

General Commentary

To kick off the week, US-Iran negotiations over reopening the Strait of Hormuz stalled after the administration rejected Tehran's latest proposal. Brent crossed back over the \$100/barrel as the week wore on and the 30y Treasury reached its highest yield since 2002. A run of softer growth and labor data helped to reset the rate outlook. Consumer confidence fell to its lowest since 2014 and core PCE cooled to 3.0% year over year against 3.3% expected. Friday's payrolls report showed just 29,000 jobs added, below every estimate, alongside a downward revision to the prior two months and an unemployment rate that ticked up to 4.2%. Dovish remarks from Fed officials Williams and Jefferson reinforced the shift. By Friday, Fed Funds futures had pared the odds of an October hike to just 18% from 64% a week earlier and no longer fully priced a hike for the rest of 2026. The inflation side did not fully relent. Consumer spending rose 0.9% in August, the fastest in over a year, and ISM prices paid rose to their highest since May even as factory activity slowed. That tension showed up in the shape of the curve. The front end held firm, with the 2y finishing 2bps lower, while the long end bore the brunt of the selloff, with the 30y closing 14bps cheaper on the week.

IG Munis

Munis staged a historic round trip. The AAA MMD curve was cut 13-15bps on Monday and extended its losses into Tuesday before a furious three-session rally took hold. Wednesday's 7-13bp bump was the largest single-session move since April 2025, and the recovery carried through Friday. On the week, the AAA MMD curve finished 8bps richer from 2y through 10y, while the long end was cut 2bps. With Treasuries finishing weaker, munis outperformed sharply and clawed back a portion of September's damage. Even so, September closed as the worst month for the IG index since September 2008.

Secondary supply reached record proportions. According to JPM Research, BWIC volumes set an all-time high on Tuesday at \$7.9bn, with Monday's \$6.7bn and Wednesday's \$7.7bn close behind, and seven of the ten largest BWIC days on record now fall within the past two weeks. On the week, volumes ran 81% above the elevated five-week average, though the hit rate held steady near 55% and customer purchases jumped 88%, a sign that buyer demand was able to keep pace. Dealers pointed to sticker shock from the rate move, a heavy new issue calendar, slowing fund flows (Lipper reported \$608mn of outflows for the week), and large-scale programmatic tax-loss harvesting as the drivers of the outsized sale volumes, rather than any credit concern. The dislocation was stark during the lows at the beginning of the week, when we tracked several AA 4% coupon bonds in the 20y maturity range trading in the high 5% to low 6% yield area, generally 5 points and more than 50bps off of evals.

The mid-week reversal was driven by an extraordinary wave of passive demand. According to JPM Research, ETFs bought as much as \$2bn of high-grade paper over a day or two, and the asset class posted its largest daily ETF inflow in JPM's data on Tuesday. Index-eligible buying forced inventory offerings higher, rate locks tightened dramatically, and bonds went away from dealer and hedge fund balance sheets. October 1 reinvestment, the Treasury rally, and a fear of missing the trough pulled additional buyers in, while crossover accounts were drawn by absolute yields that reached their highest since 2007-08 at Tuesday's lows. Next week's calendar may take the wind out of the market's sails, as projected issuance may climb to as high as \$20bn as day-to-day deals shelved during the selloff look to return.

At Tuesday's lows, the backup had pushed valuations to their most attractive levels in years, with the 10y ratio near 80% and the 30y near 94%. The rally took much of that back. The 10y ratio closed the week below 74% and the 30y just under 90%. We see some room left for muni outperformance if the demand that drove the snapback holds. Still, munis are far less cheap than they were only days ago, and the headwinds are real. Tax-loss selling will continue into year-end, the new issue calendar remains near record levels, and the negative total return that just printed for the month could drive further client outflows.

HY Munis

High yield lagged the high-grade rebound. Monday was the most trying session. Bids evaporated, bonds that traded gapped wider, and price discovery broke down. On that washout, weaker toll road structures such as NTE and I-10 were off 20-25bps as duration was punished, and one 127-item, \$49mm bid list saw only four items trade. According to JPM Research, HY customer BWICs rose 69% on the week while customer purchases climbed just 5%. The benchmark names never joined the rally. Buckeye Tobacco ended the week at 7.49%, off ~25bps from the week prior and weaker even than its 7.47% level at Tuesday's lows. Cofina drifted to 5.60% from 5.56% last week and nonrated 3 World Trade Center moved to 5.26% from 5.15% the prior Friday.

The gap between trade levels and evals told the clearest story of how far high yield lagged. It was most extreme early in the week, when the tape was sloppy. More telling was Thursday, when the broader tone had improved markedly yet smaller and less common names still cleared well behind their marks. A nonrated Colorado charter school traded at 7.85% against a 7.02% eval, a nonrated California workforce housing bond cleared at 6.73% versus a 6.36% mark, and a B1/BB mandatory put bond traded 5.50% against a 5.18% eval. Higher-quality and more common names held up far better. On the same bid list, a BB- Minnesota charter and a widely held Utah development district both traded within a few bps of their evals.

New issue was limited, though one larger deal was able to clear. A \$193mm Ba1 Florida student housing deal priced into the difficult tape, with the senior exempts mostly 1-3x oversubscribed and balances left on the smaller tax-exempt subordinate and taxable senior tranches. In credit-specific news, the Brightline operating company bonds traded lower after Friday's Chapter 11 filing. A roughly \$190mm strip came out for the bid on Monday and traded near \$45, down from a \$64 eval, driving large single day NAV moves in certain high yield funds, before recovering to around \$55 by Wednesday. More broadly, HY funds saw \$380mn of outflows as the asset class absorbed the selloff. Yet despite the clear underperformance, the HY index spread to investment grade widened just 3bps on the week and remains near its post-crisis tights, leaving the relative value case little changed.

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Market Commentary

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