

# Municipal Market Weekly Update

MACKAY MUNICIPAL MANAGERS.™ THE MINDS BEHIND MUNIS.



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## Authors:

**Eric Kazatsky**  
Client Portfolio  
Manager

**Eric Snyder, CFA**  
Client Portfolio  
Manager

## Munis Prove to Be Compelling Portfolio Addition for Back to School

- Munis appear attractive
- Relative spreads at decades wide levels
- Managing duration and call exposure, just as important as credit

### Relative Performance

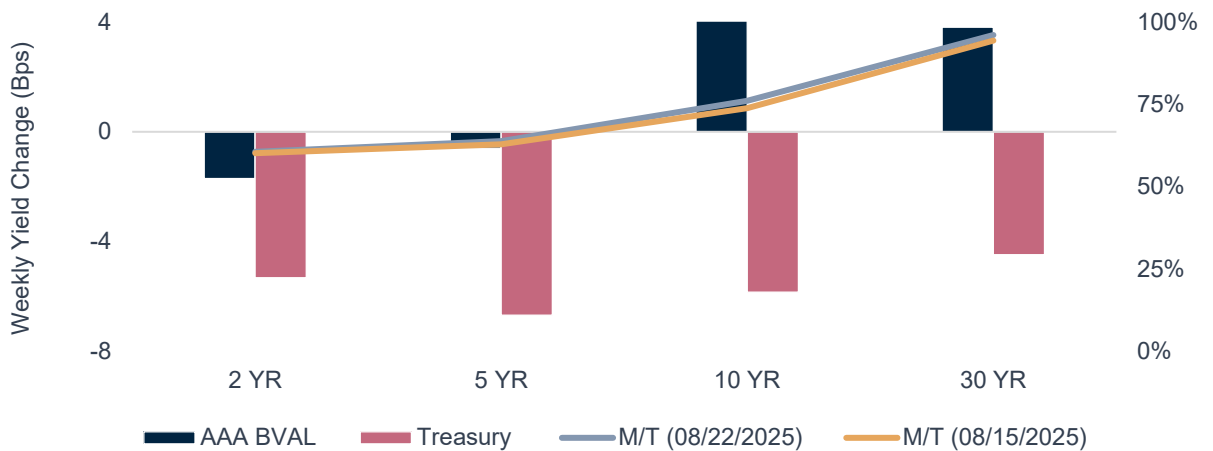
Over the past week, municipal bonds underperformed relative to U.S. Treasuries. While both markets experienced yield declines in the short end, municipals underperformed Treasuries in the 2-year portion of the curve, with AAA muni yields falling by 1.7 bps compared to a 5.3 bps drop in Treasury yields. This smaller decline in muni yields contributed to a slight widening in the 2-year municipal-to-Treasury (M/T) ratio to 60.6.

Further out the curve, municipals diverged more sharply:

- 5-year AAA muni yields declined by 0.6 bps, while Treasuries dropped 6.7 bps, leading to a 0.84% widening in the M/T ratio.
- 10-year muni yields rose and Treasuries dropped, with munis up 5.2 bps and Treasuries down 5.8 bps, resulting in a 1.92% increase in the M/T ratio.
- 30-year muni yields rose by 3.8 bps while Treasuries dropped by 2 bps, widening the M/T ratio by 1.17%, from 94.32% to 95.49%.

This week's moves reinforce that demand from price-insensitive buyers, particularly in the SMA channel, continues to anchor the front end and belly of the curve, even at relatively tighter ratios and yield levels. As highlighted in our prior weekly letter, the historically steep muni curve underscores the current opportunity for investors to capture more attractive absolute and relative value beyond the 10-year spot.

## MUNIS LAGGED TREASURIES ACROSS THE CURVE<sup>1</sup>



1. Data as of August 22, 2025. Source: Bloomberg. Spot Muni, Spot AA rates.

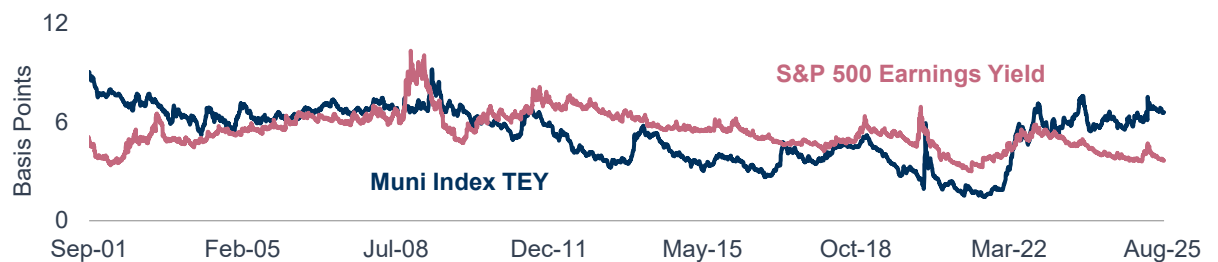
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## Market Technicals

