Invesco Van Kampen High Yield Muni A ACTHX

A lot of action without too much change.

This has been a busy year for Invesco Van Kampen High Yield Municipal, but not a bad one.

The first big news involved two comanagers: Franklin Ruben left the firm in March 2012, while Gerard Pollard stepped back into an analyst role. The pair had been on the fund only since mid-2010, though, and left behind three longer-tenured skippers who have been co-managing the fund for several years.

Then Invesco merged sibling Invesco High Income Municipal into this portfolio on April 27, 2012. Such combinations can sometimes be worrisome if the funds’ sector concentrations are much different, but that wasn’t the case here. The fund’s managers noted that roughly a third of the High Income Municipal fund’s holdings overlapped with those in this portfolio. Meanwhile the merged-away fund held a comparatively modest $750 million before it was folded into this (then) $5.2 billion offering, and the resulting sector concentrations haven’t shifted much. The fund’s nonrated stake has fallen by roughly 5 percentage points to 53%, a welcome if modest shift given that our key point of concern here has always been the potential liquidity risk of that allocation.

The latest change has been an Aug. 1 announcement that Invesco will be closing the portfolio to new investors after Sept. 4, 2012. The fund’s managers claim that they’re not currently having trouble finding securities to buy, but that they want to protect current shareholders’ interests by being conservative about asset growth. It’s not ideal to leave a full month for new investors to pile in, but the closure itself is reassuring. The fund has a history of similar closings (and later reopenings), and they’re a sign of good stewardship.

Overall, this is a fund with a good long-term history and a mostly well-diversified portfolio. The fund’s management changes and merger don’t much dent its appeal, but its 53% stake in nonrated bonds is the one feature that makes it difficult for us to pound the table in its favor.

Process Pillar: Neutral
With a mandate to produce high income from municipal bonds, everything about this fund’s process is important. The good news is its managers have made a virtue of diversification at the issue level. They’ve also avoided focusing on some of the market’s riskiest sectors, whose fat yields often draw the attention of rivals intent on gathering assets. The team also boasts of deep credit analysis; the fund’s managers are supported by an analyst team with years of experience, many as industry experts with backgrounds working in their sectors prior to shifting to the investment arena.

That is all noteworthy because it helps differentiate the fund from its average rival in the high-yield muni category, and it has aided in keeping the fund out of greater trouble. Yet there’s a key feature of this—and other—high-yield muni funds that creates a chronic worry: It is concentrated in nonrated bonds, many of which are small and may be less easy to trade during times of trouble. That concern has been academic for most of the fund’s history, but it’s one that makes the portfolio vulnerable should investors sour and redeem assets at a swift clip. Although the fund held up comparatively well during the financial crisis’ liquidity troubles of 2008, for example, it didn’t suffer the redemption pain endured by some rivals that did suffer painful write-downs.

The most notable thing about this portfolio—past or current—is what it doesn’t hold. In particular, it lacks heavy allocations to debt backed by the tobacco industry’s Master Settlement Agreement (3.8% in February) or airlines (2.7%), two of the high-yield muni sector’s favorites for the generation of fat yields. They also tend to be among the sector’s most volatile species, however, and some competitors also make greater use of leverage—another tactic that helps boost income payouts but typically produces higher highs and lower lows in a fund’s returns.

By contrast, the portfolio is heavily tilted toward various subsets of the health-care industry. The fund’s largest allocation—22% overall—is to a mix of different kinds of continuing-care retirement centers (9.7% traditional life-care, 8.1% endowment-supported, 3.7% rental), while hospitals place a close second at more than 14%. The remainder of the portfolio is typically diverse enough that macro trends in other sectors don’t usually deserve much worry one way or another.

One of the fund’s most important statistics is its allocation to nonrated bonds. At 53% (June), it’s...
among the largest of any in the high-yield muni category. And though the fund has historically not experienced major problems as a result, that construction could leave it vulnerable to liquidity issues under the wrong circumstances.

**Performance Pillar:** Neutral | Eric Jacobson 08/02/2012

Last year was a good one for munis, and this fund enjoyed its share of fun. That’s notable because funds often give up a lot of sensitivity to U.S. Treasuries by sticking with lower-quality munis and even coved the lower day-to-day volatility of that positioning.

