Investortools

Municipal Bond Market Performance

2025 Year in Review

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Overview

The municipal bond market, as measured by the Standard & Poor's Municipal Bond Investment Grade Index, had an annual Total Return of 4.343% in 2025. Table 1 contains the monthly and annual total returns and their breakdowns.

2025 saw substantial steepening of the municipal yield curve. The Federal Reserve lowered interest rates by 75 basis points over the course of 2025, and the short end of the municipal curve fell around 50 bp, roughly in line after considering taxes. However, 10-year yields fell only around 30 bp, and yields for terms longer than 20 years actually rose around 30 bp (with spot rates rising even more). The difference between the 5-year and 20-year yields increased by over 80 basis points, the largest steepening over a calendar year for that part of the curve since 2013. Overall, since the index was more exposed to the falling portion of the curve, the net curve effect (captured by Parallel Shift Return and Non-Parallel Shift Return) was positive.

Widening spreads on lower-rated bonds dampened returns slightly, but ultimately the positive effects of income dominated the bottom line.

The gains of 2025 were finally enough to recover from the massive losses in 2022, and to turn the index's cumulative return from July 2021 positive.

Table 1

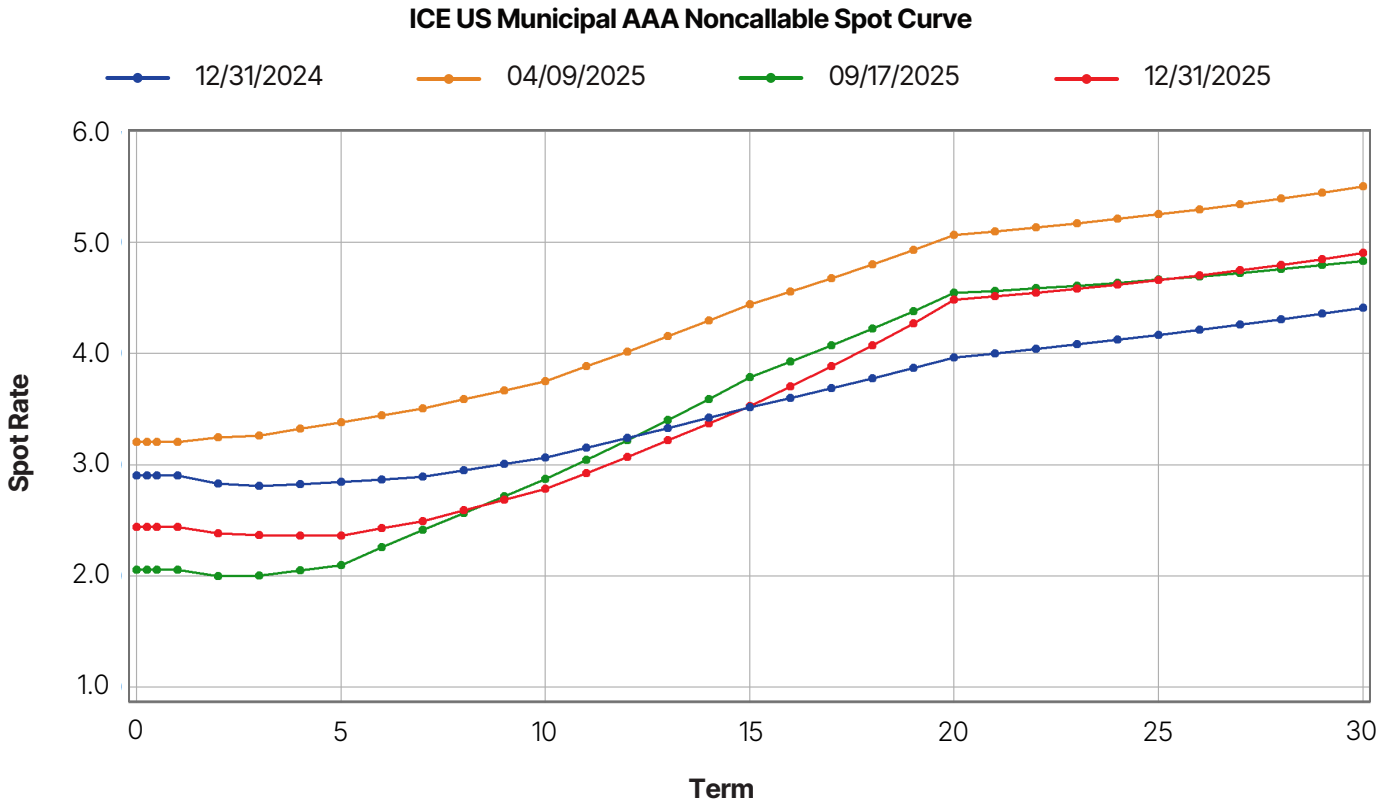
	Total Return	Coupon Return	Mkt Amort Return	Parallel Shift Return	Non-Parallel Shift Return	Sector/ Quality Return	Residual Price Return
Year	**4.343%**	**4.415%**	**-0.686%**	**2.029%**	**-1.056%**	**-0.617%**	**0.259%**
Dec	0.199%	0.373%	-0.060%	-0.043%	-0.072%	-0.099%	0.099%
Nov	0.279%	0.349%	-0.082%	0.091%	-0.071%	-0.056%	0.048%
Oct	1.074%	0.375%	-0.074%	1.221%	-0.695%	0.077%	0.169%
Sep	2.197%	0.358%	-0.028%	1.726%	0.023%	0.141%	-0.024%
Aug	0.852%	0.371%	-0.064%	0.558%	0.198%	-0.218%	0.006%
Jul	-0.173%	0.381%	-0.054%	-0.617%	0.255%	-0.131%	-0.007%
Jun	0.728%	0.357%	-0.022%	0.539%	-0.057%	-0.124%	0.035%
May	-0.085%	0.380%	-0.054%	0.084%	-0.076%	-0.356%	-0.063%
Apr	-0.491%	0.353%	-0.045%	-0.317%	-0.450%	-0.086%	0.054%
Mar	-1.578%	0.394%	-0.099%	-2.380%	0.099%	0.475%	-0.067%
Feb	0.980%	0.324%	-0.048%	0.803%	0.021%	-0.134%	0.013%
Jan	0.326%	0.360%	-0.050%	0.355%	-0.209%	-0.112%	-0.017%

