Invesco

Strategy Insights

Municipal Playbook: Defense & Offense

The municipal bond market has seen volatility in 2026, now what?

During times of volatility and rate uncertainty, it can be easy to lose sight of why municipal bonds are a beneficial component of a diversified portfolio. Historically, municipal bonds have experienced very low default rates (see Chart 1) and, we believe their credit fundamentals are the strongest that our 23-person credit research team has experienced in years. Credit upgrades have exceeded downgrades for 20 consecutive quarters.[1] We believe that combining this strong fundamental backdrop with the federally, and in some cases state and local, tax-exempt income municipals provide make the asset class an attractive long-term investment. Additionally, municipals have historically exhibited a low correlation to other asset classes (see Chart 2), which can help add diversity to portfolios, potentially resulting in lower long-term volatility.

Is now the time to play offense?

Credit fundamentals are generally solid, and municipal bond yields are among the highest levels seen in over 15 years.[2] When investors consider yields on a tax-equivalent basis, these levels are even more competitive (see Chart 3). However, interest rate movements are extremely hard to predict, and the heightened speed and magnitude of rate moves could leave investors feeling nervous. Those investors would likely say it is still time to play defense and be conservative. Which answer is correct, defense or offense? We say—why not play both? Afterall, most of the greatest sports teams have both a strong defense and a strong offense.

Defense - ORSTX

- Short duration (typically, under 2 years)
- Money market eligible floating-rate exposure
- Quicker access to higher interest securities

Offense - ISHAX

- Less duration risk than Morningstar High Yield Muni Category*
- Non-rated exposure could create less price sensitivity
- Access to high yield credits

*Source: Morningstar, June 30, 2026. The Morningstar US High Yield Muni category has an average effective duration of 7.03 years. ISHAX has an average effective duration of 4.67 years.

Average Effective Duration is a measure, as estimated by the fund's portfolio managers, of a bond fund's price sensitivity to changes in interest rates. It takes into account mortgage prepayments, puts, adjustable coupons and potential call dates.

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Defense: Invesco Short Term Municipal Fund (ORSTX)

Interest rate moves, inflation concerns and general policy uncertainty regarding the Federal Reserve have resulted in heightened stoked unease for investors across the fixed income markets, municipal bonds included. We believe that it is during times like these that it could be a prudent measure to consider a more defensive minded fund like ORSTX.

- Capital preservation: the core component of ORSTX's strategy
- Price stability: in a volatile world, a little boring can be nice. The NAV of the fund has been flat for 91% of trading days since inception (12/6/2010)[3]
- Short maturity: strong defense in a challenging rate environment by putting a cap on the portfolio's maturity. By prospectus, ORSTX seeks to maintain a dollar-weighted average effective portfolio maturity of two years or less
- Floating rate exposure: the fund maintains a large percentage of liquid floating rate paper that quickly resets to higher yields as rates rise and is also money market eligible. This can allow the fund to earn more in rising rate environments
- Short duration: the fund may benefit from a rising rate environment because as short-term bonds mature, cash can be reinvested in potentially higher yielding bonds

Offense: Invesco Short Duration High Yield Municipal Fund (ISHAX)

ISHAX may provide an offensive opportunity to a client's municipal allocation. Play offense by considering high yield exposure with a shorter duration than the Morningstar high yield municipal fund category.

- Strong fundamentals: record amounts of federal dollars are going directly to municipal issuers via the various stimulus packages
- Flat yield curve in high yield municipals: provides attractive opportunities for income without adding duration
- Non-rated exposure: Non-rated bonds tend to be less interest rate sensitive than their high-grade counterparts and are a core feature of Invesco's strategy. Each of our credits receive Invesco internal ratings generated by our 23-person credit team
- A lid on duration: a duration under five years may provide ISHAX with less interest rate sensitivity than the Morningstar high yield muni category
- Risk-adjusted income: despite having roughly half of the duration of the Morningstar Muni High Yield category average, ISHAX has a distribution yield, 4.38%, that is comparable the Morningstar category average, 4.43%.[4]

Player Formation: Portfolio Construction

Unlike a typical sports team, which plays offense and defense roughly 50% of the time, you can determine how offensive or defensive you'd like to be. Changing allocation amounts to each fund can create different duration and yield outcomes which might be more attractive based on individual investment needs and risk tolerances.

