

Municipal Bond Market Insight | August 2026

Setback or Setup?

Key takeaways

- » Municipal bonds remain in positive total return territory year-to-date, unlike Treasuries and corporates after July losses pressured fixed income across the board.
- » Record supply has not displaced resilient demand, with muni mutual fund inflows and seasonal reinvestment cash continuing to support the tax-exempt marketplace.
- » Intermediate and long municipal yields have again revisited rarefied air, creating a historically attractive entry point for appropriate investors seeking tax-exempt fixed income.
- » Fed communication under Chair Kevin Warsh may leave markets more data-dependent and volatile, reinforcing the value of disciplined curve positioning and active tax-aware implementation.

General market update

As the market mulls whether the current Fed climate represents a pause on the way toward lower rates or a pivot toward rate hikes, intermediate and long muni yields have again ascended to reach rarified air. Despite Bloomberg IG fixed income indices posting single-digit percentage losses for July, only munis remain positive year-to-date (YTD), which is impressive given heavier- than- average supply during what is usually a slower summer season.

While macro-driven volatility has become a staple of the 2026 market, muni demand has been meeting massive supply, and the asset class has held the lead IG fixed income position all year. With the second half well underway, the clock is ticking on improving year-to-date performance.

Meanwhile, geopolitical tensions and related military actions continue sporadically, as an enduring peace agreement remains elusive. Oil prices continue to ebb and flow, capturing investor attention and impacting fragile investor sentiment regarding inflation expectations. Recently struck-down tariffs have re-emerged, but the newer lower levies have thus far failed to dominate the headlines. In the foreground of the bond markets sits new Fed Chair Kevin Warsh. Having presided over two FOMC meetings, he continues to transition toward what appears to be a Fed that's less communicative and in favor of having the marketplace draw its own conclusions from incoming data.

Muni bonds gave back 185 basis points (bps) in July, reducing the YTD total return to positive 0.43%. U.S. Treasurys lost 111bps to land at a total return of negative 0.84%, and U.S. corporates surrendered 167 bps to arrive at a total return of negative 0.83%.

Supply and demand

New issuance slowed in July from last year's record pace, but the moderation should be viewed in context. According to The Bond Buyer on August 3, primary market supply was approximately \$45 billion, down 19.8% year over year. Even with the decline, July volume eclipsed the 10-year average and ranked as the third-highest July, behind only 2025 and 2020. Likely contributing to the lighter month was the FOMC meeting during the final week of July and fiscal year-end distractions for many states.

Figure 1: Fixed income returns as of July 31, 2026

	MTD return	YTD return
Bloomberg Muni Index	-1.85%	0.43%
Bloomberg US Treasury Index	-1.11%	-0.84%
Bloomberg US Aggregate Index	-1.3%	-0.69%
Bloomberg US Corporate Index	-1.67%	-0.83%

Source: Bloomberg, 7/31/2026. For illustrative purposes only. It is not possible to invest directly in an index.

Past performance is no guarantee of future results.

Figure 2: AAA municipal yields as of July 31, 2026

Year	Current	MTD change	YTD change
2-year	2.63%	27 bps	24 bps
5-year	2.91%	30 bps	50 bps
10-year	3.37%	42 bps	61 bps
30-year	4.51%	30 bps	27 bps

Source: Thomson Reuters Municipal Market Data, 7/31/2026. For illustrative purposes only. Not a recommendation to buy or sell any security.

Past performance is no guarantee of future results.

Figure 3: US Treasury yields as of July 31, 2026

Year	Current	MTD change	YTD change
2-year	4.29%	11 bps	83 bps
5-year	4.45%	22 bps	76 bps
10-year	4.74%	27 bps	60 bps
30-year	5.27%	31 bps	45 bps