Yield Curve Change

The 10-year spot rate fell 28 basis points in 2025, giving Parallel Shift Return a large contribution to the market's Total Return. However, the steepening of the curve resulted in spot rates at the longest terms rising almost 50 basis points (even more than their corresponding yields rose). This increase resulted in a large negative Non-Parallel Shift Return that partially offset the positive Parallel Shift Return. Since the index's duration exposure (measured by key rate durations) was more concentrated on the front half of the curve, the positive effect of falling rates won out.

Figure 1 shows the ICE US Municipal AAA Noncallable spot curve at key dates in 2025. All option-adjusted calculations in this report are based off of this curve.

Figure 1



Total Return Breakdown by Rating

Despite enjoying higher yields, lower-rated bonds generally underperformed higher-rated bonds in 2025. This was partially a result of spreads widening on lower-rated bonds compared to their higher-rated counterparts, and partially a result of lower-rated bonds generally having longer durations and thus being more exposed to the rate increases on the long end of the curve. Within BBB-rated bonds, the Education, Health Care, and IDR / PCR sectors were most affected by spread widening.

Table 2 shows index rating categories with a simplified return breakdown. Figure 2 shows that same return breakdown in bar graph form. The bar segments show the differing effects of yield, curve change and convexity, and spread change for the different rating categories.

Table 2

	Weight Percentage	Total Return	Return from Yield	Return from Curve Change/ Convexity	Return from Spread Change	Beginning Effective Duration
Overall	**100.00%**	**4.343%**	**3.728%**	**1.231%**	**-0.617%**	**6.058**
AAA	24.99%	4.474%	3.528%	1.321%	-0.375%	5.933
AA	55.38%	4.275%	3.687%	1.220%	-0.631%	6.136
A	15.11%	4.424%	4.001%	1.220%	-0.797%	5.846
BBB	4.02%	4.098%	4.674%	0.841%	-1.417%	7.074
Other Ratings	0.50%	3.816%	2.846%	0.933%	0.037%	1.874

Figure 2

Cumulative Return Growth by Rating

Early in the year, BBB bonds began to outperform other rating categories due to spread tightening in March. However, that quickly reversed in April, and BBB bonds continued to underperform throughout the summer due to sustained spread widening. This positioned them to end the year trailing higher-quality categories.

Figure 3 shows cumulative total return over the course of the year for various rating categories, while Figure 4 isolates the portion of that cumulative return that is due to spread change.

