MARKET COMMENTARY

AUGUST 2026

August began with a strong recovery from July's selloff but ended with renewed volatility as investors reassessed the path of interest rates.

Despite elevated issuance and changing rate expectations, municipal market demand remained resilient throughout the month.

Historically, the income available at the time of investment has been one of the most important drivers of long-term fixed income returns—and while markets continue to debate the path of interest rates, August improved the income opportunities available across much of the municipal market.

WHY AUGUST'S HIGHER YIELDS MATTER

- While markets spent much of August repricing interest-rate expectations, municipal yields reached 2026 highs. By month-end, the 10-year AAA MMD yield stood at 3.37%, and the 30-year AAA MMD yield reached 4.60%, translating to a **7.77% taxable-equivalent yield** assuming the highest tax bracket.

- For investors, these higher yields matter. They improve the income available from new investments and can contribute meaningfully to long-term fixed income returns.

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Historically, the income available at the time of investment has been one of the most important drivers of long-term fixed income returns.

- In our view, periods like August highlight the value of active management. Market volatility can create opportunities to identify relative value, employ tax loss harvesting where appropriate, and reposition portfolios into bonds with higher future income potential. August's elevated new issuance placed further pressure on the market and presented opportunities for APA's portfolio management team to capture relative value on behalf of client portfolios.

Municipal yields reached 2026 highs in August.

A MONTH OF TWO HALVES

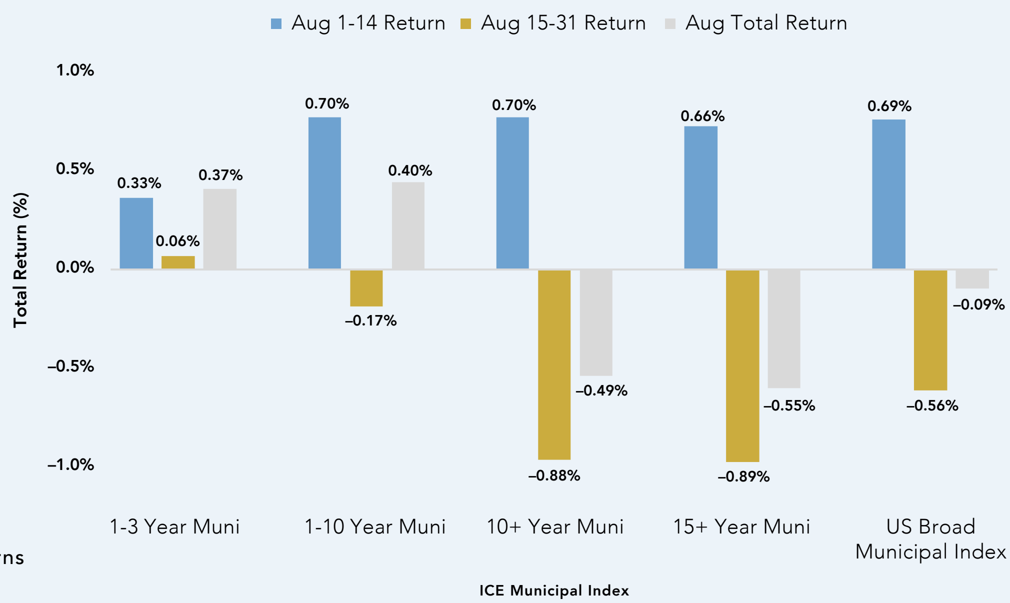
- August opened with many of the supportive conditions investors hoped to see. Inflation data generally came in softer than expected, Treasury yields moved lower, and seasonal reinvestment demand remained strong. Market sentiment improved meaningfully during the first half of the month as investors became increasingly comfortable with the inflation outlook and the possibility that the Federal Reserve would remain on hold.

- By mid-month, municipal bonds had recovered a meaningful portion of July's weakness, helped by strong demand and continued fund inflows. Through August 14, the ICE US Broad Municipal Index had returned 0.69%.

- The second half of the month proved more challenging for performance. Elevated issuance, slowing reinvestment demand, and changing Federal Reserve expectations created renewed pressure on fixed income markets.