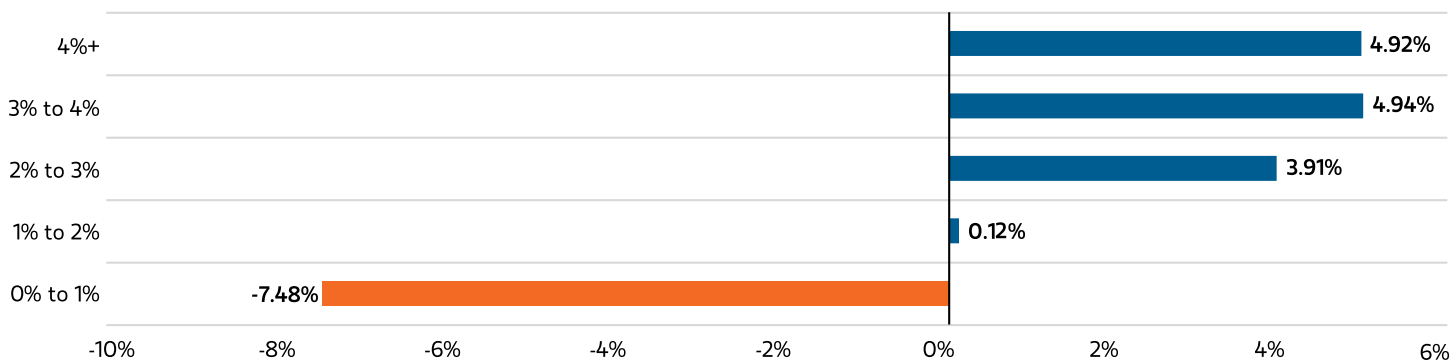
Source: Bloomberg, 7/31/2026. For illustrative purposes only. Not a recommendation to buy or sell any security.

Past performance is no guarantee of future results.

DISPLAY 1

Average Index 12-Month Forward Returns

Starting yields and forward index returns based on daily values for the last 25 years.



Source: Bloomberg Municipal Bond Index, as of 5/19/2026. For illustrative purposes only. It is not possible to invest directly in an index. **Past performance is no guarantee of future results.**

The slower pace in July placed year-to-date issuance through month's end at \$342.8 billion¹, essentially flat versus the same period last year.

State-level issuance remains concentrated. California leads the market year to date with \$51.1 billion, followed by Texas at \$40.4 billion and New York at \$32.9 billion.¹ Rounding out the top 10 states were Florida, Massachusetts, Alabama, Pennsylvania, Illinois, Washington and Connecticut. This reinforces a recurring theme in the muni market that broad national supply can be heavy, while local availability varies and certain state-specific scarcity endures.

August opened with a very strong showing, as the primary calendar kicked off the first week with over \$18 billion² entering a largely receptive market. Outsized reinvestment needs from August 1 bond maturities, called bonds and coupon payments rank among the top three months of the year.

Also assisting liquidity were year- to- date mutual fund inflows that have been robust and positive for 15 consecutive weeks through July 29th. At \$59 billion according to Lipper/JP Morgan, these inflows are running at the second-highest YTD pace on record.

Market opportunity

Intermediate and long muni yields revisited YTD highs in late July and were maintained into the first week of August. Prevailing 20-year maturity benchmark yields during the opening days of August were higher than 90% of the time over the last two decades, according to Bloomberg data. While the fixed income selloff experienced in July erased almost all the prior YTD return for the second time this year,

the muni market was able to retain its leadership position, as well as a minimally positive return, which was not the case for U.S. Treasuries and U.S. IG corporates.

Is this a setback toward an enduring higher-rate regime, or is it a setup for improved future returns? We believe the latter. To see what muni history says about entry points, please see the accompanying "Starting Yields Matter" visual, which employs Bloomberg data. For appropriate clients, consider the intermediate and long parts of the municipal curve. Intermediate municipals can serve as a core allocation for clients seeking tax-efficient income with moderate interest rate sensitivity. Longer- term municipals remain attractive for clients with longer time horizons, but extensions should be framed as locking in yield and income-driven, not as a tactical bet on near-term Fed cuts.

Historically, higher initial yields have been associated with stronger 12-month forward return outcomes, while very low starting yield environments have provided less income cushion and weaker forward return profiles. That history does not remove near-term volatility, but it supports a constructive view for investors with an appropriate investment horizon to lock in elevated tax-exempt yields.

