NB PRIVATE WEALTH

Municipal Basis Points

2Q 2025

MUNICIPAL FIXED INCOME TEAM

Diamonds in the Rough

- In the wake of tariff announcements, a sell-off in municipal bonds has resulted in what we consider compelling valuations in the asset class.
- Abundant supply may dampen price return potential in the near term, but offers investors a window to pick up yield in quality assets.
- Given the possibility of further Federal Reserve cuts, putting excess cash to work could offer the potential to limit the risk of reinvestment at lower interest rates.
- In an uncertain environment, a focus on quality and security selection appears warranted.

Macro and Markets

We could be entering a true bond-pickers' market.

Returns in the municipal market started well in the first quarter, but fizzled in March. Supply was heavy throughout the period, but increasingly weighed on market sentiment, pushing yields higher. As a result, municipals generally trailed Treasuries during the quarter, leaving valuations at more attractive levels than at the start of 2025. That said, the biggest story of the year came after quarter-end, when the Trump administration announced on April 2 that it would be raising tariffs by far more than many had expected. This created extreme volatility in the equity market, but also hurt Treasuries, which did not perform as a "safe haven" asset class. Yields moved sharply higher as it appeared some investors were shunning U.S. dollar-denominated assets.

During the week of April 7, the municipal market experienced wild price swings and a sharp move higher in yields. Multiple factors combined to cause the market to weaken, including Treasury market volatility, municipal fund outflows, a sharp rise in "bid-wanted" activity, and concerns about continued heavy supply. Importantly, the sell-off did not appear to be related to municipal credit quality. For the week of April 7, AAA municipal yields moved higher by roughly 65 basis points across the yield curve.[1] Most of the scheduled new issue supply for the week was pulled to avoid generating additional market pressure.

We recognize that a sell-off of this kind is never fun, especially in an asset class known for historically preserving capital in challenging market and economic environments. That said, we see many bright spots in the current outlook. Muni valuations relative to Treasuries look very compelling to us. On April 14, intermediate investment grade municipals were yielding about 3.77%, for a taxable-equivalent yield of 6.37% (assuming a federal tax rate of 40.8%). When compared to intermediate Treasuries, which were yielding 4.12% at the same time, municipal bonds have an advantage of 225 basis points on a tax-adjusted basis. Moreover, we believe that municipals now offer compelling value versus other quality fixed income. Importantly, the new issue calendar reopened the week of April 14, indicating dealer confidence in the demand for municipals at these new, adjusted levels.

While we expect volatility to stay elevated until tariff policy comes into clearer focus, we think today's valuations are pricing in a lot of market uncertainty. We also believe that higher degrees of volatility may make it harder to know what bonds are worth. In our view, that backdrop may be ideal for our approach to investing, which revolves around using a large broker-dealer network to locate mispriced securities. In effect, we find ourselves in a bond-pickers market. Finally, the rates backup should increase the opportunity set, where appropriate, to execute tax-loss swaps in client portfolios, which can be an important additional source of value.

We recognize that the recent market environment has been difficult, but yields are now much higher, and we expect more deals and secondary market opportunities to offer price concessions. In our opinion, we are moving into a period where active management could really shine.

[1] Bloomberg is the source for all yield data in this publication.

Strategy and Outlook

High yields and high quality are key reasons to consider municipals now.

KEY MARKET TRENDS

Higher yields. Municipal yields began the year by moving lower, but experienced a sharp rise in March and early April. In our view, this upward movement was primarily due to increased selling pressure from exchange-traded funds, tax-season outflows, elevated weekly new-issue supply, and heightened interest rate volatility due to tariff concerns.

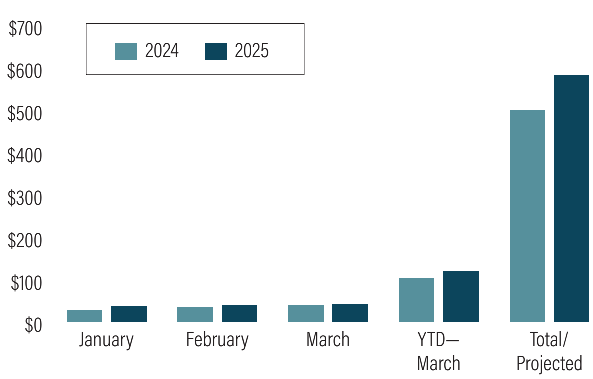
The tariff difference. Following the global tariff announcements on April 2, the market now anticipates more Federal Reserve rate cuts in 2025 than previously expected. These revised forecasts are driven by concerns about slowing economic growth amid fears of a prolonged trade war.

