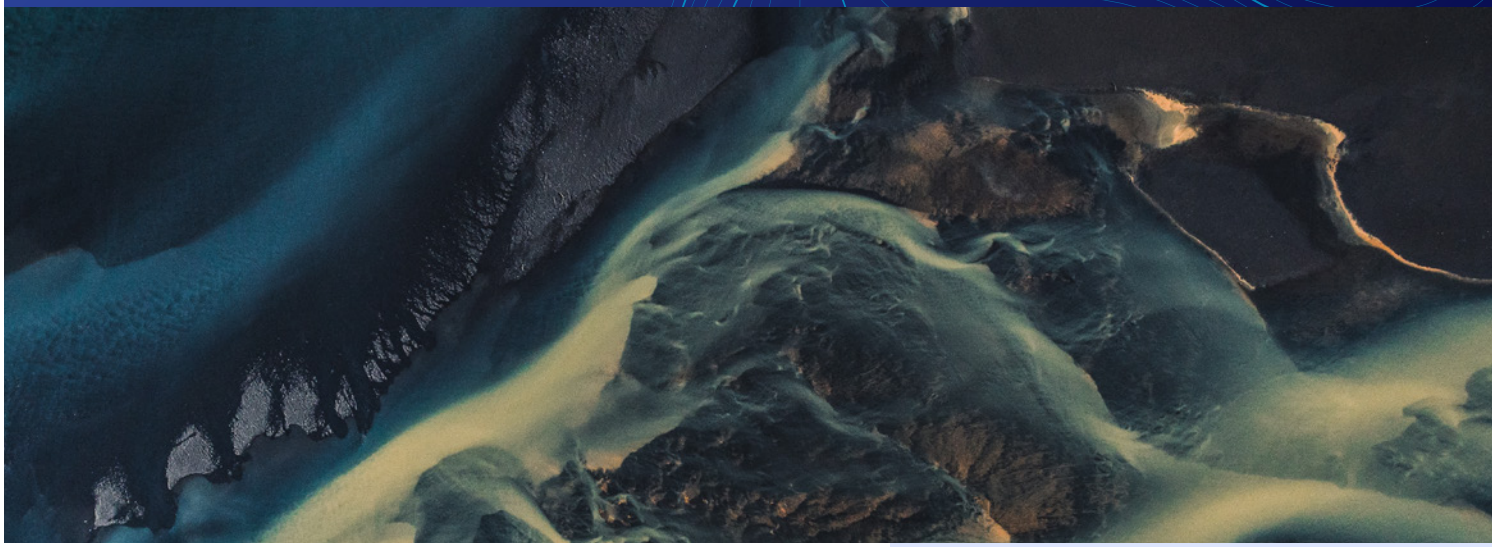
First Eagle Investments

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Insights



3Q26 Municipal Bond Market Overview

The third quarter was a rough one for fixed income, and municipal bonds were no exception.

Tax-exempt yields moved sharply higher across the yield curve in third quarter, even more so than Treasury yields. The S&P Municipal Bond High Yield Index fell 5.9% in the third quarter, outperforming the 6.4% loss of the S&P Municipal Yield Index, which includes bonds across the quality spectrum. The S&P Short Duration Municipal Yield Index declined only 3.4% during a period in which duration was punished. For context, the Bloomberg US Aggregate Bond Index declined 3.5% during the period.[1]

Inflation and Fed tightening drove this selloff as renewed conflict with Iran pushed oil above $100 a barrel as resilient growth and persistent inflation prompted a September rate hike and expectations for further tightening.[2] Meanwhile, issuer fundamentals remain healthy, which we believe has strengthened the muni opportunity set in the face of higher yields.

KEY TAKEAWAYS

- Munis underperformed during the third quarter as Treasury yields moved sharply higher across the curve. High yield and shorter-duration municipal bonds held up comparatively better.
- Renewed conflict with Iran pushed oil above $100 a barrel, while resilient growth and persistent inflation prompted a September rate hike and expectations for further tightening.
- Record supply was met with mixed demand as year-to-date issuance reached a third consecutive annual record as municipal bond mutual funds experienced outflows while exchanged-traded fund issuance was robust throughout the quarter.
- Credit fundamentals continue to be supportive, which we believe have strengthened the muni opportunity set in the face of higher yields.

1. Source: FactSet; data as of September 30, 2026.
2. Source: Bloomberg; data as of September 30, 2026.

Rising Rates Tell the Story

After a strong first half of 2026, municipal bonds entered the third quarter somewhat richly valued compared to taxable alternatives, and this proved to be an additional challenge to performance during a sharp selloff in rates.