The July selloff therefore looks less like a reason to exit the muni asset class and more like a renewed opportunity to reassess positioning with an eye toward prudently extending duration. Intermediate maturities can still function as a core allocation for tax-sensitive investors, while longer maturities may be appropriate for clients with sufficient risk tolerance, longer time horizons and a focus on durable after-tax income.

¹ Source: The Bond Buyer, as of 08/04/2026

² Source: Iperio, as of 07/31/2026

Where we see opportunity:

- Extending selectively into intermediate and long municipal maturities where yields remain historically elevated and steep yield curve compensation remains meaningful.
- Framing longer-duration allocations as income-locking opportunities rather than tactical bets on near-term Fed easing.
- Using professional management to navigate uneven supply, liquidity differences and, state-specific scarcity, and to leverage year-round market dislocations for tax- loss harvesting, where appropriate.
- Deploying tax-aware fixed income implementation inside 10-year maturities, including Tax-Optimized Ladder strategies, where munis, Treasurys and corporates compete on an after-tax basis.

Economic outlook

The FOMC meeting in July resulted in no change in monetary policy, as widely expected. Little additional color was offered during the accompanying press conference. Chair Warsh's apparent desire to offer less communication harkens back to the days of former Fed Chair Alan Greenspan, when the market was left to itself to crunch incoming economic data and decipher Fed intent. Future meetings and potentially less frequent and less granular messaging from the Fed could be very interesting in future months while the markets acclimate to this new Fed regime. Is the Fed now truly data-dependent?. Only time will tell, and we expect some related volatility.

Speaking of data dependency, the market received its first major economic release after the July FOMC meeting in the July Employment Situation Report, which was released the morning of August 7. The data revealed a loss of 23,000 jobs versus expectations for an 80,000 gain, and the unemployment rate edged lower to 4.1% versus expectations for an unchanged 4.2%. Average hourly earnings growth came in at 0.1% month-over-month versus expectations for 0.3%, which eased the year-over-year change to 3.2% versus expectations for 3.5% growth. The report was weaker than anticipated generally, but there were seasonal factors and possibly post-World Cup impacts that played a role. The market will now likely focus its attention on the upcoming Core CPI and Core PCE data releases.

Key economic data

Change in nonfarm payrolls (July.)	-23K
Unemployment rate (July)	4.1%
Core CPI-YoY change (June)	2.6%
Core PCE-YoY change (June)	3.3%
Average hourly earnings-YoY change (July)	3.2%
Real GDP annualized (2Qs)	1.5%

Source: Bloomberg, 7/31/2026

While disinflation appears to be the trend, it's seemingly not returning to the Fed's 2% inflation target in a timely fashion, as dictated and defined by the Fed itself. This highlights the question of the Fed's patience in waiting for inflation growth to recede to an acceptable or desirable level, a question that may also be impacted by the Fed's ongoing need for credibility in the marketplace.

For muni investors, a less explicit Fed may be a source of intermittent volatility, but that volatility may also be a repeated source of opportunity this year. Elevated starting yields can create a larger income cushion than investors had for much of the last decade, while resilient demand and continued reinvestment needs remain constructive technical supports. In our view, the setback in July may represent a setup for better forward return potential if yields stabilize or drift lower over the next 12 to 18 months.

The prevailing yields in tax-exempts continue to offer attractive after-tax income and meaningful diversification benefits in an unsettled market environment. The value proposition remains grounded in historically compelling intermediate and long muni yields, a steep yield curve that still rewards selective extension and robust demand that has continued to absorb substantial supply. We continue to favor disciplined yield-curve positioning, prudent relative-value analysis and active tax-conscious implementation as core components of high-quality portfolio construction.

The question for August is whether July's weakness was a setback or a setup. In our view, the answer may depend less on an immediate Fed pivot and more on starting yields, reinvestment demand, investor patience, and, of course, economic data. It has been an interesting year thus far, and the summer remains consistent in one important respect: Tax-exempt value continues to be available for investors prepared to capture it thoughtfully.

