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Why municipal bonds matter today

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Investors evaluating today's fixed income markets face a familiar challenge: generating attractive income while managing uncertainty around interest rates, inflation and economic growth.

Municipal bonds have traditionally played a unique role in addressing this challenge by providing federally tax-exempt income, historically strong credit quality, and diversification benefits within a broader portfolio. Today, that case may be even stronger.

Instead of the steady interest-rate cuts many investors expected, inflation has remained persistent, economic growth has proved resilient and labor markets have stayed relatively strong. As a result, longer-term Treasury yields have risen sharply.

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Higher interest rates have lifted municipal bond yields to levels not seen for many years. At the same time, investor demand remains robust despite elevated issuance, creating a market environment that offers potentially attractive opportunities for long-term investors[1]. Municipals may also help diversify a portfolio. Their return profile is not perfectly correlated with equities or other fixed income sectors, allowing them to serve a distinct role within a broader asset allocation strategy. The municipal market has also demonstrated notable resilience, highlighting the continued strength of investor demand. For investors seeking income, diversification and risk management in a changing market environment, municipal bonds remain an important consideration.

What are municipal bonds

Municipal bonds are debt securities issued by states, cities, counties, and other public entities to fund essential services and infrastructure projects. For investors, they generally provide three key benefits:

- Tax-efficient income
- Capital preservation potential through exposure to generally high-quality issuers
- Diversification relative to other asset classes

For many investors, the tax advantages may be particularly important. Municipal bond income is generally exempt from federal income taxes and may also be exempt from state taxes depending on the investor's circumstances. As a result, tax-equivalent yields can compare favorably with many taxable fixed income alternatives, particularly for investors in higher tax brackets.

Why municipal bonds continue to deserve a place in investor portfolios

For many investors, the core attractions of municipal bonds remain unchanged.

They can provide:

- High-quality credit exposure, helping to preserve capital over time
- A predictable income stream, with regular coupon payments
- Federal tax-exempt income, and often state tax benefits depending on the investor's circumstances
- Portfolio diversification, as municipal returns are not perfectly correlated with other major asset classes
- Liquidity, supported by an active secondary market
- Historically lower volatility than many other investment sectors

Today’s higher-yield environment has arguably strengthened the case for municipal investing.

Risks

Municipal securities are subject to interest rate, credit, illiquidity and market and political risks. The ability of a municipal issuer to make payments and the value of municipal securities can be affected by uncertainties in the municipal securities market. Municipal securities and issuers of municipal securities may be more susceptible to downgrade, default and bankruptcy as a result of economic stress. Municipal securities market can be significantly affected by political changes. Reductions in tax rates may make municipal securities less attractive in comparison to taxable bonds.

1 Past performance is not a guarantee of future results.

Higher yields have created new opportunities

Markets have undergone a significant repricing over the past few years. Higher Treasury yields have also pushed municipal yields higher. And for long-term investors, this can create an important opportunity.

Rather than waiting for the 'perfect' entry point, today's yield levels already offer higher compelling income potential compared with recent history. While uncertainty around the moves of the Federal Reserve remains, the income currently available allows investors to be paid while markets evolve.

How UBS-AM evaluates municipal bonds

We believe successful municipal investing requires more than selecting bonds with attractive yields.UBS-AM combines credit research, yield-curve analysis, portfolio construction expertise, and risk management in its municipal investment process. Analysts and portfolio managers continuously evaluate issuers, sectors, and market conditions to identify opportunities while managing risk.

Particular emphasis is placed on understanding issuer fundamentals, monitoring changes in credit quality, evaluating bond structures and call provisions, and identifying relative-value opportunities across the municipal universe.
The objective is not simply to generate tax-exempt income, but to construct portfolios designed to deliver risk-adjusted returns over time.

Active credit research

Within the UBS-AM Municipal Fixed Income team, a dedicated group of credit analysts use proprietary credit research to scrutinize underlying issuers and produce its own credit opinions.

The Municipal Credit Research team seeks to identify securities that preserve client capital, provide appropriate compensation for credit and structural risk, and align with the objectives and constraints of separately managed account clients.

Top-down research provides the context for individual credit decisions and helps the team identify sectors or issuers that may benefit from, or be vulnerable to, changes in the economic, fiscal, political, regulatory, and capital market environment.

Bottom-up research determines the fundamental credit quality of an issuer or obligor and identifies the risks associated with a specific security. The analysis incorporates both quantitative and qualitative factors. Financial performance is reviewed over multiple periods to distinguish cyclical or temporary changes from structural deterioration or improvement, in addition to scrutiny of specific legal and structural protections of each security.

Relative value analysis is incorporated into every investment decision. Fundamental approval establishes whether the team is willing to own a credit. Relative value determines whether the security should be purchased, retained, reduced, or sold at the prevailing market price.