Figure 3

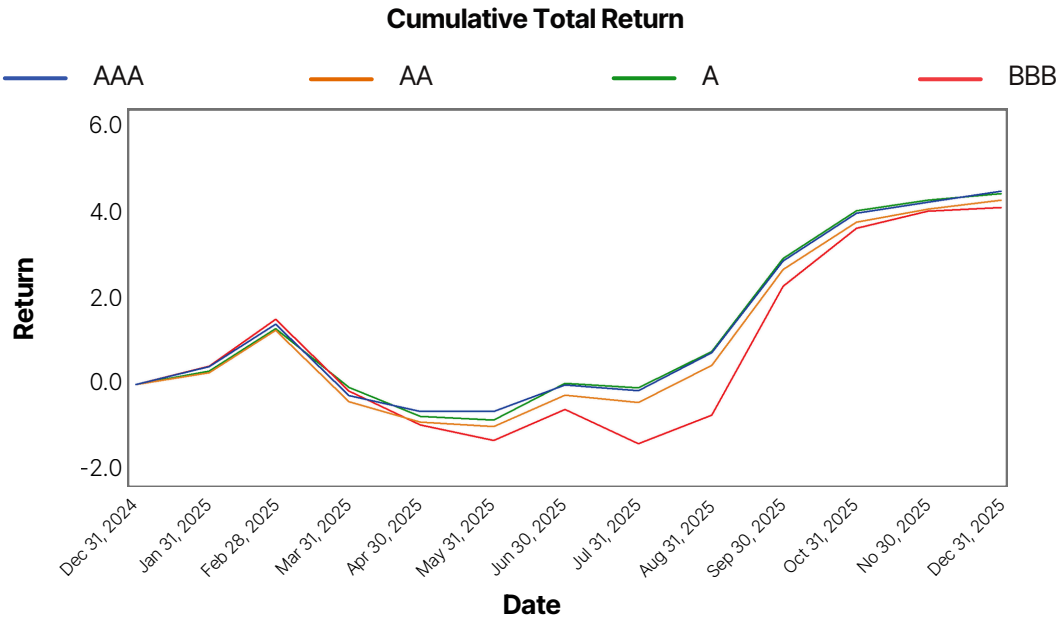
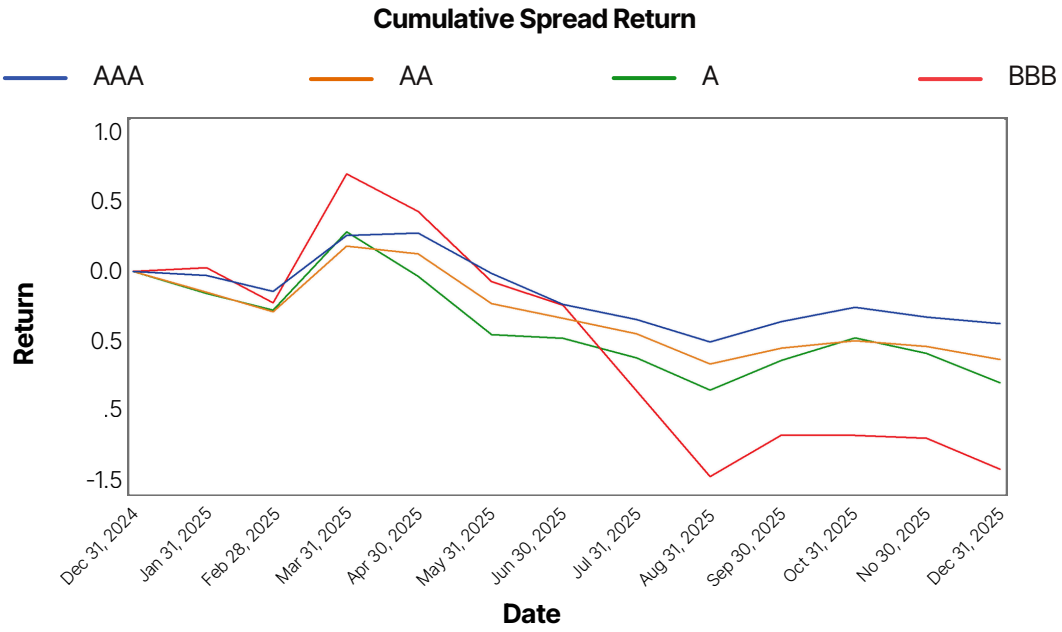


Figure 4



Total Return Breakdown by Sector

The highest-performing sectors of 2025 were Housing and IDR / PCR.

The IDR / PCR sector had the best Return from Curve Chg / Convexity of all sectors, having an optimal duration structure for 2025's yield curve movement, with durations primarily landing in the range of 3 to 10 years. These shorter terms saw falling yields in 2025 (unlike the 15-year and longer terms), and yet also had long enough durations to meaningfully benefit from those falling yields (unlike the short durations of the Prerefunded/ETM sector). However, the sector's overall spread effect was negative.

The Housing sector, meanwhile, had by far the best Return from Spread Change as option-adjusted spreads tightened for that sector while most other spreads were widening. The sector's biggest spread boost came in March and April.

