

Municipal Bonds vs. Taxable Bonds

What the tax exemption is actually worth, and to whom

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Why municipal bonds get their own conversation

Almost every bond an investor owns pays interest that the federal government taxes as ordinary income. Municipal bonds — debt issued by states, cities, school districts and other public entities — generally do not. That single feature changes how they should be compared to everything else in a fixed income portfolio.

Because the exemption is worth more to an investor in a high tax bracket than a low one, there is no single answer to “are munis attractive?” It depends on who is asking, what they would otherwise buy, and where they live. This primer walks through the arithmetic that settles the question, then puts today’s market in the context of the last decade.

THE ONE CALCULATION THAT MATTERS

Tax-equivalent yield

A 4% tax-free yield and a 4% taxable yield are not the same thing. To compare them, the muni yield is grossed up into the taxable yield needed to keep the same amount after tax:

Tax-equivalent yield = Muni yield ÷ (1 – marginal tax rate)

At today’s Bloomberg Municipal Bond Index yield-to-worst of **4.07%**, an investor in the top 37% federal bracket would need **6.46%** from a taxable bond to break even. The 10-year Treasury pays 4.80% and investment grade corporates roughly 5.26%.

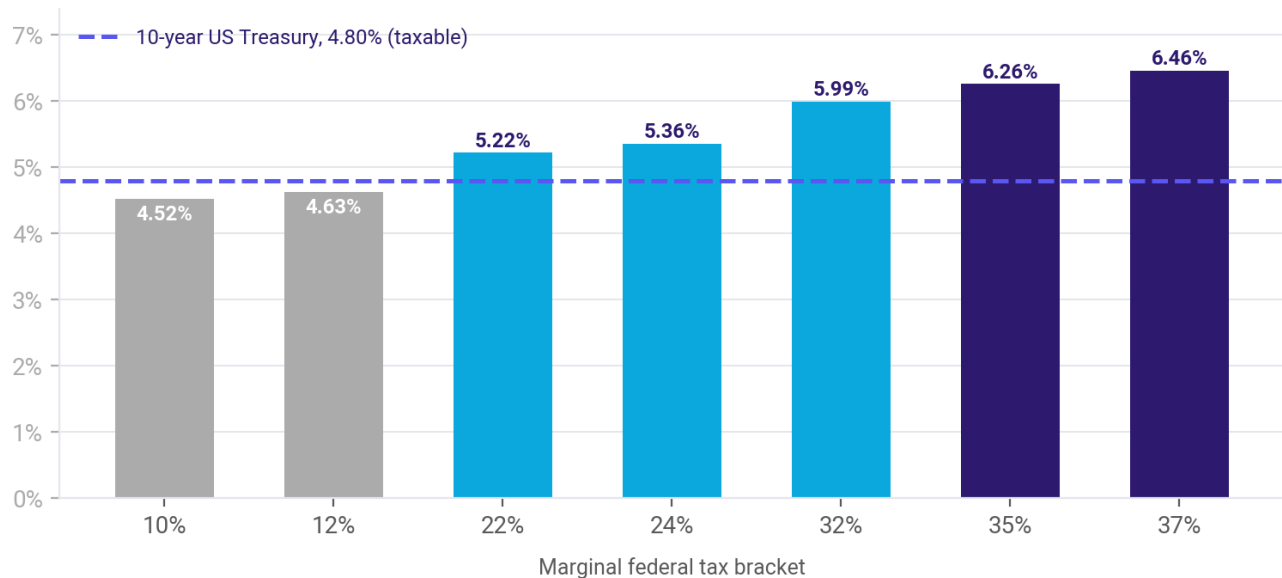
The breakeven tax rate

Run the formula backwards and it answers a sharper question: at what tax rate does the investor stop caring? Breakeven = $1 - (\text{muni yield} \div \text{taxable yield})$. Against the 10-year Treasury that is $1 - (4.07 \div 4.80) = 15.1\%$. Any investor whose marginal federal rate exceeds roughly 15% is better off in munis on a tax-equivalent basis — which covers every federal bracket from 22% up.