In times of volatility, we believe that investors may benefit by playing both sides of the ball: offense and defense.

	Distribution Yield	30-day SEC Yield	Average Effective Duration
Invesco Short Term Municipal Fund (ORSTX)	2.76%	2.43%	1.88 years
Invesco Short Duration High Yield Municipal Fund (ISHAX)	4.38%	3.90%	4.67 years
75% ORSTX / 25% ISHAX Portfolio*	3.17%	–	2.58 years
50% ORSTX / 50% ISHAX Portfolio*	3.57%	–	3.28 years
25% ORSTX / 75% ISHAX Portfolio*	3.98%	–	3.97 years

*The performance results shown are hypothetical (not real) and were achieved by means of the retroactive application of the statistical model.
It may not be possible to replicate the hypothetical results.

Standard Performance as of June 30, 2026	3-Month	1 Year	3 Year	5 Years	10 Years	Since Inception
Invesco Short Term Municipal Fund, A-shares (ORSTX)	0.96%	1.11%	2.93%	1.85%	1.82%	2.08%
With max load, 0.00%	0.96%	1.11%	2.93%	1.85%	1.82%	2.08%
Invesco Short Duration High Yield Municipal Fund, A-shares (ISHAX)	2.29%	3.09%	5.12%	1.61%	2.58%	3.11%
With max load, 4.25%	-0.26%	0.52%	4.23%	1.11%	2.32%	2.86%

ORSTX, inception: 12/6/10. Total Annual Expense Ratio, per prospectus: Class A-shares, 0.76%.
ISHAX, inception: 9/30/15. Total Annual Expense Ratio, per prospectus: Class A-shares, 0.85%.
Source: Invesco, as of June 30, 2026.

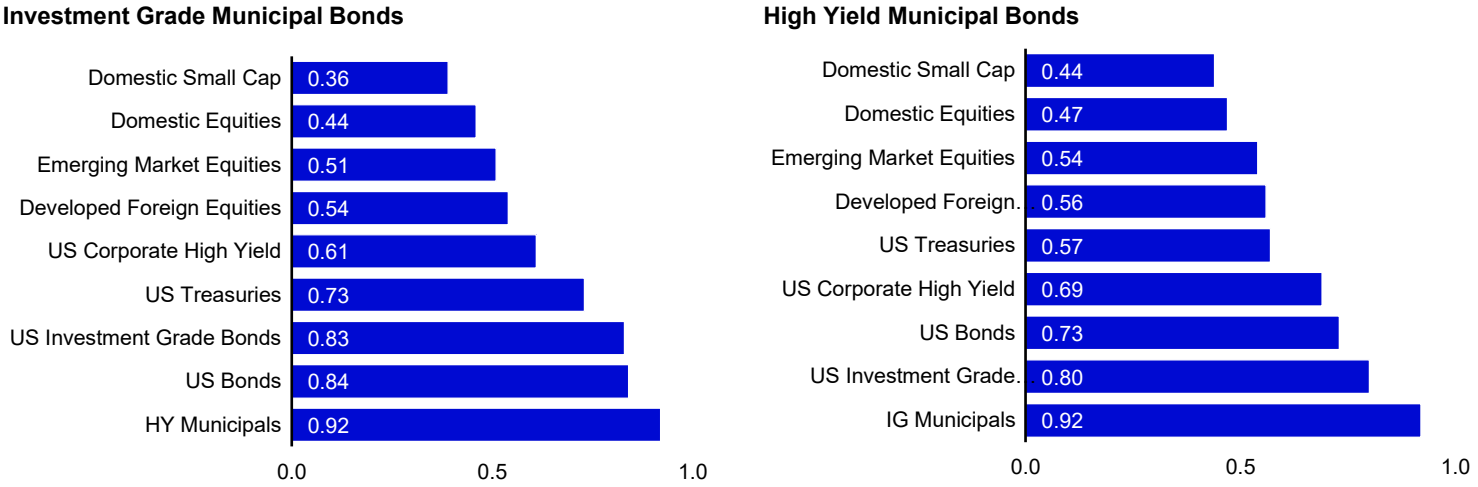
Performance quoted is past performance and cannot guarantee comparable future results; current performance may be lower or higher. Visit invesco.com/performance for the most recent month-end performance. Performance figures reflect reinvested distributions and changes in net asset value (NAV). Investment return and principal value will vary so that you may have a gain or loss when you sell shares. Performance shown at NAV does not include applicable front-end sales charges, which would have reduced the performance. Fund performance reflects any applicable fee waivers and/or expense reimbursements. Had the adviser not waived fees and/or reimbursed expenses currently or in the past, returns would have been lower. See the prospectus for more information.

