The Week in Muniland

August 18, 2025

Rare Air

Key Takeaways

1. **The muni market lost steam last week, but has recovered a great deal since the post–Liberation Day drubbing.**
2. **The muni market is in some rare air with high yields, steep yield curve and long maturity bonds that are relatively cheap.**
3. **The asymmetry of returns is quite astounding, which should provide investors comfort.**

The municipal market made slight gains through Thursday, then declined Friday as US Treasury yields increased. The Bloomberg Municipal Bond Index (the Index) returned -0.03% last week. Month-to-date returns now sit at 0.60%, while year-to-date returns are 0.05%.

- **Why it matters:** Recall that post–Liberation Day, April 7–9, the Index was down 5.2%. Since April 9, the Index has recovered 4.2%. With new issue supply up nearly 20% year over year, the recovery has been somewhat slow. What has been noticeable is that longer-maturity bonds have more recently outperformed shorter-maturity bonds. As shown in *Display 2,* long municipal bonds have significantly underperformed short municipal bonds and even USTs. However, since July 18, the Bloomberg 22-plus-year muni index is up 2.1%, while the Bloomberg 3-year muni index is up 0.74%. Investors are beginning to realize the value in long-maturity muni bonds given how steep the curve is (*Display 1*), as crossover buyers, those buyers who buy taxable bonds, have been stepping into the long end of the muni market. Looking toward next week, the muni market should perform well, as the new issue calendar is only $9 billion. It would be nice to add some additional positive performance as we head into September, which can be a difficult performance month in the muni market.

The municipal market finds itself in some rare air when it comes to today's opportunity.

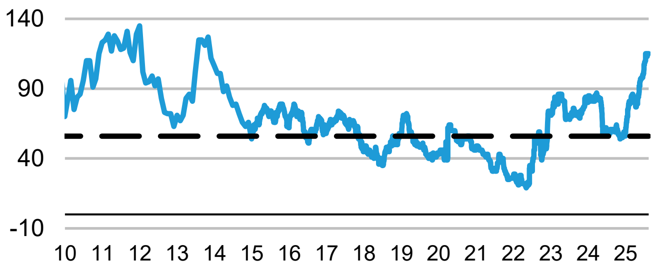
- **Why it matters:** The muni market today can be described as a market where yields are high, the yield curve is steep, and bonds are relatively cheap. The Index has a yield to worst of 3.91%, which, outside of a few points in 2022 and 2023, is as high as it's been since 2008/2009. The 10s/20s-year AAA muni curve, Display 1, is as steep as it's been since 2014, and long muni bonds are significantly cheap relative to USTs (*Display 3*). Also, the 30-year AAA yield, at 5%, is as high as it's been since 2010. The reason is not fundamental; if it was, then UST yields would be higher and the UST curve steeper. The cause has been the well-documented increase in municipal new issue supply. Supply should subside through the end of August, but will likely pick up again in September and October. We may see the muni market move sideways with heavier supply, although a Fed rate cut in September or October would be a significant positive.

The asymmetry of returns is quite startling, and as investors look to move out of cash or even lengthen duration, they should consider the hop-skip-and-jump approach.

- **Why it matters:** What is the upside/downside of muni bonds going forward? The prognostications are compelling. If UST yields fall 100 basis points (bp), short muni bonds, using the Bloomberg 1–5-year muni index (the short index) as a proxy, would be up approximately 4.4%, while the Bloomberg 20-year muni index (the long index) would be up approximately 10.7%. But what if yields rise? In a scenario where UST yields increase 100 bp, the short index would be up approximately 1.1%, while the long index would be down only approximately 1%. We are assuming that the muni yields move 60% of a UST move. The point being, given the high yields of muni bonds, especially long bonds, across the curve, and how they hold their value in a rising-rate environment, investors should consider moving out of cash. Their investments will significantly outperform cash if yields fall but modestly underperform if yields rise. Investors can either hop into short duration, skip into an intermediate portfolio, or jump all the way into long duration. Either way, the downside risk is minimal.

Displays of the Week: August 18, 2025

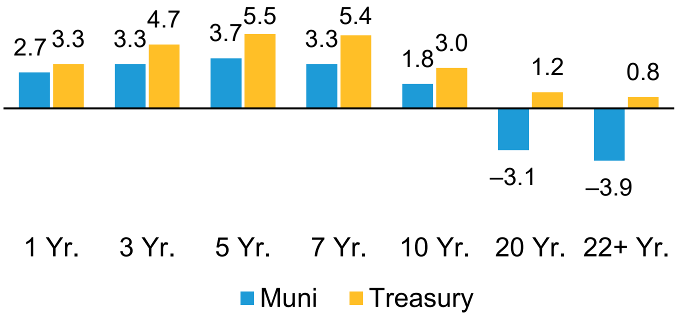
Display 1: 10s/20s Municipal Yield-Curve Slope (Basis Points)



As of August 15, 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 15, 2025
Source: Bloomberg and AB

Longer-maturity muni bonds have significantly underperformed shorter-maturity bonds, as well as longer-maturity US Treasuries.

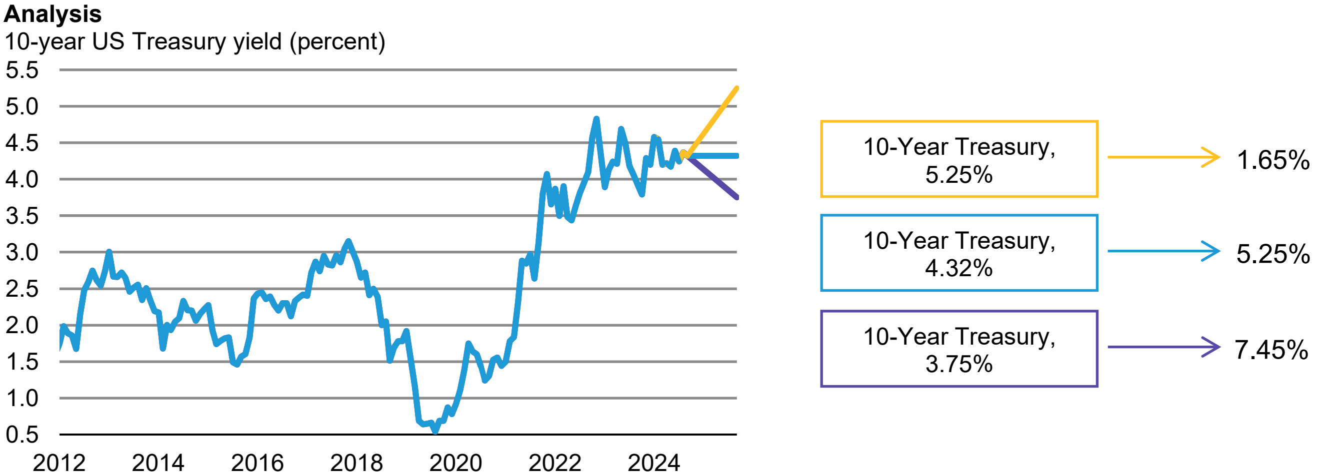
Display 3: Municipal/Treasury After-Tax Spreads (Basis Points)

	Aug 15, 2025	Dec 31, 2024	Five-Year Average
Two-Year	3	30	16
Five-Year	13	27	22
10-Year	68	36	43
15-Year	116	46	67
20-Year	149	74	75
30-Year	169	107	95

As of August 15, 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



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 15, 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

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