

**MUNICIPAL BONDS**

# Credit Trends Are Deteriorating, Making Selection Critical

*This report is excerpted from the [Second Quarter 2026 Fixed-Income Sector Views](#).*

Expect weak reinvestment demand from principal and interest payments until June.

Municipal bond performance will likely be driven by the coupon, with limited price appreciation at current valuation levels. The AAA tax-exempt curve steepened by 30 basis points during the quarter, but ultra short paper underperformed due to tight starting valuations and changes to central bank rate cut expectations. Headwinds should exceed tailwinds in municipal credit.

## Sector Commentary

- ♦ Tax exempt/Treasury yield ratios withstood geopolitics-driven rate volatility to end the first quarter essentially where they began 2026. Ratios in the 5-year and 10-year spots are around 66 percent and 71 percent, respectively, vs. a three-year range of 55–88 percent, and have generally kept up with the long end of the curve, where the 30-year ratio sits at around 91 percent compared to a three-year range of 79–101 percent.
- ♦ Taxable municipal spreads were flat during the first quarter, but tightened versus investment-grade corporates. Supply remains low year to date, down 9 percent year over year to \$6 billion. Besides one-off deals, most municipalities are unlikely to issue taxable debt given current relative valuations between exempts and taxables. Thus taxable muni spreads are likely to follow investment-grade spreads for most of the year.

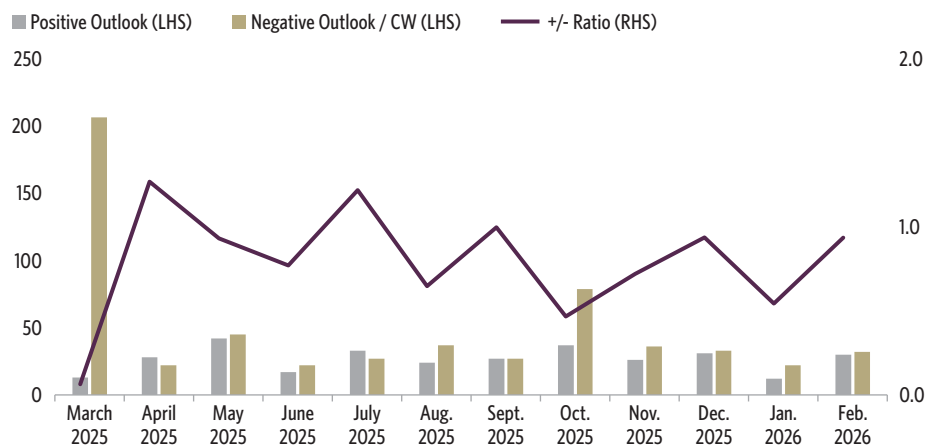
## Investment Themes

- ♦ Issuers have proactively shifted deal structures to inside 10 years, where most separately managed accounts operate and have shown very strong demand for tax-exempt bonds. We believe better values can be had for investors willing to move further out the curve.
- ♦ At Standard & Poor’s, negative outlook revisions have exceeded positive revisions for most of the last 12 months, implying more downgrades than upgrades for the next six–18 months in municipal credit. We expect negative credit trajectories to continue.
- ♦ Despite growing budgetary pressures from slowing revenue growth and cuts to federal transfers, an increasing number of states are considering phasing out property taxes, which are steadier than other tax streams and provide a backbone for local government finance. Reducing property taxes without lining up a viable alternative ultimately leads to service reductions and negatively impacts municipal credit quality.

*By Allen Li and Michael Park*

Standard & Poor’s negative outlook revisions have mostly outpaced positives, signaling more ratings downgrades than upgrades over the next six-18 months.

### Headwinds Exceed Tailwinds in Municipal Credit



Source: Guggenheim Investments, Standard and Poor’s. Data as of 2.28.2026.

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One **basis point** is equal to 0.01%.

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