As we approach Labor Day, the change of seasons comes into focus—football, falling leaves, back-to-school. It's also a natural time to reassess portfolios: looking to the months ahead and thinking about what areas of the market/portfolio may appear the most over-valued. We could point to equities at multiples well above their 5-year average or corporate bond spreads at a multi-decade tight level, as examples of this. Alternatively, we would propose eyeing your portfolio with a goal toward identifying areas that we view have become increasingly attractive as we all have been distracted with the summer season.

## MUNI VS S&P 500<sup>2</sup>

### MUNI INDEX YIELD VS STOCK EARNINGS



### MUNI'S BEATING STOCKS FOR INCOME



2. Data as of 08/18/2025. Source: Bloomberg.

## Market Technicals (Continued)

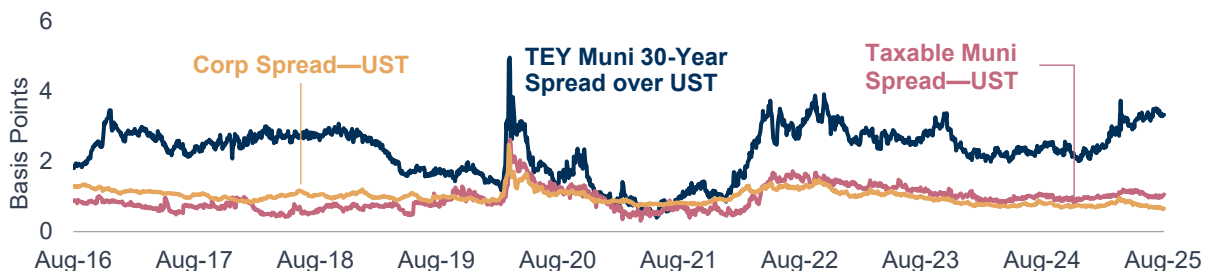
Munis are historically cheap right now. Even compared to equities (see above). That said, we recognize that such strong statements from an asset manager can sound self-serving. That's why this week we let the data do the talking—analyzing the tax-exempt market through both absolute and relative value lenses.

In the next two charts (see below), we focus on the cross-over investor — those who may not traditionally buy munis and may be unaware of how wide the sector looks on a spread basis. By normalizing municipals to a taxable-equivalent yield and comparing them to a true risk-free baseline, the picture becomes clear.

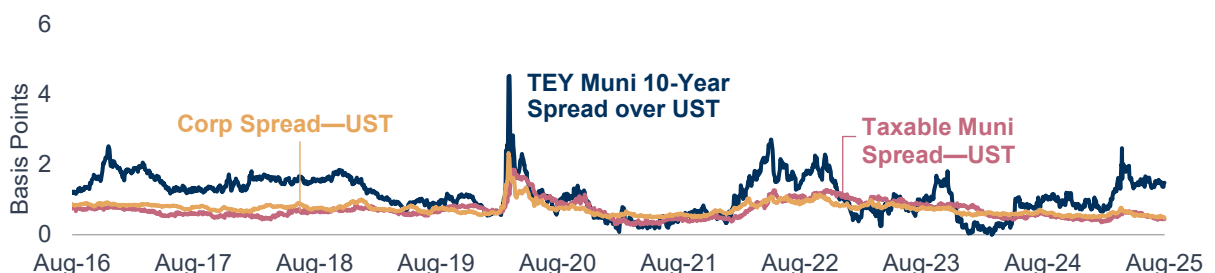
Specifically, we take the taxable-equivalent yield<sup>3</sup> of tax-free munis and spread it against the corresponding point on the U.S. Treasury curve. Looking at the long end as an example, municipal bonds currently offer nearly 340 basis points over 30-year Treasuries<sup>4</sup>. While not unprecedented, outside of the pandemic-driven spike, this spread has only reached these levels twice in the past decade. The takeaway: municipals are offering historically attractive relative value versus risk-free rates.

Our second example moves to the 10-year point on the curve, where we have more comparative data across tax-free munis, taxable munis, and corporates. At this maturity, tax-free munis offer a 151 basis point spread over the 10-year Treasury — roughly half the level seen at the long end, but still compelling. The takeaway is clear: focusing on the second chart below, municipals remain a strong choice on a spread basis and the most attractive from a relative value standpoint. Notably, taxable muni and corporate spreads have tightened sharply year-to-date, which only enhances the relative advantage of tax-frees.

