

September 30, 2025

Third Quarter Fixed Income Letter to Clients

The U.S. fixed income markets showed modest strength during the third quarter of 2025. The Federal Reserve cut the policy rate by 25 basis points in mid-September, calling the action a prudent cut amid signs of cooling labor markets. Markets further priced in a greater probability of Federal Reserve rate cuts later in 2025. US Treasury bond yields finished the quarter modestly lower for all maturities. The five-year treasury yield went from 3.79% to 3.74%. The 10-year yield ended the quarter at 4.16%, down from 4.24% at the start of the quarter. And the 30-year yield ended at 4.73%, down from 4.78%. With yields on many fixed income securities now at historically attractive levels, bonds have reemerged as a compelling investment, though risks remain, especially from inflation surprises, fiscal stress, and liquidity strains.

Tax-free municipal bonds outperformed treasuries and many taxable bond indices in Q3, aided by falling treasury yields, attractive absolute tax-free yields, and steady demand, even as issuance picked up. After underperforming earlier in the year, the municipal bond market began to stabilize, offering pockets of relative value, particularly in the intermediate and longer maturities amid more favorable technical and Fed policy dynamics. We continue to believe that for investors in higher tax brackets, tax-free municipal bonds remain a compelling component of a balanced income portfolio as an income-generating asset, offering attractive after-tax yields and upside underlying valuations if rates continue to trend lower.

Looking ahead, the bond market landscape remains nuanced. Security selection, duration flexibility, and risk management will be critical in navigating asymmetric risks from inflation surprises, credit dislocations, or rapid shifts in central bank posture. For tax-sensitive clients in high marginal tax brackets who are comfortable with duration driven volatility, we increase moderate exposure to intermediate (5–12 year) and selected long (15–25 year) municipals because the move lower in Treasury yields improved tax-equivalent returns materially. However, for clients who seek income with low-volatility capital preservation, we prioritize high-quality, short-to-intermediate maturities (1–10 years) where liquidity and predictability are higher.

At this time, the bottom line is that the municipal bond market is now more “fairly priced” than earlier in the year, with less downside and more room for measured tactical upside. Our bias remains toward diversified portfolios with flexible duration, disciplined credit selection, and liquidity buffers to navigate evolving conditions.

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