THE CASE FOR MUNIS: BEYOND THE COMFORT OF CASH

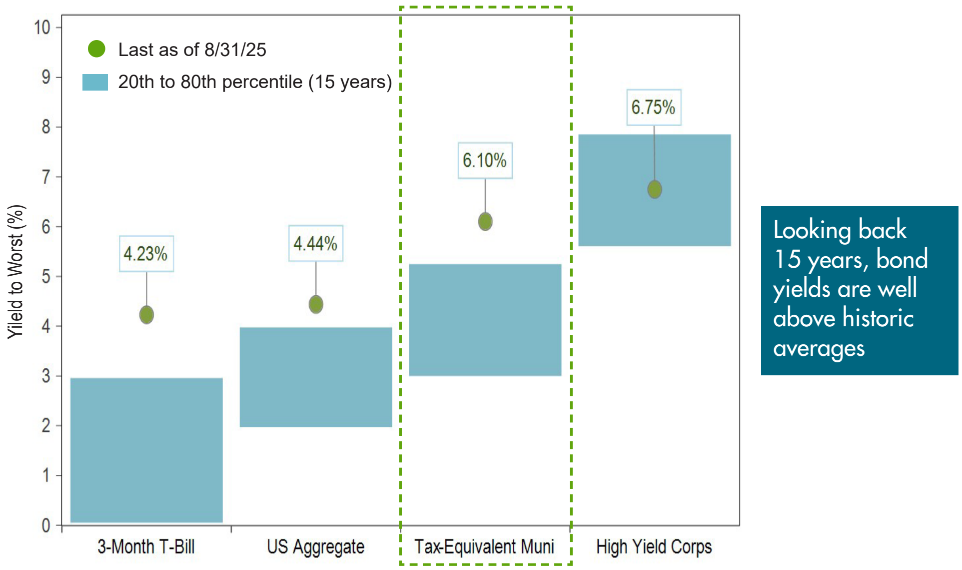
In our second installment of "The Case for Munis," we highlight the risks of staying in cash, and the compelling opportunities that tax-exempt bonds offer in today's market.

The sharp rise in yields that started in 2022 has resulted in historically weak trailing returns for municipal bond investors. The response for many has been to retreat to the safety of cash. With money market rates hovering around 4%, this may feel like a rational decision, but risks associated with maintaining that positioning have increased dramatically. Not only are money market rates set to decline, but we are also seeing the most compelling entry point for the muni market in the last 15 years (**Figure 1**).

FIGURE 1

Fixed Income Offers a Dramatically Improved Yield Environment

As of August 31, 2025



Sources: Bloomberg, GW&K Investment Managent, and Macrobond.

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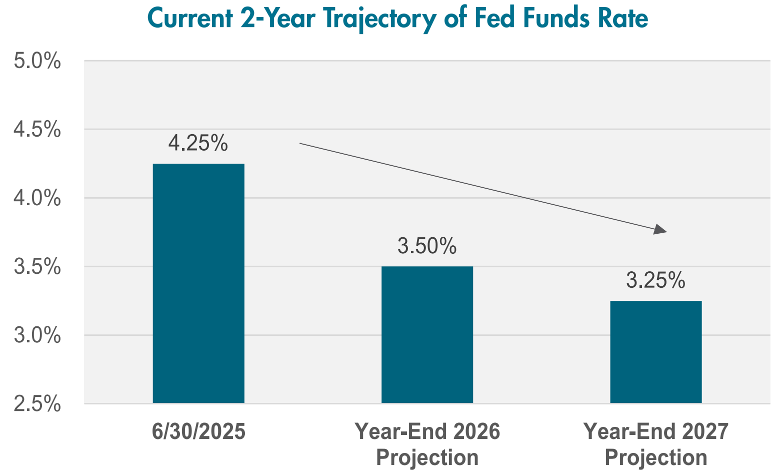
As you can see in **Figure 2**, short rates, by the Fed's own projections, are set to fall by 100 basis points (bps) over the next two years. As that process plays out, cash-heavy investors will see their income/returns decline significantly.

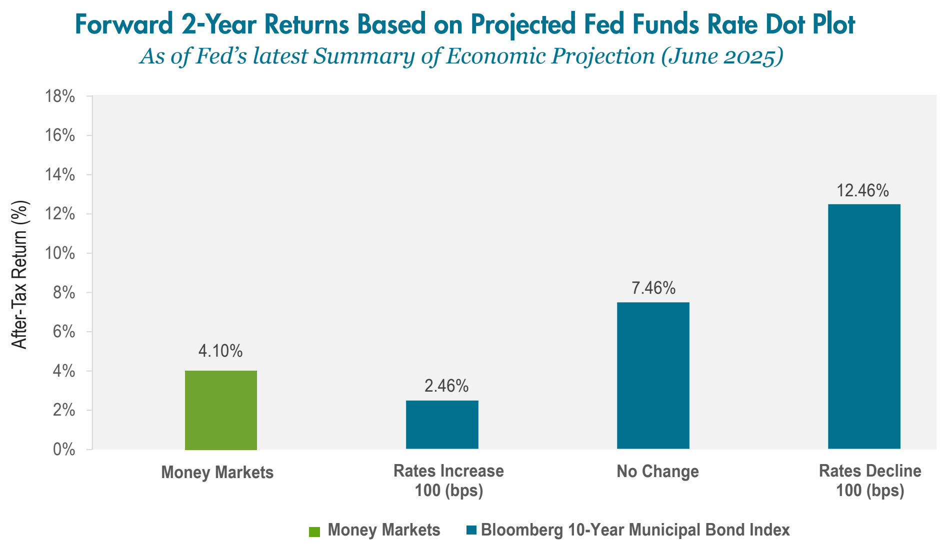
FIGURE 2
What the US Federal Reserve Intends for Rates



Data as of June 2025.
Sources: Federal Reserve and FactSet.

Meanwhile, the extreme steepening of the muni yield curve has increased the penalty for remaining in cash and reduced the "risk" of taking on duration. In **Figure 3**, we show three potential paths for rates based on the Fed's projections. While a rising rate environment results in a slightly lower return than money market funds, flat and declining rate scenarios produce a clear advantage for owning bonds.

FIGURE 3
Municipal Bond Tax-Adjusted Performance



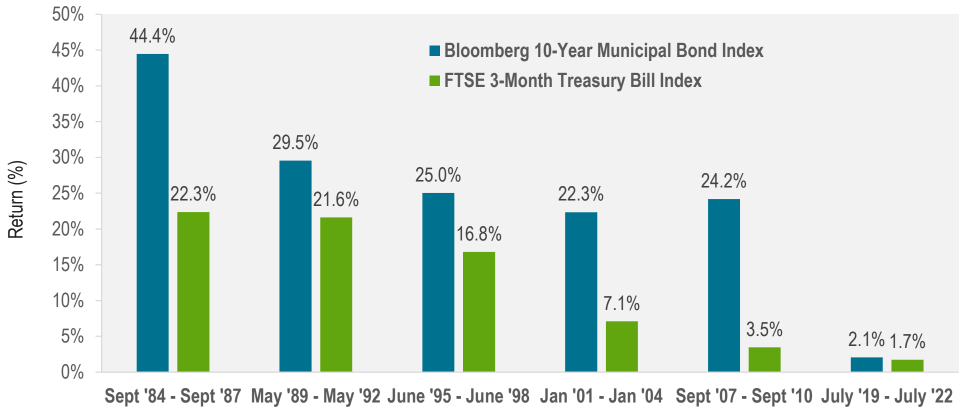
Sitting in cash forfeits the potential for total return that fixed income can offer

Sources: Federal Reserve and FactSet.
Municipal bond market performance represented by the Bloomberg 10-Year Index. Tax-adjustment to T-Bill Index assumes 37.0% federal tax rate + 3.8% ACA surtax. Cumulative returns shown above were calculated on a monthly basis. Past performance is no guarantee of future results

To be sure, no one can predict the exact path long-term rates will take after the upcoming Federal Open Market Committee meetings, but history has repeatedly shown that, when the Fed is easing, leaning into duration has been a winning strategy (**Figure 4**).

FIGURE 4
Bonds Outperform Cash During Cutting Cycles

3-Year Cumulative Returns



Sources: Federal Reserve and FactSet.
Cumulative returns shown above were calculated on a monthly basis following the last hike in each cycle. Past performance is no guarantee of future results.

So yes, 4% cash seems like a logical decision but it is this very risk aversion that has created an opportunity for those willing to add a modest amount of duration. We think the time is now to at least leg into the market.

GW&K is a market leader and pioneer in municipal bond investing having managed portfolios for clients since our founding in 1974. Our investment approach is active, flexible, and rooted in disciplined research to preserve and enhance principal and income. Learn more about our capabilities and don't hesitate to contact us.

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