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OUTLOOK FOURTH QUARTER 2026

Rate spike creates a compelling entry point for munis

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The municipal market returned -6.35% in the third quarter, the worst quarterly showing since 1981, driven largely by rate dislocation rather than credit deterioration. Credit fundamentals and inflows remain strong. With yields at the 99th percentile, we view this as a compelling entry point.

Key takeaways

- **Yields hit historic highs. The Bloomberg Municipal Bond Index yields 4.78% — the 99th percentile for yields dating back 20 years — meaning that yields on 01 October are in the highest 1% of all observations over the past two decades.[1]**
- **Credit fundamentals remain sound. The selloff was rate-driven, not a credit event. State and local revenues are sound, and elevated investor inflows remain on track for the second highest annual level on record.**
- **History favors patient investors. In the past, when yields on the Bloomberg Municipal Index exceeded 4%, the ensuing three-year cumulative return averaged 19.81%, or 6.19% annualized.[2] This demonstrates long-term income — not rate timing — has driven investment performance.**

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

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Oil prices and technicals drove rate volatility

A mix of macro and geopolitical factors drove one of the largest interest rate spikes for 10-year U.S. Treasuries in 25 years. By extension, 10-year municipal paper moved higher by 115 basis points (bps) — the largest quarterly move since the 2022 rate hike cycle.

In our view, a multitude of factors drove the rate selloff, including the inflationary pressure of elevated oil prices, a more hawkish U.S. Federal Reserve and continued fiscal profligacy, all with the backdrop of a surprisingly firm labor market and strong underlying economic data.

Importantly, this rate backup was not caused by weak municipal fundamentals. On the contrary, credit conditions for municipalities remain sound, supported by positive growth in personal income taxes, sales taxes and property taxes. Credit spreads stayed relatively stable through the volatility, and trading remained orderly — a sign of investor conviction.

The Bloomberg Municipal Bond Index underperformed the broad-based Aggregate Index, a proxy for the overall U.S. fixed income market, by 284 bps for the quarter. We believe this meaningful underperformance was driven by technical factors unique to the muni market that accelerated in September:

- **Heavy supply:** $167 billion for the quarter and $57 billion in September alone (up 22% from September 2025).
- **Lower reinvestment flows:** September experienced only $37.5 billion of bond calls, maturities, coupons and sinking funds — versus an average of $57.4 billion in July and August.
- **Tax-loss selling:** Large-scale swapping of bonds to reset an investor's tax basis often pushes yields wider.

We expect $600 billion in 2026 issuance. However, supply could trend lower if primary market paper from bond refinancings, which were up 6.8% through the third quarter, slows in the fourth quarter. This would be a potentially helpful technical for the market.

