

# Municipal Market Weekly Update

MACKAY MUNICIPAL MANAGERS.™ THE MINDS BEHIND MUNIS.



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## Muni Rally Runs into Spooky Returns Season

- Munis prove they are not all gas, no brakes
- October is historically witching returns period
- Relative is the key to muni value

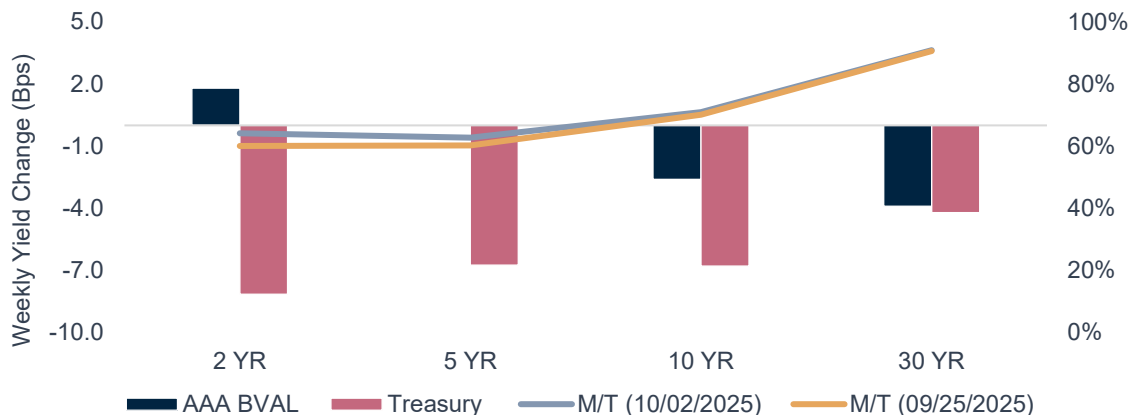
### Relative Performance

Over the past week, municipal performance, at least on a relative basis was mixed. Longer duration tax-exempts continued their winning ways, with long muni rates declining by 3.9bps, however they failed to keep pace with the decline in long US Treasuries. A similar trend was noted in the 10YR portion of the curve, though to a much larger degree. September wrapped up with the strongest monthly return for tax-frees this year—and the best since 2023. It also marks the strongest September performance since 2009, signaling a sharp turnaround for tax-exempts, fueled by a much-needed rally in broader rates. While we take a bit of a victory lap as an asset class, we need to remember that context is everything and to us, the real story here is the long end of the municipal curve getting off life support. Long munis had a terrible first half, due in part to:

- Uncertainty surrounding the tax exemption.
- Suppressed demand from natural buyers of the long end like banks and insurance companies.
- Rapid steepening of the curve.

However, as we have touched on in prior weeklies, starting August 1, the long end has massively outperformed shorter tenor municipals, closing in on 400bps.

**FIGURE 1: MUNIS UNDERPERFORMED TREASURIES ACROSS THE CURVE<sup>1</sup>**



1. Data as of October 02, 2025. Source: Bloomberg. Spot Muni, Spot AA rates.

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



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## Technicals

Despite September's strong performance, October could spook investors—pun intended. But humor aside, the month is shaping up to be technically challenging for the tax-exempt market, with three key pressures weighing on munis:

### Weak Historical Returns

October has posted positive returns in only 3 of the past 10 years. While past performance isn't predictive, the historical trend leans negative—and for those who value data, it's hard to ignore.

### Heavy Issuance

Next week's calendar nears \$10 billion<sup>2</sup>, and the 30-day visible supply looks similarly strong. While we're unlikely to match last October's \$66 billion peak, this year's average monthly issuance around \$50 billion remains substantial.

