U.S. Municipal Bond Market

Market Recalibration Ignites a Summer 2025 Municipal Bond Opportunity

- Municipal bonds are undervalued—don't wait.
- Generationally attractive tax-exempt yields are still available.
- M/T ratios are flashing strong relative value.
- Heavy and potentially record issuance is creating opportunity.
- Credit quality remains solid across most sectors.
- High-quality GOs, revenue bonds, TX PSF-backed schools, airports, and top-rated colleges offer attractive yields with strong credit profiles.

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Ultra-Strong Case for Municipal Bonds Right Now

We are in one of the most attractive municipal bond buyer's markets in recent memory. A combination of recalibrating economic sentiment, rising yields, and favorable technicals has created a compelling entry point—especially for tax-sensitive investors.

Recalibrating Confidence: The Macro Backdrop

Investor sentiment is shifting. What once looked like the beginning of a global downturn is now being reassessed as a temporary scare—or even a false alarm. Confidence is returning. CEOs are sounding more optimistic, consumers are spending, and U.S. equity markets are reaching record highs. The July CEO Confidence Index reflects this shift with more than half of business leaders expecting conditions to improve over the next year.

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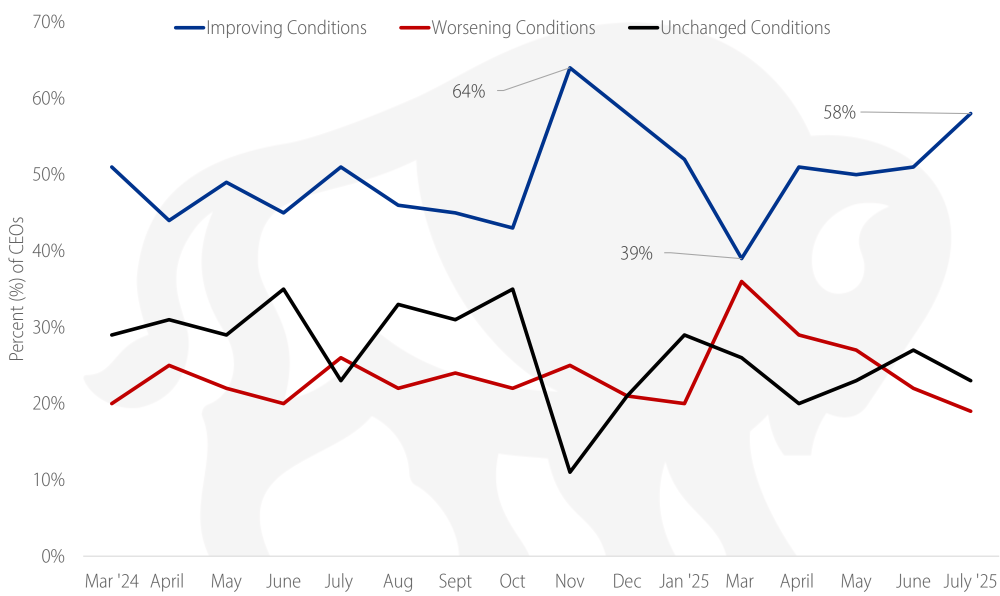
U.S. CEOs Forecast Business Conditions 12 Months Out



Source: ChiefExecutive.net and HilltopSecurities.

Still, uncertainty remains. Treasury yields are elevated and, in some cases, still rising as investors weigh fiscal policy, inflation, monetary leadership through 2026, and the potential impact of the One Big Beautiful Bill Act (OBBBA). While the bill's tax-cutting provisions have reassured some, its contribution to widening structural deficits is adding to bond market unease.

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Trade tensions are increasingly viewed as strategic rather than chaotic, and the feared inflationary spike from tariffs has yet to materialize. As noted in Consumer Inflation Edges Slightly Higher, but Tariff-Related Surge Still Absent, recent data supports a more measured outlook. The economy is not cruising—it's recalibrating.

This recalibration, combined with favorable municipal market dynamics, has created a clear buyer's market. Crossover institutional investors are already stepping in. Individual investors should consider doing the same.

From Uncertainty to Opportunity: Municipals Should Take Center Stage

The summer of uncertainty is quickly becoming the summer of municipal bond opportunity.

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Municipal bond yields have risen sharply in response to recent inflation data and shifting interest rate expectations. For tax-sensitive investors, municipals are not just attractive—they're timely and undervalued.

Generationally Attractive Municipal Yields Still in Play—But for How Long?

The window for generationally attractive municipal yields remains open, but it may not last.

After drifting lower earlier this summer, yields have reversed course in recent days, reigniting one of the most compelling buying opportunities we've seen in years. The 30-year AAA Municipal Market Data (MMD) yield surged to 4.77% at the end of last week, up from 4.36% in early May.

