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Stock Market Investing Tips, Techniques, and Resources



Default Rate of Municipal Bonds

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One of the principal concerns when choosing interest bearing investments is the rate of default of that kind of debt and specifically for the specific borrower. In this regard the [default rate of all US municipal bonds](#) rated and unrated between 1970 and 2011 was one in 150 or 0.64% according to an article in *Seeking Alpha*. A default could have been for just a year and defaults on Munis did not necessarily mean that bond holders lost all of their invested capital. Back in 2001 Moody's reported that for all of their rated municipal bonds the default rate was 0.0043%. What sort of default rate of municipal bonds can you expect going forward and why would you want to invest in municipal bonds?

Why Invest in Municipal Bonds?

Forbes published a useful article about [municipal bonds](#). Investors in the highest tax brackets have historically looked at municipal bonds as a way to avoid taxes on interest income. Very often, bonds issued by local and state governments are not subject to federal taxes. And, many municipal bonds are not taxed at the state or local level although this may require that you are a resident of the city or state that issues the bond. Unfortunately, folks subject to the alternative minimum tax may not be able to take advantage of all of the potential tax advantages of municipal bonds.

Current Default Rate of Municipal Bonds

A Moody's report from July, 2021 states that through the end of 2020 municipal bond defaults remained relatively low despite a small increase over the previous decade. Municipal bond defaults recorded by Moody's are listed as the 5-year cumulative default rate from 1970 to 2020 and remained at 0.08% at the end of the decade. While this is higher than what was reported at the beginning of the century for Moody's-rated municipal bonds, it compares favorably to the global corporate default rate over the last five years which was 6.89%! The report noted that there was one Moody-rated US municipal bond default in 2020 which was the archdiocese of New Orleans which was characterized as a preemptive and defensive measure.

Investment Return on Municipal Bonds

As October, 2021, the rate of interest on a 10 year municipal bond averages 1.16% which had edged up for the 0.89% average for the previous twelve months. If you qualify for all possible tax breaks your current municipal bond return on investment will be 1.16% per year. This beats current CD yields for comparable maturities by anywhere from 0.1% to 0.3%. CDs have the benefit of being insured by the FDIC but municipal bonds rated by Moody's have a 0.08% default rate. Because inflation has been creeping up, even the best tax-free rate of return on a municipal bond is giving you a [negative real interest rate](#).

Why Tie Up Your Money for Ten Years with Negative Real Interest Rates?

Those of old enough to remember the 1970s interest rates in adult life may also have invested in municipal bonds at the time. When you could get 12% for a CD and pay taxes it made sense to take 7% for a municipal bond on which you did not pay taxes. Although inflation ate up your gains in the 1970s and early 1980s, inflation subsided and municipal bonds were a profitable investment and more so because of the tax break. Today, you will be stuck with a 1% yield if you invest in a municipal bond today while we may in fact be moving into even higher rates of inflation making for ever-more-negative real interest rates!

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