

Discipline Drives Differentiated Results in 2026

We believe that the municipal market enters 2026 from a position of relative stability. Credit fundamentals remain generally solid, defaults have historically been limited, and income levels are attractive relative to recent history. Yet beneath this calm surface, the drivers of performance are changing in important ways. The broad-based supports that helped lift most municipal bonds in recent years are being replaced by a market that is more differentiated, more technical, and less forgiving of imprecision.

As the extraordinary federal aid that once eased budget pressures and muted fiscal trade-offs recedes into history, policy outcomes are likely to diverge more meaningfully across states and local governments. These forces increase the gap between issuers with durable, predictable revenue streams and those more reliant on discretionary budget decisions.

Technical forces are reinforcing this shift. Investor demand has become increasingly concentrated in passive and rules-based strategies that favor a narrow set of maturities and bond types, often without regard to valuation. This concentration has left some areas of the market crowded and fully priced, while others remain overlooked and under-owned. In 2026, where bonds sit on the curve — and whether investors have the flexibility to reach less trafficked segments — will matter as much as the overall direction of interest rates.

At the same time, dispersion is widening across return outcomes. Yield alone is no longer a sufficient guide to performance, particularly in lower-quality segments of the market. As individual credit stories begin to matter more, disciplined security selection, liquidity awareness, and downside risk management become essential components of return generation rather than secondary considerations.

Taken together, these shifts suggest that broad, one-size-fits-all exposure may be less effective in 2026. Market conditions are likely to place greater emphasis on selectivity across credit, maturity, structure, and strategy. Investors who emphasize resilience, flexibility, and disciplined risk management may be better positioned to navigate a market in which opportunities remain, but may be unevenly distributed.

1

ESSENTIAL SERVICE MUNIS LEAD IN 2026, PROVING REVENUE RESILIENCE

Investment grade essential-service revenue-backed bonds, supported by secured or dedicated revenue streams, appear well positioned to outperform their tax-backed equivalents in 2026. Their credit strength is driven less by political decision-making and more by stable, diversified cash flows and strong debt service coverage tied to non-discretionary demand. As fiscal tightening and political churn raise questions around GO flexibility, these revenue sectors may increasingly serve as relative safe havens within the municipal market.

Political shifts—highlighted by 36 gubernatorial elections—add a secondary layer of uncertainty. Platforms centered on expanded social spending or broader policy ambitions may further pressure operating budgets already challenged by reduced federal inflows. While this political noise will not affect all issuers equally, it is likely to widen dispersion and create pockets of mispricing across the GO market.

Diminishing federal support is becoming a defining factor for the municipal market in 2026, creating downstream volatility for many state and local governments. As federal aid—pandemic-related or otherwise—recedes, budget pressures intensify, leaving governments with fewer resources to manage rising costs, fund social programs, and maintain financial flexibility. These strains fall most heavily on general obligation (GO) credits in our view, where policymakers must navigate competing priorities within increasingly constrained budgets.

2

INVESTMENT GRADE CURVE POSITIONING DRIVES RETURNS IN 2026

In 2025, the municipal yield curve normalized from significant steepening (Source: Bloomberg), leaving the 12-22 year segment particularly attractive. Regardless of where interest rates ultimately move, we believe the best relative value in Investment Grade municipals resides in this area. In our observation, persistent demand from SMA and passive strategies has compressed valuations from 10 years and in on the curve, pushing investors toward the outer limits of their comfort zones in search of incremental yield. However, the structural constraints of these investment vehicles ultimately cap their ability to extend further, leaving the most compelling relative value firmly in the hands of flexible, unconstrained managers operating in less crowded portions of the curve.

The structure of the Investment Grade municipal curve remains one of the most important return drivers for 2026. New issuance patterns should concentrate in shorter and intermediate maturities as issuers seek to capitalize on rich valuations created by SMA and ETF demand. This technical imbalance reinforces valuation compression in the front and belly of the curve and further supports deliberate positioning in the longer end, where superior valuation, favorable rolldown potential, and improved forward return characteristics create a meaningful performance advantage.

3

DISPERSION OF HIGH YIELD MUNI FUND RETURNS PUTS ONUS ON CREDIT SELECTION VS INCOME

Yield isn't everything in High Yield. For those solely focused on the "yield" portion of total returns, it is important to note that income is only one leg of the total return stool, and yield alone is an insufficient guide—particularly as dispersion across high yield fund returns, already evident in 2025, is poised to widen further in 2026. Idiosyncratic credit risks are increasingly driving outcomes and putting price appreciation at risk, especially as several high-profile credit events approach key inflection points. In this environment, capital preservation, volatility management, and the avoidance of permanent impairment are just as critical as income generation.

Emphasizing liquidity, transparency, and proactive downside risk management—while avoiding the more esoteric risks embedded in lower-quality or project-finance-driven credits—allows investors to capture incremental spread without assuming disproportionate volatility. Success in 2026 will depend on disciplined credit research, proactive surveillance, and targeted, thoughtful risk-taking where compensation is clear and measurable.

4

INTERMEDIATE TAXABLE MUNICIPALS ELEVATE MULTI-ASSET PORTFOLIOS

Having outperformed the Bloomberg Aggregate Fixed Income index in 8 of the last 10 years (Source: Bloomberg), we believe intermediate taxable municipals can strengthen the return profiles of "core"-focused fixed income portfolios. For multi-asset allocators, taxable munis provide an under-recognized source of yield, diversification, and credit resilience that historically have weathered volatility shocks across fixed income markets.

We expect these benefits to prove particularly prominent when compared with US corporate bonds in 2026, as an oncoming wave of corporate supply could lead to deteriorating technicals as well as negative ratings migration in that asset class. An allocation to taxable munis, which offer greater credit quality stability and a more favorable supply-demand dynamic, is likely to gird multi-asset portfolios against these

	<p>potential detractors. Rising international interest should only add to this relief by supporting deeper liquidity and tighter spreads.</p>
<p>5</p> <p>COMPLEMENT PASSIVE SMA EXPOSURE BY ADDING MORE FLEXIBLE PRODUCTS</p>	<p>Passive SMAs have several structural constraints that prevent them from accessing some of the most attractively priced segments of the municipal market. Not only does this reality represent foregone opportunities and exposure to less attractive positions, but it also leaves demand imbalances that increase the relative value of the securities and tactics that these vehicles pass over. That alpha need not be left uncaptured; adding allocations to managers that have greater flexibility can complete the return picture. Areas such as AMT bonds, electric and natural-gas prepay, and housing securities remain underrepresented in passive portfolios—not due to credit concerns, but because passive methodologies are not equipped to analyze their structural complexity or variable cash flows. Active managers, by contrast, can target these overlooked areas while also managing positions to proactively capture structural advantages brought by shifting markets.</p>

Source: Bloomberg

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The Bloomberg Aggregate Bond Index, or "Agg," is a critical benchmark for the U.S. investment-grade bond market, reflecting over \$50 trillion in fixed-income securities. It includes U.S. Treasurys, high-grade corporate bonds, and other investment-grade assets. While it offers a comprehensive view, it excludes high-yield and certain municipal bonds.