U.S. Municipal Bond Market

Range Break in the Signal Hunt: Municipals Enter 2026 with Strength

- Investor mood is shifting from bracing to building as growth looks steady, inflation is cooler, and the rate path looks less hostile, even if the timing is still the debate.
- The October–December trading range held, then early January sent a clear signal. Just last week municipal yields moved below the range we tracked for months, driven mainly by strong demand meeting a lighter new-issue calendar, a classic setup that can keep pressure on yields to drift lower.
- Lower yields are a reminder for investors to stay engaged and be ready to act. The risk is investors could miss the window, and yields fall substantially while waiting for a perfect entry point.

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From Bracing to Building

Investors are looking for and finding positive signs. The tone has shifted in a more constructive direction to begin 2026, relative to the last couple times the calendar turned, for several reasons.

For much of 2025, investors were bracing. Cash-equivalent investments remained at or near record levels. Many were waiting for the next surprise after being subjected to unforeseen events like major policy headlines, Liberation Day for example, immigration-related stories, the potential impact of technological change, and other tensions. In some cases, investors were treating every story, announcement, or data release as though it might flip the entire market on its side. That kind of posture is exhausting, and it can lead people to miss the moments when conditions quietly improve.

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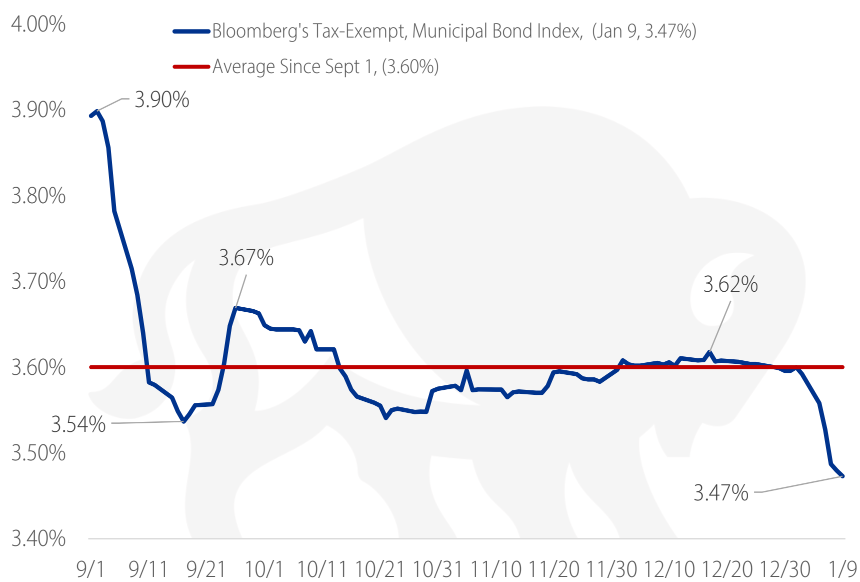
There Was a Break in Municipal Yields Last Week



Source: Bloomberg and HilltopSecurities.

Now, we are seeing that posture change. Investors are starting to build again. They are eager to add to portfolios. Many are pondering what their portfolios need to look like in a backdrop with positive momentum, one that is less threatened by macro instability and policy uncertainty. This is a welcome shift in outlook.

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A few specific drivers are lining up and helping to create this more constructive view. Improved economic growth in 2026 is likely to build on top of 2025's stable growth. The interest rate environment looks less hostile than it did when inflation was running hot. There is uncertainty related to who will be the Federal Reserve chair later this year, but the trajectory of the Fed's interest rate target is likely to be lower in 2026. The bigger question is timing, not direction.

The October to December Range Held, Then Early January Delivered a Clue

This is where it gets interesting for those focused on the municipal bond market, because of where municipal yields traveled during the first week of the year.

We are seeing demand for municipals build and are expecting that demand to stay firm in January. Municipal yields are still generationally attractive, even though they have broken below the range we have been tracking since mid-October.

The first week of 2026 brought a clean clue as municipal yields fell below the range we had been tracking for months.

In mid-December, we indicated municipal yields were range bound and patience would matter as we hunted for clearer signals. The trading range was pretty consistent from mid-October through year end. The first week of 2026 brought a clean clue as municipal yields fell below the range we had been tracking for months. The move was mainly a result of a supply-and-demand imbalance.

This is an important development investors should be aware of. Municipal yields dropped by about 10 basis points last week, mostly because heavy and rising demand is meeting less supply than we have seen recently. It also reinforces the idea that investors need to stay engaged in the market and be ready to act, because the trend for yields is likely to move lower.

December 2025 Jobs Data- Mixed, Not Dramatic

The December jobs report was mixed, not dramatic, and it continues to point to a January pause from the Fed. As Hilltop's Scott McIntyre wrote on Jan. 9, "December's mixed employment report shows slowing payroll growth and a lower unemployment rate, signaling the Fed will hold rates steady at the January meeting." Some market indicators agreed, dialing back near-term cut expectations after Friday's release.

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The Fed is setting the pace. It is authoring market sentiment for now. With the jobs report mixed and inflation well below its 2022 peaks, most expectations point to no January rate cut and a measured approach later in the year. That steadiness lets investors focus on income and selection rather than chasing every data surprise.

Recent HilltopSecurities Municipal Commentary

- Finishing 2025 with Patience, "Range-bound" Until New Signals Arrive, December 16, 2025
- Why the Fed's Likely Dec. 10 Move Matters for Municipal Investors, December 9, 2025
- Rate Cut Expectations Surge, Could Mean Renewed Momentum for Municipals, December 1, 2025
- Markets Swing and Fed Expectations Shift While Municipals Hold Steady, November 24, 2025
- September Jobs Data Clears One Cloud, But the Forecast Stays Gray and Unclear, November 20, 2025

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