

MARKET VECTORS® ETFs

The Investment Case for Pre-Refunded Municipal Bonds

- ▶ HIGHEST CREDIT QUALITY AND LIQUIDITY IN MUNICIPAL BOND MARKET
- ▶ ATTRACTIVE TAX-EXEMPT INCOME AND HISTORICAL RETURNS

Highest credit quality

The investment case for pre-refunded municipal bonds revolves around their high credit quality—which is, in fact, the highest available in the \$2.8 trillion municipal bond market.

“Pre-re’s,” as they are known, are bonds that are refinanced by their issuers and remain outstanding in the marketplace. These bonds are created when municipal issuers refinance outstanding debt for the same reason that homeowners often refinance their mortgages—to take advantage of lower interest rates and reduce their financing costs. They accomplish this by issuing so-called refunding bonds whose proceeds are used to buy securities that are placed in escrow and dedicated to paying the interest and principal on the original issue, which then becomes “pre-refunded.”

These bonds derive their high credit quality from the escrowed securities that secure them. In general, those securities consist solely of obligations that are directly issued or unconditionally guaranteed by the U.S. government—specifically, U.S. Treasury bonds as well as State and Local Government Series bonds, or

SLGs, a type of Treasury security issued specifically for escrow use by municipal issuers.¹ In some cases, permitted escrow holdings also include agency securities—which are not unconditionally guaranteed by the government—and high-quality third-party securities such as certificates of deposit and highly rated municipal bonds. But these bonds are estimated to comprise only one-quarter of the pre-refunded market segment.²

The quality of pre-re’s is further enhanced by the structure of their escrow accounts, which are irrevocably pledged as security for bond repayments and are managed by independent trustees.¹ Those trustees are responsible for verifying that the size and timing of the escrow cash flows will be sufficient to meet interest and principal payments.¹ Moreover, the criteria for permitted investments are clearly defined by federal law and SEC and IRS regulations, as are the rules governing changes in account holdings.¹

Triple-A standing

Issuers are not required to have their bonds re-rated when they refund them, and many do not. But when pre-refunded bonds are rated, those backed solely by Treasuries and SLGs are generally given a triple-A standing by the major credit rating agencies such as Moody’s, reflecting their government backing.^{1,3} Bonds backed in part by other types of securities may carry that rating as well, but are widely viewed as being of lower relative quality.¹

The bottom line is that pre-refunded bonds backed by U.S. Treasuries and SLGs are virtually equivalent in quality to Treasuries themselves. Because these bonds are secured by an irrevocable trust of Treasury obligations and are backed by the full faith and credit of the U.S. government, their default risk is equal to that of the debt of the Treasury—which is essentially negligible.

Reflecting their quality, pre-refunded bonds constitute the most liquid segment of the muni market. These bonds are heavily traded and generally remain liquid even during times of market distress. When the global

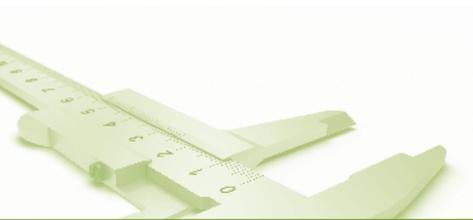
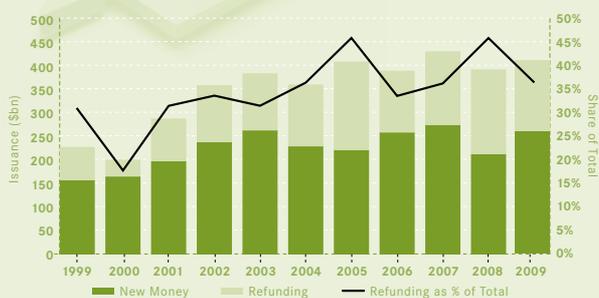


Figure 1 Municipal Refunding Activity: 1999-2009



Source: Municipal Market Advisors Research

Figure 2 Taxable-Equivalent Comparison

	Market Yields As of 3/31/2010
United States Treasury Note Coupon: 2.625% Issue date: 12/31/09 Maturity date: 12/31/14	Treasury: 2.45%
Massachusetts General Obligation Pre-Refunded Bond Coupon: 5.000% Issue date: 10/12/05 Refunding date: 9/1/15 Maturity date: 9/1/25	Pre-re: 1.85%
TEY* - Federal tax rate of 25%	2.47%
TEY* - Federal tax rate of 35%	2.84%
Pre-re advantage over Treasuries At 25% Federal tax bracket	2 basis points
At 35% Federal tax bracket	39 basis points

* Tax-equivalent yield: How much the taxable Treasury would have to yield to match the yield of the tax-exempt pre-refunded bond on an after-tax basis
Source: Van Eck Research and Bloomberg

credit crisis sent the world's markets into a tailspin in late 2008, for example, pre-re's maintained their liquidity, while the muni market as a whole often did not.