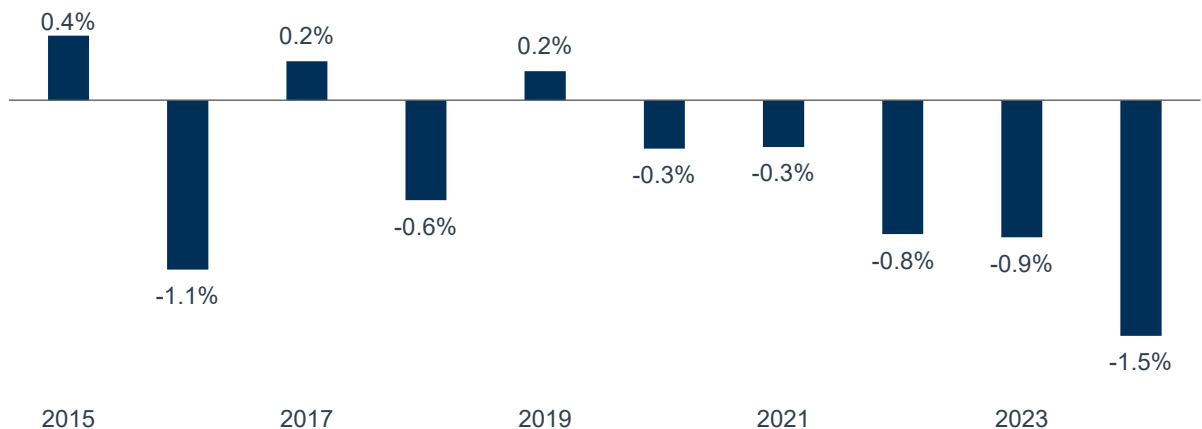
### Supply-Demand Imbalance

Even \$50 billion in issuance could strain technicals, especially against just \$33 billion in reinvestment demand<sup>3</sup>.

2. Source: Municipal Securities Rule Making Board

3. Source: Bloomberg.

**FIGURE 2: HISTORICAL OCTOBER PERFORMANCE<sup>4</sup>**



4. Data as of October 31, 2024. Source: Bloomberg.

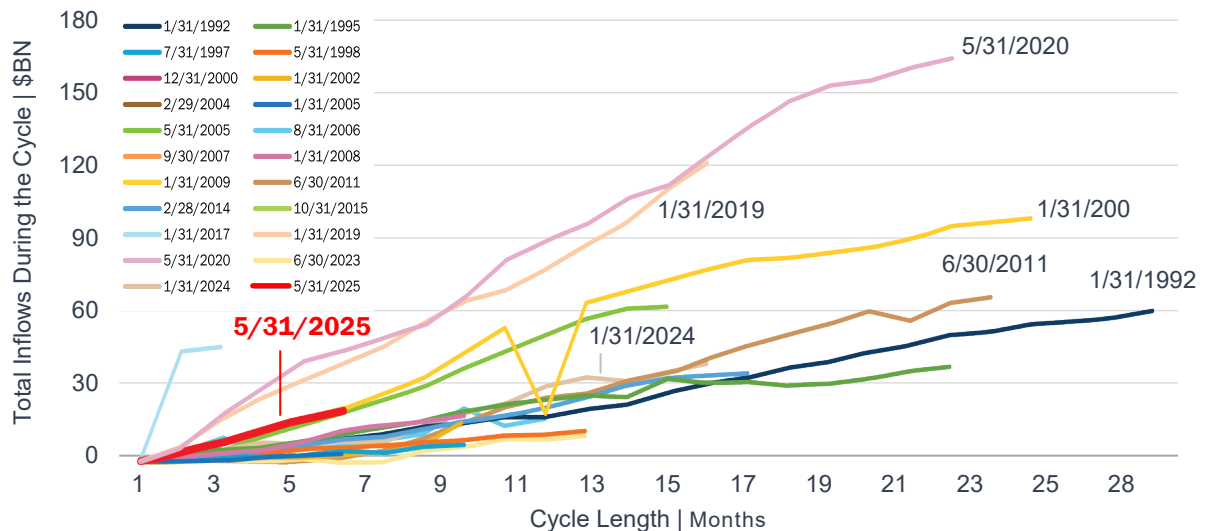
## Still, Flows May Be The Wildcard That Flips The Script

Munis often follow a positive feedback loop: perceived cheapness along the curve attracts institutional buyers, tightening ratios and boosting performance. Strong returns then draw in retail investors, reinforcing the rally through sustained fund flows. Historically, expectations of gains have triggered additional inflows.

Moreover, inflow cycles can persist. As Morgan Stanley recently noted via Emerging Portfolio Fund Research (EPFR) data, cumulative muni inflows could exceed \$100 billion if past cycles are any guide. Recent price action, improving flows, and tighter spreads suggest this October might not be as haunted as history implies.

