



Municipal Basis Points

4Q 2025

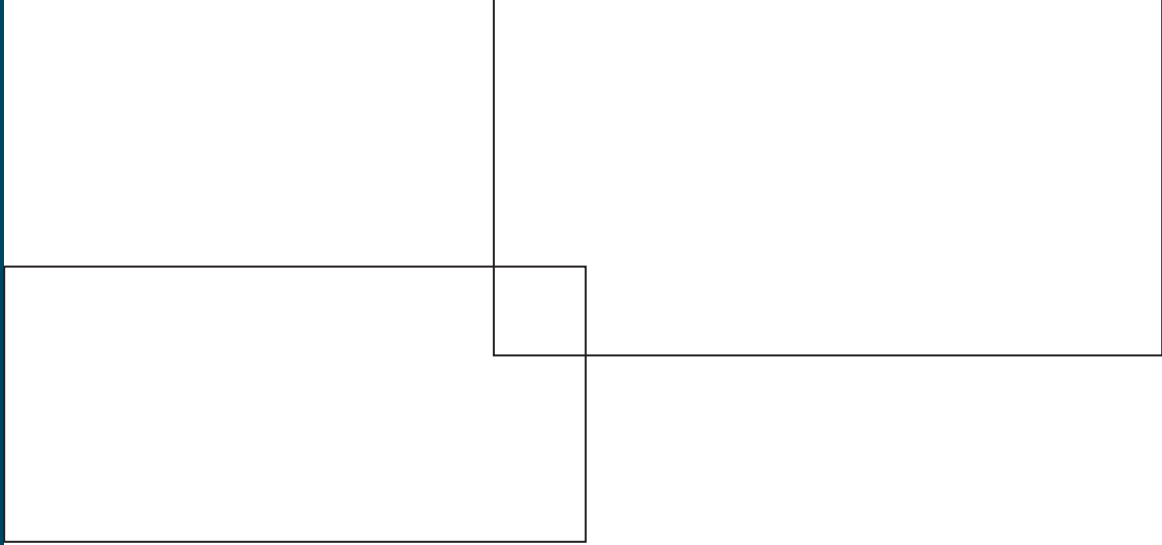
MUNICIPAL FIXED INCOME TEAM



PRIVATE WEALTH

Under the Microscope

- Municipal bond markets experienced a strong third quarter, supported by high absolute yields, appealing relative value and increasing confidence about Federal Reserve interest rate cuts.
- While technical factors could cause municipals to cheapen somewhat versus Treasuries in the near term, we would see such pockets of weakness as a potential buying opportunity.
- Given tighter credit valuations and government policy shifts, active security selection may be as crucial as ever.



Macro and Markets

We believe tight credit spreads and rapid policy change make active security selection crucial in today's municipal market.

The municipal bond market posted strong results in the third quarter, continuing to validate our view that the post-Liberation Day sell-off in April was a buying opportunity and not the start of a sea change in market fundamentals. High absolute yields, relative value versus Treasuries, and increasing confidence that the Federal Reserve would resume its easing cycle contributed to market strength. The rally was especially impressive given the supply backdrop, which remained heavy and should lead to record new issuance volume for the year.

Yield-curve dynamics were noteworthy during the quarter, with the “belly” of the curve (four- to seven-year maturities) outperforming longer bonds in July and August.¹ In our view, the primary driver of that strength was the market's belief that the Fed's renewed rate-cutting would be more rapid than expected—a belief reinforced by weaker labor market data and inflation readings that were in line with expectations. In September, we started to see curve-flattening as investors felt more comfortable buying longer-dated issues to take advantage of their higher yields. Lower-rated bonds slightly underperformed for the quarter. In our view, they lagged high-grade bonds, not because of cracks in the credit story, but more because of the narrow yield advantage they offered over highly rated bonds. Fund inflows, mostly from exchange-traded funds, were a tailwind as the quarter progressed.

Looking forward, technical factors related to issuance and maturing bonds should lead to increased net supply in October, potentially causing municipals to cheapen somewhat versus Treasuries. However, we would view any pockets of weakness as a potential buying opportunity, especially given the Fed's easing campaign. With tighter valuations on credit and a host of policy changes from the federal government, we believe that active security selection will take on greater importance going forward. At the same time, should a backup in rates materialize, it should provide a window to tax-loss harvesting when opportunities arise.

¹ All data is from Bloomberg, as of September 30, 2025, unless otherwise noted.

Strategy and Outlook

Supply trends, rate dynamics and reinvestment risk could all be on investors' radar.

LOOKING BACK

Yields. Municipal yields declined over the third quarter (and prices rose), driven by robust investor demand. The five-year segment of the yield curve performed particularly well, likely due to a shift out of cash equivalents as investors positioned themselves ahead of the widely anticipated September rate cut.

YIELDS HAVE RETRACED THEIR STEPS SINCE THE APRIL SELL-OFF

Municipal 1- to 15-Year Index, Yield-to-Worst



Source: Bloomberg, as of September 30, 2025.

Policy. The Fed cut interest rates 25 basis points at its September meeting. Markets expect further reductions through year-end, reflecting concern over slowing economic growth and labor market weakness.

