

Investment Insights

Thoughts From The Municipal Bond Desk



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Tim: Long-term investment-grade municipal yields rose above 5% on July 18, which is pretty rare.¹ What does that mean for muni market?

Mark: Yes, a highly rated, long-term municipal bond reaching a 5% yield is an infrequent occurrence, and yields of the Bloomberg Municipal Long Bond Index (22+) have surpassed 5% only three other times in the past ten years—this past April and before that, in October 2022 and October 2023.¹ In each of these cases, crossover buyers, such as hedge funds, banks, and insurance companies, came into the municipal market to capture the relative value, and yields declined soon after.¹ The yield crossed 5% on July 15 and remained above that line as of July 28.² The muni market may remain choppy in the coming weeks, but I believe there is a lot of value in longer-term investment grade credits.

Tim: Not surprisingly, high yield municipals appeared to be pressured by the increasing yields in those investment grade bonds.

Mark: Yes, high yield munis have been hit by a double-whammy this month. In addition to having relatively longer duration than investment grade bonds, high yield munis were also affected by significant volatility in the transportation sector.¹ As of July 15, the high yield transportation sector returned -9.1%, month to date and -7.5%, year to date.¹ The catalyst came from news that Brightline, which owns and operates a train system between Miami and Orlando, would defer an interest payment on its credits financing a route expansion to Tampa. That postponement is not a default, as Brightline is permitted under the terms of the bond documents to defer up to three interest payments.³ However, all of Brightline's bonds traded lower since mid July, which has weighed on the high yield transportation sector, as investors wait to see if the company will be able to secure new financing to pay down those specific credits. Unexpected events like this one underline the importance of portfolio diversification, in my opinion, as diversification has the potential to mitigate portfolio risk.

Tim: On a more positive note, municipal credit fundamentals remain solid, as tax revenues continue to beat expectations.

Mark: That's right! I am encouraged by the trend of moderate revenue growth and fiscal responsibility practiced by municipalities. In their Spring Fiscal Survey of States, the National Association of State Budget Officers (NASBO) reported revenue projections for fiscal 2026 that are 2.8% higher than current fiscal 2025 estimates, translating to a fourth consecutive year of modest revenue growth.⁴ Many observers have predicted that economic growth may slow due to the imposition of trade tariffs and because of the decline in federal spending, especially the cuts to Medicaid and food assistance that are expected to have a large impact on state budgets.⁵ The economic outlook has led a number of state governments to scale back spending plans in their 2025-2026 fiscal years, as they have during previous periods of uncertainty and during economic downturns. For example, states' general fund spending growth is slowing, with budgeted fiscal year 2026 general fund spending only growing 0.8% above fiscal 2025's estimated levels.⁴ This should allow for states to maintain or increase their rainy-day fund levels.⁴

Overview

- Yields on long-duration investment grade municipals climbed above 5% in mid July, which may spark buying from crossover investors.
- High yield municipal bonds, which generally have a longer duration, were hard hit by the increase in longer-term yields.
- The high yield transportation sector has been a weak point for the high yield muni market so far in 2025, reinforcing the importance of portfolio diversification.
- Credit conditions remain sound, with state governments seeing moderate revenue growth, while taking steps to prepare for potentially weaker economic conditions.

Munis by the numbers

A quick look at some commonly used municipal market datapoints.

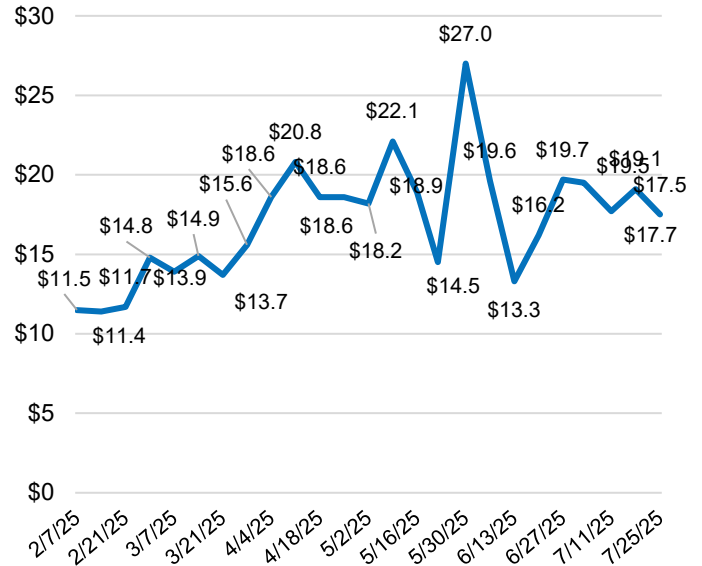
Fund Flows - Weekly and Monthly Reporters (\$millions)