Chart 1: Historically low long-term default rate

Cumulative Historical Default Rates Rated Issues Only	Moody's (1970-2024)		S&P (1986-2025)	S&P (1981-2025)
Rating Categories (Moody's/S&P)	**Munis (%)**	**Corps (%)**	**Munis (%)**	**Corps (%)**
Aaa/AAA	0.00	0.34	0.00	0.82
Aa/AA	0.02	0.71	0.02	0.95
A/A	0.10	1.84	0.08	1.53
Baa/BBB	1.04	3.42	0.71	3.71
Ba/BB	3.23	15.32	3.85	12.62
B/B	16.44	33.59	9.90	23.90
Caa-C/CCC-C	24.36	47.96	35.77	55.00
Investment Grade	0.09	2.14	0.14	2.28
Non-Invest Grade	6.69	29.71	6.97	21.94
All	0.15	10.82	0.23	10.90

Sources: Moody's Investor Services ("Moody's") data through December 31, 2024, released August 4, 2025, latest data available. Standard and Poor's ("S&P") data through December 31, 2025, released May 11, 2026, latest data available. Past default rates are no assurance of future default rates. The data presented is the most recent data available from the various bond rating agencies. A credit rating is an assessment provided by a nationally recognized statistical rating organization (NRSRO) of the creditworthiness of an issuer with respect to debt obligations, including specific securities, money market instruments or other debts. For more information on rating methodologies, please visit the following NRSRO websites: www.standardandpoors.com and select 'Understanding Credit Ratings' under Rating Resources 'About Ratings' on the homepage; https://ratings.moodys.io/ratings and select 'Understanding Ratings' on the homepage; www.fitchratings.com and select 'Ratings Definitions Criteria' under 'Resources' on the homepage. Then select 'Rating Definitions' under 'Resources' on the 'Contents' menu.

Chart 2: Long term correlations (10 Years)



Source: Bloomberg, as of June 30, 2026, based on monthly returns. Asset Classes are represented by the following Index returns: Bloomberg Municipal Bond Index represents IG Municipals, Bloomberg High Yield Municipal Bond Index represents High Yield Municipals, Bloomberg US Corporate Investment Grade Index represents US Investment Grade Bonds, Bloomberg US Aggregate Bond Index represents US Bonds, Bloomberg US Corporate High Yield Index represents US Corporate High Yield, Bloomberg US Government Index represents US Treasuries, MSCI EAFE Index represents Developed Foreign Equities, MSCI Emerging Markets Index represents Emerging Market Equities, S&P 500 Index represents Domestic Equities, Russell 2000 Index represents Domestic Small Cap. An investment cannot be made directly in an index. Diversification does not guarantee a profit or eliminate the risk of loss.

Chart 3: Tax-equivalent yield

	Yield to Worst	Tax-Equivalent Yield
Bloomberg Municipal Bond Index	3.58%	6.05%
Bloomberg Municipal High Yield Index	5.41%	9.14%
10 Year US Treasury	4.46%	–

Sources: Bloomberg, US Treasury, as of June 30, 2026.