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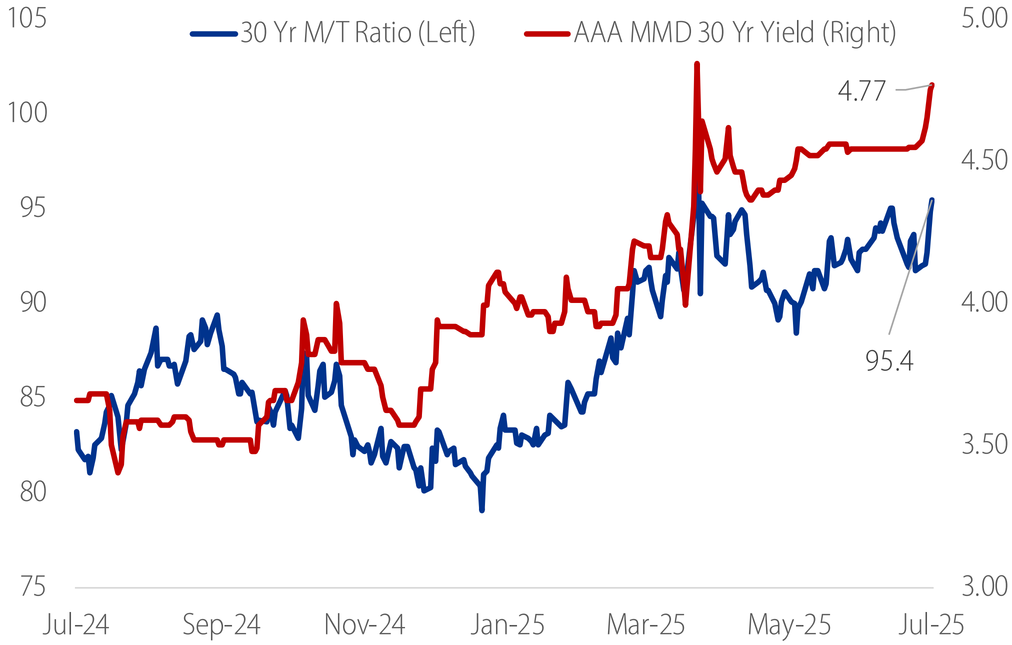
For investors waiting to deploy capital, now is the time to act.

Yields & M/T Ratios are Rising and Attractive



Source: LSEG, MMD and HilltopSecurities.

Municipal-to-Treasury (M/T) ratios have surged across the curve, creating one of the most attractive relative value environments of the year.

M/T Ratios Flashing Rare Value—Crossover Buyers Are Moving In

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The 30-year M/T ratio, based on AAA Municipal Market Data (MMD), climbed to just over 95% of the equivalent U.S. Treasury yield last Friday. That's one of the highest readings of 2025 and a clear signal that municipals are undervalued.

M/T ratios are a key indicator of relative value. When they rise, non-traditional municipal buyers often step in—sometimes to hold, sometimes to trade. Either way, their activity reinforces the opportunity. But this window can close quickly—sometimes in a matter of days—making timing critical.

Municipal bond issuance is on pace for another record year, adding fuel to an already compelling buyer's market.

Primary Market on Pace for Another Year of Record Issuance

Municipal bond issuance is on pace for another record year, adding fuel to an already compelling buyer's market. Supply is not only exceeding the five-year average—it just set a new first-half issuance record. This surge is contributing to the elevated M/T ratios we highlighted earlier, enhancing relative value for discerning investors.

The recent passage of the One Big, Beautiful Bill Act (OBBBA) has also brought much-needed policy clarity. It removes a major overhang for municipal investors and reinforces the long-term value of tax-exempt income. We expect this clarity to help stabilize issuance in the second half of 2025 as issuance is likely to cool in the months ahead but remain near at a record level for 2025.

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Back in November 2024, we published a secondary issuance forecast of $535 billion (see page 2). With the passage of the OBBBA reducing the risk of tax-exemption changes, we've now elevated that $535 billion scenario to our base case. Year-to-date issuance closely tracks our now base case projection, and while we expect supply to remain strong, we anticipate a taper into year-end as noted above.

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Very Strong Credit Quality

Municipal credit quality continues to hold up well. While not quite as strong as it was two years ago, it remains solid compared to previous economic cycles.

Upgrades still outpace downgrades, although the pace has slowed compared to recent quarters. This upgrade to downgrade trend varies by sector keep in mind, but overall, rating agency data points to stable fundamentals despite broader market volatility.

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High-Quality Opportunities Without Reaching for Risk

This is one of those rare periods when investors can find attractive yields and sector-specific opportunities without extending too far out on the credit curve.

Following Moody's downgrade of the U.S. sovereign rating, we expected increased interest in Aaa/AAA rated municipal bonds. Current market conditions make this an ideal time to focus on high-quality credits.

We continue to emphasize high-quality general obligation and revenue bonds for most individual investors. Municipal bonds are often used as a wealth preservation tool, and this strategy aligns with that purpose.

Texas Permanent School Fund-backed school district bonds are especially appealing right now. We also continue to favor tax-exempt and taxable airport bonds, along with high-quality public and private colleges. These sectors offer a compelling combination of yield and credit strength, making them well suited for both active and long-term municipal investors.

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Recent HilltopSecurities Municipal Commentary

- Manufacturing Revival Meets Economic Reality, July 17, 2025
- Infrastructure, Muni Investors, and Trump Score Big with the OBBBA, July 3, 2025
- Cyberattacks on U.S. Infrastructure May Be Blowback from U.S. Strike on Iran, June 23, 2025
- Trump's FEMA "Phase Out" Triggers New Era of Risk Realignment Across America, June 16, 2025
- Navigating the Chaos: Embracing Selectivity in Today's Municipal Bond Market, June 10, 2025

Readers may view all of the HilltopSecurities Municipal Commentary here.