Week ended July 23, 2025

	Combined	Open End Mutual Funds	ETFs
All term muni funds	14,732	3,091	11,641
Investment Grade	10,646	(191)	10,837
High Yield	4,086	3,282	804
Long Term (10yr +)	2,633	(2,081)	4,715
Intermediate (5-10yr)	4,278	1,202	3,076
Short / Intermediate (3-5yr)	2,801	996	1,805
Short (1-3yr)	5,019	2,974	2,045
National funds	15,130	4,381	10,749
New York	(312)	(435)	123
California	707	(58)	765

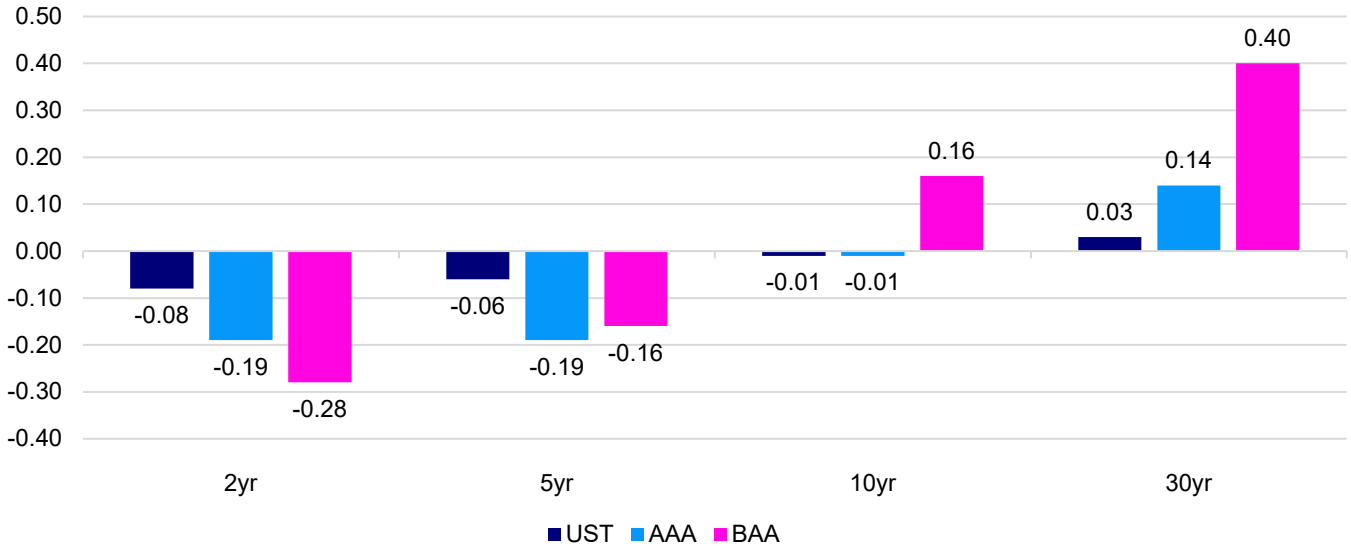
Source: Year to date LSEG Lipper Global Fund Flows, J.P. Morgan. Data refreshed on July 23, 2025. Note: Figures shown on this table are combination of weekly and monthly reporters.

30-day Visible Supply (\$billions)



Source: Bond Buyer Weekly 30-Day Visible Supply - Total dollar volume of bonds to be offered over the next thirty days. It does not include 'Sealed Bids Invited' or 'Proposed Bond Issues'. Only includes Municipal Bonds. From February 7, 2025 – July 25, 2025.

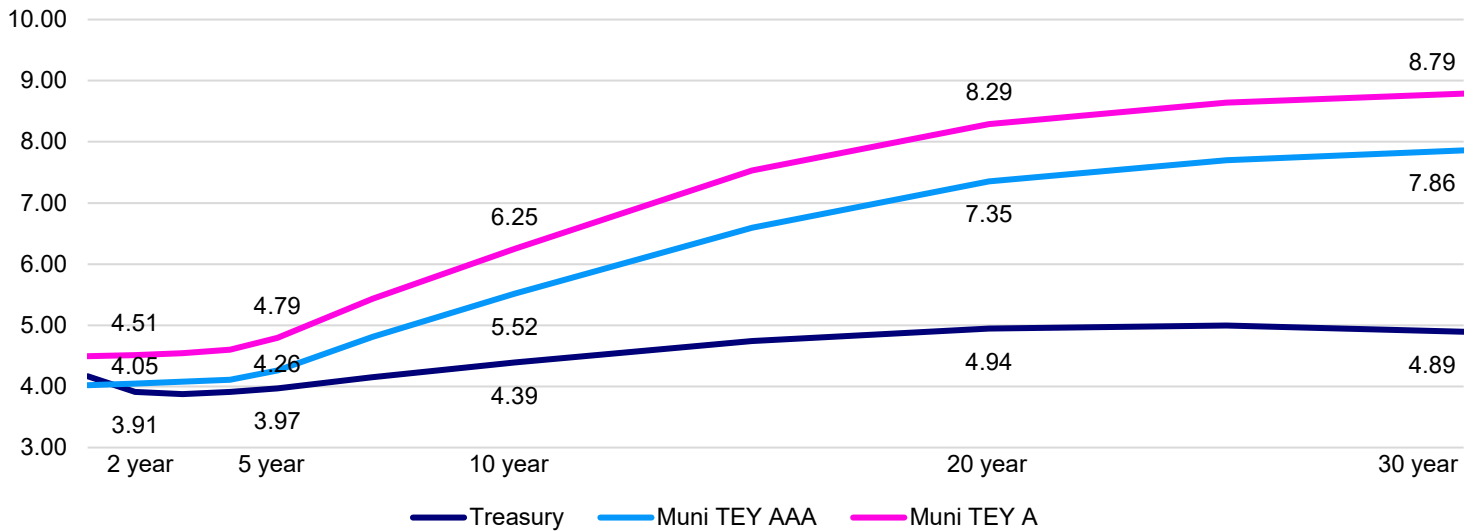
1-Month Yield Change 6/16/25 – 7/16/25 (% Change)



