The Week in Muniland

August 4, 2025

Turning the Corner?

Key Takeaways

1. **The muni market rallied for the second consecutive week.**
2. **Munis are ridiculously attractive, with the value clearly on the longer end of the yield curve.**
3. **The Fed is poised to cut rates beginning at its September meeting.**

The municipal market had back-to-back positive weeks, which hasn't been easy to say lately, as two-, 10- and 30-year AAA yields fell 11, 9 and 11 basis points (bps), respectively. The Bloomberg Municipal Bond Index (the Index) returned 0.85% last week, bringing year-to-date returns to –0.16%.

- **Why it matters:** The muni market may be turning the corner with the long end of the yield curve, which realized some buyer support this week as the Bloomberg 20-year Index returned 1.29%, while the Bloomberg five-year Index returned 0.37%. Given how attractive and cheap long bonds have been, it's about time long-maturity bonds have begun to outperform shorter-maturity bonds. Providing support to the muni market are open-end fund/ETF flows that were positive for the second straight week and 13 out of the past 14 weeks. Demand continues to be skewed to short and intermediate strategies; they took in 78% of total flows this week, while only 22% of flows went into longer strategies. J.P. Morgan noted that long-term open-end funds continued to see outflows last week, while long ETFs realized inflows.

The municipal market remains ridiculously attractive, with the long end of the curve being particularly cheap, no matter how you slice and dice the data.

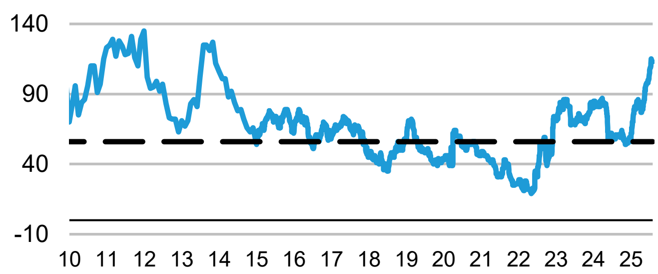
- **Why it matters:** As shown in *Display 2*, long muni bonds have not only underperformed shorter muni bonds, but they also underperformed long US Treasuries. The reason is an enormous amount of new-issue supply coupled with tepid demand for long bonds. As a result, the municipal yield curve has become obscenely steep, as seen in *Display 1.* The 10- to 20-year AAA curve hasn't been this steep since 2014. As also seen in Display 1, when the curve becomes too steep there is an eventual snapback toward a more normal curve, and when that snapback occurs, long bonds will outperform shorter bonds. So, it's not a question of if, but rather a question of when the muni yield curve flattens. Also, from an absolute yield perspective (*Display 3*), munis are ridiculously attractive. On a taxable equivalent basis, AAA munis are yielding 1.6% more than AAA corporate bonds, while A-rated munis are yielding 2.3% more than A-rated corporate bonds. There's a time and a place for any investment. Muni investors should be looking at the long end of the curve to lock in value we haven't seen in over a decade.

A couple of economic data points were released this week that lend credence to the expectation that the Fed will cut rates later this year.

- **Why it matters:** First, the US economy expanded at a 3.0% annualized rate in the second quarter of 2025, although on an annualized basis, the economy grew at a 1.2% clip in the first half of this year, notably slower than the rapid growth of the past few years. We expect the slowdown to continue and likely even deepen in the next couple of quarters. Next, the US employment report for July was unusual. While the headline print of 73K jobs added was somewhat lower than expected, the real news was a massive downward revision to the May and June data, which now show 258K fewer jobs added than previously reported. The pace of hiring is now meaningfully slower than previously reported. What is unusual, however, is that aside from the rate of hiring, everything else looks normal. Unemployment, wage growth and hours worked remain stable. How will the Fed balance that? We continue to believe that cuts in September, October and December are likely, and we expect that the market will price for that outcome in fairly short order.