The liquidity of these bonds is reinforced by their ample supply in the marketplace. Today, pre-re's are estimated to constitute 10.5% of the municipal market,¹ and include both general obligation and revenue bonds. Over the past decade, refunding bonds comprised about 35% of the total par value of municipal issues.⁴ Although some of these refunding proceeds were used to immediately retire debt, most went into creating new pre-refunded bonds. The volume of refundings varies from year to year (Figure 1), depending on market conditions, but the supply of pre-re's is replenished on an ongoing basis.⁴

Tax-advantaged income

As with all munis, the interest income generated by pre-refunded bonds is exempt from federal and, in many cases, state and local taxes. Figure 2 illustrates the potential magnitude of that tax advantage by comparing two currently outstanding

“Pre-refunded bonds offer the highest credit quality in the muni market.”

bonds—a Treasury note and pre-refunded Massachusetts general obligation bond with similar maturity dates. In the past decade, market yields on pre-refunded bonds have averaged about 80% of those on comparable Treasuries. Reflecting that, the Treasury and pre-re bonds in this example were priced at market yields of 2.45% and 1.85%, respectively, at end-March 2010. The table summarizes the yields that the taxable Treasury would have to pay in order to deliver the same after-tax yield as the tax-exempt pre-refunded bond. At the highest federal tax rate of 35%, that yield was 2.84%—which means that the pre-refunded bond held a yield advantage of 39 basis points over the Treasury on a taxable-equivalent basis.

As illustrated, pre-refunded bonds generally hold a taxable-equivalent yield advantage over comparable Treasury bonds, especially at higher tax rates. That advantage is all the more noteworthy since the two types of bonds are essentially equal in credit risk.

Lower price volatility

Pre-refunded bonds have short-to-intermediate maturities because they are typically escrowed until their first call date.¹ If there is no call date or the issuer prefers it, they are escrowed until their original maturity date; these escrowed bonds or ETMs, as they are called, are considered part of the pre-re market segment and are identical to pre-re's except for their somewhat longer maturities.¹ Figure 3 shows the combined maturity breakdown of both types of bonds, as measured by the composition of the Barclays Capital Municipal Pre-Refunded Index, the most comprehensive index tracking

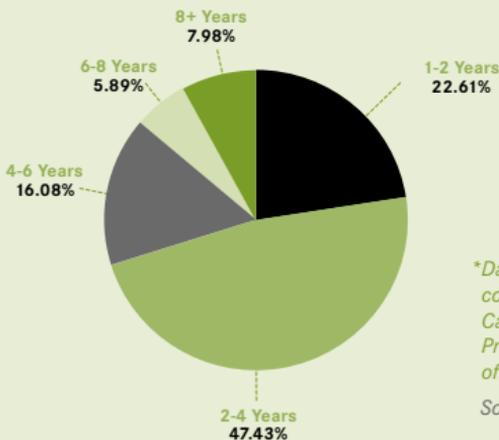
the pre-refunded and escrowed market segment. At end-December 2009, 88% of the bonds in the index had maturities of six years or less, and the index had an overall average maturity of 3.8 years.²

Given their shorter maturities, these bonds exhibit less price volatility than those with longer maturities, and tend to hold their value better during times of market stress.³ This does not mean they exhibit price stability on an absolute basis. On the contrary, they can exhibit significant price volatility. On a relative basis, however, their price volatility is more moderate than that of municipal bonds with longer maturities.

Attractive risk/reward

While past performance is no guarantee of future results, pre-refunded munis have historically offered competitive returns relative to the municipal bond market as a whole (Figure 4).² In 2008, an exceptionally difficult year for munis, pre-re's were the only broad segment of the tax-exempt market that produced a positive return²—reflecting their high credit quality and liquidity.

