Parametric

Municipal Bond Market Insight | September 2026

Taking Stock of Your Bonds

Key takeaways

- Municipal bonds completed August in positive total return territory year-to-date (YTD), unlike Treasurys and corporates and despite muni underperformance during the month compared with taxables.
- Record supply continued unabated, as did robust muni mutual fund inflows, but a seasonal shift in September may lighten additional inflows.
- Intermediate and long muni yields have again reached YTD highs and signal an attractive entry point.
- In a tale of two markets, equity risk premium is among its lowest in 20 years, while muni yields are the highest they've been in 20 years.

General market update

It's been an interesting and at times trying year thus far for muni bondholders and fixed income in general. As the market continues to contemplate the Fed's next move regarding whether to hike rates or stay with the data-dependent pause, the volatility exhibited in the Treasury market and other related fixed income has been noteworthy and often uncomfortable. But with that volatility comes opportunity. There's plenty to consider in the muni market this final month of Q3 2026.

Despite munis logging a negative performance and underperforming both Treasurys and corporate bonds in August, tax exempts still emerged in the positive return column YTD. Their taxable counterparts, which had positive performance during the month, were able to mitigate their respective YTD negative total returns. At the close of August, munis had surrendered 23 basis points (bps) of total return to arrive at a YTD positive performance of 0.2%. Treasurys advanced 31 bps and limited their YTD negative performance to -0.53%, while investment-grade corporate bonds added 43 bps to cut their YTD negative performance to -0.4%. The 2026 total return race is currently a game of inches, if not centimeters.

These subtle moves mask the significant factors that have impacted the bond markets for months, including geopolitical tensions and related sporadic military actions, the ebb and flow of oil prices and what appears to be a tightening spigot of Fed communication under still-new chair Warsh. Meanwhile, the AI bullet train continues to roll along at speeds that both delight and frighten, depending on your position.

Supply

August issuance was not just heavy for a summer month; it was the strongest August on record. According to The Bond Buyer on September 1, supply totaled $59.6 billion, up 14.5% compared with August of last year. The month left YTD issuance just shy of $400 billion, up 4.1% from 2025, as rate-hike concerns, several large transactions and a later Labor Day holiday may have pulled borrowing forward.

Figure 1: Fixed income returns as of August 31, 2026

	MTD return	YTD return
Bloomberg Muni Index	-0.23%	0.2%
Bloomberg US Treasury Index	0.31%	-0.53%
Bloomberg US Aggregate Index	0.39%	-0.31%
Bloomberg US Corporate Index	0.43%	-0.4%

Source: Bloomberg, 8/31/2026. For illustrative purposes only. It is not possible to invest directly in an index. **Past performance is no guarantee of future results.**

Figure 2: AAA municipal yields as of August 31, 2026

Year	Current	MTD change	YTD change
2-year	2.53%	-10 bps	2-year
5-year	2.84%	-7 bps	5-year
10-year	3.37%	0 bps	10-year
30-year	4.6%	9 bps	30-year

Source: LSEG Municipal Market Data, 8/31/2026. For illustrative purposes only and is not meant to depict the performance of a specific investment. Not a recommendation to buy or sell any security. **Past performance is no guarantee of future results.**

Figure 3: US Treasury yields as of August 31, 2026

Year	Current	MTD change	YTD change
2-year	4.35%	6 bps	89 bps
5-year	4.5%	5 bps	81 bps
10-year	4.76%	2 bps	62 bps
30-year	5.25%	-2 bps	43 bps

Source: Bloomberg, 8/31/2026. For illustrative purposes only and is not meant to depict the performance of a specific investment. Not a recommendation to buy or sell any security. **Past performance is no guarantee of future results.**

Issuance remains concentrated, with California leading as the biggest issuer, followed by Texas, then New York. Florida and Alabama rounded out the top five, while Massachusetts, Pennsylvania, Michigan, Washington and Illinois completed the top 10. In what's become a two-year long trend, the national supply picture can look robust, while certain states lack inventory.

On the demand side, muni mutual funds had registered 19 consecutive weeks of inflows by the last week of August according to LSEG and JP Morgan (8/26/2026). This multi-month positive stretch brought the YTD total to $67 billion and represented the second highest on record.

Looking forward, we expect seasonal factors to again come into play, as bond redemptions from maturing and called bonds, plus coupons, dip materially in September by approximately 45%, according to ICE data (8/10/2026). This seasonal downshift in potential reinvestment cash may adversely impact muni mutual fund flows in the coming months, with today's higher yields being a possible offset.

