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The Investment Conversation: What Will Drive the Municipal Bond Market in 2026?

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In this podcast, Lord Abbett Portfolio Manager Dan Solender examines the factors likely to influence municipal-bond market performance in the year ahead.

ANDY D'SOUZA: Welcome back to *The Investment Conversation*. I'm Andy D'Souza, partner and Chief Marketing Officer here, at Lord Abbett. As part of our 2026 investment outlook, we're going to talk with our investment leaders about key themes for the markets in the coming year, across equities, municipal bonds, taxable fixed income and private credit. Today we're speaking with Lord Abbett partner and head of tax-free fixed income, Dan Solender. Dan, welcome to the show.

DAN SOLENDER: Thanks for having me. And thanks, everyone, for listening to us.

D'SOUZA: Again.

SOLENDER: Again.

D'SOUZA: Last time we spoke was in June. At the time, we spoke about a couple things, Dan. Rate were near all-time highs, I believe, or multi-year highs. We also had very high rates of supply in the marketplace. Kind of walk us through what's happened since June in the market.

SOLENDER: Sure. Those themes have continued. We had an interesting year. We came into this year with rates being at the high end of where they've been for the past 10 years. And they're pretty much still in that similar range. We came in, coming off a record supply [of newly issued municipal bonds] year of around $500 billion last year, and we're actually ahead of that right now, and we're going to be ahead of it for the year, so another record year for supply.

So it's been good, all that supply, it's a great thing that all the infrastructure and all the financing needs of the municipalities and projects around the country are able to be financed. At the same time, all that supply does put some pressure on the market. And this year's been no exception for that, with the supply being high.

D'SOUZA: How about the demand side of things?

SOLENDER: There's been kind of a range of demand in the market. We have different ways that people can invest in municipal bonds. There's separately managed accounts, there's funds, there's individual bonds. And the separately managed account side has been booming in a big way, as it has been for several years.

Predominantly, that part of the market is focused on bonds 10 years or shorter. The mutual funds are really where the demand comes in for the longer part of the market, and that demand's been inconsistent. In 2022, there were huge outflows, and we're still trying to catch up from that, the money has not totally come back to the market yet.

So it's had a strange impact on the market, that you have this heavy supply, heavy demand inside of 10 years, then kind of lighter demand out longer. And a lot of the new issues come to the market with longer bonds. So you have the short end of the market, and the intermediate part of the market perform pretty well. And actually, outperforming the longer end, where rates are higher, because those rates have to stay higher for all these deals to clear the market.

D'SOUZA: And how about the shape of the yield curve? I know we talked about that in the past, and how sometimes it's diverged from the taxable yield curve. Anything of note this year, and looking forward?

SOLENDER: That's one of the strange things the last few years. When everyone kind of hears what's going on through the financial news, and they keep hearing about a flat yield curve, and an inverted yield curve, we did have an inverted yield curve in the intermediate range a couple years ago. Which is now straightened out, it's more normalized.

But our market has actually had a steep yield curve for several years, and it's gotten even steeper this year. It's really kind of strange, if you look at the way rates have moved, 15 years or shorter on maturities, rates have come down this year, and pretty seriously come down inside of 10 years.

Longer than 15 years, rates have gone up this year, so we've gotten even steeper in the longer maturities, seeing things get even steeper. So, it is a strange dynamic, where other markets have flat yield curves, while municipal yield curves, came in here steep and have gotten steeper.

D'SOUZA: And on the performance front, I think last time we spoke, you mentioned that you'd seen that taxable bonds had outperformed tax-free bonds in the early part of the year. But in the last couple months, we've seen that kind of reverse a bit. What's sort of the cause for that, you think, and do you see that continuing going forward?

SOLENDER: You know, for the year, we've started to come back a little bit, ever since September, when the Fed [U.S. Federal Reserve] started lowering rates. We've seen things pick up a little bit, and rates rally a little bit more in munis. But for the year, tax-exempt munis have still underperformed taxable [bonds].

So, for the year, it's still a situation where we're underperforming, so there is this opportunity. And it's kind of strange, because if you look at the longer maturities, you've had positive returns. They were negative back in September.

