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### High Absolute Yields Give Investors Reason Not to Reach too Hard for Credit

- Smaller Dealer Balance Sheets Start to Transform Market
- How Cheap Can Munis Get?
- Buyers Pump Brakes on Reaching for Yield

#### Relative Performance

Big news on the macro front is that the U.S. has agreed to a trade deal with the European Union, agreeing to a 15% tariff rate on most EU goods. While this news was broadly seen as a positive tailwind to the US equities market, the bond market has yet to rejoice on yet another trade deal getting done. Somewhat surprising is that the chipping away at trade deal uncertainty has not helped temper some of the uncertainty driven weakness in bonds. One thought is that the bond market is still looking forward in time to what the true fiscal impacts could be from tariffs, more broadly, and thinking that they might be a net drag on the US economy.

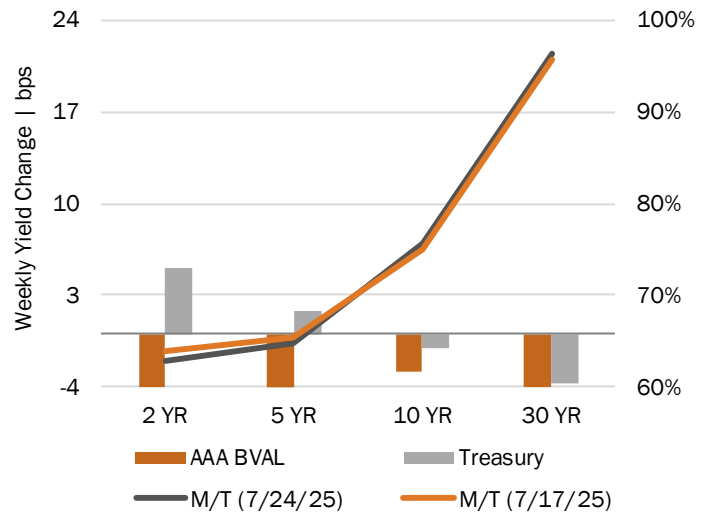
Over the past five trading days, AAA exempts and US Treasuries took somewhat divergent paths, especially inside 5 years, where munis appeared to outperform. As such, Municipal-to-Treasury (M/T) yield ratios were tighter in shorter tenors, with the 5-year M/T ratio declining to 62.6% from 63.9%. This week's supply calendar of ~\$12 billion should keep the market engaged and help with additional price discovery across the yield curve.

#### Market Technicals— Rates Much Less Euphoric Than Stocks on EU Deal

2025 YTD muni issuance figures have now grown to \$347 billion, representing a 20% YoY growth rate. In terms of how deals are coming to market, negotiated new issuance has grown by 17% YoY, compared to competitive new issuance sales which have grown at almost twice that pace.

For those unfamiliar with market terms: When a muni issuer wants to raise money by issuing municipal bonds, they choose

