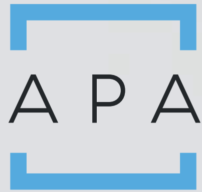
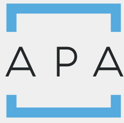


ASSET PRESERVATION
ADVISORS

MARKET COMMENTARY

Q3 2025

CARING FOR CLIENT PORTFOLIOS, BOND BY BOND.



THIRD QUARTER HIGHLIGHTS

- July and August saw the municipal curve continue to steepen, as short-end yields moved lower, while the move in intermediate to longer yields was more muted.
- However, this reversed course in September, as municipals rallied broadly, led by intermediate to longer maturities. As a result, September saw broad muni indices post their best monthly return since December 2003.
- Following a stronger-than-expected payroll report to start the quarter, subsequent reports suggested cracks in the labor market, reflecting lower month-over-month gains and downward revisions to prior periods. This caused a sharp move lower in yields, as additional Fed easing was priced in.
- Municipal mutual funds saw $8.8 billion of net inflows in Q3, including $4.5 billion in September, as renewed demand helped drive the rally into quarter-end.
- Municipal supply remained robust in Q3, totaling $150.2 billion and pushing year-to-date issuance to $433.8 billion—up 12% from last year's record pace.

QUARTERLY MARKET UPDATE

The quarter began with a continued steepening of the municipal curve, as short-term yields decreased while intermediate and long-term yields moved higher over July. Additionally, after lagging Treasuries in the first half of the year, municipals outperformed at the start of the quarter. Short-term Treasury yields moved higher in early July following a stronger-than-expected payrolls report (+147,000), while the CPI reading of +0.3% month-over-month and +2.7% year-over-year reinforced the view that inflation pressures remain persistent. For the month, two- and five-year Treasury yields rose by 22 basis points and 17 basis points, respectively, while comparable municipal tenors fell by 19 basis points and 14 basis points, respectively, as fund inflows and strong coupon and maturity reinvestment demand stayed concentrated on the short end.

The July 9 release of the FOMC minutes revealed that several officials had already begun advocating for rate cuts. The committee ultimately kept rates steady during their meeting on July 16th and 17th, while two members dissented, supporting a cut—the first such split decision in decades. The Q2 GDP report, released in late July, showed the U.S. economy grew at a 3.0% annualized rate, beating expectations, and reversing a decline in the prior period.

August started with a weaker-than-expected payroll report, showing job growth of just 73,000 and over -250,000 in net revisions from previous months. With markets highly attentive to the Fed, the softer-than-expected report caused a sharp drop in short-term yields early in the month, as market participants increased their expectations for rate cuts. Steady inflation at 2.7% year-over-year caused yields to

retrace some of their earlier move, while Chair Powell's dovish speech at the August Jackson Hole Symposium again helped push yields lower to end the month.

Municipal curve steepening continued in August, as the 2, 5, 10, and 30-year tenors of the AAA curve declined by 19, 16, 10, and 6 basis points, respectively. After these moves, the muni 2s/10s slope ended the month at 102 basis points, while the spread between 5-year and 30-year bonds closed at 224 basis points, up from 24 and 103 basis points, respectively, at the start of the year.

Muni new issue supply in August hit $50 billion, marking the fifth month in a row with issuance of $50 billion or more. On the credit front, two headline issuers received rating upgrades in August: S&P Global upgraded the New York Metropolitan Transportation Authority (MTA) one notch to A from A-, while the state of New Jersey's general obligation (GO) bonds also received a one-notch upgrade from S&P to A+ from A.

September saw the broad municipal market index post its strongest monthly return since December 2023, and the strongest September return in 12 years, driven by a rally in long maturities and the first meaningful curve flattening of the year. After months of persistent steepening that created attractive long-end valuations, a slowdown in issuance and renewed demand helped support the move. The stated 2-year AAA muni yield rose 10 basis points for the month, while the 10-year yield declined by 30 basis points, resulting in 40 basis points of flattening between 2s and 10s.