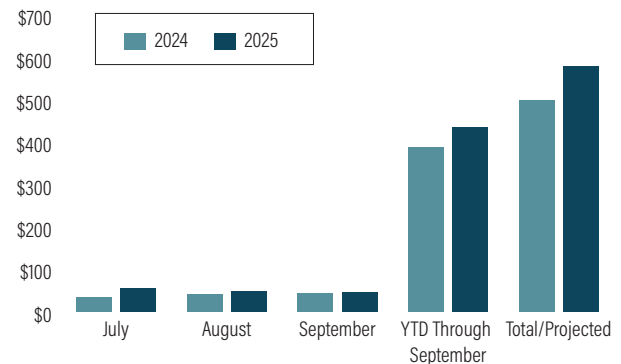
Supply. Year-to-date, municipal issuance has reached approximately \$440 billion,² representing a 15% increase over the same period last year. Analysts project that total supply in 2025 will approach \$550 billion, surpassing last year's record. Key issues affecting supply included:

- **Tax policy uncertainty.** Many issuers accelerated bond sales amid concern about the potential loss of tax-exempt status prior to the enactment of the One Big Beautiful Bill Act in July. However, the law preserves the municipal interest exemption, so its passage provided relief to the market and helped attract investment flows to the market.
- **Voter-approved bonds.** Numerous bond measures approved last November authorized municipalities to issue new debt for infrastructure, education and other public needs.

- **Rising costs.** Costs for both new construction and maintenance have climbed significantly in recent years, requiring more debt to cover expenditures.

NEW ISSUANCE IS ON A RECORD-SETTING PACE

\$ Billions



Source: Bank of America, as of September 30, 2025.

LOOKING AHEAD

Duration shift. We have recently adjusted our duration (interest-rate sensitivity) positioning to neutral relative to the benchmarks, given that AAA and AA municipals appear close to fully valued compared to Treasuries in the shorter and intermediate maturities, in our view.

Reinvestment risk. Investors may wish to consider reducing cash-equivalent holdings to avoid reinvestment risk as the Fed resumes rate cuts and cash yields decline. In our view, municipal yields remain attractive across the curve compared to current cash rates.

Fall technicals. We think municipal bonds may provide improving entry points in the coming weeks, as supply is typically elevated in October.

Appealing yields. On a taxable-equivalent basis, munis continue to provide a significant yield advantage over comparable U.S. Treasuries.³

² Source: Bank of America, as of September 30, 2025.

³ Source: Bloomberg. The ICE BofA 1- to 10-Year Municipal Index provided a 4.8% tax-equivalent yield (based on a 40.8% federal tax rate), compared to 3.77% for the ICE BofA 1- to 10-Year Treasury Index, as of September 30, 2025.

Deeper Dive

A proposed FEMA restructuring could have significant implications for municipal credit.

As we move through the heart of hurricane season, attention is focusing on the future of the Federal Emergency Management Agency (FEMA) in light of major changes floated by the Trump administration. The proposals would represent a shift in federal disaster policy, with the administration seeking to reduce the role of FEMA, placing more responsibility and costs on state and local governments. According to the White House, the goal is to simplify federal disaster response and allow communities to work more directly with Washington, DC. However, we believe the practical effect could be increased fiscal pressure on many municipalities, particularly those with exposure to climate-related risks.

FEMA has historically provided essential support to local governments in the aftermath of natural disasters, helping to stabilize budgets and restore infrastructure. A reduced federal role may leave municipalities more reliant on their own financial resources, which could be strained during periods of emergency. In addition to direct costs, there are broader implications for local economies. Insurance premiums for homeowners in high-risk areas are rising, driven by updated risk models and greater recognition of climate-related vulnerabilities. These increases may affect housing affordability and, over time, weaken local tax bases, adding another layer of stress to municipal budgets.

While these developments introduce uncertainty, certain factors may help offset the risk. Municipalities with strong reserve policies, diversified revenue streams and a history of investing in hazard mitigation could be better-positioned to

manage these challenges. States are also exploring regional mutual aid agreements, such as those supported by the Emergency Management Assistance Compact (EMAC), to improve coordination and resource sharing. EMAC, adopted by all 50 states and U.S. territories, is helping to provide a framework for interstate assistance during emergencies, including personnel deployment and reimbursement mechanisms. Notably, Congress is seeing bipartisan interest in preserving and potentially strengthening FEMA's role, though the outcome remains unclear.

For issuers, the impact may vary. Municipalities with broad economic bases, sound governance and proactive planning should be able to manage the financial and operational challenges that may arise from a reduced federal role. However, issuers in regions with elevated exposure to climate-related risks—particularly those with limited financial flexibility or concentrated revenue sources—may face greater vulnerability. These differences underscore the importance of issuer-specific analysis, especially in areas where the potential shift in federal support could materially affect credit quality.

Looking ahead, we believe that it will be important to carefully assess credits where disaster recovery responsibilities may be shifting. Understanding how issuers are positioned to respond, particularly in terms of liquidity, governance and long-term adaptability, will be key parts of the puzzle. In our view, the focus of research should remain on identifying credits that can sustain financial stability under a range of scenarios.

New Jersey and Connecticut Upgrades

Two state municipal issuers, New Jersey and Connecticut, received welcome news in September, when they received upgrades from Moody's to Aa3 and Aa2, respectively, with stable outlooks. The upgrades reflect disciplined financial management by two frequent market issuers with improving fiscal conditions. Positive governance factors and proactive fiscal management practices—such as maintaining operating surpluses, strengthening reserves and consistently funding pension obligations—have yielded tangible improvements in credit quality. These actions underscore the resilience of well-managed municipal issuers in today's uncertain environment, and benefit two credits that we have favored for some time.

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