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Municipal Bond Market

Q4 2025

Market Review

- The municipal bond market, as measured by the Bloomberg Municipal Bonds Index, posted a return of 1.56% for the fourth quarter of 2025 (Q4). Meanwhile new issuance of municipal (muni) bonds increased 14% year-over-year compared to 2024, culminating in a new annual record with tax-exempt issuance surpassing $500 billion. By quarter end, the yield on the benchmark 10-year UST note moved two basis points (bps) higher to 4.17%. US market sentiment dipped in throughout the quarter due to consumers concerns over personal finances problems, driven by weak labor and persistent inflation expectations, according to the latest University of Michigan's consumer surveys. The mid-November resolution of the US federal government shutdown supported sentiment through year-end. Federal Reserve (Fed) policy also drove overall returns, with three consecutive 25-bp rate cuts which were well received by the market. However, the future path of cuts grew ambiguous as Fed members were split on the need for further adjustments

Outlook

- While Q4 muni bond issuance exceeded historical averages, the pace of issuance slowed going into year-end, nonetheless full-year issuance exceeded last year's already elevated levels. Looking ahead to 2026, demand will play a crucial role as supply is projected to reach exceptional highs, primarily driven by infrastructure capital requirements that can no longer depend on previous government stimulus programs alone. This provides a stronger technical backdrop as demand has also increased over the past several months. The muni-bond yield curve remained relatively stable during the quarter.

- Fundamentals remain stable; however, slower economic growth will limit expansion in revenues across many sectors, in particular tax revenues. Rainy day funds remain healthy at the state and local government levels, which bolster fiscal resilience despite ongoing expense growth.

- Municipal bond valuations continue to appear attractive, particularly on a tax-adjusted basis. Yields remain above five-year averages, allowing investors to lock in compelling income. In a more challenging environment, strong bottom-up research and disciplined security selection will be essential to identifying relative value and preserving portfolio quality.

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