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Fourth quarter 2025 outlook

Taxable municipal bonds: room to run

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Year-to-date, taxable municipal bonds have returned 6.43%, marking the best start to a year through the third quarter since 2020. While taxable municipals have slightly underperformed corporate bonds in 2025, their spread advantages over similarly rated corporates provide a solid runway for additional gains.

KEY TAKEAWAYS

- **Compelling entry points:** Municipals have underperformed the corporate market year-to-date, creating opportunities for the asset class to continue recent positive momentum.
- **Strong fundamentals:** Municipal credit remains resilient, with tax revenue collections and reserves at all-time highs despite slowing economic data elsewhere.
- **Seasonal factors:** An uptick in new issuance could create attractive buying opportunities for active managers.
- **Credit selection:** As sector-specific challenges widen performance gaps between stronger and weaker credits, disciplined security selection becomes increasingly critical to achieving optimal portfolio returns.

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BEST IDEAS FOR Q4: TAXABLE MUNICIPAL RALLY GATHERS PACE

Strong market momentum and robust credit fundamentals are driving opportunities in the municipal market. Looking ahead, our best ideas for portfolio positioning in the fourth quarter include:

Adding BABs while you can

Build American Bonds (BABs) offer high coupons and relatively high yield per unit of duration. At the end of the third quarter, BAB spreads were 97 basis points (bps) compared to non-BAB index spreads of 51 bps. As extraordinary redemptions (ERPs) have increased in recent years, BABs are becoming scarcer.

Year-to-date ERP activity by par volume declined by over 50% from prior year. So far in 2025, $5.35 billion in ERPs have reduced outstanding BABs to approximately $79.8 billion. For investors focused on total returns, BABs offer spread opportunities compared to non-BAB alternatives and BBB rated corporate bonds. (Figure 1)

> *Rigorous credit selection and thorough research remain essential to capture sector opportunities.*

Exploring pressured sectors

Municipal sectors caught in political crosshairs, such as higher education and health care, are trading at attractive levels relative to historical norms.

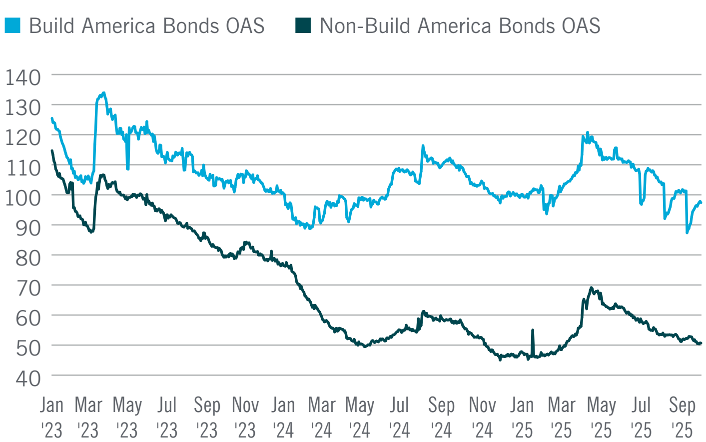
Higher education institutions faced pressure from Washington early in the year, as well as elevated new issuance in March and April 2025. Spreads reached a month-end high of 70 bps in April before tightening by 13 bps over the next five months, ending the third quarter at 57 bps.

Health care spreads widened slightly across the quality spectrum due to uncertainty about future Medicaid spending. Spreads were 99 bps as of April month end but have slowly tightened since July to 93 bps in September. As headline risk subsides, spreads should compress.

Well-managed hospital systems retain flexibility to reduce expenses and absorb revenue pressures from potential Medicaid reductions. Rigorous credit selection and thorough research remain essential to capture sector opportunities. NYSDA Roswell Park Cancer Institute Obligated Group Revenue Bonds (S&P AA rated) new issue priced at +85 option-adjusted spread in August, but spreads have tightened to +55 bps in under two months.