### 30-YEAR TREASURY SPREADS<sup>5</sup>



### 10-YEAR TREASURY SPREADS<sup>6</sup>



3. The tax-equivalent yield is the return a taxable bond needs to equal the yield on a comparable tax-exempt municipal bond. Calculation assumes the maximum federal tax rate of 37% plus the 3.8% net investment income tax.

4. Source: Bloomberg as of August 18, 2025.

5. Source: Bloomberg as of August 18, 2025.

6. Source: Bloomberg as of August 18, 2025.

## Questions from the Field

**Q. Can you walk me through how duration and call risk interact in municipal bond funds, especially in a rising rate environment?**

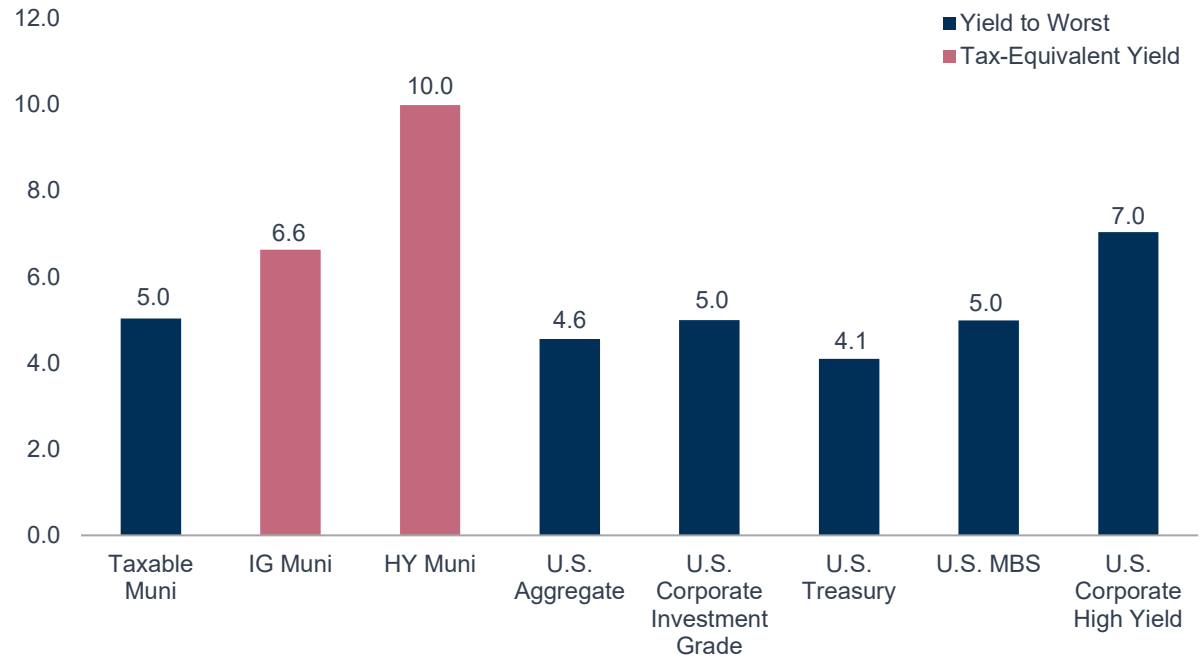
Duration and call risk really go hand in hand in the municipal bond market, and they matter a lot more in a rising rate environment like we have been experiencing in the past several years.

Duration is simply a measure of a bond's sensitivity to interest rate changes. Unless positioned extremely short on the curve, the conclusion is that many municipal funds experience some price pressure when rates move higher or the curve meaningfully steepens. However, what's often overlooked is that rising rates also allow the fund to reinvest cash flows at much more attractive yields, which helps offset that initial impact over time.