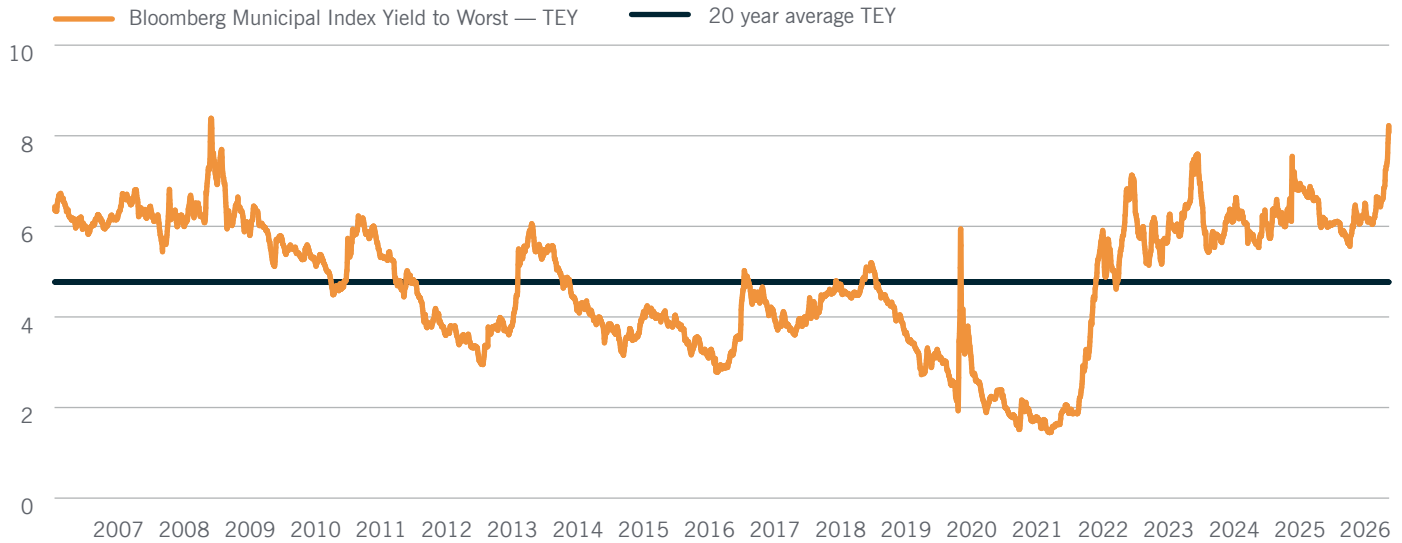
> **Portfolio implication:** Municipal credit is sound, and the swift reset in rate expectations may attract buyers looking to reallocate away from risk assets.

Higher yields reset investor opportunity

Municipal yields reached their highest levels since 2008, giving investors more tax-exempt income and a greater cushion against volatility (Figure 1).

Figure 1: Higher yields may provide greater cushion against volatility

Taxable-equivalent yield (%)



Data source: Bloomberg, L.P., 29 Sep 2006 – 30 Sep 2026. **Performance data shown represents past performance and does not predict or guarantee future results. Representative index:** Bloomberg Municipal Bond Index. **Taxable-equivalent yield (TEY)** is the yield a taxable investment needs to possess (before taxes) for its yield to be equal to that of a tax-free municipal investment. The yields shown are based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income. Individual tax rates may vary. They do not take into account the effects of the federal alternative minimum tax (AMT) or capital gains taxes.

Income has historically driven over 85% of municipal total return, underscoring the value of a high starting yield.[2] A larger income component can help offset price declines during periods of volatility while improving the potential for positive long-term total returns.

Consider: The Bloomberg Municipal Bond Index's price return declined -7.31% year-to-date. However, its total return, while still negative, was -4.18%. The 3.38% coupon helped cushion the impact of a rising rate environment.

Yield remains the most reliable predictor of long-term performance (Figure 2). Over the past 20 years, when the Bloomberg Municipal Bond Index yield exceeded 4%, average municipal returns over the ensuing three years reached 19.81%, or 6.19% annually — roughly 9.81% on a taxable-equivalent basis.

Historically, rate volatility weighed most on investors when starting yields were low. Higher starting yields now offer greater insulation from future rate shocks, improving the expected balance of outcomes.

The Bloomberg Municipal Bond Index reflects 11.63% upside potential if rates fall 1% versus expected -2.34% downside if rates rise the same amount (1%). If bond math holds, we'd expect approximately 5x as much upside as downside with a +/-1% rate move, a marked improvement over the 30-year average.

Portfolio implication: Investors with multiyear horizons have a stronger case to deploy capital now. High starting yields matter more than waiting for certainty on rates.