Ongoing credit surveillance can identify changes in credit quality of issuers or securities before they are fully reflected in ratings or market prices. Analysts closely monitor surveillance triggers and maintain internal credit opinions independent of the credit rating agencies.

Active vs. passive

While many investors focus primarily on the tax-exempt income, successful municipal investing offers more than simply collecting coupons.

Total return comes from two sources:

– The income generated by coupon payments

– Capital appreciation, or preservation, as the price of the bonds changes over time

Managing both elements requires careful portfolio construction. Interest rates, credit quality, bond structures and market valuations all influence the total return. Understanding how these factors interact is a key component of investing in municipal bonds.

The market is also highly fragmented, with thousands of issuers, varying credit characteristics, different bond structures, and diverse liquidity profiles.

This complexity creates a meaningful distinction between passive exposure and active management.

A passive approach generally seeks to capture income and replicate broad market exposure. Active management seeks to deliver both income and total return by identifying opportunities across sectors, issuers, maturities, coupons, and credit profiles.

Active solutions can adjust duration, reposition portfolios along the yield curve, identify relative-value opportunities, and respond to changing credit conditions. In an environment characterized by elevated issuance and increasing issuer differentiation, these capabilities may become increasingly important.

We believe there are many potential benefits to investors from active management of a diversified municipal bond portfolio for a variety of reasons relating to the bonds and the market. That said we also offer more passive ladder options that could be considered 'buy and hold,' but incorporate an actively monitored credit overlay, so we can sell out of positions if we deem the credit quality is deteriorating.

At UBS Asset Management, our focus is not simply on selecting municipal bonds. It is on helping investors navigate changing market conditions, identifying opportunities across the municipal universe and building suitable portfolios designed to deliver attractive returns over the long term.

Strong demand from investors is supporting the municipal market

One of the defining features of today's municipal market has been the combination of elevated supply and equally impressive investor demand.

Record inflows into municipal funds and separately managed accounts have helped absorb this supply, creating a favorable technical backdrop – in simple terms, there has been sufficient buyer demand to absorb the new issuance without materially weakening valuations.

This balance between supply and demand has helped support the municipal market despite uncertainty surrounding inflation, Federal Reserve policy, and economic growth. The result is a technical backdrop that we believe remains broadly constructive for municipal investors.

An expert partner in municipal bond portfolio management

UBS-AM, which manages approximately around USD 40 billion in municipal bond strategies exclusively for UBS clients in the US,[2] brings together global interest-rate strategists, municipal credit specialists and experienced portfolio managers and traders to assess and seek to manage these risks continuously.

Portfolio managers also work to minimize trading costs by purchasing large institutional sized blocks and allocate them throughout our clients' portfolios and strategies – an often-overlooked contributor to long-term returns. We typically execute trades of USD 1 million or more – which can result in lower trading fees, an often-overlooked contributor to long-term returns.

Additionally, as a large institutional player, UBS-AM has access to bond supply in the primary market, which is not available to the retail investor. The team has established relationships with nearly 80 broker/dealers, which most individual advisors don't have.

Access to the issuers in the primary market is a key to sourcing bonds for portfolios. We typically source over 40% of our bonds in the primary market which offers diversity in issuer, maturity, structure and is usually the cheapest investable option given that they are priced to move.

UBS-AM has expanded its municipal platform to give investors and advisors much more flexibility, including increasing state-specific exposure and state-specific strategies, such as single-state laddered portfolios and ultra-short duration strategies.

2 As of 31 March 2026. Reporting for AUM may lag other quarterly updates due to reporting requirements.

An expert team

Managing municipal portfolios requires specialist expertise developed over many market cycles.
UBS Asset Management brings:



More than 30 years of fixed income investment experience



Approximately USD 554 billion in fixed income assets under management



Around USD 39 billion invested in municipal bond strategies



Investment professionals with an average of 18 years' industry experience



A municipal investment team with a 25+ year track record[3]

This depth of experience supports a highly disciplined investment process built around rigorous research, active portfolio management and long-term client outcomes.

Moving forward

The path ahead for interest rates remains uncertain. Inflation has moderated but remains above target, economic growth continues to surprise to the upside, and the timing of future Federal Reserve policy changes remains difficult to predict.

These uncertainties should not discourage long-term investors. Today's municipal market offers yields that are considerably more attractive than those available for much of the past decade. Combined with generally strong credit fundamentals and robust investor demand, in our view the asset class continues to present compelling opportunities for investors seeking tax-efficient income.

The key is to maintain a disciplined approach, focusing on quality, credit selection, portfolio structure and thoughtful positioning across the yield curve. This is where active management can make the greatest difference.

