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### **MORNINGSTAR**

#### ***Our Favorite Short-Term Muni-Bond Funds***

by Scott Berry | 12-15-2002

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

With interest rates spiking in October, California issuing a mountain of new debt in November, and United Airlines UAL filing for bankruptcy protection in December, the municipal bond market has faced rough sledding of late. But while the average short-term muni fund dropped 0.80% in October alone, it has held up quite well compared with its intermediate- and long-term rivals. In fact, for the trailing three months ended Dec. 13, 2002, the short-term muni-bond category as a whole managed a small gain (0.07%), while every other municipal bond category tracked by Morningstar lost money.

In general, less-interest-rate sensitive funds have performed a bit better than longer-duration offerings. Calvert Tax-Free Reserve Limited-Term Portfolio CTFLX, for example, has gained 0.59% over the trailing three months, while Strong Ultra Short-Term Municipal Income SMUAX has gained 0.34%. Both funds are typically among the category's least rate-sensitive. On the other hand, Bernstein Diversified Municipal Bond SNDPX and Nuveen Limited Term Municipal Bond FLTDX, which both straddle the line between the short-term and intermediate-term national municipal bond categories, have posted small losses.

Among our Fund Analyst Picks, Evergeen High Income Municipal Bond VMPAX stood out. Manager Clark Stamper has recently concentrated on short-term high-quality issues, and his caution has paid off, as the fund has gained 0.33% over the trailing three-month period. T. Rowe Price Tax-Free Short-Intermediate PRFSX and USAA Tax-Exempt Short-Term USSTX have also performed well, due in part to their relatively low expenses.

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

	<b>YTD Return ( % )</b>	<b>3-Year Return ( % )</b>	<b>5-Year Return ( % )</b>	<b>Expense Ratio ( % )</b>
<b>Evergreen High Income Municipal Bd A VMPAX</b>	<b>4.59</b>	<b>5.88</b>	<b>4.23</b>	<b>0.83</b>
Strong Short-Term Municipal Bond Inv STSMX	4.58	4.84	4.38	0.60
T. Rowe Price Tax-Free Short-Interm PRFSX	5.04	5.74	4.74	0.52
USAA Tax-Exempt Short-Term USSTX	4.41	5.16	4.52	0.46
Vanguard Ltd-Term Tax-Ex VMLTX	5.34	5.69	4.80	0.19
<b>Muni Short Average</b>	<b>4.65</b>	<b>5.08</b>	<b>4.23</b>	<b>0.81</b>

Returns through 12/13/2002.

**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 recent months, Stamper has been decidedly defensive, sticking with high-quality short-term bonds. His caution has paid off thus far, as the fund has weathered the market's volatility better than most.

**Strong Short-Term Municipal Bond STSMX**

This fund takes on more credit risk than many rivals, as manager Lyle Fitterer typically holds a large stash of BB and BBB rated issues. He does, however, keep the fund's duration in a tight two- to three-year range, which has helped moderate the fund's volatility. The portfolio can struggle to keep pace with its average peer during flights to quality. 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-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 low- to mid-quality credits, and keeps duration short and fairly steady, which moderates volatility.

**Vanguard Limited-Term Tax-Exempt VMLTX**

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Ultra-low expenses are the key here. This category's winners and losers are often separated by less than 1%, 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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