

Municipal Fixed Income Commentary

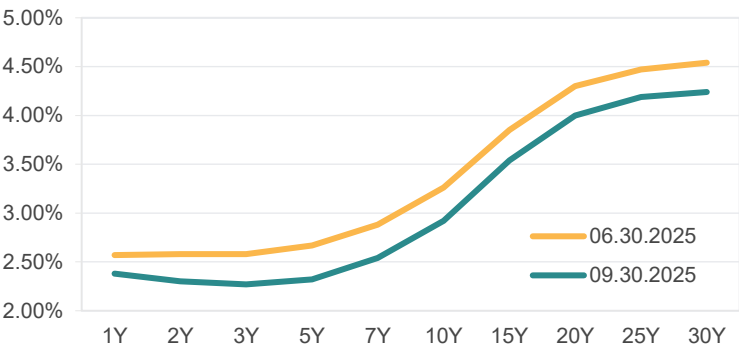
3rd Quarter 2025

In the third quarter, municipal bonds navigated persistent fiscal and monetary policy uncertainty to ultimately deliver strong performance as yields consistently moved lower during the quarter. The ICE BofA 1-10 Year Municipal Securities Index posted a total return of 2.27% and outperformed duration-matched U.S. Treasuries by 99 basis points (bps). Elevated municipal new issue supply paired with resilient economic data at the beginning of the quarter pressured longer maturities higher, with municipal-to-treasury ratios reaching 77% in the 10-year and 96% in the 30-year at their peak levels, creating attractive entry points. As softer data emerged and expectations for the Federal Reserve (Fed) easing gained traction, investors capitalized on these levels, sparking a sustained rally and driving ratios to 71% and 90%, respectively, to end the quarter. Market sentiment was further supported by the passage of the One Big Beautiful Bill Act (OBBBA) on July 4, which removed the overhang of potential tax-exemption risk for municipals and stoked demand.

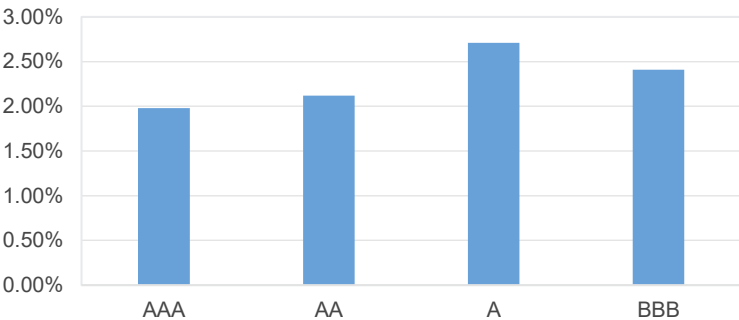
Primary market activity remained elevated at approximately \$150B, an 8% increase from the same period last year, bringing year-to-date issuance to roughly \$428B - up 14% year-over-year. Secondary market activity remained elevated, with bid-wanted activity averaging 1.1B in par value per day according to Bloomberg. This robust supply was met with strong reinvestment demand amid over \$130B in redemptions and 10 weeks of mutual-fund inflows totaling over \$11B during the quarter according to Lipper data, reflecting the market's seasonally enhanced demand during the summer months. The two-year to 10-year yield differential, which steepened to a five-year high of 104 bps through August, flattened over 40 bps in September as the Fed delivered its first 25-bps rate cut since 2024 and investors extended duration exposure, ending the quarter with a decisive re-flattening. The 10-year AAA benchmark finished the quarter at 2.92%, roughly in line with its trailing 12-month average.

Municipal credit returns were broadly positive in the third quarter, with performance favoring lower-rated credits amid tightening spreads and robust demand. Within the 1-10 Year Index, A-rated bonds led returns at 2.72%, followed by BBBs at 2.42%, AAs at 2.14%, and AAAs at 1.99%. Revenue-backed sectors such as airports, hospitals, and the prepaid gas and prepaid electric sector outperformed; in particular, gas and electric prepaids posted total returns of 3.13% and 3.82%, respectively, benefiting from option-adjusted spread (OAS) tightening of roughly 22 bps. The passage of the OBBBA provided an additional tailwind for bonds subject to the Alternative Minimum Tax (AMT), primarily in the airport sector, where spreads tightened by 11 bps as the legislation permanently limited AMT applicability for most taxpayers. Among individual issuers, Los Angeles Department of Water and Power (LADWP) was a standout performer with OAS tightening 28 bps to 15 bps, rebounding from wildfire-related weakness earlier in the year.

