MetLife Investment Management



FIXED INCOME | AUGUST 2026

Municipals Market Review and Outlook

Q2 2026

	6/30/2026	3/31/2026	2Q 2026 change
10-Year U.S. Treasury Yields	4.47%	4.32%	0.15%
30-Year U.S. Treasury Yields	4.95%	4.91%	0.04%
Bloomberg Taxable Muni Index OAS (bps)	49	50	-1
Bloomberg Taxable Muni Index YTW	5.12%	4.97%	0.15%
Bloomberg US Corporate Index OAS (bps)	74	89	-15
Quarterly Taxable Municipal Issuance ($B)	$13.0	$6.1	113%

Source: Bloomberg LP as of June 30, 2026.

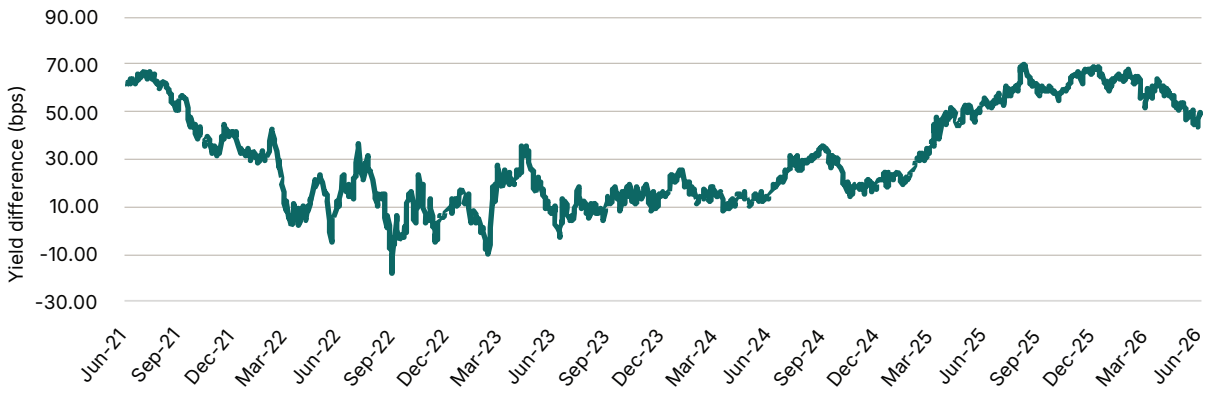
As with previous quarters, the investment landscape in the second quarter included various economic and geopolitical risks that collectively did very little to derail fixed income markets, including taxable municipals. The option-adjusted spread (OAS) for the Bloomberg Eligible Taxable Municipal index finished the second quarter at 67 basis points (bps)–three bps tighter in the quarter and just one bp from the all-time tights. The market shrugged off persistent inflation, the war with Iran, AI disruption, elevated deficits, erratic policy and a number of other factors that in most other environments would likely have pressured risk appetites. Not so this time. The key variable that seems to be driving investment flows and spreads is yields. The yield on the Bloomberg Taxable Municipal index ended the quarter at 5.12%, which corresponds to the 87th percentile over a 10-year period. As interest rates drifted higher across the curve in the quarter, the powerful demand for investment grade (IG) assets at yields over 5% continued to compress spreads. The index OAS closed the quarter at the 1st percentile over the last 10 years. Those offsetting factors–higher rates and tighter spreads–led to modestly positive total returns. The Taxable Municipal index posted a total return of 0.73% in the second quarter.[1]

