

Western Asset Municipal Bond Ladders (1-30 Years)

Commentary | as of December 31, 2025

Key Takeaways

- 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.
- Municipal supply conditions continue at a record pace as municipal issuance reached \$148 billion in 4Q25, up 22% from 4Q24 levels. Tax-exempt issuance fell 10% quarter-over-quarter (QoQ) to \$130 billion and taxable issuance rose 78% QoQ to \$18 billion. 2025 new-issue supply of \$588 billion is 17% higher than the prior year, with tax-exempt issuance up 16% year-over-year (YoY) and taxable issuance up 34% YoY.
- Municipal demand fluctuated throughout the year but improved steadily toward year-end 2025. Muni mutual fund flows were limited in the first half of the year amid choppy economic data and policy uncertainty but strengthened in the second half as it became clear that the Federal Reserve (Fed) would continue its rate-cutting cycle and as prior underperformance contributed to more attractive valuations. Overall, municipal mutual funds recorded \$51 billion of net inflows in 2025, up 21% YoY, extending cumulative net inflows from early 2024 to \$93 billion, according to Lipper.
- 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, 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.

Performance Review

- The Bloomberg U.S. Municipal Bond Index returned 1.56% in the fourth quarter.
- The 1-year to 30-year muni yield curve flattened by 30 basis points (bps) to 170 bps.
- BBB munis outperformed the index by 21 bps, returning 1.77%.

Outlook

- Western Asset's outlook remains constructive, though we recognize that growth momentum is tempered by uncertainty in areas such as inflation, central bank policy, geopolitics and fiscal sustainability.
- Having cut rates at three successive meetings since September, the Federal Reserve (Fed) may now moderate its pace of easing and await further signals from the post-shutdown data releases. Fiscal vulnerabilities and persistent inflation may see the yield curve steepen further.
- We expect that attractive relative value, along with the likelihood for the Fed to continue to move front-end rates lower, will support municipal demand and after-tax total return potential in 2026.
- We continue to focus on disciplined, fundamental, relative value investing, seeking pockets of opportunity in fixed income while remaining mindful of technical and macroeconomic risks.

Average annual total returns (%) - as of December 31, 2025-PRELIMINARY

Composite	3-Mo*	6-Mo*	YTD*	1-Yr	3-Yr	5-Yr	10-Yr	15-Yr	20-Yr	25-Yr	Inception	Inception Date
Net of Fees	1.23	3.63	2.57	2.57	2.09	-1.25	0.85	—	—	—	0.92	3/31/2015
Pure Gross of Fees	1.61	4.40	4.11	4.11	3.62	0.24	2.36	—	—	—	2.43	3/31/2015

*Cumulative total returns

The strategy returns shown are preliminary composite returns, subject to future revision (downward or upward).

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What are the Risks?

All investments involve risks, including possible loss of principal. Fixed income securities involve interest rate, credit, inflation and reinvestment risks, and possible loss of principal. As interest rates rise, the value of fixed income securities falls. **Liquidity risk** exists when securities or other investments become more difficult to sell, or are unable to be sold, at the price at which they have been valued. Portfolios focused on a **single state** are subject to greater risk of adverse economic and regulatory changes than a geographically diversified portfolio.

Glossary

A **basis point (bp, or bps)** is one one-hundredth of one percent (1/100% or 0.01%).

The **S&P 500 Index** features 500 leading U.S. publicly traded companies, with a primary emphasis on market capitalization. Source: © S&P Dow Jones Indices LLC. All rights reserved.

The **yield curve** shows the relationship between yields and maturity dates for a similar class of bonds.

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