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It May Be Time To Activate Your Muni Bond Portfolio

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SUMMARY

- Following the Great Financial Crisis, during a period of ultra-low interest rates, the municipal bond market was characterized by low absolute yields with limited opportunities to add value through active management such as yield curve positioning or extending duration.
- Following the COVID-19 pandemic, loose monetary and fiscal policy minimized credit differentiation and diminished the value of fundamental credit analysis.
- During those years, municipal bond investors—reluctant to part with bonds in their portfolios that were bought in a higher yield environment and had embedded gains—may have turned to more passive, buy-and-hold approaches.
- As economic conditions shift and monetary policies change, we are generally seeing more divergence amongst issuers and opportunities to add value through credit selection.
- We believe investors may do better now in the current environment with a more active approach to municipal bond portfolio management.



Perhaps the greatest disadvantage of passive and laddered portfolios is the lack of active management of maturities. Typically, ladder strategies set bond maturities at 6- or 12-month intervals over 5- or 10-year periods. Proceeds from maturing bonds are reinvested in new bonds added to the long end of the ladder's maturity structure, regardless of the relative value in that particular area of the curve.

In effect, this laddered or passive portfolio management approach minimizes—if not fully ignores—the duration of each bond in the portfolio and its impact on the portfolio's average duration. Duration¹ provides a measure of interest rate risk exposure, which is continually changing during the life of a bond.

Investment conditions in the municipal market began to change as the Federal Reserve (Fed) began raising interest rates in 2022 to stem inflation, and cut rates beginning in 2025 as inflation ebbed. While active portfolio management adapts when market conditions change, passive laddered approaches can be restrictive in their approach.

FIGURE 1: 10 AAA MUNICIPAL BOND YIELD RANGES

Year(s)	Yield Range	Prevailing Conditions
2014-2019	~1.50% to ~2.50%	Post-QE Low Rates
2020-2021	~0.60% to ~1.20%	COVID Pandemic-Driven Low Rates
2022-2023	~2.00% to ~3.00%	Fed Interest Rate Tightening Cycle
2025	~3.00% to ~3.25%	2025 Peak, Highest levels of the Decade
2026	~2.70%	As of March 7, 2026

Source: Breckinridge Capital Advisors, as of March 7, 2026. Past performance is no guarantee of future results.

Four key changes occurring in the municipal markets over the last five years—increasing and decreasing yields, changing yield curve structures, more credit differentiation, and shifting liquidity conditions—help to highlight the contrast between active and passive approaches.

Higher yields: Absolute yields are higher in 2026 than at any time during the period prior to 2025 (See Figure 1). Higher absolute yields may offer the opportunity to capture higher income across the curve.

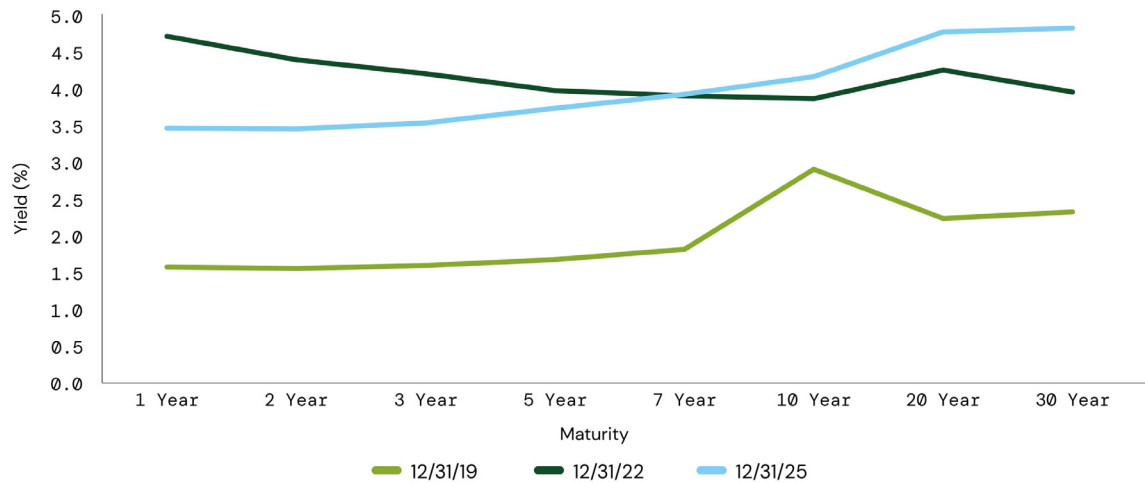
We believe yields will remain lower than 2025's peak but elevated compared with levels earlier in the decade, as the Fed manages interest rate moves lower because inflation remains above its 2 percent target, while unemployment and business activity remain uncertain.

1. A bond's duration is the weighted average of the length of the periods of times before the bond's fixed cash flows are received. When the price of an asset is considered as a function of yield, duration also measures and expresses in years the price sensitivity to yield, the rate of change of price with respect to yield, or the percentage change in price for a parallel shift in yields.



Changes in the shape of the yield curve (See Figure 2): Absolute yield levels and shifting yield curve shapes, as represented by the U.S. Treasury yield curve, also illustrate the changing opportunities presented to active managers of bond portfolios.