Figure 1: Build America Bonds offer opportunity

BABs vs non-BABs



BABs vs BBB corporates

Data source: Bloomberg L.P., 31 Dec 2023 – 31 Mar 2025. **Performance data shown represents past performance and does not predict or guarantee future results.**

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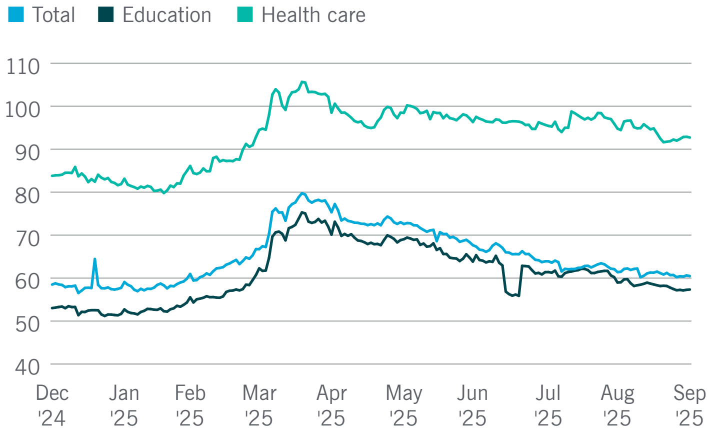
Figure 2: Sector option-adjusted spreads



Data source: Moody's Investors Service, U.S. Municipal Bond Defaults and Recoveries, 1970-2025, 30 Sep 2025, with data as of 30 Sep 2025, updated annually. **Performance data shown represents past performance and does not predict or guarantee future results.**

FED CUTS RATES, MORE TO COME?

The Fed cut rates 25 bps in September, which was largely anticipated by the market. The Fed further updated its forward guidance from 25 bps of additional rate cuts to 50 bps for the balance of the year, despite inflation running marginally above expectations.

The bigger surprise for the quarter was a weakening labor market, with jobless claims hitting a new post-Covid high of 263,000 in August alongside a general trend of slowing job creation. The Fed's emphasis on employment downside risks despite "somewhat elevated" inflation supports expectations for continued easing, with markets currently pricing in 100 bps of additional cuts by year-end 2026.

Given this backdrop of declining interest rates for short maturity paper, investors can capture meaningful yield increases by moving out of cash — which is likely to continue to experience lower yields as the Fed pursues additional rate cuts — and rotating into higher yielding municipal bonds.

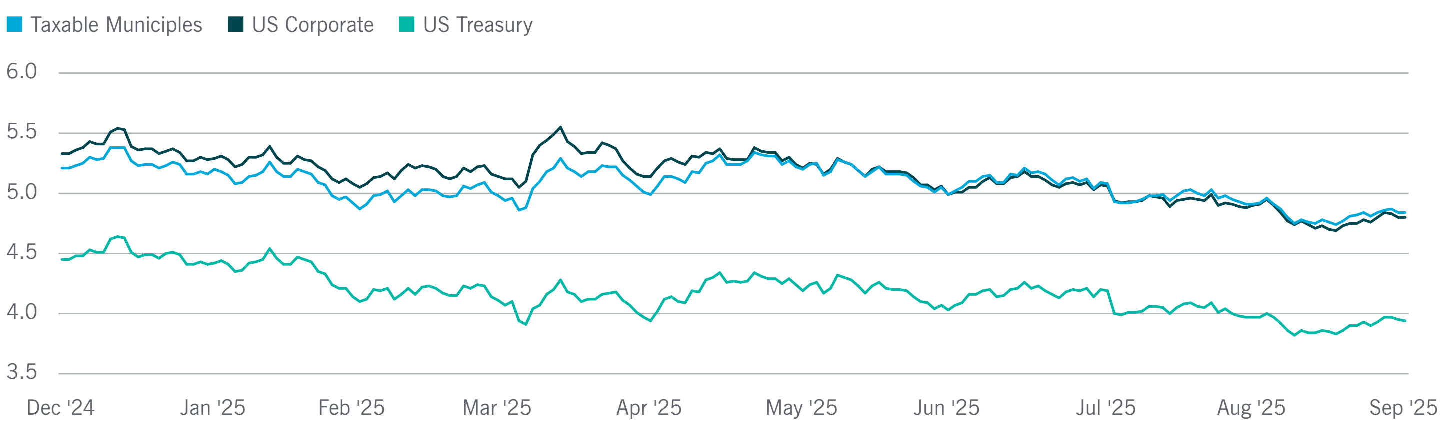
MUNICIPAL RALLY CONTINUES, BUT BARGAINS STILL EXIST

Taxable municipal bonds outperformed U.S. Treasuries during the third quarter by 100 bps, with the Bloomberg Taxable Municipal Bond Index returning 2.51% versus1.51% for U.S. Treasuries. However, taxable municipals trailed corporates, as the Bloomberg Investment Grade Corporate Index returned 2.60%.

The U.S. Treasury curve became less inverted during the third quarter. Long-end yields were relatively unchanged, while rates fell on the short end following interest rate cuts.

