U.S. Municipal Bond Market

# The Fed's Wake: Attractive Yields are Receding, Yet Still Within Reach as Bond Scarcity Looms

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- The FOMC cut its target rate by 25 basis points today, Sept. 17, lowering it to 4.00%–4.25%. This move potentially sets the stage for a sustained trend of declining yields.
- Generationally attractive tax-exempt yields are slipping away, and the cost of waiting is rising with each passing day. Municipal yields have already fallen 34 basis points in recent weeks in response to weak labor data and shifting rate expectations.
- A portion of the $7 trillion still parked in money market accounts is poised to enter or re-enter fixed income markets, potentially intensifying demand for tax-exempt bonds.
- Investment dollars are already flowing into municipal mutual funds, signaling growing investor appetite.
- Municipal bond issuance is likely to slow into year-end, creating scarcity in high-quality tax-exempt supply. Investors should consider acting now before yields compress further and opportunities become even more difficult to find.

## The Fed Has Spoken

Today, Sept. 17, the U.S. Federal Reserve's Federal Open Market Committee (FOMC) cut its target rate by 25 basis points, lowering it to a range of 4.00% to 4.25%. This move marks a clear pivot toward easing policy.

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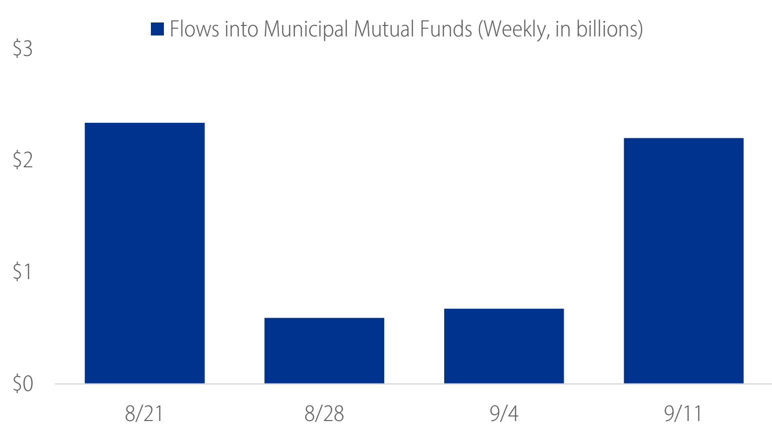
The FOMC's decision signals that the battle against inflation is giving way to growing concerns about economic growth and most importantly, labor market softness. Investors should view this as an important turning point. The era of attractive tax-exempt yields is already winding down, and the window to lock in favorable rates is narrowing by the day. The shift in policy is not just symbolic; it is actively reshaping the yield curve, impacting absolute yields and influencing investor behavior.

### Investment Dollars Flowed Steadily into Municipal Mutual Funds




Source: Lipper and Hilltop Securities.

This change also reflects a broader recalibration of risk and return expectations across fixed income markets, and investors should be prepared to adjust strategies accordingly. Please see our The Municipal Bond Market's Post-Golden Age Realignment, August 12 report for more details specific to the municipal credit landscape.

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## Yields Already Moved Since Weak Labor Data Released

Even before the FOMC announcement, weak labor data triggered a swift repricing in fixed income markets, with tax-exempt yields falling 34 basis points since Sept. 2. This reaction underscores how sensitive the market is to signs of economic softening and shifts in policy direction. Investors who wait for further confirmation risk chasing yield rather than capturing it. The repricing is not hypothetical; it is already underway, and the next leg down could arrive quickly, especially if rate cuts accumulate.

Generationally attractive tax-exempt yields are slipping away, and the cost of waiting is rising with each passing day. In this environment, hesitation carries a cost, and proactive positioning can preserve long-term value.