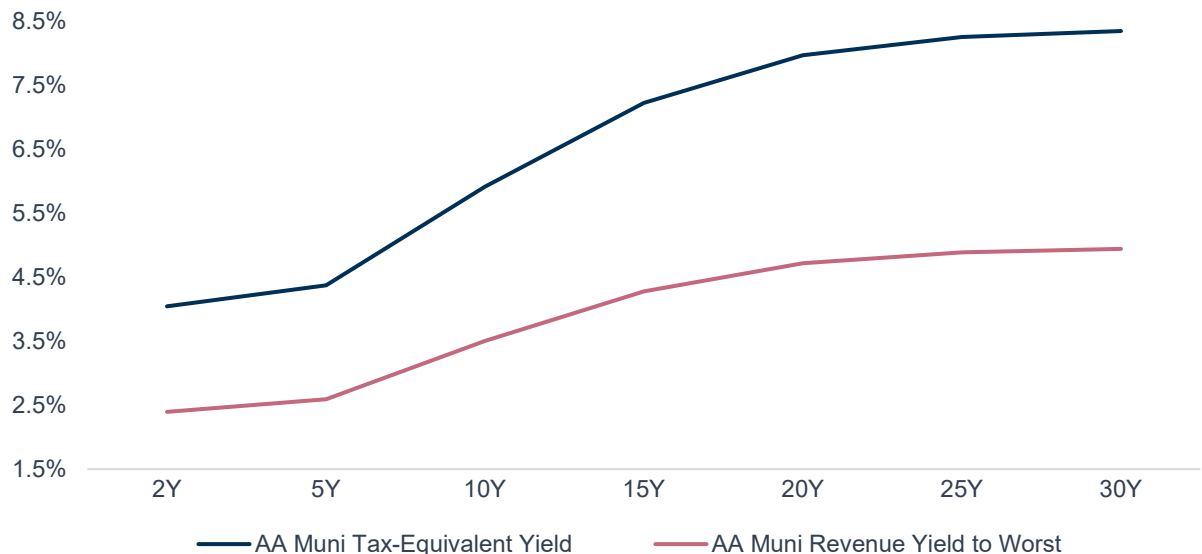
On the call side, many municipal bonds come with a 10-year call provision. In periods of falling rates, that can be a real headwind because issuers will refinance their debt, call the bonds away, and force reinvestment at lower yields. But in today's environment, with rates moving higher, call risk is much less of a concern. Issuers have very little incentive to refinance into more expensive debt, so the income streams we are locking in are actually more predictable.

From a portfolio construction standpoint, we actively manage both duration and call exposure. That means diversifying across sectors and structures, targeting call-protected bonds where it makes sense, and structuring maturities to reduce the volatility that comes from big rate moves. The goal is to balance risk while still delivering consistent, tax-free income for clients.

## INDEX YIELDS (in %)<sup>7</sup>



## AA MUNI TAX-EQUIVALENT YIELD CURVE<sup>8</sup>



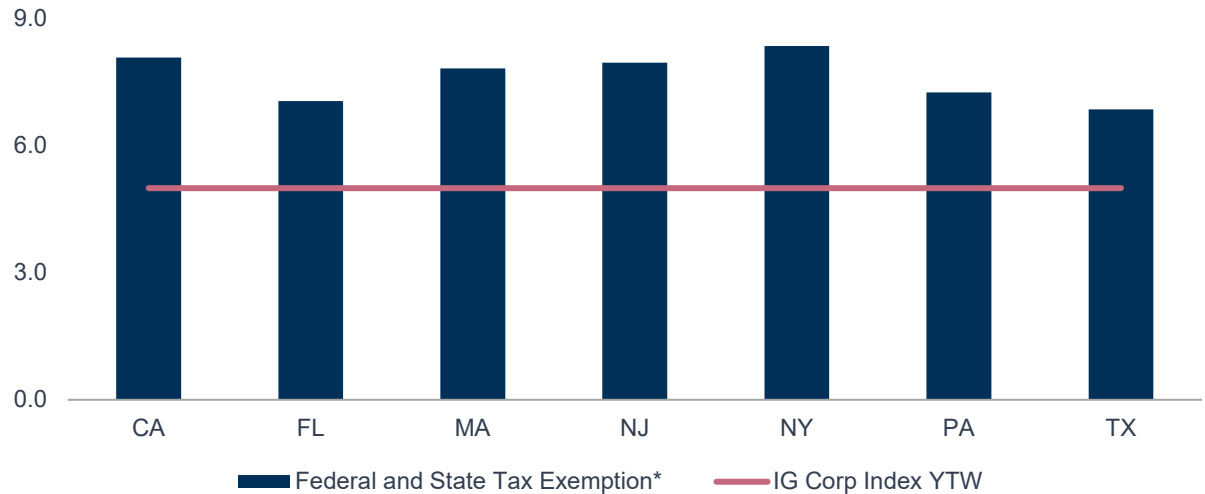
Data as of 08/22/2025.

7. Source: Bloomberg. Using 40.8% federal tax rate, including 3.8% Net Investment Income Tax. Taxable Muni: Bloomberg Taxable Municipal Bond Index; IG Muni: Bloomberg Taxable Municipal Bond Index; HY Muni: Bloomberg High Yield Municipal Bond Index; U.S. Aggregate: Bloomberg U.S. Aggregate Bond Index; U.S. Corporate Investment Grade: Bloomberg U.S. Corporate Investment Grade Index; U.S. Treasury: Bloomberg U.S. Treasury Index; U.S. MBS: Bloomberg U.S. Mortgage-Backed Securities Index; U.S. Corporate High Yield: Bloomberg U.S. Corporate High Yield Index.

