Parametric

Municipal Bond Market Insight | October 2025

Finally on the Scoreboard: What It Means

Key takeaways

- Muni total return is now up 2.6% year to date (YTD).
- September's price performance was the strongest monthly showing in 16 years.
- Intermediate and long yields remain compelling and still offer attractive value.
- Year-round tax-loss harvesting has again proved prescient thus far, but the year's not over.

General market update

As our title suggests, September saw positive performance in fixed income markets but a great and overdue catch-up for municipal bonds. As we discussed in last month's insight, your starting point matters greatly, and it was and remains "an excellent opportunity to build high-quality portfolios at bargain prices." Recapping the broad events of September and the opening days of October, on the heels of a much weaker-than-expected August Payroll Situation Report, the Fed fulfilled market expectations by cutting the overnight fed funds rate 25 basis points (bps) at the September Federal Open Markets Committee (FOMC) meeting and signaled that additional cuts were in the offing by the end of this calendar year. For the month, the Bloomberg US Treasury Index returned 0.85%, while the Bloomberg US Corporate Index gained 1.5% on tightening credit spreads. Municipals, enjoying a mild respite from formerly relentless supply, posted an impressive 2.32% to register their strongest month in 16 years (JP Morgan, 10/2/2025). YTD through September 30, the US Treasury Index is up 5.36%, the Corporate Index is up 6.88% and the Muni Index is finally on the scoreboard at 2.64%, and the prospects for further gains look promising.

Supply

As we've been discussing for much of this year, supply has been a major muni market factor during 2025. Simply stated, there has been an overabundance of new-issue bonds coming to market. Although the tax-exempt market has successfully digested the outsized weekly calendars in an orderly fashion, that market saturation came at the price of performance. Our viewpoint has consistently been that this supply will ebb enough to enable stronger performance during the second half of the year. With the shot clock ticking loudly as we head deeper into October, it's heartening to see that year-over-year (YoY) supply was actually down by 10.5% in September, which follows a negative 4.8% print in August, and the muni market has certainly responded with pricing gains. We believe there's more ground to cover. We'll cover that thought process in a moment.

Figure 1: Fixed income returns as of September 30, 2025

	MTD return	YTD return
Bloomberg Muni Index	2.32%	2.64%
Bloomberg US Treasury Index	0.85%	5.36%
Bloomberg US Aggregate Index	1.09%	6.13%
Bloomberg US Corporate Index	1.5%	6.88%

Source: Bloomberg, 9/30/2025. 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, 2025

Year	Current	MTD change	YTD change
2-year	2.3%	10 bps	-52 bps
5-year	2.32%	-5 bps	-55 bps
10-year	2.92%	-30 bps	-14 bps
30-year	4.24%	-37 bps	34 bps

Source: Thomson Reuters Municipal Market Data, 9/30/2025. 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 September 30, 2025

Year	Current	MTD change	YTD change
2-year	3.6%	+2 bps	-65 bps
5-year	3.73%	+4 bps	-67 bps
10-year	4.14%	-8 bps	-44 bps
30-year	4.73%	-19 bps	64 bps

Source: Bloomberg, 9/30/2025. 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.

Though a mildly lighter supply environment has indeed arrived, as evidenced by the two consecutive monthly YoY declines and even spot shortages of bonds in certain "specialty" high-tax states, it doesn't feel like there has been a material slowdown. After supply-fatigued trading and underwriting desks worked through the muni summer that wasn't (supply typically slows but didn't this year), the September experience was jarring, given the saw-toothed issuance pattern that transpired. Looking at the scheduled sales by week according to Ipreo, we see this on-and-off dynamic that featured $7.5 billion, $11 billion, $5 billion, $15 billion and $7 billion into the first week of October. On average, that's about $9 billion per week, which is a healthy clip, but the lighter interim weeks left no time for market pundits to catch their collective breath. In fact, as we pen this note, next week's calendar is scheduled to bring a healthy $13 billion to market, so the saw-toothed action continues.

