



Just Because You're Paranoid Doesn't Mean They Aren't After You

January 2026

- Munis have now delivered solid returns, for the past three consecutive years, resulting in over +13% returns cumulatively, or +4.00% annually, as of 1/19/26, according to the Bloomberg Muni Index.
- Municipal bonds delivered performance that was higher, on a taxable equivalent basis, than every other fixed income market in 2025, including Treasury bonds, corporate bonds, high yield bonds, and global bonds, according to Bloomberg Municipal Bond Index, as of 1/19/26.
- There are now almost a dozen states considering raising income or surtaxes on taxpayers, including individuals making more than \$1 million.
- We say to those in the highest tax brackets, just because you are paranoid doesn't mean they aren't after you.
- Holders of cash and short duration instruments are giving up the opportunity to increase their tax-free cash flow by 100%, as the yield differential between short and long-term municipal bonds is now over 2.00% or 200 basis points, more than double the yield of short-term bonds and after-tax taxable cash yields.
- Municipal bond investors willing to extend out to modestly longer maturities can achieve taxable equivalent yields approaching 7%.

The casual market observer is forgiven if, in early 2025, they concluded it would be an underwhelming year for municipal bond returns. If you close one eye and look at the first half of 2025 in isolation, that summation would have appeared reasonable. However, for those with an investment horizon longer than six months, you would have also seen the second half of 2025 deliver one of the most powerful recoveries in municipal bond prices in some time. As our clients and loyal followers know, we have been imploring investors to prepare for a turnaround in market sentiment, for a number of quarters. We remained firm in our conviction that a recovery in municipal bond performance would likely be swift and powerful. In the early days of 2026, we reflect not only on market conditions that have brought us to this point but also contemplate the various risks and opportunities investors are likely to experience in 2026.

Market conditions in the first half of 2025 were indeed challenging. The municipal bond market stumbled out of the gate, plagued by uncertainty surrounding the potential loss of municipal bonds' coveted tax-exempt status. Fear of losing the municipal bond tax-exemption has become the proverbial Sword of Damocles, hanging over the muni market, for over three decades. While the risk of losing tax-exempt status is perceived to be quite low, for constitutional reasons, as we discussed extensively in our Q1 2025 Market Commentary [Shaken](#), it has not stopped retail investors from overreacting each time the topic begins to leak into media headlines. The mere whisper of the potential loss of muni tax-exemption gets the financial news printing presses humming. The media and the broader financial services industry understand all too well that there is no better way to alarm wealthy, tax sensitive, retail investors, in an effort to capture their breathless attention, than to suggest that one of the last and purest tax shelters available may be taken away. Nonetheless, once the news broke that the One Big Beautiful Bill Act (OBBBA) had passed and the muni tax-exemption had been preserved, retail nerves settled as quickly as they had previously risen. Investors took stock of the relative cheapness of the municipal asset class more broadly and wisely concluded that munis were simply too attractive to ignore, igniting the recovery and rally that ensued in the latter part of 2025, which has continued into 2026.

What started off as a spiritless year for munis, ended on a particularly strong note. Munis have now delivered solid returns, for the past three consecutive years, resulting in over +13% returns cumulatively, or +4.00% annually, as of 1/19/26, according to the Bloomberg Muni Index. Some may also be surprised to learn that municipal bonds delivered performance that was higher, on a taxable equivalent basis, than every other fixed income market in 2025, including Treasury bonds, corporate bonds, high yield bonds, and global bonds, according to Bloomberg Municipal Bond Index, as of 1/19/26.

While this may come as a shock to some, it is a reminder of how frequently investors fail to properly measure and appreciate the full value of the tax-free income that municipal bonds deliver. The challenge for investors is that municipal bond returns are almost always quoted on an after-tax basis, that is returns are not “grossed up” to reflect the tax-free income they generate, while taxable markets, bonds and equities, almost always quote returns on a before-tax basis. We frequently remind investors, to achieve a true apples-to-apples comparison of their investments, they must carefully calculate the “taxable equivalent” yield and return of their municipal bond holdings when comparing with taxable alternatives. We understand that not everyone enjoys pouring over statements, performing mathematical equations. However, not doing so can result in lost performance and/or unnecessarily increased risk exposures.

