

General Commentary

With desks back to being fully staffed after the new year, participants walked in the door Monday morning trying to figure out how to digest the news from over the weekend that the US ousted Venezuela's president, while at the same time ruminating over the Supreme Court's impending ruling on the administration's tariff policy. Bond markets mostly shrugged off the political noise and instead took their cues from the economic data reports that were back to regularly scheduled publishing. The December ISM report showed manufacturing activity contracted for the 10th straight month, however, services expanded at the fastest rate in over a year. On the labor market front, the ADP Employment report came in below expectations and JOLTs showed Job Openings fell to the lowest in more than a year, while Layoffs rebounded. December nonfarm payrolls rose just 50k, but the household survey of the unemployment rate unexpectedly fell. Ultimately, the mixed prints show a picture of an economy that is still grinding along and a labor market that is sluggish but not collapsing. This helped reinforce the notion that the Fed will stay on hold for a few months as the odds for an interest rate cut to occur by April's meeting fell from 79% to just 49%. The treasury curve flattened with the front end off by 6bps, while the long bond's yield fell by 5bps.

IG Munis

The muni market came out of the gate hot with the benchmark MMD curve rallying 11-13bps out to 10y and 4bps out long, thus outperforming treasuries by as much as 18bps up front. Heavy January reinvestment cash, a lighter than expected new issue calendar, and reasonably attractive absolute yields all contributed to the demand. Additionally, Lipper reported mutual funds took in \$1.45bn this week which just added more fuel to the fire. Dealers reported very strong SMA demand, especially in the 15-20y tenors where the curve is the steepest. Inquiries were robust with multiple buyers looking at all different types of structures, coupons, states, and sectors. With the outperformance, MMD/UST ratios tumbled across most of the curve with the 5-10y range moving to a paltry 60%. This helped rebalance the market during the back half of the week as BWIC lists picked up and investors looked to monetize some of the recent performance. In particular, sale lists surged for long duration and lower coupon bonds, suggesting some accounts would prefer to fade stronger weeks like this and instead deploy capital during heavy new issuance periods.

HY Munis

The HY market finally participated in the upside after a weak 2nd half of 2025. Mutual funds that had been hit with outflows into the end of the year finally saw a reversal with Lipper reporting \$291mm of inflows. With no new issue to speak of, investors turned to the most liquid benchmark names to quickly get cash invested. Previous laggards, like Buckeye

Tobacco which had seen its spread widen approximately 50bps over Q4, caught a strong bid this week. Bonds rallied 15bps and outperformed long high grades by over 10bps. Likewise, most other large, liquid names like Cofina Sales Tax or GA SR400 Express Lanes rallied ~10bps on the week. Dealers reported strong demand for select credits/sectors, with several names in the 6%+ area seeing trade activity for the first time in weeks. While the HY Muni index only saw its yield rally 6bps and thus underperform the IG index's 11bp move, we suspect evals may be lagging across the broader swath of the market that has not traded yet. After underperforming and widening out in 2025, the HY market's higher starting yields and relatively benign credit environment point to a rebound in performance for 2026.

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Market Commentary

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