**FIGURE 3: MUNI RALLY LURES RETAIL BACK TO MARKET<sup>5</sup>**

Fund Flows: Inflows Cycles | Billions Vs. Length of Cycle in Months

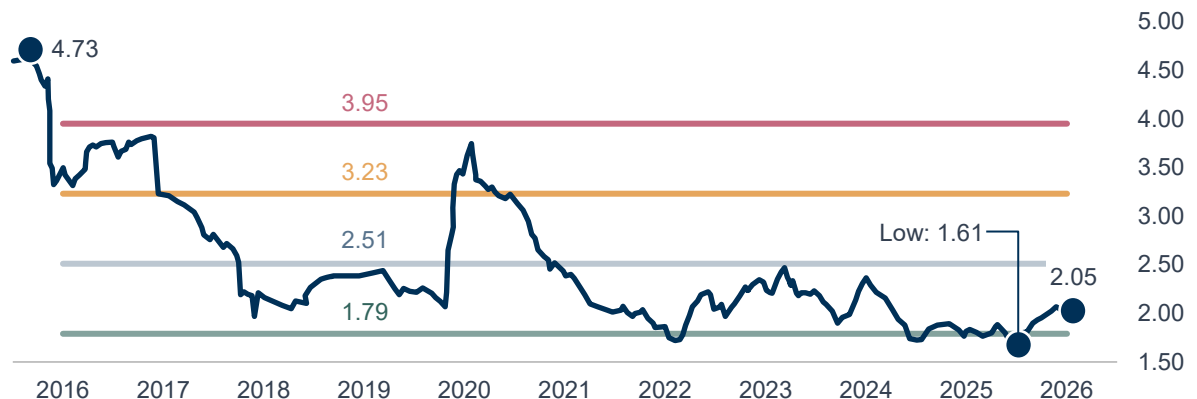


5. Source: EPRF, Refinitiv, Morgan Stanley Research.

## Questions from the Field

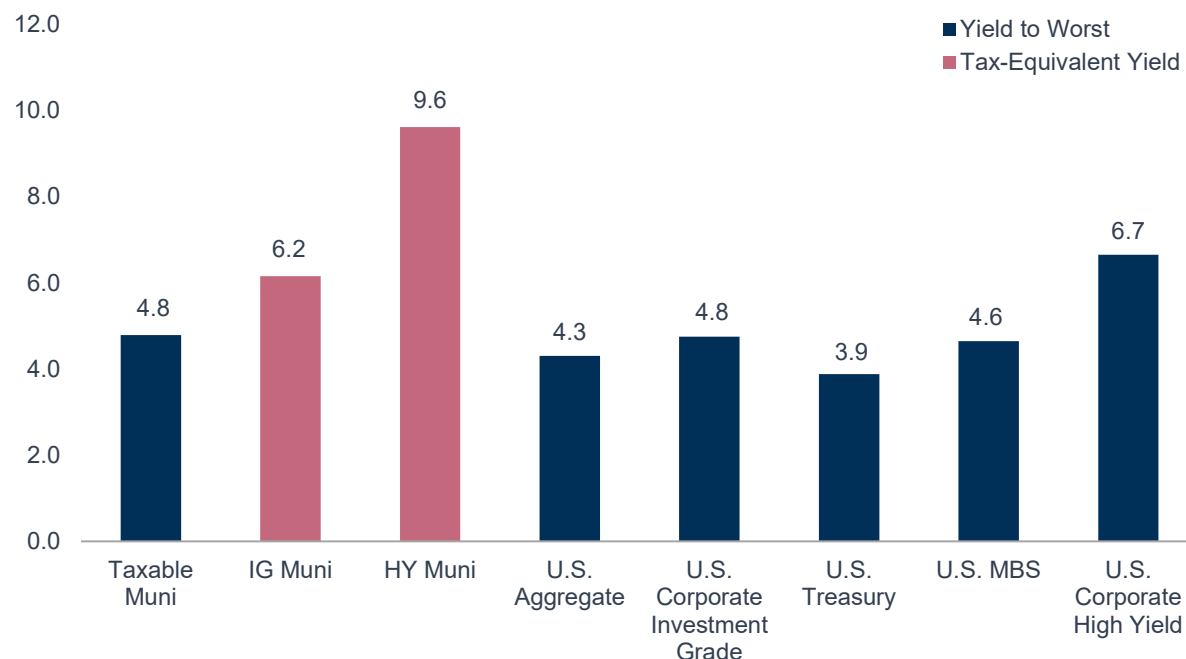
### Q. How are you thinking about relative value when it comes to spreads down the credit curve?

For our team, relative value and managing the dollar cost per unit of risk is always top of mind. That being said, one of the ways we can look at relative value in lower IG/HY credit is to look at the spread of tax-free high yield bonds compared to that of Baa rated municipals. Using Bloomberg index YTW data for both, shows that the relative spread of high yield vs Baa munis still sits below the long-term average, at just 205bps. While solidly off the cycle tights of 161bps, it is also well below the wides of 473bps. At this time, the data would indicate support of our broader move in moving up in credit quality over the past year.