FIGURE 2: CHANGING TREASURY YIELD CURVE MEANS CURVE POSITIONING OPPORTUNITIES



Source: U.S. Department of the Treasury, as of March 7, 2026. Past performance is not indicative of future results.

The yield curve was inverted during most of the period framed by the onset and decline of the COVID pandemic. With higher yields available to investors at the short and long ends of the curve than in the middle or belly of the curve, active management of yield curve positioning could be relevant.

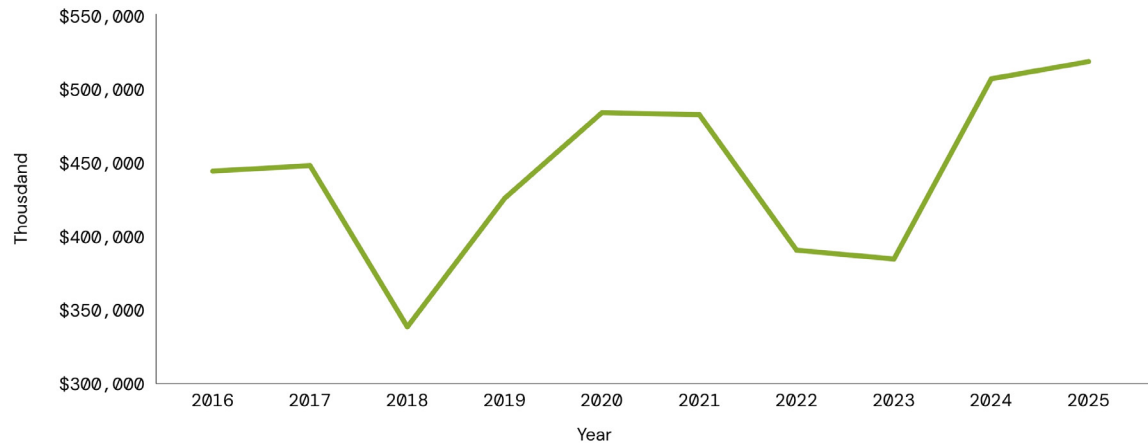
For example, an inverted yield curve may offer opportunities to capture higher yields through a barbelled maturity structure that overweights holdings on the shorter and longer ends of the curve. In addition, a barbelled structure may provide accelerated reinvestment opportunities (in the form of both purchase/sale swaps and maturities) when rates rise, allowing for a greater ability to potentially build income.

Ladder strategies are generally limited in their ability to implement a barbelled structure due to the nature of their maturity structure and approach. A ladder's equally weighted maturity schedule often forces purchases into a specific area of the yield curve, which can limit an investor's response to market opportunities. Conversely, as rates fall or yield curves revert to more historically common upward slopes, a professional manager can assess the various risks to the income stream and structure portfolios accordingly.

Market liquidity and bond issuance: The pace of municipal bond issuance accelerated in 2024, and has remained elevated entering 2026 (See Figure 3). Increased liquidity in the market offers opportunities to find value through trading strategies. In addition, higher bond issuance in the primary market results in secondary market flows and spread widening, which we view as an opportunity. Laddered approaches may unnecessarily confine consideration of new bonds to a limited opportunity set defined by a specific maturity term.



FIGURE 3: ANNUAL MUNICIPAL BOND ISSUANCE



Source: The Bond Buyer, as of March 7, 2026. Past performance is no guarantee of future results.

In addition, the rise of electronic trading and the growth of separately managed accounts is helping to further increase liquidity and lower transaction costs. As a result, it may be less expensive to capture the additional income and value opportunities that are available in today's market that we have described here.

Capturing Income Through Tax-Loss Harvesting

We believe tax-loss harvesting (TLH) is one such opportunity important to capturing value in bond investing. TLH, or alternatively tax-loss swapping, involves selling one or more bonds in which an investor has unrealized capital losses and using those harvested losses to offset capital gains and potentially increase the income generated by the portfolio.

If there are remaining losses after offsetting gains (in other words, net losses), an investor may also apply the losses to offset ordinary income. Investors also may be allowed to carry forward for tax purposes in future years additional net losses above this limit.²

Capturing Relative Value Through Credit Differentiation

As the municipal market shifts in response to changing economic, business, and investment market conditions and increased issuance, potential opportunities have increased to capture higher relative value based on credit differentiation across issuers and sectors.

We believe the municipal market enters 2026 with strong but fading credit quality (See Breckinridge's *2026 Municipal Market Outlook*). The technical backdrop is stable. Municipal spreads and Municipal/Treasury (M/T) ratios are at the lower end of their post-2021 range. In 2026, we believe there will be greater differentiation in credit spreads and favor a neutral approach to duration given mixed economic data and Federal Reserve's dissonant communications on the path for interest rates.

2. Based on 2026 federal tax guidelines, which are subject to change.



Conclusion

Active portfolio managers, who are generally less constrained across maturity exposures than laddered/passive strategies, may benefit from increasing opportunities in today's municipal market conditions. Those changes include higher yields, changes in the shape of the yield curve, increased liquidity in the form of higher bond issuance, and greater dimensions of credit differentiation. We believe a passive approach characterized by a buy-and-hold strategy may result in unintended bets on the direction of interest rates. In our view, active management has several advantages that could translate into higher after-tax returns for investors.

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