A weak employment report early in the month, showing payroll gains of just 22,000 alongside downward revisions to prior months, initially pushed shorter yields lower as markets priced in additional Fed easing. However, following the FOMC's 25-basis-point rate cut on September 17th, stronger GDP revisions and firmer late-month economic data tempered expectations for further cuts, leading short-term rates to retrace higher into month-end. For the month, 2-, 5-, 10-, and 30-year Treasury yields adjusted by +1, +6, -7, and -19 basis points, respectively, while comparable AAA muni yields moved by +10, -5, -30, and -37 basis points, respectively.

After five consecutive months of over $50 billion in supply, issuance slowed to $44.6 billion in September, providing a technical tailwind following record summer supply. Demand strengthened significantly, with nearly $4 billion in mutual fund inflows and ongoing institutional participation. On the ratings front, Connecticut GO bonds received upgrades from two agencies: Moody's upgraded Connecticut from Aa3 to Aa2, and Fitch upgraded the state from AA- to AA. Additionally, following S&P's upgrade a month earlier, Moody's upgraded New Jersey's general obligation (GO) bond rating to Aa3 from A1, citing the state's budget surplus and efforts to repair the pension system.

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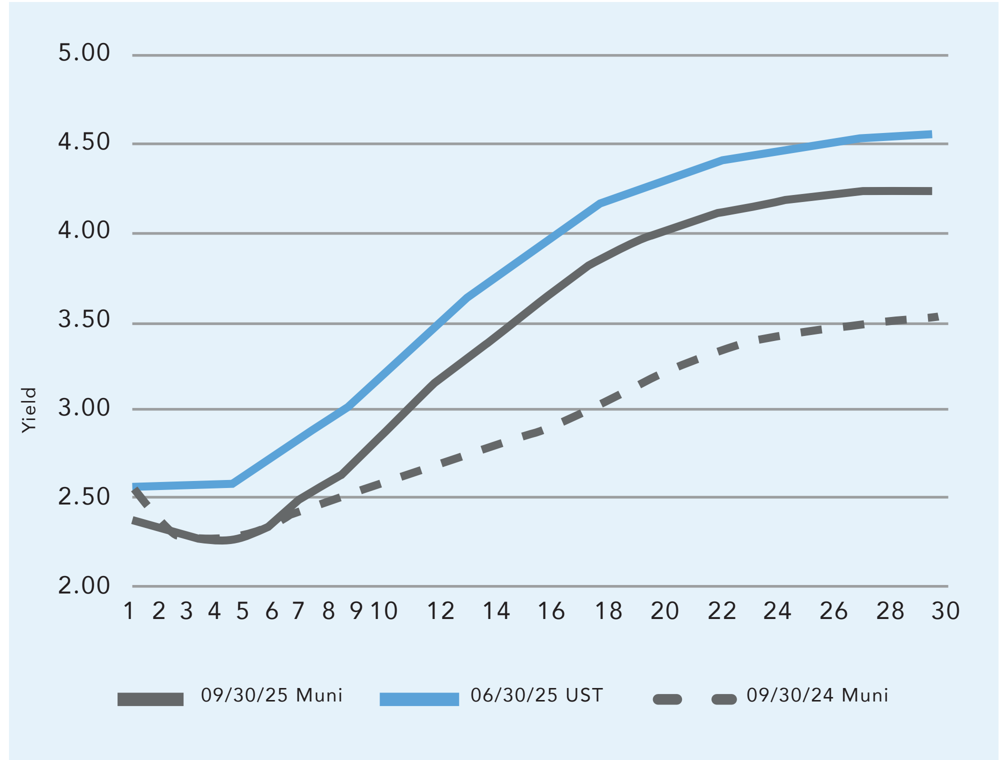
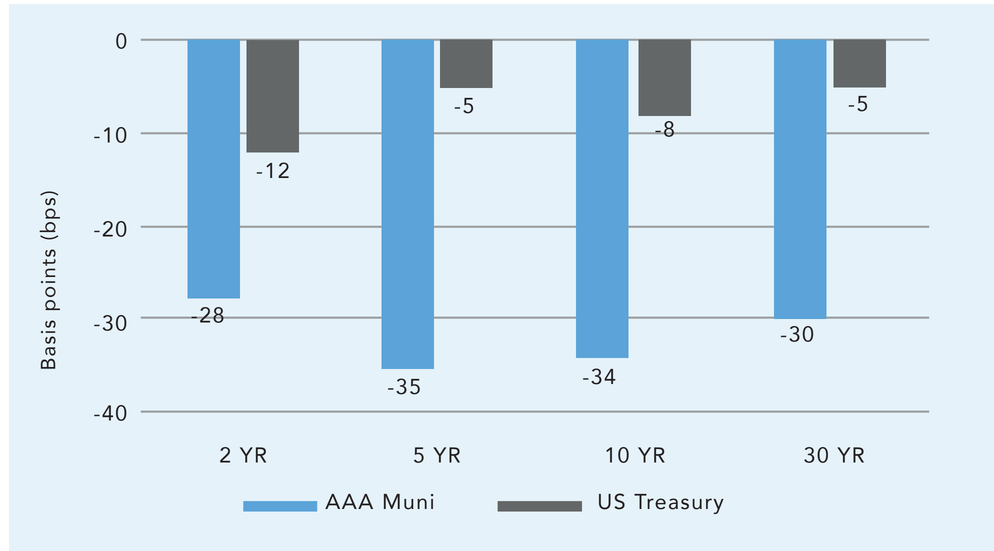
MUNI & TREASURY YIELD CURVES