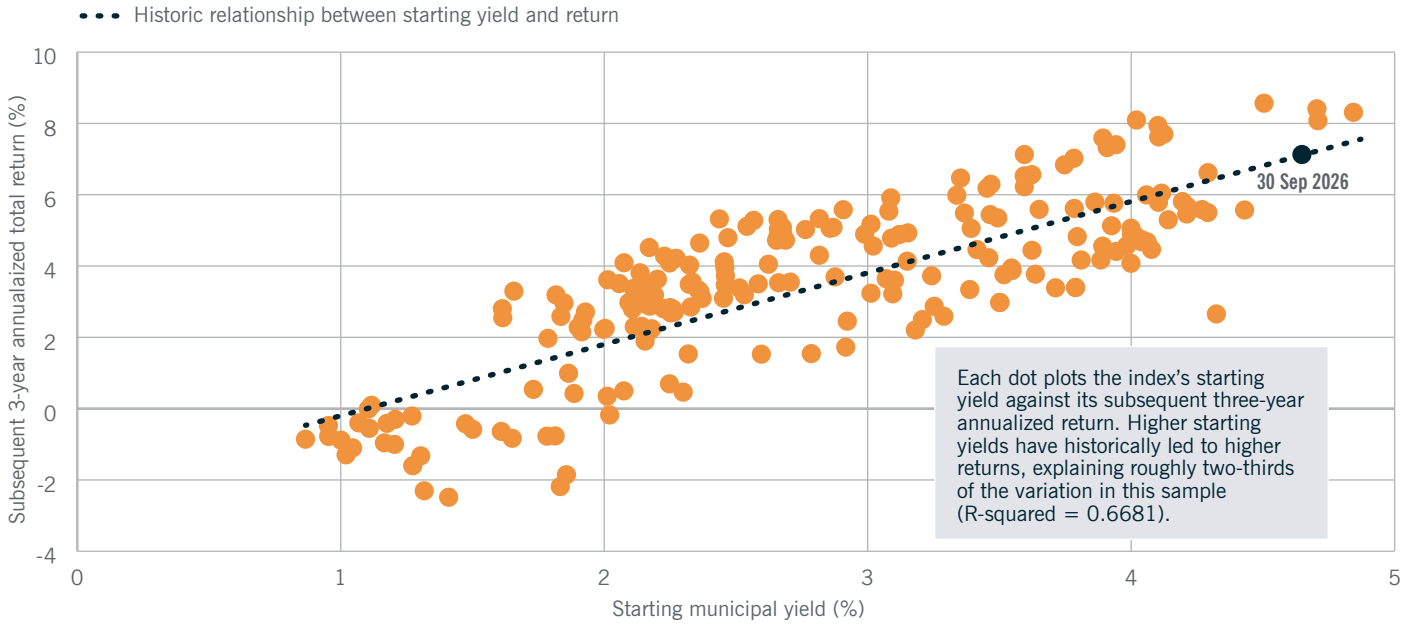
Munis reclaim their role as ballast

Bond market volatility during the quarter drove flows to money market instruments at the fastest pace since March of 2020. Despite the move, we see bright spots ahead that support the municipal market's role as a portfolio stabilizer.

Supply could slow in the fourth quarter, as issuers planning to refund existing debt may wait for a more favorable rate environment. Refunding supply has driven much of this year's overall new issuance, up 20% year-over-year through the third quarter versus just 1% growth in new-money supply. Recent data shows callable bonds refinancing at lower rates, with only 43% of eligible August calls refunded compared to a 75% monthly average this year. Lower supply may help the muni market find its footing and could be met with reemerging demand.

Figure 2: Higher starting yields have historically supported higher forward returns

Taxable-equivalent yield (%)



Data source: Bloomberg, L.P., 29 Sep 2006 – 30 Sep 2026. **Performance data shown represents past performance and does not predict or guarantee future results. Representative index:** Bloomberg Municipal Bond Index. Yield represents yield-to-worst. Monthly data showing rolling 3-year returns.

The demand picture has held up reasonably well, despite some end-of-the quarter giveback, while trading has been orderly. This suggests investors still value municipals' income potential. Shareholder inflows have topped $68 billion year-to-date, one of the strongest years on record.

Net flows remained largely positive, even in September, as investors rotated from open-end mutual funds to exchange-traded funds — suggesting tax-loss selling rather than a broader exit. Corporate buyers such as banks and insurance companies, historically marginal buyers during periods of elevated rates, could return as they rotate out of less favorable taxable fixed income.

> **Portfolio implication:** Municipal bonds can offer the potential to lock in high levels of tax-exempt income. Maintain cash for liquidity needs, but consider putting strategic capital to work.