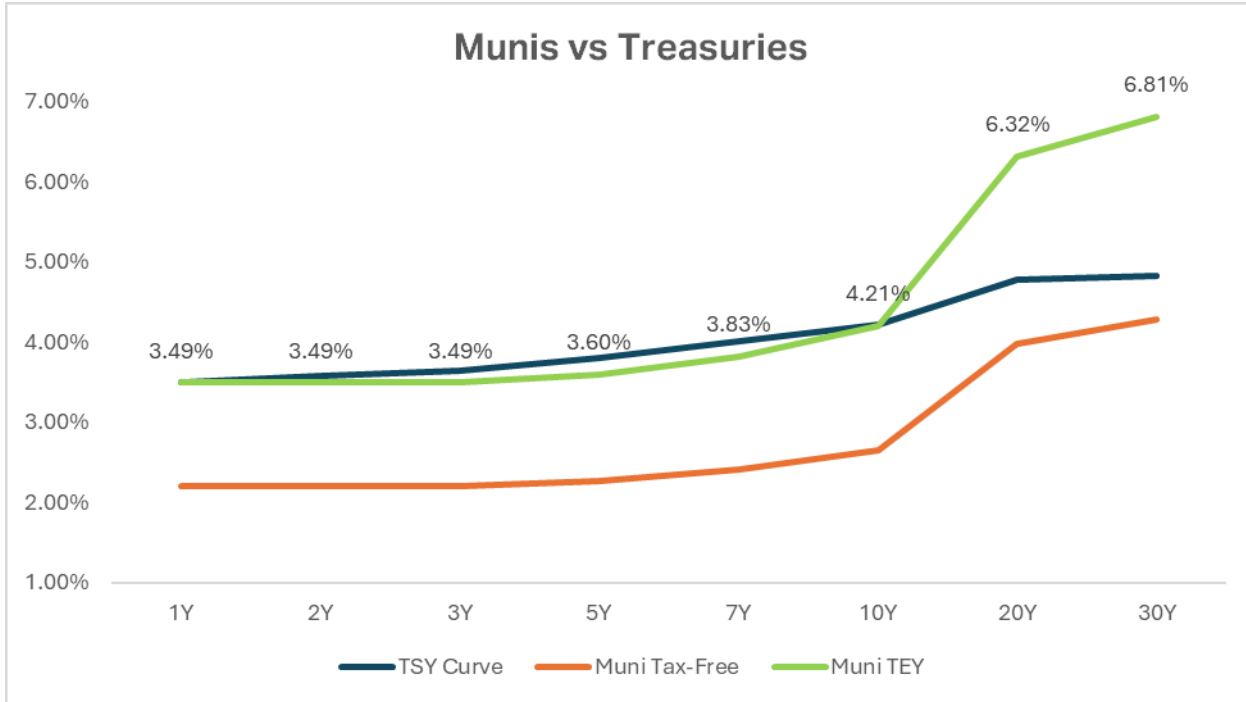
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Despite the passage of the OBBBA, we know that taxes more broadly will likely remain roughly the same for most taxpayers across the country. Yet, taxes may actually be rising for many wealthy investors, depending on where they live. There are now almost a dozen states considering raising income or surtaxes on taxpayers, including individuals making more than \$1 million. A number of states are also considering additional wealth taxes, i.e. California. We believe these initiatives are the clearest indication that state and local governments are planning to increase revenue rather than reduce spending, as they face the reality of billions of dollars in budgets deficits. While this may be bad news for taxpayers, it is welcome news for municipal bond holders, as we expect municipal credit quality to remain stable going forward. Our confidence is tied to the knowledge that municipalities have the authority and, in several instances, a willingness to raise revenues through higher taxes and user fees to fund debt service and future expenditures. This new reality speaks directly to the power of tax-free cash flow and will likely mean that the tax-exempt income municipal bonds deliver will increase in value as we look to a future of higher local taxes, even if Federal income tax rates remain roughly the same. Therefore, we say to those in the highest tax brackets, just because you are paranoid doesn't mean they aren't after you.