Treasury yields moved sharply higher across the curve. The 10-year Treasury yield traded 85 basis points higher to finish the quarter at 5.3%, while the 30-year advanced 73 basis points to 5.6%. The increase in muni bond yields was even more pronounced; based on the BVAL AAA Callable Municipal Curve, the 10-year climbed 124 basis points to 4.1% and the 30-year moved 112 basis points higher to 5.2%.[3] None of these levels have been seen consistently since before the global financial crisis.

Already elevated macroeconomic uncertainty increased further over the past few months, as a resurgence in the Iran war pushed Brent crude oil back above $100/barrel and intensified the inflation pressures facing policymakers worldwide.

The rhetoric of Federal Reserve Chair Warsh grew increasingly hawkish, and the Federal Open Market Committee made good on his words in mid-September by voting unanimously to raise the federal funds target rate by 25 basis points to a range of 3.75–4.00%. Notably, Warsh in his comments characterized the rate increase as removing "a dose of accommodation," suggesting he views current policy settings as at least somewhat stimulative. The dot plot of policymaker forecasts points to one more rate hike in 2026 and none in 2027. However, a hot September consumer price index (CPI) report—core inflation of 3.7% driven by a 20.4% increase in the energy component—prompted futures markets to expect more aggressive action; futures pricing reflects four more hikes over the next 12 months.[4]

The Fed's ability to focus on the price-stability component of its dual mandate has been assisted by a resilient economy. After limited growth in fourth quarter 2025, US real gross domestic product (GDP) accelerated in the first half of 2026, with the economy expanding at a rate of 2.5% and 2.2% in the first and second quarters, respectively, driven by business investment and consumer spending.[5] High-frequency data suggest economic momentum has picked up of late, and the Atlanta Fed GDPNow model estimates growth of 3.6% in the third quarter.[6]

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Muni Issuance Continues at Record Pace

Despite rising yields, muni bond issuance is on track to establish a third consecutive annual record in 2026. Year-to-date issuance of $467 billion exceeds the $442 billion of issuance in the first three quarters of 2025 and is on pace to exceed $600 billion for the first time.[7]

One notable aspect of issuance throughout 2026 has been the prevalence of pre-paid gas bonds, which are issued to finance the upfront purchase of energy supplies by municipal utilities; year-to-date issuance of $33 billion already exceeds that of full-year 2025. While these bonds typically have a 30-year maturity, most newer issues are structured with mandatory tender dates at five to seven years.

3. Source: Municipal Securities Rulemaking Board; data as of September 30, 2026.
4. Source: *The Wall Street Journal*; data as of October 14, 2026.
5. Source: US Bureau of Economic Analysis; data as of September 30, 2026.
6. Source: Federal Reserve Bank of Atlanta; data as of October 8, 2026.
7. Source: Municipal Securities Rulemaking Board; data as of September 30, 2026.

Demand for muni bonds was bifurcated during the quarter, softening in mutual funds but remaining very strong in exchange-traded funds (ETFs). After inflows of $16 billion in each of the first two quarters of the year, tax-exempt mutual funds saw outflows of $4.3 billion in the third quarter. September was particularly weak, which is not an unusual seasonal phenomenon. Municipal bond ETF issuance, in contrast, was robust throughout the quarter, and the $55 billion in ETF net issuance year to date already exceeds 2025's full-year record of $46 billion.[8]

Demand for muni bonds was bifurcated during the quarter, softening in mutual funds but remaining very strong in ETFs.

Meanwhile, issuer fundamentals continue to be generally supportive amid a backdrop of decent economic growth. Though state general fund revenue has fallen off the record pace of fiscal 2021 and 2022, it has continued to grow. Most states that have released data publicly ended fiscal 2026 with above-forecast revenue. Fiscal 2026 collections are on track to exceed original estimates, driven by better-than-expected personal income tax receipts and growing sales tax collections. Modest revenue gains are expected in fiscal 2027, which would reflect the fifth consecutive year of expansion. Recommended budgets for fiscal 2027 suggest flat general fund spending next year, and most states plan to continue bolstering their rainy-day funds—many of which are already at nominal highs—in anticipation of future needs.[9]

Though muni bond ratings downgrades exceeded upgrades in the third quarter, favorable revisions outpaced unfavorable ones. Further, 96% of S&P Global's municipal rating universe carries a stable or positive outlook.