Who the exemption actually helps

The chart below applies the gross-up to each federal bracket at today's index yield. Only the two lowest brackets fall short of the Treasury — and even then by less than a quarter of a percentage point.

Municipal tax-equivalent yield by federal bracket



Federal bracket	Muni TEY	10Y Treasury	Spread	Verdict
10%	4.52%	4.80%	-27 bps	Taxable favored
12%	4.63%	4.80%	-17 bps	Taxable favored
22%	5.22%	4.80%	+42 bps	Munis favored
24%	5.36%	4.80%	+56 bps	Munis favored
32%	5.99%	4.80%	+119 bps	Munis favored
35%	6.26%	4.80%	+147 bps	Munis favored
37%	6.46%	4.80%	+167 bps	Munis favored

Federal rates only. Muni yield-to-worst of 4.07% and 10-year Treasury of 4.80% as of September 8, 2026. Source: Bloomberg.

THE COMPARISON YOU CHOOSE CHANGES THE ANSWER

Breakeven against corporates, not just Treasuries

A breakeven rate is only meaningful relative to a specific alternative. Measured against the 10-year Treasury at 4.80%, the breakeven is 15.1%. Measured against investment grade corporate bonds at roughly 5.26%, it rises to **22.6%** — because the taxable bond being given up yields more. The higher the yield on the taxable alternative, the higher the tax rate required to justify the tax-exempt bond. Investors comparing munis to a corporate bond fund, a CD or a money market fund should rerun the arithmetic with that yield, not the Treasury's.

The state tax layer

Municipal bonds bought by a resident of the issuing state are typically exempt from that state's income tax as well. For a California or New York resident holding in-state paper, the effective exemption stacks, and the tax-equivalent yield rises accordingly.

Federal bracket	CA combined	CA TEY	NY combined	NY TEY
10%	23.3%	5.31%	20.9%	5.15%
12%	25.3%	5.45%	22.9%	5.28%
22%	35.3%	6.29%	32.9%	6.07%
24%	37.3%	6.49%	34.9%	6.26%
32%	45.3%	7.44%	42.9%	7.13%
35%	48.3%	7.88%	45.9%	7.53%
37%	50.3%	8.19%	47.9%	7.82%

Combined rates shown on a simplified additive basis (top state rates of 13.3% for California and 10.9% for New York). Source: Bloomberg, Revisor calculations.

An important comparison error to avoid

It is tempting to hold these in-state tax-equivalent yields up against the Treasury — but that double-counts the benefit. **Treasury interest is already exempt from state and local income tax.** Against Treasuries, the correct comparison uses the federal rate alone, exactly as on the previous page. The state tax layer earns its keep against corporate bonds, CDs, agency debt and taxable bond funds — instruments that are fully taxable at both levels.

Two further caveats

- **The additive method overstates the combined rate.** State income tax is deductible federally, so the true combined rate is lower than federal plus state — though the SALT deduction cap limits how much of that relief most investors actually receive. The tables above are a reasonable approximation, not a filing-grade number.
- **In-state concentration is a real trade-off.** Capturing the state exemption means concentrating credit and economic exposure in a single state's issuers. For larger portfolios that can be a meaningful diversification cost, and it is worth weighing against the incremental yield rather than assuming the exemption is free.

WHERE MUNIS DO NOT BELONG

Tax-deferred accounts

The exemption is worth nothing inside an IRA, 401(k) or other tax-deferred account, because the account already shelters the income. What remains is the lower nominal yield — 4.07% instead of 4.80% — which is a straightforward drag. As a general rule, munis belong in taxable accounts and taxable bonds belong in tax-deferred ones.

Where the market stands today

4.07%MUNI INDEX
YIELD-TO-WORST**6.46%**TAX-EQUIVALENT YIELD
TOP FEDERAL BRACKET**~72%**10-YEAR MUNI /
TREASURY RATIO**~63%**RATED AA
OR BETTER

The tax-equivalent yield on offer today is the highest reading in the past decade, and sits 167 basis points above the 10-year Treasury. That is the constructive half of the picture.