Given how well Treasuries performed in 2011, one would have expected it to be no small issue. It turned out to be an even stronger year for lower-quality munis, though. Barclays Capital’s Muni High Yield Bond Index rose 10.7% for the year, for example, while its standard Municipal Bond Index gained 9.3%.

This fund performed better than both over the same stretch, turning in an 11.3% gain and placing in the best third of distinct high-yield muni funds. Sticking with long-maturity bonds—the fund’s average maturity was nearly 21 years—made a big difference. By contrast, Barclays’ “regular” index recently had an average maturity of 13.5 years, while its high-yield muni benchmark clocked a 19.5-year figure.

Although the portfolio has continued to thrive along with the high-yield muni market, the past 18 months have been unusual, and shareholders here would do well to remember the fund’s much more difficult 2008. Although the fund performed well compared with some others in the category, it tumbled 24% when high-yield munis took it on the chin. Its longer-term success, meanwhile, has moderated some in recent years.

**People Pillar:** Positive

This fund was for many years synonymous with its former lead manager, Wayne Godlin, who left the firm at the end of 2009 and moved to Alliance Bernstein. His departure has been a source of concern, though most of his team has remained with the fund. There are no obvious signs at this point that his absence has resulted directly in any erosion of the fund’s results.

The fund’s management team is spread around the country and boasts six analysts and three portfolio managers. The managers include Bill Black (with Van Kampen since 1998), Mark Paris (2002), and James Phillips (1991). Gerard Pollard had been a manager on the fund but shifted back to an analyst role in March 2012. Former co-manager Franklin Ruben left Invesco at the same time.

Despite that bit of turmoil, just about every member of the team has numerous years of experience, many as industry experts with backgrounds of significant time spent working in their specific sectors prior to shifting to the investment sphere. Those working in an analyst capacity include Mary Jane Minier (head of the firm’s high-yield municipal credit research), Brian Winters, Doug Gibbs, Art Schloss, Bill Womack, Matthew Nichols, and now Gerard Pollard.

**Parent Pillar:** Positive | Kathryn Spica, CFA 04/10/2012

Invesco has meaningfully improved its stewardship profile. Notably, the fund’s fund lineup is more sensible in the wake of its 2010 acquisition of Van Kampen’s lineup of funds. Invesco fund executives and directors have clearly communicated with investors throughout the integration process, showing thoughtfulness and transparency. Among other changes, Van Kampen’s Jim Gilligan replaced Invesco’s U.S. Value Equity CIO Brent Stanley, and the combined lineup of funds was reduced by half (mainly via merging overlapping strategies). Funds with lower fees and the better management team survived, and changes to the fund offerings are still under way. The result is a more balanced asset mix between growth and value styles, a far cry from the momentum-based approach that defined many of Invesco’s equity funds in the early 2000s.

Invesco certainly deserves credit for raising its stewardship game, but the firm just clears the threshold to earn a positive Parent rating under Morningstar’s methodology. While fees are reasonable overall, they could be lower, and managers’ investments in their own funds’ shares often fall short of the industry’s best-practices level. Some areas of weakness remain, especially among the taxable fixed-income funds. The firm will need to demonstrate that its culture improvements are sticky and result in tangible long-term benefits for fund shareholders.

**Price Pillar:** Positive

The high-yield municipal category is one area of the bond market in which claims of necessity for higher research expenses would carry some water in the context of a smallish portfolio. Fortunately for investors here, the portfolio boasts nearly $5 billion in assets and can afford to levy a relatively investor-friendly price tag of 0.76%, which is below-average for this comparison group.
**Fund Objective:** The fund seeks high interest income exempt from federal income tax as is consistent with the investment policies of the fund by investing primarily in medium- and lower grade municipal securities.

**Invesco High Yield Municipal Fund Class A Shares**

Average Annual Total Returns (%) as of December 31, 2012

<table>
<thead>
<tr>
<th>Period</th>
<th>w/max 4.25% sales charge</th>
<th>w/o sales charges</th>
<th>Barclays High Yield Municipal Bond Index</th>
<th>Morningstar High Yield Municipal Category Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inception (1/2/86)</td>
<td>6.10</td>
<td>6.27</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>10 Years</td>
<td>5.24</td>
<td>5.70</td>
<td>7.08</td>
<td>4.82</td>
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<tr>
<td>5 Years</td>
<td>4.68</td>
<td>5.58</td>
<td>6.15</td>
<td>4.74</td>
</tr>
<tr>
<td>1 Year</td>
<td>9.05</td>
<td>13.92</td>
<td>18.14</td>
<td>13.82</td>
</tr>
</tbody>
</table>

The percentile rankings are based on the average annual total returns for the periods stated and do not include any sales charges, but do include reinvestment of dividends and capital gains and Rule 12b-1 fees. Past performance is no guarantee of future results.