Market opportunity

As we noted in our opening, there's plenty to consider in the muni market, a fact that's not lost on either current bondholders or prospective buyers. With muni yields drifting higher amid massive new issue supply and in sympathy with Treasury yields and global rates, compelling entry points have been beckoning investors to increase allocations toward intermediate and long-duration high-quality tax exempts. How compelling are these prevailing yields? In the opening days of September, 15-and 20-year muni yields were higher than 99% of the time over the past 10 years and at least 97% of the time over the past 20 years. Can these yields drift higher? Certainly yes, but this historic value demands attention.

Helping keep these intermediate and long-duration muni yields elevated is a combination of record-high new issuance, a 10- to 20-year yield curve slope 2.5 times steeper than Treasurys and, finally, retail buyer reluctance to invest in maturities beyond 10 years despite the vast majority of 11-year and longer maturities having 10-year call features.

Speaking of rising muni yields, current bondholders have been very active in tax-loss harvesting over the past month, a process we highly recommend as a year-round exercise to make tax-exempt portfolios even more tax efficient.

There are two sides to every trade, including when tax-loss harvesting. Shifting gears a bit, US equities are exhibiting just the opposite investor sentiment from bonds. According to Bloomberg (9/3/2026), the equity risk premium (ERP) for the S&P 500®, at just 39 bps, is lower than 93% of the time over the past 20 years. Using weekly observations, the ERP was lower only 71 times out of the last 1,045 observations.

While the purpose of this note isn't to opine on the equity market, there's a related connection between stocks and bonds, in that the tax-loss harvesting used in tax exempts can also be used to offset gains elsewhere, with equities being a likely candidate. Whether equity investors are delighted, concerned or frightened, locking in high-coupon, high-quality tax-exempt bond yields at 20-year highs for the long term looks compelling today.

Economic outlook

With the September Federal Open Markets Committee (FOMC) meeting fast approaching, market sentiment regarding the Fed's next move has been hanging on every data point, along with comments from Fed officials, which have been few. While the market learns to read chair Warsh, the data has been mixed, as have comments from Fed voting members.

Disinflation may be the trend, but its timeline may be too slow for the Warsh Fed. Regarding the mixed data, look no further than the August Employment Situation Report. The much-stronger-than-expected data featured a gain of 162,000 jobs—almost three times the 55,000 expected—and private payrolls growth of 127,000—more than double the 50,000 expected. The balance of the data set was in line with expectations and included average hourly earnings, average weekly hours, the labor force participation rate and an unchanged 4.1% unemployment rate.

Evidencing that "one month does not a trend make," the August employment report painted a very different picture from the July report, which featured a 23,000-job loss, shattering expectations for an 80,000 increase. With a seemingly resilient US economy in hand, the market's attention now pivots toward inflation.

The Producer Price Index and the Consumer Price Index for August are scheduled for the week before the Fed meeting, potentially playing crucial roles in the outcome of the convocation. The Fed's "preferred" measure of inflation, Core PCE, won't be available until the end of the month, while July's Core PCE was directly in line with expectations, both month-over-month (+0.2%) and year-over-year (+3.3%)

But 3.3% inflation isn't 2% inflation, and chair Warsh reiterated his Fed's commitment to that 2% target at the Fed's Jackson Hole meeting during the final days of August. Bond yields rose in response. Approximately one week later, Fed governor Waller, a voting member, noted signs of disinflation and appeared to indicate that he'll support no change at the September FOMC meeting. Bond yields declined in response.

With mixed data and mixed Fed speak in hand, Fed funds futures pricing on September 4 suggested a 61% chance of a hike in September, which amounts to little more than a low-conviction coin toss.

For muni investors, this all circles us back to whether muni yields could move higher, and they could. Intermediate and long muni yields are already above 97% of the last two decades. Could they go above 100%? Yes. Many bondholders are taking advantage of these elevated levels to tax-loss harvest and lock in the new higher yields. Is it worth taking stock of your muni bond positions and asset allocation today? Yes, indeed.

Key economic data

Change in nonfarm payrolls (Aug.)	+162K
Unemployment rate (Aug.)	4.1%
Core CPI–YoY change (July)	2.5%
Core PCE–YoY change (July)	3.3%
Average hourly earnings–YoY change (Aug.)	3.1%
Real GDP annualized (Q2 2026)	1.5%

Source: Bloomberg, 8/31/2026

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Parametric is headquartered at 800 Fifth Avenue, Suite 2800, Seattle, WA 98104. For more information regarding Parametric and its investment strategies, or to request a copy of Parametric's Form ADV or a list of composites, contact us at 206 694 5500 or visit www.parametricportfolio.com.

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