#### MUNIS OUTPERFORM ACROSS THE CURVE

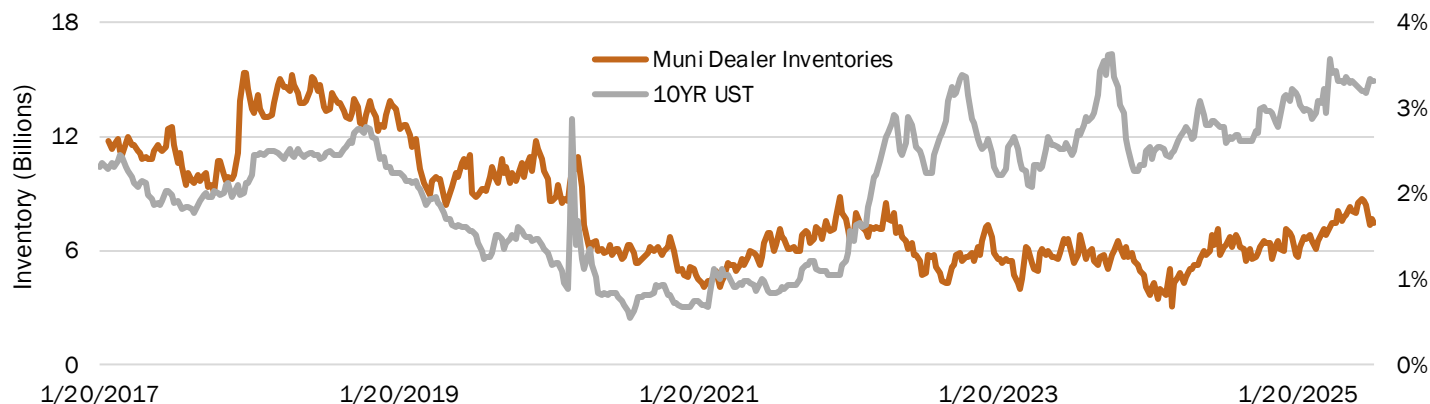


Data as of July 25, 2025.  
Spot Muni, Spot AA rates  
Source: Bloomberg

between two main methods to sell the bonds to investors: **negotiated underwriting and competitive underwriting**. They differ in how the underwriter is selected and how the bond terms are set.

- **FOR NEGOTIATED:** The issuer and the underwriter work closely over weeks or months. The underwriter helps with market timing, structuring the deal, preparing documents, and marketing the bonds.
- **FOR COMPETITIVE:** The issuer sets the bond structure in advance and solicits bids on a specific date. The underwriters submit bids, and the issuer picks the best one.

### RIISING RATES PUTS CRIMP ON DEALER RISK APPETITES



Data as of July 28, 2025.  
Source: Bloomberg

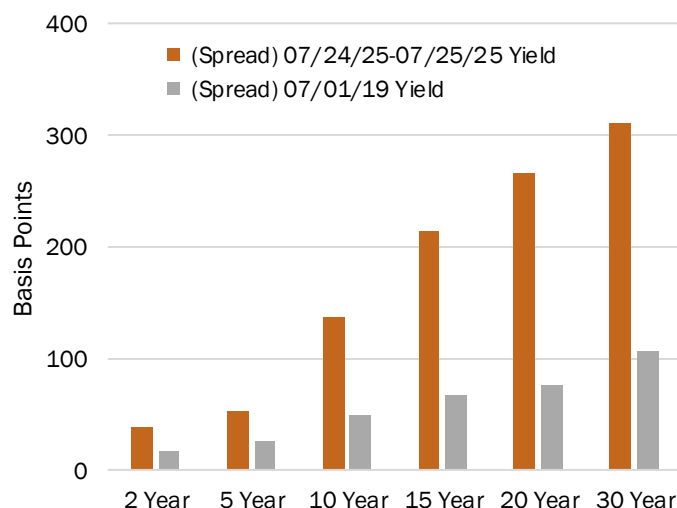
At the current run rate, the year-to-date competitive sales of \$61 billion may surpass last year's \$86 billion. The shift in issuers accessing the markets via competitive auctions makes some sense in terms of how the muni market dynamics have shifted. Less broker dealers, and by proxy less balance sheet commitment for tax-exempts has not gone un-noticed. Municipal advisors most likely feel that by offering bonds competitively, they can save on some transaction fees and also lean into how much cash is on the sidelines still looking for quality paper. In the below chart, we note that primary dealer municipal balance sheet positions are still below pre-pandemic levels and further, have dropped as rates have risen. One knock-on effect of lower balance sheet commitment to the tax-exempt space are wider bid-ask spreads when volatility rises. We have seen this play out in both the Baa credit rung as well as with high yield munis, earlier this year. The era of tighter secondary liquidity could now be here to stay.

### Knock, Knock, Knocking on Cheapness Door

We've consistently highlighted the compelling relative value of municipals in recent publications and client discussions. When compared to same-tenor U.S. Treasuries—or even AA and A-rated corporates—munis appear deeply undervalued across much of the curve.

The growing advantage of municipals is particularly evident when comparing taxable-equivalent yields of A-rated muni revenue bonds with A-rated corporates. In 2019, 10-year spot

### MUNIS ADVANTAGE OVER CORPORATES AT MULTI-YEAR HIGHS



Data as of July 25, 2025.  
Source: Bloomberg

yields were nearly identical. Today, munis offer a 222 bps advantage at the 10-year mark for investors in the highest tax brackets. The differential becomes even more compelling further out the curve—322 bps at 15 years and 434 bps at 30 years.