**** Overall Morningstar Rating (as of December 31, 2012)

Morningstar ratings are based on a risk-adjusted return measure that accounts for variation in a fund’s monthly performance (including the effect of sales charges, loads and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The overall rating is derived from a weighted average of three-, five- and 10-year rating metrics, as applicable. Class A shares received four stars for the overall, three stars for the three years and five years and four stars for 10 years; The fund was rated among 146, 146, 126 and 91 high yield municipal funds for the overall period, three, five and 10 years respectively. Ratings are as of December 31, 2012, and are subject to change every month. With-load ratings include the effect of sales charges, loads and redemption fees. A fund is eligible for a Morningstar Rating three years after inception. The top 10% of funds in a category receive five stars, the next 22.5% four stars, the next 35% three stars, the next 22.5% two stars and the bottom 10% one star. (Each share class is counted as a fraction of one fund within this scale and rates separately, which may cause slight variations in the distribution percentages.) Ratings for other share classes may differ due to different performance characteristics. ©2013 Morningstar, Inc. All rights reserved. The information contained herein is proprietary to Morningstar and/or its content providers. It may not be copied or distributed and is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

**Morningstar Analyst Rating**

The Morningstar Analyst Rating is not a credit or risk rating. It is a subjective evaluation performed by the mutual fund analysts of Morningstar, Inc. Morningstar evaluates funds based on five key pillars, which are process, performance, people, parent, and price. Morningstar's analysts use this five pillar evaluation to identify funds they believe are more likely to outperform over the long term on a risk-adjusted basis. Analysts consider quantitative and qualitative factors in their research, and the weighting of each pillar may vary.

The Analyst Rating ultimately reflects the analyst's overall assessment and is overseen by Morningstar's Analyst Rating Committee. The approach serves not as a formula but as a framework to ensure consistency across Morningstar's global coverage universe. The Analyst Rating scale ranges from Gold to Negative, with Gold being the highest rating and Negative being the lowest rating. A fund with a "Gold" rating distinguishes itself across the five pillars and has garnered the analysts' highest level of conviction. A fund with a 'Silver' rating has notable advantages across several, but perhaps not all, of the five pillars—strengths that give the analysts a high level of conviction. A "Bronze"-rated fund has advantages that outweigh the disadvantages across the five pillars, with sufficient level of analyst conviction to warrant a positive rating. A fund with a 'Neutral' rating isn't seriously flawed across the five pillars, nor does it distinguish itself very positively. A "Negative" rated fund is flawed in at least one if not more pillars and is considered an inferior offering to its peers. Analyst Ratings are reevaluated at least every 14 months. For more detailed information about Morningstar's Analyst Rating, including its methodology, please go to http://corporate.morningstar.com/us/documents/MethodologyDocuments/AnalystRatingsForFundsMethodology.pdf.

The Morningstar Analyst Rating should not be used as the sole basis in evaluating a mutual fund. Morningstar Analyst Ratings are based on Morningstar's current expectations about future events; therefore, in no way does Morningstar represent ratings as a guarantee nor should they be viewed by an investor as such.
Morningstar Analyst Ratings involve unknown risks and uncertainties which may cause Morningstar's expectations not to occur or to differ significantly from what we expected.

**About risk:** All or a portion of the fund’s otherwise tax-exempt income may be taxable to those shareholders subject to the federal alternative minimum tax. 

If interest rates fall, it is possible that issuers of debt securities with high interest rates will prepay or call their securities prior to maturity, possibly causing the proceeds to be reinvested in securities bearing the new, lower interest rates and reducing the fund’s income and distributions to shareholders.

The issuer of instruments in which the fund invests may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer’s credit rating.