Despite this strong performance, municipals still present significant relative value for investors deploying cash now. Taxable municipal absolute yields sit higher than U.S. corporates and Treasuries. At the end of the third quarter, taxable municipals yielded 4.84%, compared to 4.80% for

Figure 3: Taxable municipals are attractive relative to corporates



Data source: Bloomberg. Indices: Bloomberg Municipal Index Taxable Bonds Total Return Index Value, Bloomberg US Corporate Bond Index, Bloomberg US Treasury Index

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corporates and 3.94% for U.S. Treasuries. These conditions present an attractive opportunity for investors looking for corporate-like yield with generally lower default risk.

TECHNICAL TAILWINDS GATHER STRENGTH

Total municipal bond supply is projected to exceed last year's record $500 billion, though issuance should slow in the fourth quarter. According to the Securities Information and Markets Association, $434 billion has been issued year-to-date – 12% higher than 2024, but down from the 15% increase in the second quarter. Taxable municipal issuance is flat year-over-year at $24.6 billion. Taxable municipal supply cooled in the third quarter, down 40% versus the second quarter and settling in at $6.6 billion.

We anticipate taxable issuance will increase in the fourth quarter from third quarter's limited new issue volume, and 2025 taxable new issue volume should be nearly flat year-over-year. New issuance totaled $8.8 billion in the fourth quarter for 2023 and 2024, and we expect similar issuance in 2025 which would represent a 32% quarter-over-quarter increase. Increased fourth quarter new issuance should create buying opportunities for active managers , as some investors may shift focus to corporate markets following the third quarter's low new issue volumes. Year-to-date, taxable single-family housing, general obligation and higher education sectors have seen the most issuance.

Taxable new issue supply remains flat year-to-date and has stayed suppressed over the past three years, driving strong demand for deals. The combination of moderating supply, reinvestment of BAB ERP proceeds and supportive demand creates favorable technical conditions heading into the fourth quarter.

> *Increased fourth quarter new issuance should create buying opportunities for active managers*

MUNICIPAL YIELD RETURNS TO THE SPOTLIGHT

Despite elevated risk and uncertainty, long-term municipals offer attractive yields, providing downside cushion against further volatility. The Bloomberg Taxable Municipal Index currently yields 4.84%, well above the five-year average yield of 4.21%.

While the long end of the U.S. Treasury curve was steady into quarter-end, the duration opportunity remains attractive. The two-year U.S. Treasury bill yield stands at 3.61%. In a rate cutting environment, investors should expect this to fall alongside policy rates, while long-end yields should remain range bound.

MUNICIPAL FUNDAMENTALS STRONG DESPITE YIELD CHALLENGE

Municipal credit fundamentals remain steady, with state and local tax revenue collections up 5.1% through the first half of 2025, compared to 2024. All major tax categories – income, sales and property – increased, with individual income tax collections leading at 10.9% year-over-year growth. Tax revenues remain at all-time highs despite slowing economic growth, positioning the sector well even if growth decelerates further.

POLICY CLARITY SUPPORTS THE MUNICIPAL MARKET OUTLOOK

The passage of the One Big Beautiful Bill's on 4 July 2025 brought collective relief to the municipal market by preserving the municipal tax exemption. While broader federal policy changes may still impact certain sectors, individual securities will be positioned differently based on their unique fundamentals. This environment makes rigorous credit selection increasingly critical for generating outperformance.

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Figure 4: Muni sector score card

\+ Positive = Neutral – Negative

Sector	Credit fundamentals	Credit momentum	Valuations	Key takeaway
State and local governments	+	=	+	Tax collections up and reserves at all time highs-provides cushion against economic slowdown
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	=	=	+	Large capital projects coupled with slowdown in air travel and shipping to ports, against backdrop of strong credit fundamentals
Housing	+	=	+	Need for affordable housing bolsters credit
Water and sewer utilities	+	=	+	Essential service, monopolistic providers with strong reserves and cash flow
Health care	=	=	+	Haves and have-nots (largely smaller rural hospitals). Stronger hospitals will likely weather Medicaid changes, while weaker providers will seek partners or struggle

Data source: Nuveen, 30 Sep 2025. 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.

MUNICIPALS POISED TO FINISH STRONG

Historically high yields, attractive valuations and strong credit fundamentals continue to drive solid positive returns for taxable municipals.

The current environment presents a compelling entry point for taxable municipal investors. With Fed rate cuts expected, stable demand and seasonal supply/demand dynamics likely favoring performance ahead. Municipal headwinds appear to have reversed course, helping to deliver multiple performance opportunities heading into 2026.

For more information, please visit nuveen.com.

Endnotes

Sources

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: Siebert Research. 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.

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