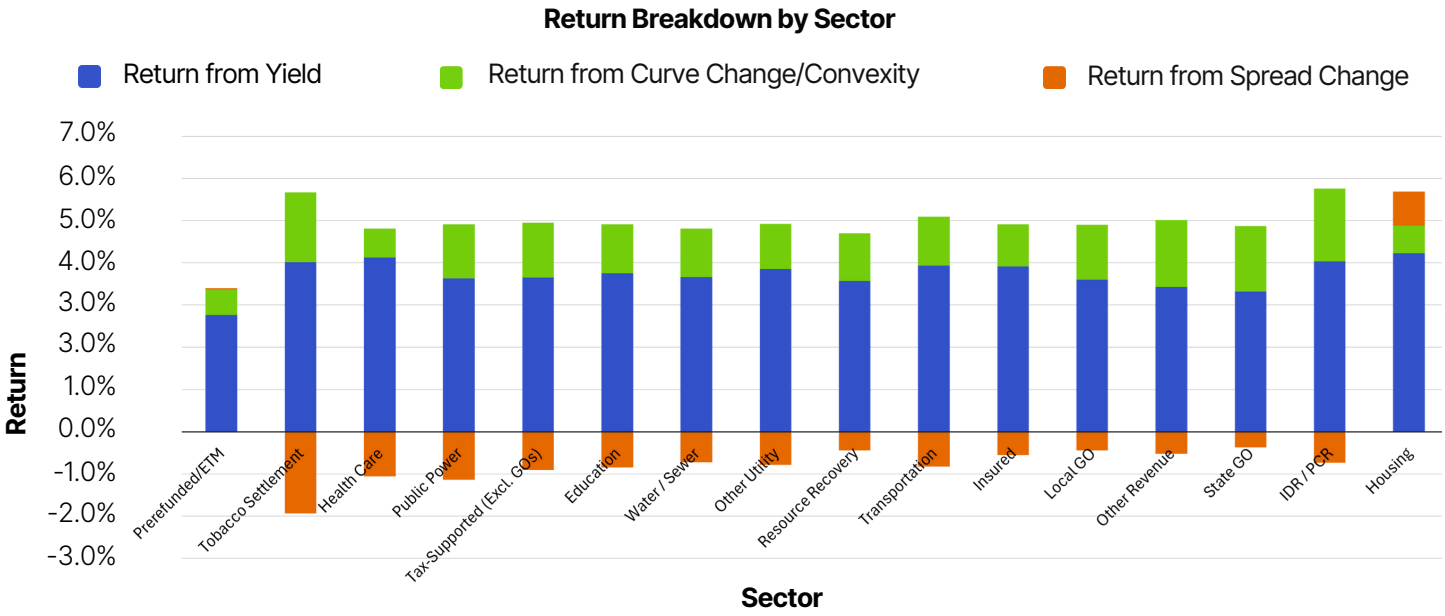
Table 3 lists these index sectors, sorted by ascending Total Return, with a simplified return breakdown.

Table 3

	Weight Percentage	Total Return	Return from Yield	Return from Curve Chg/ Convexity	Return from Spread Chg	Beginning Effective Duration	Beginning Average Rating
Overall	**100.00%**	**4.343%**	**3.728%**	**1.231%**	**-0.617%**	**6.058**	**AA**
Prerefunded/ETM	2.97%	3.399%	2.769%	0.597%	0.032%	1.303	AA
Tobacco Settlement	0.27%	3.741%	4.020%	1.655%	-1.934%	5.297	BBB+
Health Care	7.60%	3.760%	4.124%	0.691%	-1.055%	6.566	A+
Public Power	2.86%	3.779%	3.630%	1.287%	-1.137%	5.720	AA
Tax-Supported (Excl. GOs)	12.43%	4.049%	3.649%	1.301%	-0.901%	6.269	AA+
Education	6.67%	4.077%	3.754%	1.163%	-0.840%	6.212	AA
Water/Sewer	6.60%	4.091%	3.665%	1.148%	-0.722%	6.277	AA+
Other Utility	1.06%	4.143%	3.857%	1.065%	-0.780%	6.557	AA-
Resource Recovery	0.04%	4.256%	3.568%	1.131%	-0.443%	5.350	AA
Transportation	11.02%	4.270%	3.940%	1.158%	-0.828%	6.435	AA-
Insured	6.78%	4.355%	3.913%	0.999%	-0.557%	7.278	A+
Local GO	20.88%	4.465%	3.602%	1.305%	-0.442%	6.041	AAA-
Other Revenue	2.74%	4.492%	3.429%	1.588%	-0.526%	5.403	AA+
State GO	8.82%	4.504%	3.321%	1.555%	-0.372%	4.972	AA+
IDR / PCR	4.93%	5.032%	4.035%	1.727%	-0.730%	5.282	A
Housing	4.32%	5.688%	4.229%	0.652%	0.807%	8.145	AA+

Figure 5 shows these sectors ordered from lowest return on the left to highest return on the right. The bar segments show the differing effects of yield, curve change and convexity, and spread change for each sector.

Figure 5



States With the Largest Market Value

Some of the largest states, as measured by their bonds' total market value in the Standard & Poor's Municipal Bond Investment Grade Index, outperformed the general market for various reasons. Washington and Georgia, for instance, outperformed the national average due to below-average exposure to the rising long end of the curve. Maryland experienced very little change in spreads, and its Return from Spread Change was less negative than most other states.

On the other end of the spectrum, spreads on New York bonds widened substantially. This, combined with above-average exposure to the long end of the curve, led to particularly poor performance for New York.