Source: Refinitiv MMD Curve, US Department of Treasury, from June 16, 2025 – July 16, 2025. UST = United States Treasury. A credit rating is an assessment provided by a nationally recognized statistical rating organization (NRSRO) of the creditworthiness of an issuer with respect to debt obligations, including specific securities, money market instruments or other debts. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice. NR indicates the debtor was not rated and should not be interpreted as indicating low quality. For more information on rating methodologies, please visit the following NRSRO websites: www.standardandpoors.com and select 'Understanding Credit Ratings' under Rating Resources 'About Ratings' on the homepage.; <https://ratings.moodys.io/ratings> and select 'Rating Methodologies' on the homepage.; www.fitchratings.com and select 'Ratings Definitions Criteria' under 'Resources' on the homepage. Then select 'Rating Definitions' under 'Resources' on the 'Contents' menu.

Munis by the numbers

Current Muni Treasury Ratio and Tax-Equivalent Yields (%)

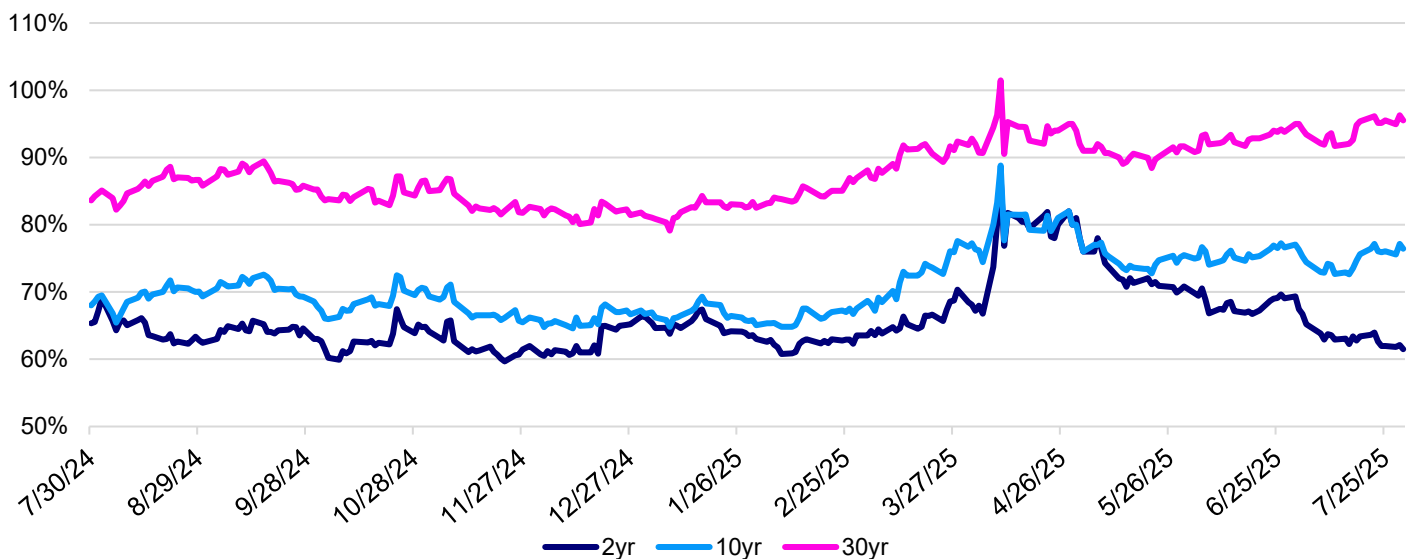


Term	US Treasury (UST)	Muni AAA	Muni A	Muni TEY AAA	Muni TEY A	Muni UST Ratio	Muni TEY UST Ratio
2 year	3.91	2.40	2.67	4.05	4.51	61.3%	103.5%
5 year	3.97	2.52	2.84	4.26	4.79	63.5%	107.3%
10 year	4.39	3.27	3.70	5.52	6.25	74.4%	125.6%
20 year	4.94	4.35	4.91	7.35	8.29	88.0%	148.7%
30 year	4.89	4.65	5.20	7.86	8.79	95.1%	160.7%