8. Source: Municipal Securities Rulemaking Board; data as of October 6, 2026.
9. Source: National Association of State Budget Officers; data as of August 6, 2026.

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Past performance is not indicative of future results.

Risks

All investments involve the risk of loss of principal.

Investments in bonds are subject to interest-rate risk and can lose principal value when interest rates rise, while they typically increase their principal values when interest rates decline. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner, or that negative perception of the issuer's ability to make such payments may cause the price of that bond to decline.

Municipal bonds are subject to credit risk, interest rate risk, liquidity risk and call risk. However, the obligations of some municipal issuers may not be enforceable through the exercise of traditional creditors' rights. The reorganization under federal bankruptcy laws of a municipal bond issuer may result in the bonds being cancelled without payment or repaid only in part, or in delays in collecting principal and interest.

The information is not intended to provide and should not be relied on for accounting or tax advice. Any tax information presented is not intended to constitute an analysis of all tax considerations.

10-year Treasury yield is the interest rate paid on a US Treasury bond with a maturity of 10 years upon issuance.

30-year Treasury yield is the interest rate paid on a US Treasury bond with a maturity of 30 years upon issuance.

AAA credit rating—as used by S&P Global Ratings and Fitch Ratings—is an investment grade rating on a bond considered to have an extremely strong capacity to meet its financial commitments. The equivalent rating from Moody's Investors Service is Aaa.

BVAL AAA Callable Curve is a benchmark yield curve that tracks high-quality, tax-exempt US municipal bonds rated AAA using noncallable bond yields through year 10 and callable bond yields thereafter.

A **credit rating** is an assessment provided by a nationally recognized statistical rating organization (NRSRO) of credit worthiness of an issuer with respect to debt obligations, including specific securities, money market instruments, or other bonds. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice. Not Rated (NR) indicates that the debtor was not rated and should not be interpreted as indicating low quality.

Exchange-traded funds (ETF) are listed investment vehicles that seek to provide exposure to a benchmark, index or actively managed strategy.

Federal funds rate is the interest rate at which depository institutions (banks and credit unions) lend reserve balances to other depository institutions overnight on an uncollateralized basis.

Gross domestic product (GDP) measures the total value of all economic output in goods and services for an economy.

GDPNow is a running estimate of real GDP growth based on available economic data maintained by the Federal Reserve Bank of Atlanta. It is not an official forecast of the Atlanta Fed.

High yield municipal bonds are debt securities issued by states, cities, counties and other public entities that offer a higher rate of interest due to their perceived higher risk of default.

S&P Global Ratings is a nationally recognized statistical rating organization (NRSRO) that assesses the creditworthiness of an issuer with respect to debt obligations, including specific securities, money market instruments, or other bonds. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice. Not Rated (NR) indicates that the debtor was not rated and should not be interpreted as indicating low quality. For more information on the S&P Global Ratings' methodology, please visit spglobal.com and select "Understanding Credit Ratings" under About Ratings.

A **separately managed account (SMA)** is a portfolio of securities that is managed by a professional investment firm.

Taxable equivalent yield (TEY) reflects the pretax yield that a taxable fixed-income investment would need to offer to produce the same after-tax yield as tax-exempt security. The TEY shown is calculated based on the most common federal tax bracket(s).

A **yield curve** is a graphical representation of interest rates on debt of equal credit quality across a range of maturities.

Bloomberg US Aggregate Bond Index (Gross/Total) measures the performance of the investment grade, US dollar-denominated, fixed-rate taxable bond market in the US, including Treasuries, government-related and corporate securities, fixed-rate agency MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS. A total-return index tracks price changes and reinvestment of distribution income.

Consumer price index (CPI) (Price) measures inflation as experienced by consumers in their day-to-day living expenses by capturing the average change over time in the prices paid for a representative basket of consumer goods and services. A price-return index only measures price changes.

S&P Municipal Bond High Yield Index (Gross/Total) measures the performance of bonds in the S&P Municipal Bond Index that are not rated or whose ratings are below investment grade. A total-return index tracks price changes and reinvestment of distribution income.

S&P Municipal Yield Index (Gross/Total) measures the performance of high yield and investment grade municipal bonds. A total-return index tracks price changes and reinvestment of distribution income.

S&P Short Duration Municipal Yield Index (Gross/Total) measures the performance of high yield and investment grade municipal bonds with maturities of one to 12 years. A total-return index tracks price changes and reinvestment of distribution income.

Indexes are unmanaged and do not incur management fees or other operating expenses. One cannot invest directly in an index.

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