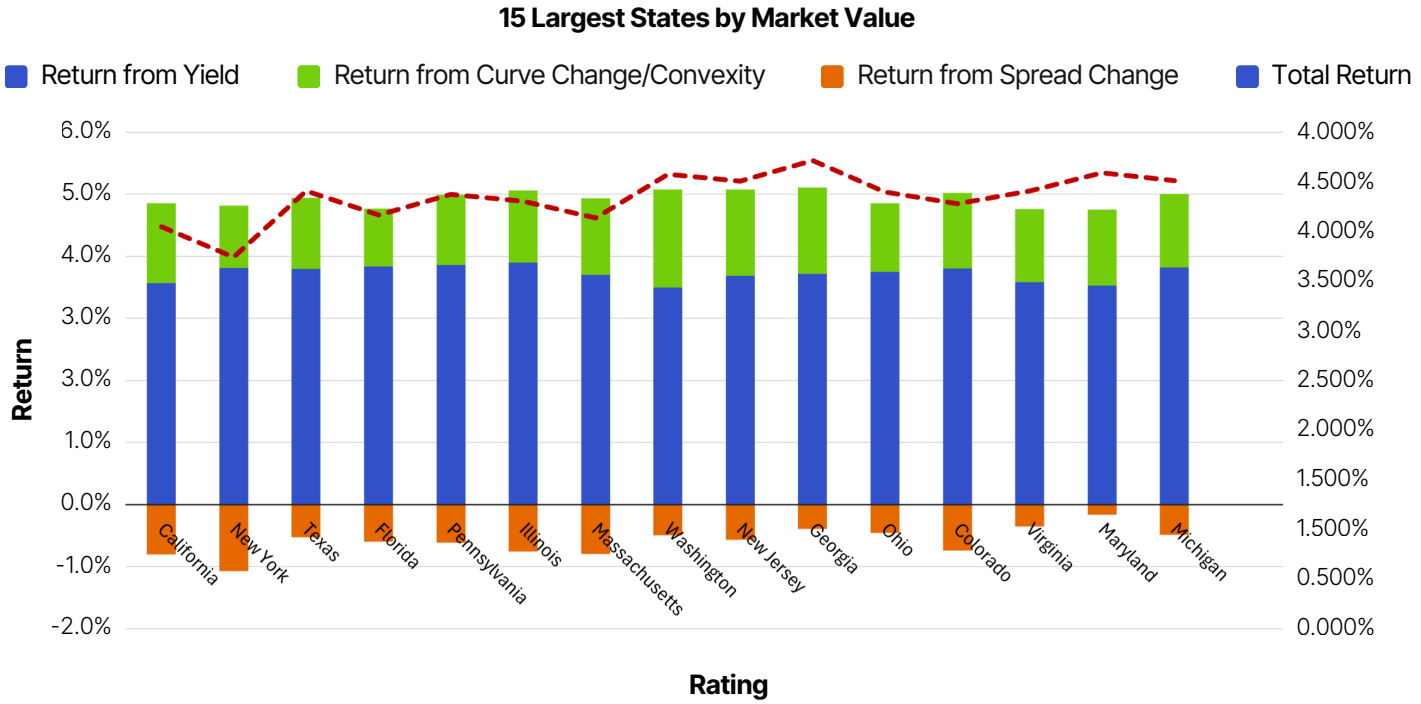
Table 4 shows the fifteen largest states, as measured by the total market value of their bonds in the Standard & Poor's Municipal Bond Investment Grade Index. The states are sorted by market value weight and accompanied by a simplified return breakdown.

Table 4

	Weight Percentage	Total Return	Return from Yield	Return from Curve Chg/ Convexity	Return from Spread Chg	Beginning Effective Duration	Beginning Average Rating
Overall	**100.00%**	**4.343%**	**3.728%**	**1.231%**	**-0.617%**	**6.058**	**AA**
California	15.67%	4.049%	3.564%	1.292%	-0.807%	5.911	AA
New York	13.21%	3.741%	3.815%	1.003%	-1.076%	6.666	AA
Texas	11.91%	4.408%	3.796%	1.145%	-0.532%	6.420	AA+
Florida	4.18%	4.167%	3.835%	0.936%	-0.604%	6.314	AA-
Pennsylvania	3.84%	4.372%	3.857%	1.132%	-0.617%	6.103	A+
Illinois	3.64%	4.305%	3.899%	1.163%	-0.758%	5.926	A+
Massachusetts	3.05%	4.138%	3.698%	1.236%	-0.797%	6.318	AA+
Washington	3.04%	4.578%	3.498%	1.577%	-0.496%	5.272	AA+
New Jersey	3.02%	4.506%	3.687%	1.387%	-0.567%	5.937	A+
Georgia	2.39%	4.714%	3.717%	1.389%	-0.392%	5.544	AA
Ohio	2.28%	4.398%	3.746%	1.112%	-0.460%	5.969	AA
Colorado	2.24%	4.279%	3.801%	1.219%	-0.741%	6.304	AA
Virginia	2.12%	4.410%	3.582%	1.181%	-0.354%	5.898	AA+
Maryland	1.88%	4.591%	3.527%	1.225%	-0.162%	5.603	AA+
Michigan	1.75%	4.513%	3.817%	1.186%	-0.490%	5.943	AA

Figure 6 shows these states ordered from largest (by market value) on the left to smallest on the right. The bar segments show the differing effects of yield, curve change and convexity, and spread change for each state. The dotted line shows the overall total return for each state.

