The Week in Muniland

August 11, 2025

Here Comes the Sun

Key Takeaways

1. **The muni market continued to generate strong returns in a week of heavy issuance.**
2. **There are catalysts that should continue to support the muni market going forward.**
3. **Municipal defaults remain low, particularly compared to corporate bonds.**

The municipal market continued its run of strong performance last week, with two-, 10- and 30-year AAA yields falling five, four and two basis points (bps), respectively. The Bloomberg Municipal Bond Index (the Index) returned 0.24% last week. Month-to-date returns now sit at 0.64%, and year-to-date returns are finally back in the green at 0.09%.

- **Why it matters:** In addition to positive absolute returns, municipals also outperformed US Treasuries, with after-tax spreads tightening ~5–10 bps across the curve. What is more notable, however, is the backdrop in which this outperformance occurred. The market was able to digest consecutive days of ~$7 billion of issuance—last week's supply was one of the largest single weeks on record. Demand remained supportive with investors adding $1.7 billion to the market last week, with a relative split distribution across mutual funds and exchange-traded funds. The municipal market has seen inflows in 13 of the last 14 weeks. Importantly, flows were skewed toward longer-maturity products, with long-term funds recording the highest amount of inflows last week at $574 million. This has helped drive the outperformance of longer-maturity municipals so far this month. The Bloomberg 20-Year Municipal Index has returned 0.84% this month compared to the 0.20% return of the Bloomberg 1-Year Municipal Bond Index. This week's calendar takes a bit of a breather (relative, of course) with ~$12 billion expected to price.

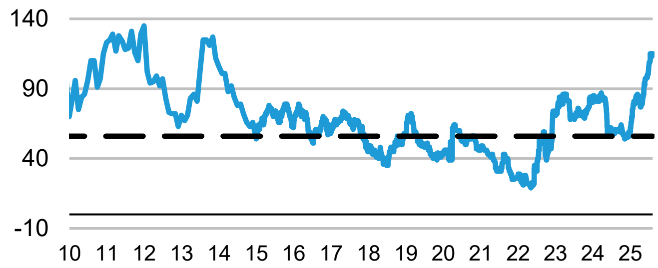
With Index year-to-date returns back in positive territory (not seen since April), investors may be wondering what changed.

- **Why it matters:** Over the last three weeks, the Index has returned 1.50%. To be clear, the muni market is not out of the woods yet, and three weeks do not make a trend. That said, the municipal market has begun to show its underlying strength. August 1 coupon payments have helped absorb supply, but as mentioned above, fund flows have also benefited the market. Going forward, while supply is expected to remain elevated versus longer-term averages, it is quite possible to see issuance decrease from that of the first half of 2025, particularly toward the end of this year. And as long as economic data remain supportive of a rate cut, we expect demand for municipals to help absorb the supply. Furthermore, outperformance of short-maturity municipals this year (both relative to longer maturities and versus comparable maturity Treasuries) has driven absolute yield levels on the front end of the curve to unappealing levels: one-year AAA municipals are currently yielding ~2.25%. Therefore, we expect investors to begin to push further out on the curve to take advantage of attractive absolute and relative valuations (*Display 3*).

Municipal defaults remain exceptionally rare. According to Moody's recently released data, the 10-year cumulative default rate for Moody's rated municipal bonds is just 0.16%.

- **Why it matters:** For comparison, global corporates have posted a 10-year default rate of 10.57%. That is more than 65 times higher than municipal bonds. Broadly speaking, the municipal sector in general continued to benefit from positive credit trends, including robust reserves, strong revenue and operating performance, and stable to declining leverage, per the report. Furthermore, the median Moody's rating for municipal issuers is Aa3, compared to Baa3 for global corporates. The rarity of municipal defaults, especially when compared to corporates, should allow investors to allocate to the asset class with confidence—even through economic cycles and policy shifts—as this translates to generally lower credit risk, higher ratings stability and a strong foundation for long-term, tax-advantaged income.

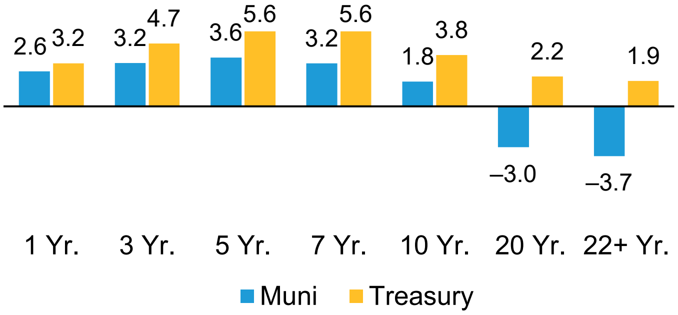
Display 1: 10s/20s Municipal Yield-Curve Slope (Basis Points)



As of August 8, 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 8, 2025
Source: Bloomberg and AB

Longer-maturity muni bonds have significantly underperformed shorter-maturity bonds.

Display 3: Municipal/Treasury After-Tax Spreads (Basis Points)

	Aug 8, 2025	Dec 31, 2024	Five-Year Average
Two-Year	5	30	16
Five-Year	14	27	22
10-Year	67	36	43
15-Year	117	46	67
20-Year	150	74	75
30-Year	171	107	95

As of August 8, 2025
Source: Bloomberg and AB

Short maturity municipal bonds have become expensive relative to longer term averages.

Display 4: Expected 12-Month Municipal Returns Scenario Analysis

10-year US Treasury yield (percent)

10-Year Treasury, 5.25% → 1.21%

10-Year Treasury, 4.28% → 5.02%

10-Year Treasury, 3.75% → 6.94%

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 8, 2025. Source: Bloomberg and AB

The views expressed herein do not constitute research, investment advice or trade recommendations, and do not necessarily represent the views of all AB portfolio-management teams. Views are subject to change over time.

A Word About Risk

Market Risk: The market values of the Portfolio's holdings rise and fall from day to day, so investments may lose value. **Interest-Rate Risk:** Fixed-income securities may lose value if interest rates rise or fall—long-term securities tend to rise and fall more than short-term securities. The values of mortgage-related and asset-backed securities are particularly sensitive to changes in interest rates due to prepayment risk. **Credit Risk:** A bond's credit rating reflects the issuer's ability to make timely payments of interest or principal—the lower the rating, the higher the risk of default. If the issuer's financial strength deteriorates, the issuer's rating may be lowered, and the bond's value may decline. **Inflation Risk:** Prices for goods and services tend to rise over time, which may erode the purchasing power of investments. **Foreign (Non-US) Risk:** Investing in non-US securities may be more volatile because of the political, regulatory, market and economic uncertainties associated with such securities. These risks are magnified in securities of emerging or developing markets. **Currency Risk:** If a non-US security's trading currency weakens versus the US dollar, its value may be negatively affected when translated back into US-dollar terms. **Diversification Risk:** Portfolios that hold a smaller number of securities may be more volatile than more diversified portfolios, since the gains or losses from each security will have a greater impact on the Portfolio's overall value. **Derivatives Risk:** Investments in derivative instruments such as options, futures, forwards or swaps can be riskier than traditional investments and may be more volatile, especially in a down market. **Leverage Risk:** Trying to enhance investment returns by borrowing money or using other leverage tools magnifies both gains and losses, resulting in greater volatility. **Municipal Market Risk:** Debt securities issued by state or local governments may be subject to special political, legal, economic and market factors that can have a significant effect on the Portfolio's yield or value. An investor cannot invest directly in an index. **Investment and Insurance Products:** Not FDIC insured I Not a bank deposit I Not insured by any federal government agency I No bank guarantee I May lose value