The less constructive half is valuation. The muni/Treasury ratio — the muni yield expressed as a percentage of the comparable Treasury yield — sits near 72% at the 10-year point. Historically that is on the rich side; ratios closer to 80–85% have marked cheaper entry points. Munis are not inexpensive on a pre-tax basis. The case rests on the tax adjustment, which is precisely why the investor's bracket does so much of the work.

Supply and demand

2026 is tracking toward a third consecutive year of issuance above \$500 billion, with the first half alone reaching roughly \$295 billion — the heaviest in a decade. This reflects catch-up borrowing after nearly two decades of restraint against an estimated \$9 trillion infrastructure funding gap. Demand has absorbed it: fund and ETF flows ran positive for eleven consecutive weeks through mid-July, and separately managed account demand has been steady. That balance is what has kept ratios compressed despite the supply.

The market has not been calm throughout. July 2026 was the worst month for munis since 2003, with the index falling about 1.72% as Treasury yields rose into heavy issuance; March saw a 2.3% decline before recovering. Seasonality matters here — September and October typically bring heavier supply and softer technicals before year-end reinvestment demand returns.

Credit quality

The index is a high-quality one. Roughly 63% is rated AA or better and only about 3% is BBB, which makes munis a natural complement to a taxable sleeve that carries most of its risk in corporate credit.

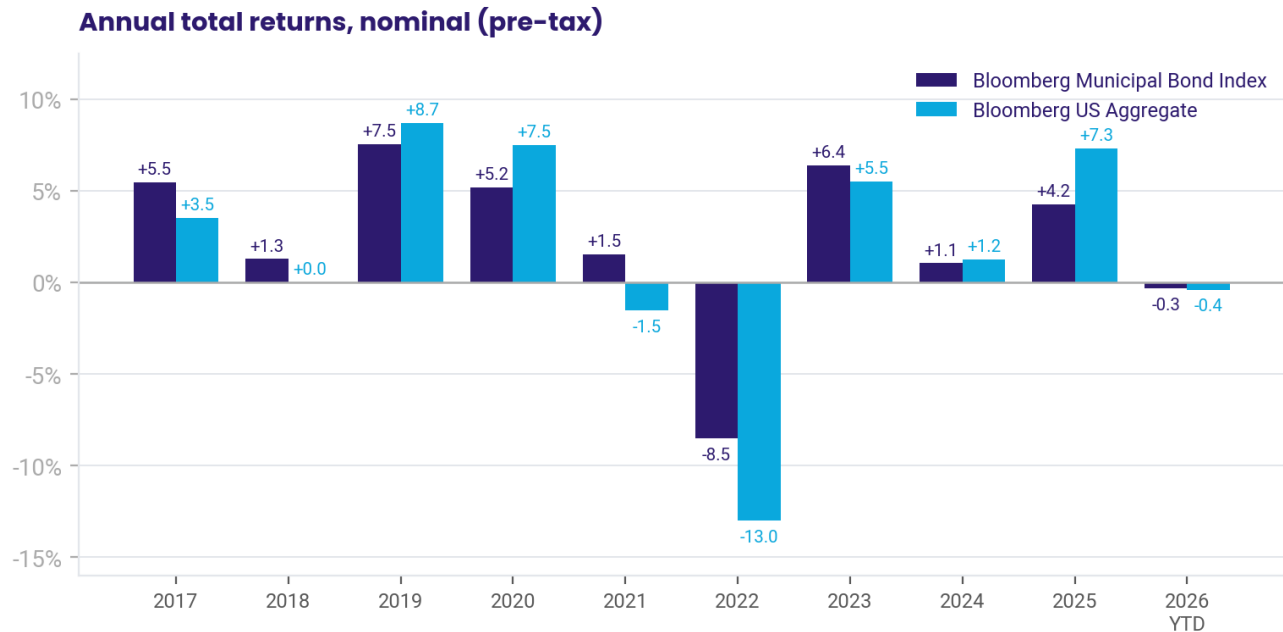
Credit quality of the Bloomberg Municipal Bond Index



Source: Bloomberg, as of September 8, 2026. Ratings by Bloomberg composite.

