AllianceBernstein

Weekly Market Commentary

The Week in Muniland

August 25, 2025

Lock Them in a Vault

Key Takeaways

1. **With bond yields as high as they are today, investors should be locking away these bonds in a vault.**
2. **The asymmetry of returns is astounding, which should provide comfort to investors.**
3. **The fed remains on course to cut rates in September.**

The municipal market this week was once again bifurcated as short yields fell and long yields mostly rose, resulting in an even steeper yield curve. The Bloomberg Municipal Bond Index (the Index) returned +0.01% last week. Month-to-date returns now sit at 0.61%, while year-to-date returns remain slightly positive at 0.06%.

- **Why it matters:** Muni investors are by and large hiding out in the shorter end of the yield curve. Two- and five-year maturity yields fell 6 and 4 basis points (bps), respectively, while 10-year yields fell 1 bp and 30-year yields rose 1. Although supply was fairly light, the lack of demand for longer-maturity bonds continues. The 10s/20s AAA muni curve (*Display 1*) is as steep as it's been since 2014. Also, given how much shorter-maturity bonds have rallied this year (*Display 2*), their yields are becoming uninspiring. For example, a five-year AAA bond is yielding on average 2.37% versus 4.39% (7.42% taxable equivalent yield) for a 20-year AAA bond. This pickup in yield is meaningful, not only from an income perspective but also from a downside mitigation perspective. In today's environment, investors should look to take advantage of these high yields and look through any potential short-term volatility. Basically, lock the bonds in a vault, because when you open the vault in 12 months, you'll be thrilled to own those bonds that have a +7% tax equivalent yield.

The beauty of bonds is that they're math. Having a better understanding of the upside and especially the downside scenario may give investors the willingness to own longer bonds today.

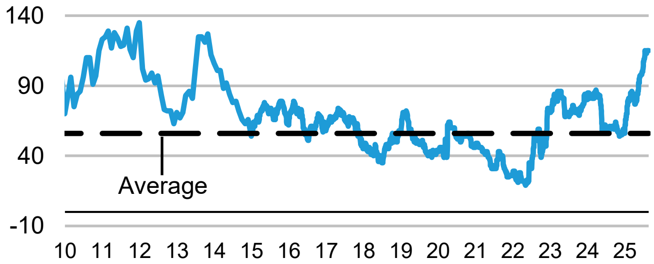
- **Why it matters:** The yield to worst of the Index is 3.91% or 6.60% on a taxable equivalent basis! Higher yields are important, as they provide protection against future rises in rates. For example, just to break even on a dollar invested today in the Index, the 10-year US Treasury would have to increase approximately 92 bps to 5.18% over the next 12 months—not a very likely scenario. In addition, let's assume that over the next 12 months, muni yields decline a modest 30 bps. In a 7.1-year duration portfolio, that would add an approximately 2.1% appreciation on top of the 3.91% yield, for a total return of 6%. The point is that muni returns could approach mid-single-digit returns with just a modest move in rates. Perhaps more important, if rates were to move significantly higher, bonds would hold their value by virtue of today's high yields. The market will not move in a linear fashion, as there will be up and down weeks, but the muni opportunity is sizable.

Chair Powell's speech at Jackson Hole did not, in our view, significantly change the way we should expect the Fed to proceed.

- **Why it matters:** The recent weaker labor market data have certainly paved the way for potential rate cuts, though it's clear that the fed is not ready to make any commitments just yet. With another payroll report and inflation print due before the September meeting, there's still much to consider. Given the current scenario, we are anticipating a rate cut in September. However, the pace of subsequent cuts will largely depend on the incoming data. Our projection remains at three cuts totaling 75 bps for this year. Nevertheless, should the labor market data deteriorate further, we could see a swifter response. Powell has indicated that once layoffs commence, the situation could rapidly worsen, and if that seems to be the case, the fed might opt for a cut greater than 25 bps. At the same time, they seem to prefer a cautious approach given the uncertainties surrounding inflation. The post-pandemic experience, where a seemingly one-off rise in inflation became persistent, serves as a reminder of the risks involved.

Displays of the Week: August 25, 2025

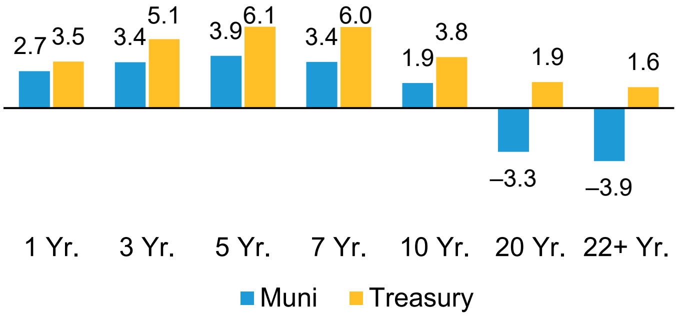
Display 1: 10s/20s Municipal Yield-Curve Slope (Basis Points)



As of August 22, 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 22, 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)

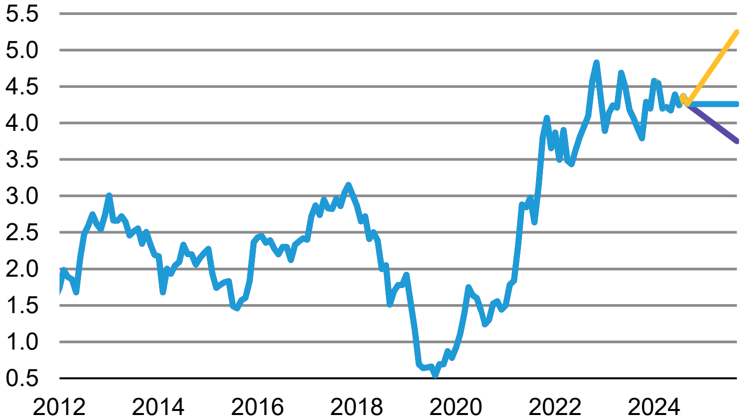
	Aug 22, 2025	Dec 31, 2024	Five-Year Average
Two-Year	1	30	16
Five-Year	14	27	22
10-Year	71	36	43
15-Year	120	46	67
20-Year	152	74	75
30-Year	172	107	95

As of August 22, 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% → 1.40%

10-Year Treasury, 4.26% → 5.25%

10-Year Treasury, 3.75% → 7.25%

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 22, 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