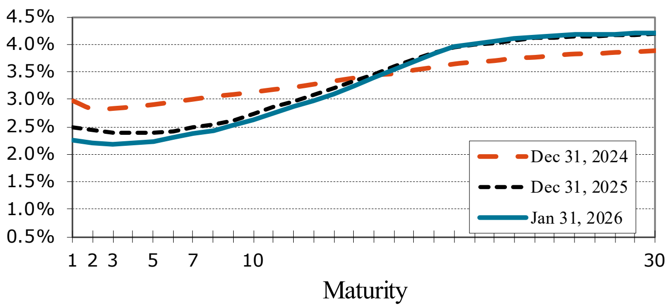
Baird Advisors
Municipal Fixed Income Market Commentary
January 2026

Curve Steepens and Tax-Exempt Yields Fall Amid Strong Demand

Tax-exempt yields declined to start the year, and the municipal curve continued to steepen. 2yr rates fell 22 bps, 10yr yields eased 11 bps, and the 30-year *rose* 2 bps. The 2s30s AAA curve slope ended January at +199 bps—24 bps steeper for the month. Performance in January was strong, supported by a classic "January Effect," as robust reinvestment demand from principal and interest payments met manageable net supply. Municipals outperformed Treasuries supported by strong investor interest, with tax-free mutual funds and ETFs seeing $6.4B of net inflows during the month. New-issue tax-exempt supply totaled a healthy $33B, down 3% from January 2025, when issuers accelerated deals amid uncertainty surrounding proposed changes to the OBBB tax bill and potential implications for the municipal tax exemption. Street forecasts for full-year 2026 issuance remain in the ~$600B range, and we expect supply to continue building from here. Looking ahead, the market should remain well supported with a record $40.2B of February principal and interest payments providing an additional boost to market demand.

AAA Municipal Yields



Maturity	12/31/24	9/30/25	12/31/25	1/31/26	1Mo Chg
1	2.97%	2.30%	2.49%	2.25%	-0.24%
2	2.82%	2.27%	2.44%	2.22%	-0.22%
3	2.83%	2.25%	2.38%	2.19%	-0.19%
5	2.90%	2.31%	2.39%	2.24%	-0.15%
7	3.00%	2.54%	2.50%	2.38%	-0.12%
10	3.13%	2.92%	2.73%	2.62%	-0.11%
30	3.87%	4.30%	4.19%	4.21%	0.02%

Growth in Prepay Gas

Prepay gas issuance has outpaced the growth of the broader municipal market. This sector allows municipal utility issuers to secure long-term natural gas supplies at a discount. These transactions are supported by a corporate counterparty that guarantees the debt, benefiting both sides: the municipal issuer receives cheaper gas, and the corporate issuer gains access to lower-cost, tax-exempt financing relative to traditional corporate bond financing yields. When the structure first emerged, most deals were guaranteed by large U.S. money-center banks and broker-dealers such as JPMorgan and Morgan Stanley. Since then, the market has broadened to include insurers like Pacific Life with additional corporate participants expected. The sector has grown from just under 2% of the broad municipal index in 2019 to just over 5% as of December 31, 2025. One driver of the sector's popularity is deal size—typically around $1 billion—offering scale, liquidity, and regular market making. Most are issued with put or maturity dates 10 years or less, a curve segment where sourcing wide spreads and issuance can be more difficult. While corporate-backed issuance has long existed within the municipal market, the sector's rapid growth and increased index weight introduces more corporate credit risk into traditional municipal portfolios than ever before. Investors should remain mindful that solid credit research and diversification of individual corporate counterparties underlying these transactions are key to success in the sector. We expect prepay gas issuance to continue increasing as these deals gain traction beyond mutual funds and ETFs and reach more individual and retail SMA buyers.

Positive Returns to Start 2026

January returns were positive to start the year as yields fell across most of the curve. Although short rates fell the most, the intermediate part of the curve delivered the strongest performance. Revenue bonds outperformed both GOs and Prerefunded debt to begin the year. Across the quality spectrum, returns amongst IG rating buckets were similar, with A-rated issues slightly outperforming other rating categories. IG and HY performed relatively in line, with HY having a slight edge.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Bloomberg Index/Sector	2025	January	*Duration*	Bloomberg Quality	2025	January	*Duration*
Municipal Bond Index	4.25%	0.94%	*6.77*	AAA	4.25%	0.90%	*6.99*
General Obligation bonds	4.31%	0.92%	*6.37*	AA	4.21%	0.93%	*6.63*
Revenue bonds	4.21%	0.95%	*6.97*	A	4.35%	0.98%	*6.76*
Prerefunded bonds	4.02%	0.74%	*2.63*	BBB	4.13%	0.94%	*7.60*
Long maturities (22+ yrs.)	1.95%	0.50%	*11.49*	High Yield	2.46%	0.98%	*7.74*
Intermediate maturities (1 - 17 yrs.)	5.18%	1.06%	*4.87*	HY, ex-Puerto Rico	2.48%	0.79%	*7.72*
Short maturities (1 - 5 yrs.)	4.11%	0.78%	*2.36*				

Disclosures

Fixed income is generally considered to be a more conservative investment than stocks, but bonds and other fixed income investments still carry a variety of risks such as interest rate risk, credit risk, inflation risk, and liquidity risk. In a rising interest rate environment, the value of fixed-income securities generally decline and conversely, in a falling interest rate environment, the value of fixed-income securities generally increase. High yield securities may be subject to heightened market, interest rate or credit risk and should not be purchased solely because of the stated yield.

The Bloomberg Municipal Bond Index is a broad-based, total-return index. The bonds are all investment-grade, tax-exempt, and fixed-rate securities with long-term maturities (greater than 2 years). They are selected from issues larger than $50 million. The components listed below the Municipal Bond Index (long maturities, intermediate maturities, short maturities, prefunded bonds, general obligation bonds and revenue bonds) are subsectors of the Bloomberg Municipal Bond Index and do not represent separate indices.

The Bloomberg High Yield Municipal Index includes bonds with a par value of at least $3 million and must be issued as part of a transaction of at least $20 million. The maximum rating for inclusion is Ba1/BB+/BB+ using the middle rating.

For more information about the Bloomberg Municipal Bond Index or Bloomberg High Yield Municipal Index, please visit https://index.barcap.com/Home/Guides_and_Factsheets.

Municipal securities investments are not appropriate for all investors, especially those taxed at lower rates. The alternative minimum tax (AMT) may be applicable, even for securities identified as tax exempt. Past performance is not a guarantee of future results.

Ratings are measured on a scale that ranges from AAA or Aaa (highest) to D or C (lowest). Investment grade investments are those rated from highest down to BBB- or Baa3.

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