Ten years of results

Yield is the case for owning munis; returns are the record of what that case has produced. Over the last decade the Bloomberg Municipal Bond Index outperformed the Bloomberg US Aggregate in six of ten years — before any tax adjustment at all.



Year	Muni index	US Aggregate	Muni advantage
2017	+5.45%	+3.54%	+191 bps
2018	+1.28%	+0.01%	+127 bps
2019	+7.54%	+8.72%	-118 bps
2020	+5.21%	+7.51%	-230 bps
2021	+1.52%	-1.54%	+306 bps
2022	-8.53%	-13.01%	+448 bps
2023	+6.40%	+5.53%	+87 bps
2024	+1.05%	+1.25%	-20 bps
2025	+4.25%	+7.30%	-305 bps
2026 YTD	-0.33%	-0.40%	+7 bps

Nominal total returns, before any tax adjustment. 2026 through September 8. Source: Bloomberg.

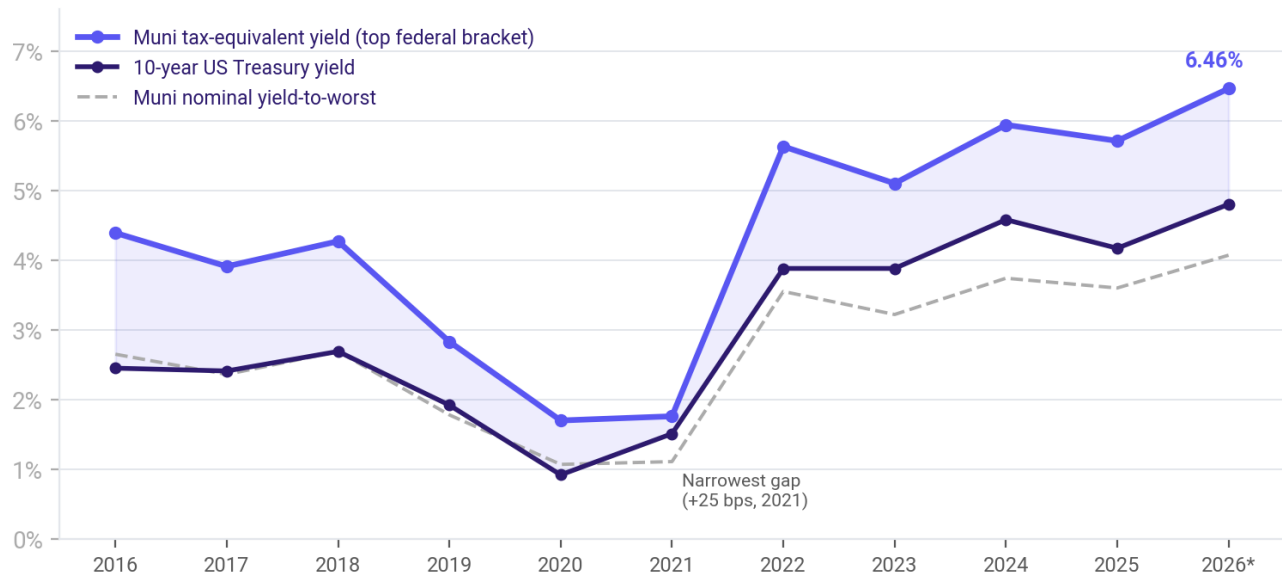
The pattern is not random

Munis won the rising-rate and risk-off years and lost the duration rallies. The clearest example is 2022: the index fell 8.53% while the Aggregate fell 13.01%, a 448 basis point gap produced by shorter effective duration and no corporate spread widening. The reverse held in 2019, 2020 and 2025, when longer duration and tightening spreads carried the Aggregate. And every figure above understates the muni result for a taxable investor, because part of the muni return arrives as untaxed coupon income while the Aggregate's equivalent is taxed as ordinary income.

