Parametric

Municipal Bond Market Insight | February 2026

From Lagging to Leading

Key takeaways

» Municipals outperformed both Treasurys and corporate bonds in January.

» Despite the mild gains, intermediate and long yields remain compelling on an absolute basis.

» Although 2025 was a positive-return year, tax-loss harvesting was strong.

» We expect positive returns for 2026, likely with volatility that facilitates tax-loss harvesting throughout the year.

General market update

For the opening month of 2026, municipals sharply outperformed both Treasurys and corporate bonds. The Bloomberg Municipal Bond Index registered a total return of 0.94%, compared with -0.09% for Treasurys and just 0.18% for corporates. Certainly, one month does not a year make, but we view the impressive January performance as a down payment on a stronger year for muni bondholders. Importantly, prevailing yields on the intermediate and long end of the yield curve suggest there's still plenty of room to run.

While the month was marked by geopolitical concerns that drove Treasury and related spread product yields (corporates) mildly higher, tax exempts were largely cushioned by steady demand and a mild respite from otherwise robust primary market supply. As we discussed last month, the underperformance compared with Treasurys and corporates in 2025 left muni yields in attractive territory and set the stage for a strong open for 2026.

As the month drew to a close, the late-January Federal Open Markets Committee (FOMC) meeting resulted in a widely-expected unchanged Fed funds target of between 3.5% and 3.75% that was met with a muted market reaction. Just days later, the Trump Administration announced its nominee for the next Fed Chair, Kevin Warsh, a former Fed governor known for favoring the transparency of rate policy moves over balance sheet adjustments.

Supply and demand

Varying supply/demand dynamics continue to be a differentiator for the muni bond market, which was clearly on display in January. As we frequently mention, it's a seasonal market.

According to *The Bond Buyer*, primary market issuance in January came in at $34.3 billion, a 7% decline year-over-year but still ranking as the third highest January in the last decade, above the $29.7 billion average. All but $1.3 billion of issuance was tax-exempt, which helped to satisfy steady demand. Yet, despite robust weekly new issue calendars, and even with the record issuance of 2025, there remain spot shortages of bonds in certain states. For prospective buyers, this frequently calls for patience when constructing new state-preference and state-specific bond portfolios, whereas national portfolios are a quicker build.

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

	MTD return	YTD return
Bloomberg Muni Index	0.94%	0.94%
Bloomberg US Treasury Index	-0.09%	-0.09%
Bloomberg US Aggregate Index	0.11%	0.11%
Bloomberg US Corporate Index	0.18%	0.18%

Source: Bloomberg, 1/30/2026. 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 January 30,2026

Year	Current	MTD change	YTD change
2-year	2.18%	-21 bps	-21 bps
5-year	2.24%	-17 bps	-17 bps
10-year	2.63%	-13 bps	-13 bps
30-year	4.29%	5 bps	5 bps

Source: Thomson Reuters Municipal Market Data, 1/30/2026. 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.
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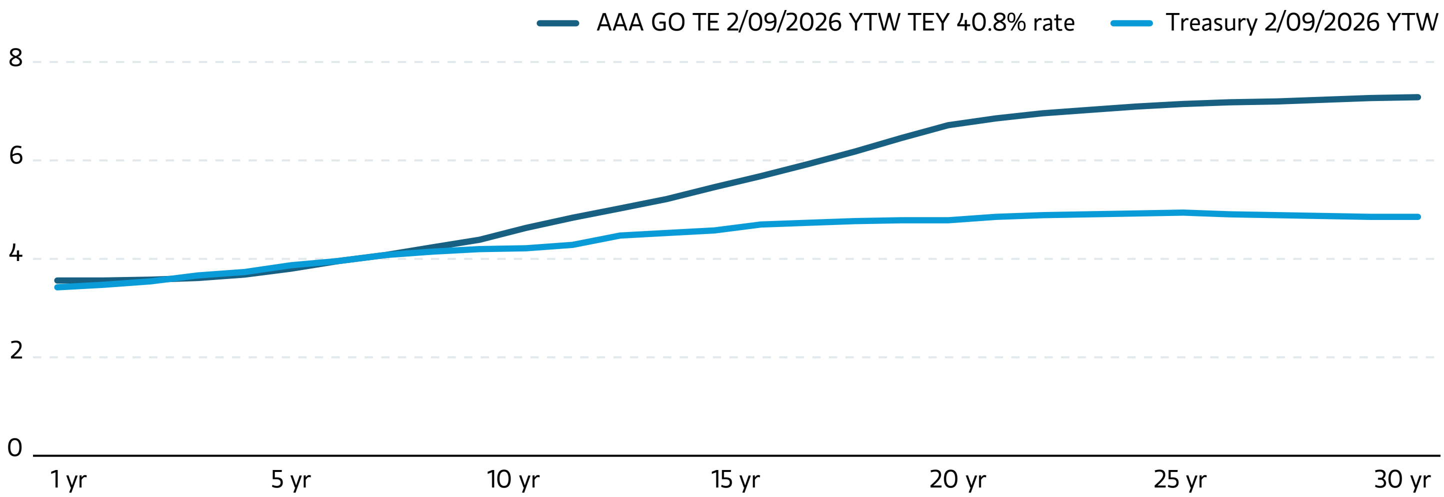
Figure 3: US Treasury yields as of January 30,2026

