Madison INVESTMENTS

MADISON MUNICIPAL BOND

December 31, 2025 | Separately Managed Account Investment Strategy Letter

MARKET REVIEW

During the fourth quarter, the longest federal government shutdown in U.S. history (43 days), coupled with the lack of published economic data, left investors searching for the direction of the overall economy. Despite delayed and canceled economic releases during the quarter, the Federal Reserve saw fit to cut the Federal Funds rate two times (October and December) by a total of 50 basis points, although the decisions were not unanimous. The markets seemed to take it all in stride as interest rates remained rangebound and the stock market set another record. Investors seem to believe that if the AI boom continues and "data center" buildouts take over large swaths of undeveloped real estate, there is money to be made in the markets.

Overall, the economy seems to be resilient despite all the headwinds. Third quarter GDP came in at 4.3% and personal consumption posted a gain of 3.5%, both well above expectations. In addition, spending during the holiday season set another record despite the unemployment rate ticking up to 4.5% in November. Even so, "Main Street" doesn't seem to be as sanguine about things as Wall Street. Grocery prices remain elevated, the average price of a new vehicle just surpassed $50,000 and health care insurance premiums are set to explode for those enrolled in the Affordable Care Act (ACA). Combining those factors with a relatively stagnant jobs market and continued sticky inflation make for a cranky consumer for all but those in the upper tier of the disposable income range.

The municipal bond market underperformed its taxable counterparts for the year as another deluge of supply weighed on returns. For the quarter, the broad municipal bond market posted a total return of 1.45% and a 3.92% return for the year (ICE BoA Municipal Bond index). New issue supply totaled over $570 million, up 15% from last year's record issuance. U.S. public schools issued $82 billion in debt, exceeding the record set in 2024 by 42%. Construction costs for new schools and renovations for aging buildings present a budgetary challenge for many districts. Federal, and in many cases, state aid is declining so local referendums are becoming ubiquitous on many ballots across the country. The heavy supply required concessions to entice investor interest, thereby negatively affecting total returns.

From a fundamental perspective, the muni market seems to be in fairly good shape. However, continued federal aid cuts in everything from K-12 schools to Medicaid reimbursements will be worth keeping a close eye on. In addition, federal workforce reductions across the country and "targeted" threats to withhold money typically allocated to universities and other research entities could cause some municipalities who are reliant on these grants to make painful budget adjustments. Examples are the District of Columbia and the state of Maryland, which were both downgraded because of federal workforce reductions.

PERFORMANCE/ATTRIBUTION

The broad municipal bond market (ICE BoA Municipal Bond index) posted a 1.45% return during the fourth quarter, bringing year-to-date performance to 3.92%. Most of the quarterly return was generated in October as issuance temporarily waned. The muni market outperformed Treasuries by 0.62% during the fourth quarter but lagged Treasuries by 2.32% year-to-date.

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Yield/Income:	Income contributed 1.11% of return during the fourth quarter and 4.53% during 2025.
Duration:	Like last quarter, longer duration muni indices generally posted higher returns than those with shorter duration. Stable interest rates for maturities exceeding two years supported longer duration assets.
Yield Curve:	For the quarter, munis with maturities between 8- and 17-years generated returns ranging from 1.76% to 2.62%, whereas shorter maturities averaged roughly a 0.50% return. For the year, munis with maturities between 4- and 17-years produced average annual returns exceeding 5.0%. In contrast, munis with maturities less than 2-years and greater than 22-years posted returns of 3.46% and 1.75%, respectively.
Sector/Quality:	Credit spreads decreased by -4 basis points (bps) during the quarter as investors locked in yield ahead of anticipated rate declines in the coming year. Year to date, spreads increased by +40 bps, in large part due to heavy supply. In contrast to the overall market, Pre-refunded and Utility spreads widened by +14 bps and +16 bps, respectively. Investors likely sold Pre-refunded bonds due to low yields.

OUTLOOK

As the year ends, we're thinking about the opportunities and challenges 2026 may present. Monetary policy is apt to take center stage as a new Federal Reserve Chair takes the helm in May. Some economists see little need for interest rate adjustments while others have penciled in three rate cuts. The direction of rates will likely influence the level of returns we can expect from the municipal bond market. In addition, projected issuance could test investors' resolve for positioning munis at current yield ratios. Lastly, reallocation out of the muni sector could also pressure credit spreads. Fortunately, the elevated yields investors locked in during the past couple of years should provide an element of protection against potential price swings.

The concerns raised earlier regarding traditional federal support to the states have the potential to upend budget assumptions in the near term. Fortuitously, many states come into the new year with ample "rainy day" funds that can be used to close unanticipated budget shortfalls. We foresee the rating agencies withdrawing ratings from a few local issuers due to lack of timely financials, although we believe the change in secondary spreads will be muted. We plan to opportunistically invest in quality bonds that have stood the test of time and closely monitor events that may upset the financial well-being of issuers within riskier muni sectors.

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Any performance data shown represents past performance. Past performance is no guarantee of future results.

Non-deposit investment products are not federally insured, involve investment risk, may lose value and are not obligations of, or guaranteed by, any financial institution. Investment returns and principal value will fluctuate.

This report is for informational purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security and is not investment advice.

Upon request, Madison may furnish to the client or institution a list of all security recommendations made within the past year.

ICE BofA Municipal Securities Index measures the performance of United States dollar-denominated investment grade tax-exempt debt publicly issued by U.S. states and territories, and their political subdivisions, in the U.S. domestic market.

In addition to the ongoing market risk applicable to portfolio securities, bonds are subject to interest rate risk, credit risk and inflation risk. When interest rates rise, bond prices fall; generally, the longer a bond's maturity, the more sensitive it is to this risk. Credit risk is the possibility that the issuer of a security will be unable to make interest payments and repay the principal on its debt. Bonds may also be subject to call risk, which allows the issuer to retain the right to redeem the debt, fully or partially, before the scheduled maturity date. Proceeds from sales prior to maturity may be more or less than originally invested due to changes in market conditions or changes in the credit quality of the issuer.

Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only, and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.

The federal funds rate is the target interest rate range set by the Federal Open Market Committee (FOMC) for banks to lend or borrow excess reserves overnight. It influences monetary and financial conditions, short-term interest rates, and the stock market.

Investment income may be subject to certain state and local taxes and, depending on your tax status, the federal alternative minimum tax. Capital gains are not exempt from federal income tax.

Yield Curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity. There are three main types of yield curve shapes: normal (upward-sloping curve), inverted (downward-sloping curve), and flat.

Duration is a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates. Duration measures how long it takes, in years, for an investor to be repaid the bond's price by the bond's total cash flows.

Bond Spread is the difference between yields on differing debt instruments of varying maturities, credit ratings, and risk, calculated by deducting the yield of one instrument from another.

A basis point is one hundredth of a percent.

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