Issuance defies gravity. Municipal issuance for the first quarter reached approximately $120 billion, a 15% increase from last year. Issuance for the year could now easily surpass last year's record of $500 billion. Among the drivers:

- **Voter-approved borrowing.** Voters approved a significant number of bonds last November, providing municipalities with authorization to issue new debt and finance infrastructure, education and other public projects.
- **Accelerated Issuance.** Uncertainty regarding the fate of the 2017 tax cuts could prompt issuers to accelerate some bond issuance before new tax legislation is enacted.

MUNICIPAL SUPPLY REMAINS ROBUST

$ Billions



Source: Bank of America, as of March 31, 2025.

INVESTMENT IMPLICATIONS

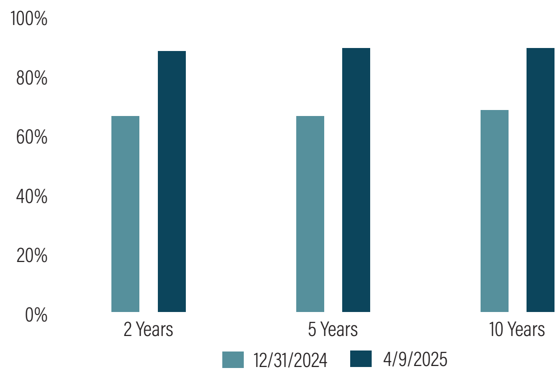
Flows to longer bonds. Since last September's initial rate cut, mutual fund flows have shifted from shorter to longer maturities, a trend likely to accelerate as the Fed resumes its rate-cutting cycle. That said, we maintain a neutral view on duration (sensitivity to changes to interest rates) due to seasonally weak market technical and rates volatility.

Move out of cash? Investors may wish to consider reducing cash holdings to mitigate the risk of reinvesting at lower rates. Municipal yields, in our view, now offer attractive opportunities across the yield curve compared to cash rates and comparable Treasuries (see display below).

Credit quality remains elevated. Municipalities are currently supported by strong credit quality, bolstered by higher-than-expected tax collections. This fiscal resilience positions many well to weather a potential economic slowdown.

MUNICIPALS CURRENTLY OFFER UNUSUAL VALUE

Municipal vs. Treasury Yields



Source: Bloomberg, as of April 9, 2025.

Deeper Dive

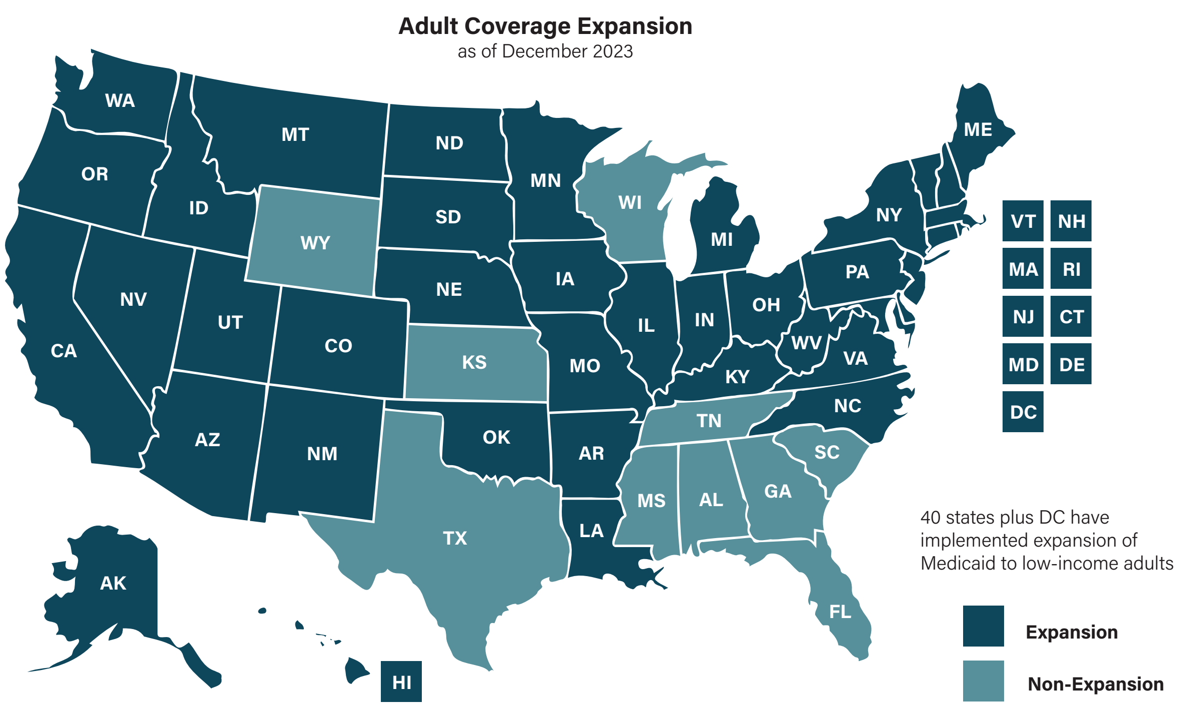
Medicaid reform could pressure not-for-profit hospitals, but careful research can still reveal opportunity in the sector.

