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Kiplinger's Investing for Income

Strategies to Boost Your Cash Yield

We Know This: 2022 Will Not Be Boring

The hot topic for the new year is whether the Federal Reserve can reclaim its reputation as an able guardian of price stability without raising interest rates too fast and shocking the stock and bond markets. We think this balancing act is possible. Traders emphatically applauded Fed chairman Jerome Powell's December 15 message, which outlined the extent and timing of credit tightening, by staging a sharp rally, indicating that the markets still trust the Fed to refrain from undermining 2022's expected robust growth and earnings. There is no sign of a new taper tantrum.

As for Omicron, provided that it plateaus and subsides, its effect on the investment markets and the economy will be no more detrimental than all of the other variants of COVID-19 over the past 18 months. Investors instead face challenges from traditional market metrics. Following the exceptional returns for the second half of 2020 and all of 2021, high-dividend and high-interest-paying securities are expensive. That includes core sectors such as pipeline partnerships and bank stocks, most subsectors of real estate investment trusts, and high-yield corporate bonds. Their widespread 15%-and-higher returns will be difficult to repeat, regardless of the battles against inflation and disease.

So, our objective—and yours, too—for 2022 is to make as few errors as possible. This does not mean cowering in CDs. Even if you are not paying rent or buying fertilizer, the inflation-adjusted cost of sheltering in cash or near-cash is substantial. The combo of sticky 1% bank rates and speeding inflation does not reward risk aversion. Treasuries, still at 1.5% for 10 years and 1.85% for 30, remain our least favorite bond brand.

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However, on the encouraging side, those expensive investments that pay a high and reliable dividend will not fall apart and forfeit 2021's profits. A REIT or a closed-end fund may now sell at a premium to net asset value, or a bank stock may trade at its highest price since 2006, but antsy would-be sellers have nowhere else to go. There is also so much cash in the economy that credit ratings and balance sheets are ironclad. That is why several bond managers told us they remain fine with triple-B and junk-rated corporate bonds. Linda Bakhshian, value-stock manager for Federated Hermes, predicts that "2022 will be much more dividend-friendly than 2021," which was decent for dividends thanks to prosperity in industries ranging from oil to real estate to construction to transportation.

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Unless otherwise noted, all prices and related data are as of December 10, 2021

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We have read that it is foolish to offer detailed 2022 forecasts because of all these issues. But that is our job, and last January we deemed 2021 "A New Year in Finance Like None Before" and yet persisted with our sector-by-sector thumbs-up or thumbs-down judgments. We were mainly on target. We gave thumbs up to blue-chip dividend stocks, and NOBL, an exchange-traded fund of S&P Dividend Aristocrats, returned 22%. We lauded junk bonds, and they led all bond categories for the year. We praised pipelines as undervalued, and they soared. Finally, we called apartment REITs a contrarian sleeper thought, and apartment REITs rolled into year-end with average returns of 57%. We blew it when we forecast that corporate bonds would make 5%—they are about at breakeven—and we missed the oil and gas producers' rally. But we did not say anything harmful or that we regret.

As we hinted, we do not envision similar crazy-high returns. The following assessments are relative; we still like pipelines for their dividends, but if you earn 10% there instead of 30%, that still fulfills our one-thumb-up rating. Nothing gets two thumbs, a rare ovation reserved for when we think a category can double its usual pace.

ONE THUMB UP

Blue-chip dividend stocks. Until the economy goes into hibernation, income-with-moderate growth is a cornerstone. Banks and industrials should lead again.

Floating-rate bank loans. Short-term rates, which influence the payouts, are about to head higher by springtime.

High-yield corporate bonds. Naysayers say the yield advantage over Treasury bonds is too narrow, but they said that last year and junk flourished. Plus, "fallen angels" are returning to investment-grade.

Pipelines. Excellent cash flow continues.

Tax-free municipals. Still in tight supply, with credit upgrades everywhere. Munis are less sensitive to Fed talk and interest-rate action than other bonds.

Taxable municipals. After a disappointing breakeven 2021, their high yields will not remain overlooked.

Utilities. These were also left behind in last year's rush for growth, but dividends of 4% or so with low volatility are compelling.

NEUTRAL

Cash. Obviously not for yield, but for safety and flexibility.