Source: Bloomberg as of July 30, 2025. TEY = Tax-Equivalent Yield. UST = United States Treasury. US Treasury is represented by the public obligations of the US Treasury. Treasuries are backed by the full faith and credit of the US government as to the timely payment of principal and interest, while legislative or economic conditions could affect a municipal securities issuer's ability to make payments of principal or interest. Muni AAA is represented by the Municipal AAA GO bond yield, a Municipal Market Data proprietary yield curve of AAA-rated state general obligation bonds, based on the institutional block size of \$2million-plus market activity in both the primary and secondary bond market. The Muni TEY AAA is the Tax-Equivalent Yield is assuming a top tax rate of 40.8% of the Muni AAA yield. Muni A is the Bloomberg Municipal Bond A Index is an unmanaged index of the A-rated municipal bond market. The Muni TEY A is the Tax-Equivalent Yield is assuming a top tax rate of 40.8% of the Muni A yield. The Muni UST Ratio is the comparison of the Muni AAA vs. the yield on the US Treasury. The Muni TEY UST Ratio is the Tax-Equivalent Yield is assuming a top tax rate of 40.8% of the Muni UST Ratio. An investment cannot be made directly into an index.

Tax-Equivalent Yield is assuming a top tax rate of 40.8%, 37% federal tax rate and 3.8% net investment income tax (NIIT), effective Jan. 1, 2025. Irs.gov, as of October 22, 2024. Top marginal tax rate for single taxpayers with more than \$626,350 in taxable income or couples with \$751,600 or more. NIIT is the net investment income tax investment income for single taxpayers with more than \$200,000 in taxable income or couples with \$250,000 or more.

Municipal/Treasury Ratio



Source: Thomson Reuters TM3, as of July 30, 2025. US Treasury is represented by the public obligations of the US Treasury. Treasuries are backed by the full faith and credit of the US government as to the timely payment of principal and interest, while legislative or economic conditions could affect a municipal securities issuer's ability to make payments of principal or interest. The Municipal AAA GO bond yield is represented by the Municipal Market Data proprietary yield curve of AAA-rated state general obligation bonds, based on the institutional block size of \$2million-plus market activity in both the primary and secondary bond market. Past performance does not predict future returns. An investment cannot be made directly into an index.

Sources:

1. Barclays Municipal Research, as of July 18, 2025. The Bloomberg High Yield Transportation Index is a specialized sub-index designed to track the performance of high yield municipal debt issued by municipalities within the transportation sector. The specific methodology involves several key criteria for bond inclusion and the index rebalances monthly.

Bloomberg High Yield Transportation Index Methodology:

Eligibility requirements:

Currency: Principal and interest must be denominated in US Dollars.

Sector: Only municipal bonds from issuers classified within the transportation sector are eligible.

Credit Rating: Securities must be rated below investment grade (high yield) with a middle rating of Ba1/BB+/BB+ or lower from Moody's, S&P, and Fitch, respectively.

Maturity: At least one year until final maturity, regardless of optionality.

Liquidity: Bonds require a minimum amount outstanding (e.g., \$500 million) to ensure sufficient liquidity.

Coupon Type: Includes fixed-rate coupons and callable bonds.

Excluded: Zero-coupon bonds

2. Bloomberg, as of July 28, 2025.

3. The Bond Buyer, as of July 15, 2025.

4. National Association of State Budget Officers, as of June 27, 2025.

5. BofA Global Research, as of July 18, 2025.

About risk

Municipal securities are subject to the risk that legislative or economic conditions could affect an issuer's ability to make payments of principal and/or interest.

Junk bonds involve greater risk of default or price changes due to changes in the issuer's credit quality.

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. The values of junk bonds fluctuate more than those of high-quality bonds and can decline significantly over short time periods.

All fixed income securities are subject to two types of risk: credit risk and interest rate risk. Credit risk refers to the possibility that the issuer of a security will be unable to make interest payments and/ or repay the principal on its debt. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa.

Municipal bonds are issued by state and local government agencies to finance public projects and services. They typically pay interest that is tax-free in their state of issuance. Because of their tax benefits, municipal bonds usually offer lower pre-tax yields than similar taxable bonds.

All data as of July 30, 2025, unless otherwise stated.

All data provided by Invesco unless otherwise noted.

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