For illustrative purposes only. Data based on the Bloomberg Municipal Bond Index. Tax-Equivalent Yield is based on the 2026 top federal tax rate of 40.8%, 37% federal tax rate and 3.8% net investment income tax (NIIT), effective Jan. 1, 2026. Irs.gov, as of October 9, 2025. Top marginal tax rate for single taxpayers with more than $640,600 in taxable income or couples with more than $768,700. NIIT is the net investment income tax investment income for single taxpayers with more than $200,000 in taxable income or couples with more than $250,000.

Bloomberg Municipal Bond Index is an unmanaged index considered representative of the tax-exempt bond market. The Bloomberg Municipal High Yield Bond Index is an unmanaged index considered representative of noninvestment grade and non-rated municipal bonds. An investment cannot be made into an index.

About Risk

ORSTX

Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa.

An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

All or a portion of the Fund's otherwise tax-exempt income may be subject to the federal alternative minimum tax.

There is no guarantee that the Fund's income will be exempt from federal and state income taxes.

If interest rates fall, callable security issuers may call or prepay their securities before maturity, causing the Fund to reinvest proceeds in securities with lower interest rates and reducing Fund income and distributions.

Municipal securities are subject to the risk that legislative or economic conditions could affect an issuer's ability to make payments of principal and/ or interest.

The Fund may invest in municipal securities issued by entities having similar characteristics, which may make the Fund more susceptible to fluctuation.

Derivatives may be more volatile and less liquid than traditional investments and are subject to market, interest rate, credit, leverage, counterparty and management risks. An investment in a derivative could lose more than the cash amount invested.

Economic problems in certain US states increase the risk of investing in municipal obligations, such as California, New York or Texas, including the risk of potential issuer default, heightens the risk that the prices of municipal obligations, and the Fund's net asset value, will experience greater volatility. See the prospectus for more information.

The Fund will invest in bonds with short- or intermediate-term (five years or less) maturity which may have additional risks, including interest rate changes over the life of the bond. The average maturity of the Fund's investments will affect the volatility of the Fund's share price.

The Fund invests in obligations, exempt from regular federal individual income taxes, of the governments of U.S. territories, commonwealths and possessions such as Puerto Rico, the U.S. Virgin Islands, Guam and the Northern Mariana Islands. As result, the Fund may be adversely affected by local political, economic, social and environmental conditions and developments, including natural disasters affecting such obligations. Certain municipalities the Fund invests in, such as Puerto Rico, have significant financial difficulties, including risk of default, insolvency or bankruptcy; and may be subject to credit rating downgrades affecting the payment of principal and interest, the market values and marketability of such municipal obligations.

The investment techniques and risk analysis used by the portfolio managers may not produce the desired results.

The Fund is subject to certain other risks. Please see the current prospectus for more information regarding the risks associated with an investment in the Fund.

ISHAX

All or a portion of the Fund's otherwise tax-exempt income may be subject to the federal alternative minimum tax.

The Fund may use leverage to seek to enhance income, which creates the likelihood of greater volatility of the Fund's shares and may also impair the ability to maintain its qualification for federal income tax purposes as a regulated investment company.

An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Derivatives may be more volatile and less liquid than traditional investments and are subject to market, interest rate, credit, leverage, counterparty and management risks. An investment in a derivative could lose more than the cash amount invested.

Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa.

Junk bonds have a greater risk of default or price changes due to changes in the issuer's credit quality. Junk bond values fluctuate more than high quality bonds and can decline significantly over a short time.

The Fund may hold illiquid securities that it may be unable to sell at the preferred time or price and could lose its entire investment in such securities.

Securities which are in the medium- and lower-grade categories generally offer higher yields than are offered by higher-grade securities of similar maturity, but they also generally involve more volatility and greater risks, such as greater credit, market, liquidity, management, and regulatory risks.

