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Beyond yields

Like hamburgers, yields come in two types: natural and artificial, i.e., unleveraged and leveraged. There's no trouble telling one from the other. Unleveraged yields are the ones you can hardly see.

Last Thursday, an index of investment-grade corporate debt sank beneath 2% for the first time. Interest income from corporate bonds is, of course, taxable. If you are privileged to pay an effective tax rate of about 50%, you need to earn not 2% but 4% (more or less) to generate the 2% aftertax yield on offer in long-dated New York City general obligation bonds.

(Not that there are no investment-grade corporate yields of 4% or more available. You'll find a few in the remnants department of the off-brand yield store; the triple-B-minus-rated United Airlines Mileage Plus Holdings, LLC first-lien 6½s of June 2027, priced at 102.25 for a yield to worst of 5.97%, is one such example.)

The accompanying table, compiled by colleague Harrison Waddill, updates our coverage of a sample of closed-end municipal-bond funds (see the issue of *Grant's* dated Feb. 8, 2019). These are leveraged, ergo artificial, constructs. Each carries debt equivalent to about 39% of assets to produce tax-exempt current yields even greater than 4%.

To achieve it, the funds borrow short and invest long. "Sifma," short for the Securities Industry and Financial Markets Association Municipal Swap Index, is the rate at which they borrow. It's a seven-day rate, now quoted at 21 basis points.

Bankers know that to "borrow short and lend long" is a step on the road to perdition, though that prejudice dates from a time when the Fed was liable to raise its policy rate as well as to lower it. The Bank of Powell, of course, is on record as not only not preparing to tighten but also not preparing even to think about tightening.

Just the same, the hearty lunch of 4%-plus tax-exempt income does not come for free. Bond yields may rise and credit spreads may widen, the Fed notwithstanding. Discounts to net asset value may deepen.

Perhaps MIY, the BlackRock Michigan Quality Fund, is the pick of the accompanying litter, especially for New

Income through artifice

As of 7/20/20	1 Assets (in $ mns)	2 Current premium (discount)	3 Narrowing (widening) of discount*	4 Dividend yield	Taxable yields required for NYC residents to match the yield in column 4: Treasurys**	Out-of-state municipals***	Corporates†	Dividend coverage††	Three-month unrealized net investment income†††
BlackRock MuniYield New York Quality Fund	$570.77	-11.5%	1.2%	4.37%	7.39%	5.01%	9.40%	109.6%	$0.047
BlackRock MuniHoldings New York Quality Fund	467.29	-10.3	2.4	4.58	7.74	5.25	9.85	105.4	0.045
BlackRock MuniYield Pennsylvania Quality Fund	211.93	-13.1	-0.3	4.77	8.06	5.46	10.26	106.6	0.018
BlackRock MuniYield Michigan Quality Fund	466.15	-12.1	2.0	4.41	7.44	5.05	9.48	109.6	0.048

* From *Grant's*, Feb. 8, 2019.
** Assumes 40.8% tax rate.
*** Assumes 12.7% tax rate.
† Assumes 53.5% tax rate.
†† As of June 30, 2020. Ratio of three-month average earning income per share to latest declared distribution.
††† As of June 30, 2020. Three-month average undistributed net investment income balance per share.

sources: The Bloomberg; fund documents

York City residents who prefer not to invest in Mayor Bill de Blasio's hometown. "The 4.41% dividend yield," Waddill observes, "equates to an after-tax 3.85% for New Yorkers. MIY's dividend coverage is the best of the group, and its leverage the lowest. It trades at a 12.1% discount to net asset value."

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