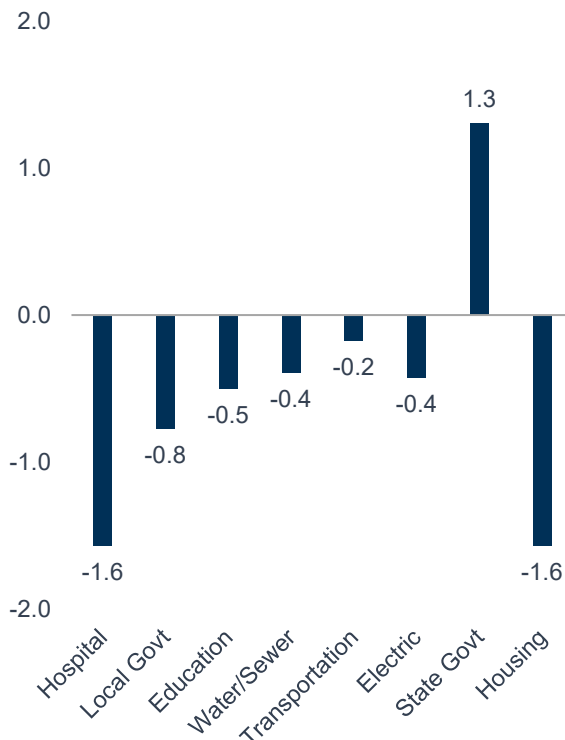
8. Source: Bloomberg. Using 40.8% federal tax rate, including 3.8% Net Investment Income Tax.

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

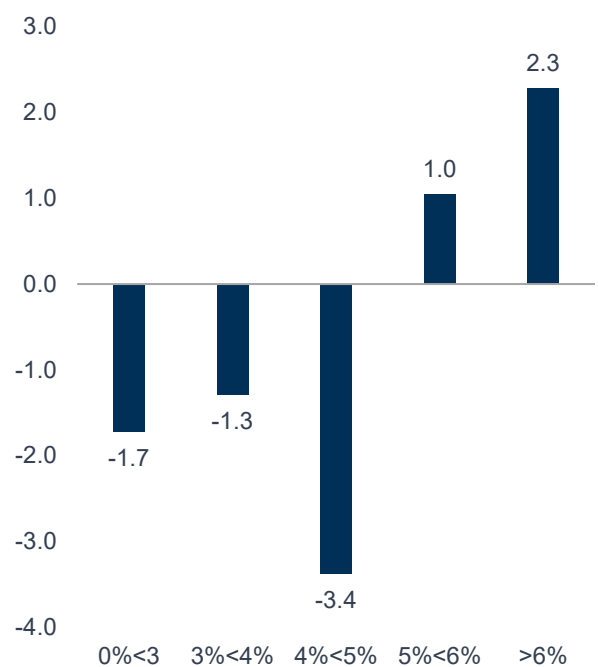
## IN-STATE MUNI TAX-EQUIVALENT YTW (in %)<sup>9</sup>



## YTD TOTAL RETURNS BY SECTOR (in %)<sup>10</sup>



## YTD TOTAL RETURNS BY COUPON (in %)<sup>11</sup>



Data as of 08/22/2025.

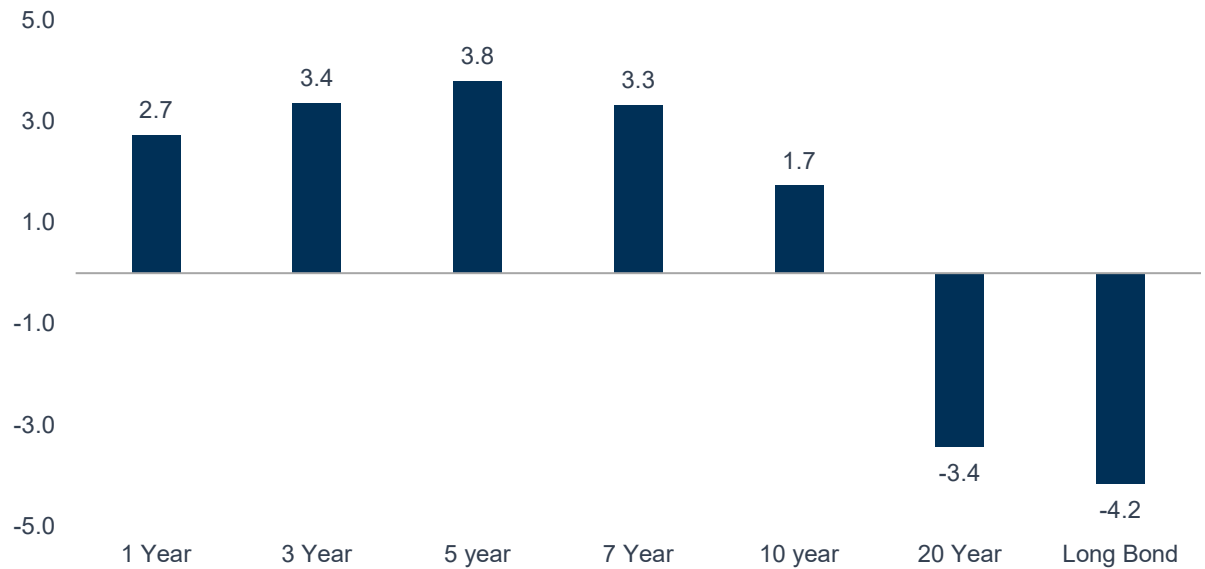
9. Source: Bloomberg. \*Using 40.8% federal tax rate, including 3.8% Net Investment Income Tax. Using respective maximum state income tax rate.