Oil and gas producers. We missed this a year ago, and it is hard to advise chasing names like Exxon and Oxy after their dead-cat bounces. But if crude holds at $70, endangered dividends will stay secure. Exxon issued a 1-cent raise in October after years of rumors that it would chop its payout by half.

Preferred stock. New issues pay only 4%, older ones trade well above par, and some closed-end funds are trading at big premiums, too. We love the category, but it's easy to overpay today.

Property REITs. The past year was a bonanza, but single-digit returns are more likely for the year ahead. Again, the issue is valuation—or overvaluation. Half of our REIT Dream Team trades at 20% above NAV. A bunch of second-tier office and hotel REITs are cheap, but for a reason.

THUMBS DOWN

Emerging-markets anything. The dollar will get stronger, and COVID is brutal in poor countries. Stocks, bonds and currencies are all fraught.

Europe. "A slow-melting ice cube," a fund manager told us. Negative bond yields and a weak euro do not excite.

Short-term bond funds. Credit quality is fine, but you have little reason to expect even 2%.

Treasuries. Nailed it last year: You do not get paid (much), and you cannot profit from spread tightening or credit upgrades. Just not our thing.

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Extremely Healthy Dividends

Health and medical stocks are trendy, and not only because Moderna's COVID-19 vaccine turned that obscure company into a behemoth with $5 billion in cash and a share price 15 times its pre-pandemic level. Workaday outfits are also bulging with cash. Quest Diagnostics, half of the lab-testing duopoly, has $1 billion of cash on its balance sheet and $2 billion of free cash flow over the past 12 months. It returned 40% for 2021 through mid-December. Refinitiv, which compiles earnings data, says 91% of health companies in the S&P 500 index are exceeding profit estimates. Evidence abounds that health providers perennially raise rates and prices faster than the rise in overall inflation, and that will not change with inflation running hotter going into 2022. Dental fees, for example, have risen at 1.5 times the rate of all consumer prices since 2000, and analysts of dental-supply companies expect sharper-than-usual relative price hikes this year because so many people skipped dental work for fear of COVID infection and the industry wants to catch up.

But it did not take a deadly virus to create the financial colossus that is American health care, which accounts for 13% of the S&P 500 and 18% of gross domestic product—and is destined to reach 20% of GDP. Government leaders, economists and 330 million other Americans may complain, but short of strict price controls or a demographic earthquake, it looks inevitable. So, in another episode of Follow the Dollar, meds qualify as a core source of dividend income. Among the 30 names in the Dow Jones industrial average, the five health stocks average a 2.9% yield—compared with 1.9% for the 30 overall—and with rapid five-year dividend growth of 10.3%. Health-oriented real estate investment trusts yield an average of 4.2%, compared with 3% for all property-owning REITs.

But this bounty is scattered. Investing in health for income resembles scouring information technology for regular payouts, in that legacy companies pay high dividends, while edgier firms, such as Moderna, do not pay a cash dividend. Do be assured that the rich and famous old-line outfits will keep paying; the year-end round of dividend raises was generous, led by 15.3% from Eli Lilly, 10.3% from Stryker, and 10.2% each from Amgen and Bristol-Myers Squibb. Clamor to regulate U.S. drug prices is disparaged as a scheme to turn Amgen, Lilly and the rest into regulated utilities—but gas, electric and water utility regulators take care of investors, so such fear is misguided.

There are several ways to capture medical income. Readers know we revere high-distribution closed-end funds, so that makes a natural starting point. **Gabelli Healthcare & Wellness** (GRX, $13, yield 4.7%, one-year total return 18.6%) is lightly leveraged for a stock CEF, at 13%, but it does distribute that nice 4.7% without returning capital or relying on trading gains. It spans the sector from drugs to insurance to hospitals. Its 10% discount to net asset value is, alas, a constant. The unleveraged **BlackRock Health Sciences** (BME, $47, distribution 5.4%, one-year return 7.5%) is comparable to Gabelli in long-term returns and distributions but relies on trading gains more than on dividend income. If you snag BME at a discount, however, it has a history of going to a premium. It now trades at 2% over NAV.

