

Tax Efficient Fixed Income Market Commentary



October 2025

3rd Quarter Review

It was a good quarter for holders of municipal bonds with all investment grade maturities registering robust performance and outperforming Treasuries. A growing belief that the labor market was deteriorating took hold during the quarter, driven home by unexpectedly weak payroll reports for the July and August periods. In response, the Federal Open Market Committee (FOMC) resumed easing at their September meeting, cutting the overnight rate by twenty-five basis points. This kicked off a strong rally, but subsequent comments from Fed Chair, Jerome Powell that insinuated caution caused the market to moderate its reaction. For the quarter Treasury yields declined by five to ten basis points, while municipal yields fell by 30 to 35 basis points with modest steepening of the yield curve.

During the opening weeks of the summer, it was not as clear that it would be a good quarter for bonds. Strong economic releases, hawkish comments from the Fed and municipal issuance that continued at a record pace, pushed yields higher. Although new money flowed into municipals, demand during July was concentrated in shorter maturities, so the yield curve steepened by over 30 basis points. For the balance of the quarter, issuance normalized, falling from \$53 billion in July to \$49 billion in August and \$45 billion in September. At the same time demand picked up. Mutual funds, which saw inflows average over a billion dollars per week during July and August, scooped up longer investments, which caused the yield curve to flatten significantly during September. While the yield curve steepened over the full quarter, the flattening, which occurred during September, tempered the extremes seen earlier in the period.

Volatility in the municipal market offered multiple opportunities to adjust targets and reposition portfolios. We opened the quarter, working to extend portfolio durations to 105 to 110% of the durations of the respective benchmarks and had significant success in repositioning portfolios due to the heavy issuance that came to market in July. At the same time, we maintained very bulleted maturity structures with overweight to four to eight-year bonds. This positioning was maintained until mid-September when our investment committee voted to reduce durations to be slightly longer than the benchmarks' durations. Driving this decision were, a desire to recognize how well bonds had performed, and a key internal quantitative metric had fallen into a less favorable range. At the same time, the amount of steepening in the yield curve over the quarter caused us to reduce the degree of our bulleted structure in portfolios. Although we continue to see the pressures over the long term to be weighted towards a steep yield curve, we wanted to recognize how much it has already moved.

Kenneth Potts

Senior Vice President, Portfolio Manager

Reese Trucks

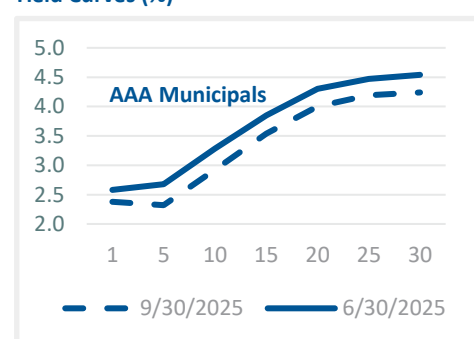
Senior Vice President, Credit Research,
Fixed Income Investments

Market Returns (%)

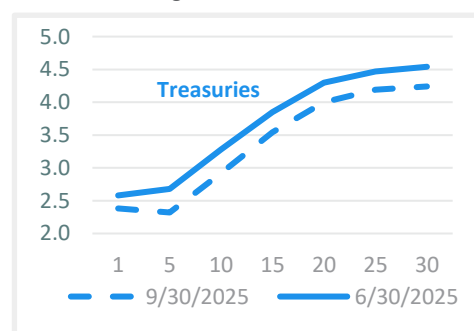
	3Q 2025	2025 YTD
Bloomberg Muni Index	3.00%	2.64%
1 Year	0.99%	2.89%
3 Year	1.52%	3.63%
5 Year	2.19%	4.51%
7 Year	2.74%	4.84%
10 Year	3.03%	4.10%
15 Year	3.43%	2.40%
20 Year	3.73%	0.90%
1-10 Year	2.33%	4.12%
1-15 Year	2.59%	3.71%
Prerefunded 5 Year	4.73%	2.20%
AAA	3.07%	2.63%
AA	2.95%	2.61%
A	3.08%	2.80%
BBB	2.84%	2.32%
U.S. Treasury	1.51%	5.35%

Source: Bloomberg

Yield Curves (%)



Source: Bloomberg



Source: Bloomberg

For more information on any indices, please see the "Index Definitions" sections in the "Important Disclosures" page at the end of this presentation.