The bear flattening of the Treasury curve was a meaningful driver of performance for taxable municipals in the second quarter. Yields on the 5-, 10- and 30-year Treasury increased by 0.27%, 0.15%, and 0.04%, respectively. This caused the 10s/30s curve to drift lower, landing at 49 bps as of June 30, which is 18 bps lower, year to date. The curve twist is evident in the performance of the index by duration bucket. The shortest 0-5-year duration fared the worst, with a return of 0.37%, while the longest duration 10-20-year bucket performed the best, with a return of 1.41%. The intermediate bucket returned 0.64%, ranking right in the middle. By credit quality, there was a clear correlation between ratings and returns–the higher the rating, the lower the return. BBBs had the best performance, with a total return of 0.97%. Every other rating category moving up the rating ladder from there had incrementally weaker returns, namely As (0.82%), AAs (0.73%) and AAAs (0.57%). With the caveat that BBBs represent only 2.6% of the Bloomberg Taxable Municipal index, the pattern of returns by credit quality makes sense in an environment of stable spreads because the lower rating categories have incrementally wider spreads, which boosted returns from carry. For example, as of June 30, index BBBs had an index OAS of 145 bps, while the OAS for As, Aas and AAAs was 64 bps, 46 bps and 30 bps, respectively. The outperformance by lower quality also aligns with the fact that AAAs have the shortest duration (6.97), while BBBs have the longest (7.76). This fits with the dynamics of the flatter Treasury curve, in which the yield of the 5-year Treasury increased by more than the yield on the 10-year and 30-year Treasury, respectively.[1]

Shifting to tax-exempts, the asset class continued to perform admirably in the second quarter, despite record tax-exempt issuance through midyear and higher rates across the curve. These are the exact conditions that historically have often been associated with outflows and pressure on valuations. This time, it has been the exact opposite. Performance is solid; fund inflows through June 30 are the second highest on record, and ratios are well below medium- and long-term averages, which suggest lofty valuations. Before we attempt to explain how or why, let's look at the numbers. The broad tax-exempt Bloomberg Municipal Bond index (MBINDEX) returned 2.50% in the quarter. The shorter 5-year (4-6) index returned 1.07%. In both cases, tax-exempts outperformed the taxable index. As of June 30, the ratio of the BVAL AAA tax-exempt yield relative to the Treasury yield on the corresponding maturity was lower than the 3-year average ratio at each of the 5-, 10- and 30-year points on the curve, by an average of 4.1 percentage points. Using a 10-year look back, current ratios appear even richer, by a lot. Current ratios are lower than the 10-year average by 15, 17 and 12 percentage points at the 5-, 10- and 30-year points on the curve, respectively. To put this in context, as of June 30, the yield on the BVAL AAA tax-exempt curve at the 10-year point would have to increase by 74 bps to match the average ratio over the last 10 years. On this basis, tax-exempts appear rich–quite rich. But they also appeared rich last quarter and at the beginning of the year. And yet, they performed quite well throughout this period. Why? We suggest that it's for the same reason that spreads are compressed in taxable municipals and IG corporates: yields.[1]