Turning to real estate, the two highest-yielding medical REITs by far are **Omega Healthcare Investors** (OHI), at 9.4%, and **Sabra Health Care** (SBRA), at 9.0%; the rest are clustered around yields of 3.5% to 5%. Omega develops and leases nursing homes, and it has investment-grade credit and a good growth record. Despite the sky-high dividends, investors lost 18% over the past year as COVID caused missed rents and boosted other business costs. But at $28, Omega trades slightly below net asset value, so as a wager on nursing homes to outlast Omicron, it is inexpensive. Sabra, at $13, is similar: It has high, stable dividends, but COVID exacted a 17% one-year loss. At least Sabra is 13% below NAV. But it is speculative.

The blue-chip dividend-ace meds are familiar: pharma kings and medical device firms, from AbbVie (ABBV) and Becton Dickinson (BDX) to Medtronic (MDT) and Stryker (SYK). Trouble is, although they doggedly raise dividends (Stryker's five-year average boost is 12.8%), the shares are so dear that only the giant drugmakers yield much. An idea is to buy **Johnson & Johnson** (JNJ), which at $165 yields 2.6%, and then wait to see whether its spinoff of mass-market brands such as Neutrogena and Tylenol from its bigger drug side results in a higher total payout. When Abbott split in 2013, its dividend profile benefited. There's just money to burn in this business.

Assessing Black Friday—or Any Given Day

Here is a reminder about our (un)patented three-day rule, which says to wait three business days before you react to any startling political or economic event. Trading since the day after Thanksgiving, when news of the Omicron strain of COVID-19 emerged, exemplifies this ordinance. On that Friday, stock and energy prices sank while interest rates plunged, coincidentally gifting bonds and bond funds with tremendous one-day gains. After the weekend, it all partly reversed on Monday—only for the markets to reprise Black Friday on Tuesday, when they were torched by Federal Reserve chairman Jerome Powell's guarantee that Omicron will not dissuade the Fed from "tapering" its campaign to cap long-term interest rates or from tightening bank credit to counter inflation. By Wednesday, though, order was restored, thanks to the natural tendency for rushed selling to dissipate, setting the tone for extreme bullishness the next week on hopes that Omicron will not dramatically disrupt life and economic activity.

This churning was understandable, but it should also prove insignificant with regard to your investment actions. The markets are inefficient, especially in areas such as BBB and high-yield bonds, small-company stocks, and real estate finance. And, says Steve Repoff, a bond manager for GW&K Investments, the truly awful perils, such as bank failures and mass defaults, are MIA. "There is not a case to be made for a credit crisis," Repoff says. He muses that if the Fed boosts interest rates too far and too often, the yield curve might invert (meaning that short-term rates might go higher than long-term yields), and that is frequently a predictor of a recession.

So, he thinks Omicron might nudge the Fed to move a bit more slowly now on the inflation-fighting front, allowing the economy to continue to run hot and to count on supply-side factors to fight inflation. The Kiplinger economic team forecasts that inflation will be 2.8% by the end of 2022 and that 10-year Treasury yields will not go much above 2% next year. (We at this newsletter still envision a gradual return toward the "2-2-2" world of growth, inflation and interest rates that served everyone's investments so well for so long prior to the pandemic.)

As we repeated in 2021, it is still an investor's world. That image accounts for sharp movements in asset prices, which, as our three-day rule advises, require you to take punches and, equally important, not overplay bounce-backs for "fear of missing out." Let others make the mistakes, which are inevitable with so much cash sloshing around. "We've seen more-active capital markets than usual in the past 18 months because of massive injections of capital," says John McClain, a high-yield bond manager for Brandywine Global. Sometimes, he continues, stocks and bonds will move in the same direction, although that may contradict everything you have thought or learned in college economics and finance classes.

McClain adds that small price moves are exacerbated by low liquidity and high valuations. That means although an S&P 500 index fund or a total bond market exchange-traded fund might be flat on a given day, something else can still gain or lose 2% in a couple of hours. There is no way to forecast this, and no payoff from trying to trade through such turbulence. The days and weeks after Thanksgiving were as educational as they were profitable. We expect an echo when the Fed raises rates the first time, perhaps in April. Remain a portfolio spectator then, too.