Source: Municipal Market Data

Q3 2025 YIELD MOVES (bps)

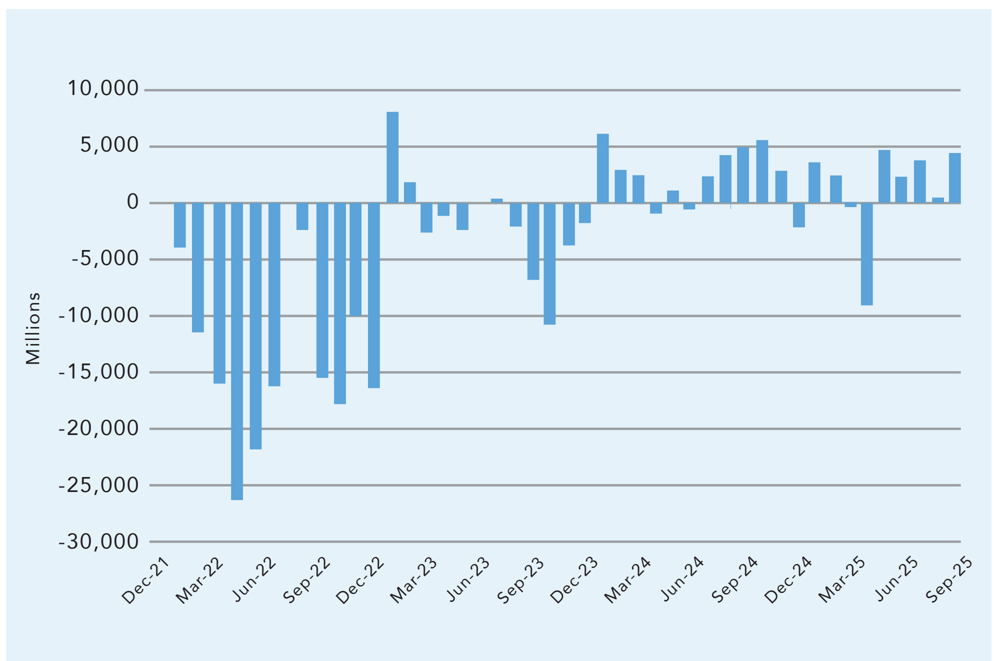


Source: Municipal Market Data, US Treasury

FUND FLOWS

Municipal mutual funds experienced widespread inflows during Q3, with flows rising in September, which helped drive the overall rally in the final month of the quarter. In September, fund inflows reached $4.5 billion, bringing the total net inflows for the quarter to $8.8 billion.