10. Source: Bloomberg. Using 40.8% federal tax rate, including 3.8% Net Investment Income Tax.

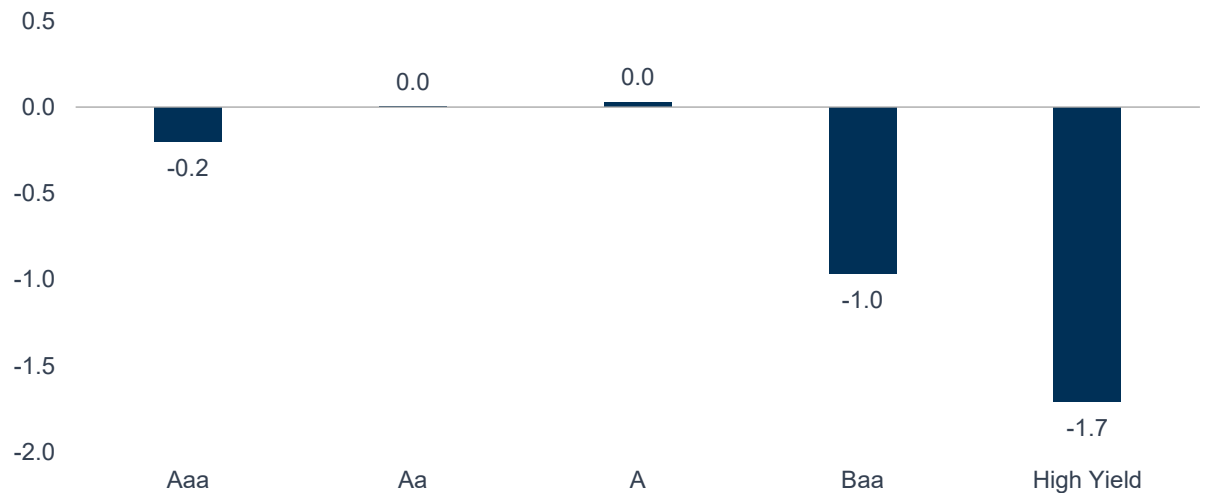
11. Source: Bloomberg. Using 40.8% federal tax rate, including 3.8% Net Investment Income Tax.

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## YTD TOTAL RETURNS BY MATURITY (in %)<sup>12</sup>



## YTD TOTAL RETURNS BY RATING CATEGORY (in %)<sup>13</sup>



Data as of 08/22/2025.

12. Source: Bloomberg.

13. Source: Bloomberg.

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## BLOOMBERG MUNICIPAL YIELD-TO-WORST<sup>14</sup> (YTW)



## MUNI YIELDS

| Tenor   | 08/15/2025   | 08/22/2025    | Change (+/-) |
|---|--------------|---------------|--------------|
| <b>Bloomberg AAA Muni Key Rate Yields<sup>15</sup></b>        |              |               |              |
| 2-year  | 2.26%        | 2.22%         | -0.04%       |
| 5-year  | 2.41%        | 2.39%         | -0.03%       |
| 10-year   | 3.19%        | 3.22%         | 0.03%        |
| 30-year   | 4.64%        | 4.66%         | 0.02%        |
| <b>U.S. Treasury Key Rate Yields<sup>15</sup></b>             |              |               |              |
| 2-year  | 3.75%        | 3.68%         | -0.07%       |
| 5-year  | 3.85%        | 3.76%         | -0.09%       |
| 10-year   | 4.33%        | 4.26%         | -0.07%       |
| 30-year   | 4.92%        | 4.88%         | -0.04%       |
| <b>U.S. Treasury &amp; AAA Muni Curve Slopes<sup>16</sup></b> |              |               |              |
|   | <b>2s10s</b> | <b>10s30s</b> | <b>2s30s</b> |
| U.S. Treasury Curve Slope                                     | +58 bps      | +62 bps       | +120 bps     |
| AAA Muni Curve Slope  | +100 bps     | +144 bps      | +244 bps     |

Data as of 08/22/2025.

