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MORNINGSTAR

The Pick of the Muni-Short Category

by Chris Kelsch | 12-29-1999

Maybe you're looking for a bond fund that can deliver exciting total returns. Or perhaps you're seeking one with a first-rate yield. If so, I'm afraid you won't find anything of that sort here. (Rather, you should check out The Pick of the High-Yield Bond Category.) What you will find in the short-term municipal-bond fund category is plenty of funds that provide significantly more income than the typical money-market offering without taking on much more risk.

These funds focus on bonds with durations of less than four-and-a-half years; investing in short-term bonds lessens the funds' sensitivity to fluctuations in interest rates. What's more, they invest across a variety of states and sectors, and that diversification dampens volatility as well.

More importantly, the income generated from muni-short funds is exempt from federal taxes. That increases their appeal, especially for investors in higher tax brackets. However, as with all bond funds, it's important to look for an offering with low expenses. This group traditionally has a narrow range of returns, and a fund with a low expense ratio has a built-in advantage over its competitors.

Analyst Picks: Muni Short Category

	3-Year Return (%)	5-Year Return (%)	3-Year Risk Score*	Expense Ratio (%)
Vanguard Ltd-Term Tax-Ex VMLTX	3.95	4.92	0.31	0.21
Evergreen High Income Municipal Bd A VMPAX	3.02	4.64	0.51	1.80
Strong Short-Term Municipal Bond Inv STSMX	4.67	5.07	0.25	0.60
T. Rowe Price Tax-Free Short-Interm PRFSX	3.80	4.82	0.36	0.53
USAA Tax-Exempt Short-Term USSTX	4.27	5.14	0.17	0.38
Muni Short Average	3.51	4.55	0.39	0.85

Data as of 11-30-99.

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Vanguard Limited-Term Tax-Exempt VMLTX

This fund shows how important low expenses are. Its expense ratio is 64 basis points below the group norm, which gives it a big edge, year in and year out. Thus, its long-term returns rank in its group's top half. This is a particularly impressive feat considering that this quality-conscious fund pays less attention than most of its peers to low-rated credits, which have outperformed in recent years. And it has consistently provided a generous stream of income to boot.

Davis Tax-Free High Income B VMPIX

The Davis fund family is known for the success of its equity funds, but this offering proves it's no slouch on the bond side. Manager Clark Stamper has shown a knack for finding smaller, underpriced gems, and the fund has generated some of the best long-term returns in the muni-short group, as well as a handsome payout. Although the fund's expense ratio looks high at first glance, it is in line with other B shares in its category.

Strong Short-Term Municipal Bond STSMX

This fund is a good choice for those who don't mind taking on additional credit risk to capture more income. Since manager Steven Harrop took over in 1995, this fund has dusted its peers. Harrop has loaded up on BBB-rated bonds and nonrateds, which have supplied generous income while boosting returns, thanks to a prolonged rally in lower-rated credits. Meanwhile, he keeps duration in a tight two- to three-year range, which has kept volatility moderate. Investors should be careful, though. The fund will likely lag its peers if there is a flight to quality.

T. Rowe Price Tax-Free Short-Intermediate PRFSX

True to its family's legacy, this offering favors a cautious, measured approach. 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 32 basis points 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

Manager Clifford Gadsen has found a great formula for success. He is keen on low- to mid-rated credits, which have rallied strongly in recent years, so the fund's long-term returns are strong. At the same time, he keeps duration short and fairly steady, which moderates volatility. And low expenses sweeten the deal. So far, investors have been rewarded with a nice income stream and good returns, but they should be aware that the fund is subject to stumbles in lower-rated credits.

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