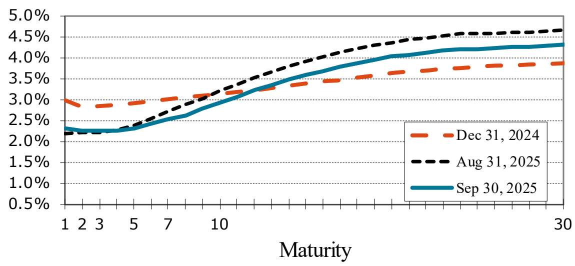
Baird Advisors
Municipal Fixed Income Market Commentary
September 2025

Municipal Yields Fall in Q3 Amid Strong Demand

Municipal yields declined in Q3 amid strong investor demand and a modest slowing in issuance. While the curve flattened in September, with short-term rates rising (+11 bps) and long-term yields falling (-34 bps), for the quarter, yields fell in a nearly parallel manner. The move lower during the quarter maintained the strong YTD steepening trend from the first half of the year which still offered investors significant reward for extending out along the curve. Not surprisingly, given the appealing yield levels and positively sloped curve, municipal bond funds recorded net inflows in the quarter of $19.7 billion, including $5.8 billion in September alone. This brings the YTD net fund inflow total to $29.2 billion, slightly ahead of 2024's $25.2B YTD inflows. Supply was also robust in Q3, rising 12% compared to the same quarter last year, pushing YTD issuance to $438 billion, a 16% increase over the record pace in 2024. Yet, September was the first month this year in which supply fell on a YoY basis, indicating that some issuance was pulled forward prior to the uncertainty around the OBBB legislation which passed in July. Historically, the fourth quarter has offered elevated issuance, implying a more than ample supply of bonds available for investors through year end.

AAA Municipal Yields



Maturity	12/31/24	6/30/25	8/31/25	9/30/25	1Mo Chg	Q3 Chg	YTD Chg
1	2.97%	2.59%	2.19%	2.30%	0.11%	-0.29%	-0.67%
2	2.82%	2.61%	2.21%	2.27%	0.06%	-0.34%	-0.55%
3	2.83%	2.65%	2.22%	2.25%	0.03%	-0.40%	-0.58%
5	2.90%	2.72%	2.37%	2.31%	-0.06%	-0.41%	-0.59%
7	3.00%	2.88%	2.72%	2.54%	-0.18%	-0.34%	-0.46%
10	3.13%	3.21%	3.20%	2.92%	-0.28%	-0.29%	-0.21%
30	3.87%	4.52%	4.64%	4.30%	-0.34%	-0.22%	0.43%

States Face Rising Fiscal Responsibility

Late August marked the 20th anniversary of Hurricane Katrina and the devastation it wrought on the Gulf Coast, particularly New Orleans. In the aftermath, the region received approximately $78B in federal aid, in addition to insurance payouts and state support, all of which played a critical role in stabilizing local conditions and helping with the eventual recovery. Historically, investors have viewed such natural disasters primarily as short-term events with modest/temporary credit rating impact as defaults for municipal issuers have been avoided. However, the federal landscape is shifting, and state and local governments may bear a greater financial responsibility in the future when disasters occur. Both municipalities and municipal investors need to be prepared for this. Proposed FEMA reforms may raise the minimum damage threshold for federal aid, cap assistance at lower levels or even replace FEMA support with state-level block grants. These proposed changes are similar to changes occurring in healthcare funding under the OBBB in which states may be required to absorb a greater share of Medicaid costs, with tighter eligibility standards and reduced federal cost-sharing. State and local government fiscal strength and resiliency will become increasingly important. The ability (and willingness) of municipal entities to absorb these additional and often unexpected costs should be considered. Currently, most states are in a strong fiscal position, with elevated reserves and robust rainy-day funds, positioning them to help fill potential gaps if federal support is reduced. However, evolving federal policies and state-level responses should be closely monitored as these shifts represent the risk of a reallocation of fiscal responsibility from the federal to the local level.

Positive Returns in September, Q3 and YTD

Returns were positive for September, which lifted both third quarter and YTD returns. Performance by maturity varied in each respective period, as long maturities were the best performers for the month and quarter but lagged the other segments YTD. Sector performance was relatively similar across the time periods, with Prerefunded issues holding their YTD lead. Across the Investment Grade quality spectrum performance has been similar, yet BBBs and High Yield municipals lagged higher quality in Q3 and YTD.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Bloomberg Index/Sector	September	Q3	YTD	*Duration*	Bloomberg Quality	September	Q3	YTD	*Duration*
Municipal Bond Index	2.32%	3.00%	2.64%	*6.86*	AAA	2.43%	3.07%	2.63%	*7.04*
General Obligation bonds	2.20%	2.96%	2.67%	*6.54*	AA	2.23%	2.95%	2.61%	*6.76*
Revenue bonds	2.39%	3.03%	2.61%	*7.04*	A	2.34%	3.08%	2.80%	*6.76*
Prerefunded bonds	0.28%	1.37%	3.43%	*2.50*	BBB	2.81%	2.84%	2.32%	*7.73*
Long maturities (22+ yrs.)	4.05%	3.82%	0.31%	*11.18*	High Yield	2.64%	1.63%	1.29%	*7.69*
Intermediate maturities (1 - 17 yrs.)	1.48%	2.59%	3.71%	*5.05*	HY, ex-Puerto Rico	2.47%	1.43%	1.39%	*7.65*
Short maturities (1 - 5 yrs.)	0.17%	1.53%	3.63%	*2.35*					

Disclosures

Fixed income is generally considered to be a more conservative investment than stocks, but bonds and other fixed income investments still carry a variety of risks such as interest rate risk, credit risk, inflation risk, and liquidity risk. In a rising interest rate environment, the value of fixed-income securities generally decline and conversely, in a falling interest rate environment, the value of fixed-income securities generally increase. High yield securities may be subject to heightened market, interest rate or credit risk and should not be purchased solely because of the stated yield.

The Bloomberg Municipal Bond Index is a broad-based, total-return index. The bonds are all investment-grade, tax-exempt, and fixed-rate securities with long-term maturities (greater than 2 years). They are selected from issues larger than $50 million. The components listed below the Municipal Bond Index (long maturities, intermediate maturities, short maturities, prefunded bonds, general obligation bonds and revenue bonds) are subsectors of the Bloomberg Municipal Bond Index and do not represent separate indices.

The Bloomberg High Yield Municipal Index includes bonds with a par value of at least $3 million and must be issued as part of a transaction of at least $20 million. The maximum rating for inclusion is Ba1/BB+/BB+ using the middle rating.

For more information about the Bloomberg Municipal Bond Index or Bloomberg High Yield Municipal Index, please visit https://index.barcap.com/Home/Guides_and_Factsheets.

Municipal securities investments are not appropriate for all investors, especially those taxed at lower rates. The alternative minimum tax (AMT) may be applicable, even for securities identified as tax exempt. Past performance is not a guarantee of future results.

Ratings are measured on a scale that ranges from AAA or Aaa (highest) to D or C (lowest). Investment grade investments are those rated from highest down to BBB- or Baa3.

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