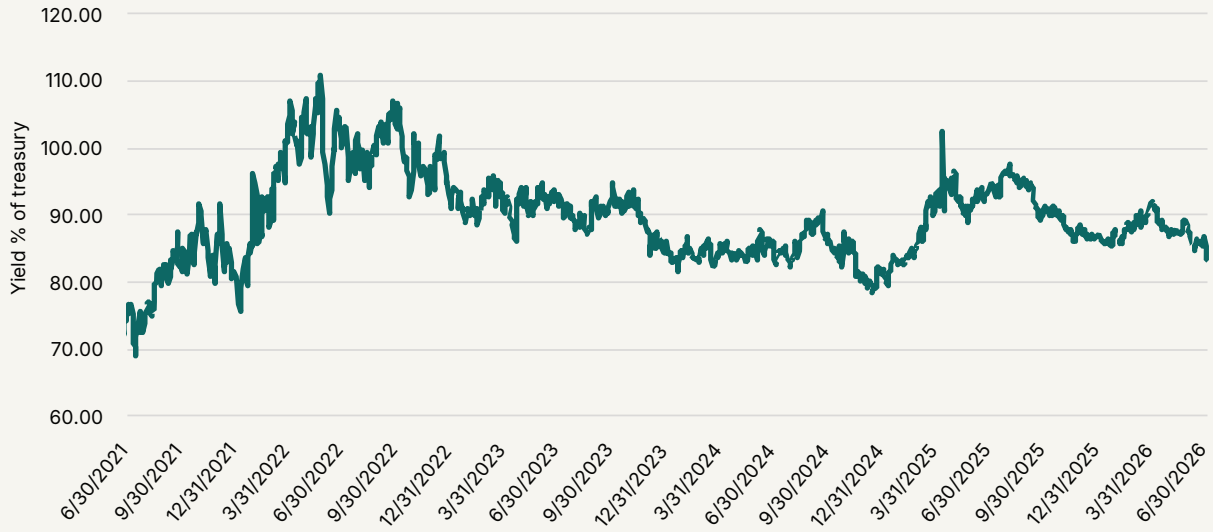
Stretched valuations are not unique to tax-exempt municipals. As previously noted, the OAS on the Bloomberg Taxable Municipal was at the first percentile as of June 30, while IG corporate spreads were at the third percentile. The key difference between these asset classes is the buyer base. IG corporates and taxable municipals are purchased overwhelmingly by institutional investors, whereas tax-exempt municipals cater overwhelmingly to retail investors. We have often noted that when the traditional retail investor is the marginal buyer setting prices (and by extension, yields) in the tax-exempt market, it's just not a fair fight for the institutional investor subject to corporate tax rates. The tax advantage of the retail investor is simply too great. Such has been the case, year to date. Let's consider the value proposition of tax-exempt yields at different points on the curve from the perspectives of both the retail investor2 and the institutional investor. On June 30, the BVAL AAA tax-exempt yields in 5, 10 and 30 years were 2.69%, 3.10% and 4.28%, respectively. Let's further assume a fixed spread of 0.15% on hypothetical generic AA-rated securities with a standard 5% coupon and a 10-year par call, if applicable. From the perspective of the institutional investor subject to a 21% corporate tax rate, those tax-exempt yields gross up to 3.59%, 4.11% and 5.61% in 5, 10 and 30 years, respectively. In 5 and 10 years–which are right in the sweet spot for retail investors–the taxable equivalent yields (TEYs) are 64 bps and 36 bps below the respective Treasury yields. Why would an institutional investor buy tax-exempts that gross up to less than Treasuries, let alone spread assets like taxable municipals or IG corporates? Generally, they're not. It's retail that's buying. From a retail perspective, at a combined federal and state income tax rate of 42%, the TEYs are far more attractive. For this buyer, the TEYs in 5, 10 and 30 years are 4.90%, 5.60% and 7.64%, respectively–all significantly higher than the respective Treasury yields (by 67 bps, 113 bps and 269 bps, specifically). That alone goes a long way to explain why tax-exempt valuations appear stretched. From the retail investor's perspective, tax-exempts are still more attractive than most alternatives on a taxable-equivalent basis, and that's even before considering the generally higher-quality and lower-volatility characteristics of investment-grade tax-exempt municipals. The flip side is that for now, the institutional investor is effectively priced out of the market, except maybe at the very long end of the curve.[1]

Figure 1 | Treasury curve: 10s/30s



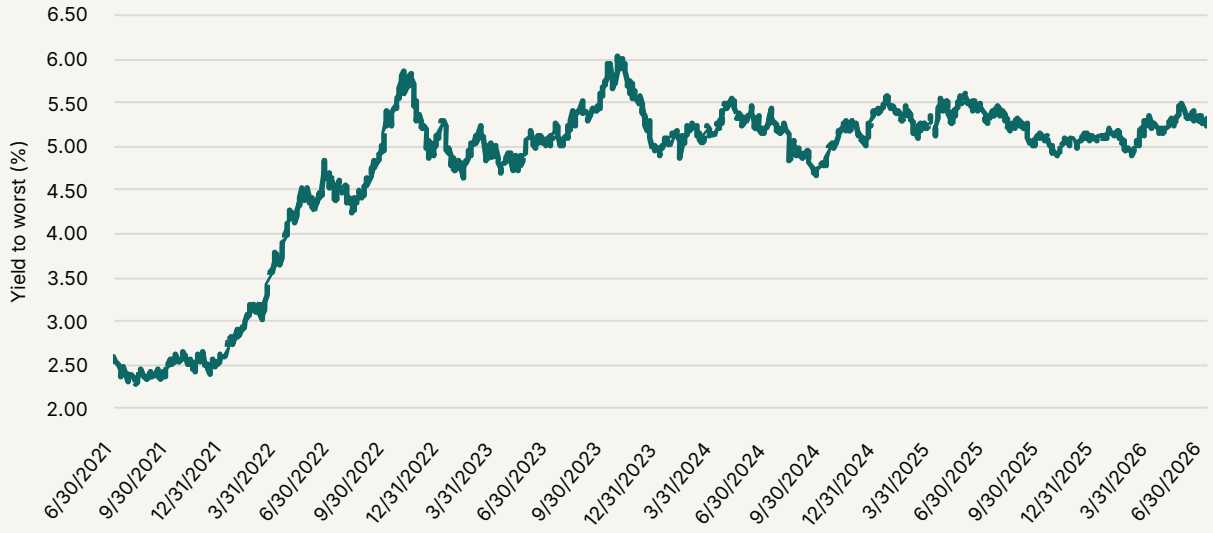
Source: Bloomberg, J.P. Morgan as of June 30, 2026