The tax-equivalent yield across a decade

Grossing up the index yield each year against the 10-year Treasury shows how unusual today's starting point is. On a tax-equivalent basis munis have offered a positive spread over Treasuries in every year of the past decade — but the size of that spread has varied enormously.

Year-end yields, 2016–2026



*2026 as of September 8. Top federal rate: 39.6% for 2016–2017, 37% from 2018.

Year-end	Muni YTW	Muni TEY	10Y Treasury	TEY spread
2016	2.65%	4.39%	2.45%	+194 bps
2018	2.69%	4.27%	2.69%	+158 bps
2020	1.07%	1.70%	0.92%	+78 bps
2021	1.11%	1.76%	1.51%	+25 bps
2022	3.55%	5.63%	3.88%	+175 bps
2024	3.74%	5.94%	4.58%	+136 bps
2025	3.60%	5.71%	4.17%	+154 bps
2026 current	4.07%	6.46%	4.80%	+167 bps

Selected years shown. Top federal rate of 39.6% applied through 2017 and 37% from 2018 onward. Source: Bloomberg, Revisor calculations.

What the history says

- **2021 was the weakest case in the series.** With nominal yields near 1.1%, even a full gross-up produced only 1.76% against a 1.51% Treasury — a 25 basis point pickup. When absolute yields are low, the exemption has little to work with.
- **The 2022 reset has held.** Since the rate shock, tax-equivalent yields have stayed in a 5.1% to 6.5% range, structurally different from the sub-3% regime of 2019 to 2021.

- **Today sits at the top of that range.** A 6.46% tax-equivalent yield is the highest reading in the series — a function of higher absolute yields, not of munis being cheap relative to Treasuries.

Putting it together

For a taxable account in the 22% bracket or above, the tax-equivalent arithmetic currently favors municipal bonds over comparable taxable alternatives — more so in a high-tax state holding in-state paper, and more so still against corporates than against Treasuries. For tax-deferred accounts and the lowest brackets, it does not. Valuation is rich on a pre-tax basis and supply is heavy, so entry point matters for total return even where the after-tax logic is sound. None of that changes with market conditions in the way the yield does — the bracket question is the durable one.

A few terms

Yield-to-worst	The lowest yield an investor can receive short of default, accounting for issuer call options. The standard yield measure for a callable-heavy market like munis.
Muni / Treasury ratio	The muni yield as a percentage of the same-maturity Treasury yield. A lower ratio means munis are richer on a pre-tax basis; a higher ratio, cheaper.
General obligation vs. revenue	GO bonds are backed by the issuer's taxing power; revenue bonds are backed only by the cash flows of a specific project such as a toll road or water system.
De minimis rule	A muni bought at a sufficient discount to par can have part of that discount taxed as ordinary income rather than capital gain — a live issue in higher-rate markets.
AMT bonds	Interest on certain private-activity munis is includable for alternative minimum tax purposes, so the exemption is not universal.
SMA	A separately managed account holding individual bonds directly, rather than fund shares. A large and growing share of muni demand.

Disclosures. This material is for educational and informational purposes only and does not constitute investment, tax or legal advice, or a recommendation to buy or sell any security. Yields and index data are sourced from Bloomberg as of September 8, 2026 and are subject to change. Tax-equivalent yield calculations use stated marginal rates and do not account for the alternative minimum tax, the 3.8% net investment income tax, state tax deductibility, the SALT deduction cap, or an individual's complete tax situation. Combined state and federal rates are shown on a simplified additive basis. Index returns are nominal, do not reflect fees, expenses or taxes, and are not available for direct investment. Past performance does not guarantee future results. All investments involve risk, including possible loss of principal. Investors should consult a qualified tax advisor regarding their individual circumstances.