U.S. Municipal Bond Market

The Bond Market Selloff Is Making Attractive M/T Ratios the New Municipal Opportunity of 2026

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Summary

- Strong demand has absorbed potentially record-breaking issuance, but **improving relative value may now be the stronger municipal market signal**. Municipal/Treasury Ratios are near or above their 2026 highs, which could draw more crossover buyers into the market.
- The bond-market selloff has raised tax-exempt yields and created better opportunities for investors. Investors do not need to call the bottom to recognize that municipal income, and relative value has improved.

Strengthening Relative Value is Today's Key Municipal Market Signal

Rising yields have strengthened the case for municipal bonds, but **improving relative value indicators may be the more important signal**. Municipal-to-Treasury Ratios (M/T Ratios) rose above their 2026 averages recently and are now near or above their highs for the year. If that improvement continues, crossover buyers could become more active. Strong demand has defined the municipal market so far in 2026. The combination of higher tax-exempt yields and improving relative value could become the more important story from here. At a time of considerable economic and market uncertainty, municipal investors are being offered more income at more attractive valuations. That is a municipal market signal and an opportunity worth watching closely.

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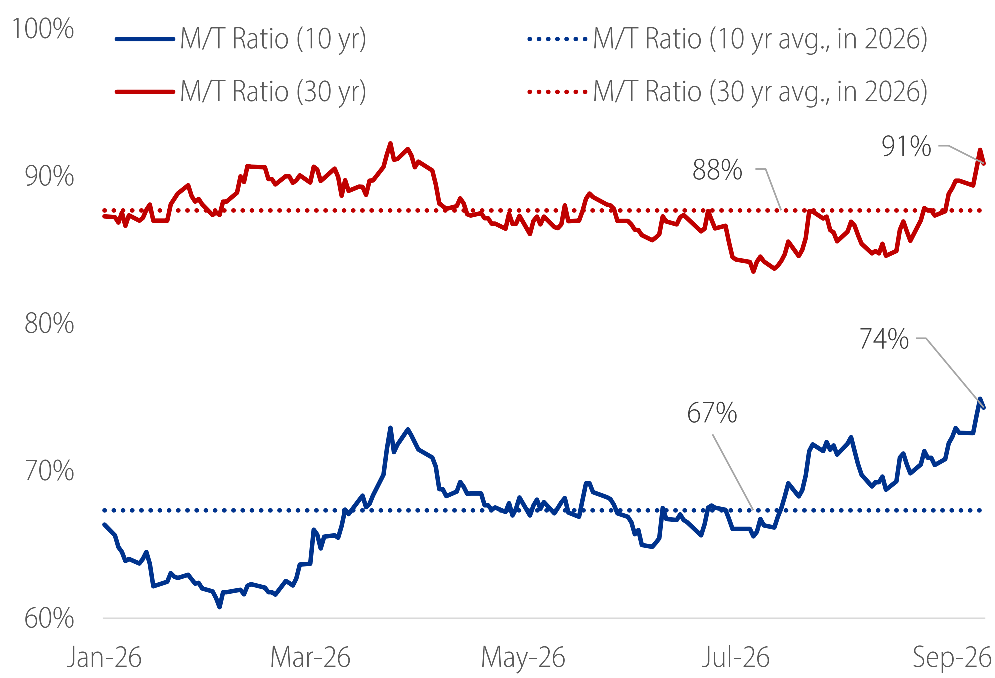
Attractive M/T Ratios Could Increase Crossover Buyer Interest



Source: LSEG Refinitiv and HilltopSecurities.

A Market With No Shortage of Risk

Investors have no shortage of candidates for the defining market story of 2026. Federal debt recently crossed $40 trillion. President Donald Trump has proposed a $5,000 payment to every adult American if Republicans retain Congress, an idea that could cost more than $1.2 trillion. The artificial intelligence (AI) buildout continues to drive meaningful capital spending, and AI safety made headlines over the weekend. Meanwhile, the war with Iran continues to disrupt energy markets and send oil prices higher, potentially putting additional pressure on inflation and interest rates.

