Munis: Active or Passive? There’s No Debate
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There is a debate raging in the financial markets regarding active versus passive management. And in the municipal market, which is a highly inefficient market, the data just doesn’t support it.

Think of it this way: you could easily go out and buy the S&P 500. Just go along and buy 500, whatever stocks are in the S&P 500. The broad municipal bond index has 50,000 issues in it. Trying to build an index, a passive index, is nearly impossible in the municipal market. Now, another thing to keep in mind is that how much the municipal market has changed over the last decade.

Pre 2008, 60% of the new issue market was insured. 60% was insured. Today, it’s roughly 5%. Losing that bond insurance did two things: it turned the municipal market overnight into a credit market, so you have issuers trading under their own rating, whether its single A, BBB, whatever it may be, and you lost liquidity. So an already inefficient market became even more inefficient.

So the data, if you look at the industry data, looking at passive managers versus active managers since 2008—or more specific, January of 2009 through the third quarter of this year—active municipal bond managers outperform passive municipal bond managers 99% of the time over two-year rolling periods.

With such overwhelming data, when I talk to people and I say, “It’s not 70%, it’s not 75, it’s not 80, it’s 99%.” With that overwhelming data, it should be enough to end the debate of active versus passive in the municipal market.

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