Displays of the Week: August 4, 2025

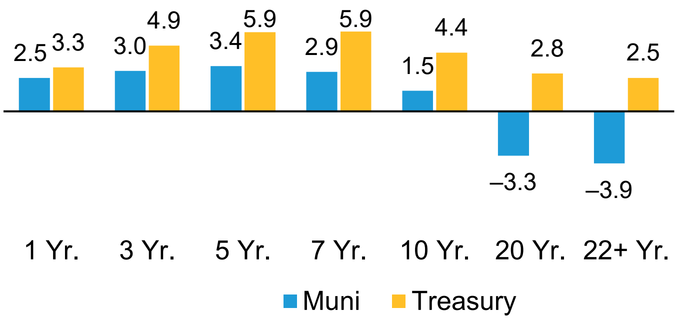
Display 1: 10s/20s Municipal Yield Curve Slope (Basis Points)



As of August 1, 2025. Source: Municipal Market Data and AllianceBernstein (AB)

The yield curve is as steep as it's been since 2014.

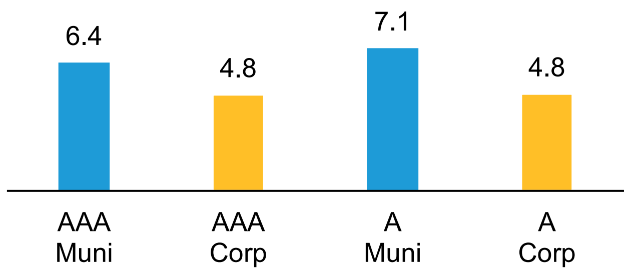
Display 2: YTD Index Returns by Maturity (Percent)



As of August 1, 2025
Source: Bloomberg and AB

Longer maturity muni bonds have significantly underperformed shorter maturity bonds.

Display 3: Muni vs. Corporate: Tax-Equivalent Yield-to-Worst Comparison (Percent)

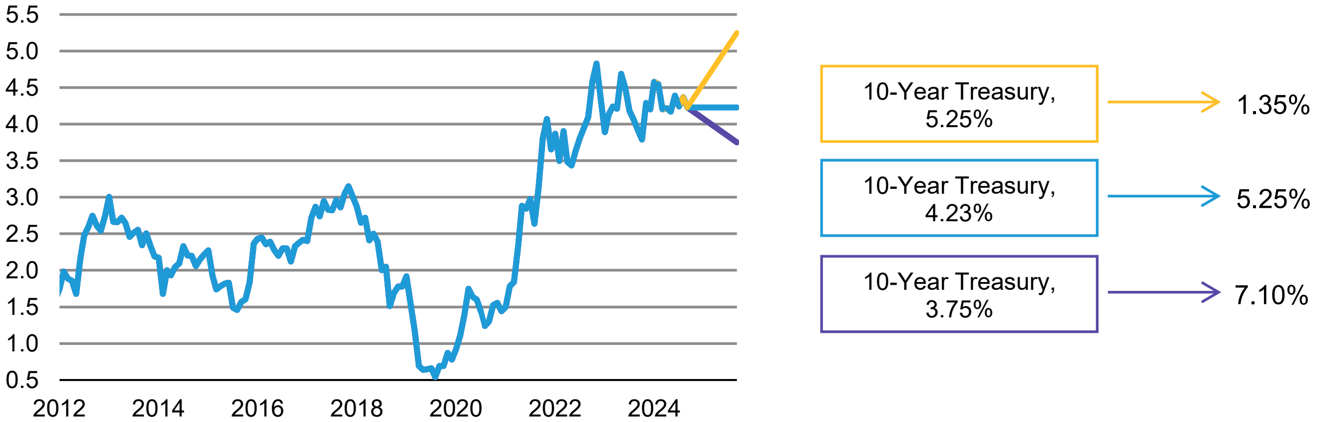


As of August 1, 2025
Source: Bloomberg and AB

Taxable equivalent muni yields are significantly higher than corporate bond yields.

Display 4: Expected 12-Month Municipal Returns Scenario Analysis

10-year US Treasury yield (percent)



Past performance and historical analysis do not guarantee future results.
Display reflects expected returns of the Index under three scenarios:
10-year US Treasury yields rise to 5.25%, remain the same or decline to 3.75% over the next 12 months.
As of August 1, 2025. Source: Bloomberg and AB

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