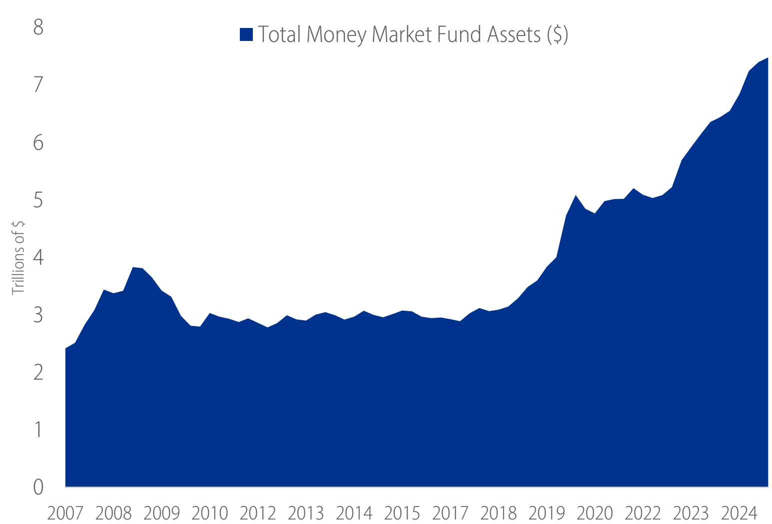
## The Reallocation Wave is Building

With over $7 trillion still sitting in money market accounts, a reallocation into fixed income is possible. Investors are beginning to shift from short-term safety to short, mid and long-term yield options. Municipal bonds, with their attractive tax-exempt status and strong credit fundamentals, are a natural destination. As demand rises, competition for quality paper will intensify. We are seeing demand rise now. Those who act early may secure better yields and stronger portfolio positioning. The longer investors wait, the more crowded the trade becomes, and the less yield remains.

*In this environment, hesitation carries a cost, and proactive positioning can preserve long-term value.*

This shift is not about timing the market. It is about staying disciplined and maintaining a consistent investment strategy. Regular fixed-income asset allocation remains essential. Investors who stay focused and understand the structural advantages of municipals in a declining rate environment will be better positioned to capture durable long-term value on a regular basis.

### Some Money Market Assets are Likely to be Reallocated




**Source: Federal Reserve and HilltopSecurities.**

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## The Squeeze: Bond Scarcity Meets Rising Demand

*Municipal bond primary market issuance is set to decline relative to the record setting pace we saw in the first part of this year.*

Municipal bond primary market issuance is set to decline relative to the record setting pace we saw in the first part of this year. This is partly because issuers were so active during the first eight months of the year and partly because the calendar, especially in November and December, rarely supports months with more than $40 billion in activity. This potential contraction in supply is colliding with rising demand, creating a scarcity premium. This is the "squeeze" we are referring to in the sub-title above.

Investors seeking high-quality, tax-exempt income are already feeling the impact: fewer options, tighter spreads, and lower yields than in recent months. Waiting could mean accepting even lower yields or taking on more risk. Scarcity is no longer theoretical; it is reshaping the market now.

Demand for municipal bonds is accelerating. Nearly $6 billion has flowed into municipal bond mutual funds since the week of August 21, according to Lipper, as some investors make this shift. This trend is likely to strengthen as rate cuts push more capital out of cash and into duration. The supply-demand imbalance is gaining momentum, and those who delay may face fewer opportunities on less favorable terms. In this environment, selectivity and speed could define success.

## Recent HilltopSecurities Municipal Commentary

*The supply-demand imbalance is gaining momentum, and those who delay may face fewer opportunities on less favorable terms. In this environment, selectivity and speed could define success.*

- From Budget Issues to Labor Challenges: Insights from the HilltopSecurities 2025 Public Finance Leaders Survey, September 15, 2025
- Labor Pains, Rate Gains, and Why Muni Investors Can't Wait, September 8, 2025
- Fed Signals September Shift and Tax Threat Resurfaces, August 25, 2025
- The Municipal Bond Market's Post-Golden Age Realignment, August 12, 2025
- Relative Value Remains Attractive as Economic Outlook Dims and Political Risks Rise, August 4, 2025

Readers may view all of the HilltopSecurities Municipal Commentary here.