But now you've had positive total returns. But that return has come from the income portion. With rates going up, the price portion has still gone down. And that's really been driven by this supply differential and the demand imbalance with supply.

And [things really changed] in municipals when, more than a couple years ago, under the first Trump administration, the corporate tax rate went from 35% to 21%. Banks and insurance companies used to buy a lot of municipal bonds, and now they're kind of net sellers in most environments.

So that long end really depends on the individual investors. And they're coming in--inflows have picked up since September, and that's kind of why we're rallying a little bit. But it's still a little bit of an imbalance.

D'SOUZA: And we talked a bit about supply and demand, some of the [technical factors in the market] there, and some of the yield curve factors as well. What about the credit backdrop-- how's credit in this market?

SOLENDER: Credit is actually very strong. We're coming off a time period, kind of going back a few years, we came into COVID, everyone was very worried about what was going to happen. There were all kinds of outlooks that were going to be terrible, but the economy held up well.

And in municipals, it held up very well. And then you had all this stimulus money come in, which really helped areas that were struggling a little bit, that money really held them over for a few years. So you've had these [state and local government] budgets coming in above targets and getting surpluses, and you've had stimulus money.

And now, we're in an environment where the stimulus money has kind of been spent, and the budgets are still strong, so everything is holding up well. But we've had a huge upgrade to downgrade ratio [of municipal issuers by credit rating agencies], a lot more upgrades than downgrades, now it's a little bit more upgrades, but not as out of whack.

But that's really because the ratings have gotten so much higher, you have the extreme, like in Illinois, which had a BBB- rating with a negative outlook back in 2020, and now it's an A-minus credit, and it's doing fine. And New Jersey was kind of trending negatively, and now it's double-A, so the market is at a higher credit quality standard, which is a positive thing. And overall, everyone thinks of general obligations [when they think of municipal bonds], but we have more revenue bonds, and their credit quality has improved as well. Everything is really holding up well right now.

D'SOUZA: Anything else to note around either New York or California, a couple of the large issuers out there?

SOLENDER: Definitely. I mean, California's fascinating, because obviously there's politics in the country right now impacting perception, so politics often impacts people's opinions of municipals, and we're not taking sides [just analyzing the market]. And you hear about California's budget numbers, and anytime anything comes out, they're the fourth largest economy in the world on their own, so the numbers are big.

So, they had, like, a $100 billion surplus a couple years ago. And what's interesting right now is that amid concerns about different things--they've increased their budget a big amount in the last 10 years--but actually their debt has gone down. So, they've become a solid double-A credit.

And even if there's some volatility in the revenues, their balance sheet looks so much better, and they've put all this money in reserve funds now, too, so that they have a lot put away to make it through times when things turn down. So, California's doing very well, and is a very solid credit.

You kind of get to New York [City], and New York's in an interesting situation right now. We have a new mayor coming in.. But the main thing in the backdrop is that New York [City] went through some really tough times [i.e., fiscal difficulties] in the 1970s, and all these [legislative] controls were put in place to make it difficult for a mayor to have that much control.

[The mayor-elect] needs the governor's [of New York State] approval, he needs City Council's approval [for various expenditures]. There are a lot of things that a mayor can say, but not as much as they can do on their own. So, New York [City] went from being a triple-B credit in 1990s, to a double-A credit now, and it's solidly in that range. Despite all the headlines that are going to make it challenging, it is a very good credit, and a very strong economy, no matter who's in charge of it.

D'SOUZA: And if you shift from the view of other city or state lens, and put on the view of the high-yield municipal market, the high-yield section of the marketplace, and not the lower-end credits, how's that holding up?

SOLENDER: High yield's been interesting because starting at the supply level, we talk about record supply, that's been on the investment-grade side. The high-yield side is just seeing average supply. And that's because now rates are higher than they were a few years ago, and not as many projects are as economical as they used to be, when you could borrow in 2021, when high-yield rates were 5% or lower, it is a whole different situation than now, they're 6%, 7%.

