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MORNINGSTAR

Our Favorite Short-Term Muni-Bond Funds

by Scott Berry | 04-17-2003

The relative stability offered by short-term municipal-bond funds has been on full display in recent months.

With interest rates spiking last October, California issuing a mountain of new debt in November, and United Airlines filing for bankruptcy protection in December, the municipal-bond market has faced rough sledding of late. The market has improved a bit in recent weeks, but for the year to date through April 16, 2003, the muni-short category gained just 0.52%, and other muni categories haven't fared much better.

The category as a whole has been tightly bunched in recent months. Less interest-rate sensitive funds, such as Calvert Tax-Free Reserve Limited-Term Portfolio and Strong Ultra Short-Term Municipal Income have performed relatively well, as have more rate-sensitive offerings, such as Nuveen Limited Term Municipal Bond and Fidelity Spartan Short-Intermediate Municipal Income.

Strong Short-Term Municipal Bond and USAA Tax-Exempt Short-Term have ranked among the category leaders in recent months. Both funds hold sizable stakes in mid-quality bonds, which have seen their fortunes improve. USAA Tax-Exempt Short-Term has also benefited from its low expense ratio. (We recently removed Strong Short-Term Municipal Bond from our Analysts Picks. We are concerned that the troubles at Strong High-Yield Municipal Bond could possibly spill over to this fund.)

This category doesn't pack a big punch, but it does offer some protection against rising interest rates. We think conservative municipal-bond investors and those looking to balance the risks of a long-term bond portfolio will find it to their liking.

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Analyst Picks: Muni Short Category

	YTD Return (%)	3-Year Return (%)	5-Year Return (%)	Expense Ratio (%)
Evergreen High Income Municipal Bd A VMPAX	0.28	5.29	4.05	0.83
T. Rowe Price Tax-Free Short-Interm PRFSX	0.40	5.95	4.79	0.52
USAA Tax-Exempt Short-Term USSTX	1.03	5.23	4.53	0.46
Vanguard Ltd-Term Tax-Ex VMLTX	0.56	5.91	4.87	0.19
Muni Short Average	0.52	5.15	4.23	0.80

Returns through 04/16/2003.

Evergreen High Income Municipal Bond VMPAX

This fund has more flexibility than most. Manager Clark Stamper actively managed the fund's interest-rate sensitivity and is not shy about venturing into lower-rated bonds. The fund stumbled a bit in 1999, but it bounced back strongly in 2000 and earned topnotch returns in 2001. In 2002, however, the fund's defensive interest-rate positioning held it back, as rates dropped to historically low levels.

T. Rowe Price Tax-Free Short-Intermediate PRFSX

This fund is a solid all-around offering. It boasts a below-average expense ratio, sticks mainly with high-quality bonds, and has delivered strong long-term returns. The fund's risk/reward profile is impressive, and it has consistently delivered a better-than-average income payout.

USAA Tax Exempt Short-Term USSTX

This fund also takes advantage of its low expense ratio. Manager Clifford Gladson is keen on mid-quality bonds and keeps duration short and fairly steady, which moderates volatility.

Vanguard Limited-Term Tax-Exempt VMLTX

Ultra-low expenses are the key here. This category's winners and losers are often separated by less than 1 percentage point, so the importance of this fund's expense advantage can not be stressed enough. And because of that advantage, the fund doesn't need to take on lots of extra credit risk to keep up with the group's more-aggressive members. Quite simply, it is a terrific choice.

Scott Berry, CFA, is an analyst with Morningstar.com.

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