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Higher Interest Rates: What Municipal Bond Investors Should Know.

While rising interest rates have weighed on returns in 2026, strong market fundamentals and elevated yields offer an attractive entry point for long-term investors.

Key Takeaways

- Municipal bonds have historically been a resilient asset class. The recent rise in interest rates has triggered an unusual period of volatility, sending the broad municipal market index down 4.3% in September, its worst monthly return since 2008. Yet monthly losses exceeding 4% have occurred in less than 1% of observations since 1987, and periods of underperformance have historically been followed by strong recoveries.
- The fundamentals of the municipal bond market remain strong. State rainy-day funds are elevated and the share of the investment-grade municipal market based upon the Bloomberg Municipal Bond Index rated AAA or AA has risen to 79.2%, providing a strong foundation for the market despite recent price volatility.
- Municipal bond yields have reached near their highest levels in two decades, with the Bloomberg Municipal Bond Index yielding 4.87% as of September 30, 2026, equivalent to a taxable yield of approximately 8.23%.1 These elevated yields offer an attractive starting point for investors seeking tax-exempt income.
- Starting yields have historically been a powerful indicator of longer-term returns. While further rate volatility is possible, higher income can help cushion price declines, and falling rates could provide additional appreciation.
- Active management, supported by rigorous credit research and careful bond selection, can help investors capitalize on today’s attractive yields while managing risk.

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