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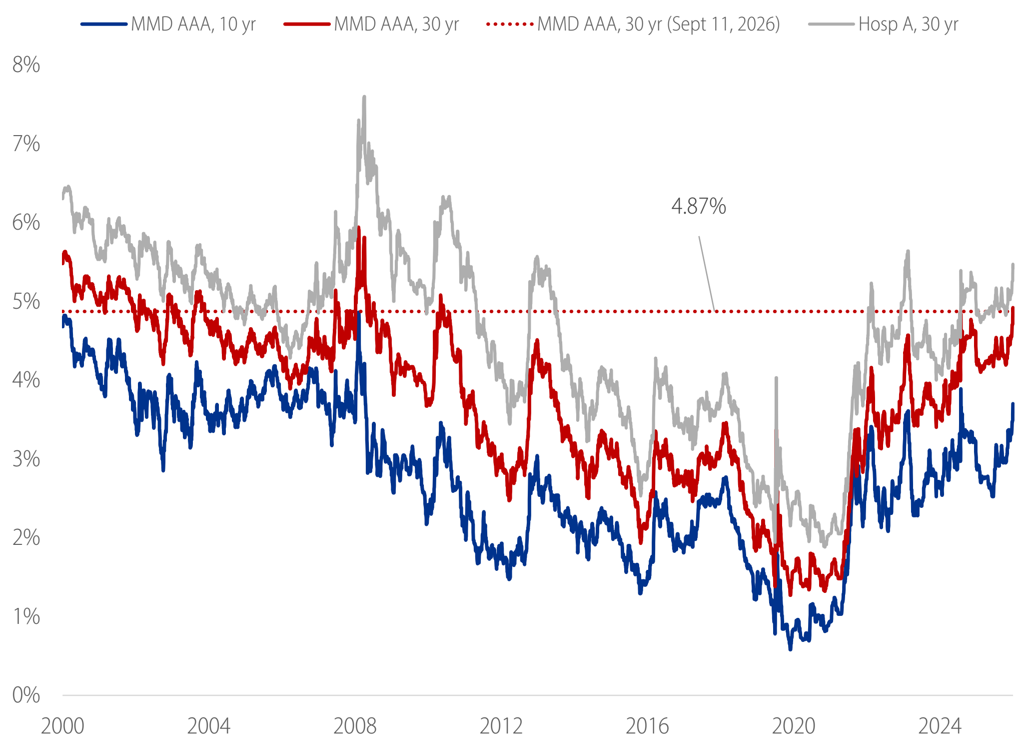
More uncertainty potentially lies ahead. Treasury Secretary Scott Bessent testifies Tuesday, followed by the Federal Open Market Committee's rate decision Wednesday. To begin this week, markets placed the probability of an increase in the Fed's target rate near 90%, according to Fed Funds futures.

In May, we put substantial and potentially record-breaking demand at the top of our candidates for the municipal market story of the year. That case has strengthened. Municipal funds recorded a 21st consecutive week of inflows through Sept. 10, bringing year-to-date inflows to approximately $40 billion, according to Lipper. Potentially record-breaking issuance has accompanied those flows, with more than $400 billion issued through August, including nearly $60 billion in August alone.

Long-Term Municipal Yields Return to Historically Attractive Levels



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Demand, however, is no longer the entire investment case. Higher rates, heavy issuance, inflation concerns, and geopolitical pressure have pushed municipal yields higher and, perhaps more importantly, **improved relative value indicators**. Ten and 30-year Municipal Market Data (MMD) AAA yields have risen almost 50 basis points since mid-August. Long-term tax-exempt yields now roughly hover around 5.00% across portions of the investment-grade municipal market.

Investors do not need to call the bottom to recognize that the municipal bond market opportunity has improved.

From Strong Demand for Municipals to a Better Opportunity

The recent bond market selloff may have further to run. But it is also raising tax-exempt income, improving relative value, and giving investors more choices amid growing market uncertainty. In May, demand looked like the municipal story of 2026. Now, the signals are shifting. Investors do not need to call the bottom to recognize that the municipal bond market opportunity has improved.

Recent HilltopSecurities Municipal Commentary

- Warsh Calls on the Fed to Meet the Moment as Rate Hike Odds and Municipal Yields Rise, September 2, 2026
- The Market Thought Lower Rates Were Coming, August 27, 2026
- How $40 Trillion of Federal Debt Could Reach U.S. Infrastructure and Public Finance, August 20, 2026
- The Transition from Credit Momentum to Credit Selection, Public Finance Enters a More Demanding Phase, August 18, 2026
- Many Public Pensions Look Better, but Credit Risk and Hard Choices Remain, August 11, 2026

Readers may view all of the HilltopSecurities Municipal Commentary here.