

TIP SHEET:

Ivy High-Yield Fund on Defensive as Munis Heat Up

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By KELLY NOLAN

Michael Walls, senior vice president and portfolio manager of the Ivy Municipal High Income Fund (IYIAX), is on the defensive.

“I’m one that believes the market is getting a little carried away with itself,” said Mr. Walls, a 14-year veteran of the muni bond industry who has managed the Ivy high-yield fund for past three years. “It’s much more of an issuer’s market than a buyer’s.”

Investors’ thirst for yield in the ultralow interest-rate environment has led to a compression of spreads, or difference in yield, between lower-rated and highly rated bonds. That strong demand for higher-returning assets has also allowed issuers to offer fewer protections to investors when they sell new bonds.

Meanwhile, investors have poured money into muni-related mutual funds every week except one so far this year, according to Lipper FMI, despite the fact there’s still plenty of uncertainty in the muni market about what may happen in the months ahead. Potential budget cuts from federal sequestration loom in January, and the winner of the U.S. presidential election is far from clear, leaving tax policy murky, along with the tax-exempt status of muni bonds.

In response, Mr. Walls has been more defensive with his \$1.5 billion muni fund, which is based in Overland Park, Kan. Most of the fund’s investments have higher, above-market coupons of at least 6%, and in recent weeks, he’s also been snapping up

floating-rate munis and some higher-quality auction-rate debt. Both moves are intended to act as a hedge to the fixed-rate munis in the fund, and as a buffer if and when interest rates do rise.

Mr. Walls favors buying debt from charter schools and senior life care bonds, but he is selective about his purchases. For charter schools, Mr. Walls likes buying debt from states with stronger and more established programs, like Colorado, Florida and Texas. He avoids charter school bonds from Georgia and Pennsylvania.

Mr. Walls views life-care bonds as a proxy for owning health-care bonds, without having to deal with reimbursement issues related to Medicare, as most life-care facilities are private pay.

He’s also avoided buying hospital bonds recently, as these facilities are offering less protection to investors on their deals. A first lien on a mortgage used to be commonly offered for lower-rated hospital deals sold a few years ago, for instance, and now such a cushion is scarce.

“I haven’t bought a hospital bond in about a year,” he said. “There’s a lot of questions about what will happen to Medicare and Medicaid,” with changes from the U.S. health-care overhaul looming.

Mr. Wall’s fund is also underweight in more volatile sectors, such as tobacco bonds and prepaid gas bonds, which fluctuate a lot in terms of their pricing. An issue for tobacco bonds is the continued drop in U.S. consumption of cigarettes. Prepaid gas bonds are essentially backed by the credit of investment banks.

Mr. Wall’s defensive strategy has caused his fund to underperform its peers in the short term, but outperform over a longer period of time. Through Friday, the fund had a total return in 2012 of 10.5%, which was about 1.9 percentage points less than its category but 4.4 percentage points more than its benchmark, the Barclays Municipal TR USD, according to Morningstar. Over

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a three-year period, the fund’s total return was 9.61%, 0.9 percentage point more than its category and nearly 3 percentage points more than the Barclays muni benchmark.

Jeff Tjornehoj, head of Lipper Americas Research, agreed the Ivy Municipal High Income fund’s strategy allowed it to outperform in the long term.

“This fund frequently meets or slightly underperforms its peer group average during up markets in order to step around the occasional pothole in the high yield muni cycle,” he said. “That risk-aware mindset has enabled the fund to post peer-group and benchmark-beating returns over the long haul.”

(Kelly Nolan covers municipal bonds for Dow Jones Newswires.)

(over please)

Ivy Municipal High Income Fund (IYIAX)

Performance as of 03/31/2013	Inception Date	1-Year	3-Year	5-Year	10-Year	Life	Expense
Share Class A (NAV)	05/18/2009	8.71%	8.89%	N/A	N/A	12.09%	0.90%
Share Class A (Load)	05/18/2009	4.08%	7.32%	N/A	N/A	10.84%	0.90%
Barclays HY Muni TR USD	-	14.30%	10.88%	7.18%	N/A	-	-

Top 10 Holdings	
(as a % of net assets as of 03/31/2013)	
MA Port Auth, Spl Fac Rev Bonds (Delta Air Lines, Inc., Proj), Ser 2001B (Auction Rate Sec) (InsuredBy AMBAC), 0.3%, 1/1/2031	2.2
TX Muni Gas Acquisition and Supply Corp I, Gas Supply Rev Bonds, Ser 2008D, 6.3%, 12/15/2026	1.4
TX Private Activity Bond Surface Trans Corp, Sr Lien Rev Bonds (LBJ Infra Group LLC IH-635 Managed Lanes Proj), Ser 2010	1.2
Citizens Ppty Ins Corp, Sr Secured Bonds, Ser 2012A-1, 1.4%, 6/1/2015	1.2
Bay Area Toll Auth, San Francisco Bay Area Toll Bridge Rev Bonds, Ser 2001 A, 1.4%, 4/1/2036	1.2
PA Tpk Comsn, Tpk Sub Rev Bonds, Ser 2009E, 0.0%, 12/1/2038	1.2
NJ Econ Dev Auth, Sch Fac Constr Rfdg Notes (SIFMA Index Notes), Ser 2013I, 1.7%, 9/1/2027	1.2
AZ Hlth Fac Auth, Rev Bonds (Banner Hlth), Ser 2007B, 1.0%, 1/1/2037	1.1
IL Fin Auth, Rev Bonds (Admiral at the Lake Proj), Ser 2010A, 8.0%, 5/15/2040	1.1
Delaware Cnty Indl Dev Auth, Charter Sch Rev Bonds (Chester Cmnty Charter Sch Proj), Ser 2010A, 6.1%, 8/15/2040	1.0

Data quoted is past performance and current performance may be lower or higher. Past performance is no guarantee of future results. Investment return and principal value of an investment will fluctuate, and shares, when redeemed, may be worth more or less than their original cost. Please visit www.ivyfund.com for the Fund's most recent month-end performance. Class A Share performance, including sales charges, reflects the maximum applicable front-end sales load of 4.25 percent. Performance at net asset value (NAV) does not include the effect of sales charges. The Barclays Municipal High Yield index is an unmanaged index generally representing the municipal bond market. It is not possible to invest directly in an index.

Consider all factors: As with any mutual fund, the value of the Fund's shares will change, and you could lose money on your investment. Fixed income securities are subject to interest rate risk and, as such, the net asset value of the Fund may fall as interest rates rise. Investing in high income

securities may carry a greater risk of nonpayment of interest or principal than higher rated bonds. The Fund may include a significant portion of its investments that will pay interest that is taxable under the Alternative Minimum Tax (AMT). An investment in the Fund is not a bank deposit and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. These and other risks are more fully described in the Fund's prospectus. Not all funds or fund classes may be offered at all broker/ dealers.

Net Assets as of 03/31/2013: \$1.7bil

Investors should consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. For a prospectus, or if available a summary prospectus, containing this and other information for the Fund, call your financial advisor or visit us online at www.ivyfund.com. Please read the prospectus or summary prospectus carefully before investing.

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