Market Review and Update

Overview

Throughout the third quarter of 2025 the municipal market continues to see exceptionally high bond issuance volume, and a reduction of taxable and tax-exempt rates as the Fed shifts into a rate-cut cycle and markets continue to stabilize around ongoing trade disruptions. At its last meeting in September the FOMC voted to cut rates to 4.00-4.25%. Based on Fed futures trading there is close to a 99% probability of another rate cut at the October FOMC meeting held over the 28th and 29th.

Interest Rates

- **Treasury Rates:** Treasury rates (industry accepted benchmark for taxable bonds) continue to be volatile in 2025 as the market reacts to world events, particularly the Trump administration's ongoing tariff negotiations. As of mid-October, bond markets have calmed. Current long-term Treasury rates are at or close to the highest they have been over the past fifteen years. The 2-year treasury rate is currently 3.46% and the 30-year treasury rate is 4.57%.
- **Municipal Market Rates:** Tax exempt municipal bond rates, as represented by the AAA BVAL rates (benchmark for tax-exempt rates produced by Bloomberg) rose significantly in April in response to tariffs, mirroring the movements in the Treasury market. Since April, they have eased considerably but remain elevated. The 30-year rate is currently at 4.07%.
- **Fed Funds Rate:** The Fed cut rates to 4.00% - 4.25% range at the September 2025 meeting. Citing labor market concerns, the FOMC has begun to signal a renewed interest in near-term rate cuts, with the market pricing in an expected two further cuts in Q4 2025.
- **Municipal Market Supply-Demand Dynamics:** Tax-exempt municipal bond issuance volume remained high in 2025, with five consecutive months from April through August exceeding $50 billion in aggregate issuance volume, and September volume measuring over $44 billion. This volume was supported by modest inflows into bond funds over the same period.
- **Equity Markets:** Since showing major volatility earlier in the year, equity markets have steadily calmed as investors welcomed temporary tariff exemptions. Throughout Q3 major indices steadily climbed back to all-time highs, though anxieties remain over a sluggish labor market and high price levels.

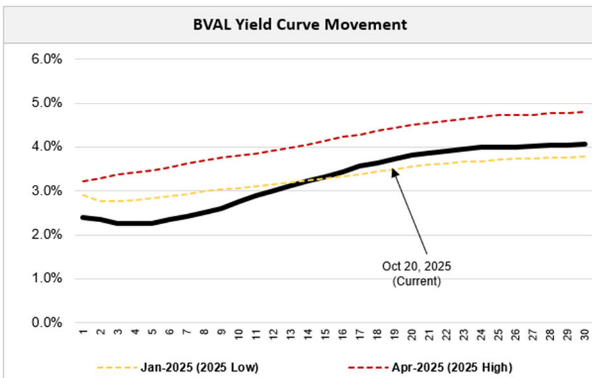
U.S. Economy

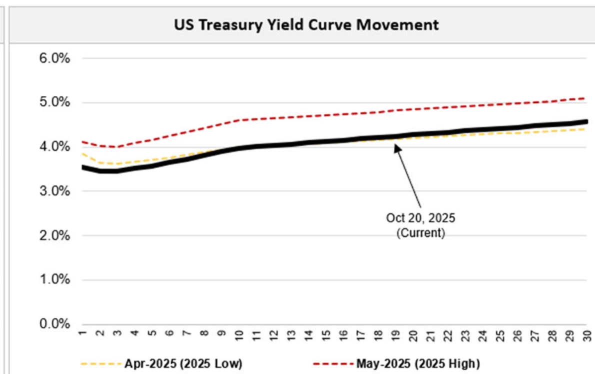
- **Jobs and Unemployment**: Initial Jobless Claims of 218,000 for the week of September 20 is trending favorably compared to a short spike earlier in the month. The unemployment rate rose slightly to 4.3% in August 2025, aligning with market expectations. The results continue to reflect a softening in the labor market, currently at the highest level of joblessness since October 2021.
- **GDP**: The US economy grew 3.8% annualized rate in the second quarter of 2025, well above initial estimates and the strongest quarter since 2023. The stronger figure reflected upward revisions in consumer spending.
- **Inflation**: The annual inflation rate accelerated to 3.0% in September from 2.7% in July, the highest level since January 2025. Annual core inflation, which excludes items such as food and energy, improved slightly to 3% in September.
- **Personal Spending**: As one of the key drivers of the economy, personal spending increased by 0.6% in August 2025 for the third month in a row, and outperforming market expectations. It was the sharpest increase in personal spending in five months, extending the period of resilience from the US consumer despite heightened economic uncertainty and elevated borrowing costs.
- **Retail Sales:** Retail sales in the US increased 0.6% month-over-month in August 2025, beating market expectations of a smaller 0.2% gain.
- **Manufacturing and Service Data:** The S&P Global U.S. Composite Purchasing Managers Index (PMI) fell to 53.9 in September, in line with preliminary estimates. A reading above 50 indicates expansion in business activity, vice versa for readings below 50. The growth is primarily driven by the service sector (PMI 54.2). Manufacturing PMI eased to 52.0 in September following a 3-year high in August.