Midterm elections could influence credit landscape

This November, voters in several states will decide tax measures with meaningful implications for municipal credit. Seventeen states have enacted or are proposing property tax relief measures, and several other states are considering or have implemented new income taxes (Figure 3). These potential tax changes underscore why careful, credit-specific research remains essential.

Below, we outline three states' tax measures illustrating how we're thinking about these issues.

Florida's tax relief plan carries fiscal risk

Florida voters will consider a constitutional amendment that would dramatically expand homestead exemptions, eventually raising the exemption to $250,000 in January 2028 for all non-school property tax levies.

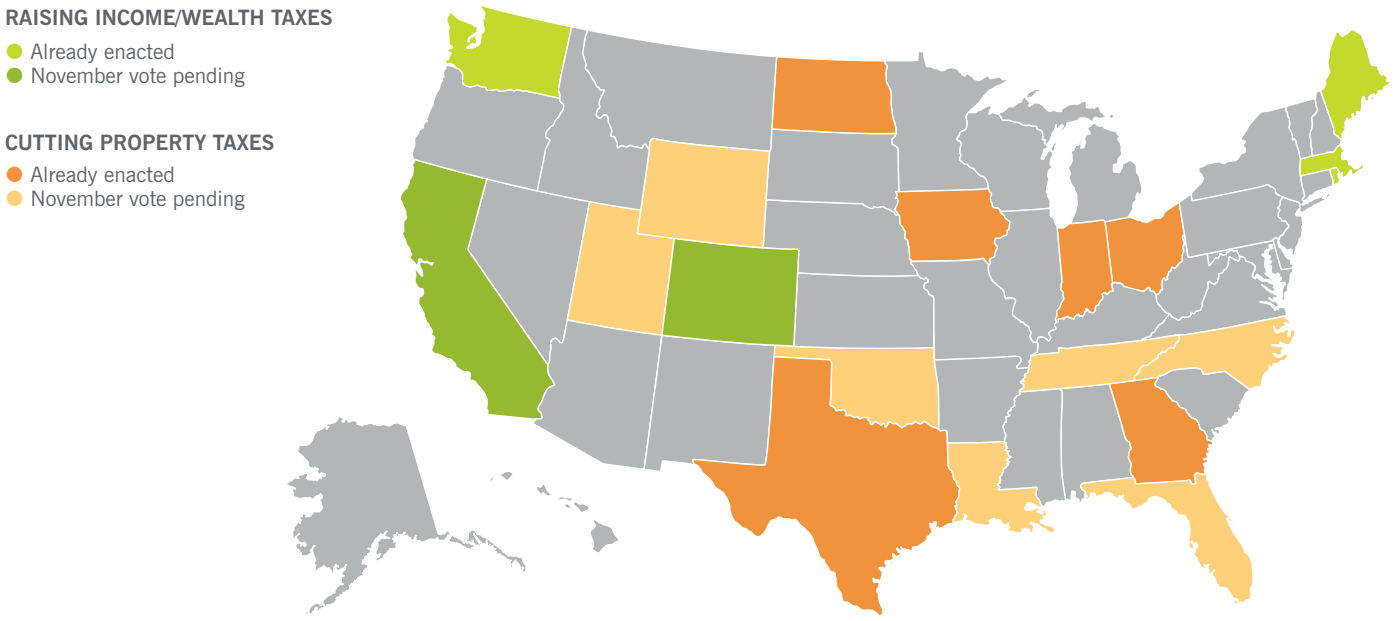
Requiring 60% voter approval, this measure, if passed, would significantly constrain local governments' ability to fund operations, with communities that rely heavily on residential property taxes facing the steepest revenue losses. Importantly, general obligation debt service remains protected, but operating budgets could face real pressure.

Takeaway: Differentiate Florida issuers by residential tax reliance and revenue flexibility. Essential-service coverage and protected debt service remain key credit anchors.