Figure 2 | BVAL AAA muni yield % of treasury 30-year



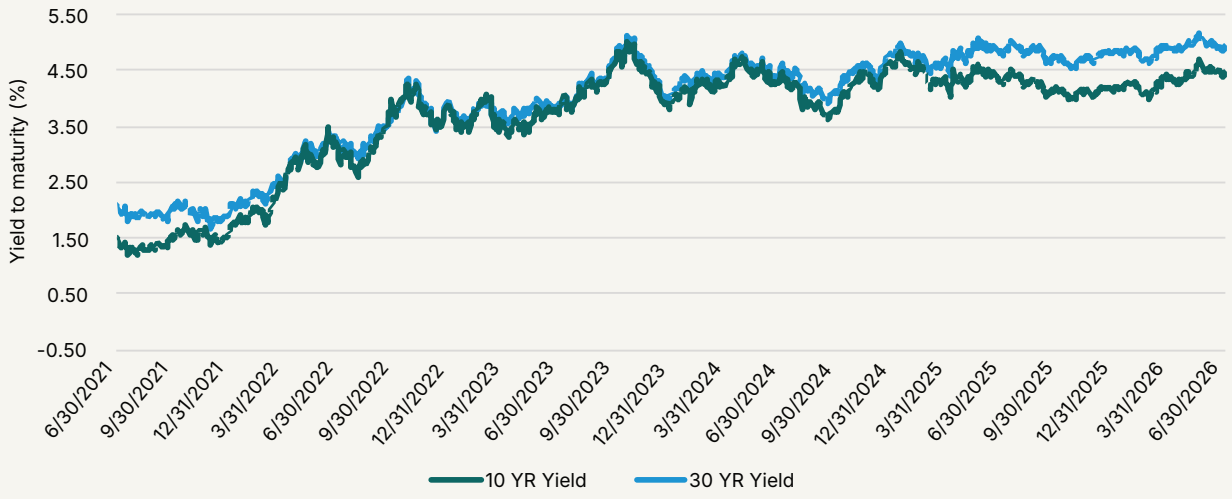
Source: Bloomberg as of June 30, 2026

Figure 3 | Yield on Bloomberg aggregate–eligible taxable municipal index



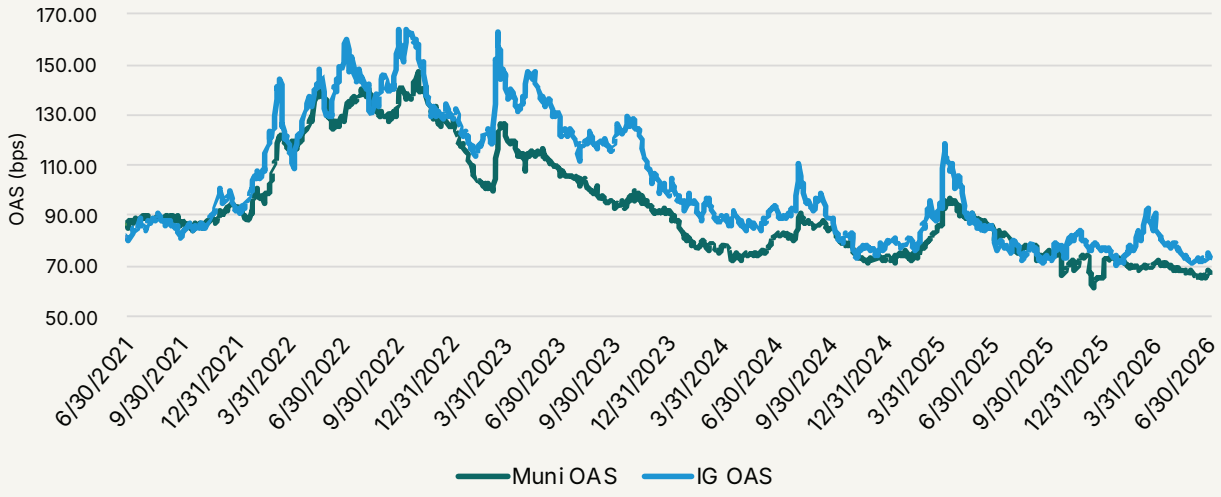
Source: Bloomberg as of June 30, 2026

Figure 4 | 10-year and 30-year treasury yields



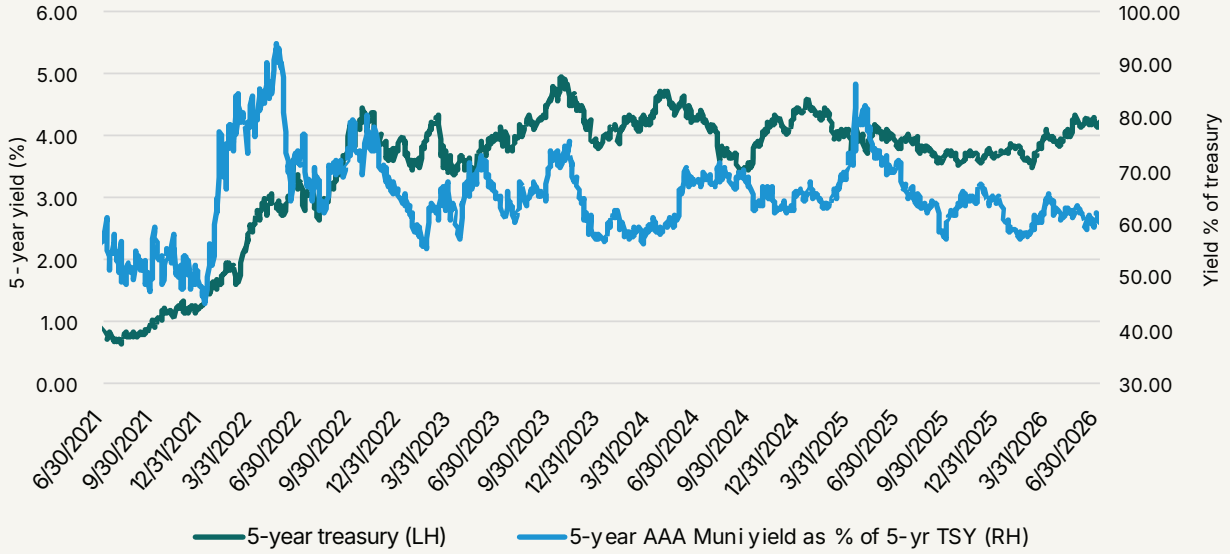
Source: Bloomberg as of June 30, 2026

Figure 5 | Taxable municipal spreads vs. IG corporates



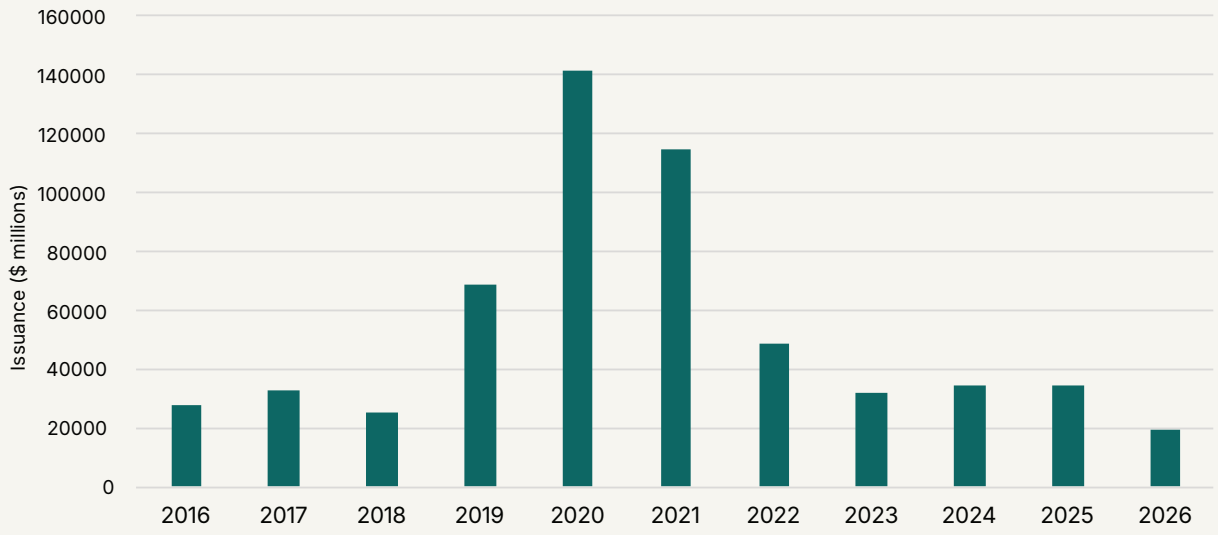
Source: Bloomberg as of June 30, 2026

Figure 6 | 5-year treasury vs. 5-year AAA municipal ratio



Source: Bloomberg as of June 30, 2026

Figure 7 | Taxable municipal issuance YTD



Source: Bloomberg as of June 30, 2026

OUTLOOK

The narrow trading range in taxable municipal spreads has largely persisted, reflecting the same balance between supply, yields and fundamentals that we highlighted last quarter. Taxable municipal valuations remain near historically tight levels, supported by limited net issuance, attractive absolute yields and strong underlying credit