Consumer Sentiment: The University of Michigan's consumer sentiment was revised lower to 53.6 in October 2025 from a preliminary of 55 and 55.1 in September. It is the lowest reading in five months.

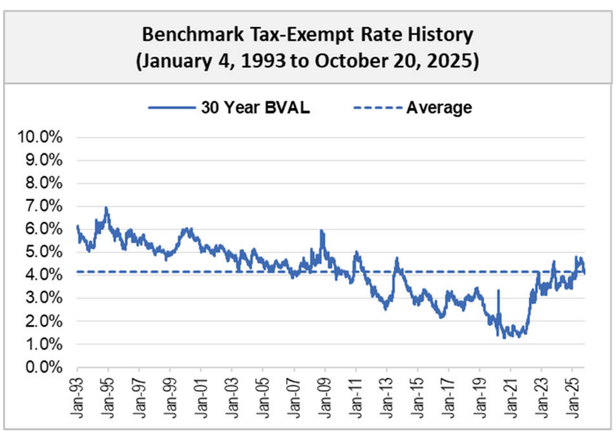
Long-Term Tax-Exempt and Taxable Interest Rates

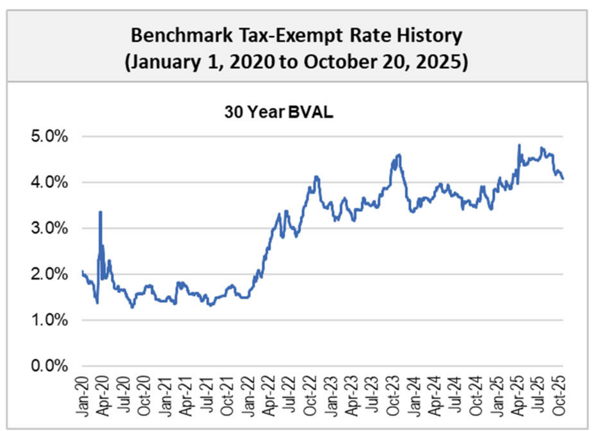
The Bloomberg Valuation Service's (BVAL) AAA yield curve (i.e., the "BVAL AAA" which is a widely accepted benchmark for tax-exempt municipal bond rates) has been very volatile over the course of 2025 but is experiencing a period of stability in September and October. The two charts below show the current AAA BVAL yield curve and the current US Treasury yield curve (benchmark of taxable municipal bond rates) in comparison to the lowest and highest rates this year. As seen in the chart, the BVAL AAA curve has seen reductions along the curve and is currently at year-to-date lows on the short end as the result of recent Fed cuts and the additional expected cuts. The long-end of the BVAL AAA yield curve has also seen reductions, impacted by various headline news, most pertinently the softening labor market and the ongoing government shutdown. While Treasury rates have also backed off from the 2025 peak, they have stayed in a narrow band throughout 2025. On the short end, both yield curves maintain slight inversion in reaction to a variety of market uncertainties reigniting fears of a recession. In general, the theme of volatility continued in 2025, as investors reacted to new trade, economic and government policies of the current administration, as well as periodic releases of economic data. Market volatility eased in September and October, largely due to the emergence of a firm consensus around the Fed's future rate path and a pause in new economic data releases following the government shutdown.





The current 30-year BVAL AAA bond yield is 4.07%, which is 7 bps lower than its long-term average of 4.14%.