An area of particularly strong demand during the quarter was for California bonds, which in many cases left in-state investors earning lower after-tax yields than those offered by out-of-state bonds. Additionally, we are seeing signs of weakening in the credit quality of the state. As a result, during July, we lowered our target for in-state bonds to 60% of portfolio for California investors in state focused mandates.

During July, following the signing into law of the reconciliation and tax bill, we made the decision to increase exposure to private activity bonds subject to the Alternative Minimum Tax (AMT). This is because the changes in the tax laws which result in few people paying the tax were made permanent. As such, we believe that the 40 or more additional basis points of yield that we earn on these bonds will compress over time, as more investors realize that owning AMT bonds is no longer an issue.

Looking ahead

Since Congress did not pass a funding bill to keep the government operating until its next fiscal year and with both sides seemingly far apart, the Government is shutdown at the time of this commentary. Essential services remain operational and Federal Reserve functions and Treasury debt auctions/principal and interest payments will continue as normal. However, the Department of Labor has confirmed that the weekly claims report will not be published during the shutdown, and the September employment report was not released.

The Republicans offered what they term a “clean continuing resolution”, that reportedly doesn’t contain any changes from the last CR signed in March. However, this was voted down repeatedly in the Senate, mostly along partisan lines with just three Democrats voting for it. A key point of contention is healthcare policy with the Democrats pushing for the bill to address the expiring ACA subsidies and recent Medicaid cuts. House Speaker Mike Johnson (R-Louisiana) called it “a December policy issue, not a September funding issue.” Since 1976, there have been 21 instances of government shutdowns, with most of them lasting just 1-2 days. The longest government shutdown, however, started in December 2018 and lasted for 35 days.

Separately, the White House has paused \$18 billion in New York infrastructure funding which affects the Hudson Tunnel and the Second Avenue Subway projects. The Trump administration has also halted \$2.1 billion in funding for rail infrastructure projects in Chicago, citing concerns over race-based contracting practices. In September, \$2.4 billion in funding for California’s very costly high-speed rail project was redirected to other projects.

The Trump Administration is expected to fund coal plant upgrades. The Administration will reportedly expand coal mine leasing on federal lands, opening up over thirteen million acres in North Dakota, Wyoming and Montana, simultaneously providing \$625 million to upgrade and expand regional power generation fueled by coal to support more baseload power.

Key elections are coming up that could be seen as a referendum on the Trump agenda.

- NYC high-profile Mayoral race
 - The mayoral election in the nation's most populous city always grabs outsized attention, especially this year as New York City may elect its first millennial mayor
 - Former Governor Cuomo is running as the independent candidate
- NJ Governor (Phil Murphy is term-limited)
- VA Governor (Glen Youngkin is term-limited)

Municipal Credit Update

- New York City may face annual deficits of up to \$13 billion due to under-budgeting costs for social services and overtime, according to state Comptroller DiNapoli. The city's five-year financial plan forecasts a potential budget gap of \$10.6 billion in FY27, increasing to \$13 billion in FY28 and after. He also said that slower economic growth and federal budget cuts could intensify fiscal pressure on the city.
- Contribution rates for state and local pensions have reached historic highs, with government employers paying almost one third of payroll on average across all 50 states and D.C. According to a recent public pension funding report, the national average funded ratio has increased from 78.3% to 81.4% and is expected to shave total unfunded liabilities down from \$1.5 trillion to \$1.35 trillion.
- S&P upgraded the MTA one notch to A due to “several factors that provide additional stability and predictability to MTA’s credit profile”. These include the state’s decision to increase the payroll mobility tax, the initial financial success of congestion pricing, ongoing recovery in ridership levels, maintenance of healthy liquidity levels, and manageable projected out-year deficits. Due to the projected shortfalls, the MTA voted to increase subway fares \$0.10 beginning in 2026 as well as fares on LIRR, Metro North, and on MTA-owned bridges and tunnels.
- Pennsylvania Governor Shapiro instructed the state’s Department of Transportation to approve a request directing a one-time funding lifeline to the mass transit system in order to avoid service cuts. SEPTA (Southeastern Pennsylvania Transportation Authority) sought \$394mn in capital assistance funds to help cover a \$213mn budget deficit that would have triggered the rollout of drastic service cuts.

