

Municipal Market Weekly Update

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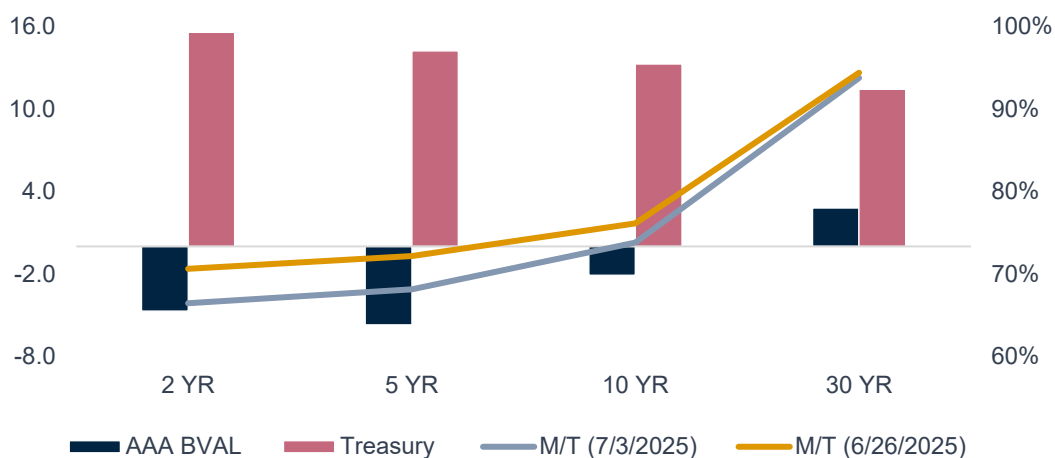
Turn of Spreads Set to Lure High Yield Muni Tourists

- President Trump signs into law the “One Big Beautiful Bill Act”
- Municipals fail to follow post tax bill rate dump
- High Yield Muni spreads look to normalize from cycle tights

Rate rally rolls on as munis ignore macro

Taxable US Treasuries and tax-free municipals appeared to be operating in two very different economic and tax regimes over the past five trading days. While we most often can note that taxables lead and municipals follow directionally, it is a rarer occurrence whereby municipals fail to follow the path set forth by their taxable equivalents. Much of the weakness in US Treasuries can be attributed to the passing of the One Big Beautiful Bill Act, which is set to add close to \$3 trillion to the deficit, according to figures from the Committee for a Responsible Federal Budget. While some outlooks are calling for interest rates to rise under the new OBBA provisions, the limited time left on the term clock for the current Federal Reserve Chair, Jerome Powell could signal to the markets that some relief, at least in terms of short end curve management, could be on the docket for 2026.

MUNIS OUTPERFORM¹



1. Data as of July 3, 2025. Source: Bloomberg

July has the greenest history on its side

Last week we discussed the seasonal technicals that should be a guiding force in terms of positive tailwinds for the tax-exempt asset class over the next 60-days. However, many of us are visual learners, and while past performance is truly not indicative of future results. July has been a historically strong(er) month for munis.

In fact, looking at the monthly index performance heat map, July is the only month over the past decade which has yet to record a single monthly loss. Aside from November, July also has the highest average monthly returns at just under 1% over the past ten years. With the all clear for municipals now signaled after the passing of the OBBA and some clarity on absolute tax rates, our belief is that fund flows should moderate on the 2H of 2025. We are additionally constructive at the return of banks and insurance companies re-engaging with the long end of the curve at these still elevated ratios.

MUNI MONTHLY INDEX PERFORMANCE²

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
10 YR AVG	0.53	-0.27	-0.13	-0.37	0.79	0.36	0.91	-0.08	-0.82	-0.46	1.26	0.63
2025	0.50	0.99	-1.69	-0.81	0.06	0.62						
2024	-0.51	0.13	0.00	-1.24	-0.29	1.53	0.91	0.79	0.99	-1.46	1.73	-1.46
2023	2.87	-2.26	2.22	-0.23	-0.87	1.00	0.40	-1.44	-2.93	-0.85	6.35	2.32
2022	-2.74	-0.36	-3.24	-2.77	1.49	-1.64	2.64	-2.19	-3.84	-0.83	4.68	0.29
2021	0.64	-1.59	0.62	0.84	0.30	0.27	0.83	-0.37	-0.72	-0.29	0.85	0.16
2020	1.80	1.29	-3.63	-1.26	3.18	0.82	1.68	-0.47	0.02	-0.3	1.51	0.61
2019	0.76	0.54	1.58	0.38	1.38	0.37	0.81	1.58	-0.8	0.18	0.25	0.31
2018	-1.18	-0.30	0.37	-0.36	1.15	0.09	0.24	0.26	-0.65	-0.62	1.11	1.2
2017	0.66	0.69	0.22	0.73	1.59	-0.36	0.81	0.76	-0.51	0.24	-0.54	1.05
2016	1.19	0.16	0.32	0.74	0.27	1.59	0.06	0.13	-0.50	-1.05	-3.73	1.17
2015	1.77	-1.03	0.29	-0.52	-0.28	-0.09	0.72	0.20	0.72	0.40	0.40	0.70