So, your supply is not that high. Demand on the mutual fund side, the biggest demand is for high yield; in terms of the fastest-growing category for funds, it's high yield. So, you have better demand than investment grade, lower supply. And then from a credit perspective, things are going really well, and we have had another year where defaults are in the 2% or lower range, which is pretty low for high yield. And with municipals, too, you can kind of see distress coming a little bit differently than the high-yield taxable markets, because when municipals get in trouble, they have to ask [borrowers] for forbearance on their covenants, they have to ask to dip into reserve funds.

It's a whole process before they get to a default, and we're not seeing much distress. That's really even lower than it was a year or two ago. So overall, credit quality is good. And one final thing on that, too, which is interesting. Everyone, once again, gets their information from other markets.

On the taxable markets I hear sometimes people saying credit spreads are tight. In the municipal bond market, credit spreads are not tight. There's a huge range [of issuers] in the high-yield market. There are certain very liquid issuers that are in the high-yield market, just because they don't have ratings right now.

And then there are others, like Puerto Rico bonds, which are restructured, for the most part, other than the power authority [PREPA] and are trading yields around five-ish, 5.25%. And then you have high-yield deals--the rest of the market trading at 6%, 6.5%, 7% where there is a different spread. So, the kind of long answer, supply and demand dynamics are pretty solid. Credit quality is good, and then there is [the situation that] spreads are still attractive for buying bonds.

D'SOUZA: And I guess talking to your colleagues on the taxable side of the house, and also in the private credit side of the house, we've all talked about some of the headlines that are out there, that are getting attention, and the talk, of course, the "cockroaches" [i.e., negative credit events] in the marketplace, and some headline defaults, these sort of we've referred to it.

In looking at other markets, it seems like there's a bit of insulation here, in your market, even in the high-yield sector, from what would maybe be seen as happening, or concerned to be happening on the taxable side--would that be accurate?

SOLENDER: It is. I mean, it's the starting point just for the whole market. Everyone's looking at Treasury [bonds] and the federal government, how much debt they have, and how the [U.S.] deficit growing, and you look at the numbers. In the last decade Treasury debt has gone from, like, $12 trillion to something like $28 trillion-plus.

So, it's more than doubled. Municipal bond debt has gone from $3.9 trillion to $4.3 trillion; it's barely moved. So, we don't have the same issues as the federal government, because state governments and local governments have to balance budgets. So, they can't just borrow without balancing budgets.

And for the investment grade, as far as a starting point, they're in a much better situation. And then we do have a lot of things that are insulated from how the economy's doing. You have charter schools, which are for students, there's a huge demand for those [no matter what the economic environment is].

There's senior living facilities, which have some economic [issues] to them, but with demographics and a population where Baby Boomers are all getting to the age where they need places to move to at certain points. We have health care, which people need in all environments, and a whole range of things like this. So that there are a lot of sectors that are just insulated from what's going on in the general economy, which makes it a good place to be, in a range of environments.

D'SOUZA: So, you mentioned a couple of the different sectors that you maybe see some opportunities going forward for an active manager, like you are. What about from, I guess, a yield curve perspective, do you see any parts of the yield curve look more attractive to you right now, relatively speaking?

SOLENDER: You know, people always want to ask us, like, "Where's the best place to be?" And we try not to give advice.

D'SOUZA: Sure.

SOLENDER: But my answer is similar in all markets, because, and it's a little more extreme right now, because of a steep yield curve, but if you want the best returns, our yield curve is always upward sloping. We have this whole dynamic where the longer end is [historically higher].

So if you want better returns, better yields, and you can handle the volatility, which we've seen the last few years, there has always been volatility, over three-, five-, and 10-year time periods, you're going to do better going out on the longer part of the yield curve.

Just the whole benefit of the tax exemption--you look at the yields, and there's the multiplier effect for tax-equivalent yield: the bigger your yield is, the better that is. And we have a steep yield curve, too, so you get a good return from rolling down the yield curve.

If you're looking for the best risk-return [scenario], in terms of not taking as much volatility, but getting the best return for risk [taken], the intermediate part of the market is really good. And that five- to 10-year range is really good for that.