Since taking office in January, the Trump administration has targeted numerous areas of federal spending for change, including health care, and more specifically not-for-profit (NFP) hospital reimbursement. While it is still unclear exactly how policies and regulations may shift, the focus thus far appears to be on potential reductions in Medicaid spending. In general, hospitals have experienced improvement since the stresses that accompanied COVID-19. However, despite healthier volumes and success in managing costs such as staffing and labor, expenses overall have proven sticky and financial metrics have been slow to recover to pre-pandemic levels; we therefore believe certain portions of the sector could face material strains if federal funding is meaningfully reduced or eliminated.

Specifically, hospitals in the 41 states that expanded Medicaid under the Affordable Care Act face the risk of potential reductions in the Federal Medical Assistance Percentage, which determines the federal government's share of Medicaid funding. Currently, the federal government covers 90% of costs for expansion enrollees (down from 100% in 2014 – 2016), but this could drop to the standard 50 – 77% share. Changes to eligibility requirements could also lead to participants losing coverage entirely. Additionally, 12 states have "trigger" laws tied to their Medicaid expansion programs requiring them to reconsider, or potentially eliminate, Medicaid payments if federal funding decreases. This could result in significant cuts to Medicaid reimbursement from both federal and state sources. Further, challenges like

MEDICAID COVERAGE: WHAT WENT UP MAY COME DOWN

2025 Revenue Forecast (Year-Over-Year)



Source: Medicaid.gov.

STATES ARE VULNERABLE TO AUTOMATIC MEDICAID LOSSES FROM FEDERAL FUNDING CUTS

States where Medicaid expansion would quickly end if federal funding falls below 90%	States where Medicaid expansion would likely be reduced or eliminated through a review process should federal funding fall below 90%
Arizona	Idaho
Arkansas	Iowa
Illinois	New Mexico
Indiana	
Montana	
New Hampshire	
North Carolina	
Utah	
Virginia	

Source: Georgetown University McCourt School of Public Policy Center for Children and Families.

a recession or rising unemployment could increase uncompensated care and self-pay, straining hospital revenues. We believe providers that are heavily reliant on Medicaid are especially vulnerable to these pressures.

Hospitals could face additional fiscal pressures due to rising expenses. Tariffs and disruptions to supply chains could exacerbate already elevated costs, including medical supplies and pharmaceuticals. We note that tariffs on several products sourced from China, including masks, syringes and needles, took effect in late 2024. Any additional duties imposed by the Trump administration, or retaliatory actions by China, would compound the problem. Finally, the constant focus on technological advances in treatment, cyber security and artificial intelligence could also continue to pressure expenses. In our view, hospitals with weaker profitability could experience the greatest difficulty absorbing any additional costs.

Despite industry headwinds, we continue to believe NFP hospitals offer investment opportunities. Our long-standing conviction remains that larger providers with solid operating results and strong balance sheets are best positioned to handle sector volatility. Large multistate providers also enjoy strong competitive positions within their respective markets, diversity in geography, economies and regulatory environments, and substantial economies of scale and bargaining power with commercial payors, unions and vendors. Moreover, we believe that highly rated states have the economic, financial and administrative wherewithal to help support providers as the health care landscape shifts. We remain selective with regard to NFP hospitals, monitoring providers and developments in the sector overall.

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1290 Avenue of the Americas
New York, NY 10104–0001
www.nb.com

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