The Week in Muniland

September 15, 2025

The Future's So Bright, I Gotta Wear Shades

Key Takeaways

1. **Muni bonds continue their impressive rally, particularly longer-maturity bonds.**
2. **It is not too late for investors to take advantage of cheap municipal bonds.**
3. **With August CPI in line with expectations, the Fed is poised to cut rates at its September 17 meeting.**

The municipal market continued its impressive rally this week, with long-maturity bonds materially outperforming shorter-maturity bonds. The Bloomberg Municipal Bond Index (the Index) returned 1.48% and is now up 2.38% month to date. The year-to-date return is now 2.70%.

- **Why it matters:** The rally in longer-maturity bonds has been impressive but not surprising. It was only a matter of time until the bonds that were extremely cheap *(Display 3)* would outperform shorter-maturity bonds. It was also just a matter of time before the obscenely steep municipal yield curve *(Display 1)* would begin to flatten. The question was never if, but rather when. Month-to-date the Bloomberg 20-year Maturity Index is up 3.64%, while the Bloomberg 22+ Maturity Index is up 3.98%. Over the same period, the Bloomberg 5-year Maturity Index is up 0.95%. It's our expectation that longer-maturity bonds will continue to outperform shorter-maturity bonds given they remain cheap relative to US Treasuries and the curve remains abnormally steep.

One question we've been getting is, since bonds have rallied so much this month, is it too late to invest? The answer is an emphatic no!

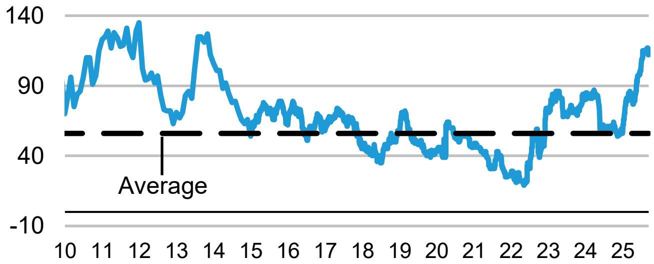
- **Why it matters:** The fact that the slope of the municipal yield curve remains extremely steep and long bonds are cheap relative to US Treasuries (UST) indicates that long muni bonds have a long way to go until they are considered fair value. Short-maturity bonds have clearly become expensive as significant investor demand has driven those yields lower. In fact, shorter muni bonds have become so expensive, we recommend that investors, when able, consider owning shorter USTs in place of shorter high-grade municipals, since on an after-tax yield basis they will earn more on the UST (see two-year bond in *Display 3*). For some perspective, if yields fall just 50 basis points over the next 12 months, the five-year and 20-year indices would return approximately 4.4% and 9.2%, respectively *(Display 2)*. However, given the expensiveness of the short end of the yield curve and the cheapness in the long end, it's more likely long bond yields will fall more than short bond yields. Next week brings a very light new issue bond calendar, at only $6 billion, coupled with modest September 15 reinvestment cash hitting the market—a positive technical tailwind. The light calendar is due to the Fed meeting at which they will most likely cut rates by 25 bps—an outcome the market is fully pricing in. The near-term future for bonds remains bright. It's not too late, but it is time to get off the sidelines.

The US Consumer Price Index (CPI) for August was in line with expectations. Core CPI rose 0.3% month over month and is now up 3.1% year over year.

- **Why it matters:** The underlying details of the inflation data do not suggest convergence to the Fed's target over a reasonable forecast horizon. Core inflation is not annualizing close to 2%, and the most recent prints reflect an acceleration rather than a deceleration. Not only that, but the pressure on prices is not limited to tariffs; services inflation has picked back up as well. Nonetheless, we expect the Fed to cut rates by 25 bps next week. Why? Risk management. While price pressures are not coming down, neither are they rising in a way that seems disruptive. At the same time, the balance of risks around the labor market has clearly deteriorated. With the Fed funds target rate above neutral, meaning that it is restraining economic activity, we believe the Fed will respond to the greater threat, which is the labor market. Therefore, we continue to believe they will cut rates at each of their three remaining meetings this year, even with inflation above target.

Displays of the Week: September 15, 2025

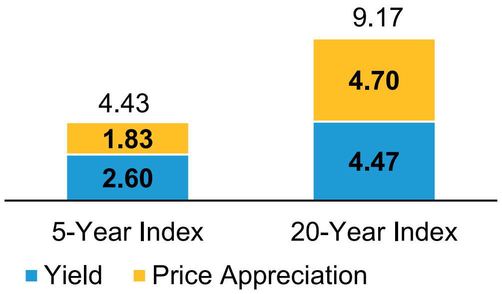
Display 1: 10s/20s Municipal Yield-Curve Slope (Basis Points)



Through September 12, 2025. Source: Municipal Market Data and AllianceBernstein (AB)

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

Display 2: 12-Month Hypothetical Return if Yields Fall Just 50 Basis Points



As of September 12, 2025. Bloomberg Indices Index.
Source: Bloomberg and AB

Long maturity bonds offer more potential for a higher return as yields fall.

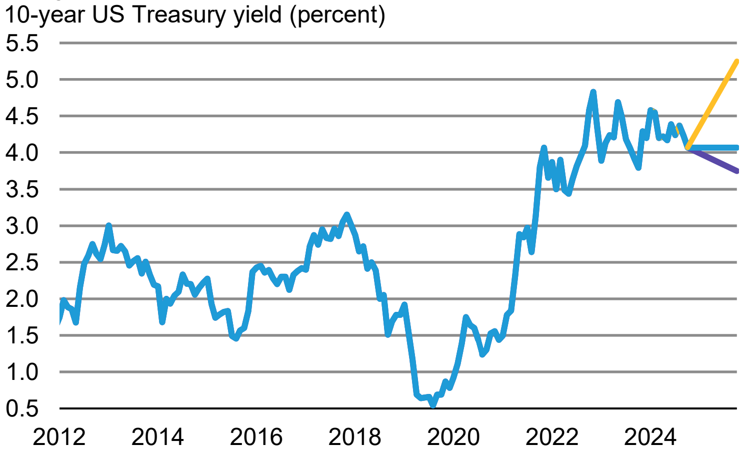
Display 3: Municipal/Treasury After-Tax Spreads (Basis Points)

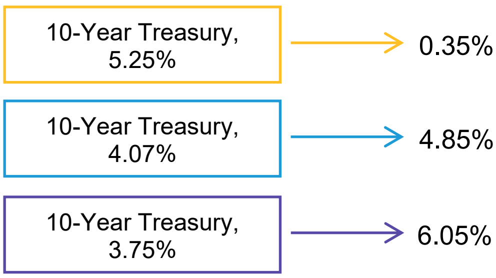
	Sep 12, 2025	Aug 29, 2025	Five-Year Average
Two-Year	-10	5	16
Five-Year	4	17	22
10-Year	53	73	43
15-Year	93	115	67
20-Year	128	151	75
30-Year	148	170	95

As of September 12, 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 September 12, 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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