

Municipal Fixed Income Commentary

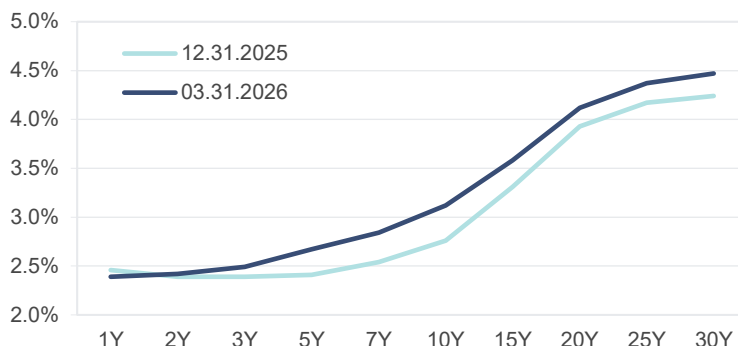
1Q 2026

The municipal market began 2026 on a bifurcated note, as exogenous factors disrupted otherwise steady internal market conditions. In the first two months of the quarter, the ICE BofA 1-10 Year U.S. Municipal Securities Index returned 1.80% supported by favorable seasonal technicals and strong investor demand. Market sentiment shifted abruptly in March, however, as rising geopolitical risk and heightened global rate volatility triggered the largest monthly municipal sell-off since Spring 2025. Yields moved higher across the curve, reversing earlier gains and leaving returns modestly negative for the quarter. The index declined 1.98% in the final month, bringing the full-quarter return to -0.22% and resulting in underperformance versus U.S. Treasuries of 37 basis points (bps).

While primary market activity remained robust throughout the quarter, it was readily absorbed. Issuance totaled approximately \$129B, representing an increase of approximately 8% compared to the same period in 2025. Counterbalancing the elevated supply, Lipper reported that municipal fund flows were positive for the first 11 consecutive weeks of the year, frequently exceeding \$1B per week, underscoring the strength of the technical backdrop. Bid wanted activity further contributed to the favorable technical environment with an average of \$960MM in daily par value, a decline from \$1.1B in the matching period year-over-year and \$976MM in the prior quarter. Yield-curve dynamics were a separate defining feature of the quarter, evolving meaningfully across distinct phases. January and February were characterized by a curve steepening, as heavy reinvestment demand amidst stable Federal Reserve expectations drove 2-year municipal-to-treasury ratios to 57%, the lowest level of the quarter. Then as the Iranian conflict ensued in late February, heightened volatility and elevated selling pressure pushed yields higher across the curve, particularly in intermediate and long maturities. Over the full quarter, Refinitiv AAA 2-year to 10-year spread differential steepened by approximately 33 bps, with 10-year yields driving much of the move. Ratios ended at 64% for the 2-year and 72% for the 10-year, within a percentage point for each metric of the market averages over the past five years.

Overall, credit markets were relatively stable throughout the quarter, with limited dispersion and incremental spread tightening in select sectors offsetting the broader rates-driven weakness in total returns. BBB-rated bonds generated a total return of 0.17%, outperforming higher-quality counterparts, while A-, AA-, and AAA-rated securities returned -0.15%, -0.23%, and -0.38%, respectively, reflecting the longer-duration and resulting greater rate sensitivity of higher-quality bonds during the March sell-off. Sector performance exhibited

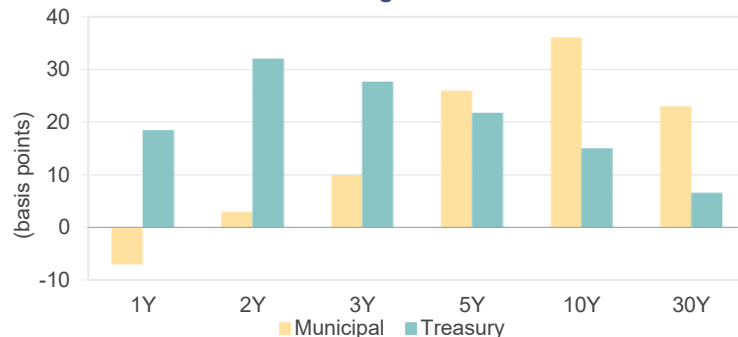
Refinitiv AAA Municipal Yields



1Q26 Total Return % by Rating Category



1Q26 Change in Rates



Data is as of 03.31.2026. 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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a modest risk-on bias beneath the surface, with spread-oriented sectors such as transportation outperforming more defensive areas such as general obligation and essential service revenue bonds. Option-adjusted spread (OAS) movements were generally contained across the market. Prepaid gas and electric bonds tightened by approximately 7 bps to close at 106 bps and the Metropolitan Transportation Authority (MTA) saw spreads compress by 13 bps to finish at 20 bps, reflecting resilient investor demand despite elevated volatility. Notably, performance within the prepaid sector was heavily segmented reflecting issuer-specific spread widening linked to private-credit concerns.

Municipal credit fundamentals remained generally sound during the first quarter, though rating agency activity showed a modest tilt toward negative actions. S&P reported that downgrades outpaced upgrades during the first two months of the year, driven primarily by issuer-specific factors rather than signs of systemic credit deterioration. Pressure remained concentrated within select sectors, particularly local governments and not-for-profit healthcare, where rising labor costs, ongoing capital needs, and post-pandemic revenue normalization continued to challenge operating margins. In contrast, state-level credit quality remained a key source of stability, supported by strong reserve positions and conservative fiscal management. According to the National Association of State Budget Officers, the median rainy day fund balance as a percentage of spending is expected to increase to 14.4% in fiscal 2026. Looking ahead, most of the fiscal year 2027 budget proposals reflect prudent growth assumptions alongside a continued emphasis on maintaining elevated reserve levels, positioning states to navigate a more uncertain macroeconomic environment.

Our View

We exited the first quarter with municipal valuations more balanced, volatility elevated, and the forward return profile improved relative to the start of the year. While technical conditions were favorable early in the quarter, March's repricing has created more favorable entry points, particularly in intermediate maturities where the market has reset most decisively. We remain constructive on municipal credit fundamentals overall and view the recent market weakness as principally rate-driven rather than credit-led. Looking ahead, we expect new issuance supply to remain elevated in the second quarter but anticipate continued strong investor demand to absorb supply. We enter the second quarter maintaining a bulleted curve positioning and neutral relative duration but following the curve steepening and reset of municipal yields higher, we see opportunities to selectively add duration during periods of continued volatility. We remain focused on credits with durable fundamentals and continue looking for opportunities to selectively allocate into lower-rated sectors and credits where compensation for risk remains attractive. As market conditions stabilize, we anticipate the combination of improved yields, normalized ratios, and supportive demand to provide a constructive backdrop for municipal performance over the remainder of the year.

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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.