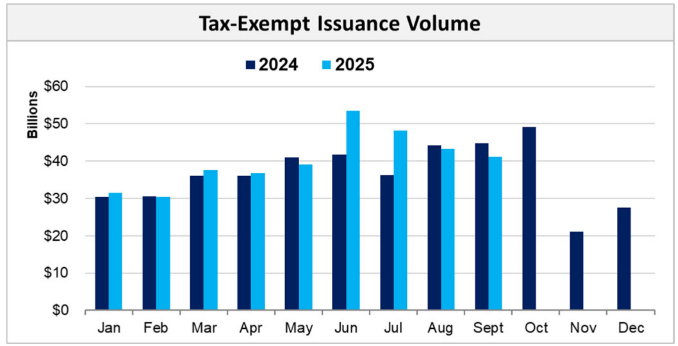




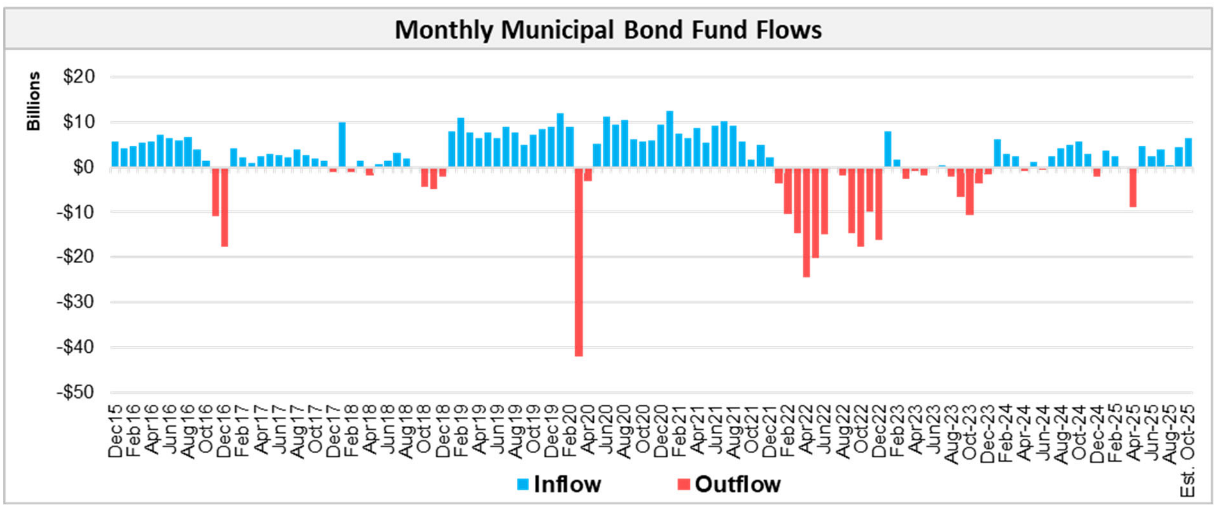
**The 1993-2010 data represents the AAA Municipal Market Data (MMD) data which is also a widely accepted tax-exempt benchmark rate. The 2011-2025 data represents the AAA BVAL rates*

__Municipal Market Supply and Demand__

2025 has been a robust year for bond issuance so far. Year-to-date, tax-exempt issuance volume has risen 14.0%, reaching $389.5 billion in par through September. The June–July period was particularly strong, with issuance surging over 30% compared to the same stretch in 2024—which was already a record-setting year. Although volumes in August and September were relatively flat, the full-year outlook suggests 2025 will likely close with higher overall issuance.



Mutual funds are one of the largest investors in municipal bonds, and the net inflow or net outflow from mutual funds is indicative of demand for municipal bonds. There were outflows from municipal bond funds for the majority of 2022 and 2023 indicating weak investor appetite for municipal bonds owing to a very volatile interest rate environment. Over the past two years the course has changed and there have been modest inflows throughout 2025 year-to-date, indicating an improving appetite for bonds.



__Credit Spreads__

Mirroring the movements in rates, credit spreads have also been volatile for the last few years since the pandemic. Spreads that had widened significantly in 2022 and 2023 generally improved over the last two years. Specifically in 2025, credit spreads have generally improved since the brief and disruptive shock in April following the initial tariff announcements. The improving trend is also partly supported by the current demand for bonds driven by a prevailing risk-off sentiment among investors seeking safety amid market uncertainty.

Interest Rate Forecasts

The Fed cut rates for the first time in a year, lowering to 4.00-4.25% at its most recent meeting in September. The Fed dot plot released after that meeting suggests the Fed seems to be inclined towards two additional rate cuts this year, with the market also forecasting an average of two cuts.

The next table provides an average of interest rate forecasts by industry professionals. These are surveyed and compiled by Bloomberg. The market is forecasting two further 0.25% rate cuts in 2025. The two-year U.S. Treasury rate is forecasted to rise 0.05% to 3.51% by the end of 2025. The ten-year U.S. Treasury rate is forecasted to rise by 0.16% to 4.15% by end of 2025. The 30-year U.S. Treasury rate is also forecast to rise by 0.14% to 4.72% by end of 2025.

Street's Interest Rate Forecast

Forecast	10/20/25	Q4 25	Q1 26	Q2 26	Q3 26	Q4 26	Q1 27	Q2 27	Q3 27	Q4 27
30-Year UST	4.58 %	4.72 %	4.68 %	4.65 %	4.63 %	4.65 %	4.64 %	4.60 %	4.61 %	4.58 %
10-Year UST	3.99 %	4.15 %	4.10 %	4.09 %	4.08 %	4.08 %	4.01 %	3.98 %	3.99 %	3.97 %
5-Year UST	3.58 %	3.66 %	3.63 %	3.61 %	3.64 %	3.61 %	3.62 %	3.63 %	3.70 %	3.67 %
2-Year UST	3.46 %	3.51 %	3.41 %	3.36 %	3.36 %	3.32 %	3.32 %	3.34 %	3.38 %	3.35 %
3M Secured Overnight Financing Rate	3.87 %	3.77 %	3.57 %	3.36 %	3.27 %	3.20 %	3.29 %	3.30 %	3.36 %	3.33 %
Federal Funds Target Rate Upper Bound	4.25 %	3.85 %	3.64 %	3.44 %	3.34 %	3.29 %	3.22 %	3.22 %	3.24 %	3.22 %
Federal Funds Target Rate Lower Bound	4.00 %	3.60 %	3.39 %	3.19 %	3.09 %	3.04 %	2.97 %	2.97 %	2.99 %	2.97 %