

Muni Monthly

Performance Overview

Municipals Outperformed in January, Partially Reversing 2025 Underperformance

Fixed-income markets were volatile in January amid elevated geopolitical tensions and trade threats. Yields moved higher mid-month following tariff threats related to President Trump's effort to formally acquire Greenland, but ultimately eased as a framework with Europe was reached. Economic data was relatively steady and the labor market modestly softened as the unemployment rate increased slightly, offset by steady manufacturing data. The Federal Reserve kept rates steady, maintain the fed funds target rate range at 3.50%-3.75%.

The Treasury curve moved 3-5 basis points (bps) higher across the curve during the month. The high-grade municipal curve outperformed, with yields moving 13-20 bps lower in maturities inside of 20 years, and up to 5 bps higher in longer maturities. All told, the Bloomberg Municipal Bond Index returned 0.94%, outperforming the US Treasury and Corporate Indices which returned -0.09% and 0.18%, respectively, reversing some of the muni underperformance observed in 2025.

Exhibit 1: Municipal vs. Taxable Index Returns



Source: Bloomberg, Western Asset. As of 06 Feb 26.

Technicals

Muni Demand Accelerated as Supply Declined

Muni outperformance was supported by traditional "January Effect" conditions, a period of technical strength where heavy coupon and principal reinvestment coincides with limited new issuance. ICI estimates municipal funds and ETFs recorded \$13 billion of net inflows in January, the highest level since the market's \$120 billion major outflow cycle ended in early 2024. Meanwhile, monthly new-issue supply of \$35 billion was down 6% from January 2025 levels and down 44% from the recent highs observed in October 2025, further strengthening market technicals.

Exhibit 2: Muni Demand Has Risen to New Heights as Supply Declined



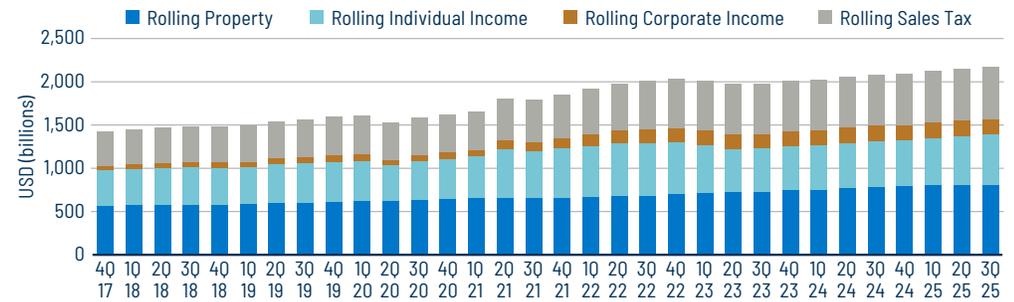
Source: Bloomberg, ICI, Western Asset. As of 31 Jan 26.

Fundamentals

Record Revenue Collections Support Muni Fundamentals

In January, the Census released 3Q25 state and local tax collection estimates, which were delayed due to the government shutdown, but underscored continued resilience for traditional state and local credit conditions. Twelve-month trailing collections increased 4.2% year-over-year (YoY) to \$2.2 trillion, marking a record high, according to Census data. On a 12-month trailing basis, individual income tax collections increased 8.6% YoY and sales tax collections increased 2.6%, while corporate income tax collections declined 3.6%. Twelve-month rolling property tax collections increased 4.2% YoY.

Exhibit 3: 12-Month Trailing State and Local Revenue Collections



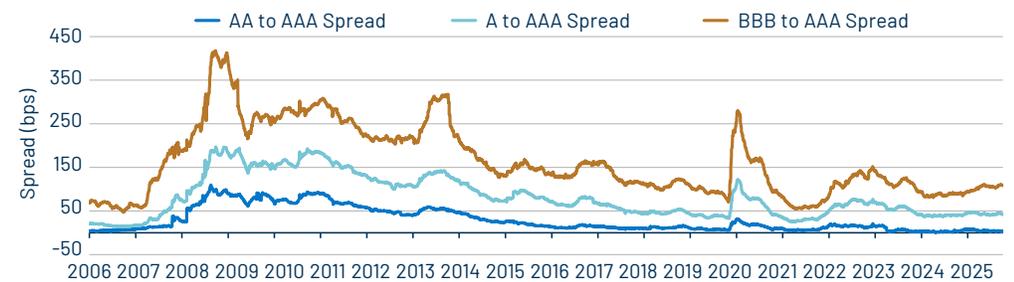
Source: Census, Western Asset. Major state and local tax revenue are not seasonally adjusted. As of 15 Jan 26.

