Q3 2026 REVIEW & OUTLOOK

Muni Yields Spiked to Highs Not Seen in Nearly Two Decades

A quarterly perspective on the municipal bond market from the MTAM investment team.

-4.4%	+55bps to 5.3%	>5.0%
September Muni Total Return	10YR U.S. Treasury Yield	Long-Dated AAA Muni Yields

What happened?

Market drivers: Weaker autumn technicals in the municipal market, coupled with a surge in Treasury yields, triggered one of the sharpest tax-exempt bond market **sell-offs not seen since the Great Financial Crisis in 2008.**

Market impact: The Bloomberg Municipal Bond Index lost **4.4%** in September, erasing earlier gains and pushing the fixed-income sector's year-to-date total return into negative territory at **-4.2%.**

Performance by maturity: Short-dated bonds held up best in the third quarter and year to date, while longer-duration debt posted the largest losses.

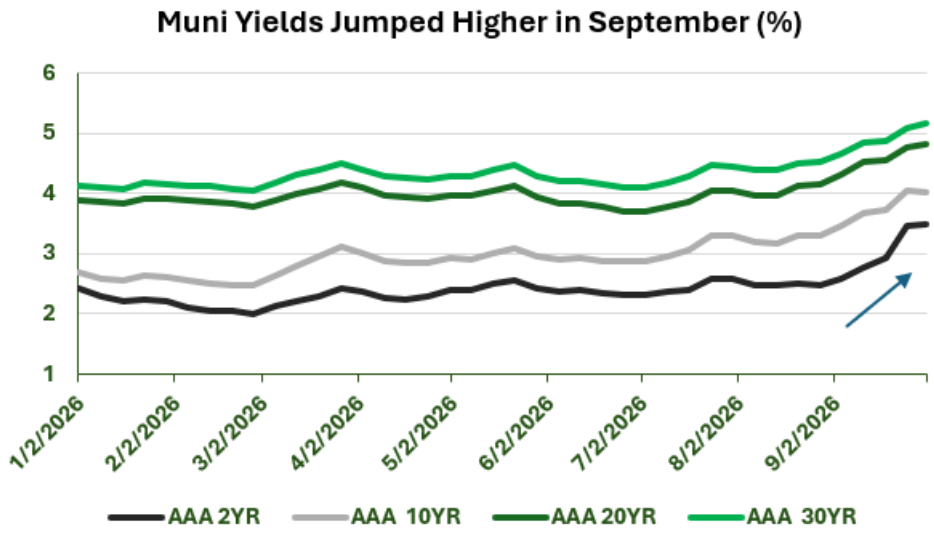
Underlying cause: The sharp price declines reflected rising interest rates—not concerns about municipal credit fundamentals. As a point of reference, the 10-year US Treasury benchmark yield jumped by over 50bps in four short weeks (to **5.30%** from **4.75%**), reflecting higher oil prices, inflationary fears, and geopolitical tension. This abrupt and sudden spike in Treasury yields coinciding with record high municipal new issue volume did not bode well for municipal market performance. This in turn led to municipal mutual fund redemptions and institutional selling that placed additional downward pressure on tax-exempt bond prices.

Opportunity for Income Buyers

On the bright side, high-quality municipal bond yields now sit at exceptionally attractive levels (see chart).

At present, AAA yields at the front part of the curve range from **3.5% to 4.0%,** up from 2.4% to 2.7% in

January. Meanwhile, yields on longest-dated high-grade municipals climbed to over **5.0%,** up from roughly 4.0% in the early part of 2026.



Source: Bloomberg AAA Muni yields YTD 2026, as of 30 September 2026

OUR VIEW

"With absolute municipal yields at their most attractive levels in years, we expect demand to improve as Treasury volatility subsides. We continue to favor high-quality general obligations and essential-service revenue bonds while avoiding weaker, more volatile sectors."

Tax-Equivalent Yield Opportunity

On a tax-equivalent yield (TEY) basis, a 10-year tax-exempt municipal at 4.0% jumps to **6.75%,** reflecting a top federal marginal income tax rate of 40.8%. And, the TEY on a 5.0% municipal not subject to federal income tax, now exceeds **8.0%,** suggesting compelling value.

4Q Outlook

In the near term, elevated municipal bond yields not seen in nearly two decades should bring buyers back to the tax-exempt debt market once US Treasury volatility subsides. At the same time, we anticipate a robust tax-loss harvesting season to ensue amid record new issuance.

On the credit front, broad fundamentals remain sound at the state level, but federal policy risks such as potential reductions in Medicaid funding bear monitoring. In November, all eyes will be on the outcome of the US mid-term elections which may have meaningful implications for the municipal market. Against that backdrop, we continue to favor high-quality sectors (General obligation debt, essential services revenue bonds) and avoid the riskier segments of the market (not-for-profit health care, private higher education, charter schools, and tobacco securitizations, as examples).

WE FAVOR	WE AVOID
• Tax-backed general obligations	• Tobacco settlement securitizations
• Water & sewer systems	• Charter schools
• Electric utilities	• Weaker not-for-profit healthcare
• Essential-service transportation	• Small private higher education

Key Takeaways

- Muni yields reached nearly two-decade highs amid sharply higher Treasury yields and weaker market technicals.
- September's 4.4% decline pushed YTD municipal returns down to -4.2%, with longer-duration bonds experiencing the greatest pressure.
- Higher yields have created compelling income opportunities, with AAA municipal yields ranging from roughly 3.5% to over 5.0% across the curve.
- Credit fundamentals remain sound. We continue to favor high-quality GOs and essential-service revenue bonds while avoiding riskier sectors.

About the Authors

Kathleen McNamara, CFA

INVESTMENT COMMITTEE MEMBER: MUNICIPAL STRATEGY

Joined MTAM in 2026 as a member of the Independent Investment Committee. Four decades in the municipal industry, including 16 years as Senior Municipal Strategist at UBS, responsible for strategy, market analysis, and relative-value work. Previously at Lehman Brothers and Smith Barney.

The Municipal Bond Management Team

Jim Langley

HEAD MUNICIPAL BOND PORTFOLIO MANAGER

Hunter Frey

CEO

Dominick Mirenda

DIRECTOR OF PORTFOLIO ADMINISTRATION

Scott Brown

OPERATIONS SPECIALIST

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