Figure 3 Maturity Breakdown of Pre-Refunded and Escrowed Bonds*



*Data shown reflects composition of Barclays Capital Municipal Pre-Refunded Index as of December 31, 2009

Source: Barclays Capital

As the global financial crisis has deepened, causing steep declines in stocks and bonds, pre-refunded municipal bonds have emerged as one of the top performers more broadly for the same reasons.² On a taxable-equivalent basis over the one and three years ending in December 2009, these bonds outperformed most broad segments of the tax-exempt and taxable U.S. bond markets.^{2,5}

The longer-term performance picture is summarized in **Figure 5**, which shows the risk-reward profile of pre-refunded munis versus U.S. stocks and bonds and international bonds over the ten years ending in December 2009, based on indexes that track them. On a taxable-equivalent basis, pre-re's performed extremely well over this time period—producing the third highest compound annual returns at the second lowest level of volatility.^{2,5}



Figure 4 Municipal Bond Returns*

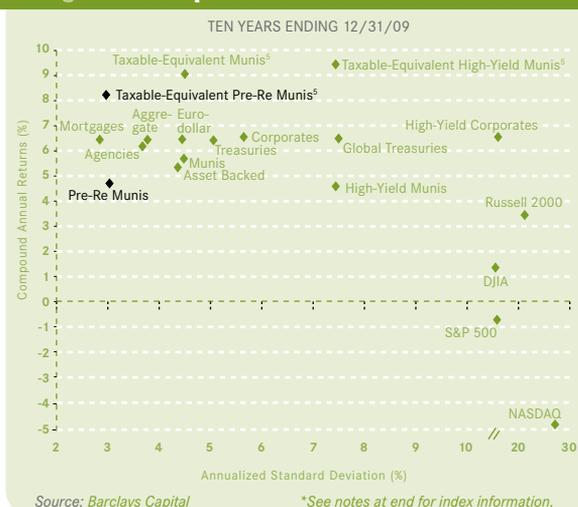
	Pre-Refunded Municipal Bonds	Municipal Bond Market
2009	4.7%	12.9%
2008	6.8%	-2.5%
2007	5.1%	3.4%
2006	3.4%	4.8%
2005	1.3%	3.5%
2004	2.4%	4.5%
2003	3.8%	5.3%
2002	8.3%	9.6%
2001	6.0%	5.1%
2000	7.2%	11.7%

*As measured by the Barclays Capital Municipal Pre-Refunded Index and the Barclays Capital U.S. Municipal Index.

Source: Barclays Capital and Bloomberg

Data as of 12/31/09

Figure 5 Comparative Index Performance*



Fixed-income risks

Although pre-refunded bonds backed by Treasuries and SLGs are essentially devoid of credit risk, they are subject to the other risks associated with fixed-income securities—most notably, interest rate risk, which means that the prices of these bonds fluctuate in response to interest rate changes. It is also important for investors to bear in mind that the escrowed securities backing these bonds are used to pay interest and principal, and do not provide a guarantee of market price.

Taking that into account, the investment case for pre-refunded municipal bonds remains potentially compelling—particularly in the difficult climate that prevails today, where the benefits they offer are especially advantageous. As such, this market segment may warrant consideration by investors seeking:

- Highest level of credit quality
- Exceptional liquidity
- Relatively low price volatility
- Attractive tax-free income
- Potentially attractive returns

Unless otherwise indicated, the statements in this report are the product of Van Eck Associates Corporation research and reflect the opinions of Van Eck Associates Corporation. This report is not intended to be a forecast of future events, a guarantee of future results or investment advice. Current market conditions may not continue. Past performance is no guarantee of future results.

Municipal bonds are subject to risks related to litigation, legislation, political change, conditions in underlying sectors or in local business communities and economies, bankruptcy or other changes in the issuer's financial condition, and/or the discontinuance of taxes supporting the project or assets or the inability to collect revenues for the project or from the assets. Additional risks include credit, interest rate, call, reinvestment, tax, market and lease obligation risk. Interest and principal payments for pre-refunded bonds are funded from securities in an escrow account. The escrowed securities do not guarantee the price of these bonds. Municipal bonds may be less liquid than taxable bonds. There is no guarantee that the Fund's income will be exempt from federal or state income taxes, and changes in those tax rates or in alternative minimum tax rates or in the tax treatment of municipal bonds may make them less attractive as investments and cause them to lose value. Capital gains, if any, are subject to capital gains tax.

Please note that Van Eck Securities Corporation offers Market Vectors Pre-Refunded Municipal Index ETF (the "Fund") that invests in the asset class included in this research report. This material must be accompanied or preceded by a prospectus. An investor should consider the Fund's investment objective, risks, and charges and expenses carefully before investing. The prospectus contains this and other information. Please read it carefully before investing.