### Muni Spread Buckets Clearing Away Pandemic Cloud

The rise in rates over the past year has reshaped credit spreads across the muni spectrum. In the chart below, we compare the yield-to-worst (YTW) spreads between credit tiers:

- Bloomberg Baa vs. A Muni Index
- Bloomberg A vs. AA Muni Index
- Bloomberg AA vs. AAA Muni Index

### Key Takeaways

- AA and A spreads have remained relatively stable.
- Baa spreads are widening, driven by two primary factors:

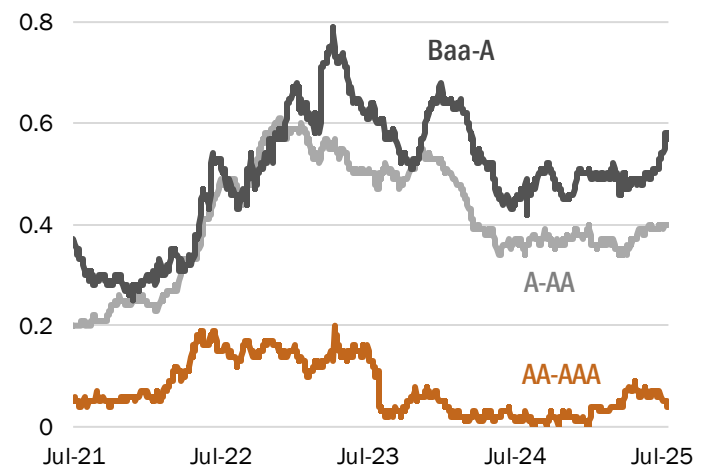
#### LIQUIDITY-DRIVEN SELLING

High-yield muni funds facing redemptions have predominantly offloaded Baa paper, increasing supply and pressuring spreads.

#### RISK APPETITE SHIFT

In low-rate environments like 2022, investors reached down the credit spectrum, compressing spreads. With higher yields

### A AND AA MUNI SPREADS RANGEBOUND AS REACHING FOR YIELD SLOWS



Data as of July 25, 2025

Source: Bloomberg

now available across the curve, there's less incentive to take on additional credit risk—keeping demand centered in the A and AA buckets.

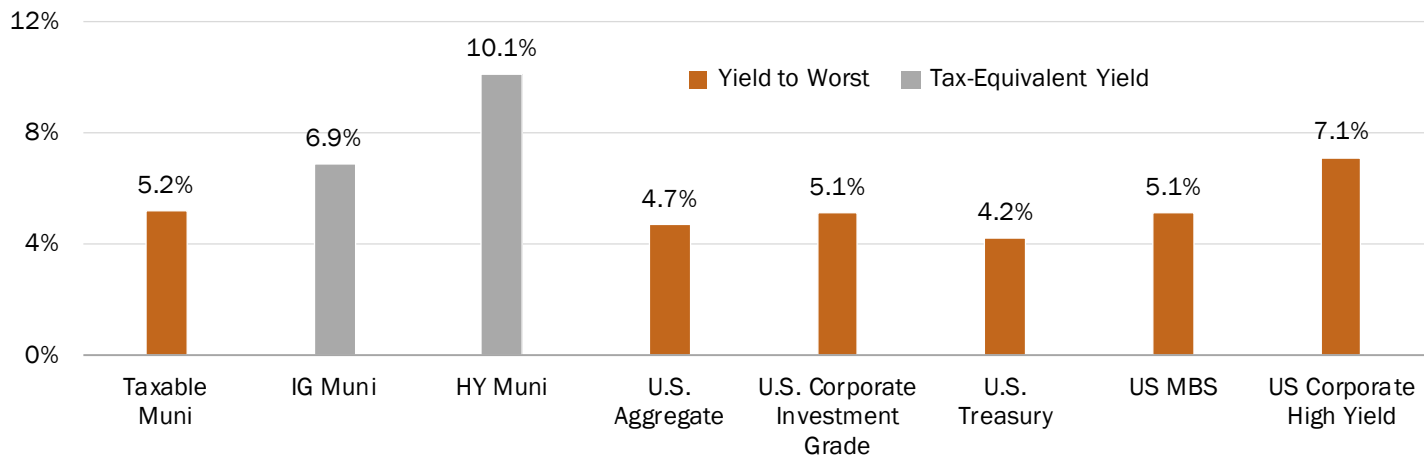
### Questions from the Field

**Q** What are some factors driving increased muni issuance in 2025?

- A**
- Cost of New Builds much more expensive post Pandemic
  - Pandemic Era Stimulus resulted in muted sales volumes