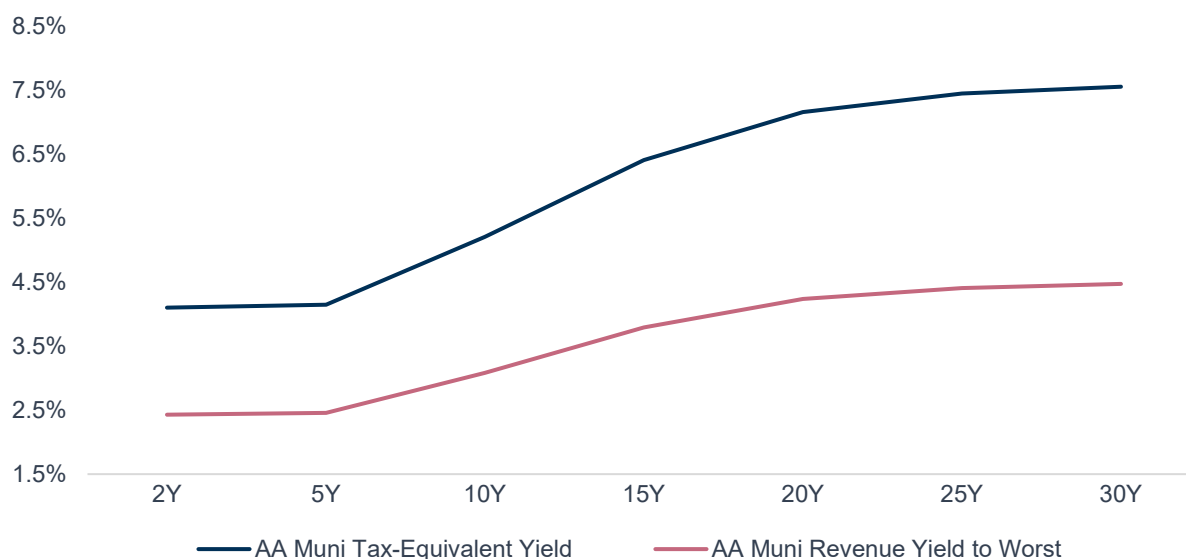
**FIGURE 4: HIGH YIELD VS BBB RATES<sup>6</sup>**


6. Source: Data as of October 03, 2025. Bloomberg.

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



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



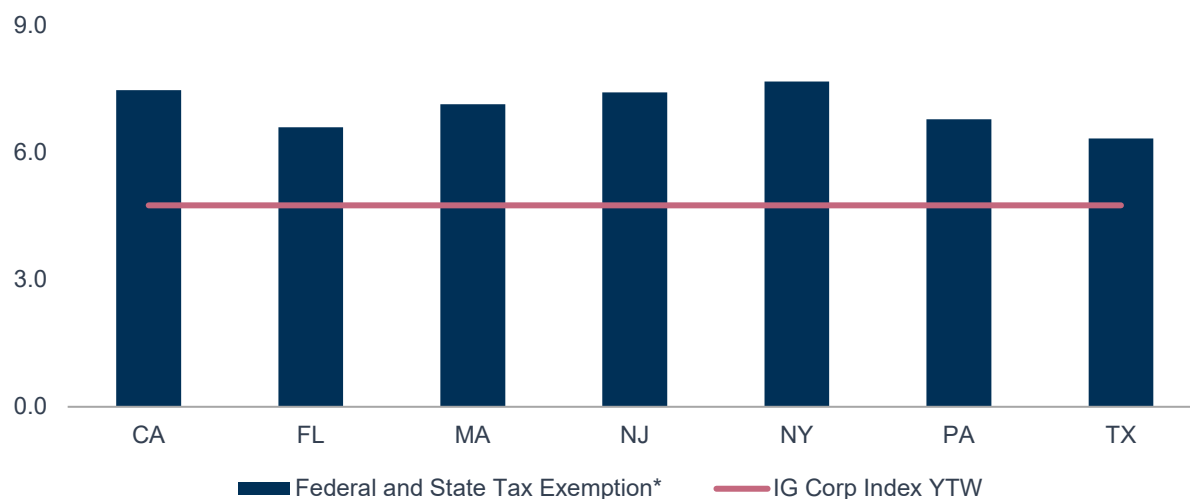
Data as of 10/02/2025.

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.**

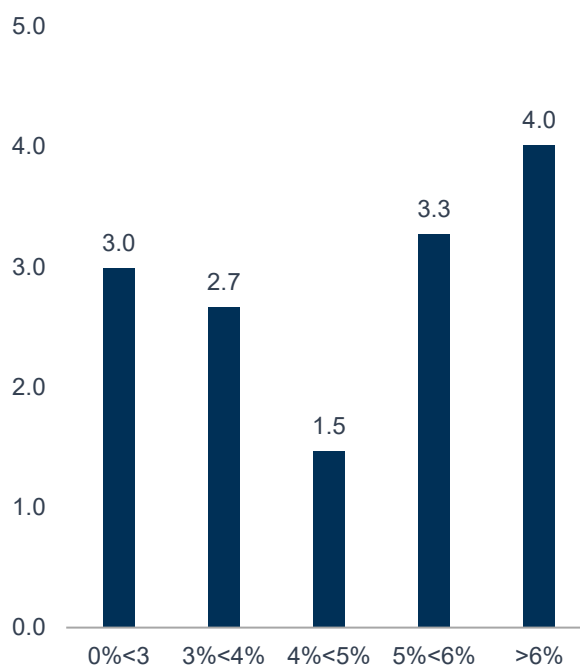
## IN-STATE MUNI TAX-EQUIVALENT YTW (in %)<sup>9</sup>



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



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



Data as of 10/02/2025.