Timely Tactic of the Month

There is nothing to equal the 7.2% tag on Series I savings bonds—although they have a minimum holding period and a $10,000 limit, and they will be a repriced in April. But an unorthodox idea for storing cash and angling for a high return is riding the dollar's global strength with **UUP**, the **Invesco DB U.S. Dollar Bullish ETF** ($25.84). This is a direct wager on whether the dollar will gain or lose exchange value against a basket of major Western currencies and the yen, as measured by a Deutsche Bank index that determines the fund's share price. As the U.S. puts more economic distance between itself and the rest of the world, prospects are high that UUP will approach or match its 2021 return of 6.5%. The fund last paid a dividend in 2019, and no return is guaranteed, but risk is low, and the Federal Reserve is apt to bolster the buck whenever it hikes rates.

Kiplinger's 25 for Income

Each of our of selections is trading within a set range, and this month saw prices swing wildly within their usual bounds. Realty Income, for example, fell 8%, from $73 to $67, but it has traded as low as $56 during 2021. Valero's range is $56 to $85, so its 7.5% decline, to $71, is a speed bump; what is more important is that on December 9, Valero paid its eighth consecutive 98-cent quarterly dividend, a fine record of stability despite all the ups and downs of oil refining and marketing. We had countervailing pluses, too: Digital Realty is up 6.7% to its high for the year, and National Grid advanced 6.2% to its high since 2017. We expect several of the 25 to raise dividends early in 2022 and for some closed-end funds whose share prices dropped faster than their net asset values to recover some lost ground. No changes to the lineup, though we will re-evaluate AT&T depending on the details of its planned reorganization in a few months. Meanwhile, the yield on new money goes higher and higher. We are not the only ones puzzled. By the way, T popped 7% on December 16. Something is up.

Utility stocks		**Price**	**Yield**	**Frequency**
American Electric Power (AEP)	Traditional electric company serving 11 eastern and southern states	$83.99	3.7%	quarterly
AT&T (T)	Wireless-service giant that grew out of the former SBC	22.84	9.1	quarterly
American Water (AWK)	Largest investor-owned water utility, serving 16 states	176.14	1.4	quarterly
National Grid (NGG)	British national gas and electric utility that also operates in New York and New England	69.54	4.9	semiannually
Xcel Energy (XEL)	Central states electric system that emphasizes wind energy	66.51	2.8	quarterly
High-yielding open-end bond funds				
Baird Core Plus Bond (BCOSX)	A rare general bond fund that usually beats its benchmarks handily	$12.29	1.9%	quarterly
Dodge & Cox Global Bond (DODLX)	A mix of domestic and foreign corporate bonds, mostly denominated in U.S. dollars	11.78	2.3	quarterly
Fidelity Capital & Income (FAGIX)	Creative and aggressive junk bond fund	11.18	3.0	monthly
Hotchkis & Wiley High Yield (HWHAX)	Boutique high-yield fund that concentrates on small companies	11.38	4.2	monthly
Loomis Sayles Bond (LSBRX)	Go-anywhere investment-grade bond fund	13.52	2.5	monthly
TCW Emerging Markets (TGEIX)	A higher-quality approach to emerging markets, with all debt in hard currency	7.77	4.6	monthly
Closed-end mutual funds and ETFs				
AllianceBernstein Global High Income (AWF)	High-yield corporate bonds and government bonds from emerging markets	$12.09	6.5%	monthly
BNY Mellon Municipal Bond Infrastructure (DMB)	*A leveraged closed-end fund that likes transportation and hospital bonds*	*14.41*	*4.4*	*monthly*
iShares U.S. Preferred ETF (PFF)	This exchange-traded index fund spreads your money in more than 301 preferred stocks	38.69	4.3	monthly
Nuveen Credit Strategies Income (JQC)	A leveraged floating-rate fund that also has some junk bonds	6.43	7.2	monthly
Nuveen Municipal Value (NUV)	*This non-leveraged closed-end is an alternative to the BNY Mellon Infrastructure fund*	*10.39*	*3.2*	*monthly*
Pimco Corporate & Income Strategy (PCN)	An unusual mixture of high-yield corporate, muni and foreign bonds	17.72	7.6	monthly
Real estate investment trusts				
Annaly Capital Management (NLY)	Borrows cheaply to reinvest in government-guaranteed mortgage securities	$8.38	10.5%	quarterly
Digital Realty Trust (DLR)	Developer and operator of data centers in the U.S., Canada, Europe and Asia	167.10	2.8	quarterly
Realty Income (O)	Landlord to chain stores and restaurants, also known for 611 straight monthly dividends	66.94	4.4	monthly
Welltower (WELL)	Develops and owns assisted-living facilities, hospitals and medical labs	82.71	3.0	quarterly
Energy investments and partnerships				
Brookfield Infrastructure Partners (BIP)*	Owns toll highways, ports and transmission lines	$57.44	3.6%	quarterly
Magellan Midstream Partners (MMP)*	One of the largest pipeline carriers of gasoline, diesel and chemicals	45.50	9.1	quarterly
Suburban Propane Partners (SPH)*	Propane distributor normally yields substantially more than junk bonds	14.67	8.9	quarterly
Valero Energy (VLO)	World's largest independent refiner, known for large dividend increases	70.85	5.5	quarterly

