

US Municipal Bond

Key Takeaways

- *The FOMC cut the fed funds policy rate twice over the quarter, by 25 bps each, to a target range of 3.50% to 3.75%.*
- *Municipal credit fundamentals continued to show resilience despite slowing growth trends.*
- *The improved credit trends were reflected in ratings activity. Public rating agency upgrades outpaced downgrades by more than two to one, according to Bloomberg.*

Market Review

The investment-grade municipal market posted positive returns in the fourth quarter, outperforming taxable fixed-income asset classes. While municipal technicals continued to be challenged by elevated supply conditions in the fourth quarter, investor demand improved toward the end of the year, contributing to municipals' outperformance.

Fixed-income market volatility persisted in the fourth quarter of 2025 as investors and policymakers navigated mixed economic signals. The longest US government shutdown, which restricted data availability, ended in November after 43 days. The US Treasury (UST) yield curve steepened, with short and intermediate UST yields finishing the quarter lower, while long-term yields increased. Equities performed well, with the S&P 500 Index reaching new highs, while credit spreads were mixed.

Total nonfarm payrolls rose by 64,000 in November, significantly higher than the -105,000 jobs reported in October. The unemployment rate also rose to 4.6% in November, up from 4.4% in September. Inflation data continued to moderate in November, with headline Consumer Price Index (CPI) falling to 2.7% year-over-year (YoY) (compared to 3.0% in September) and core CPI falling to 2.6% (from 3.0% in September).

Investment Outlook

Municipal markets continue to offer attractive taxable-equivalent yields heading into 2026, especially in longer maturities. This follows record new-issue supply in 2025 and improving demand toward year-end. Municipal credit fundamentals remain resilient, supported by strong state and local tax collections despite slower growth trends. However, selective high-yield exposures underscore the importance of credit research. Recent relative

The Federal Open Market Committee (FOMC) cut the Federal Reserve (Fed) policy rate twice over the quarter, by 25 basis points (bps) to a target range of 3.50% to 3.75%. In December, the committee added language to its statement linking "the extent and timing" of further policy actions to incoming data and the evolving outlook. The Fed also resumed reserve purchases to provide for ample liquidity and smoother policy transmission.

Municipal credit fundamentals continued to show resilience despite slowing growth trends. Census-reported 2Q25 state and local tax collection estimates, which capture fiscal year-end results for most governments, showed 12-month trailing collections increased 4% YoY to \$2.1 trillion, a record high. Twelve-month trailing individual income tax collections rose 8% YoY and sales tax collections increased 2% YoY while corporate income tax collections were relatively flat. Rolling 12-month property tax collections, the primary revenue source for local governments, increased 2% YoY.

The improved credit trends were reflected in ratings activity. Public rating agency upgrades outpaced downgrades by more than two to one, according to Bloomberg. Muni default activity also remained limited and largely isolated to select high-yield sectors and issuers. Through December 15, 2025, the muni market recorded 51 first-time payment defaults totaling \$1.5 billion, down from 60 defaults totaling \$2.1 billion in 2024, according to Bloomberg.

underperformance and record supply have enhanced the tax-efficient income opportunities available in municipals. The smaller decline in municipal yields has improved after-tax relative valuations across most segments of the curve and credit structures, benefiting investors seeking higher after-tax income.

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The Bloomberg Municipal Bond Index is a flagship measure of the USD-denominated tax exempt bond market over 1 year to maturity. The index includes four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds. Securities must be rated investment grade (Baa3/BBB-/BBB- or higher).

The Bloomberg Municipal Taxable Bonds Index is a flagship measure of the USD-denominated taxable municipal bond market over 1 year to maturity. Securities must be rated investment grade (Baa3/BBB-/BBB- or higher).

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