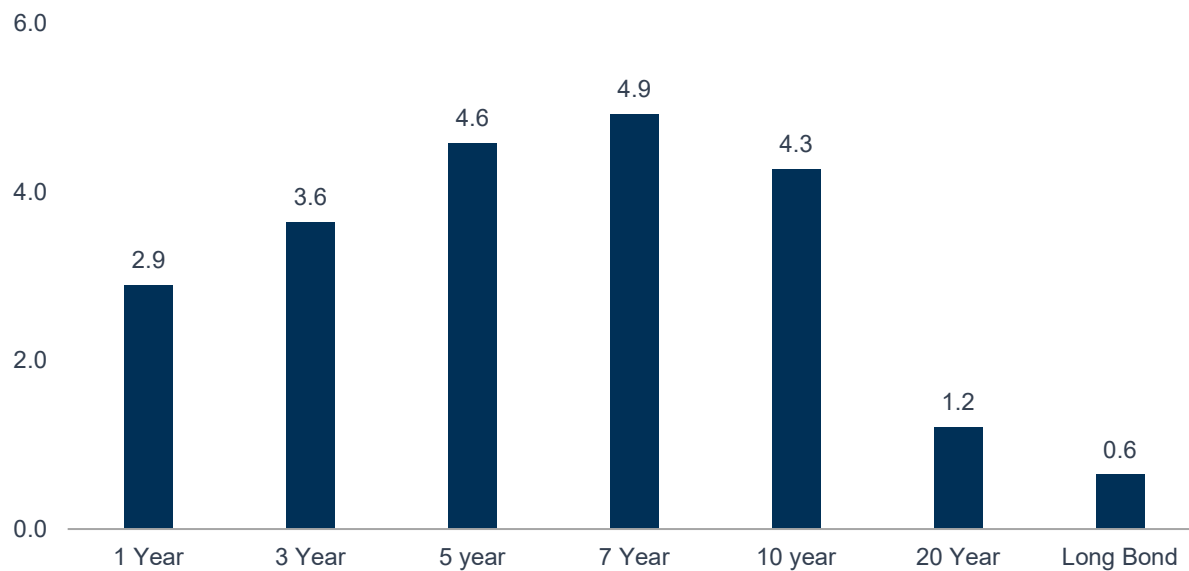
9. Source: Bloomberg. \*Using 40.8% federal tax rate, including 3.8% Net Investment Income Tax. Using respective maximum state income tax rate.

10. Source: Bloomberg.

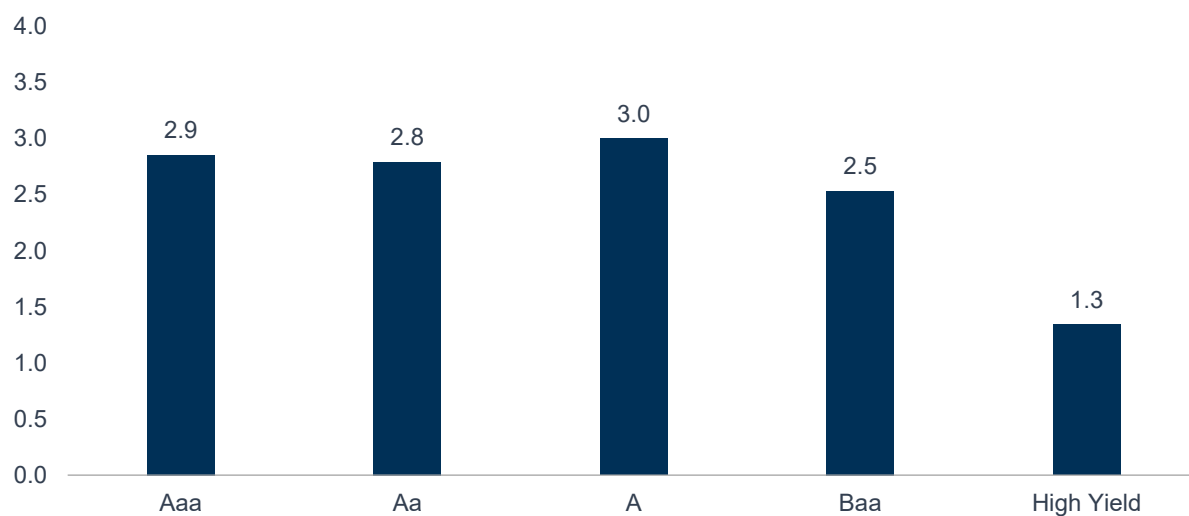
11. Source: Bloomberg.