ABOUT

Parametric Portfolio Associates® LLC ("Parametric"), headquartered in Seattle, is registered as an investment advisor with the US Securities and Exchange Commission under the Investment Advisers Act of 1940. Parametric is a leading global asset management firm, providing investment strategies and customized exposure management directly to institutional investors and indirectly to individual investors through financial intermediaries. Parametric offers a variety of rules-based investment strategies, including alpha-seeking equity, fixed income, alternative and options strategies. Parametric also offers implementation services, including customized equity, traditional overlay and centralized portfolio management. Parametric is part of Morgan Stanley Investment Management, the asset management division of Morgan Stanley, and offers these capabilities through offices located in Seattle, Boston, Minneapolis, New York and Westport, Connecticut.

DISCLOSURES

This material may not be reproduced, in whole or in part, without the written consent of Parametric. Parametric and its affiliates are not responsible for its use by other parties.

This information is intended solely to report on investment strategies and opportunities identified by Parametric. Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. We believe the information provided here is reliable but do not warrant its accuracy or completeness. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Past performance is not indicative of future results. The views and strategies described may not be suitable for all investors. Investing entails risks, and there can be no assurance that Parametric will achieve profits or avoid incurring losses. Parametric and Morgan Stanley do not provide legal, tax or accounting advice or services. Clients should consult with their own tax or legal advisor prior to entering into any transaction or strategy described herein.

Charts, graphs and other visual presentations and text information were derived from internal, proprietary or service vendor technology sources or may have been extracted from other firm databases. As a result, the tabulation of certain reports may not precisely match other published data. Data may have originated from various sources, including, but not limited to, Bloomberg, MSCI/Barra, FactSet or other systems and programs. Parametric makes no representation or endorsement concerning the accuracy or propriety of information received from any third party.

The views expressed in this report are those of the authors and are current only through the date stated at the top of this page. These views are subject to change at any time based on market or other conditions, and Parametric

disclaims any responsibility to update such views. These views may not be relied on as investment advice and, because investment decisions are based on many factors, may not be relied on as an indication of trading intent on behalf of any Parametric strategy. This commentary may contain statements that are not historical facts, referred to as "forward-looking statements." The strategy's actual future results may differ significantly from those stated in any forward-looking statement, depending on factors such as changes in securities or financial markets or general economic conditions.

References to specific securities and their issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, a recommendation to purchase or sell such securities. There is no guarantee as to its accuracy or completeness. Past performance is no guarantee of future results. All investments are subject to the risk of loss. Prospective investors should consult with a tax or legal advisor before making any investment decision.

The index data referenced herein is the property of ICE Data Indices, LLC ("ICE"), its affiliates and its third-party suppliers. ICE, its affiliates and its third-party suppliers accept no liability in connection with its use.

An imbalance in supply and demand in the income market may result in valuation uncertainties and greater volatility, less liquidity, widening credit spreads and a lack of price transparency in the market. As interest rates rise, the value of certain income investments is likely to decline. Investments in income securities may be affected by changes in the creditworthiness of the issuer and are subject to the risk of nonpayment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer's ability to make principal and interest payments. While certain US government-sponsored agencies may be chartered or sponsored by acts of Congress, their securities are neither issued nor guaranteed by the US Treasury. Mortgage- and asset-backed securities are subject to credit, interest rate, prepayment and extension risk. Derivative instruments can be used to take both long and short positions, be highly volatile, result in economic leverage (which can magnify losses) and involve risks in addition to the risks of the underlying instrument on which the derivative is based, such as counterparty, correlation and liquidity risk. Diversification does not guarantee profit or eliminate the risk of loss.

All contents ©2026 Parametric Portfolio Associates® LLC. All rights reserved. Parametric Portfolio Associates® and Parametric® are trademarks registered with the US Patent and Trademark Office and certain foreign jurisdictions.

Parametric is headquartered at 800 Fifth Avenue, Suite 2800, Seattle, WA 98104. For more information regarding Parametric and its investment strategies, or to request a copy of Parametric's Form ADV or a list of composites, contact us at 206 694 5500 or visit www.parametricportfolio.com.

NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT