

DECEMBER 2025



APA MARKET COMMENTARY: DECEMBER 2025

The Fed's December rate cut and internal dissent barely moved munis, which finished 2025 resiliently with a 4.3% return, despite market volatility and record-breaking supply.

Active management mattered, in our opinion. Muni market volatility created year-round tax loss harvesting opportunities that reinforced the need for an active approach throughout the entire year rather than waiting until year-end.

A steep yield curve continues to offer compelling long-end taxable-equivalent value. APA remains positioned in a modified barbell structure to take advantage of the higher yields on the long end of the curve while preserving downside protection on the front end.

While we believe downgrades within the high-grade municipal credit universe are likely to remain isolated and most states and large issuers are still in far better shape than pre-pandemic, stress in the high-yield muni market is becoming more pronounced. If clients have outside holdings in the high-yield space that may raise concerns, please send them over to our team to review.

MUNI MARKET SHRUGS OFF RATE CUT

- The Federal Reserve concluded 2025 with a third consecutive 25-basis-point rate cut, lowering the federal funds target range to 3.50%–3.75%.

DECEMBER 2025

- Committee views were divided: two members opposed further cuts, while one supported a 50-basis-point reduction. December meeting minutes later highlighted growing disagreement within the Fed.
- Municipal bonds showed little reaction. After the strong September–October rally, the market remained stable in December, with the Bloomberg Municipal Bond Index returning 9 basis points for the month.

A NOISY YEAR FOR MUNIS, YET RETURNS HELD STEADY

- Full-year performance masks the range of challenges municipal bonds navigated in 2025. Early in the year, renewed threats to the tax exemption emerged, tariff-related concerns drove sharp volatility in April, and persistent supply pressures weighed on select parts of the curve. Despite these headwinds, broad returns underscored the resilience of municipals.
- A 4.3% gain in 2025 for the Bloomberg Municipal Bond Index surpassed the outcomes of six of the prior 10 years. Although four months posted losses, most gains were concentrated between August and October, and riskier sectors did not consistently benefit from tighter bidding given the availability of generous higher-grade names. Additionally, the IG muni index outperformed the HY muni index in 2025 (4.3% vs 2.5%).



Bloomberg Municipal Bond Index surpasses six of the prior 10 years' returns.

APA PROACTIVE TAX LOSS HARVESTING: TIMING IS EVERYTHING

- Even with solid muni returns in 2025, the year's volatility reinforced the importance of taking an opportunistic year-round approach to tax-loss harvesting rather than waiting until year-end, when key windows to harvest losses and enhance client income may already have passed.

DECEMBER 2025

- Munis’ underperformance versus other fixed income sectors such as Treasuries and investment-grade corporates underscores the value of active, tax-efficient management. While year-end performance was strong, we feel that active, tax-efficient management throughout the year helps narrow that gap and continues to deliver a compelling advantage through higher taxable-equivalent yields.



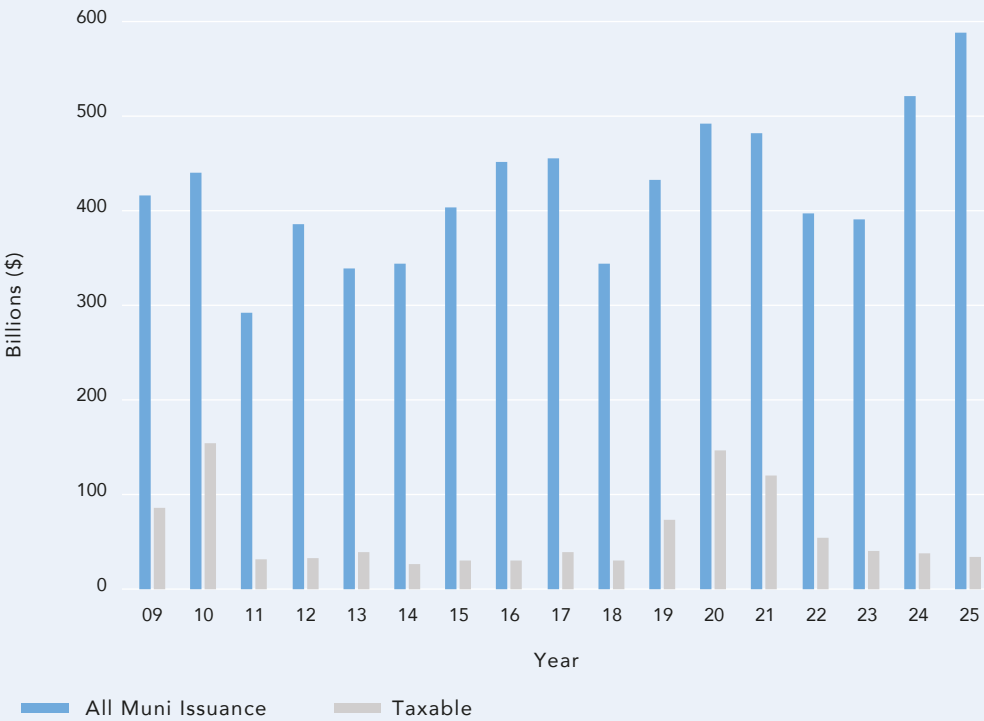
It is our view that active portfolio management with year-round tax-loss harvesting can capture opportunities to boost taxable-equivalent yields for clients.

