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Stamper Capital & Investments, Inc.

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MORNINGSTAR

Our Favorite Muni Short Funds

by Eric Jacobson | 09-19-2001

Analyst Picks: Muni Short Category

	YTD Return (%)	3-Year Return (%)	5-Year Return (%)	Expense Ratio (%)
Vanguard Ltd-Term Tax-Ex VMLTX	5.67	4.99	5.15	0.18
Evergreen High Income Municipal Bd A VMPAX	5.62	4.35	5.39	1.03
Strong Short-Term Municipal Bond Inv STSMX	4.76	4.17	5.13	0.60
T. Rowe Price Tax-Free Short-Interm PRFSX	5.60	4.89	5.08	0.53
USAA Tax-Exempt Short-Term USSTX	4.95	4.69	5.10	0.38
Muni Short Average	4.77	4.17	4.63	0.87

*Risk scores through 08-31-2001. Returns through 09-17-2001.

Don't let the rankings fool you. It's true that the average muni short fund is lagging all the other municipal categories thus far in 2001. That's largely the consequence of a healthy rebound in long-term bond returns after midyear, however, and the numbers looked almost the opposite before that. The point isn't that muni short funds make a better investment, but that they may fill a useful role if you're looking for some balance to a portfolio heavy in long-term bonds. In years such as 1999 and 1994 when interest rates rose sharply, for example, funds in this category performed admirably. Obviously then, muni short funds generally serve an important role as portfolio protectors.

It's important to be selective here, though. Funds in this category can carry durations (a standard measure of interest-rate sensitivity) anywhere south of 4.5 years, and some focus on the very shortest or longest ends of that range. As such, their performance characteristics look quite different. Moreover, a number of funds in this group invest in lower-quality bonds. Generally, the idea is to earn higher income to stay ahead of this competitive category. That approach engenders obvious risks, however, that can sometimes lay dormant until a major economic crunch or rash of sector problems, for example.

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If you do elect to buy a fund from this group, meanwhile, it's worth considering just how conservative you want to be. Despite their protective features, loading up on funds in this category will almost certainly lower the return potential of a portfolio. During 2000, for example, anyone who overweighted funds in this category would have missed out on big gains earned by longer-term funds.

Vanguard Ltd-Term Tax-Ex VMLTX

By now, you probably know that the magic formula for the Vanguard bond group has one main ingredient: ultralow expenses. That's no different here, where the fund's price tag is a staggering 78% lower than the category average. As such, 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, this is just a terrific choice.

Evergreen High Income Municipal Bd VMPAX

Manager Clark Stamper is known for his ability to scour the market for underpriced bonds. The fund's long-term record (largely earned under the name Davis Tax-Free High Income, until Stamper inked a deal to work with Evergreen) is excellent. And though the fund stumbled a bit in 1999, it bounced back strongly in 2000 and continues to turn in topnotch returns thus far in 2001.

Strong Short-Term Municipal Bond In STSMX

Manager Lyle Fitterer, loads up on BBB rated bonds and nonrateds, which have supplied generous income while boosting returns, thanks to a prolonged rally in lower-rated credits. As such, this fund does take on more credit risk than many rivals. Fitterer does keep duration in a tight two- to three-year range, however, which has kept volatility moderate. Investors should buy this fund with eyes wide open. The portfolio will likely lag its peers if there is a flight to quality--as it did in 2000. However, it remains a good choice for those who don't mind taking on additional credit risk to capture more income.

T. Rowe Price Tax-Free Short-Interm PRFSX

Manager Charles Hill doesn't make big interest-rate bets, and the fund is only allowed to invest 5% of assets in nonrated and below-investment-grade bonds. Meanwhile, Hill has demonstrated a talent for ferreting out higher-yielding winners, and the fund has gotten a boost from its low expense ratio, which is well below the group norm. As a result, 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 has found a great formula for success. Manager Clifford Gladson is keen on low- to mid-rated credits, which have rallied strongly for much of the past few years, so the fund's long-term returns are strong. At the same time, he keeps duration short and fairly steady, which moderates volatility. The fund also sports a low expense ratio. So far, investors have been rewarded with a nice income stream and good returns, but as with other funds that take on credit risk, this one could be vulnerable if the economy or certain

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sectors sustain a prolonged downturn.

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Returns - Figures quoted are total returns calculated for the share class and time periods shown. Performance includes the reinvestment of income dividends and capital gains distributions. Performance does not reflect the deduction of taxes that a shareholder would pay on a fund distribution or the redemption of fund shares. Please go to Morningstar's and/or Lipper's websites for more information.

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