

September 2025

Muni market: embracing challenge to create opportunity

The municipal bond market is approaching a compelling inflection point. While headlines focus on yield curves and historical comparisons, a deeper narrative is emerging — one of resilience, strategic opportunity and potential reward for forward-thinking investors.

We spoke with Dan Close, CFA, Head of Municipal Bonds, who offers a fresh perspective on how today's market challenges are creating tomorrow's investment opportunities.



Dan Close, CFA
Head of Municipal Bonds

KEY TAKEAWAYS:

- Performance dispersion between maturities creates tactical opportunities through strategic trading, tax loss harvesting and investment in new issues.
- Municipal bonds provide steady tax-exempt income while offering potential price appreciation as yields normalize.
- Municipal issuers maintain robust finances and healthy reserves despite current yields sitting at the 94th percentile of their decade-long historical range.¹

WHAT HAS DRIVEN MUNICIPAL MARKET UNDERPERFORMANCE?

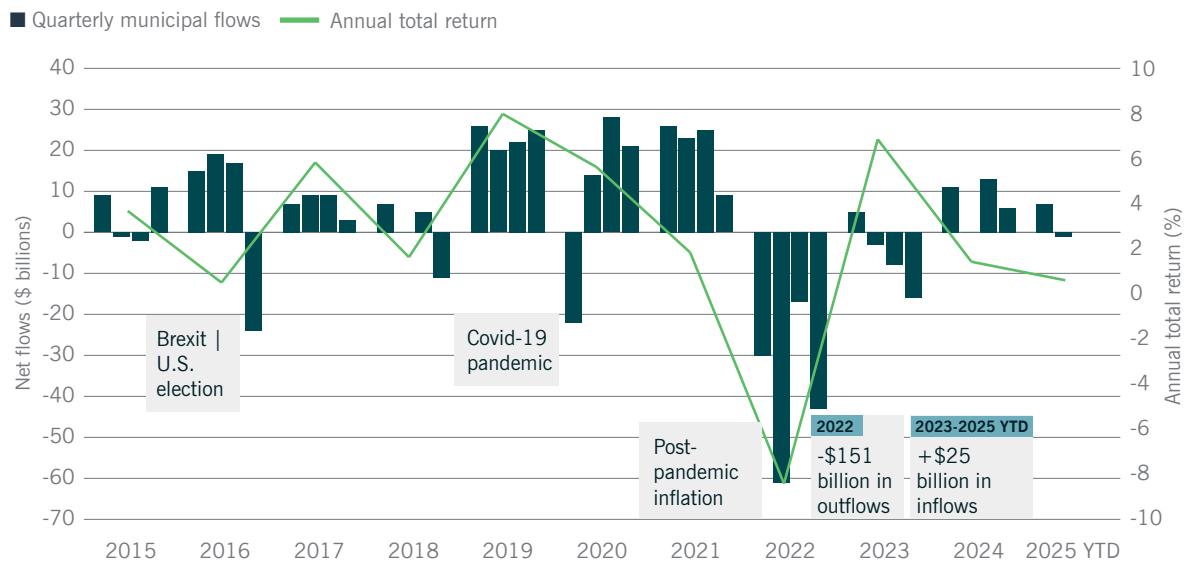
I would point to several factors that have influenced investor sentiment and market dynamics:

Unprecedented supply pressure: Exceptional municipal new issuance creates challenges that weigh on prices. We think the muni market is currently on track to reach \$578B of supply for 2025, with \$385B through 31 August. This follows outsized supply in 2024 of \$496B, significantly exceeding the previous decade's average annual supply of \$381B.

Challenging flow environment: Inflows have been strongly correlated with municipal performance (Figure 1). Following -\$151B in outflows during 2022 and -\$21B in 2023, municipals rebounded somewhat in 2024 and 2025 year-to-date with \$29B and \$11B in inflows, respectively.