Valuations

Muni Credit Spreads Remain Tight, Warranting Diligent Credit Selection

Despite municipal yields moving lower with the yields of other fixed-income asset classes over the past year, tax-exempt income opportunities remain attractive compared with historical averages. Municipals offer a compelling after-tax yield pickup versus taxable counterparts, a trend that could continue as we transition out of “January effect” conditions into a weaker technical environment ahead of tax season. Given that tax-exempt credit spreads remain at historically tight levels, Western Asset emphasizes that diligent credit selection is paramount. Western Asset believes that long-term investors may be well-served by potential income opportunities offered by any upcoming seasonal weakness.

Exhibit 4: Tax-Exempt Investment-Grade Quality Spreads



Source: Western Asset, Bloomberg. As of 06 Feb 26. Spreads represent the reference Bloomberg Quality Index YTW (Bloomberg AA Municipal Index, Bloomberg A Municipal Index, Bloomberg BBB Municipal Index) less the Bloomberg AAA Municipal Index YTW. Yield-to-worst (YTW) is the lowest potential yield that can be received on a bond without the issuer actually defaulting.

Munis and the Macro¹

	Prior Month (Revised From)	Consensus	Actual
GDP Annualized QoQ (2Q25)	4.30%	4.30%	4.40%
CPI YoY	2.70%	2.70%	2.70%
PCE	2.80%	2.70%	2.70%
Unemployment Rate	4.50%	4.50%	4.40%
Change in Nonfarm Payrolls	56k (64k)	70k	50k

Yield and Curve Changes - AAA Munis vs. Treasuries³

	2-Yr	5-Yr	10-Yr	30-Yr
1/30/2026				
AAA Muni	2.18%	2.24%	2.63%	4.29%
Treasury	3.52%	3.79%	4.24%	4.87%
M/T Ratio	62%	59%	62%	88%
Change				
Muni Δ (bps)	▼ -23	▼ -17	▼ -13	▲ 5
Treasury Δ (bps)	▲ 5	▲ 6	▲ 7	▲ 3
Ratio Δ (%)	▼ -8	▼ -6	▼ -4	▲ 1
10-Yr Average				
AAA Muni	1.58%	1.71%	2.09%	3%
Treasury	2.34%	2.46%	2.71%	3%
Ratio	67%	69%	77%	92%

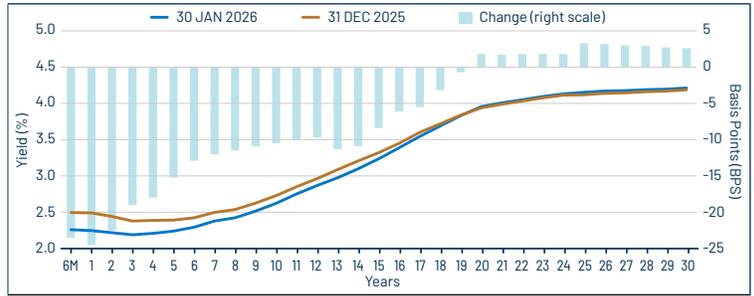
After-Tax Yield Pickup⁵

Quality/Maturity Segment	Muni YTW	Taxable Equivalent YTW	Taxable YTW	Taxable Equivalent Muni Yield Pickup	5-Yr Average
10-Yr AAA Munis vs Treasuries	2.60%	4.40%	4.24%	16	62
30Y AAA Muni vs Treasury	4.16%	7.02%	4.87%	215	178
AA Munis vs Corps	3.31%	5.59%	4.66%	93	81
A Munis vs Corps	3.72%	6.28%	4.71%	157	123
BBB Munis vs Corps	4.38%	7.40%	5.01%	239	167
HY Munis vs Corps	5.52%	9.33%	6.58%	274	123