Figure 6



Highest / Lowest Performing States / Territories

Despite particularly low yields, the U.S. Virgin Islands was the highest-performing state/territory for the second straight year. The Virgin Islands had an extremely short average duration for the first portion of the year as yields were increasing but then saw a flood of new issues mid-year. This increased the territory's average duration substantially just in time for yields to drop again. This remarkable timing was the primary source of the territory's strong return.

The Virgin Islands (along with many other high-performing states/territories) also benefited from overall spread tightening, while much of the rest of the nation saw spreads widen. This was especially true for Wyoming, which has an unusually large exposure to the Housing sector (the higest-performing sector nationally).

Several of these high-performing states (especially Wyoming, North Dakota, and Arkansas) were held back from performing even better due to unusually long average durations.

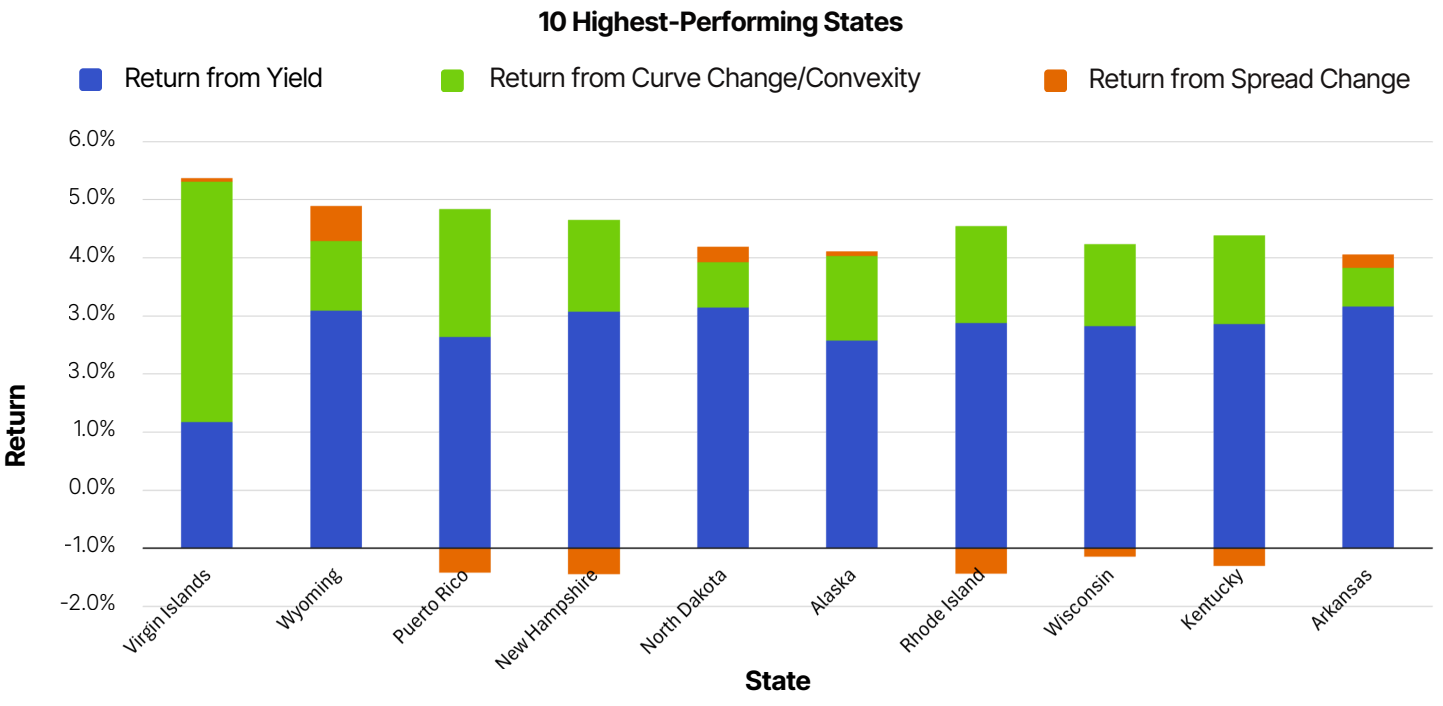
Table 5 ranks the 10 states and territories with the highest total returns and provides simplified return breakdown.