In addition to risks relating to their underlying instruments, the use of derivatives may include other, possibly greater, risks such as counterparty, leverage, correlation, liquidity, tax, market, interest rate and management risks. Derivatives may also be more difficult to purchase, sell or value than other investments. The fund may lose more than the cash amount invested in derivatives.

Junk bonds involve a greater risk of default or price changes due to changes in the credit quality of the issuer. 

The income you receive from the fund is based primarily on prevailing interest rates, which can vary widely over the short- and long-term. If interest rates drop, your income from the fund may drop as well.

Interest rate risk refers to the risk that bond prices generally fall as interest rates rise; conversely, bond prices generally rise as interest rates fall.

Inverse floating rate obligations may be subject to greater price volatility than a fixed income security with similar qualities. When short-term interest rates rise, they may decrease in value and produce less or no income and are subject to risks similar to derivatives.

Leverage created from borrowing or certain types of transactions or instruments may impair the fund’s liquidity, cause it to liquidate positions at an unfavorable time, increase volatility or otherwise not achieve its intended objective.

The fund may hold illiquid securities that it is unable to sell at the preferred time or price and could lose its entire investment in such securities.

The investment techniques and risk analysis used by the fund’s portfolio managers may not produce the desired results.

Securities which are in the medium- and lower-grade categories generally offer higher yields than are offered by higher-grade securities of similar maturity, but they also generally involve more volatility and greater risks, such as greater credit risk, market risk, liquidity risk, management risk, and regulatory risk.

The fund may invest in municipal securities issued by entities having similar characteristics. The issuers may be located in the same geographic area or may pay their interest obligations from revenue of similar projects. This may make the fund’s investments more susceptible to similar social, economic, political or regulatory occurrences. As the similarity in issuers increases, the potential for fluctuation in the fund’s net asset value also increases.

Economic and regulatory factors may affect a municipal security’s value, interest payment, repayment of principal and the fund’s ability to sell it. An issuer’s failure to comply with tax requirements may make income paid thereon taxable, thus reducing the security’s value. In addition, there could be changes in applicable tax laws or tax treatments that reduce or eliminate the current federal income tax exemption on municipal securities or otherwise adversely affect the current federal or state tax status of municipal securities.

Reinvestment risk is the risk that a bond’s cash flows (coupon income and principal repayment) will be reinvested at an interest rate below that on the original bond.

Fluctuations in the values of synthetic securities may not correlate perfectly with the instruments they are designed to replicate. Synthetic securities may be subject to interest rate changes, market price fluctuations, counterparty risk and liquidity risk.

The absence of an active secondary market for certain variable and floating rate notes could make it difficult to dispose of the instruments, and a portfolio could suffer a loss if the issuer defaults during periods in which a portfolio is not entitled to exercise its demand rights.

U.S. Treasury securities are direct obligations of the U.S. government and can take the form of bonds, notes or bills. U.S. Treasuries are backed by the “full faith and credit” of the U.S. government, if held to maturity.

Diversification does not guarantee a profit or eliminate the risk of loss.

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE
Before investing, investors should carefully read the prospectus and/or summary prospectus and carefully consider the investment objectives, risks, charges and expenses. For this and more complete information about the fund(s), investors should ask their advisors for a prospectus/summary prospectus or visit invesco.com/fundprospectus.

Note: Not all products, materials or services available at all firms. Advisors, please contact your home office.

Barclays Capital High Yield Municipal Bond Index is generally representative of bonds that are noninvestment grade, unrated or below Ba1. Barclays Capital Municipal Bond Index includes investment-grade, tax-exempt, and fixed-rate bonds with long-term maturities (greater than two years) selected from issues larger than $50 million. The indexes do not include any expenses, fees, or sales charges, which would lower performance. The indexes are unmanaged and should not be considered an investment.

A credit rating is an assessment provided by a nationally recognized statistical rating organization (NRSRO) of the creditworthiness of an issuer with respect to debt obligations, including specific securities, money market instruments or other debts. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice. Not Rated indicates the debtor was not rated, and should not be interpreted as indicating low quality. For more information on rating methodologies, please visit the following NRSRO websites:
www.standardandpoors.com and select 'Understanding Ratings' under Rating Resources on the homepage;
www.moodys.com and select 'Rating Methodologies' under Research and Ratings on the homepage.

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On Sept. 24, 2012, Van Kampen was removed from the fund’s name.