The investment techniques and risk analysis used by the portfolio managers may not produce the desired results.

The Fund invests in obligations, exempt from regular federal individual income taxes, of the governments of U.S. territories, commonwealths and possessions such as Puerto Rico, the U.S. Virgin Islands, Guam and the Northern Mariana Islands. As result, the Fund may be adversely affected by local political, economic, social and environmental conditions and developments, including natural disasters affecting such obligations. Certain municipalities the Fund invests in, such as Puerto Rico, have significant financial difficulties, including risk of default, insolvency or bankruptcy; and may be subject to credit rating downgrades affecting the payment of principal and interest, the market values and marketability of such municipal obligations.

There is no guarantee that the Fund's income will be exempt from federal and state income taxes.

Municipal securities are subject to the risk that legislative or economic conditions could affect an issuer's ability to make payments of principal and/ or interest.

The Fund may invest in municipal securities issued by entities having similar characteristics, which may make the Fund more susceptible to fluctuation.

The Fund is subject to certain other risks. Please see the prospectus for more information regarding the risks associated with an investment in the Fund.

Invesco Municipal Bond team
The Invesco Fixed Income Municipal Bond team's investment philosophy is based on the belief that creating long-term value through comprehensive, forward-looking research is the key to providing clients with diversified portfolios that aim to maximize risk-adjusted returns. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions, there can be no assurance that actual results will not differ materially from expectations. Proprietary credit research and risk management are the foundations of our investment process, supported by a deep and experienced team of investment professionals with expertise that spans the entire municipal investment universe. We maintain an integrated, team-based investment process that combines the strength of our fundamental credit research analysts with the market knowledge and investment experience of our portfolio managers. Our position as the sixth largest active municipal investment manager by assets in the US* enables us to access preferred market opportunities and gain valuable market insight. Our team has established relationships with more than 120 national and regional municipal debt dealers in the US. We believe these established relationships, as well as our size, allow us to achieve fluid execution in daily transactions. Our ability to aggregate trades across multiple portfolios also enables us to obtain lower institutional pricing, which can contribute to portfolio performance.
*Source: Simfund as of June 30, 2026.

Distribution Yield without sales charge represents a single distribution from the fund and does not represent the total return of the fund. The yield is calculated by annualizing the most recent distribution and dividing by the fund public offering price at max load.
SEC 30-day Yield is annualized and divided by maximum offering price on month-end.

Sources:
1. Standard and Poor's as of March 31, 2026, using 1-year rolling average, latest data available.
2. Bloomberg, as of June 30, 2026. The municipal bond index is represented by the Bloomberg Municipal Bond Index, an unmanaged index considered representative of the tax-exempt bond market. An investment cannot be made into an index. The numbers are the tax-equivalent yield (TEY) to show the shareholder experience. Assuming the 2025 top federal tax rate of 40.8%, 37% federal tax rate and 3.8% net investment income tax (NIIT), effective Jan. 1, 2026. Irs.gov, as of October 9, 2025. Top marginal tax rate for single taxpayers with more than $640,600 in taxable income or couples with more than $768,700. NIIT is the net investment income tax investment income for single taxpayers with more than $200,000 in taxable income or couples with more than $250,000.

Date	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18
TEY	5.84%	4.33%	3.33%	5.57%	3.70%	3.73%	4.69%	4.17%	4.54%
Date	12/31/19	12/31/20	12/31/21	12/31/22	12/31/23	12/31/24	9/30/25	12/31/25	
TEY	3.01%	1.81%	1.87%	5.99%	5.43%	6.32%	6.19%	6.08%	

3. Bloomberg, as of June 30, 2026.
4. Morningstar, as of June 30, 2026.

ORSTX: The Fund's investment objective is to seek tax-free income. For the prospectus, click here.
ISHAX: The Fund's investment objective is to seek federal tax-exempt current income and taxable capital appreciation. For the prospectus, click here.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions. The opinions expressed are those of the author, are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

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