RECORD SUPPLY IN 2025 -
AND THE CALENDAR ISN'T LETTING UP

- After a record-breaking ~\$580 billion of issuance in 2025, expectations point to another heavy year ahead, with forecasts ranging from \$480B to \$745B.

RECORD
\$579.94B

MUNI
ISSUANCE
HITS \$579.94
BILLION
RECORD IN
2025



Source:
The Bond Buyer
[January 2026]

DECEMBER 2025

- However, taxable munis told a different story. Issuance declined 12% last year, helping drive a 7.8% return for the sector in 2025. The new year could bring a shift in issuance if rates decline and refunding opportunities resurface. In 2020, taxable munis represented 30% of total municipal supply, but preliminary full-year 2025 figures show that share down to just 6%.
- Looking ahead, we expect supply to pick back up after the lull of late December and early January. If rates remain rangebound on the short end, we could also see an increase in taxable municipal issuance as advance-refunding candidates come back on the table.

FUND FLOWS REMAIN SOLID

- Muni fund flows totaled about \$4B for the month, driven primarily by inflows from National, ETF, and Intermediate strategies. This brought total 2025 flows to \$49B, with ETFs contributing \$35B compared to \$14B from mutual and closed-end funds.

STEEP CURVE CONTINUES

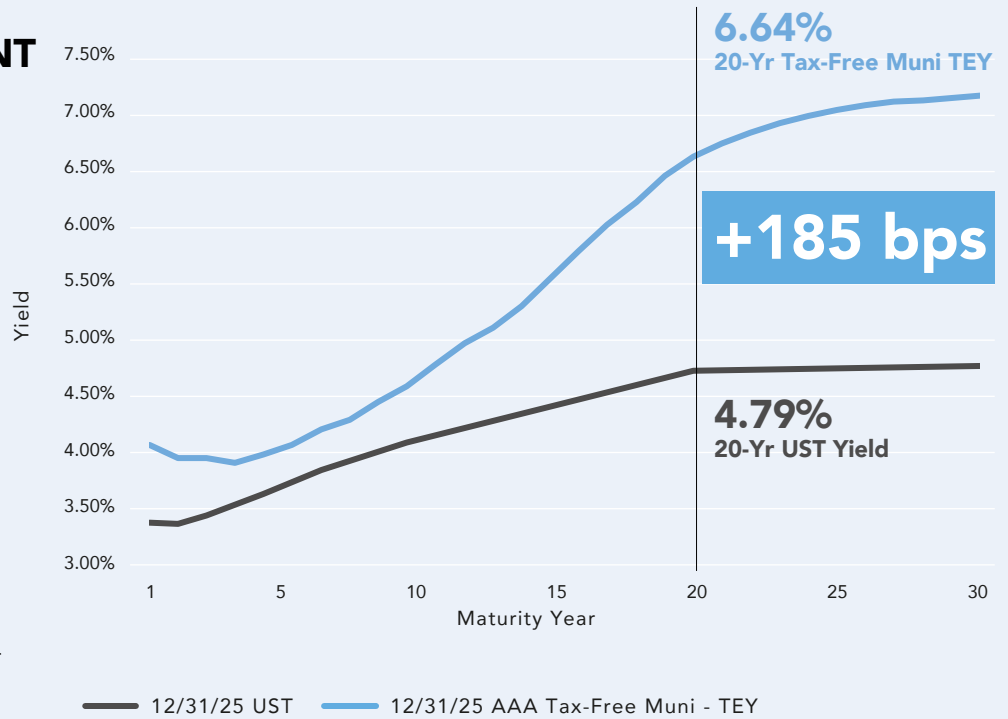


The yield curve remains notably steep.

- The yield curve remains notably steep, creating opportunities for investors to capture additional yield on a taxable-equivalent basis. As of year-end, 20-year AAA munis offered roughly +185 basis points over comparable-maturity Treasuries, highlighting the relative value available in the long end of the muni curve.

DECEMBER 2025

TAX-EQUIVALENT MUNI YIELDS OUTPACE TREASURIES ACROSS THE CURVE



- We continue to position client accounts in a modified barbell structure, balancing downside protection with the yield pickup available on the long end of the curve.

KNOW WHAT YOU OWN

- The three major rating agencies downgraded \$187B in par value in 2025 compared to \$111B in 2024 and \$97B in 2023. School districts, a sector we have repeatedly highlighted in previous publications, led the downgrades by sector with \$38B.
- In the overall market, 2025 saw a larger value of credits upgraded at \$364B of par value. However, after a deeper review, we believe this weighting is skewed by a few benchmark credits and does not diminish the importance of knowing what clients own on an individual bond-by-bond basis going into 2026.

DECEMBER 2025

- For high-yield muni investors, December underscored credit risk as Brightline Train Florida LLC's senior bonds were cut five notches by S&P Global Ratings, which now anticipates a default by early 2027.



Cracks are emerging in the high-yield space.

- Downgrades in the high-grade municipal universe will likely remain isolated, as most states and large issuers are still in far better shape than pre-pandemic. Yet, more concerning are the cracks emerging in the high-yield muni space, where defaults and distress have moved sharply higher in historically risky sectors and, more importantly, in funds concentrated in only a few names.



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