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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 10/02/2025.

12. Source: Bloomberg.

13. Source: Bloomberg.

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



## MUNI YIELDS

| Tenor                                                         | 09/25/2025   | 10/02/2025    | Change (+/-) |
|---------------------------------------------------------------|--------------|---------------|--------------|
| <b>Bloomberg AAA Muni Key Rate Yields<sup>15</sup></b>        |              |               |              |
| 2-year                                                        | 2.20%        | 2.27%         | +0.08%       |
| 5-year                                                        | 2.27%        | 2.30%         | +0.04%       |
| 10-year                                                       | 2.92%        | 2.90%         | -0.02%       |
| 30-year                                                       | 4.30%        | 4.27%         | -0.04%       |
| <b>U.S. Treasury Key Rate Yields<sup>15</sup></b>             |              |               |              |
| 2-year                                                        | 3.64%        | 3.55%         | -0.09%       |
| 5-year                                                        | 3.75%        | 3.67%         | -0.08%       |
| 10-year                                                       | 4.18%        | 4.10%         | -0.08%       |
| 30-year                                                       | 4.75%        | 4.69%         | -0.06%       |
| <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                                     | +55 bps      | +59 bps       | +114 bps     |
| AAA Muni Curve Slope                                          | +63 bps      | +137 bps      | +199 bps     |

Data as of 10/02/2025.

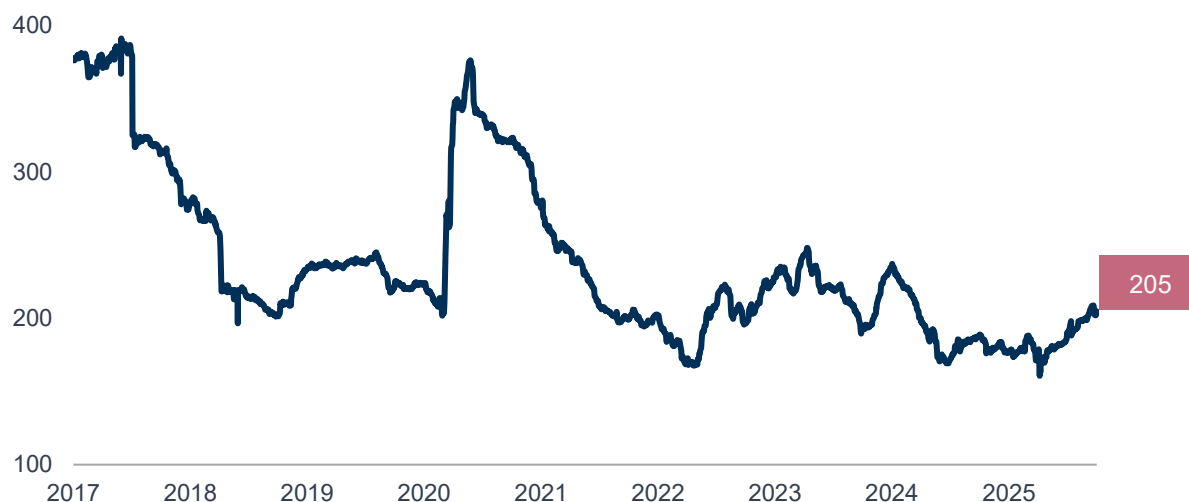
14. Source: Bloomberg. "Post GIFC Average" measures the period from 01/01/2010–10/02/2025.

