

You Can't Know Where You're Going If You Don't Know Where You've Been

This is the time of the year when financial market commentators take a moment to make sense of the year just past and to ruminate on what the next twelve months might bring. As historians are fond of reminding us, “You can’t know where you’re going if you don’t know where you’ve been.”

What can we say about the municipal bond market in 2025? Here is one visual that might sum it up: if there was a financial market dictionary or encyclopedia of some sort (a dated notion, I know), under the entry of “resilience,” a simple graph of 2025’s municipal bond market yields might suffice. Last year offered more than its share of market moving events affecting bond markets. It would take some time to catalogue the litany of new and unusual events investors had to sort through in 2025. Let us just say that if there was a Nobel prize awarded for “dealing with stuff,” the year 2025 would be a worthy recipient or certainly deserving of a nomination at least. Still, in digesting all that transpired in 2025, the Bloomberg 1-15 Year Muni Index managed to finish the year with a more than respectable total return of +5.18%. This was no small feat given a -2.53% year to date total return as of the first week of April. Municipal bond market resilience is indeed a remarkable thing. While a number of factors contributed to the bounce back, it was the steady drumbeat of sizable net inflows into municipal bond ETFs and funds from May through the end of the year that stood out. This robust demand for munis absorbed, generally without incident, the plentiful new issue supply that came to market last year.

In thinking about the 2026 municipal bond market, we can begin with the fundamentals of expected supply and demand. Muni market participants are forecasting new issue supply for 2026 at \$625 billion to \$650 billion, a 9% to 10% increase over 2025’s high level. This is meaningful growth but not necessarily dramatic. We would lean toward the lower end of those projections given the high volume of munis issued in 2025 and the possibility of somewhat subdued economic activity and revenue collection this year. We believe muni bond issuers are likely to exercise caution in taking on large amounts of new debt in 2026. A very large increase in new issue volume would surprise us. Regarding muni bond demand, it has not been wise recently to bet against the ongoing attractiveness of municipal bond yields for high tax bracket investors and the seemingly relentless flow of funds into muni bond investments.

What might put a dent in the robust demand for municipal bonds we expect in 2026? Some of the usual culprits would include unusually strong competition from other asset classes (think of a large, extended, seemingly unstoppable stock market rally), sharply rising interest rates creating sizable declines in bond values, and a very visible credit event. We suggest the probabilities on the first two culprits are not high. The third culprit we mention brings us to the city of Chicago. For all its troubles, the city remains strategically located and the third largest in population with a still sizable, diverse economy not dominated by a single industry. State and local governments (particularly large cities) have in their toolbox a number of self-correcting measures to fight their way back to fiscal balance. This is not to dismiss the real challenges Chicago faces. The current structural imbalances in Chicago’s budget will require imagination and heavy lifting to resolve...and copious amounts of political haggling. It is those kinds of debates that grab headlines. If serious and persistent enough with a large very visible issuer, that kind of newspaper noise can bleed into the broader muni bond market in terms of wider credit spreads. We would view that spread widening, if it were to occur, as a likely opportunity to capture attractive yield.

Regarding non-muni specific factors to consider in 2026, the never-ending tug-of-war continues. Forces that might prompt lower rates include Federal Reserve policy (including a new Chairman with a bias for lower rates), moderating energy prices and AI-induced productivity gains that keep inflation from intensifying, a generally subdued labor market, and a possible scaling back of economic activity generally

from lower income consumers. Forces working to push rates higher include the nagging fear from many market participants (especially longer maturity bond traders?) that inflation is not whipped and could reignite, concerns (finally) about the Federal government's high borrowing and budget deficit, and an economy surprisingly durable in terms of capital investment and upper income consumer spending. The possibility that these generally offset each other and a trading range persists in 2026 at current levels or at a modestly lower level seems more than reasonable.

To the extent the trading range mentioned above becomes a reality and if geo-political and other events provide a highly uncertain and perhaps even chaotic landscape in 2026, municipal bonds could garner even more attention as a comparatively stable and resilient asset class...one that happens to deliver attractive tax-exempt income for high tax bracket investors as well.

Tracking every 2025 tax-exempt muni bond purchase we have made for our clients in our intermediate muni bond strategy through 12/31/2025, we have captured an average yield to call of 106 basis points and an average yield to maturity of 111 basis points above similar maturity, standard high-grade triple A muni bond scales. All bond purchases were investment grade rated with maturities of 15 years and under, an average rating of single A, an average maturity of eight years, and an average call of three years.

Currently, single A-rated municipal bonds in the attractive 8 to 15-year range offer yields of 3.40% to 4.10% tax-free, or a 5.40% to 6.51% taxable equivalent yield for top tax bracket investors. We continue, as always, to use careful judgment on the pace at which we invest cash. We remain committed to our dogged and judicious search for value in the investment grade, intermediate maturity space of the municipal bond market.

Tom Dalpiaz, Portfolio Manager – Municipal Bonds

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26 Main Street, Suite 304, Chatham, NJ 07928

Tel: 212-935-0755 Fax 888-901-4201



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