Important Disclosures



Past performance is not a guarantee of future results. Inherent in any investment is the potential for loss.

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Index Definitions:

It is not possible to invest directly in an index. Investors pursuing a strategy similar to an index may experience higher or lower returns and will bear the cost of fees and expenses that will reduce returns.

The Bloomberg Municipal Bond Index is a rules-based and market value weighted index engineered for the long-term tax-exempt bond market. To be included in the index, bonds must be rated investment-grade (Baa3/BBB- or higher) by at least two of the following ratings agencies: Moody's, S&P, Fitch. If only two of the three agencies rate the security, the lower rating is used to determine index eligibility. If only one of the three agencies rates a security, the rating must be investment-grade. They must have an outstanding par value of at least \$7 million and be issued as part of transaction of at least \$75 million. The bonds must be fixed rate, have a double date after December 31, 1990, and must be at least one year from maturity date. Remarketed issues, taxable municipal bonds, bonds with floating rates, and derivatives, are excluded from the benchmark.

Subindices include: Bloomberg 1 Year (1-2 year maturities), Bloomberg 3 Year (2-4 year maturities), Bloomberg 5 Year (4-6 year maturities), Bloomberg 7 Year (6-8 year maturities), Bloomberg 10 Year (8-12 year maturities), Bloomberg 15 Year (12-17 year maturities), Bloomberg 20 Year (17-22 year maturities), Bloomberg 1-10 Year (1-12 year maturities).

The Bloomberg Pre-refunded Index is composed of general obligation bonds, revenue bonds, insured bonds (including all insured bonds with a Aaa/AAA rating), and prerefunded bonds.

The Federal Open Market Committee (FOMC) is a committee within the Federal Reserve System (the Fed) that is charged under United States law with overseeing the nation's open market operations (e.g., the Fed's buying and selling of United States Treasury securities). This Federal Reserve committee makes key decisions about interest rates and the growth of the United States money supply. Under the terms of the original Federal Reserve Act, each of the Federal Reserve banks was authorized to buy and sell in the open market bonds and short-term obligations of the United States Government, bank acceptances, cable transfers, and bills of exchange. Hence, the reserve banks were at times bidding against each other in the open market. In 1922, an informal committee was established to execute purchases and sales. The Banking Act of 1933 formed an official FOMC.

Federal Funds Rate: The federal funds rate is the central interest rate in the U.S. financial market. It influences other interest rates such as the prime rate, which is the rate banks charge their customers with higher credit ratings. Additionally, the federal funds rate indirectly influences longer-term interest rates such as mortgages, loans, and savings, all of which are very important to consumer wealth and confidence. (Source: Board of Governors of the Federal Reserve System)

Personal Consumption Expenditures Price Index (PCE): A measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

Unemployment Rate: The unemployment rate represents the number of unemployed people as a percentage of the labor force (the labor force is the sum of the employed and unemployed). The unemployment rate is published by the US Department of Labor.

The unemployment rate is calculated as: $(\text{Unemployed} \div \text{Labor Force}) \times 100$.

Core PCE: PCE excluding food and energy sector prices.

Consumer Price Index (CPI): The Consumer Price Index (CPI) measures the monthly change in prices paid by U.S. consumers. The Bureau of Labor Statistics (BLS) calculates the CPI as a weighted average of prices for a basket of goods and services representative of aggregate U.S. consumer spending.

Core CPI: CPI excluding food and energy sector prices.