

Municipal Bond Market Insight | October 2026

The Long View

Key takeaways

- » Fixed income yields rose sharply in September amid concerns about rising inflation, the Federal Reserve's policy path and interest rates remaining higher for longer.
- » Yields across the municipal market are now near their highest levels in 20 years, while credit quality remains broadly stable.
- » The shift toward higher yields has created a compelling opportunity for tax-loss harvesting.
- » Muni tax-equivalent yields are nearing levels commonly associated with equity returns.

General market update

The challenging year for the bond market intensified in September, impacting both the broader fixed income markets and the muni market. The Fed hiked rates at the September Federal Open Markets Committee (FOMC) meeting and is now expected to do so once more this year and again in early 2027. While geopolitical unrest and related military actions ebbed and flowed, oil prices continued to rise, the US economy endured and uncertainty around the Fed's new monetary policy path drove yields meaningfully higher.

The impact to the muni market was a yield increase that eclipsed 20-year highs across the curve. This otherwise attractive spike in tax-exempt yields obviously came at the expense of performance. The muni asset class now resides in negative territory year to date (YTD), along with its federally taxable counterparts, which have been there a while.

At -4.36%, the month-to-date total return on Bloomberg's broadest muni index had its worst monthly performance since September 2008, when the index returned -4.69%. This left YTD total return for munis at -4.18. Treasuries gave up less ground—224 basis points (bps)—which left YTD performance at -2.77%. Investment-grade (IG) corporates were in the middle of the pack, losing 272 bps to arrive at a YTD total return of -3.11%. With virtually all fixed income now in the negative, the questions are whether there's enough time to stage a comeback by year-end and what to do right now.

Supply

September issuance wasn't just heavy; it was the highest September print on record, according to LSEG. Total issuance was \$55 billion, up 13.7% year over year (YoY) compared with last September. YTD supply is now \$459 billion, 6.3% higher than at the same point last year, as muni bond issuers continued to access the market despite volatility and rising rates that drove a sharp decline in refunding deals compared with last September.

Issuance remained heavily weighted toward new-money borrowing, as new-money issuance rose 44%, while refundings fell 25% YoY. The decline in refunding activity was unsurprising given the higher rates, while the strength in new-money borrowing continued to highlight ongoing issuer needs.

Figure 1: Fixed income returns as of September 30, 2026

	MTD return	YTD return
Bloomberg Muni Index	-4.36%	-4.18%
Bloomberg US Treasury Index	-2.24%	-2.77%
Bloomberg US Aggregate Index	-2.61%	-2.91%
Bloomberg US Corporate Index	-2.72%	-3.11%

Source: Bloomberg, 9/30/2026. 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 September 30, 2026

Year	Current	MTD change	YTD change
2-year	3.54%	101 bps	115 bps
5-year	3.74%	90 bps	133 bps
10-year	4.1%	73 bps	134 bps
30-year	5.13%	53 bps	89 bps

Source: LSEG Municipal Market Data, 9/30/2026. 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 September 30, 2026