Funds in italics pay tax-exempt income. Investments with an asterisk (*) are partnerships. Prices and yields as of December 10, 2021. SOURCES: Fund companies, Morningstar Inc., Yahoo.

Ask Jeff

Readers are invited to send questions about income investments to jkosnett@kiplinger.com. I'll answer you personally if there's no space here for a published reply.

Dear Jeff:
I have money in a fixed deferred annuity now, and I am thinking of buying more, such as an offering by MassMutual that locks in 1.9% for three years. I can then roll into a new annuity and continue the tax deferral. Because it is hard to find this much yield with negligible risk, am I missing something? This seems like a tax-deferred CD. I have not seen anything about this product in your newsletter.
Eugene

Dear Eugene:
As a MassMutual long-term-care and disability policyholder, I trust the company totally. So if you are satisfied with 1.9% for three years, I have no objection. We do emphasize liquid securities and bank deposits before life insurance contracts because those usually have surrender charges or other withdrawal fees, as well as many riders that are impossible for us to recommend to a broad audience. But if you can abide those and have other freely accessible cash, 1.9%, compared with a three-year bank CD at half that, is a winner. You can shop fixed annuities at brokerages including Fidelity and Charles Schwab. Readers who investigate may find they need to invest a minimum of $100,000 to get the best rates.

Dear Jeff:
AT&T stock keeps going down, but I think that sometime in January, when the tax-loss selling season abates, its low price and high dividend will restore buying interest, especially now that T is closer to getting out of media businesses to tend to its real knitting in telecommunications. Right?
Jonathan

Dear Jonathan:
That is my sense of this puzzle. In July's letter, shortly after AT&T (then worth around $30) announced it was spinning off Warner and Discovery in 2022 and dumping DirecTV, we suggested holding or buying more shares if it dipped below $26; it is now at $23. But T's wireless business is good, it handily beat estimated third-quarter earnings, and buyers can get in for a current dividend yield of nearly 9%—twice what a typical junk bond fund delivers. I can only echo the commentators who say Wall Street hates the company and refuses to give the shareholders a break.

Dear Jeff:
I am several years from retirement, and as I transition from asset accumulation to income, I figure a 50-50 stock-bond split seems reasonable. How would you apportion the bond part among core bond funds, high-yield, TIPS, closed-ends, preferreds or anything else?
James

Dear James:
You are on the right road, because it would be timid and counterproductive to overweight simple or total market bond funds and ETFs and end up with a hunk of short and intermediate Treasuries and low-yield mortgages. Two years out, I would still expect discounted closed-end bond funds, preferred stocks, and BBB and high-yield corporates to outyield and outperform T-bonds. You skipped over municipals, but as you size up your new tax situation, munis may figure into the mix. TIPS may or may not add up, depending on inflation and the course of interest rates and the fact that the income is deferred. But the key is to spread the money around and stagger your payment dates. Anyone preparing to take a lump sum and start a fixed-income plan should diversify as widely as with a stock allocation, if not more so.

Dear Jeff:
If you are frustrated by the turnover in closed-ends for the Kip 25, may I nominate BBN, the BlackRock Taxable Municipal Bond Trust? Your thoughts?
Larry

Dear Larry:
I have long advocated for taxable municipals, and there is no question this is a well-managed fund that pairs well with BAB, an Invesco taxable-muni ETF. The BlackRock fund began 2021 at 5% above net asset value, but that has dwindled to about par, lowering the 2021 total return to 2.2% but teeing up the ETF nicely for the year ahead. You make a case for us to name BBN the 26th member of the squad.

