Parametric

Municipal Bond Market Insight | September 2025

Glass Half Full

Key takeaways

» Today's prevailing yields may set the table for favorable performance ahead.

» Tax-exempt yields are near decade highs, and relative value is above the two-year average.

» Now could be an excellent time to build high-quality municipal portfolios at bargain prices.

General market update

As we head into fall, US economic momentum has been solid, despite the ongoing tariff saga and geopolitical tensions, but some of the cracks that market pundits have been looking for all year may be starting to show. The data-dependent Fed has taken notice and appears to be indicating that the September 16-17 Federal Open Market Committee (FOMC) meeting will be "live", with the possibility of a 25-basis-point (bp) cut to the fed funds overnight rate. As we write this, the futures market indicates an 88% probability of said cut.

During August, the 10-year Treasury moved within a relatively tight range of 4.2% to 4.34%. Coming off a 4.36% yield on the final day of July, yields declined quickly to the 4.2% low in the first few trading days only to rise to 4.34% by mid-month, then complete the roundtrip back to 4.21 on the last trading day of August.

For the month, the Bloomberg US Treasury Index returned 1.06%, while the Bloomberg US Corporate Index gained 1.01% on tightening credit spreads. Municipals, continuing to be challenged by relentless new-issue supply, logged a 0.87% total return. Year-to-date (YTD), the US Treasury Index is up 4.48%, the Corporate Index is up 5.3% and the Muni Index is up just 0.32% (explanation below).

If you're interested, check out our perspective on the One Big Beautiful Bill Act.

Supply

Municipal bond supply usually dwindles in July and August just as proceeds from bonds maturing, bonds being called away and coupon payments (all sources of reinvestment demand) hit bondholder accounts and create supply scarcity or net-negative supply. As we discussed last month, this seasonal dynamic usually drives strong price performance, but this isn't a usual year. Although we did experience the year's highest amount of reinvestment cash, there was no supply dwindling to speak of for most of the summer.

Figure 1: Fixed income returns as of August 29, 2025

	MTD return	YTD return
Bloomberg Muni Index	0.87%	0.32%
Bloomberg US Treasury Index	1.06%	4.48%
Bloomberg US Aggregate Index	1.2%	4.99%
Bloomberg US Corporate Index	1.01%	5.3%

Source: Bloomberg, 8/29/2025. 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 August 29, 2025

Year	Current	MTD change	YTD change
2-year	2.20%	-19 bps	-62 bps
5-year	2.37%	-16 bps	-50 bps
10-year	3.22%	-10 bps	16 bps
30-year	4.61%	-6 bps	71 bps

Source: Thomson Reuters Municipal Market Data, 8/29/2025. For illustrative purposes only. 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 29, 2025

Year	Current	MTD change	YTD change
2-year	3.62%	-33 bps	-63 bps
5-year	3.67%	-30 bps	-73 bps
10-year	4.23%	-13 bps	-35 bps
30-year	4.93%	4 bps	14 bps

Source: Bloomberg, 8/29/2025. For illustrative purposes only. Not a recommendation to buy or sell any security.

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DISPLAY 4

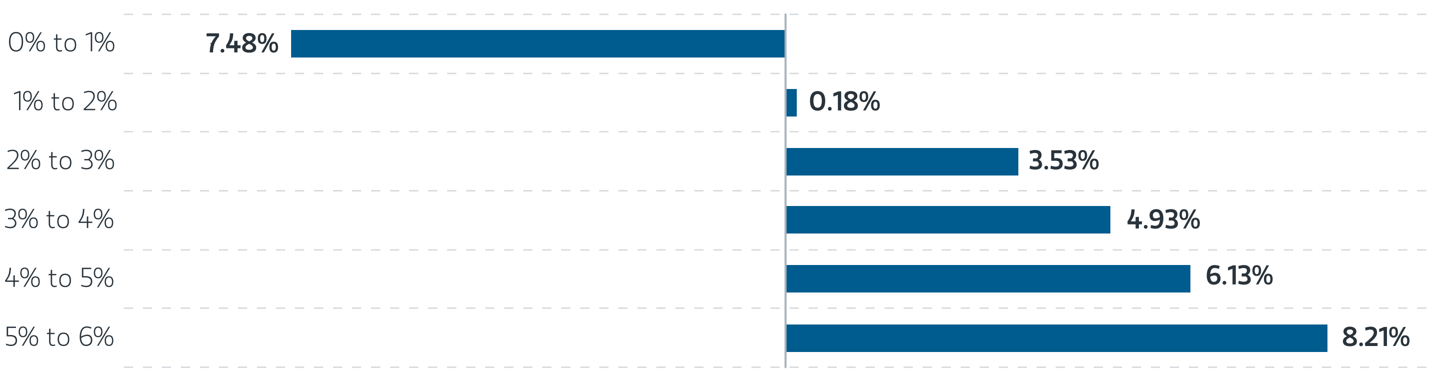
Tax-equivalent yields as of September 2, 2025

MATURITY	TAX-EXEMPT YIELD	NATIONAL TAX-EQUIVALENT YIELD*	NY TAX-EQUIVALENT YIELD**	CA TAX-EQUIVALENT YIELD***
5-year	2.41%	4.07%	4.99%	5.25%
10-year	3.21%	5.42%	6.65%	6.99%
20-year	4.36%	7.36%	9.03%	9.5%
30-year	4.58%	7.74%	9.48%	9.98%

Source: LSEG MMD and Parametric 9/2/2025. *National tax-equivalent yield assumes 37% federal bracket and 3.8% net investment income tax. **New York tax-equivalent yield assumes 37% federal bracket, 3.8% net investment income tax and 10.9% New York state income tax rate. ***California tax-equivalent yield assumes 37% federal bracket, 3.8% net investment income tax and 13.3% CA state income tax rate. **Past performance is no guarantee of future results.** Index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment.