Year to date, the municipal bond market has had new issue sales of \$332 billion, which represents a YoY growth rate of 20%. Last year with full year issuance of \$540 billion, the municipal bond market had a high-water mark in terms of sales, eclipsing previous high-water marks in 2009-2010, when Build America Bonds were the most popular structures. As we see it, there are two factors driving increased sales volumes, now and going forward. The first is that things just cost more. We can blame inflation, to a degree, but the cost to build new schools, roads, or other capital projects has increased significantly since pre-pandemic. The second factor is that pandemic era stimulus which was on borrower balance sheets (and helped keep issuance lower for a few years) is now gone and municipal issuers need to get back into the schedule of financing projects that keep infrastructure in good repair. It appears there was a slight backlog from lower sales years in 2022 and 2023.

## INDEX YIELDS



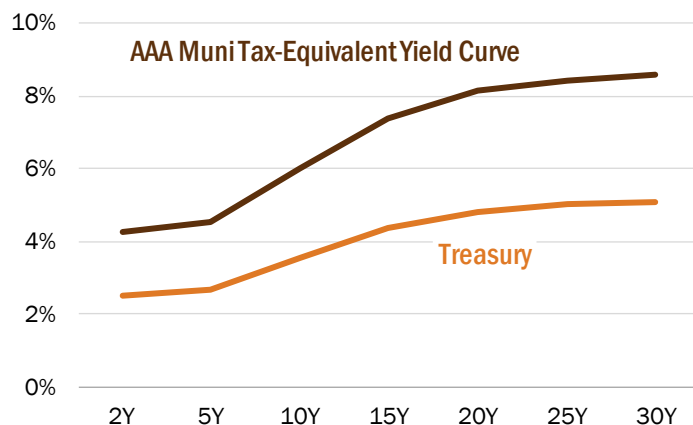
Data as of July 25, 2025.

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 US Aggregate Bond Index; U.S. Corporate Investment Grade: Bloomberg US Corporate Investment Grade Index; U.S. Treasury: Bloomberg US Treasury Index; US MBS: Bloomberg US Mortgage Backed Securities Index; US Corporate High Yield: Bloomberg US Corporate High Yield Index.

Source: Bloomberg

## AAA MUNI TAX-EQUIVALENT YIELD CURVE

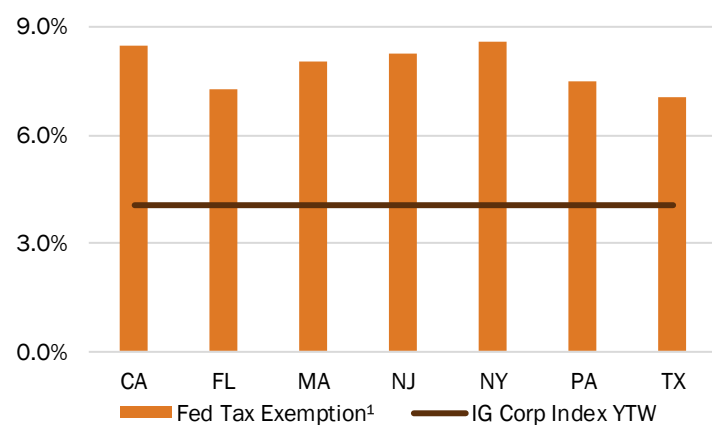


Data as of July 25, 2025.

Using 40.8% federal tax rate, including 3.8% Net Investment Income Tax.

