

Municipal Bonds

Long-Dated Munis: Relative Value Amid Yield Curve Steepness

This report is excerpted from the *Fourth Quarter 2025 Fixed-Income Sector Views*.

Fiscal challenges emerge as federal stimulus depletes, impacting municipal credit dynamics.

Longer-dated municipal bonds are likely to maintain their relative outperformance over shorter maturities, supported by the steepness of the municipal yield curve both in absolute terms and compared to the Treasury curve. However, state and local governments may face increasing fiscal challenges as pandemic-era federal stimulus funds are depleted, potentially influencing both technical and credit spreads, and funding strategies in the municipal market.

Sector Commentary

- Tax-exempt municipal bonds returned 3.0 percent in the third quarter, with long-dated maturities outperforming as the yield curve flattened from prior steep levels. Performance improved following the Fed's September rate decision.
- Principal and interest payments are entering a seasonal lull, averaging \$49 billion per month from October to December, compared to \$72 billion during the summer. New issuance, averaging over \$10 billion weekly since September, may pressure tax-exempt/Treasury yield ratios without sustained mutual fund and ETF inflows.
- Taxable municipal bonds posted a 2.5 percent return in the third quarter, driven by tighter spreads and a Treasury rally, though spreads underperformed investment-grade corporates. Year-to-date issuance of \$25 billion reflects a 10 percent decline from the same period in 2024, highlighting reduced supply in the taxable municipal market.

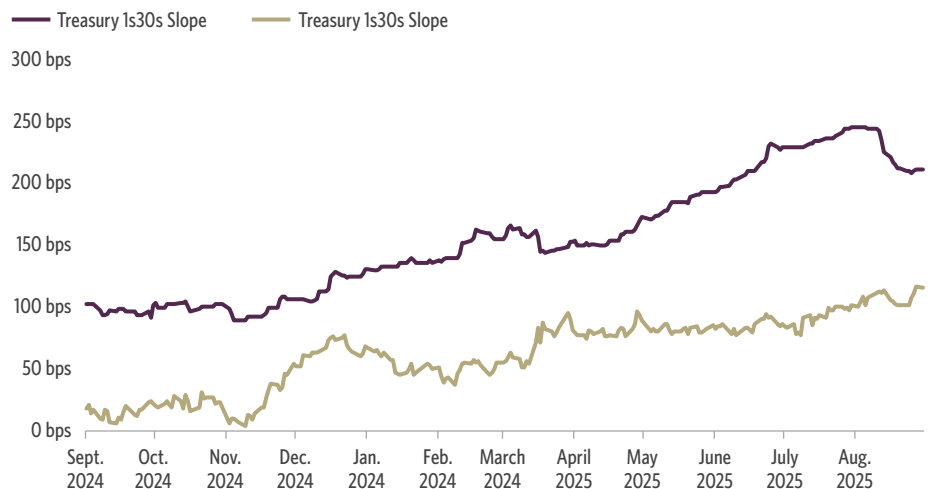
Investment Themes

- The AAA tax-exempt yield curve has flattened by 58 basis points from its 12-month wide, with a 184 basis point spread between 1-year and 30-year maturities. The municipal curve remains steeper than the Treasury curve.
- Municipal/Treasury yield ratios have compressed following the recent rally, potentially slowing further curve flattening. Long-dated tax-exempt bonds offer attractive relative value versus shorter maturities, compensating investors for duration risk.
- Fiscal year 2026 marks the first full budget cycle for most states without residual federal stimulus funds from COVID-era programs. States like Michigan and Pennsylvania face extended budget negotiations, while Louisiana and others experience revenue declines from prior tax cuts. These fiscal pressures are expected to cascade to local entities, widening budget gaps for cities, schools, and other municipal issuers.

By Allen Li and Michael Park

Municipal/Treasury yield ratios have compressed following the recent rally, potentially slowing further curve flattening. Long-dated tax-exempt bonds offer attractive relative value versus shorter maturities, compensating investors for duration risk.

Municipal/Treasury Yield Ratios Have Compressed Following the Recent Rally



Source: Guggenheim Investments, Municipal Market Monitor. Data as of 9.30.2025.

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

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Investing involves risk, including the possible loss of principal. In general, the value of a fixed-income security falls when interest rates rise and rises when interest rates fall. Longer term bonds are more sensitive to interest rate changes and subject to greater volatility than those with shorter maturities. During periods of declining rates, the interest rates on floating rate securities generally reset downward and their value is unlikely to rise to the same extent as comparable fixed rate securities. High yield and unrated debt securities are at a greater risk of default than investment grade bonds and may be less liquid, which may increase volatility. Investors in asset-backed securities, including mortgage-backed securities and collateralized loan obligations ("CLOs"), generally receive payments that are part interest and part return of principal. These payments may vary based on the rate loans are repaid. Some asset-backed securities may have structures that make their reaction to interest rates and other factors difficult to predict, making their prices volatile and they are subject to liquidity and valuation risk. CLOs bear similar risks to investing in loans directly, such as credit, interest rate, counterparty, prepayment, liquidity, and valuation risks. Loans are often below investment grade, may be unrated, and typically offer a fixed or floating interest rate.

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