15. Source: Bloomberg.

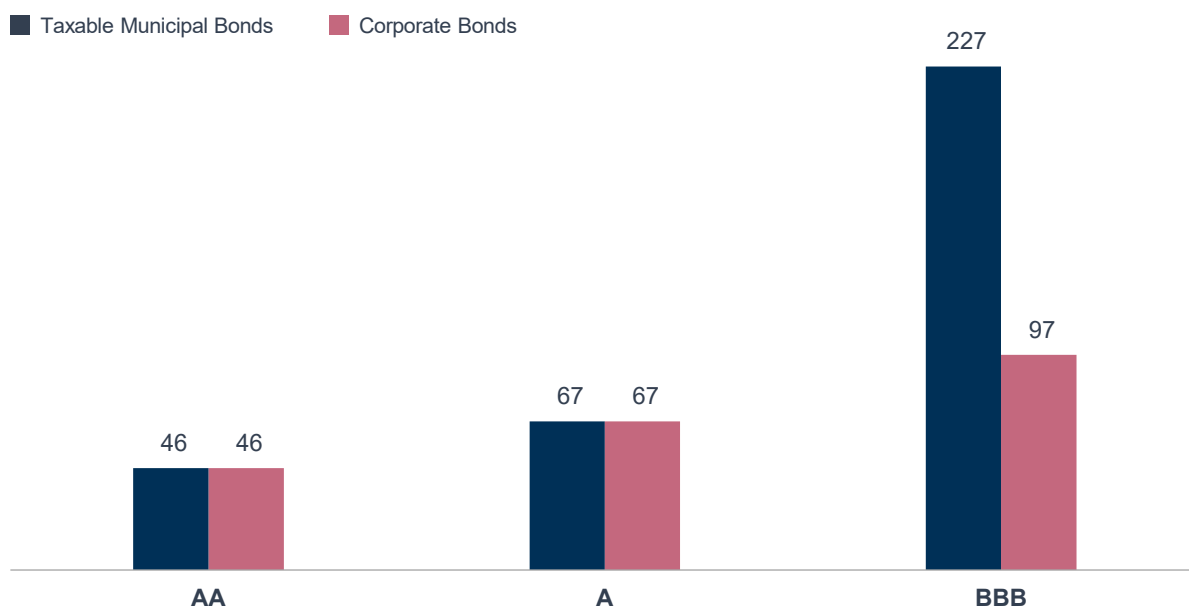
16. Source: Bloomberg. 2s10s—is spread between 10yr and 2yr yield; 10s30s—refers to spread between 30yr and 10yr yield; 2s30s—refers to spread between 30yr and 2yr yield.

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 DIFFERENTIAL<sup>17</sup>



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



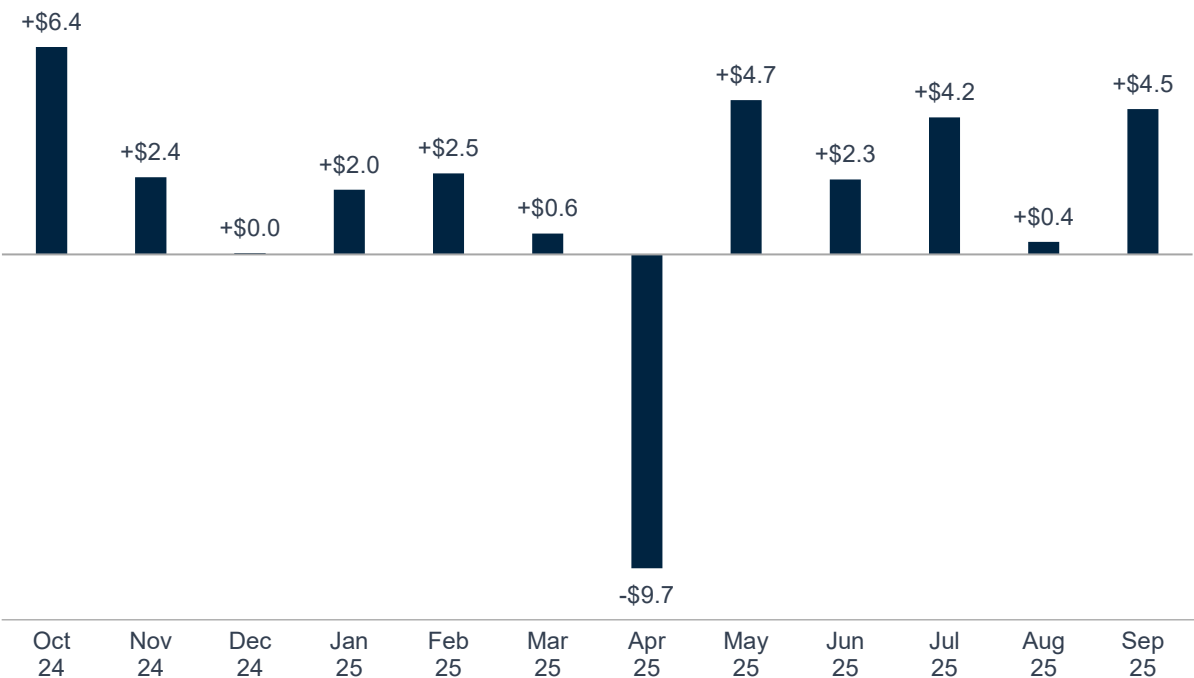
17. Data as of 10/02/2025. Source: Bloomberg.

18. Data as of 10/02/2025. Source: Bloomberg. 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 10/02/2025.

19. Source: Bloomberg.

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## DEFINITION OF TERMS

### Option-Adjusted Spread

The option-adjusted spread (OAS) measures the spread between a bond's rate and the risk-free rate, while adjusting for any embedded options like callables or mortgage-backed securities.