Municipal Supply⁶

Year	\$B	Month	2025 Issuance	2026 Issuance	YoY	Calls/Maturities	Net
2018	356	January	37.1	35.0	-6%	-33.9	3.2
2019	449	February	39.6				
2020	496	March	43.4				
2021	488	April	52.8				
2022	375	May	53.7				
2023	366	June	58.4				
2024	500	July	56.6				
2025	588	August	49.7				
2026	60	September	48.6				
		October	62.5				
		November	45.4				
		December	39.8				
		Total	587.8	35.0	61%	-33.9	3.2

AAA Municipal Yield Curve²



Index Returns⁴

	1-Mo Total Return	YTD Total Return
Bloomberg Municipal Bond Index	0.94%	0.94%
Returns by Maturity		
Bloomberg Municipal Bond 1-Year Index	0.56%	0.56%
Bloomberg Municipal Bond 5-Year Index	0.98%	0.98%
Bloomberg Municipal Bond 10-Year Index	1.17%	1.17%
Bloomberg Municipal Bond 20-Year Total Return Index	1.01%	1.01%
Bloomberg Municipal Bond Long Bond Index	0.50%	0.50%
Returns by Credit Quality		
Bloomberg Municipal AAA Index	0.90%	0.90%
Bloomberg Municipal AA Index	0.93%	0.93%
Bloomberg Municipal A Index	0.98%	0.98%
Bloomberg Municipal BBB Index	0.94%	0.94%
Bloomberg Muni High Yield Index	0.98%	0.98%
Returns by Sector		
GO Bond Index	0.92%	0.92%
Revenue Bond Index	0.95%	0.95%
Taxable Muni Returns		
Bloomberg Taxable Municipal Bond Index	0.05%	0.05%
Bloomberg Global Aggregate Index	0.94%	0.94%
Bloomberg U.S. Treasury Index	-0.09%	-0.09%
Bloomberg U.S. Corporate Index	0.18%	0.18%

Demand Technicals - Municipal Mutual Fund Flows⁷

Year	Flows (\$M)	2025	Flows (\$M)
2018	8,843	January	13,403
2019	102,554	February	
2020	54,468	March	
2021	105,480	April	
2022	-116,469	May	
2023	-5,695	June	
2024	45,091	July	
2025	61,549	August	
2026 YTD	13,403	September	
		October	
		November	
		December	

¹Source: Bloomberg; GDP, CPI, PCE: BEA; Unemployment, NFP: BLS. As of 30 Jan 26.

²Source: Bloomberg, Western Asset. As of 30 Jan 26. Bloomberg Valuation Service (BVAL) AAA Muni Curve and US On-/Off-the-Run Sovereign Curve.

³Source: Muni Yields: Thomson Reuters MMD 2-Year, 5-Year, 10-Year and 30-Year AAA Scales; Treasury Yields: 2-Year, 5-Year, 10-Year, and 30-Year Tenors of the US On/Off The Run Sovereign Curve.

⁴Source: Bloomberg Municipal Bond Index, Bloomberg Taxable Municipal Bond Index. As of 30 Jan 26. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Past performance is not an indicator or a guarantee of future results.

⁵Source: Bloomberg, Western Asset. As of 30 Jan 26. 10- and 30-Year comparison reflects Bloomberg Valuation Service (BVAL) AAA Muni Curve and US On-/Off-the-Run Sovereign Curve. AA Muni reflects the Bloomberg AA Muni Bond Index. A Muni reflects the Bloomberg A Muni Bond Index. BBB Muni reflects the Bloomberg BBB Muni Bond Index. HY Muni reflects the Bloomberg High Yield Muni Bond Index. AA Corp reflects the Bloomberg AA Corporate Bond Index. A Corp reflects the Bloomberg A Corporate Bond Index. BBB Corp reflects the Bloomberg BBB Corporate Bond Index. Taxable equivalent yield considers top marginal tax rate of 40.8%. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Past performance is not an indicator or a guarantee of future results.

⁶Source: Bloomberg. As of 30 Jan 26.

⁷Source: Bloomberg, ICI. As of 30 Jan 26.



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