- While municipals remained resilient overall, the market's tone shifted noticeably as August progressed. Shorter and intermediate maturities generally retained much of their early-month gains, while longer maturities gave back those gains as investors repriced the interest-rate outlook, pushing yields higher across the long end of the curve.

INTEREST-RATE REPRICING DROVE AUGUST'S REVERSAL



Source: ICE Index Returns [8/31/26]

August began as a recovery from July's selloff but finished with renewed volatility as markets reassessed the interest-rate outlook.

JACKSON HOLE REPRICED THE RATE OUTLOOK

- August provided no shortage of rate-market developments. The U.S. debt load surpassed $40 trillion, Treasury market liquidity remained a topic of discussion, and investors continued debating the path of central bank policy. Against that backdrop, the market's focus ultimately intensified following Fed Chair Kevin Warsh's Jackson Hole speech.

- Earlier in the month, investors had become increasingly confident that further tightening was unlikely in the near term. By mid-August, the market-implied probability of a September rate hike had fallen to approximately 32%.

- That outlook changed quickly during the final week of the month. Following Jackson Hole, markets increased the probability of a September hike from approximately 34% to 54%.

APA

- Treasury markets reacted sharply. The 2-year Treasury yield rose 11 basis points on the day of the speech, marking the largest same-day move following a Fed Chair's Jackson Hole address since 1996. Municipal yields moved higher as well, although more modestly, as investors reassessed the path of interest rates and adjusted expectations for future Federal Reserve policy.

Jackson Hole reminded investors that interest-rate expectations can change quickly.

SUPPLY, SUPPLY, SUPPLY

- Municipal issuance hit a new record in August. Long-term tax-exempt issuance reached $57.6 billion, the highest monthly total ever, topping the previous record set in October 2024. Total long-term municipal issuance came in at $61.7 billion, the second-highest month on record behind October 2020. The month brought year-to-date issuance to $399 billion.

Supply hit a new record in August.

- Demand kept pace despite the heavy calendar. Municipal fund inflows remained positive throughout the month, bringing year-to-date inflows to roughly $67 billion, one of the strongest paces on record.

- August effectively tested whether strong demand could withstand elevated issuance and changing rate expectations. While the market experienced periods of volatility, buyers largely remained engaged, helping the market absorb one of the heaviest issuance calendars on record.

CREDIT DIFFERENTIATION CONTINUES

- Municipal credit fundamentals remained generally stable during August, but rating activity continued to reinforce a theme APA has highlighted throughout 2026: issuer-specific discipline is becoming increasingly important in determining credit outcomes.

- Illinois received an upgrade from Moody's to A1 from A2, reflecting years of improved financial management, eight consecutive on time balanced budgets, growing reserves, and continued progress toward fiscal stability despite ongoing pension and leverage challenges.

- Not all issuers experienced the same outcome. Baltimore was downgraded to Aa3 from Aa2 as declining reserves and weakening balance sheet trends pressured the city's credit profile, while Ann Arbor Public Schools was downgraded to A2 from A1 amid declining enrollment, weaker reserves, and projected operating deficits.

- Several issuers also moved in the opposite direction. Moody’s upgraded Savannah to Aaa, while Houston was upgraded to Aa2, reflecting proactive financial management.

- Taken together, recent rating actions suggest that municipal credit conditions remain stable overall, but management decisions, financial flexibility, reserve levels, and long-term planning are increasingly separating stronger issuers from weaker ones.

ENTERING SEPTEMBER WITH HIGHER INCOME, MORE CHOICES

- August reinforced an important lesson from July: favorable municipal fundamentals cannot fully insulate the market from changes in Treasury yields and interest-rate expectations.

- September begins with another elevated supply outlook. Forecasts generally call for $50-55 billion of issuance, while net supply is expected to remain positive.

- Reinvestment demand is projected to moderate from peak summer levels, with principal and interest payments expected to total roughly $33 billion during September.

- Despite those headwinds, municipal investors enter September with a more attractive opportunity set. Higher yields, elevated issuance, and increased market dispersion are creating a broader range of opportunities across the municipal market. While the future path of interest rates remains uncertain, we believe today's tax-exempt income levels continue to provide a compelling foundation for long-term municipal investors.

ASSET PRESERVATION ADVISORS

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