Table 5

	Weight Percentage	Total Return	Return from Yield	Return from Curve Chg/ Convexity	Return from Spread Chg	Beginning Effective Duration	Beginning Average Rating
Overall	**100.00%**	**4.343%**	**3.728%**	**1.231%**	**-0.617%**	**6.058**	**AA**
Virgin Islands	0.01%	6.372%	2.177%	4.134%	0.061%	0.466	A
Wyoming	0.05%	5.889%	4.092%	1.200%	0.598%	8.084	AA
Puerto Rico	0.07%	5.414%	3.641%	2.194%	-0.420%	3.043	A-
New Hampshire	0.30%	5.205%	4.073%	1.580%	-0.447%	7.281	A+
North Dakota	0.16%	5.188%	4.140%	0.786%	0.262%	8.280	AA-
Alaska	0.20%	5.111%	3.575%	1.454%	0.083%	4.980	AA
Rhode Island	0.30%	5.108%	3.876%	1.670%	-0.438%	6.534	AA-
Wisconsin	1.39%	5.092%	3.825%	1.410%	-0.143%	5.822	AA-
Kentucky	0.97%	5.082%	3.856%	1.529%	-0.303%	5.359	AA-
Arkansas	0.27%	5.061%	4.164%	0.660%	0.236%	7.309	AA-

Figure 7 shows these highest-performing states and territories ordered from highest return on the left to lowest return on the right. The bar segments show the differing effects of yield, curve change and convexity, and spread change for each state and territory.

Figure 7



On the other end of the rankings, most of the lowest-performing states saw spreads widen substantially. This was especially true for New York, the lowest-performing state. California, the second-lowest-performing state, additionally suffered from lower-than-average yields.

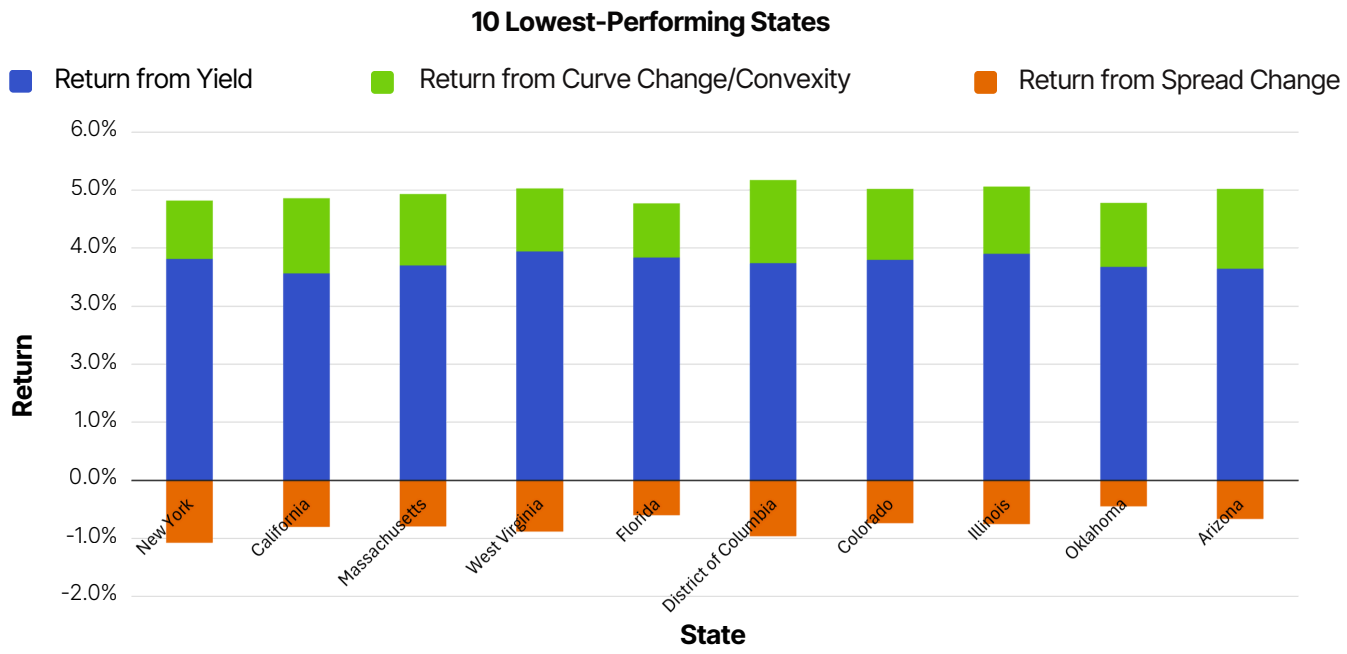
Table 6 ranks the ten states and territories with the lowest total returns and provides a simplified return breakdown.

