

U.S. Municipal Bond Market

The Fed Steps Back. Municipal Discipline Steps Forward

Summary

- The Fed is not driving our municipal thesis this week. Tax-exempt income yields near (still) generational highs, disciplined maturity selection, and credit quality are.
- A stronger-than-expected jobs report makes an imminent Fed cut less likely, but it does not weaken the municipal bond case.
- The reason to own municipals in this market is not in hope of a policy pivot. The reason is tax-exempt income, yields that remain near generational highs, and strong credit quality.
- In a market where heavy demand can make investors rushed, this is a moment to become more selective, favoring higher-quality tax-backed and essential-service sectors and looking beyond the short-end when structure and credit support it.

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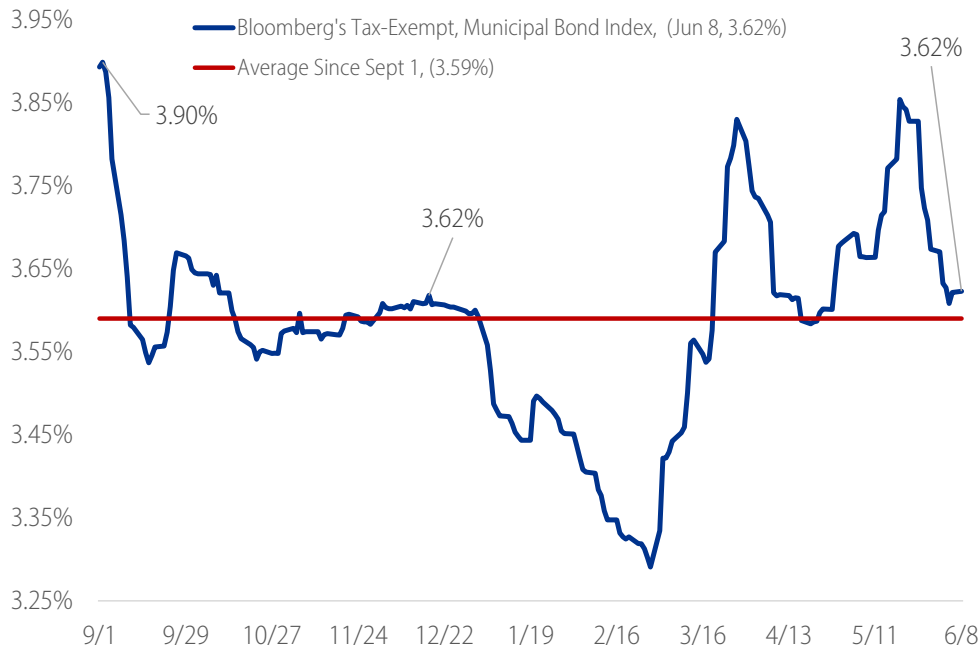
A Stronger Economy and Labor Market Complicate the Fed Path

Municipal bond investors do not need a potential Federal Reserve rate cut on the horizon to own municipals at these levels. However, with primary market volume up, and daily volatility still elevated, investors should be more selective about what they buy, when they buy, and how much risk they take when allocating capital to the sector.

Friday's jobs report confirmed that the U.S. economy is holding up better than many expected, and the labor market is not collapsing under the weight of technological advancements, nor is the economy in need of urgent or otherwise rescue from the U.S. Federal Reserve anytime soon, most likely.

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Tax-Exempt Yields Remain Elevated



Source: Bloomberg and HilltopSecurities.

Please see disclosure starting on page 3.

That matters because markets and investors have been convincing themselves of a softer, weaker economic story. Many were expecting a cooling economy that would potentially push the Fed to cut rates, while inflation remained close enough to target to allow it. Friday made that path less plausible. Friday's stronger-than-expected labor market number gives the Fed less reason to rush a decision. Friday's data also forces investors to ask whether recent equity market strength, before Friday's selloff, was built on fundamentals, liquidity, or the expectation that monetary policy would soon become more supportive.

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Goldman Sachs Chief Executive Officer David Solomon recently described the market mood as one with "more greed than there is fear." That observation fits the moment. Capital is available, is ready to be put to work, and investors are actively weighing where to put it.

What is also fitting is that Solomon was likely paraphrasing Warren Buffett's 1986 investor letter, where Buffett wrote about his company's investing goal this way: "we simply attempt to be fearful when others are greedy and to be greedy only when others are fearful." That point also fits this market, especially because municipal investors have been active in the first five months of 2026 by putting money into municipal mutual funds at a very strong pace.

For municipal investors, the takeaway from Friday's data, the market reaction, and this year's strong demand for tax-exempt income is not to step away from the market or pull investment dollars from it. **The right strategy ahead of the Federal Reserve's June 16-17 meeting is to raise the standard for what belongs in a municipal portfolio. It means more investor discipline will be required through the rest of the summer and into the balance of 2026.**

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Stronger investor discipline does not mean doing more of the same. It means simply buying a bond because the yield looks attractive, while hoping the Fed cuts soon, is not enough. The municipal bond portion of an investor's portfolio should work because the tax-exempt income matters, the maturity structure is appropriate, and the credit can withstand a higher-for-longer rate environment if that is where the market settles.

The themes investors should focus on have shifted. Earlier this year, investors were asking a different set of questions. As the market moved forward, they gravitated toward income and relative stability in a municipal market where strong demand was meeting strong supply. That demand still matters, but it can also make investors less selective than they should be. This is the moment to increase selectivity, not decrease it.

Municipals We Favor in this Environment

Sector selection and individual credit selection matters more if the Fed stays patient. In this environment we favor higher-quality tax-backed and essential service revenue bonds. Especially well managed state and local governments, high-quality water and sewer, public power, and select transportation issues. Single family housing also remains a way to pick up incremental yield, with a still mostly very strong credit story.

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We think investors should be more cautious, but not stay completely away from the higher education, and K-12 school district sector credits because of structural credit pressure.

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Maturity selection matters too. We understand why so many investors still want to stay on the shorter end of the yield curve. It remains comfortable considering the circumstances. However, the better relative value in municipals is further out on the curve. Investors do not need to make an aggressive duration bet, but they should consider, when appropriate, extending not just into intermediate maturities, but also into longer maturities where credit is strong, structure works, and tax-exempt income remains compelling even without a rate cut on the horizon.

This is how municipal investors should approach next week's June 16 -17 Fed meeting. A patient Fed does not invalidate the municipal bond opportunity we have been seeing and still see today. It simply means investors need to be even more deliberate. The Fed is not driving our municipal thesis this week. Tax-exempt income yields near (still) generational highs, disciplined maturity selection, and credit quality are.

A patient Fed does not invalidate the municipal bond opportunity we have been seeing and still see today.

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- [The Growing Divide Between Markets and Households and What It Means for Municipals](#), June 1, 2026
- [Investors are Choosing Stability, Tax-Exempt Income, and the Bonds that Finance America's Infrastructure](#), May 27, 2026
- [Selection Matters More as U.S. Municipal Credit Continues to Turn Lower](#), May 18, 2026
- [The Threat to the Tax-Exemption Keeps Building Amid Quantitative Stress, Qualitative Drift](#), May 11, 2026

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