In July of 2015 and again in late November of 2016, bond yields were surging higher which prompted us to recommend that our readers consider investing in Closed-End Funds (CEF) that hold municipal bonds (Muni CEF). In the wake of rising yields, there were some dislocations which we believed presented a great opportunity for investors who felt that increase in yields was temporary. In both instances, yields halted their increases shortly after our recommendation, and as we suspected, readers that followed our advice were rewarded with double-digit returns in a relatively short time frame. Since mid-2016, the yield on the 10-year U.S. Treasury Note has risen nearly 2% and stands at levels last seen in 2011. For those who believe the recent rise in interest rates is at or near a peak, we believe Muni CEFs once again offer similar opportunities. The following article shares highlights from our prior articles that help explain what Muni CEFs are and what drives their return. The article concludes with a fresh analysis of six funds that we believe can produce favorable returns going forward. Before preceding, we want to stress that this recommendation is for those that think yields are at or near their short-term peak. If yields continue to rise it is quite possible that Muni CEFs, due to their leverage, could underperform individual municipal bonds and other fixed income sectors. **What are CEF?s?** Closed-End Funds (CEF?s) are mutual funds with a fixed number of shares, unlike most other mutual funds whose share count fluctuates daily with investor interest. Also differentiating CEF?s from open-ended mutual funds is the fact that CEF shares are bought or sold on exchanges, not via direct transactions with the associated mutual fund company. It is this unique feature that results in CEF?s trading at a premium or discount to their net asset value (NAV). The three biggest factors which determine why a CEF might trade at a premium or discount to its NAV are:

1. Strong demand and/or low supply of the fund may result in a premium, while weak demand and/or excess supply will frequently result in a discount
2. Quality of the fund management team
3. The liquidity of the underlying fund holdings

The change in the premium or discount to NAV is just one factor determining total return for CEFs. The table below highlights all of the factors influencing the total return for M-CEF?s.

Total Return Factor	**Comment**
Price of underlying municipal bond	As yields decrease, prices increase helping total return. The opposite occurs when yields increase.
Dividend (coupon)/Yield	Most of the CEF?s we researched have a yield ranging from 5% to 8%.
Discount divergence from NAV	As the discount normalizes towards zero, the price of the M-CEF increases. If the discount widens, the price falls.
Leverage	Leverage used by the M-CEFs amplify price changes (gains and losses) and dividends.
Expense ratio	The fee that the fund manager extracts from the M-CEF?s return. Higher fees erode returns.

The following table from our 2015 article highlights key statistics from the date we recommended the funds to the date we recommended taking profits. Reviewing the sources of returns allows us to better understand how gains may be achieved this time around.

Security Attributes As of July 20, 2015

	Current

Sources of 2015 gains:

- Coupon yield- The funds we recommended had an average yield of **6.41%** which provided reliable income.
- Price appreciation due to yield- After a six month period, the yield on the funds declined to 5.98%. As a result, the prices of the underlying bonds and therefore the net asset value of the CEF?s rose by approximately 2.50%. Because the funds are leveraged the price appreciation was closer to **3.50%.**
- Price appreciation due to discount to NAV- In July of 2015 the average discount was at or near the respective lows since 2013. Over the next six months the average discount to NAV would rise from -11.19 to -8.03, resulting in an additional **16%** of price gains on the CEF?s.

Current Recommendation Yields are currently on a trajectory higher for a number of reasons. First and foremost is a widely held concern amongst bond investors that strong economic growth and low unemployment will push wages higher and spur more inflation. Second, the U.S. Treasury will offer over $1 trillion of debt this year and is forecast to do the same over the next few years. The heavy supply is creating an imbalance that has pushed yields higher. As an aside, we will have more to say about who is buying U.S. Treasury debt and why it matters in an upcoming article. The following paragraph was from 2016, the second time we recommended Muni CEFs. We believe it is just as pertinent today: *?Having begun in 1981, the current bull market in bonds is well-seasoned and no doubt much closer to the end than the beginning.• At the same time, the velocity of money is still declining in the U.S., the U.S. dollar is strengthening versus other currencies and global deflationary forces emanating from abroad remain influential.•**The U.S. economy is more sensitive than ever to the level of interest rates and economic stress resulting from higher yields could easily halt economic growth and push the economy into recession.** In such an instance, the Fed would likely end the normalization of rates and take actions to bring the Federal Funds rate back to zero or even lower.• Additionally, the Fed could re-introduce QE. If some form of these events unfold, Japan remains the most reliable model for the path of interest rates in the U.S.?* Higher interest rates are already depressing economic activity in interest rate sensitive sectors such as housing and autos. There is little doubt in our mind that as the benefits of fiscal stimulus erode over the coming quarters and the Fed continues to raise rates and reduce their balance sheet (QT), the economy will slow and inflationary impulses will subside. Such a result would help put a lid on rising interest rates. While timing is difficult and yields can certainly rise further, we believe that yields will peak, either now or within the next few months, and Muni CEF?s will offer similar opportunities as in the past. We selected the following six Muni CEFs based on a number of qualifications, including but not limited to leverage, credit, expense ratio, and discount to NAV.

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		Discount To NAV						
Ticker	Curr Yield	Current Discount	High Disco/Prem	Low Discount	Average Discount	Disco Z-score 3yr	Current vs Average	% of Lowest
NUW	6.281	-9.70	9.90	-9.82	-2.64	2.63	-7.05	98.8%
VGM	6.281	-13.94	-3.99	-14.56	-8.39	2.98	-5.54	95.7%
MMU	6.280	-10.26	4.99	-11.07	-3.12	2.98	-7.14	92.7%
KTF	6.151	-13.18	-2.21	-13.58	-8.02	2.14	-5.16	97.1%
EIM	5.353	-14.01	-6.75	-13.85	-10.03	3.02	-3.98	101.1%
PMO	5.272	-14.39	-4.60	-14.79	-9.36	2.81	-5.02	97.3%

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Ticker	Leverage	Exp. Ratio	Rating Focus	Inv. Grade %	A or Better	Insured	AMT	3 Largest States
NUW	6.70%	0.71	BBB or higher	94%	82%	24%	AMT Free	CA, IL, TX

Summary Given the move in interest rates in 2018, reluctance to take on investments that are negatively affected by higher rates is understandable. However, due to the nature of our highly leveraged economy, past episodes of rising interest rates have been met with faltering economic growth, deflationary impulses and ultimately lower interest rates. Muni CEFs offer a counter-trend position to take advantage if interest rates reverse course. Further they offer a margin of safety in the form of steep discounts to their NAV.