Higher-for-longer rates: Despite September's 25 bps rate cut and the Fed's projection of two additional cuts by year-end, interest rates are expected to remain above pre-2022 levels when fed funds averaged 76 bps over the decade. This has dampened enthusiasm for longer-duration assets, creating a steeper yield curve with shorter maturities outperforming..

Figure 1: Municipal mutual fund flows have been strongly correlated with performance



	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Annual municipal flows (\$B)	16.4	26.6	27.8	0.6	93.5	41.0	82.2	-150.6	-21.0	29.4	11.0
Annual total return (%)	3.3	0.2	5.4	1.3	7.5	5.2	1.5	-8.5	6.4	1.1	0.3

Data source: Morningstar Direct, 01 Jan 2015 – 31 Aug 2025, fund flows shown quarterly and performance shown annually. **Performance data shown represents past performance and does not predict or guarantee future results.** **Representative index:** Bloomberg Municipal Bond Index. Municipals represent the total of all municipal bond open-end funds, including high yield, but excluding exchange-traded funds. Shading represents significant market events.



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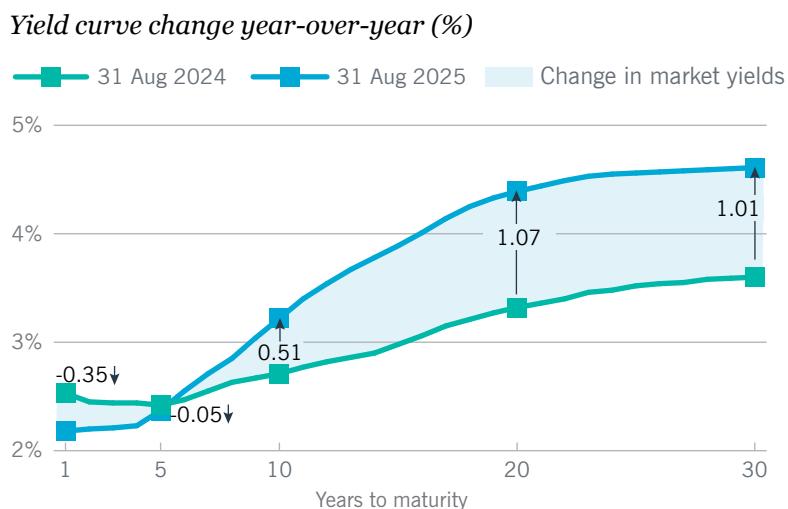
HOW HAVE MUNICIPAL BONDS PERFORMED?

Our team has been noticing an unusual divergence in performance across maturities over the past 19 months. Yields of shorter-term maturities declined in response to interest rate cuts and expectations, while yields of intermediate and long-dated maturities increased significantly due to historically elevated tax-exempt supply and relative lack of inflows into

that portion of the curve. These opposing forces have caused the municipal yield curve to steepen significantly (Figure 2).

This divergent movement across the curve has created varied performance patterns throughout the municipal bond asset class. The result is a remarkable 760 basis point performance gap between 5-year and 22+-year indexes year-to-date, with 753 basis point dispersion over the past 12 months (Figure 3).

Figure 2: Performance has diverged across maturities, and shorter municipals have been leading

