MARKET COMMENTARY

JANUARY 2026

Municipal bonds started the year strongly, with tax-exempt munis outperforming taxable fixed income as demand absorbed supply and technicals dominated market behavior.

Intermediate municipal yields rallied even as Treasury yields moved modestly higher, pushing relative valuations richer and elevating the importance of structure, curve positioning, and disciplined issuer selection.

It's becoming a case of the "haves and have-nots" in municipal credit. Smaller and more narrowly positioned issuers face growing pressure, particularly standalone hospitals, smaller private colleges, and charter schools, where rising operating costs, weaker pricing power, and limited financial flexibility persist. Active management is now more important than ever.

MARKET MEETS THE NEW FED CHAIR

- At the end of January, President Trump nominated former Fed Governor Kevin Warsh to succeed Jerome Powell as Fed Chair when Powell's term ends in May. Warsh was generally viewed as more hawkish during his prior Fed tenure from 2006–2011, though his more recent public remarks have leaned more accommodative, aligning with the Trump administration's preference for lower rates.
- Perhaps more important for market implications than his views on short-term rates are Warsh's prior comments regarding the need for continued balance

sheet reduction. Any acceleration of quantitative tightening, particularly alongside elevated Treasury issuance needs, could place upward pressure on rate volatility over time. While Warsh has been an outspoken critic from outside the Fed, how those views translate into policy decisions once in the chair remains uncertain.

- Monetary policy decisions, however, remain set by the full 12-person FOMC. While the market saw some volatility in the days around the nomination, the announcement did not materially disrupt fixed income markets during the month, with the MOVE Index (the "VIX of bonds") at its lowest level since the zero-rate environment of October 2021. Markets will be closely watching Warsh's comments while Powell remains Chair through May 15.

- The Fed also held its benchmark interest rate in a range of 3.5% to 3.75% at the January meeting, pausing its recent rate-cutting trend. In his post-meeting comments, Powell shared that it was "hard to look at the data and say that policy is significantly restrictive right now."

MUNIS OUTPERFORM WHILE TREASURY YIELDS RISE

- In line with typical seasonal patterns associated with the "January effect," municipal bonds delivered a strong start to the year, with tax-exempt munis outperforming taxable alternatives in January. The ICE 1–12 Year Municipal Index returned 0.93% for the month, supported by declining intermediate municipal yields even as Treasury yields moved modestly higher.

- Why the outperformance in munis? Two main reasons:

  1. While municipalities continue to issue robust supply, January's net supply was relatively flat, as new issue pricing was easily absorbed by redemptions from calls, maturities, and coupon payments that were quickly reinvested back into the market.

  2. Strong fund inflows, particularly into municipal ETFs.

Strong reinvestment demand and ETF inflows absorbed supply in January, allowing munis to rally even as Treasury yields moved higher and long-end returns lagged.

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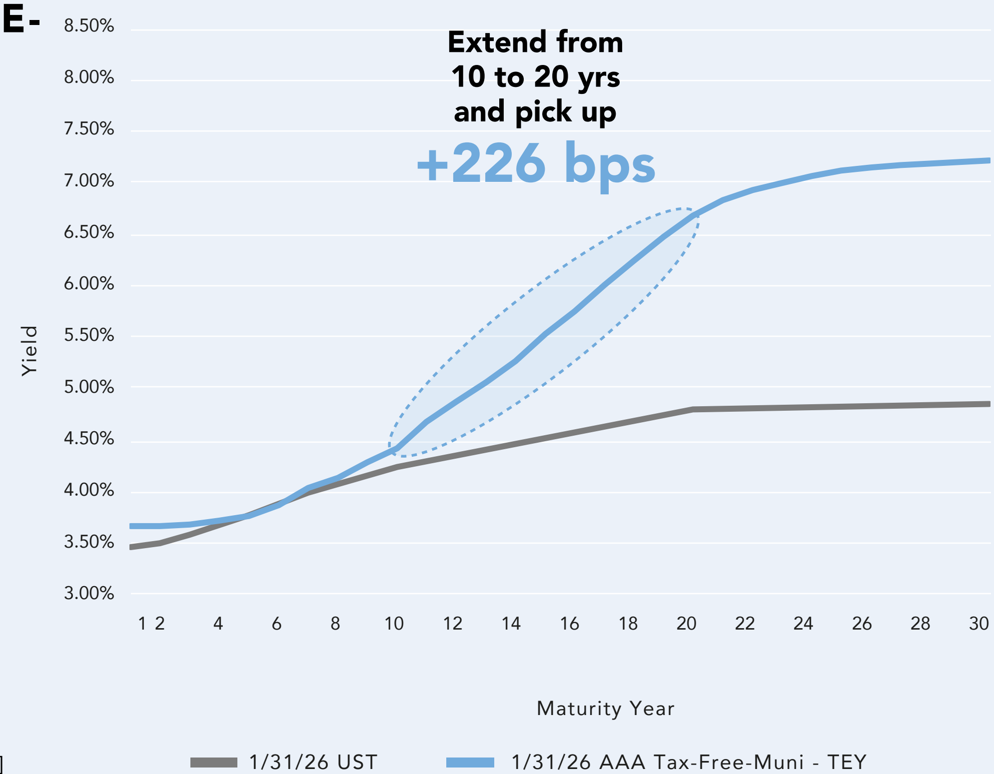
BULL STEEPENER IN JANUARY

- The AAA muni curve "bull steepened" in January, with five- and 10-year yields declining by 14 and 10 basis points, respectively, while 30-year rates rose three basis points.