Market opportunity

After highlighting outsized muni price performance in September, the natural next question appears to be, "Is the window of opportunity now closed?" We don't believe it is. A number of factors lead us to that conclusion. These include elevated muni relative value compared with Treasurys, absolute yields that remain historically compelling, a muni yield curve that is much steeper than that of Treasurys and the fact that we expect supply to ebb further in November and December. Generally positive muni mutual fund flows are also a contributing factor.

Before delving into those potential drivers of further positive performance, let's spend a moment on what the YTD positive performance means for tax-efficient muni investing—specifically, tax-loss harvesting. In prior insights we've discussed the need for professional year-round tax-loss harvesting despite many investors still approaching the process as a pre-Thanksgiving tradition. As we've seen time and time again, market losses can occur at any point during the year. Obviously, many of those losses have since been recouped, but with that recovery comes fewer opportunities to take losses as an asset that may be able to enhance after-tax returns. These losses can be used to potentially offset gains or taxable income in the current year or could be carried forward indefinitely, while resetting book yields higher. Third-party research has shown that tax management can add 1% to 2% in after-tax excess returns for equity—known as *tax alpha*—and as much as 30 bps for fixed income.

In recent years we've seen a number of examples when it paid to harvest tax losses systematically whenever the opportunity presented itself, For example, in 2023 chair Powell indicated that the Fed was done raising interest rates, and the market never looked back and rallied sharply through year-end. As a market leader in tax-efficient investing, Parametric has already sold more than $13 billion in market value YTD through September 30 to realize $330 million in net losses, delivering a potential tax benefit of more than $119 million for our Parametric fixed income SMA investors. A recent Cerulli report highlighted tax management as one of the most valuable priorities in investing for high-net-worth clients.

There is also a noticeable difference between the shapes of muni and Treasury yield curves. The muni curve is much steeper beyond the 10-year maturity. In fact, the slope of the muni yield curve between 10- and 30-year maturities (132 bps on October 2) is more than twice that of the 60-bp pickup offered by Treasurys. This means that investors may be rewarded significantly more for extending out on the curve in munis than in Treasurys if yields trend lower.

Finally, we now have a Fed that is back in easing mode after cutting in September, which could provide an additional and considerable performance tailwind if Fed signaling and market expectations are proved correct with two more 25-bp cuts by year-end, which we'll discuss in a moment.

Worth noting also is the importance of muni mutual fund flows, which tend to be pro-cyclical, meaning there are often inflows when yields are declining and outflows when yields are rising. This dynamic is counterintuitive to long-term muni buyer psychology and can provide attractive entry points during outflow episodes. Inflows have dominated in recent months, with only three outflow weeks out of the last 22 weeks. This metric bears watching given a more balanced supply/demand muni market, as we report in our latest weekly fixed income insights.

Economic outlook

Looking forward, a very recent addition to the challenge of market forecasting is the absence of certain economic data—for example, payrolls, CPI and PPI—because of the government shutdown. While we're hopeful the delay in reporting will be temporary, it does have impacts on both market sentiment and economic activity, as it heightens sensitivity to what is available. Each week of closure is also estimated to trim approximately 0.1% from US GDP growth. Thankfully, GDP growth was holding up well going into the shutdown, despite some cracks on the labor front, having been recently revised upward to 3.8% annualized.

The "old" August Payroll Situation Report came in at a materially lower 22,000 jobs created, compared with the 75,000 expected, featured an unchanged unemployment rate of 4.3% and raised expectations for a 25 bp rate cut at the September FOMC meeting, which was later fulfilled. Two weeks later the Fed lowered the target range to 4% to 4.25%, and a new Summary of Economic Projections (the "dot plot") signaled two more cuts this year, while upgrading its outlook for growth in 2026 and forecasting modestly higher inflation next year. The fed funds futures market currently indicates a 97% probability for a cut at the October 29 FOMC meeting and 87% odds for a cut at the December meeting (Bloomberg, 10/3/2025).

Key economic data

Change in nonfarm payrolls (Aug.)	22K
Unemployment rate (Aug.)	4.3%
Core CPI–YoY change (Aug.)	3.1%
Core PCE–YoY change (Aug.)	2.9%
Average hourly earnings–YoY change (Aug.)	3.7%
Real GDP annualized (Q2 2025)	3.8%

Source: Bloomberg, 9/30/2025

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