonevents" for the financial markets. The group also finds that if the election is too close to call until the very end (meaning the polls are statistically close heading into November), expect stocks and interest rates to trade sideways, with big days in both directions. We know the 2016 results were a surprise and that these supercharged and heavily programmed markets can bounce violently on a whim; you may recall the wild middle-of-the-night swings in stock indexes as Trump was declared the winner. We're also seeing Wall Street firms trying to anticipate the effect a reversal of Trump's corporate income tax cut will have on 2021 and 2022 earnings. Our reaction to that is that it is way too early to make such calculations and that earnings estimates are more vulnerable to the state of the pandemic than to politics. The verdict: In the weeks ahead, do not sell anything that you would not otherwise sell.

**The Fed stands tall.** Although the central bank normally says and does little this close to a presidential election, the bank is impatient with Congress and the President for failing to put more money into the damaged economy. So, expect the Fed to issue more statements forswearing even a hint of tightening credit, despite the bump-up in inflation that sent gold over $2,000 briefly and the dollar and bond prices down. All that reversed, and we maintain this is still a bull market in bonds of all varieties.

**REIT picker's market.** Here's an oddity, though we understand its origin: Through August 20, our 10-member REIT Dream Team has an equal-weighted 2020 total return of 0.8%. But that's the product of five winners and five losers of as much as 55%. The gainers own property for communications, biotechnology and logistics, while the millstones are retail, office and residential REITs. For months, analysts have expected some reversion to the mean in out-of-favor property sectors, but this has been slow in coming. Avoid REIT index funds and either buy (or accumulate) REIT shares directly or use an active fund.

Every year or two, we hunt for investments priced to distribute 10% with cash flow and monthly or quarterly payouts that are reasonably secure. We'll never have 100% success with such suggestions, but if four out of six work, and only one blows up and falls by half, you'll be okay. We do assume an investor would commit only a small proportion of assets. We say to avoid common stocks with these crazy-high yields because the dividend and the share price are likely careening toward zero. But there are sectors, such as publicly traded private equity and business development companies, in which solvent entities can legitimately distribute 10% because the enterprise often finances its own less-creditworthy clients at 12% to 14%. This is a corner of commerce where regular banks fear to tread and the Federal Reserve's zero-interest-rate policy may as well be happening on the moon.

Our last journey to this realm was in August 2019. The 10-year U.S. Treasury bond dipped below 1.5%, startling at the time (nobody foresaw the events of 2020), and BBB-rated corporates breached 4%. That was great if you had established positions, but it was a challenge for new money or if your bond got called. So, we looked around, and not only were many finance companies' shares yielding 10%, but they also traded at or even below their net asset values. We warned about one: Eagle Point Credit (ECC). At $18.63, it then sold at 40% over NAV. ECC drifted down to $14 in February, and it is now $7.85—and still 26% over NAV. It has reduced its monthly distribution from 20 cents to 8 cents.

We had better vibes about some others, though, and the results were fine until the economy locked down. BGC Partners (BCGP), Gladstone Capital (GLAD), Manhattan Bridge Capital (LOAN) and Saratoga Investment (SAR) all traded flat or rose the rest of 2019 and into February, while maintaining their high distributions. And although the one-year losses to August 14 run from 9% for Gladstone to 32% for BGC, all seem to be over the worst and have stayed out of dividend purgatory. Manhattan Bridge is giving forbearance to two borrowers (its first interruptions ever), but the deferrals so far total $30,000 on a $56 million loan book. LOAN cut its quarterly dividends, but only from 12 cents to 11 and now 10. Our other choice, Compass Diversified Holdings (CODI), has a plus 2.4% one-year total return. While its shares are volatile, we're satisfied because after we featured CODI at $19.75, it rose to $24, sank to $11, and is now at $17.50. The longtime 36-cent quarterly dividend continues for a current yield of 8.2%.

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# Model Portfolio: Tax-Exempt Income

Municipal bonds face the threat that warring federal factions will deny special fiscal relief, leading to state and local treasuries and operating authorities springing giant leaks before long. This chatter, however, has yet to translate into downgrades, price breaks or slack demand for tax-exempts. Throughout this measuring period of April 10 through August 14, which falls entirely within the pandemic and its related economic collapse, muni fund managers and investors have refused to cave.

We agree with recommendations to skip certain debt niches, such as nursing homes and delayed or speculative mixed-use land-development projects. But we aren't arguing with the portfolio's overall results or the sharp portfolio management that has eight of the nine funds solidly in the plus column both for one year and over the past four months. And even after the hypothetical $100,000 of principal grew to $103,128, the ratio of tax-free yields to Treasury-bond rates is still appealing. Municipals are steely stuff.

Our nine selections also combined to issue $756 of income during this interval, for a final tally of $103,884—an annualized pace of 11.7% and a reversal of the small loss for the previous period, described in May's letter. As we then said, we could find no fault with the management of any of these funds, and we recommended no changes in the mix. Every fund rebounded from the sharp downturn in March, when muni-bond prices temporarily tanked. That was during a spate when it was difficult to find bidders for many of the bonds thrown into the market by panic-sellers and short-term traders, whose interest in munis was strictly as tourists and not as committed recipients of tax-free income.

We are most pleased to note that Nuveen High Yield Municipal rebounded nicely with a 6.2% gain in net asset value after dropping hard in early spring. It is still down 1.1% for 12 months, but this is one of our Greatest Generation of bond funds, and its five- and 10-year returns relative to its classification and the relevant indexes are spectacular.

There are dozens of good muni funds; this page's numbers might have been better over this period had the portfolio included any closed-ends (see cover story), because their leveraged nature increases returns during a rally like this. But as a low-cost, well-run array of proven, actively managed traditional mutual funds, the nine here are tough to match. We use funds here for convenience although we also like individual municipal bonds. However, it is difficult or impossible for us to suggest specific coupons and maturities because you may be unable to locate them on your broker's bond listings at any given time.

**Short-term: 30%.** These funds have durations of three years, so there will be little if any bounce in net asset value. Their yields are generous for the category, thanks to good bond selection and low costs.

**$15,000 T. Rowe Price Tax-Free Short-Intermediate** (PRFSX). Yield, 1.5%. One-year total return: 2.5%.

**$15,000 VanEck Vectors AMT-Free Short Municipal ETF** (SMB). Yield, 1.6%. One-year total return: 3.8%.

**Intermediate-term: 45%.** Unlike Treasuries, where 10-year bonds are considered long-term, intermediate munis include maturities as long as 20 years. They provide good income with little interest-rate risk.

**$15,000 Fidelity Intermediate Municipal Income** (FLTMX). Yield, 2.1%. One-year total return: 3.0%.

**$15,000 Schwab Tax-Free Bond** (SWNTX). Yield, 2.0%. One-year total return: 3.1%.

**$15,000 Baird Quality Intermediate Municipal Bond** (BMBSX). Yield, 1.7%. One-year total return: 3.5%.

**Long-term: 25%.** We steer clear of "junk" munis. The USAA fund reaches down to BBB more than the Vanguard fund, but it does not dip into unsafe territory.

**$6,250 Vanguard California Long-Term Tax-Exempt** (VCITX). Yield, 2.6%. One-year total return: 4.2%.

**$6,250 USAA Tax-Exempt Long-Term** (USTEX). Yield, 3.3%. One-year total return: 3.2%.

**$6,250 Vanguard Long-Term Tax-Exempt** (VWLTX). Yield, 2.8%. One-year total return: 4.5%.

**$6,250 Nuveen High Yield Municipal Bond** (NHMAX). Yield, 5.0%. One-year total return: -1.1%.

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