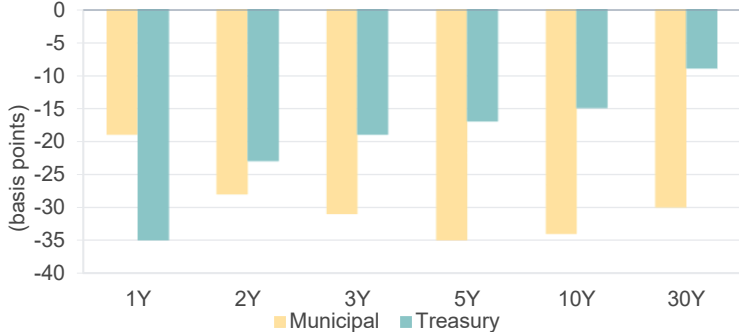
Refinitiv AAA Municipal Yields



3Q25 Total Return % by Rating Category



3Q25 Change in Rates



Data is as of 09.30.2025. Textual data source: Bloomberg L.P. Chart data sources: Bloomberg L.P.; U.S. Treasury; Refinitiv. Charts are for illustrative purposes only. Yields are subject to market conditions and are therefore expected to fluctuate. The views expressed represent opinions of Sterling Capital Management. Any type of investing involves risk and there are no guarantees that these methods will be successful. This information must be read in conjunction with the important disclosures and definitions on page 3.



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Credit fundamentals remained broadly stable during the quarter. While Moody's reported that downgrades outpaced upgrades for the first time since 2020 in 2Q25, much of this activity stemmed from the U.S. sovereign rating downgrade from Aaa to Aa1 in May, which had secondary effects on housing finance agencies and other entities with federally backed collateral. Excluding those sovereign-related adjustments, rating actions were more balanced in our view. According to U.S. Census Bureau data, seasonally adjusted state and local tax collections increased by nearly 5% year-over-year, led by continued strength in individual and corporate income taxes alongside steady gains in sales and gross receipts. Transportation Security Administration data also highlighted sustained economic activity, with average daily passenger throughput of 2.59MM, up 1.1% year-over-year. Meanwhile, public pension systems posted returns between 10% and 11% according to Moody's data, exceeding annual targets for a third consecutive year and contributing to reduced net pension liabilities and lower fixed-cost pressures. Underscoring the supportive credit environment, Connecticut received dual upgrades from Fitch and Moody's, New Jersey was upgraded by S&P, Maine earned an upgrade from Fitch, and Illinois received a positive outlook from Moody's, all reflecting prudent financial management and strengthened reserves.

Our View

Amid the Fed's effort to support the labor market while remaining cautious about the inflationary implications of tariffs, we expect real growth to moderate to 1.5% in 2025, unemployment to rise to 4.5%, and core personal consumption expenditures (CPCE) inflation to run at 2.9%. With growth and inflation data continuing to send mixed signals, we anticipate further steepening in the yield curve as the market shifts its focus from inflation concerns to broader macro risks, including trade policy dynamics and their downstream impact on employment.

Within this context, we are positioned neutral on duration and remain bulleted to benefit from ongoing curve steepening. We remain constructive on cyclical sectors such as airports and ports, supported by strong balance sheets, despite our expectation of a slowing economy and continued policy uncertainty. We also look to take advantage of any headline-driven volatility to add more risk exposure selectively, focusing on stable-to-improving names in the context of still-supportive economic fundamentals. While we anticipate the continuation of a robust issuance environment, we believe investor demand will remain strong. Just as experienced in the second quarter, we view a sustained rise in yields as a likely catalyst for renewed demand, particularly from long-term investors seeking tax-exempt income at more attractive entry points.

Important Information & Disclosures

Past performance is not indicative of future results. Any type of investing involves risk and there are no guarantees that these methods will be successful. Economic charts are provided for illustrative purposes only. The information provided herein is subject to market conditions and is therefore expected to fluctuate.

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The volatility of an index varies greatly. All indices are unmanaged and investments cannot be made directly in an index.

The ICE BofA 1-10Y Municipal Securities Index is a subset of the ICE BofA U.S. Municipal Securities Index including all securities with a remaining term to final maturity less than 10 years.

Refinitiv Municipal Market Monitor (MMD) AAA benchmark: The Municipal Market Monitor has been delivering the municipal market’s MMD AAA benchmark for over 30 years and is integrated into the most comprehensive source of critical municipal market information.

Technical Terms:

The Alternative Minimum Tax (AMT) is a parallel federal tax system designed to ensure that certain higher-income individuals pay a minimum level of tax.

BPS = basis points.

Core personal consumption expenditures (CPCE) is a measure of inflation that excludes volatile food and energy prices to provide a clearer view of underlying, long-term inflation trends. It tracks price changes for goods and services purchased by consumers in the U.S. and is a key indicator used by the Federal Reserve to guide monetary policy.

One Big Beautiful Bill Act (OBBBA) is a U.S. federal statute passed by the 119th United States Congress containing tax and spending policies that form the core of President Donald Trump’s second-term agenda. The bill was signed into law by President Trump on July 4, 2025.

Option-Adjusted Spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is then adjusted to take into account an embedded option. Typically, an analyst uses Treasury yields for the risk-free rate. The spread is added to the fixed-income security price to make the risk-free bond price the same as the bond.