quality. While current spread levels leave little room for further tightening, the obvious catalysts that could push spreads wider (IG supply, oil prices, inflation, rates, deficits, geopolitics, labor market indicators, etc.) have been largely dismissed by markets so far. Accordingly, our baseline expectation is that spreads will continue to trade in a relatively narrow range through the third quarter.

The primary sources of volatility remain external to the municipal market. Interest-rate expectations, driven by the path of inflation, economic growth and Federal Reserve policy, are likely to have a greater impact on returns than spread movements. In addition, continued heavy investment-grade corporate issuance, particularly from hyperscalers funding AI-related infrastructure, could create relative-value pressure should taxable municipal supply increase meaningfully. For now, however, the municipal market continues to benefit from favorable technical conditions.

Given compressed spreads, we continue to favor a defensive approach rather than reaching for incremental yield through lower-quality, less-liquid or more complex structures. We prefer larger, more liquid issues from issuers with strong fundamentals, predictable cash flows and limited optionality risk. In our view, investors are receiving little compensation today for assuming additional liquidity or structural risk, and those areas could underperform if market conditions become less supportive.

In tax-exempts, we see limited upside from currently stretched valuations. However, favorable summer technicals should keep any downside relatively limited absent a sharp move in rates. In light of the dominant retail presence in the market, as evidenced by the near record inflows, we see little opportunity in tax-exempts for institutional investors subject to corporate tax rates.

[1] Information in this paragraph sourced from Bloomberg LP.

[2] For simplicity, we assume that the retail investor is a high-income individual subject to the 37% federal personal income tax rate and the average of the top marginal state personal income tax rate of 5%.

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