Risks Seen and Unseen

We continue to believe that the greatest risk facing fixed income investors going forward remains reinvestment rate risk. The very high opportunity cost of investor exposures to cash, preferred savings, and short duration instruments is evident in the current slope of the yield curve, see Figure 1 below.

Figure 1.



The data provided above reflects AAA municipal bond yields and U.S. Treasury bond yields as of 01.26.2026. The Muni TEY is the taxable equivalent yield and represents the yield that must be earned on a fully taxable investment in order to equal the tax-exempt yield of the particular composite. The taxable equivalent yield is calculated by dividing the tax-exempt yield by 1 - the maximum federal income tax rate of 40.8% (37% federal + 3.8% NII tax). The impact of state taxes is not reflected.

The 'AAA', tax-free municipal bond and taxable Treasury curves illustrate clearly the meaningfully positive slope of the curve. As you can see, the additional yield investors receive for investing in longer, rather than short, duration bonds is significant. Investors with heavy exposures to preferred savings, cash, and short duration bonds, may be unaware that the lower yield and income they now receive translates into a significant loss of cash flow going forward. This is a relatively new experience for investors as short-term rates were quite high just two years ago. For example, holders of cash and short duration instruments are giving up the opportunity to increase their tax-free cash flow by 100%, as the yield differential between short and long-term municipal bonds is now over 2.00% or 200 basis points, more than double the yield of short-term bonds and after-tax taxable cash yields.

Why Inflation Isn't Rising

As we consider the factors that have put downward pressure on interest rates over the past two years, we expect many of those conditions to persist in 2026 as well. Inflation was a popular talking point throughout 2025. We continue to believe any pressure from increased tariffs is likely to be temporary, as we do not expect the current administration to materially increase tariffs yet again in 2026. Therefore, the modest price increases that may have flowed through to prices of goods and services, due to tariffs, are likely to diminish as base effect comparisons improve going forward. Owners' Equivalent Rent (OER), which represents roughly a third of the US Consumer Price Index (CPI), fell consistently throughout 2025. We expect declines in residential and commercial real estate values to continue in 2026, exerting further downward pressure on OER. Therefore, we expect CPI to continue to moderate going forward. As inflation falls, real returns (that is return after inflation) of fixed cash flow rises. For example, municipal bond investors willing to extend out to modestly longer maturities can achieve taxable equivalent yields approaching 7%. Assuming CPI averages approximately 2.70% during 2026, as it did in 2025, the real, inflation-adjusted yield that muni investors could achieve would be over +4.2%, on a net basis. For this reason, we continue to believe that municipal bonds, given their superior taxable equivalent yields and risk adjusted return potential, are among the most compelling investments investors, in the highest tax brackets, can make in 2026.

CIM Investment Management News

We are very pleased to share that 2025 was another powerful year of growth for CIM. We added new team members and continued to meaningfully grow our assets under management, as evidenced by the roughly \$900 million inflows into our strategies in 2025. We are grateful for the ongoing trust and loyalty of the clients and advisors we serve. We are also fully aware that our success would not be possible without the dedication, commitment, and strength that each CIM team member delivers to our clients each day. We would like to express our deepest thanks to all of our partners and look forward to another year of growth in 2026.

Should you have any questions about this commentary or where we are seeing the best opportunities in the municipal bond market today, please do not hesitate to reach out.

Sincerely,

Andrew Clinton
CEO

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