MONTHLY FUND FLOWS



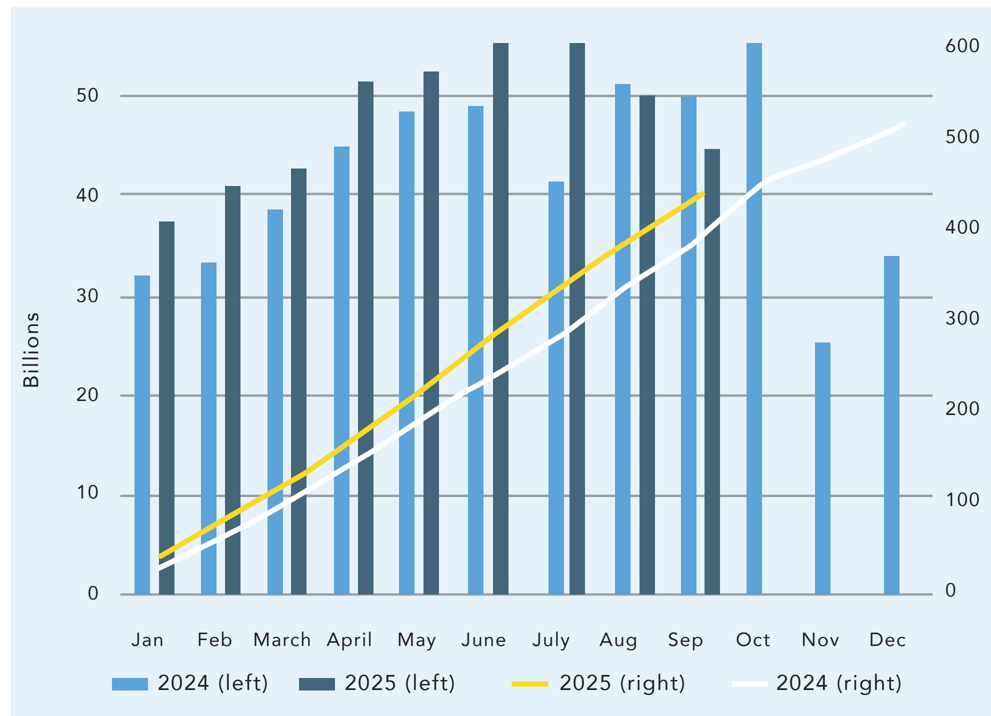
Source: Investment Company Institute (ICI)

MARKET COMMENTARY Q3 2025

SUPPLY

Municipal new issue supply remained strong throughout Q3, as the muni market experienced five consecutive months of new issue supply exceeding $50 billion through August. Issuance for the quarter totaled $150.2 billion, bringing year-to-date issuance to $433.8 billion, a 12% increase from last year's record pace. For perspective, the average annual issuance for the 10-year period from 2015 to 2024 was $433.9 billion. Looking ahead, the market expects issuance to stay robust, with October typically being one of the largest issuance months of the year.

MUNICIPAL MARKET SUPPLY



Source: SIFMA

OUTLOOK

Tax-exempts had been waiting for the rally that took place in September, for our market to play a little catch-up to what felt like every other asset class on the planet. While that underperformance through the year created attractive entry points for new money, it was undoubtedly a relief for many clients to take a breather from the constant grind of underperformance vs comparable treasuries and see a little green on the screen for their municipal allocation as the additional yield that had been locked in through the early parts of the year finally saw a consistently stronger bid.