What's New in Cash

The Fed favors investors overs savers. A key back story from the Federal Reserve's year-end policy statement concerns savers. Although the stock and long-term-bond markets are pleased by the Fed's stepped-up schedule to end its "emergency" monetary interventions, savers will have a long wait before banks and money funds grant meaningful rate increases. Three quarter-percentage-point boosts in 2022 would still leave such cash repositories as online bank accounts at 1% or slightly above, and that will not begin to cut into the heavy cash flows that should maintain the value of higher-yielding alternatives like taxable bonds and floating-rate bank-loan funds.

Put the U.S. inflation numbers in perspective. Yes, they are high, but so are some other indicators of economic vigor. Housing starts are growing at an 8.3% annualized rate. Industrial production is up 5.3%. It is evident that business and industry are rushing to refill depleted supply chains. As you consider the effects of this inflation story on your investments, watch the actual economy more closely than the political fights and rhetoric. A warm winter would also put downward pressure on official inflation by restraining heating costs. All of this helps explain why the bond "vigilantes" and other interest rate scolds are still wrong.

Stock buybacks hit records. Ugh. S&P 500 member companies bought $235 billion of their own stock in the third quarter of 2021, which reflects strong earnings. Trouble is, money used for buybacks often comes at the expense of cash dividends, which are also growing but not as fast: The S&P 500 paid a total of $485 billion in pre-pandemic 2019 and is on course to reach $550 billion for 2021, a moderate growth pace given immense cash hoards. But even if corporate officials were to reconsider and put more into cash dividends, stock prices are so high that the S&P would still yield closer to 1% than 2%.

The devil is in the symbol. Money-losing and unrated online gambling site Esports Entertainment Group just issued preferred stock with a 10% coupon, hoping it will win over its common shares (symbol GMBL) after they fell from an initial $22.50 to $4. The preferreds' ticker is GMBLP; it is $9.12 after launching at $10 on December. That's an 11% current yield, to be paid monthly. Is this gambling or investing?

Flashback

As stock indexes set records, real estate booms, and we all breathe a bit easier now that Congress has finagled its way out of default, we reminisce about our proudly contrarian headline and cover story in May 2016: "The Markets Are Calm. Is That Supposed to Scare Us?" We scoffed then at the dogma that prosperous markets tend to be a mirage and investors should always be prepared for an indiscriminate crash. (The public polls showing a majority insist that today's booming U.S. economy is really a mess are an echo of such mindless, misinformed pessimism.) And we would repeat this message today verbatim.

The weight of the evidence since 2016 duly reinforces the stance that U.S. markets do not suddenly crash, nor do most sectors of our economy tank, simply because they have been sound for many years. The Federal Reserve's resolve, the strong dollar and the lack of compelling foreign investment opportunities prevent the worst from happening. So do healthy banks, steely company balance sheets, and strong state and local finances. Hence, we are not scared away from our constructive stance by irritants, whether in the form of another few quarters of COVID trouble, important countries in economic purgatory (Turkey being the latest), fresh tensions with Russia and China, inflation readings goosed by insufficient supplies of certain goods, labor shortages, or whatever else. Why not? Well, it is hard to see evidence that the investment herd is wheezing and ready to take a breather.

At the time of our 2016 headline, 10-year Treasury bonds yielded 1.76%. On December 11, a tenner was 1.52%. So much for the bond bears. We highlighted two real estate investment trusts as exemplars of the wisdom of staying with strong companies in thriving sectors: Alexandria Real Estate and Digital Realty Trust. Alexandria was at $94 at the time; it is now $212. Digital was then $88 and now trades for $168.

There are always new scares, with the latest babble declaring grave dangers from all the government and corporate borrowing during the pandemic. But this, too, strikes us as cliched claptrap. Jason Audette, a portfolio manager for Appleton Partners, asserts that there is no reason to doubt the markets' ability to absorb all the new high-rated corporate debt. Junk bonds are flying off the shelves. Banks, pension funds and governments the world over still buy Treasuries in almost limitless quantities—and while they may be dismayed by the low yields, they have no alternative. The sum of all this: Keep cool and carry on. You need not sleep with one eye open.