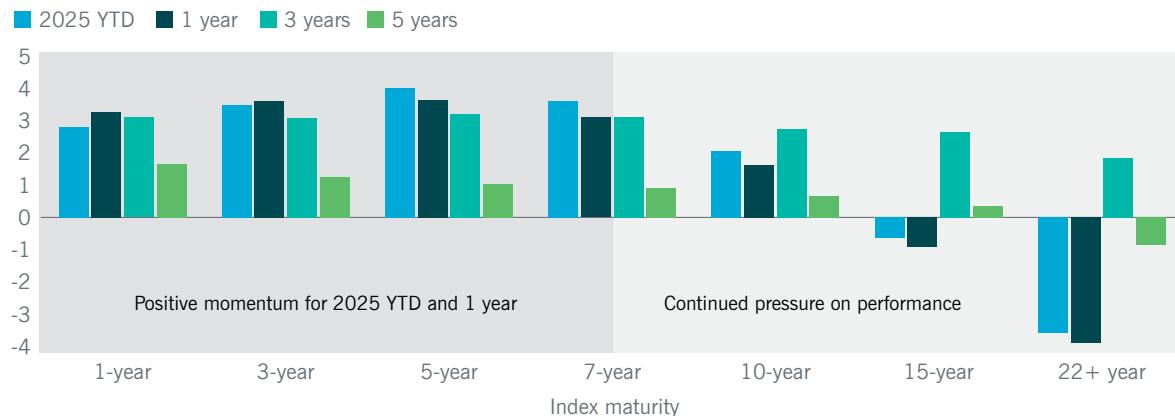


Higher yields for long-term municipals have driven prices lower, affecting performance negatively.

Data source: Refinitiv MMD yields for AAA-rated bonds and Bloomberg, L.P. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: 1-year bonds: Bloomberg 1-Year Municipal Bond Index; 5-year bonds: Bloomberg 5-Year Municipal Bond Index; 10-year bonds: Bloomberg 10-Year Municipal Bond Index; 22+-year bonds: Bloomberg Long Municipal Bond Index; municipal bond market: Bloomberg Municipal Bond Index. Index returns include reinvestment of income and do not reflect investment advisory and/or other fees that would reduce performance in an actual client account.

Figure 3: Shorter municipal bond performance has rallied year-to-date and year-over-year

Municipal bond index returns by maturity (%)



Data source: Bloomberg, L.P. 31 Aug 2020 – 31 Aug 2025. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: 1-year bonds: Bloomberg 1-Year Municipal Bond Index; 5-year bonds: Bloomberg 5-Year Municipal Bond Index; 7-year bonds: Bloomberg 7-Year Municipal Bond Index; 10-year bonds: Bloomberg 10-Year Municipal Bond Index; 15-year bonds: Bloomberg 15-Year Municipal Bond Index; 22+-year bonds: Bloomberg Long Municipal Bond Index; municipal bond market: Bloomberg Municipal Bond Index. Index returns include reinvestment of income and do not reflect investment advisory and/or other fees that would reduce performance in an actual client account.

WHERE DO YOU SEE BRIGHT SPOTS?

Municipal fundamentals remain strong, with no signs of credit deterioration. State and local governments maintain historically strong reserves and healthy tax collections, which increased 5.8% in the first quarter of 2025 compared to the same period last year.²

Nevertheless, many states are planning more conservatively for FY26 due to expectations of slower revenue growth and uncertainty around federal funding. While some states anticipate drawing down reserves, fund balances are projected to remain well above pre-pandemic levels. The median state rainy day fund balance is expected to be 12.9% of general fund expenditures for 2026, nearly double the 8% seen in 2019.³

Attractive yields generate a reliable income stream for patient investors, consistent with historical patterns where income has accounted for 85% of municipal bond total returns over time (Figure 4). Investors can benefit from this steady cash flow as they position for potential price appreciation in the future.

Looking ahead, stronger overall municipal performance will ultimately require yields to decline across the entire maturity spectrum. This necessary yield compression could emerge through broad market adjustments, gradual rate declines or a rapid correction. Any of these scenarios would significantly enhance total return potential beyond the current income advantage.

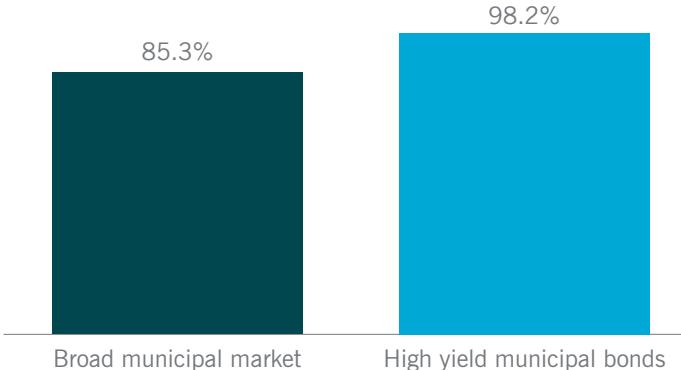
WHERE ARE YOU SEEING OPPORTUNITY?