Our active, blocking, and tackling approach through the belly of the curve, combined with duration extension during periods of volatility across the modified ladder structure, has defended against the large steepener that has occurred YTD and allowed our clients to participate in the recent upside. The long-end, while being the best performer for the month of September, is still a laggard relative to treasuries and corporates (see chart), so as we move into the fourth quarter and into next year, we will look to take advantage of the positive slope and additional roll-down the tax-free curve now provides. For our high-quality mandates, this creates more of an opportunity in a modified barbell approach, where our clients will be invested with a portion of the portfolio in the short-end of the curve, taking advantage of the attractive callable structures our market provides, while the remainder of the portfolio can be locked in around the steepest part of the intermediate curve, roughly 9-14 years, where we find an average yield pickup of 15bps a year and taxable equivalent yields of well above 5 – 6%. As a reminder, the ladder and barbell are often intended to perform in different environments, with the ladder used to defend against a steepener (which we have witnessed) and the barbell meant to perform in a flattener.

While we certainly see plenty of the sell-side research pieces still calling for "generational opportunities" in municipals, we have to acknowledge the inflationary risks, mentioned above, that could ultimately put pressure on the long-end of the curve again, and the need for further infrastructure spending we expect to see over the coming years, which may keep our unprecedented weekly new issue supply more of the norm (on pace for an annual total of more than $550bln compared to decade average of $381bln), and provide ample investment opportunities for intermediate duration positions. We must also acknowledge that much of the FOMC easing projections are already fully priced into the short end of the curve, and any change to those expectations may make it difficult for further rallies to occur there. Therefore, maintaining a selective approach by avoiding more of those "over-bought" tenors should lead to steady, income-producing allocations.

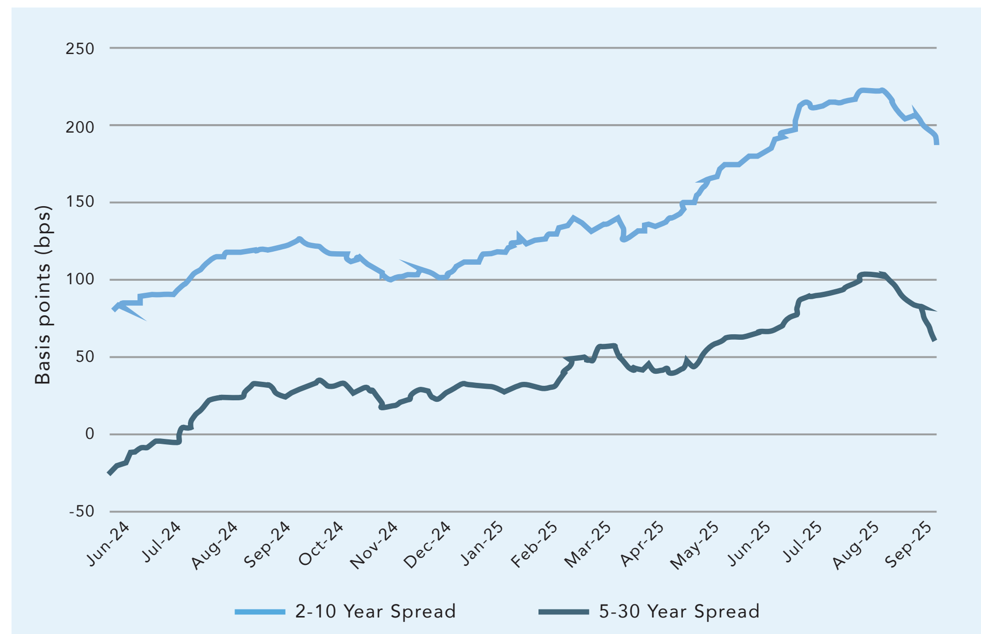
It is important to note that the municipal market, although still relatively small compared to other global fixed-income markets, is consistently growing in size and remains heavily reliant on stability from fund flows. The continued growth of passive ETFs has changed the demand components of the market, especially index-eligible names within 10 years, so the ability to remain agile and active, from a credit selection and bond structure standpoint, in the coming months will be an essential way to find value in the varying performance patterns across the curve.