14. Source: Bloomberg. "Post GIFC Average" measures the period from 01/01/2010–08/22/2025.

15. Source: Bloomberg.

16. 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.

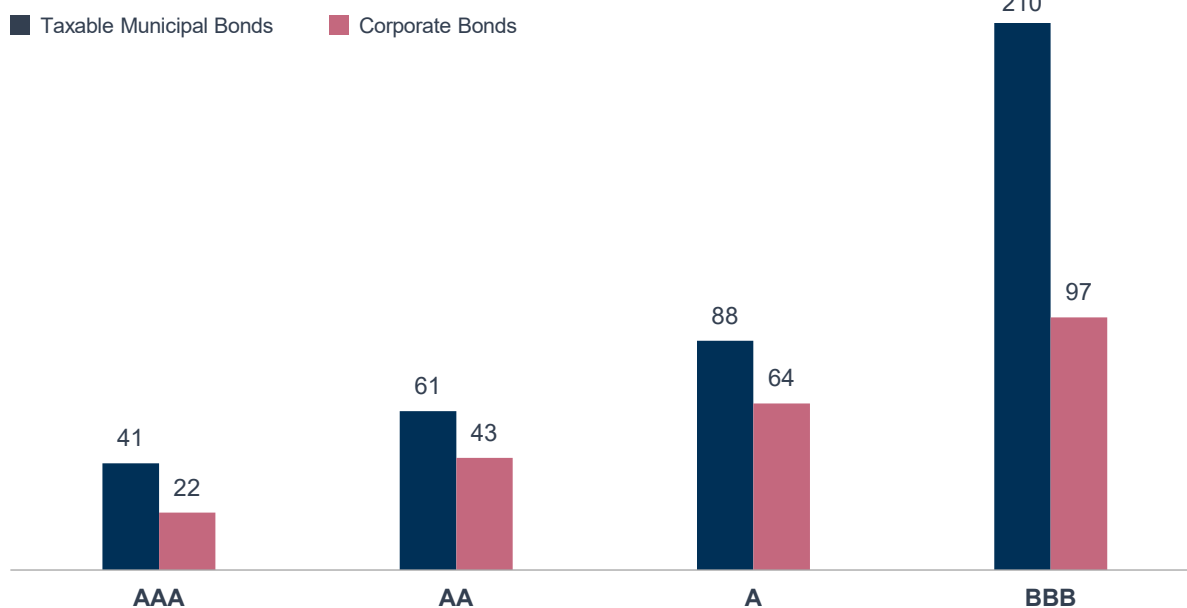
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## BLOOMBERG MUNICIPAL HIGH YIELD | AAA YIELD DIFFERENTIAL<sup>17</sup>



## TAXABLE MUNICIPAL AND CORPORATE CREDIT SPREADS<sup>18</sup>



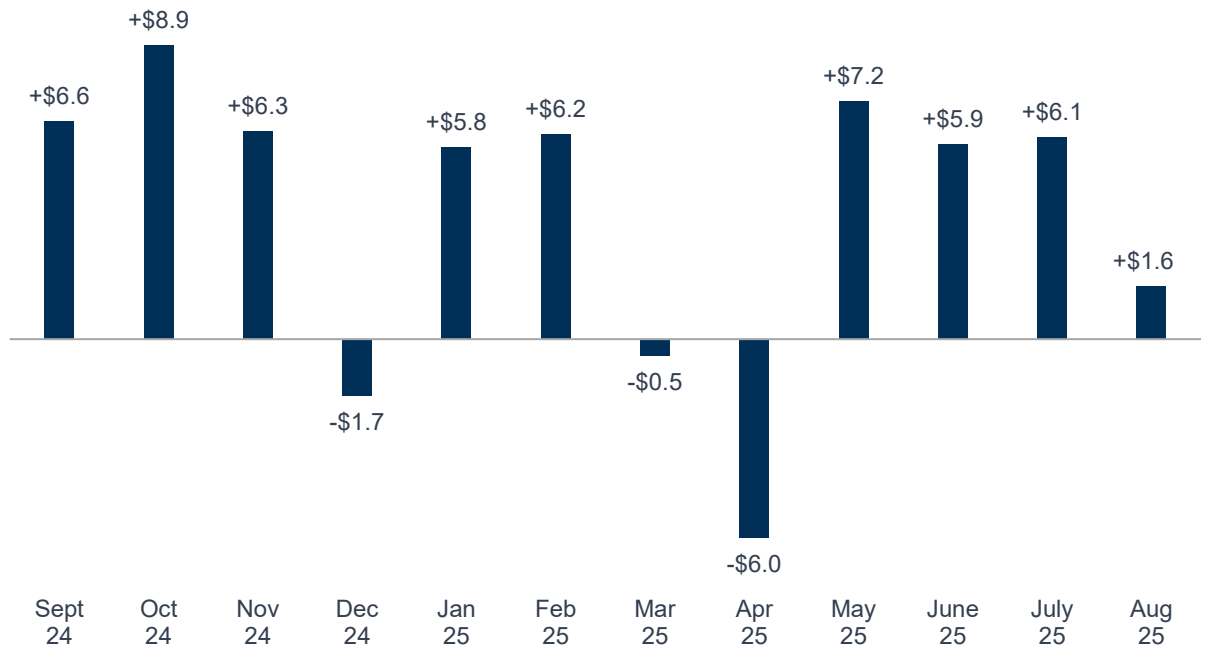
Data as of 08/22/2025.

