Municipal Fixed Income Commentary

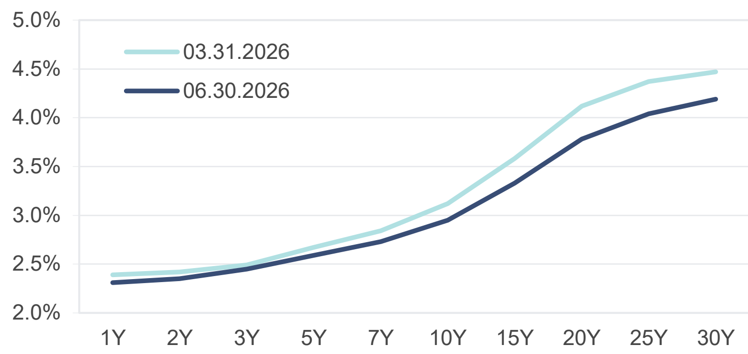
2Q 2026

Despite ongoing macroeconomic uncertainty centered on geopolitical developments and an uncertain path for Federal Reserve (Fed) monetary policy, municipal yields proved resilient, supported by a strong seasonal reinvestment backdrop and steady investor demand. Following the sharp sell-off in March, municipal bonds rallied steadily throughout the quarter as fund inflows remained positive and investors deployed capital into a market offering attractive tax-adjusted yields. The ICE BofA 1-10 Year U.S. Municipal Securities Index returned 1.25% for the quarter, outperforming duration-matched U.S. Treasuries by 84 basis points (bps).

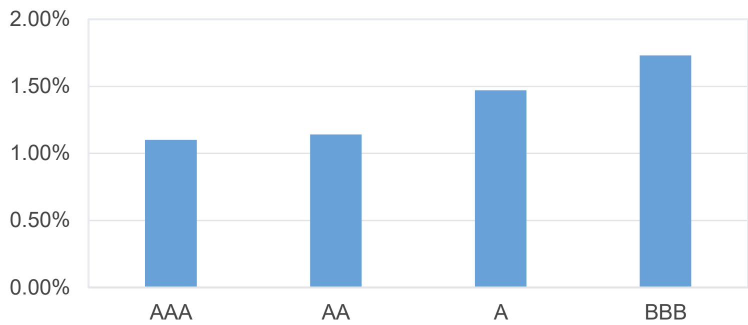
Primary market activity accelerated meaningfully during the quarter, with new issuance increasing over 26% from the first quarter to approximately $163B, an increase of approximately 2% from the same period last year. Despite the elevated supply, deals appeared to be well received, with repricing to lower yields a common occurrence as strong demand absorbed the added volume. Lipper reported positive municipal fund flows in all but one week of the quarter, totaling over $12B, coupled with approximately $119B in proceeds from maturing and called bonds fueling reinvestment demand. Bid wanted activity remained supportive of the technical backdrop, averaging $987MM in daily par value posted to Bloomberg. Yields declined across the curve over the quarter, led by the long end, with 2-year, 5-year, 10-year, and 30-year yields falling 7, 8, 17, and 28 bps, respectively, resulting in modest curve flattening. Municipal-to-treasury ratios moved decidedly lower as a result, with the 2-year ratio ending the quarter at 57% and the 10-year at 67%, both running below their 12-month, 3-year, and 5-year averages and reflecting richer municipal valuations relative to treasuries across historical measures.

Overall, credit markets remained largely stable throughout the quarter, extending the trend from the first quarter, with limited spread dispersion and broad-based positive performance across sectors. Amid this stable environment, lower quality bonds outperformed. BBB-rated bonds generated a total return of 1.73% and A-rated bonds returned 1.47%, both outpacing higher quality AA-rated and AAA-rated bonds, which returned 1.14% and 1.10%, respectively. Spread sector performance reflected a similar risk-on tone, with revenue-backed sectors outperforming. Prepaid gas and electric bonds stood out, generating total returns of 1.58% and 1.87%, respectively. Option-adjusted spreads (OAS) in the sector also tightened modestly, reflecting continued investor demand following the issuer- specific volatility experienced earlier in the year. More defensive areas of the market, including local general obligation bonds and refunded bonds, trailed the broader rally, though returns remained positive at 0.98% and 0.88%, respectively.

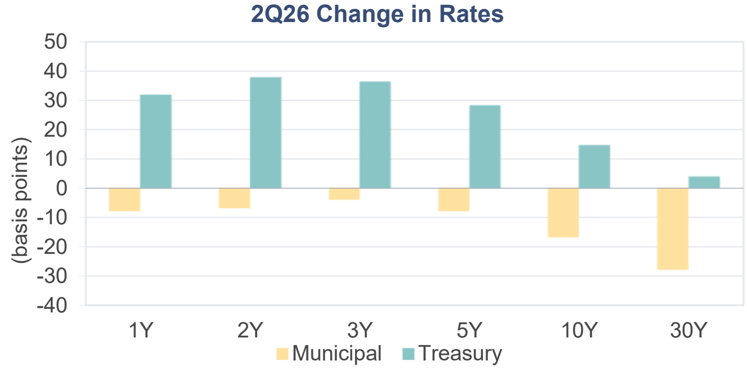
Refinitiv AAA Municipal Yields



2Q26 Total Return % by Rating Category



2Q26 Change in Rates



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Municipal credit fundamentals remained broadly firm during the quarter, supporting the stable credit environment. Moody's reported that upgrades outpaced downgrades for the second consecutive quarter in 2026, citing employment strength, stable tax bases, and conservative fiscal management as key credit strengths across the sector. The National Association of State Budget Officers (NASBO) affirmed the stable fiscal landscape in their Spring Fiscal Survey of States, reporting that state tax collections remained on a positive trajectory, increasing 4.9% in fiscal 2025, with 29 states reporting revenues above forecasts. The positive environment fueled expansion of state reserves, with rainy day funds reaching a record $191B in fiscal year 2025. As a result, states and local governments with strong reserves, improving pension positions, and demonstrated financial flexibility, including the state of Hawaii, the state of Kansas, and the city of Atlanta, Georgia, received positive rating actions during the quarter. At the same time, issuer-specific credit challenges continued to emerge, with the city of New Orleans and the state of Washington experiencing downgrades and negative outlook revisions tied to structural budget imbalances, declining reserves, and governance concerns.

Our View

We entered the quarter with municipal valuations at attractive levels following the geopolitically fueled market volatility in March. We utilized the higher yields to gradually extend portfolio durations in anticipation of a favorable technical backdrop and heightened demand. As we enter the third quarter, we continue to maintain a bulleted curve positioning coupled with long relative duration. We expect the positive technical picture to persist through the balance of the summer, with approximately $117B in bond redemptions anticipated through September potentially providing a supportive backdrop for municipal performance. We remain constructive on municipal credit fundamentals overall and continue to believe credit conditions reflect a market where broad fundamental strength coexists with pockets of idiosyncratic pressure, rather than systemic deterioration. Looking ahead, we expect new issue supply to remain elevated and anticipate that continued strong investor demand could absorb that supply. Within this environment, we continue to look for opportunities to allocate into lower-rated, more cyclical sectors for additional yield, and continue to favor prepaid gas and electric bonds in particular, given their solid credit fundamentals and attractive yields.

Data is as of 06.30.2026. Textual data sources: Bloomberg L.P.; U.S. Census Bureau; National Association of State Budget Officers (NASBO). 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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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:

BPS = basis points.

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.

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