

DON'T FORGET ABOUT MUNICIPALS: WHY NOW MAY BE A GOOD TIME TO INVEST

Uncertainty is the norm in the capital markets, yet municipal bond investors have recently been forced to grapple with unusually high levels. Record YTD net issuance, monetary policy questions, and a recent government shutdown have all led to unsettled markets. But uncertainty brings opportunity, and for those seeking tax-advantaged income, high-quality municipal bonds offer attractive yields along with sound credit fundamentals.

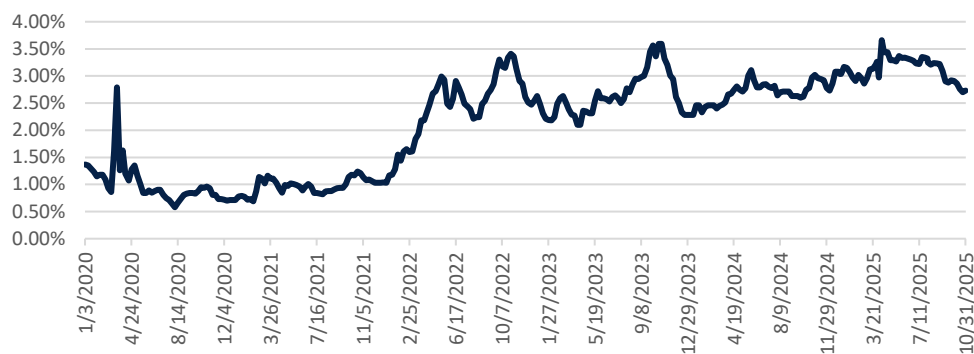
Yield Levels Are Compelling

Starting yield has historically proven to be a primary driver of forward bond returns, and today's levels are compelling.

The 10-year AAA yield of 2.75% is off recent highs but remains well above the 5-year and 10-year averages of 2.31% and 2.07%¹, respectively.

Perhaps of greater note, on a tax-equivalent basis, 10-year AAA bonds are yielding 4.65%, inviting net income when compared to taxable money markets and other high-quality alternatives.²

10-Year AAA Yields Remain Well Above Covid-Era Lows



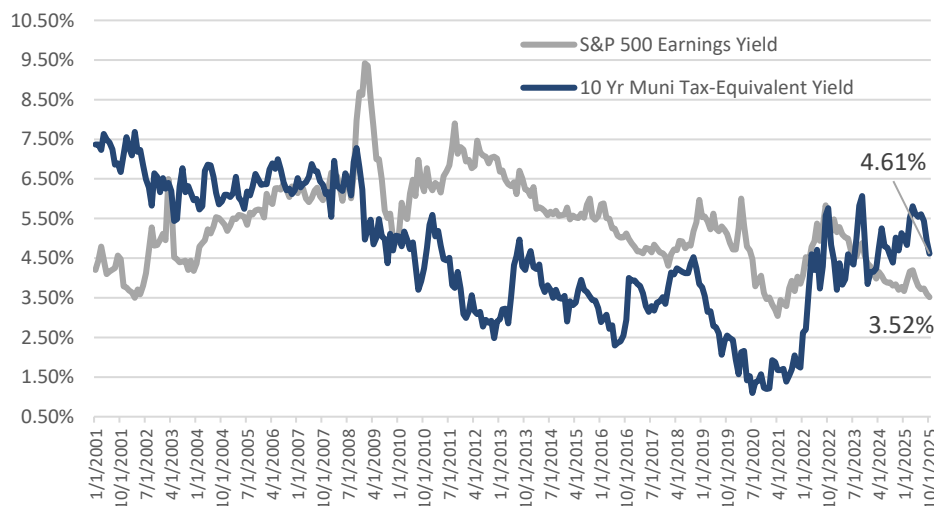
Source: MMD

Curve Normalization Offers Substantial Incremental Income

Technical factors often influence curve structure, and by extension where relative value may be found. Widespread expectations of Fed Funds rate hikes recently led to a surge in selling of municipals inside of 5-years, a technical dynamic that has sustained an inverted front-end of the AAA curve. The trough of the curve now lies with 2030 maturities, beyond which greater relative steepness is evident. This aligns well with the needs of portfolios focused on the intermediate portions of the curve as the spread between 5 and 12-year AAA municipals has reached 56bps.

Furthermore, adding duration in a slowing economy and with Fed Funds rate cuts likely to continue into 2026 is worth considering depending on one's objectives and risk tolerance. Incremental curve steepness also offers investors incentive to move out of cash and equivalent instruments.