California voters must choose one tax path

California voters face a complex set of competing wealth tax measures. Proposition 40, the Billionaire Tax Act, would impose a one-time 5% tax on the net worth of roughly 200 billionaires, potentially generating $20 billion

Figure 3: Ballot initiatives target wealth taxes and property tax cuts



Data source: Nuveen municipal credit research

annually. Two other propositions on the ballot were created to counter it.

All three share a trigger mechanism: if all pass, only the measure with the highest vote total takes effect, nullifying the other two.

Separately, Proposition 3 would extend an existing income tax on high earners past its scheduled 2031 expiration, generating between $5 billion and $15 billion annually for education.

Takeaway: Monitor which measure wins and its implementation.

Washington breaks tradition with new income tax

Washington enacted its "Millionaire's Tax" in March 2026, marking a historic shift for a state with no prior income tax. Beginning in 2028, households earning more than $1 million annually will pay a 9.9% income tax.

The measure is projected to generate $3.6 billion annually, reducing Washington's reliance on sales and excise taxes, and will affect roughly 30,000 taxpayers. Notably, yield spreads on Washington bonds widened relative to peers ahead of the announcement, potentially offering an attractive entry point for investors in high-quality paper.

Takeaway: Evaluate widened Washington spreads selectively. New revenue diversifies the tax base, but weigh implementation risk against relative value in quality issuers.

Brightline files for prepackaged bankruptcy

Brightline, the Florida passenger rail operator, filed for prepackaged Chapter 11 bankruptcy in September 2026 after ridership and revenue growth failed to keep pace with its heavily leveraged capital structure. The operating company remains outside the filing under a negotiated Restructuring Support Agreement.

The exit financing package totals $600 million, including $140 million in new first-lien debt, $350 million in subordinated financing and roughly $110 million in interest deferral.[3] The exit structure preserves $2.264 billion of existing debt and adds $490 million in new debt, bringing total obligations to $2.75 billion. Repayment hinges on Brightline growing EBITDA to roughly $170 million by FY2028 and $250 million by FY2030, up sharply from an estimated $36 million in 2026.

Nuveen funded its pro rata share of senior financing — $28.5 million in new first-lien debt and $28.9 million in interest deferral — to protect its existing holdings, declining to fund the subordinate debt and debtor in posession (DIP) loan given their speculative, equity-like risk. Since 2023, Nuveen has reduced its Brightline exposure by more than 70% and exited its Brightline West position entirely.

Takeaway: Brightline's recovery hinges on ambitious EBITDA growth and successful ridership execution ahead.

Putting today's yields to work

The third quarter selloff was difficult, but it reset the opportunity. Income has always driven municipal returns, and today's high starting yields offer meaningful tax-exempt income potential plus a cushion against further rate volatility.

For investors sitting underweight munis — particularly top-tax-bracket investors weighing cash alternatives — this may be a compelling window to put capital to work for the long term.

We see several investment priorities in the current environment:

- Selectively extend duration, particularly between 15 to 25 years, given steepness of the municipal curve.
- Favor high-quality general obligation and essential-service revenue bonds.
- Treat new-issue softness and concessions as potential buying opportunities.

Credit fundamentals stay solid despite volatility

The muni sector scorecard shows our views on credit fundamentals, momentum and valuations for major municipal sectors.

Muni sector scorecard

\+ Positive = Neutral — Negative

SECTOR	CREDIT FUNDAMENTALS	CREDIT MOMENTUM	KEY TAKEAWAY
State & local governments	=	=	Steady tax revenue growth and strong reserves provide cushion against possible economic slowdown and federal policy uncertainty.
Education	=	—	Pressure due to increased competition for students and affordability coupled with federal policy changes. Large universities will be able to navigate, smaller colleges likely to struggle.
Transportation	+	=	Airport cash balances are healthy and passenger demand remains well above pre-pandemic peak levels, though emerging uncertainty around higher oil prices could impact travel. Capital investment is needed to expand capacity.
Housing	+	=	Need for affordable housing bolsters demand. Labor supply constraints due to immigration policy shifts may delay projects.
Water & sewer utilities	+	=	Essential service, monopolistic providers with robust liquidity will continue to require significant capital investment.
Health care	=	=	Elevated labor and supply costs are normalizing. Most hospitals will adapt to federal Medicaid policy changes coming in 2027. Smaller, rural hospitals may struggle.

