

almost entirely new market area for municipal (public) bonds in the form of fund units. As a generalization municipal investment funds are not heavily invested in the "higher quality" securities (those rated "A", "Aa" and "Aaa") for 2 reasons: (1) They cannot "afford" to do so because they must strive to offer the highest return consistent with safety, and (2) their basic concept of wide diversification of portfolio is, in itself, a significant safety factor so that inclusion of such "higher quality" bonds is unnecessary. Therefore, such funds can be a "home" for unseasoned obligations which might not otherwise command a ready market. "Unseasoned" bonds, by definition, include those of new, sparsely populated or, otherwise lower echelon governmental bodies without established credit ratings. In the long run this could mean more favorable interest rates for such issuers than would otherwise be the case. The extent of such new market area is conjectural, but may ultimately prove to be multibillion in size.

It has been the experience of a major sponsor-underwriter of tax-exempt bond funds that the creation and distribution of this new investment medium is a profitable activity, as compared to the net profits that might have been earned through an alternative underwriting and distribution of municipal bonds.

Offsetting the possibility of such greater profit, is the fact that the sponsor-underwriter subjects itself to market exposure and the possibility of financial loss. Such exposure exists in two separate areas. A sponsor finds it necessary to accumulate and hold during a period of several months a large part of the municipal (public) bonds which will form the portfolio for the next series of a municipal investment fund. The sponsor may gain or lose on the portfolio accumulation phase of the operation because the value of the bonds on the date of deposit with the trustee may be greater or less than cost. When the series is created, the sponsor-underwriter is exposed to risk of financial loss during the period when such series is being distributed. The risk of financial loss while holding units is, to some extent, even greater than while holding the bonds by reason of the fact that the offering price is inflexible (under the terms of the trust indenture the public offering price of units is defined as a price "equal to the offering price per unit of the bonds in the fund plus a sales charge of $4\frac{1}{2}$ percent of the public offering price"). Thus the sponsor-underwriter cannot terminate its exposure by distributing units at retail at a price differing from that produced by application of the formula. This concept warrants maximum clarification: on occasion the municipal (public) bond market is subject to vigorous and extended fluctuations; if market prices for bonds fall sharply, a dealer may prefer to liquidate his inventory quickly at whatever price is offered in the free market, rather than to hold them and risk further loss in an extended decline (i.e., "cutting his losses short"); however, fund units do not have a free market in the same sense; a dealer owning fund units must adhere to the selling terms established in the Prospectus (i.e., he cannot sell to anyone at any price he chooses and his flexibility of action is inhibited).

However, the price of municipal bonds is subject to considerable fluctuation. For example, during the last 13 months (February 1965 to March 1966, inclusive) the D-J Index of Yields increased from 3.10 to 3.80 percent. Relating that increase to the market price of a