By combining deep municipal market expertise with rigorous research, active portfolio construction and solutions designed around investors' evolving needs, UBS-AM seeks to help clients capture the long-term benefits of municipal bonds while navigating an increasingly complex investment landscape.

For investors seeking a balance between income generation and risk management, in our view, municipal bonds can represent a strategic allocation rather than simply a tactical opportunity.

3 AUM figures are for UBS Asset Management division worldwide.Fixed income AUM figures include money market.

Source: UBS-AM, as of 31 March 2026. Firmwide assets managed by fixed income portfolio management team in each sector. Reporting for AUM may lag other quarterly updates due to reporting requirements.

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The achievement of a targeted ex-ante tracking error does not imply the achievement of an equal ex-post tracking error or actual specified return. According to independent studies, ex-ante tracking error can underestimate realized risk (ex-post tracking error), particularly in times of above-average market volatility and increased momentum. Different models for the calculation of ex-ante tracking error may lead to different results. There is no guarantee that the models used provide the same results as other available models.

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Market risk. The risk that the market value of a portfolio will fluctuate as the stock and bond markets fluctuate. Market risk may affect a single issuer, industry or section of the economy, or it may affect the market as a whole.

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Individual account holdings and performance may vary from the stated strategy composite cited due to a variety of factors such as, but not limited to account size, target weight, security prices, lot sizes, restrictions/substitutions and tax considerations.

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The Bloomberg US Municipal Bond Index includes investment grade, tax-exempt and fixed-rate bonds with long-term maturities (greater than two years) selected from issues larger than USD 50 million. The index is unmanaged and does not reflect the deduction of any fees or expenses. The index returns reflect all items of income, gain, loss and the reinvestment of dividends and other income.

The Bloomberg Municipal Short-Term Index tracks the performance of investment-grade, U.S. dollar-denominated municipal bonds with short maturities (typically 1-5 years), focusing on state/local government debt (G.O. bonds, revenue bonds) and excluding AMT-subject bonds, to provide a benchmark for short-duration, tax-exempt fixed income. Key characteristics include high credit quality (rated Aa3/AA- or higher) and inclusion of various bond types like pre-refunded and insured bonds, serving as a gauge for this less volatile segment of the municipal market.

The Bloomberg Municipal Bond: High Yield Index is a flagship measure of the US municipal tax-exempt non-investment grade bond market. Included in the index are securities from all 50 US States and four other qualifying regions (Washington DC, Puerto Rico, Guam, and the Virgin Islands). The index includes state and local general obligation bonds and revenue bonds. All bonds in the Municipal High Yield Bond Index are tax exempt, and hence are not eligible for other indices that include taxable high yield bonds, such as the US High Yield Index and EM USD Aggregate Index.

The Bloomberg Taxable Municipal Index is a market-value-weighted index that tracks the performance of U.S. dollar-denominated, investment-grade, taxable municipal bonds. It serves as a benchmark for this segment of the bond market, which includes bonds that are not tax-exempt at the federal level. To be included, a bond must meet criteria such as having a fixed rate, an outstanding par value of at least USD 7 million, being part of a transaction of at least USD 75 million, and having more than one year to maturity.

The Bloomberg US Aggregate Bond Index is composed of securities from Bloomberg Government/Credit Bond Index, Mortgage-Backed Securities Index, and the Asset-Backed Securities Index. Total return comprises price appreciation/depreciation and income as a percentage of the original investment. Indexes are rebalanced monthly by market capitalization.

The Bloomberg US Treasury Index is a measure of the US Treasury's fixed-rate, nominal debt that is denominated in US dollars.

The Bloomberg US Corporate Investment Grade Index is a major benchmark for the U.S. corporate bond market, tracking fixed-rate, taxable bonds from industrial, utility, and financial issuers, rated BBB-/Baa3 or higher, with at least one year to maturity. It's a broad, market-capitalization-weighted index that serves as a key indicator for portfolio performance, risk management, and tactical trading in the investment-grade credit space, with sub-indices available for different maturities (like 1-3 Year, 5-10 Year) and liquidity.

The Bloomberg US Corporate High Yield Bond Index is a benchmark that measures the performance of US dollar-denominated, fixed-rate corporate bonds that are considered high yield.

The Bloomberg Emerging Markets Hard Currency Aggregate Index is a key benchmark for tracking USD-denominated debt from emerging market governments, quasi-sovereigns, and corporations, measuring the performance of fixed and floating-rate bonds with strict rules for inclusion, like minimum size and maturity, serving as a standard for EM debt funds and investors seeking yield and diversification. It offers broad exposure to this asset class, differentiating from local currency or sustainability-focused indices, with criteria ensuring liquidity and country diversification.

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