Just when municipalities thought they were out of the woods with the passage of the OBBBA early in the quarter, which left the bulk of the market unscathed, the potential for disruption to states, local governments, and other municipal entities continues, as the distribution of federal funds is again called into question.

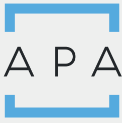
Municipal credit fundamentals remain very strong, with state and local governments still carrying high reserves and collecting ample tax revenue. With that, however, there are underlying stories that will persist and require ongoing surveillance of the fast-changing landscape, both geographically and sectorally, to stay ahead of rating agencies and market fluctuations, both on the upside and the downside. Please do not hesitate to reach out if you have any questions regarding Medicaid funding, geographical areas susceptible to Federal cuts, school choice, higher education funding, pension funding, mayoral races, and other topics, to name a few.

Looking ahead to the end of the year, we are more excited about the income our market still provides, the potential for annual roll-down on longer-dated positions, and the higher TEYs compared to other fixed income markets than we are about an expectation for a large "December rally" like we have seen in years past. The ongoing reinvestment at current prevailing rates creates a long-term allocation that, unlike the volatile period of the previous three-plus years, we believe should yield compounding that exceeds inflation rates.

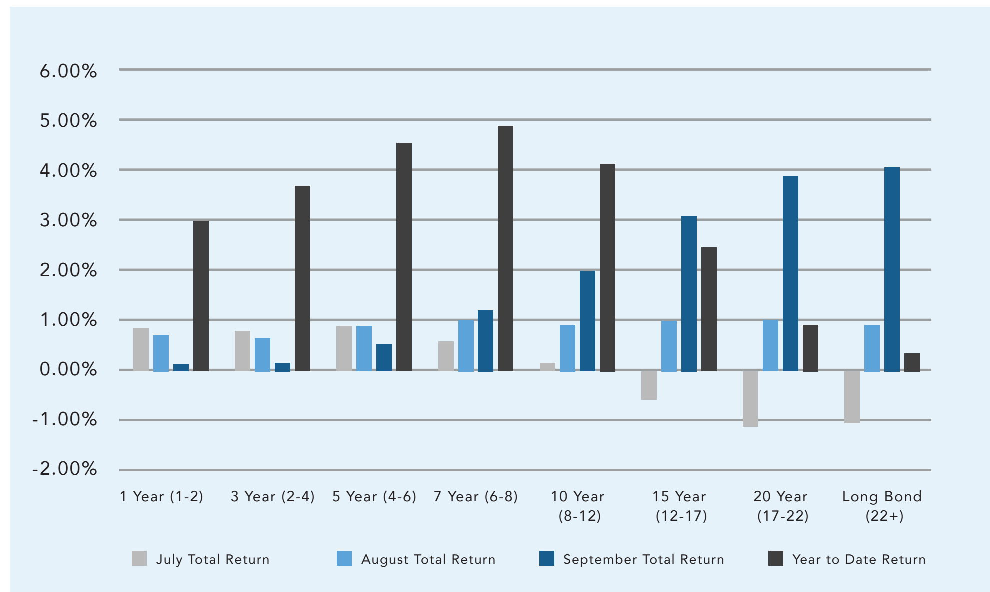
MUNI 2-10 AND 5-10 YEAR SPREAD



Source: Municipal Market Data (MMD)



MATURITY GROUP INDEX PERFORMANCE



Source: Bloomberg

*Data presented as of 9/30/2025.

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Since its founding, Asset Preservation Advisors is committed to delivering a high level of service, quality and wealth preservation. APA believes our growth in assets under management can be attributed to a consistent investment process and corresponding trading discipline.

We value highly the trust our clients have shown in APA and remain committed to adhering to a high level of ethical, moral and business standards first envisioned at our founding in 1989.

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