-3.84  6.35

2. Data as of July 3, 2025. Source: Bloomberg. Bloomberg Municipal Bond Total Return Index

Water looks warm in high yield munis...But careful on the entry

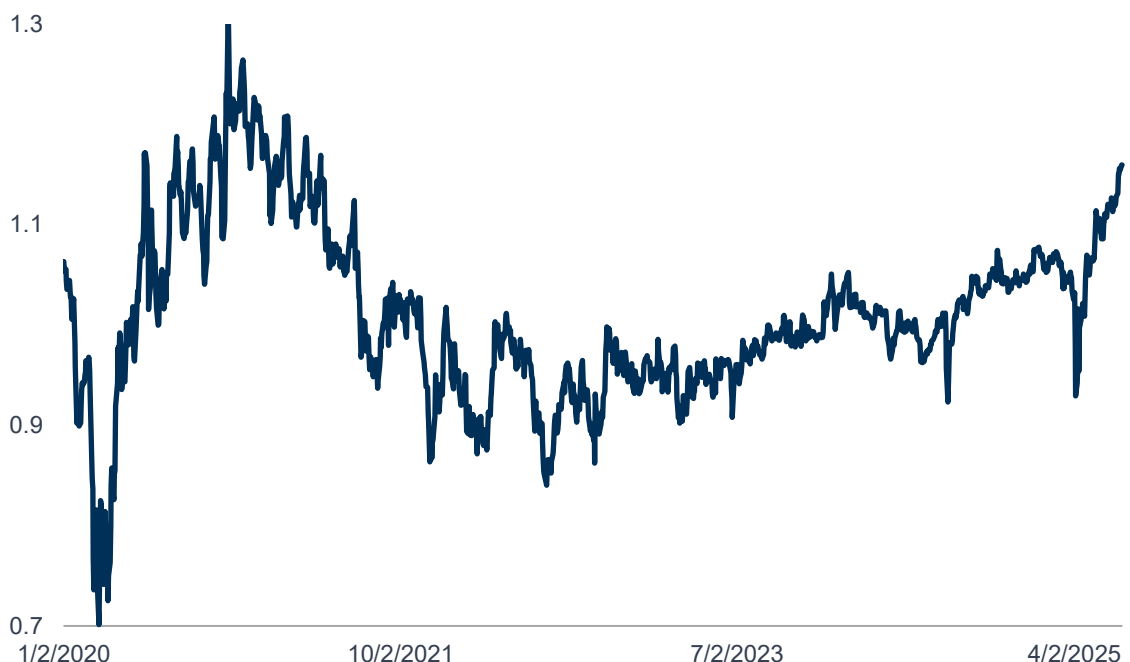
Like the mayor of Amity Island, we want nothing more than to signal the all clear for muni tourists and beach goers to jump back in the unrated waters with little cares. However, as prudent financial stewards and evaluating the risk/reward dynamics of true high yield munis in the market place, we try and strike a balance between opportunity on a macro level and risk adjusted spreads offered in the market.

What do we mean by this? From a pure data perspective, current ratios are showing that relative to high yield corporates, high yield municipals haven't looked this cheap since the start of the pandemic. IE, the water is indeed warm. Hitting that point visually, in the below chart, we looked at a simple ratio of the tax-equivalent yield of the Bloomberg High Yield Muni Index to the duration adjusted yield of the Bloomberg High Yield Corporate Index. Placing these two indices on a like-to-like basis, we are showing that the current ratio of 115% is indeed at the highest since 2020 and over 1.5 standard deviations above the long term average.

It is important to note that the ratio (see Current Spreads) involves two pieces. And a higher ratio, in this instance is driven by the decline in yield of high yield corporate rates, much more than the increase in high yield municipal rates. The compression of spreads, and suppression of rates for credits down the ratings spectrum has certainly been a challenge for both exempts and corporates over the past several years and is one of the main factors in leading to our shift higher in credit quality during this current rate cycle.