Data source: Nuveen, 30 Sep 2026. Certain statements may be deemed forward-looking statements. Please note that any such statements are not guarantees or intended to constitute a prediction of any future performance; actual results or developments may differ materially from those projected.

Challenging our 5 themes

Five themes shaped our outlook entering 2026. Many were realized, and the market selloff has delayed some.

	What's happening?	Progress report	Actions to consider
Low money market rates unlock cash rotation	$7.5T in sidelined cash may move toward higher-yielding assets	Investors flocked to money market assets amid interest rate volatility. Cash may be stickier given rate moves, but we think historically high yields may attract a more modest rotation.	Position in high-quality munis; lock in yields, particularly with call-protected longer-duration bonds.
Record supply wave meets surging reinvestment demand	2026 issuance is projected at a record ~$600B and reinvestment flows may surge 50%	Supply may slow in Q4 driven by issuers holding off on refunding bonds in the high rate environment.	Capitalize on this positive technical by allocating to munis.
Steepest yield curve in years rewards duration extension	20-year munis offer an attractive yield pickup over 5- and 10-year bonds	The steepest yield curve in years favors longer maturities, but the rise in front end rates made opportunities across the curve more attractive than recent history.	Extend duration where appropriate and consider shifting out of short Treasury instruments to tax-exempt bonds.
Federal policy shifts create differentiation opportunities	The One Big Beautiful Bill Act reduces federal support for states, hospitals, universities and utilities	Reduced federal support will pressure hospitals, higher education and public power unevenly. Credit selection matters more than ever.	Selectively add top-tier health care and higher education credits.
Record reserve levels anchor credit resilience	Most municipal borrowers enter 2026 with reserves at historic highs and recession-tested revenue sources	Record rainy day fund balances and rising tax revenues support our conviction that municipals are well-positioned even in a recessionary scenario.	Focus on state/local GOs, water/sewer utilities; favor select charter schools and land-secured in high yield.

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For more information, please visit nuveen.com.

Endnotes

1 Data source: Bloomberg, L.P., Bloomberg Municipal Index yield to worst, 30 Sep 2006 – 30 Sep 2026.

2 Data source: Bloomberg, L.P., 30 Sep 2006 – 30 Sep 2026.

3 Data source: Nuveen, based on draft restructuring materials; terms subject to definitive documentation, September 2026.

Sources

All market and economic data from Bloomberg, FactSet and Morningstar.

Gross Domestic Product: U.S. Department of Commerce. Treasury Yields and Ratios: Bloomberg (subscription required). Municipal Bond Yields: Municipal Market Data. Open-end fund flows: Investment Company Institute. Municipal Issuance: JPMorgan. Defaults: Municipals Weekly, Bank of America/Merrill Lynch Research. State Revenues: The Nelson A. Rockefeller Institute of Government, State Revenue Report. State Budget Reserves: Pew Charitable Trust. Global Growth: International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD). Standard & Poor's and Investortools: http://www.invtools.com/. Flow of Funds, The Federal Reserve Board: https://www. federalreserve.gov/releases/z1/default.htm. Payroll Data: Bureau of Labor Statistics. Bond Ratings: Standard & Poor's, Moody's, Fitch. New Money Project Financing: The Bond Buyer. State revenues: U.S. Census Bureau.

NASBO Fall 2025 Fiscal Survey; CMS.gov; New York City February 2026 Financial Plan.

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Taxable-equivalent yields are based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income. Individual tax rates may vary. Inflation rate used is the PCE Deflator, which is removed from the after tax income of the 3 month T-bill yield, resulting in an after tax and after inflation rate for cash. Yield to worst (YTW) is the lowest possible annualized return an investor can receive on a bond, assuming the issuer does not default and exercises any embedded provisions like early redemption or call options.

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