Source: Bloomberg

## IN-STATE MUNI TAX-EQUIVALENT YTW

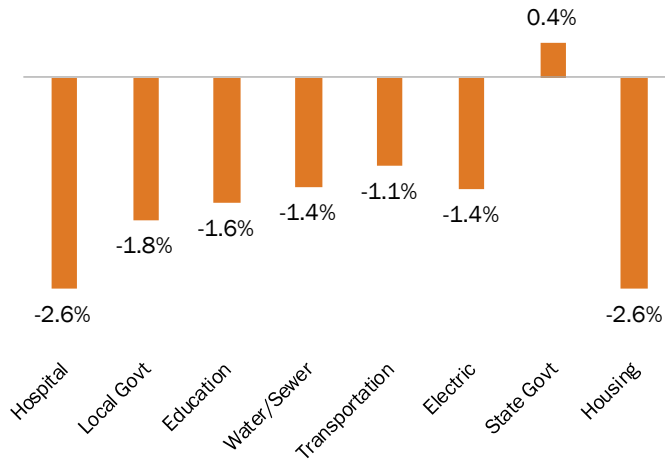


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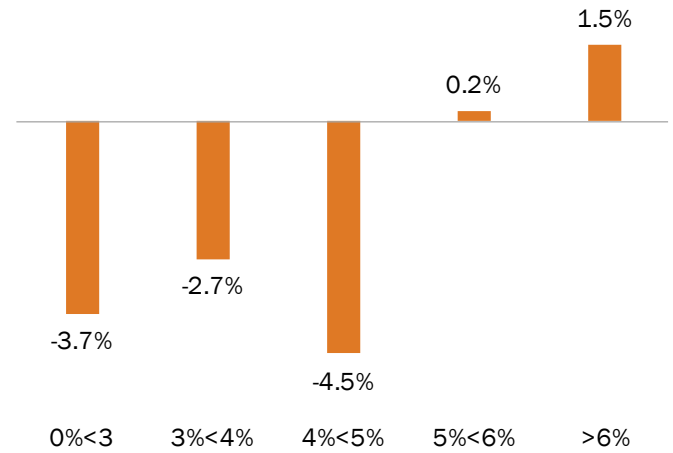
Source: Bloomberg0000

## YTD TOTAL RETURNS BY SECTOR



Data as of July 25, 2025.  
Source: Bloomberg

## YTD TOTAL RETURNS BY COUPON



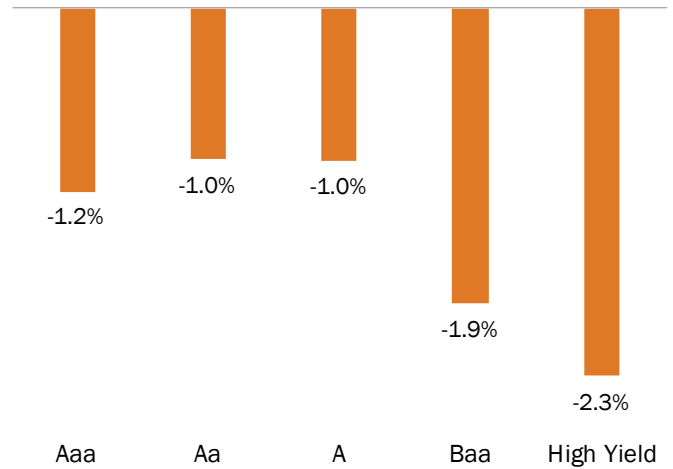
Data as of July 25, 2025.  
Source: Bloomberg

## YTD TOTAL RETURNS BY MATURITY



Data as of July 25, 2025.  
Source: Bloomberg

## YTD TOTAL RETURNS BY RATING CATEGORY



Data as of July 25, 2025.  
Source: Bloomberg

## BLOOMBERG MUNICIPAL INDEX YIELD-TO-WORST



Data as of July 25, 2025.

"Post GIFC Average" measures the period from 1/1/2010 - 7/4/2025

Source: Bloomberg

## MUNI YIELDS

Tenor	7/18/2025	7/25/2025	Change (+/-)
<b>BLOOMBERG AAA MUNI KEY RATE YIELDS</b>			
2 YEAR	2.50%	2.44%	-0.06%
5 YEAR	2.62%	2.57%	-0.05%
10 YEAR	3.36%	3.33%	-0.03%
30 YEAR	4.81%	4.77%	-0.04%
<b>US TREASURY RATE YIELDS</b>			
2 YEAR	3.88%	3.91%	0.03%
5 YEAR	3.96%	3.95%	-0.01%
10 YEAR	4.44%	4.40%	-0.04%
30 YEAR	5.00%	4.92%	-0.08%
<b>US TREASURY &amp; AAA MUNI CURVE SLOPES<sup>1</sup></b>			
	<b>2s10s</b>	<b>10s30s</b>	<b>2s30s</b>
US TREASURY CURVE SLOPE	+ 49 bps	+ 52 bps	+ 101 bps
AAA MUNI CURVE SLOPE	+ 90 bps	+ 144 bps	+ 233 bps