Although we have been facing headwinds, municipals present a strategic opportunity for investors to:

Benefit from the unusually steep yield curve: The municipal yield curve's steep 241-basis-point spread between 2- and 30-year bonds (compared to 131 basis points for Treasuries) provides exceptional compensation for extending duration. This creates opportunities to lock in attractive yields before potential normalization drives price appreciation.

Figure 4: Income has dominated total return over time

Annualized total return derived from coupon return



Data source: Bloomberg, L.P., 31 Dec 2024. Performance data shown represents past performance and does not predict or guarantee future results. Chart shows the percent of annualized total return derived from coupon return (as opposed to price appreciation) since index inception. **Investment grade bonds** are represented by the S&P Municipal Bond Index, which has an inception date of 01 Jan 1976; returns from 31 Dec 2009 – 31 Dec 2024. **High yield bonds** are represented by the S&P Municipal Yield Index, which has an inception date of 31 Jan 1993; returns from 31 Dec 2009 – 31 Dec 2024. The index return presented is for illustration purposes only and does not represent or predict performance of any Nuveen product.

Position portfolios for potential yield compression:

While performance has been uneven across the maturity spectrum, patient investors can harness both attractive current income and the potential for capital appreciation with yields set to decline.

Take advantage of improving fundamentals with attractive valuations:

Municipal issuers have strengthened their financial positions significantly, creating a more resilient foundation for investors. Combined with 10-year muni yields in the 94th percentile of their decade-long historical range, today's entry points are particularly compelling.¹

Capitalize on declining short-term yields: As yields on cash-like instruments have fallen — with the 3-month Treasury bill dropping from 5.12% to 4.15% over the past year as of 31 Aug — municipal bonds offer attractive tax-exempt income potential. With the Fed anticipating two additional rate cuts in 2025 following September's 25 basis point reduction, and roughly \$7 trillion parked in cash alternatives, now may be an opportune time to shift toward higher-yielding munis.

WHAT ARE SOME WAYS TO STAY ACTIVE AND OPTIMIZE PORTFOLIOS?

Many of our clients are investing with an eye toward tax-awareness, and today's elevated taxable-equivalent yields make municipals particularly compelling. This advantage, coupled with the compounding effect of reinvesting higher coupons, builds a foundation for potentially improving performance as portfolios mature.

While recent returns have lagged historical averages, our investment team is focusing on opportunities to generate income for clients' portfolios through strategic trading, by harvesting losses and reinvesting at higher yields. We are able to capitalize on current curve steepness by surveying both the new issue and secondary markets. Using a strategic and opportunistic approach, we continue to find favor in more attractive bond structures that have higher coupons and offer greater call protection.

Despite potential continued volatility from supply pressures and stubborn rate expectations, municipals play an important role in diversified portfolios while helping to finance essential infrastructure for states and local communities. We believe patient investors are well-positioned to benefit from both attractive current income and eventual price appreciation when markets normalize.

TAKING ACTION: PARTNER WITH NUVEEN

Our municipal investment team is actively identifying opportunities across the yield curve to create value for clients by:

- Strategically positioning for both income generation and capital appreciation potential
- Identifying value in specific sectors and credits that others may overlook
- Implementing tax-efficient strategies tailored to your state and customization preferences

Contact us today to learn more, and visit nuveen.com.

Endnotes

Sources

- 1 Bloomberg, L.P., 08 Aug 2025, as measured by the ICE BofA U.S. Municipal Securities Index.
- 2 U.S. Census Bureau Quarterly Summary of State and Local Tax Revenues (QTAX).
- 3 Fiscal Survey of the States, Governors' Proposed Budgets for Fiscal 2026, Spring 2025.

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