This is not to say we see no value in lower rated and non-rated high yield. The reality is quite the opposite, but our portfolio management philosophy anchors around a belief that larger projects, with diversified ownership interest will only add to the liquidity profile of an investment down the line.

HY MUNI/ HY CORP RATIO³



3. Data as of 7/1/2025. Source: Bloomberg. Bloomberg Municipal Bond High Yield Index; BB Corporate Credit Curve

We still see sector dorsal fins circling in the distance

One of the most interesting trends we have observed of late has been the rush of creation of new product offerings for tax-exempts focused on the high yield portion of the market. An efficient market will typically absorb new market entrants and competition. However, the allure of high yield on a spread basis still leaves much to be desired (See chart below). While we see a move toward some spread widening in high yield munis, we still appear rich compared to longer term averages. More sharks to feed in shallower water might exacerbate further spread tightening in the sector.

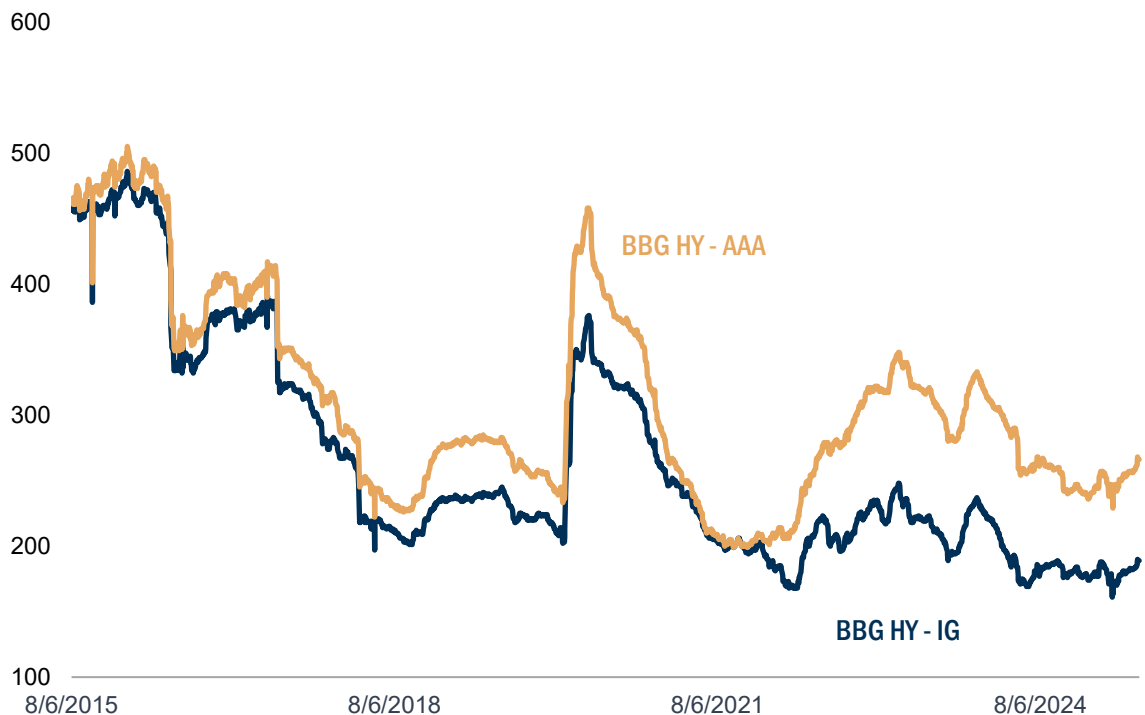
Finally, a last point we wanted to touch on has been the recent test of liquidity in the market place for non-rated paper and an unfortunate cautionary tale for market participants.

High Yield Muni Fund Plunges Nearly 50% in Sales Dump [Bloomberg](#)

As explained by high yield, PM Michael Perilli in our most recent [MUNI360.com podcast](#), our philosophy at MacKay Municipal Managers has always been centered around deep fundamental credit research, diversification, and prudent liquidity management.

To manage liquidity, we focus on avoiding leverage in open-end funds, avoiding ownership of entire deals, especially smaller non-rated deals where prices become stale and may require self-pricing since there typically won't be any trading or markets in those securities. We judiciously manage our NR exposures and focus more on liquid, readily quoted names that are marked to market on a regular basis. Diversification is a key consideration in portfolio construction as a risk mitigation tool. Lastly, we believe in maintaining a cash buffer with high quality, liquid securities that can quickly be converted to cash without impacting valuations.