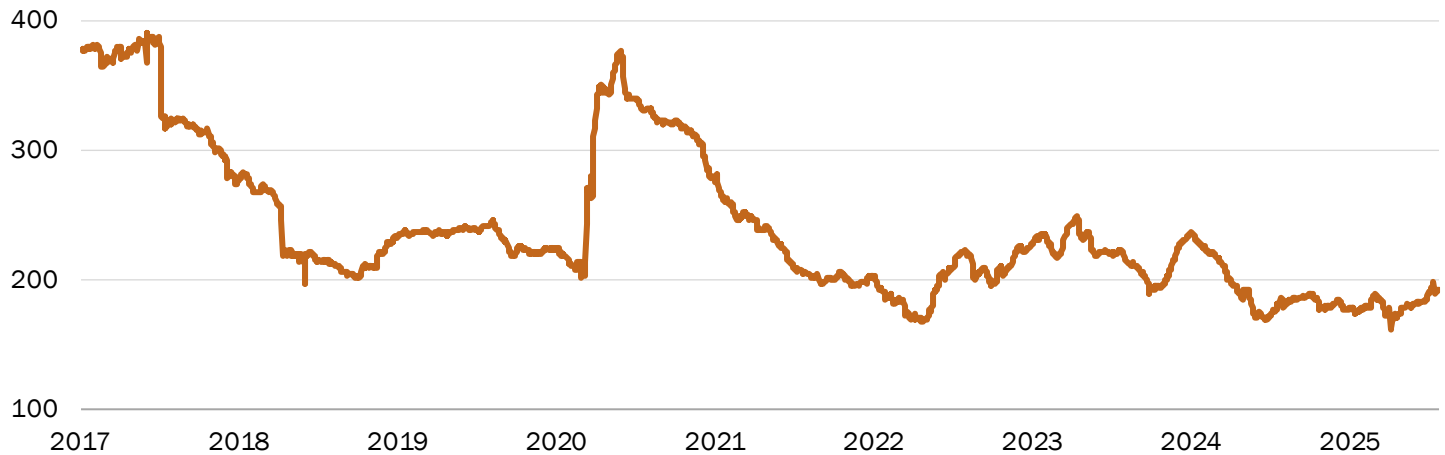
Data as of July 25, 2025.

1. 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

Source: Bloomberg

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

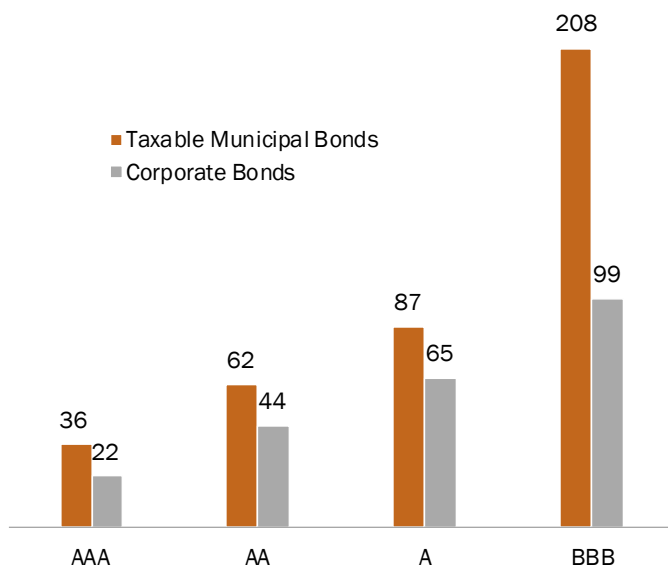
## BLOOMBERG MUNICIPAL HIGH YIELD INDEX | AAA MUNI YIELD DIFFERENTIAL



Data as of July 25, 2025.

