

Strength in the Treasury market rippled into the municipal sector with stability dominating both arenas during the fourth quarter. The 10-year AAA MMD yield began at 2.92% and finished at 2.76%, after being unchanged at 2.75% for 16 consecutive sessions between November 7 and December 2. Early in the quarter, Treasuries overwhelmed weaker seasonals in municipals and negated the net positive supply effect. Later in the quarter, inflows slowed following the Treasury market sell-off, providing buyers with modest relief through slightly wider spreads. The 2-year MMD yield began at 2.30% and finished at 2.39%, after trending higher for most of the quarter.

The 10-year prime municipal/Treasury ratio opened at 70%, closed at 66%, and was range-bound between 66% and 71% in the interim. Two-year ratios began at 64% and finished at 69%. Municipals flattened with 2-year municipal yields rising nine basis points, and 10-year yields falling 16 basis points. The steepness of the Treasury yield curve was marginally unchanged with 2-year yields falling 13 basis points, and 10-year yields rising two basis points, respectively.

The all-muni funds category experienced inflows for the quarter, and in early November had the largest inflow amount since August 2021. LSEG Lipper reported a total inflow of \$19.5 billion, with open-end funds +\$6.6 billion, and ETF +\$12.9 billion, respectively.

Primary market issuance in the fourth quarter was \$141 billion (11% taxable), bringing the YTD total to a record volume of \$565 billion, eclipsing 2024's total of \$507 billion. Large borrowers entered the primary market with 14 deals greater than \$1 billion, or 15% of new issuance. Secondary market selling ebbed a bit from previous months but still averaged a lofty \$976 million daily.

Federated Hermes CW Henderson was active but became more interest rate sensitive with ratios pushing the lower boundaries of our threshold. Rates retreated in the quarter, lessening the opportunities for tax loss harvesting, but we continued to reposition seasoned structure with new issues. With many market participants selling short-maturity bonds that aligned with our existing holdings, we were able to augment the

short end of our barbell and enhance liquidity by increasing block sizes. Short callable structure continued to offer significant yield pick-up versus non-callable bullet securities, so we remained aggressive in that space as well. Duration targets were mostly unchanged at 4.00 to 4.20 years.

At its December policy-setting meeting, the Federal Reserve lowered interest rates by 25 basis points to the 3.50% to 3.75% range. Fed officials maintained their outlook for just one cut in 2026 in a 9 to 3 vote with dissent on both ends of the policy spectrum. Projections for 2026 now show a 3.40% median for the fed funds rate, 3.10% for 2027, both unchanged from previous estimates, and 3.10% in 2028. The forecast for the unemployment rate for 2026 remained the same at 4.40%, 4.20% in 2027, down from 4.30%, and 4.20% in 2028. The Fed projected the median core PCE index to be 2.50% in 2026, down from 2.60%, unchanged at 2.10% in 2027, and longer run at 2.00% in 2028. GDP growth was projected to increase to 2.30% in 2026, up from 1.80%, 2.00% in 2027, up from 1.90%, and 1.90% in 2028. The FOMC announced the commencement of reserve-management purchases to keep reserve balances "ample" and stated it will buy shorter term Treasuries as needed but did not indicate quantities at the December meeting. This shift in reserve-management will stop shrinking the balance sheet and will end QT, thus closing the books on a process that began in 2022.

Looking ahead, 2026 could be another year of record supply with most street projections calling for more than \$600 billion in issuance. The market is well positioned to absorb the expected supply, supported by anticipated strong demand for municipals. Key drivers include elevated bond calls and maturities, attractive nominal and taxable equivalent yields, strong credit quality among higher grade issuers, favorable demographic trends, and potential portfolio rebalancing by investors.

| Market Yields | | | | |
|-----------------------|-------------------|------------------|------------------|------------------|
| | 12/31/2025 | 9/30/2025 | 6/30/2025 | 3/31/2025 |
| 1 yr. AAA Muni | 2.46 | 2.38 | 2.57 | 2.61 |
| 5 yr. AAA Muni | 2.41 | 2.32 | 2.67 | 2.86 |
| 10 yr. AAA Muni | 2.76 | 2.92 | 3.26 | 3.26 |
| 30 yr. AAA Muni | 4.24 | 4.24 | 4.54 | 4.24 |
| 10 yr. U.S. Treasury | 4.17 | 4.15 | 4.23 | 4.25 |
| 10 yr. Muni/UST Ratio | 66% | 70% | 77% | 77% |

Sources: Bloomberg and The Bond Buyer

Key Market Points & Commentary

- Supply was \$141 billion in the fourth quarter.
- Mutual fund net inflows totaled \$21.6 billion.
- The municipal yield curve flattened, with 2-year yields rising nine basis points and 10-year yields falling 16 basis points.
- As always, Federated Hermes CW Henderson's focus remains on high-quality, liquid and thoroughly researched credits with good management teams. Credits owned are monitored on a regular basis.
- Intermediate product portfolio durations are targeted at 4.00 - 4.20 years.
- Ultra Short product portfolio durations are targeted at about 0.65 years.

DISCLOSURES

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Bond credit ratings measure the risk that a security will default. Credit ratings of A or better are considered to be high credit quality; credit ratings of BBB are good credit quality and the lowest category of investment grade; credit ratings of BB and below are lower-rated securities; and credit ratings of CCC or below have high default risk.

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

Duration is a measure of a security's price sensitivity to changes in interest rates. Securities with longer durations are more sensitive to changes in interest rates than securities of shorter durations.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

Municipal bond income may be subject to the federal alternative minimum tax (AMT) and state and local taxes.

Personal Consumption Expenditure (PCE) Index: A measure of inflation at the consumer level.

For more information on the Federated Hermes CW Henderson SMAs, visit the [Product](https://www.federatedhermes.com/us) section of [FederatedHermes.com/us](https://www.federatedhermes.com/us).

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