17. Source: Bloomberg.

18. 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 FLOWS<sup>19</sup> (USD BILLION)



Data as of 08/22/2025.

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

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## INDEX DESCRIPTIONS

**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.

**Bloomberg U.S. Taxable Municipal Bond Index** is a rules-based, market-value-weighted index engineered for the long-term taxable bond market. To be included in the index, bonds must be rated investment-grade (Baa3/BBB- or higher) by at least two of the following ratings agencies if all three rate the bond: Moody's, S&P, Fitch. If only two of the three agencies rate the security, the lower rating is used to determine index eligibility. If only one of the three agencies rates a security, the rating must be investment grade. They must have an outstanding par value of at least \$7 million and be issued as part of a transaction of at least \$75 million. The bonds must be fixed rate and must be at least one year from their maturity date. Remarketed issues (unless converted to fixed rate), bonds with floating rates, and derivatives, are excluded from the benchmark.

**Bloomberg Municipal Bond Index** A rules-based, market-value-weighted index engineered for the long-term tax-exempt bond market. To be included in the index, bonds must be rated investment-grade (Baa3/BBB- or higher) by at least two of the following agencies: Moody's,

S&P, Fitch. If only two of the three agencies rate the security, the lower rating is used to determine index eligibility. If only one of the three agencies rates a security, the rating must be investment-grade. They must have an outstanding par value of at least \$7 million and be issued as part of a transaction of at least \$75 million. The bonds must be fixed rate, have a date-date after December 31, 1990, and must be at least one year from their maturity date. Remarketed issues, taxable municipal bonds, bonds with floating rates, and derivatives, are excluded from the benchmark. The index has four main sectors: general obligation bonds, revenue bonds, insured bonds (including all insured bonds with a Aaa/AAA rating), and pre-refunded bonds. Most of the index has historical data to January 1980. In addition, sub-indices have been created based on maturity, state, sector, quality, and revenue source, with inception dates later than January 1980.

**Bloomberg High Yield Municipal Bond Index** is a flagship measure of the U.S. municipal tax-exempt non-investment grade bond market. Included in the index are securities from all 50 U.S. 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. All bonds in the Municipal High Yield Bond Index are tax exempt and hence are not eligible for other indices that include taxable high yield bonds, such as the U.S. High Yield Index and EM USD Aggregate Index.

**Bloomberg U.S. Aggregate Bond Index** measures the performance of investment grade, U.S. dollar-denominated, fixed rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS. It rolls up into other flagship indices, such as the multi-currency Global Aggregate Index and the U.S. Universal Index, which includes high yield and emerging markets debt.

**Bloomberg U.S. Corporate Bond Index** measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility, and financial issuers. The index is a component of the US Credit and US Aggregate Indices, and provided the necessary inclusion rules are met, US Corporate Index securities also contribute to the multi-currency Global Aggregate Index. The index includes securities with remaining maturity of at least one year.

**Bloomberg U.S. Treasury Index** measures the performance of public obligations of the U.S. Treasury, including securities that roll up to the U.S. Aggregate, U.S. Universal, and Global Aggregate Indices.

**Bloomberg U.S. Mortgage-Backed Securities Index** is formed by grouping the universe of individual TBA-deliverable MBS pools into pool cohorts and then applying the index inclusion rules at the cohort level. Each cohort is a representation of its mapped individual pools and contributes their total amount outstanding to the U.S. MBS Index.

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