HIGH YIELD INDEX SPREADS | BASIS POINTS⁴



4. Data as of July 7, 2025. Source: Bloomberg. BBG HY – AAA: Bloomberg Municipal High Yield Index Yield to Worst - 10YR AAA Muni, BBG HY – IG: Bloomberg Municipal High Yield Index, Yield to Worst - Bloomberg Municipal Total Return Index Yield to Worst.

Questions from the Field

Q: Are taxable munis similar to the tax-exempt market in terms of any call protections/provisions?

The callability surrounding exempts does not translate exactly the same to the taxable municipal market. While some of the taxable municipal market has similar 10-year call provisions, and some is non-callable, there are other portions of the market that are subject to make-whole call provisions.

A make-whole call allows the issuer to redeem the bond before maturity by paying a price reflective of the present value of the remaining payments, IE the bond holder is made whole. This is much different than an exempt muni which could be trading at a significant premium, but called away by the issuer at par. Another point to note regarding taxable municipals versus exempts is that the high economic hurdle for an issuer to proceed with a make whole call refunding, limits the amount that these types of bonds are actually called/redeemed.

One of the positive points of the taxable municipals vs other taxable options is that if the Federal Reserve does become active and rates fall, it reasons that there will be more pre-pay risk in US Agg based products vs more rate stability in taxable municipals.

BLOOMBERG MUNICIPAL YIELD-TO-WORST⁵ (YTW)



MUNI YIELDS

Tenor	6/27/2025	7/4/2025	Change (+/-)
Bloomberg AAA Muni Key Rate Yields⁶			
2-year	2.63%	2.58%	-0.04%
5-year	2.73%	2.68%	-0.05%
10-year	3.22%	3.21%	-0.01%
30-year	4.53%	4.56%	+0.03%
US Treasury Key Rate Yields⁶			
2-year	3.73%	3.88%	+0.15%
5-year	3.83%	3.94%	+0.11%
10-year	4.29%	4.35%	+0.06%
30-year	4.85%	4.86%	+0.01%
US Treasury & AAA Muni Curve Slopes⁷			
	2s10s	10s30s	2s30s
US Treasury Curve Slope	+0.56%	+0.56%	+1.12%
AAA Muni Curve Slope	+0.60%	+1.31%	+1.91%

Data as of 7/4/2025.

5. Source: Bloomberg. "Post GIFC Average" measures the period from 1/1/2010–7/4/2025.

6. Source: Bloomberg.

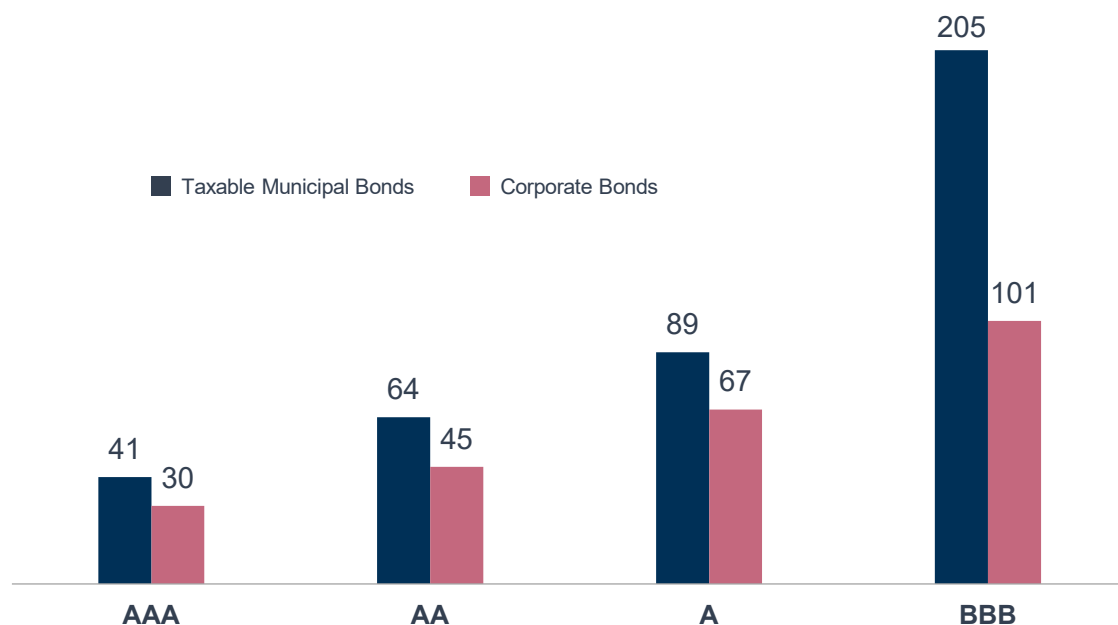
7. Source: Bloomberg. 2s10s—is spread between 10yr and 2yr yield; 10s30s—refers to spread between 30yr and 10yr yield; 2s30s—refers to spread between 30yr and 2yr yield.