S&P 500 Earnings Yield vs. 10 Yr. Municipal Tax-Equivalent Yield



Relative Valuation Looks Appealing

For those seeking alternatives to equities, municipal valuations are, by some measures, more attractive than has been the case for many years. To this point, tax-equivalent AAA municipal yields are more than 1% above the S&P 500's earnings yield, a metric that compares potential after-tax income streams. Given the greater risk of stocks, this relationship has historically been similar or negative.

Today's positive spread is atypical, which may suggest that a good opportunity for investors to add high-quality, tax-advantaged income to their portfolios. With equity valuations arguably stretched, municipals also offer diversification and risk management benefits.

Source: MMD, Bloomberg Earnings Yield for SPX

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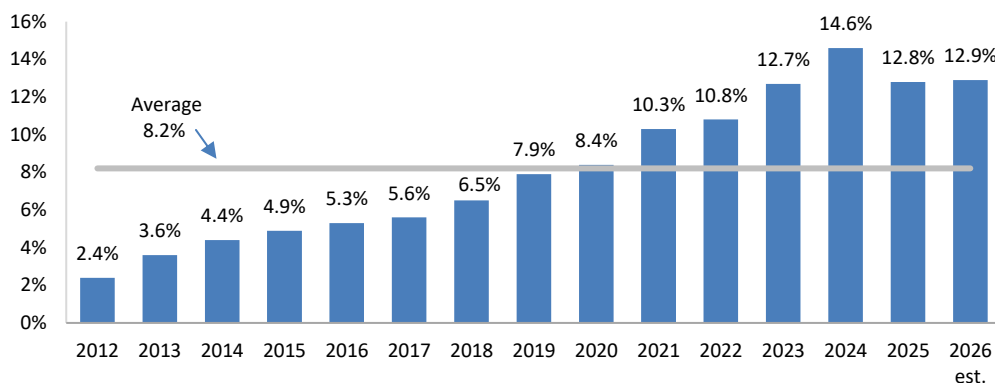
A Benign Credit Environment

Municipal credit fundamentals also largely remain in a strong position. Acute federal policy pressure on bond issuers has been narrowly focused and primarily confined to Higher Education. Within this headline grabbing sector, as well as elsewhere across the issuer landscape, we favor large, well-run entities with revenue diversity, financial flexibility, experienced management teams, and ready access to external liquidity.

Many bond issuers have fortified their balance sheets through conservative budgeting and revenue outperformance, and most came out of the Covid era in a better financial position than was initially expected, due in part to federal, state, and local aid.

State reserve fund data offers a compelling indication of fiscal strength as median rainy-day funds relative to expenditures ended FY '25 modestly below 2024's peak levels, but far above recent historical averages.

States Maintain Reserves at Historically High Levels
(Median State Rainy Day Fund as % of Expenditures)



Source: National Association of State Budget Officers, Spring 2025 Survey

A Technical Tailwind is Anticipated

Supply and demand has a great deal of influence on bond pricing, and we anticipate a largely favorable technical environment over the next few quarters. A 2025 surge in municipal issuance is unlikely to be sustained, particularly in sectors such as Higher Education. While we do not expect a sizeable decline in new offerings, even modestly reduced growth in issuance should dampen aggregate net new supply.

As to what may sustain demand, along with the desire of investors to access tax-advantaged income, look no further than the “dry powder” that lies in money market funds. The Investment Company Institute reports that money market fund assets currently exceed \$7.5 trillion.³ Fed watching is intently focused on the pace and timing of rate cuts rather than the direction of policy, and whether the Fed cuts in December or not, further anticipated easing may nudge investor assets further out on the curve.

A Favorable Entry Point for Bond Investors?

Absolute and tax-equivalent yields are inviting, municipal valuations are arguably favorable relative to riskier assets, and credit fundamentals remain sound. While asset allocation and other elements of investment strategy should always be personalized, and what's optimal for one client may not be for another, we feel financial advisors and tax sensitive investors would benefit from taking another look at municipal bonds.

1. As of 10/31/25

2. Tax-Equivalent YTW is based on the YTW and an aggregate 40.8% marginal federal income tax rate (37% plus 3.8% tax on net investment income). This calculation is intended for illustrative purposes only to demonstrate the effect of tax-free treatment of municipal bonds on yields.

3. Investment Company Institute, 11/19/25

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