Model Portfolio: Tax-Exempt Income

Since early 2021, we have suggested that you might profit by extending maturities and going further out on the credit-rating spectrum to capture more high-yield or triple-B investments. We did not formally remake the portfolio because the two shortest-term municipal funds earned more than 1%, while taxable analogs such as ultra-short Treasuries were virtually at zero. But with neither the Federal Reserve nor the marketplace inclined to boost the yield on short-term debt, tax-free or taxable, and with spiffy credit conditions across the public sector, it's time for extra spice. Our new model allocates 15% rather than 30% of the hypothetical $100,000 to the short-term funds from T. Rowe Price and VanEck. We shift that $15,000 equally among the long-term funds, bringing that segment to 40%, while the intermediate layer stays at 45%. Two funds are replaced, one for dull performance and the other because it is closed to new accounts.

This rejiggering is intended to hoist our collection back into the green, because between August 13 and September 10, all nine members lost a little principal, ranging from 2 cents off of $18.54 for the Nuveen high-yield fund to 14 cents off of $18.05 for VanEck. (The price movements were so uniform we might have been watching synchronized Olympic ice skating instead of bond trading.) Hence, the result for the reporting period was a loss of $848 of capital offset by $608 of income, for a final score of $99,760. That is a $240 loss, or 0.24%. In our previous summary the portfolio gained $926, so we came up more than $1,100 short. That is not pleasant, though no single fund fumbled enough to be responsible.

As usual, the best performer was Nuveen High Yield Municipal, which returned 1.3%, helped by its 4.3% yield. However, Nuveen closed the $25 billion fund, so we are replacing it with its closed-end copy, NMZ, the Nuveen Municipal High Income Opportunity Fund. NMZ has the same manager and deep research team. It owns some of the same bonds, but there are differences. One, NMZ is 30% leveraged, so its distribution is 5.3%, compared with the mutual fund's 4.3% yield. Two, NMZ has a better long-term performance record. Three, while the closed-end began 2021 at 3.5% above net asset value, the premium is down to 1.6%. Maybe we should have chosen it all along.

The other change is to substitute BSNSX, the two-year-old Baird Strategic Municipal Bond, for BMBSX, the stodgier and much older Baird Quality Intermediate Municipal. Baird started the Strategic fund when it recruited new talent, and after two years it is a proven success, doubling the 4% return of BMBSX in 2020 and running 1.9% in the green for 2021. The Strategic fund has a shorter duration, so for now it pays less income, but that can and will change.

Short term: 15%. These funds have minimal durations and are designed as the near-equivalent of a tax-free money market fund, though the share prices will move up and down a few pennies during a typical year.

$7,500 T. Rowe Price Tax-Free Short-Intermediate (PRSFX). Yield, 1.1%. One-year total return, 0.4%.

$7,500 VanEck Vectors AMT-Free Short Municipal ETF (SMB). Yield, 1.0%. One-year return, 0.1%.

Intermediate term: 45%. Unlike Treasuries, where 10-year bonds are considered long-term issues, intermediate munis can go out to 20 years—but with substantially less interest rate risk than long U.S. debt.

$15,000 Baird Strategic Municipal Bond (BSNSX). Yield, 0.8%. One-year return, 2.2%.

$15,000 Fidelity Intermediate Municipal Income (FLTMX). Yield, 1.3%. One-year return, 1.4%.

$15,000 Schwab Tax-Free Bond (SWNTX). Yield, 1.6%. One-year return, 1.1%.

Long-term: 40%. This is where to get maximum tax-free income, both from investment-grade bonds and from Nuveen's low-rated or unrated debt.

$10,000 Nuveen Municipal High-Income Opportunity (NMZ). Distribution, 5.3%. One-year return, 12.6%.

$10,000 USAA Tax-Exempt Long-Term (USTEX). Yield, 2.5%. One-year return, 3.9%.

$10,000 Vanguard California Long-Term Tax Exempt (VCITX). Yield, 2.3%. One-year return, –1.1%.

$10,000 Vanguard Long-Term Tax-Exempt (VWLTX). Yield, 2.5%. One-year return, 2.5%.