

Investment Insights

Thoughts From The Municipal Bond Desk



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Overview

- Investor demand for municipal bonds is stronger than expected this year, even as new bond supply continues at record levels. This growing demand could help support muni bond prices going forward.
- Pre-paid gas municipal bonds can potentially be a fit for certain investors who want higher income and tax savings. They tend to offer better yields than traditional munis and can potentially deliver strong after-tax returns, especially for those in higher tax brackets.
- Municipal credit quality remains healthy overall, with more bonds being upgraded than downgraded year to date.

Tim: Let's talk about supply and demand in the muni market. Has anything changed from what you were expecting earlier this year?

Mark: Great question, Tim. Supply is still running at record levels this year, but the big shift is on the demand side, which has been stronger than many had originally expected. Some are predicting approximately \$200 billion of new money flowing into muni bond funds, ETFs, and separately managed accounts over the course of 2026.¹ That kind of inflow could add about \$50 billion in net growth to the muni market.¹ On the supply side, I'm still expecting around \$600 to \$625 billion in issuance to come to market, largely driven by energy-related and housing deals.¹ The bottom line is that with more buyers competing for bonds, muni prices could benefit — which could be a positive setup for investors who are already in the market or looking to get in.¹

Tim: You mentioned energy deals. Let's dig into pre-paid gas municipal bonds specifically. What makes them interesting for investors compared to traditional munis?

Mark: Pre-paid gas bonds—or “prepays”—are a type of municipal bond that could potentially be a fit for certain investors who want exposure to corporate institutions while earning tax-exempt income. They are not your traditional muni bond, in that they are not the obligation of the participating municipal utility, but rather that of a corporate institution who issues the bond through a special purpose entity. More than 90% of these institutions are large banks and insurers.² As such, prepays tend to carry investment grade ratings,³ while typically paying a higher yield than other investment grade munis. For example, the Bloomberg gas prepay index yielded 3.88% at the end of May, as opposed to the general obligation index's yield of 3.46%. Year to date, the prepay index has averaged a 42-basis-point yield advantage over general obligation bonds.³ Another consideration for prepays is the fact that many are structured with built-in safety features called termination payments. In plain terms, if the energy deal falls through or the supplier runs into trouble, investors get their money back at par or possibly even a bit more. That's a layer of protection you don't always see in municipals.

Tim: The broader economy has slowed down, but the credit quality of municipal bonds still looks solid. Are you seeing the same thing?

Mark: Absolutely. The pace of credit upgrades has cooled from the boom we saw a couple of years ago, but the trend is still heading in the right direction, with more muni credits being upgraded than downgraded.⁴ So far in 2026, there have been about 425 ratings upgrades compared to roughly 365 downgrades, for a ratio of 1.17:1.³ Interestingly, the total dollar value of downgrades is higher this year, but that's mostly a result of the Los Angeles wildfires on a limited number of issuers—not because muni credit is weakening across the board.⁴ I think that looking at the number of upgrades versus downgrades gives you a clearer picture of overall credit health than looking at dollar amounts alone, because one or two very large downgrades can skew the numbers. The big takeaway is that the fundamentals behind most municipal bonds remain strong. Many state and local governments have been managing their finances carefully, which puts them in a good position to handle future borrowing for roads, schools, and other long-term projects.⁵

Munis by the numbers

A quick look at some commonly used municipal market datapoints.

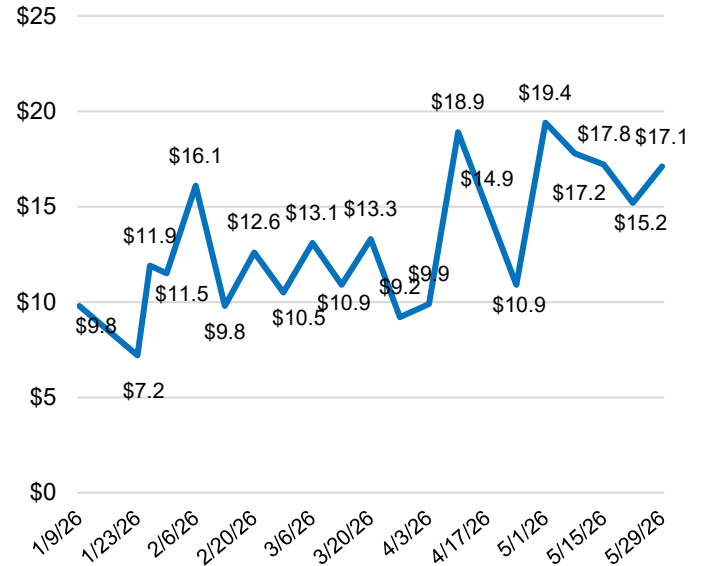
2026 Fund Flows - Weekly and Monthly Reporters (\$millions)

Week ended May 27, 2026

	Combined	Open End Mutual Funds	ETFs
All term muni funds	39,763	21,261	18,502
Investment Grade	34,016	16,663	17,352
High Yield	5,747	4,598	1,150
Long Term (10yr +)	23,296	11,100	12,196
Intermediate (5-10yr)	11,772	7,593	4,179
Short / Intermediate (3-5yr)	3,436	2,090	1,346
Short (1-3yr)	1,260	478	781
National funds	34,518	18,206	16,312
New York	646	219	427
California	3,498	1,876	1,622