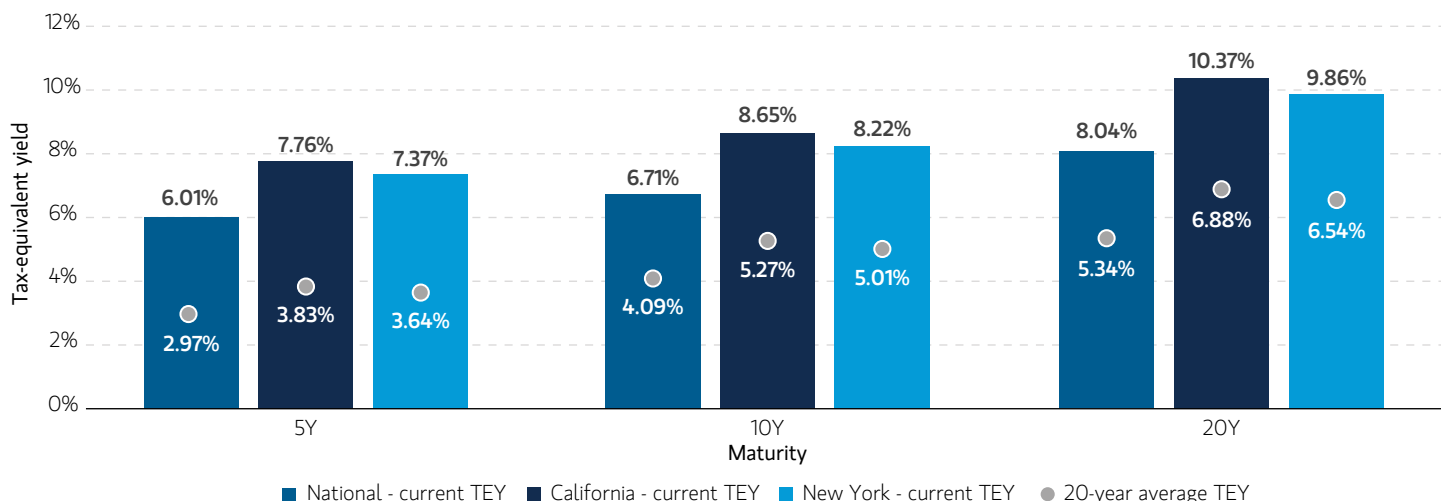
Year	Current	MTD change	YTD change
2-year	4.89%	54 bps	143 bps
5-year	5.09%	59 bps	140 bps
10-year	5.3%	54 bps	116 bps
30-year	5.64%	39 bps	82 bps

Source: Bloomberg, 9/30/2026. 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.**

DISPLAY 1

Tax-equivalent muni yields, current vs. 20-year average (top tax brackets)

as of October 5, 2026



Source: MMD (Municipal Market Data) AAA curve sheet "MMD Jan. 1, 1996 through Oct. 5, 2026." National = 37% federal + 3.8% NIIT = 40.8%; California = 40.8% + 13.3% state = 54.1%; New York = 40.8% + 10.9% state = 51.7%. Assumes the same national muni yields for all three investors, in-state bonds, and no federal deduction for state taxes. **Past performance is no guarantee of future results.** The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment.

YTD issuance remains concentrated, with the top three states dominating the primary market. California accounted for \$69 billion, up 10% YoY. Texas followed with \$59 billion, down 5%. New York came in third with \$43 billion, down 11%, followed by Alabama in a distant fourth place at \$21 billion, up 91%, while Florida rounded out fifth place with \$20 billion, a 6% increase from the same period in 2025.¹

On the demand front, muni mutual fund flows remain impressive YTD. Fund flows closed September with a mild outflow that fully offset a mild inflow the prior week. Flows had previously been positive for 21 weeks, but that trend ended with a massive mid-September outflow of \$1.8 billion.² Subsequent weeks saw much milder net flows, with a mix of substantial inflows and outflows between ETFs and open-end funds during the same week, suggesting significant tax-loss harvesting activity.

Despite the recent turbulence, YTD inflows of approximately \$75 billion remain the second highest on record, according to JPMorgan on October 1. "Statement shock" when clients open their monthly returns may prompt additional outflows, but the current 20-year high in muni yields, if sustained, will likely fuel a return to inflows as buyers examine the opportunity set at hand.

Market opportunity

Recent market moves have unlocked meaningful value across the muni yield curve. IG muni yields are now at or near their highest levels in at least 20 years, while underlying credit fundamentals remain broadly stable. That combination has created a more compelling entry point for investors seeking tax-exempt income. For example, highly rated AA bonds with 5% coupons and good structure are available on the long end of the yield curve at par or even at slight discounts. In muni market vernacular, "fives at par" have historically attracted new-money investment, as well as crossover buyers who opportunistically enter the tax-exempt market in search of total return.

Driving this uncommon value is a combination of rising global rates, a Fed in motion, near-record new issue supply and a massive pipeline of tax-loss harvesting activity that has challenged a firm bid-side. In past instances, specific market events have driven such yield spikes, but the current increase likely stems from a confluence of factors that thankfully doesn't include general muni market credit-quality concerns. Regardless of the cause, many bondholders have been implementing tax-loss harvesting appropriately in recent weeks.