Year	Current	MTD change	YTD change
2-year	3.53%	7 bps	7 bps
5-year	3.80%	11 bps	11 bps
10-year	4.24%	10 bps	10 bps
30-year	4.87%	5 bps	5 bps

Source: Bloomberg, 1/30/2026. Not a recommendation to buy or sell any security. **Past performance is no guarantee of future results.**

FIGURE 4

Muni tax-equivalent yield-to-worst vs. US Treasury yield-to-worst, as of February 9, 2026



Sources: LSEG MMD, Bloomberg, and Parametric, 2/9/2026. For illustrative purposes only. Not a recommendation to buy or sell any security.
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On the demand front, LSEG Lipper and JP Morgan preliminary tracking estimates suggest approximately $11.1 billion of mutual fund inflows in January, with ETFs capturing $6.1 billion and open-end funds garnering $5 billion. Importantly, weekly net inflows have been consistent for more than two months.

Circling back to our seasonal comments, it's also worth mentioning that January was among the largest months of the year for maturing and called bonds, with approximately $21.2 billion in redemption proceeds hitting bondholder accounts according to ICE data. These funds often fuel reinvestment back into the muni marketplace. We expect solid investor demand to continue and possibly intensify in February, as the month ranks fourth largest of the year behind only the trifecta peaks of June, July and August, each returning an estimated $29 billion to bondholders when supply is typically lighter.

Unlike with Treasurys and corporates, muni market pundits keep a keen eye on the ebbs and flows of both new-issue supply and bond redemptions/coupon payments, as periods of net-positive or net-negative supply can significantly impact tax-exempt price performance.

A quick note regarding muni relative value: The most commonly quoted relationship in determining whether munis are attractive or expensive uses the benchmark 10-year muni yield as a percentage of the on-the-run 10-year Treasury yield. That prevailing ratio stands at approximately 61%, which most market pundits would read as expensive (we believe fair value is 65%), but it's worth noting the numerator (the muni yield) has declined only seven basis points (bps) since the beginning of January, whereas the denominator (the Treasury yield) has risen materially during that same period because of global developments that have nothing to do with the muni market. At the risk of oversimplifying, it appears that Treasurys have cheapened, rather than munis becoming more expensive. The metric still matters, of course, but we'd suggest a greater focus on absolute yield in the near-term.

Market opportunity

Last month we referred to the prevailing elevated muni yields as an *enduring opportunity*. This month we switch to calling it an *ongoing* opportunity. Despite the rather mild rally that handily bested its taxable counterparts, there remains and abundance of muni value along a very steep yield curve, a trajectory that steadily rises in the intermediate and long end of the range.

The silver lining of last year's record issuance and this year's healthy primary market calendars is that tax-exempt yields are close to historic peaks driven by specific temporary market events. The difference is that such events aren't present in the current market; rather, the relentless weight of supply and the need to price those bonds to move are driving the value. Credit quality remains sound, and the market is functioning well.

Specific areas we find interesting include 10- to 20-year ladders, intermediate and long-duration actively-managed strategies and tax-optimized ladders that employ munis, corporates and Treasurys from one- to 10-year maturities. A quick look at the yield-to-worst curve paints a supportive picture, given the similar slope trajectories inside 10 years and the much steeper muni curve from 10 to 30 years.