Source: Bloomberg

## TAXABLE MUNICIPAL AND CORPORATE CREDIT SPREADS

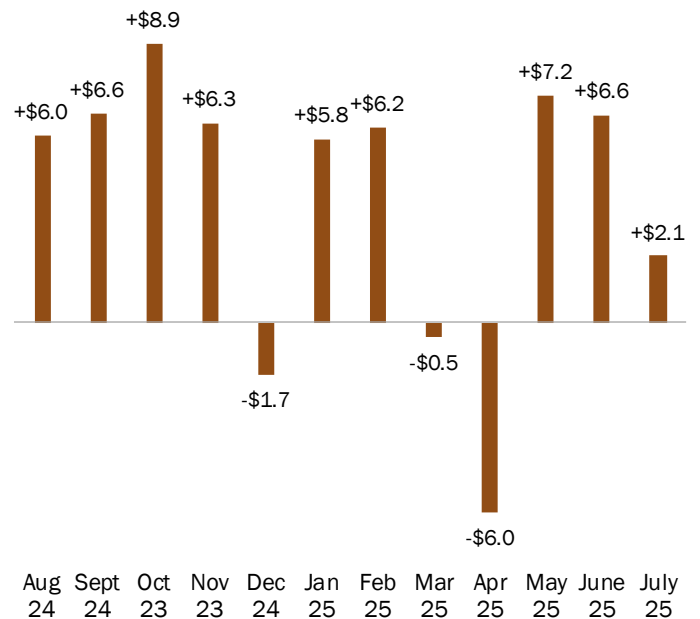


Data as of July 25, 2025.

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.

Source: ICE Data

## LONG TERM FUND FLOWS | USD \$BN



Data as of July 25, 2025.

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



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## ADDITIONAL YIELD DEFINITION

BVALAA, A, BBB and BB Yields is calculated by Bloomberg and is representative of the average 2YR spot rate on respective Bloomberg Yield curves of corporate credits with the respective average credit rating that are valued by Bloomberg's valuation service.

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## INDEX DESCRIPTIONS

### Bloomberg Municipal Bond Total Return Index

The 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 Municipal Taxable Bond Index

The Bloomberg U.S. Taxable Municipal Bond Index is a rules-based, market-value-weighted index engineered for the long-term taxable bond market. 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. 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. This index is the subindex that has been created based on 5-10 year maturity.

### 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.

### Bloomberg High Yield Municipal Bond Index

The 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. 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 US High Yield Index and EM USD Aggregate Index.

### Bloomberg US Aggregate Bond Index

The Bloomberg U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. Must have at least one year to final maturity regardless of call features. Must have at least \$300 million par amount outstanding. Must be rated investment-grade (Baa3/BBB- or higher) by at least two of the following ratings agencies: Moody's, S&P, Fitch. Must be dollar-denominated and non-convertible.

### Bloomberg US Corporate Investment Grade Index

The 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-U.S. industrial, utility and financial issuers.

**Bloomberg US Treasury Index**

Public obligations of the U.S. Treasury with a remaining maturity of one year or more. Must be a U.S. Treasury security. Must have at least \$300 million par amount outstanding. Must be rated investment-grade (Baa3/BBB- or higher) by at least two of the following ratings agencies: Moody's, S&P, Fitch. Must be fixed rate. Must be dollar-denominated and non-convertible.

**Bloomberg US Mortgage-Backed Securities Index**

The Bloomberg U.S. MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). Must have a weighted average maturity (WAM) of at least one year. Must have at least \$300 million par amount outstanding. Must be fixed rate.

**Bloomberg US Corporate High Yield Index**

The Bloomberg U.S. High Yield Index covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets (sovereign rating of Baa1/BBB+/BBB+ and below using the middle of Moody's, S&P, and Fitch) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included. Must have at least one year to final maturity regardless of call features. Must have at least \$150 million par amount outstanding. Must be rated high yield (Ba1/BB+ or lower) by at least two of the following ratings agencies: Moody's, S&P, Fitch. Must be fixed rate, although it can carry a coupon that steps up or changes according to a predetermined schedule. Must be dollar-denominated and non-convertible. Must be publicly issued.