And then the final thing, too, is we have a lot of investors out there who are saying, "I think rates are going up. I'm really worried. I don't want to put my money in. I want to leave in my money market fund or my T-bill [U.S. Treasury bill]." If you go into the shorter part of the market, and your bonds are maturing, and investment-grade municipals have a default rate pretty much zero.

Not saying they're always going to be zero, but that's what the default rates have been. Your dream in those bonds is that they mature, and you get to reinvest [the proceeds] in a higher rate environment. So, whether it's a ladder, or something in that range, that short end can be attractive too. So, I think there's a good place for everyone in the market, but to optimize returns, the longer you go [the better your chance of success], but a lot of municipal bond investors don't want to take that volatility.

D'SOUZA: Any other areas of the market or things you think about, either concerns or opportunities, looking into as we go into 2026 here, that you're thinking about, and the team's thinking about?

SOLENDER: There's a lot of opportunity, particularly on the high-yield side, for different kinds of financing than we've seen before.

D'SOUZA: Can you give me an example of one?

SOLENDER: Yeah, so an example, like, right now, you hear about the private credit market, and obviously, we're not the private credit market, we're mark-to-market every day, it's a very different world. But we do have this thing right now … There are a handful of firms that are the larger investors in high-yield municipals, and we're one of them. So, there are deals now that come to a small group of us. And [issuers] want [firms like ours] to finance the deals, they want to go to the place that has the assets to really put in place. So, we have a lot of things where, you know, a hospital might be trying to do a financing in a different way than normal.

An investment-grade hospital, they might come to us [with a deal], and a group of us may try to finance it. So, there is this opportunity on the high-yield side, where there's a lot more opportunity, and supply has grown a lot over the last few years, where there's so much more money in the high-yield muni market so that more things can be financed.

So that's one thing that's interesting. And then just on the investment-grade side, too, credit quality is very strong, the yield curve is providing a lot of opportunity, and rates are higher than they've been in a decade. So pretty much wherever you look in the market, you're going to get returns that are pretty strong compared to historical numbers in all markets.

D'SOUZA: Dan, thank you.

SOLENDER: Thanks for having me, and thanks, everyone, for listening.

D'SOUZA: This has been *The Investment Conversation*. Be sure to visit LordAbbett.com to find our complete 2026 investment outlook, along with other market and economic insights. Thank you all for listening.

GLOSSARY OF TERMS USED IN THIS BROADCAST

General obligation (GO) bonds are backed by the "full faith and credit" of a government and are issued by entities such as states, cities, counties, and school districts. Revenue bonds are backed by revenues from specific projects or facilities (such as toll roads, water/sewer systems, or airports).

A **ladder investment strategy** allows an investor to stagger bond investments over time with different dates of maturity.

Relative value assesses an investment's value by considering how it compares to valuations in other, similar investments.

Spread is the percentage difference in current yields of various classes of fixed-income securities versus Treasury bonds or another benchmark bond measure. A bond spread is often expressed as a difference in percentage points or basis points (which equal one-one hundredth of a percentage point).

Yield is the income returned on an investment, such as the interest received from holding a security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value, or face value. Yield-to-maturity (YTM) represents the expected return (expressed as an annualized rate) from the bond's future cash flows, including coupon payments over the life of the bond and the bond's principal value received at maturity. Yield-to-worst refers to the lesser of a bond's (a) yield-to-maturity or (b) the lowest yield-to-call calculated on each scheduled call date.

The **tax-equivalent yield** is the pretax yield that a taxable bond needs to possess for its yield to be equal to that of the tax-exempt yield on a municipal bond. This calculation can be used to fairly compare the yield of a tax-free bond to that of a taxable bond to see which bond has a higher applicable yield.

Yield curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. A normal, upward-sloping (steep) curve means that long-term securities have a higher yield, whereas an inverted curve shows short-term securities have a higher yield.

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Data on municipal bond yields from Bloomberg as of November 24, 2025. Data on municipal bond issuance from SIFMA as of November 24, 2025.

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