While we often compare yield curves and relative value, bond investing is also very much about absolute yields. According to benchmark muni yields provided by LSEG MMD, tax-equivalent yields for A-rated bonds range from more than 4% in just five years to almost 8% in 30 years, assuming the top federal tax rate and no state rate. For investors who reside in higher-tax states such as New York and California, those taxable equivalent yields rise to more than 8% and 9%, respectively.

The opportunity to step out of cash and diversify drivers of return is also worth mentioning. As US equities continue to climb a wall of worry regarding evaluations and the risk premium resides near 20-year lows, we think adding ballast with attractive fixed income yields while cash, CDs and Treasury bills may take longer to respond to future rate cuts albeit with less risk. Gradually moving out on the curve to lock in today's yields makes sense.

A final opportunity to consider is to approach muni investing as not just tax-exempt but also tax-efficient. This refers to the long-proven exercise of tax-loss harvesting, but with a key upgrade, not just year-end, but year-round. Tax-loss harvesting in fixed income often involves swapping into similar bonds to maintain portfolio exposure while realizing a loss. Gains and losses can occur at any time during the year, but tax-loss harvesting has long been a fourth quarter tradition. Unfortunately, market volatility often doesn't align with that timing.

As we saw last year, sharp market volatility occurred early in the second quarter with the announcement of tariff reciprocity and subsequent related granularity, a topic that still holds the ability to unsettle markets. Despite the intense April volatility, both equity and bond markets recovered little more than a month later, with a generally-range-bound bond market for much of the year followed by strength in the fourth quarter. This pattern has occurred in two of the past three years. Investors who did not engage in year-round tax-loss harvesting found those valuable losses had largely evaporated by the fourth quarter. Those who took advantage of the early and mid-year market turbulence had their losses realized long before the traditional tax-loss harvesting season even began.

Supported by our proprietary technology, Parametric sold more than $13.4 billion in market value to realize $362 million in net losses in 2025, resulting in an estimated $122 million in potential tax savings for fixed income SMA investors.

Key economic data

Change in nonfarm payrolls (Nov.)	50K
Unemployment rate (Nov.)	4.4%
Core CPI–YoY change (Nov.)	2.6%
Core PCE–YoY change (Sep.)	2.8%
Average hourly earnings–YoY change (Nov.)	3.8%
Real GDP annualized (Q3 2025)	4.4%

Source: Bloomberg, 12/31/2025.

Economic outlook

Our outlook for munis remains positive and rests on continued strong investor demand, robust new-issue supply and an interest rate setup that appears constructive for fixed income in general. We expect a mid-single-digit positive total return for tax-exempts with a mild upside potential. As we prepare this note, the street consensus year-end forecast for the 10-year Treasury stands at 4.11% (Bloomberg,2/7/2026), just nine bps lower than the prevailing yield.

With a fresh FOMC meeting under its belt, based on fed funds futures, market expectations for the next rate cut are highest (59% probability) for June (Bloomberg, 2/7/2026), which would be the new Fed chair's first FOMC meeting. This is followed by a somewhat lower probability (44%) for a September cut. Keeping in mind that the January meeting didn't feature an updated dot plot and that the current summary of economic projections suggests just one 25-bps cut in 2026 and another in 2027, optimism for a second cut this year centers largely on the arrival of the new Fed chair, as well as weakness in select economic data in coming months.

Nominee Warsh, a former Fed governor, now faces a Senate confirmation process complicated by heightened political tensions, the recent hot topic of Fed independence and intense scrutiny of outgoing chair Powell's tenure. This challenging combination makes the upcoming transition a major focus for the markets and a potential source of market volatility. It could be an interesting spring.

As we head to press, the market awaits the payroll report for January, which was delayed by another partial government shutdown. Now scheduled for release on February 11 (three days later than previously expected), the street consensus forecast for non-farm payroll growth is for just 69,000 new jobs, following December's scant 50,000 jobs. We expect the unemployment rate to hold steady at 4.4% and the labor force participation rate to remain constant at 62.4%. After being starved for key economic data in late 2025, the markets are no doubt keen to receive more timely releases, especially if they support the prevailing optimistic outlook of two rate cuts this year.

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