Table 6

	Weight Percentage	Total Return	Return from Yield	Return from Curve Chg/ Convexity	Return from Spread Chg	Beginning Effective Duration	Beginning Average Rating
Overall	**100.00%**	**4.343%**	**3.728%**	**1.231%**	**-0.617%**	**6.058**	**AA**
New York	13.21%	3.741%	3.815%	1.003%	-1.076%	6.666	AA
California	15.67%	4.049%	3.564%	1.292%	-0.807%	5.911	AA
Massachusetts	3.05%	4.138%	3.698%	1.236%	-0.797%	6.318	AA+
West Virginia	0.26%	4.143%	3.942%	1.087%	-0.886%	6.117	AA-
Florida	4.18%	4.167%	3.835%	0.936%	-0.604%	6.314	AA-
District of Columbia	1.12%	4.209%	3.742%	1.431%	-0.964%	6.238	AA+
Colorado	2.24%	4.279%	3.801%	1.219%	-0.741%	6.304	AA
Illinois	3.64%	4.305%	3.899%	1.163%	-0.758%	5.926	A+
Oklahoma	0.64%	4.332%	3.680%	1.101%	-0.449%	5.463	AA
Arizona	1.54%	4.353%	3.643%	1.379%	-0.669%	5.369	AA

Figure 8 shows these lowest-performing states ordered from lowest return on the left to highest return on the right.

Figure 8



Largest Credits by Market Value

Most of the largest credits, as measured by their bonds' total market value in the Standard & Poor's Municipal Bond Investment Grade Index, underperformed the overall market. Of the ten largest (listed below) New York credits particularly stood out in this regard, as spreads widened substantially overall on their outstanding bonds. One exception was the Port Authority of New York & New Jersey which saw more modest spread changes and benefited from higher yields, helping it slightly beat the overall market.

Table 7 shows the 10 largest credits, as measured by their total outstanding bond market value in the Standard & Poor's Municipal Bond Investment Grade Index. The credits are sorted by market value weight, accompanied by a simplified return breakdown.

Table 7

	Weight Percentage	Total Return	Return from Yield	Return from Curve Chg/ Convexity	Return from Spread Chg	Beginning Effective Duration	Beginning Average Rating
Overall	**100.00%**	**4.343%**	**3.728%**	**1.231%**	**-0.617%**	**6.058**	**AA**
California State	2.51%	4.341%	3.255%	1.403%	-0.317%	5.108	AA
NY City Transitional Finance Authority Future Tax Secured Revenue Bonds	1.74%	3.505%	3.750%	1.347%	-1.592%	6.956	AAA
NY St Personal Income Tax Revenue Bonds	1.59%	3.319%	3.738%	1.096%	-1.515%	6.629	AA+
New York State	1.21%	3.524%	3.615%	1.510%	-1.601%	6.054	AA
Massachusetts State	1.05%	3.868%	3.679%	1.168%	-0.979%	6.862	AA+
NY City Water & Sewer System	1.03%	3.481%	3.814%	0.846%	-1.179%	6.999	AA+
Washington State	0.99%	4.359%	3.370%	1.824%	-0.835%	5.184	AAA
Illinois State	0.73%	4.402%	3.729%	1.527%	-0.854%	5.127	A-
Port Authority of NY & NJ	0.67%	4.480%	3.906%	1.167%	-0.593%	6.432	AA-
NY State Sales Tax Revenue Bonds	0.67%	3.640%	3.690%	0.921%	-0.971%	6.743	AA+

Conclusion

Bond performance measurements at an overall level often only tell part of the story. More meaningful insight comes from understanding why returns unfolded the way they did and to what extent they were driven by income, yield curve movements (parallel and non-parallel), or changes in spreads. The stories emerge when total return is separated into these contributing factors, revealing how each influenced the bottom line.

Custom Index Manager™ by Investortools supports this deeper analysis. It allows performance attribution to be explored at the aggregate level, down to individual securities, and across various intermediate views such as states, sectors, and credit quality. When paired with CreditScope®, this framework extends naturally into credit-driven analysis, adding further context to performance outcomes. Custom indices can provide a more appropriate benchmark against which to measure portfolios.

By structuring performance analysis this way, investment professionals gain clarity into the key sources of strong or weak performance for an investment by itself or with respect to a benchmark. These insights help inform the investment management process and provide clearer, data-driven stories for communicating results to internal teams and external stakeholders alike.

Appendix: Return Breakdown Terms

Table 1 uses Return Breakdown terms used in Custom Index Manager™ by Investortools, Inc. More information about these terms can be found in Investortools' Factor-Based Attribution White Paper, which is available upon request.

Elsewhere in this document, a simplified breakdown is often used:

- Return from Yield = Coupon Return + Market Amort Return
- Return from Curve Change / Convexity = Parallel Shift Return + Non-Parallel Shift Return + Residual Price Return
- Return from Spread Change = Sector/Quality Return + Security-Specific Return

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