DISPLAY 5

Average index 12-month forward return



Sources: Parametric and Bloomberg, 5/1/2025. Index data based on Bloomberg Municipal Bond Index. Data analyzed from 5/1/2000 through 5/1/2025. Starting yields are represented by index yield to worst. Starting yields and forward index returns are based on daily values for the last 25 years. It is not possible to invest directly in an index. Indexes are unmanaged and do not reflect the deduction of fees or expenses. **Past performance is not indicative of future results.**

In fact, after a robust July, the first week of August brought $17 billion in new supply—the fourth largest week on record—and was followed by an $11 billion week. Then it stepped back to $8 billion, then $6.6 billion and $7.5 billion entering the first week of September (Ipreo, JP Morgan, 8/29/2025). If maintained, this deceleration could be very constructive for pricing, but the timing of the slowdown could be better. The amount of reinvestment cash hitting bondholder accounts is also stepping down. September redemptions are scheduled to be little more than half of what August brought for bondholders. That said, muni mutual fund flows, which tend to be market-driven, may play an enhanced, significant role in coming months.

Market opportunity

YTD performance for municipal bonds remains slightly positive, the market is functioning well and there are no material credit issues to speak of. Although positive, munis have been sharply lagging other fixed income like Treasurys and corporate bonds. The good news is that there are still plenty of very attractively priced bonds available. And herein lies the debate: Do we focus on the lackluster YTD performance or on the opportunity it has created?

Muni buyers typically have investment horizons longer than just a few years, and the starting point matters greatly. Considering that one primary goal may be to lock in compelling yields and tax-free income for the long-term, YTD performance headwinds may present an excellent opportunity to build high-quality portfolios at bargain prices.

Unlike other years that have experienced muni price weakness from sharply rising rates, credit concerns or the expectation of credit concerns, this year's underperformance essentially stems from one source: Supply; in other words, too much of it. Let's call it too much of a good thing.

Potential drivers of this robust supply include continued pent-up demand from issuers, deals pulled forward resulting from unfulfilled concerns over potential changes to the federal tax exemption for muni bonds and increased issuance from higher education and other sectors that feared a loss of tax-exempt market access. Interestingly, in a year marked by countless headlines, the biggest news in the muni market didn't get a headline at all: The absence of inclusion of any muni tax-exemption limitations in the One Big Beautiful Bill Act. (Nothing to see here, muni folks.) This also means that the urgency for issuers to bring their deals to market no longer exists. In fact, we expect primary market supply to decline in coming months. We've already seen four weeks of lighter calendars, which could be very positive for price momentum, if sustained.

This leaves us with the opportunity at hand. Tax exempt yields are near decade-highs, and relative value compared with Treasurys is well above the two-year average. The glass is half-full. With intermediate and long-term tax-exempt portfolio yields more than 3.5% (Bloomberg Muni 10-Year Index, 9/5/2025) and 4.85% (BBG Long Bond Index, 9/5/2025) respectively, taxable-equivalent yields for top-tax-bracket investors in the highest-tax states have eclipsed 7% and 9%, respectively.

Taking advantage of today's prevailing yields may also set the table for favorable performance ahead, especially considering that the Fed is widely expected to resume its easing of monetary policy with a rate cut in just a few weeks, which should be a tailwind for fixed income price performance. The accompanying exhibit shows the average 12-month forward returns for the Bloomberg Municipal Bond Index based on starting yield to worst. On average, a higher starting index yield to worst has led to higher forward 12-month returns. For example, the average Index return over the 12 months following all starting yields between 3% and 4% has been 4.93%.

Key economic data

Change in nonfarm payrolls (Jul.)	73K
Unemployment rate (Jul.)	4.2%
Core CPI–YoY change (Jul.)	3.1%
Core PCE–YoY change (Jul.)	2.9%
Average hourly earnings–YoY change (Jul.)	3.9%
Real GDP annualized (Q2 2025)	3.3%

Source: Bloomberg, 8/29/2025

Economic outlook

Although the second release of second-quarter GDP at +3.3% was above both the 3.1% consensus estimate and the prior reading of +3% growth, market participants appear to be content placing more emphasis on the more recent July Payroll Situation Report for clues as to US economic momentum. While one data release isn't a trend, the slightly-below-expectations jobs report was accompanied by material downward revisions to prior months' releases that were enough to shadow the upbeat GDP data.

Despite Personal Consumption Expenditures (PCE) and core PCE readings directly in line with expectations, anticipation for a rate cut this month runs high in the bond market. While most interest rate strategists are looking for a quarter-point reduction, bringing the overnight lending rate to a range of 4% to 4.25%, some are looking for a 50-bp move in what would be a repeat of last September's action. At the time, the double-cut was described by the Fed as a catch-up reduction. Although such a move seems unlikely, we said the same a year ago, which heightens the anticipation for the September 17 announcement and accompanying press conference.

Ahead of the FOMC meeting, markets will likely be sharply focused on the August Payroll Situation Report set for release on September 5, as well as subsequent data, including Institute for Supply Management Manufacturing and Services Indexes, durable goods orders, the Producer Price Index and the Consumer Price Index, all set for release before the two-day Fed meeting.

Looking beyond the September meeting, street consensus expectations for additional policy easing have recently been pulled forward. With some rate strategists now forecasting subsequent cuts this calendar year and multiple cuts in 2026, it promises to be an interesting fall.

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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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