### Standard Deviation

Standard deviation is a statistical measurement that looks at how far discrete points in a dataset are dispersed from the mean of that set. It is calculated as the square root of the variance.

### Tax Equivalent Yield

The tax-equivalent yield is the return a taxable bond needs to equal the yield on a comparable tax-exempt municipal bond. Investors use this calculation to compare the returns between a tax-free investment and a taxable alternative.

### Tax Equivalent Yield to Worst

Tax Equivalent YTW is calculated by dividing the tax-exempt yield by one minus the marginal income tax. This is used to compare YTW on a tax-exempt investment to a taxable investment.

## Volatility

Volatility is a measurement of how varied the returns of a given security or market index are over time. It is often measured from either the standard deviation or variance between those returns. In most cases, the higher the volatility, the riskier the security.

## Yield to Worst

Yield to worst is a measure of the lowest possible yield that can be received on a bond that fully operates within the terms of its contract. It is a type of yield that is referenced when a bond has provisions that would allow the issuer to close it out before it matures. YTW helps investors manage risks and ensure that specific income requirements will still be met even in the worst scenarios.

## INDEX DESCRIPTIONS

**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 AMT index** refers to a specific Bloomberg municipal bond index that includes bonds subject to the Alternative Minimum Tax (AMT). Unlike most municipal bond indices, which exclude AMT-subject securities, these indices contain bonds that typically offer higher yields to individuals who are subject to the AMT.

**Muni IG ex. AMT and ex Territories Index** is the Bloomberg Municipal Bond Index excluding AMT and U.S. Territory exposure.

**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 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.

## INDEX DESCRIPTIONS (continued)

### Subset of Bloomberg Municipal Bond Index

**1 Year:** This index is the 1 Year (1-2) component of the Municipal Bond index.

**3 Year:** This index is the 3 Year (2-4) component of the Bloomberg Municipal Bond Index.

**5 Year:** This index is the 5 Year (4-6) component of the Municipal Bond index.

**7 Year:** This index is the 7 Year (6-8) component of the Municipal Bond index.

**10 Year:** This index is the 10 Year (8-12) component of the Municipal Bond index.

**15 Year:** This index is the 15 Year (12-17) component of the Municipal Bond index.

**20 Year:** This index is the 20 Year (17-22) component of the Municipal Bond index.

**Long Bond:** This index is the Long Bond (22+) component of the Municipal Bond index.

**Bloomberg 5-Year Muni Index** is a capitalization weighted bond index created by Bloomberg intended to be representative of major municipal bonds of all quality ratings with an average maturity of approximately five years.

**Bloomberg Municipal 1-10 Year Blend 1-12 Year Index** measures the performance of short and intermediate components of the Municipal Bond Index — an unmanaged, market value-weighted index which covers the U.S. investment grade, tax-exempt bond market.

**Bloomberg Municipal Long Bond 22+ Index** (often referred to as the Bloomberg Long-Term Municipal Bond Index) tracks the performance of long-term, tax-exempt U.S. municipal bonds with maturities of 22 years or longer. This index serves as a benchmark for high-quality municipal debt and covers various sectors, including general obligation, revenue, insured, and pre-refunded bonds.

**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 U.S. and non-US industrial, utility, and financial issuers. The index is a component of the U.S. Credit and U.S. Aggregate Indices, and provided the necessary inclusion rules are met, U.S. 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.

**Bloomberg U.S. Corporate High Yield Index** measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

**Bloomberg Global Aggregate Bond Index** The Bloomberg Global Aggregate Index is a flagship measure of global investment grade debt from twenty-seven local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.

**Bloomberg Securitized Bond Index** The Bloomberg U.S. Securitized: MBS, ABS, and CMBS Index tracks all USD-denominated, investment grade, securitized issues within the "Parent Index". MBS must have a weighted average maturity of at least one year. CMBS and ABS must have a remaining average life of at least one year.

**Bloomberg U.S. Municipal Bond Index Total Return Index Value Unhedged** The Bloomberg U.S. Municipal Index covers the USD-denominated long-term tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and pre-refunded bonds

**Bloomberg U.S. Aggregate Total Return Value Unhedged** The Bloomberg U.S. Aggregate Total Return Value Unhedged Index (LBUSTRUU:IND) is a benchmark that measures the performance of the U.S. investment-grade, fixed-rate, taxable bond market, excluding any currency hedging. It tracks a broad universe of U.S. dollar-denominated securities, including U.S. Treasuries, government-related debt, corporate bonds, mortgage-backed securities (MBS), and asset-backed securities (ABS).

**Bloomberg U.S. Treasury Total Return Unhedged** The Bloomberg U.S. Treasury Index measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury.



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