Past performance is no guarantee of future results, which will vary. It is not possible to invest directly in an index.

BLOOMBERG MUNICIPAL HIGH YIELD | AAA YIELD DIFFERENTIAL⁸



TAXABLE MUNICIPAL AND CORPORATE CREDIT SPREADS⁹



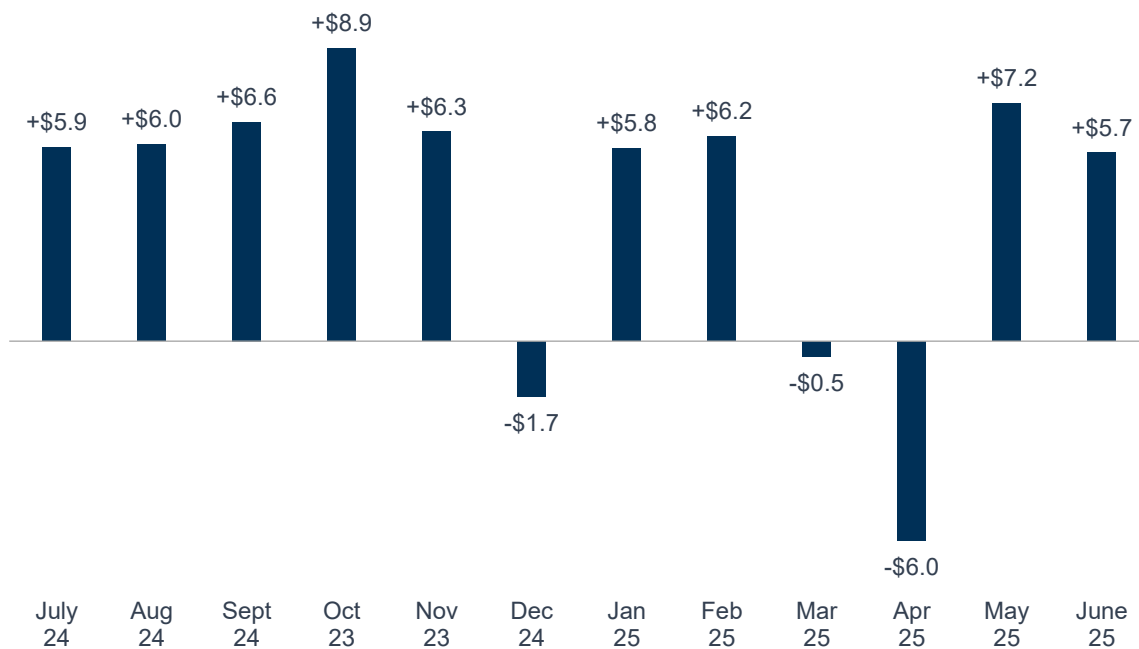
Data as of 7/4/2025.

8. Source: Bloomberg.

9. Source: ICE Data. The spread, better known as the option-adjusted spread (OAS) is the measurement of the yield of a fixed income security over that of a risk-free rate of return, which is adjusted to take into account an embedded option.

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LONG TERM FUND FLOWS¹⁰ (USD BILLION)



Data as of 7/4/2025.

10. Source: Investment Company Institute (ICI). <http://www.ici.org>.

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INDEX DESCRIPTIONS

Bloomberg Municipal Bond High Yield Index is a flagship measure of the US municipal tax-exempt non-investment grade bond market. Included in the index are securities from all 50 US States and four other qualifying regions (Washington DC, Puerto Rico, Guam, and the Virgin Islands). The index includes state and local general obligation bonds and revenue bonds.

Bloomberg Municipal Bond Total Return Index is a broad, market-weighted index that tracks the performance of the long-term, tax-exempt bond market in the United States. It includes general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds, and is designed to be a benchmark for investors in this market.



INVESTMENTS