¹ Bloomberg, as of 9/30/26

² LSEG Lipper, as of 9/30/2026

On the topic of yield-curve positioning, there's no question that recent market moves have unlocked value throughout the muni yield curve, but as most investors closely monitor the shape of the Treasury curve, it's worth noting that the muni curve is much steeper. At 101 bps, the slope of the 10- to 30-year muni yield curve is almost three times as steep as Treasurys' 35 bps for the same range, thus offering muni investors much more yield pickup for extending than available in Treasurys.

With this structure in mind, investors may want to consider intermediate to long-term positioning to capture that additional yield and lock in prevailing tax-exempt income for longer. Extending moderately along the curve may also help reduce reinvestment risk, particularly after several years in which elevated short-term rates gave investors little incentive to move beyond cash or short maturities. Investors don't need to make a large-duration call to take advantage of the opportunity.

The historical relationship between starting yields and subsequent returns provides additional context. For example, average 12-month forward returns for the Bloomberg Municipal Bond Index reveal a 5% return when starting yields are 3% or higher using data from May 2000 through May 2026. Those yields and higher are available throughout the yield curve today. While past performance is not necessarily indicative of future results, this data may offer some important context for investors considering today's levels.

Economic outlook

September's FOMC meeting resulted in a 25-bps rate hike, bringing the Fed funds target range to 3.75% to 4% and setting the Fed's monetary policy in a new direction. Because the committee rarely moves just once, and chair Warsh described the adjustment as removing a dose of accommodation, markets immediately began pricing in a materially more aggressive path, which eclipsed the updated Summary of Economic Projection's (the "dot plot") median dot, indicating just one more hike in 2026.

Since then, the economic data have remained mixed. Core PCE, the Fed's preferred measure for inflation, came in cooler for August, at +0.2% versus +0.3% expected and slowed the YoY pace to 3% from 3.3%. But as we mentioned in last month's note, 3% inflation isn't 2% inflation. In the interim, oil prices remained elevated above \$100 per barrel, which drove yields still higher in light of chair Warsh's explanatory

Key economic data

Change in nonfarm payrolls (Sep.)	+29K
Unemployment rate (Sep.)	4.2%
Core CPI–YoY change (Aug.)	2.4%
Core PCE–YoY change (Aug.)	3%
Average hourly earnings–YoY change (Sep.)	3%
Real GDP annualized (Q2 2026)	2.2%

Source: Bloomberg, 9/30/2026

references to commodity prices and geopolitical developments during the last FOMC press conference.

With the market's focus shifting heavily toward data releases, as suggested by chair Warsh during his inaugural FOMC press conference, the Employment Situation Report for September appeared to hold even more weight than usual. Released on October 2, the report showed weaker than expected jobs growth, at just 29,000 jobs created, compared with 90,000 expected, along with a downward revision to last month's outsized increase. The payroll miss meaningfully decelerated the three-month moving average to 51,000 from 71,000. The unemployment rate rose to 4.2% against expectations of no change, and on the wages front, average hourly earnings grew by just 0.1% month over month, compared with a consensus forecast of 0.3%, slowing YoY earnings growth to 3% from the prior 3.1% pace. All-in, it was weaker report, but as we also commented last month, one month does not a trend make.

With continuously mixed data and minimal Fed-speak by design, Fed funds futures pricing on October 2 suggested just a 22% chance of a hike in late-October and an 81% chance at the early-December FOMC meeting. On the same day, Brent crude oil prices were edging lower, at approximately \$102 per barrel, on the back of news that France proposed that developed nations release strategic reserves to ease gas prices.

Given the recent decline in bond prices and corresponding rise in yields over the last month, as well as mixed economic data, yields may have already been pushed toward the upper end of the range justified by current economic conditions. If inflation pressures continue to moderate, and economic growth remains just adequate, today's yields may already reflect considerable uncertainty around Fed policy, inflation and Treasury supply. It's been an interesting year and Fall has arrived with more of the same.

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