References & Footnotes

- 1 A Guide to Pre-refunded Municipal Bonds, UBS Wealth Management Research, November 2008.
- 2 Barclays Capital Inc., March 31, 2010.
- 3 Pre-Refunded Municipal Bonds, Mroningstar Direct, March 31, 2010.
- 4 Municipal Market Advisors Research, March 31, 2010.
- 5 Barclays Capital's taxable-equivalent return calculations take into account the tax-advantaged treatment of municipal bonds, and are based on an equally weighted national average federal and state (top bracket) income tax rate of 38.45% for 2009, 38.45% for 2003-08, 41.85% for 2002, 42.33% for 2001, and 42.78% prior. Local taxes have not been considered.

Figure 5 Index Information

The definitions of the fixed-income and equity indexes shown in **Figure 5** are available in the Web-based copy of this investment case, located at vaneck.com/prb.

The following Barclays Capital fixed-income indexes are shown: Eurodollar Index (Eurodollar), Global Treasury Index (Global Treasuries), Municipal Pre-Refunded Index (Pre-re Munis), U.S. Agency Index (Agencies), U.S. Aggregate Index (Aggregate), U.S. Asset-Backed Securities Index (Asset-Backed), U.S. Corporate Index (Corporates), U.S. Corporate High-Yield Index (High-Yield Corporates), U.S. High-Yield Municipal Index (High-Yield Munis), U.S. Mortgage-Backed Securities Index (Mortgages), U.S. Municipal Index (Munis), U.S. Treasury Index (Treasuries).

The following equity indexes are shown: Dow Jones Industrial Average (DJIA), NASDAQ Composite Index (NASDAQ), the Russell 2000 Index (Russell 2000) and S&P 500 Index (S&P 500).

Van Eck Securities Corporation, Distributor
335 Madison Avenue | New York, New York 10017
vaneck.com | 1.888.MKT.VCTR

PRBIC (03/10)

Van Eck® Global
SINCE 1955

The information contained herein regarding each index listed below was provided by the relevant index provider. Van Eck Associates Corporation provides this information only as a convenience and is not responsible for the index descriptions listed below.

Fixed-Income Indexes

The **Barclays Capital Eurodollar Index** contains U.S.-dollar denominated securities that are registered outside the U.S. (except for global issues which can be SEC-registered).

The **Barclays Capital Global Treasury Index** tracks fixed-rate local currency sovereign debt of investment-grade countries.

The **Barclays Capital Municipal Pre-Refunded Index** is comprised of pre-refunded and escrowed securities secured by an escrow or trust account containing direct U.S. government obligations—such as U.S. Treasuries and Treasury-issued State & Local Government Series bonds (SLGs)—and/or agencies, municipals and other high-quality securities.

The **Barclays Capital U.S. Agency Index** includes native currency agency debentures from issuers such as Fannie Mae, Freddie Mac and Federal Home Loan Bank.

The **Barclays Capital U.S. Aggregate Index** covers the U.S. dollar-denominated, investment grade, fixed-rate, taxable bond market of SEC-registered securities.

The **Barclays Capital U.S. Asset-Backed Securities Index** includes asset-backed securities (repackaged debt) in numerous sectors, including credit and charge card, auto and home equity loan securities.

The **Barclays Capital U.S. Corporate Index** covers U.S. dollar-denominated, investment-grade, fixed-rate, taxable securities sold by industrial, utility and financial issuers.

The **Barclays Capital U.S. Corporate High-Yield Index** covers the U.S.-dollar denominated, non-investment grade, fixed-rate, taxable corporate bond market and includes securities with ratings by Moody's, Fitch and S&P of Ba1/BB+/BB+ or below.

The **Barclays Capital U.S. High-Yield Municipal Index** covers the U.S. dollar-denominated, non-investment grade, fixed-rate, tax-exempt market and includes securities with ratings by Moody's, Fitch and S&P of Ba1/BB+/BB+ or below.

The **Barclays Capital U.S. Mortgage-Backed Securities Index** covers agency mortgage-backed passthrough securities (both fixed-rate and hybrid ARM) issued by Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC).

The **Barclays Capital U.S. Municipal Index** covers the U.S. dollar-denominated, long-term tax-exempt bond market and has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and pre-refunded bonds.

The **Barclays Capital U.S. Treasury Index** includes public obligations of the U.S. Treasury.

Equity Indexes

The **Dow Jones Industrial Average** is a price-weighted average of 30 actively traded blue-chip stocks, primarily industrials.

The **NASDAQ Composite** is a market value-weighted index of common stocks listed on The Nasdaq Stock Market.

The **Russell 2000 Index** measures the performance of the small-cap segment of the U.S. equity universe.

The **Standard and Poor's (S&P) 500 Index** is calculated with dividends reinvested and consists of 500 leading companies in leading industries in the U.S. economy.