Richer valuations elevate the importance of structure and curve positioning.

- While taxable-equivalent yields remain compelling for high-net-worth investors, we believe relative value across the curve has become increasingly uneven, highlighting the importance of thoughtful structure and disciplined bond selection. As of January month-end, we are seeing a 226-basis-point pickup in taxable-equivalent yield between the 10-year and 20-year portions of the AAA curve for clients in the highest tax bracket.

STEEP TAXABLE-EQUIVALENT YIELD PICKUP BETWEEN 10 AND 20 YEARS



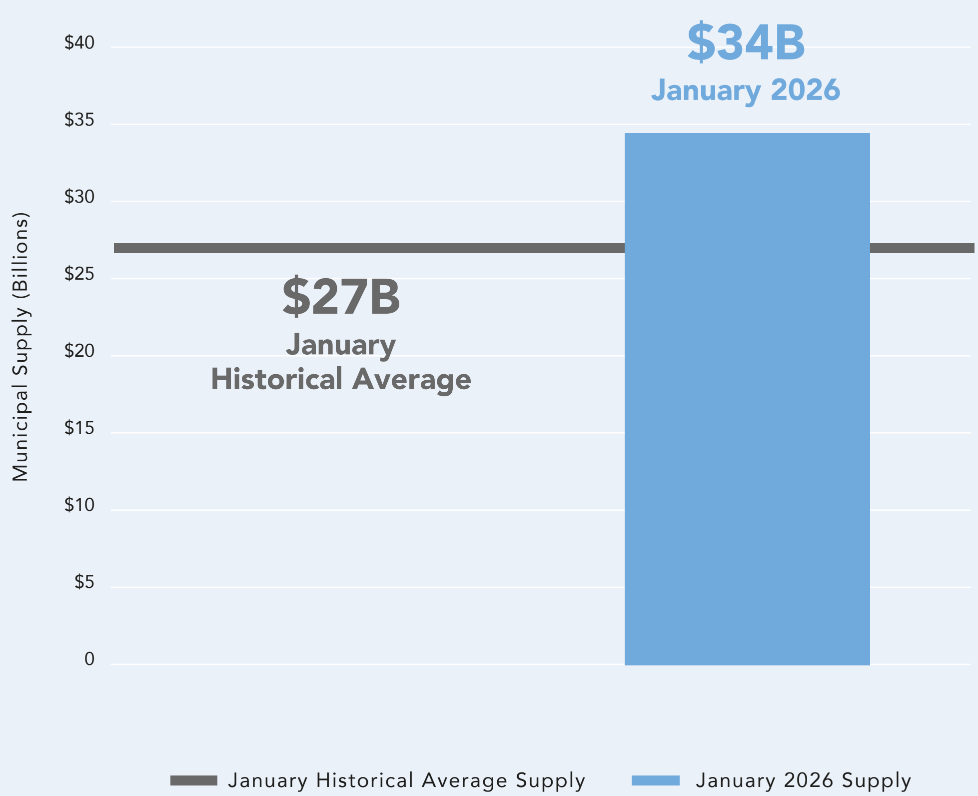
Source:
The Municipal Market Monitor (TM3) & U.S. Department of the Treasury [January 31, 2026]

- We believe this environment supports continued use of our modified barbell structure, allowing client accounts to benefit from elevated long-end yields while retaining downside protection on the short end and improving future income potential.

NEW ISSUE SUPPLY MODERATES, BUT STILL HIGHER THAN AVERAGE

- Muni issuance totaled $34B for the month. While this was 8% lower than in the same period last year, it was still higher than the $27B average supply for the month during the past five years.

MUNI ISSUANCE REMAINED ABOVE HISTORICAL AVERAGES



Source:
Barclays Live [February 3, 2026]

- Looking ahead, we expect supply to pick up in the coming months, which should coincide with higher secondary market activity and seasonal investor rebalancing ahead of tax time.

WIDENING CREDIT DISPERSION HIGHLIGHTS THE VALUE OF ACTIVE MANAGEMENT

- While municipal credit fundamentals remain broadly stable, supported by modest revenue growth at the state and local level and a still-resilient consumer backdrop, credit dispersion is increasing across sectors, reinforcing a "haves and have-nots" dynamic as cost pressures and policy uncertainty weigh unevenly on issuers.

- Larger, well-resourced issuers—including states, large local governments, multi-state healthcare systems, and major public universities—continue to demonstrate greater resilience due to scale, diversified revenue streams, and stronger balance sheets.

Recent rating actions reinforce the growing divide between well-resourced municipal issuers and more constrained credits.

- Smaller and more narrowly positioned issuers face growing pressure, particularly standalone hospitals, smaller private colleges, and charter schools, where rising operating costs, weaker pricing power, and limited financial flexibility persist. Recent rating actions across private higher education and the charter school sector—including Xavier University and Great Hearts Texas Charter School—underscore the growing divergence between well-resourced issuers and more constrained credits.

- Looking ahead, increased issuance in sectors such as public power and housing may place upward pressure on spreads and contribute to more differentiated credit opportunities, reinforcing the importance of disciplined issuer selection by your manager. Should you or your clients have any concerns with outside holdings, please send them over to our research team for review.

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