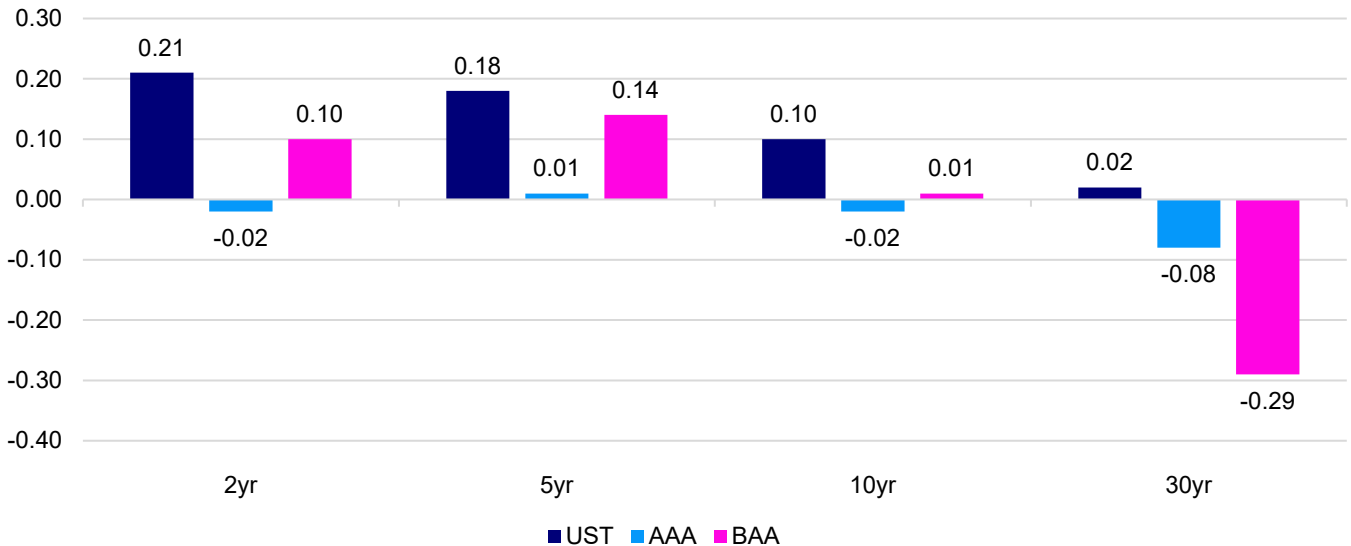
Source: Year to date LSEG Lipper Global Fund Flows, J.P. Morgan. Data refreshed on May 28, 2026. Note: Figures shown on this table are combination of weekly and monthly reporters.

30-day Visible Supply (\$billions)



Source: Bond Buyer Weekly 30-Day Visible Supply - Total dollar volume of bonds to be offered over the next thirty days. It does not include 'Sealed Bids Invited' or 'Proposed Bond Issues'. Only includes Municipal Bonds. From January 9, 2026 – May 29, 2026.

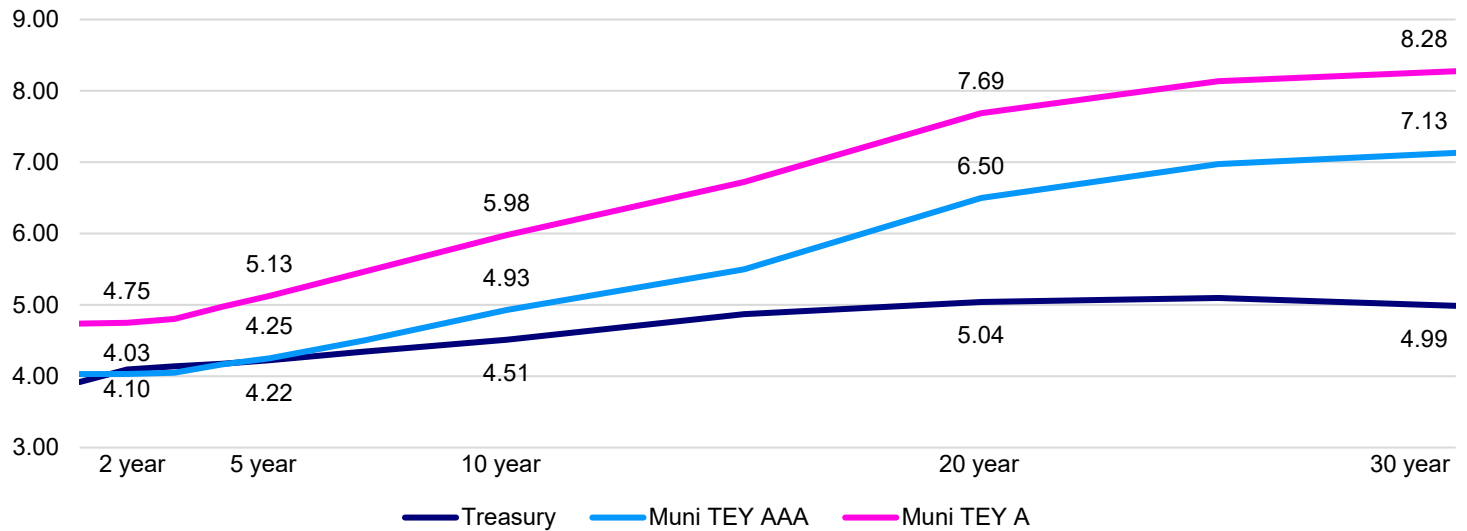
1-Month Yield Change 5/01/2026 – 6/03/2026 (% Change)



Source: Refinitiv MMD Curve, US Department of Treasury, from May 1, 2026 – June 3, 2026. UST = United States Treasury. 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. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice. NR indicates the debtor was not rated and should not be interpreted as indicating low quality. 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 'Rating Methodologies' 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.

Munis by the numbers

Current Muni Treasury Ratio and Tax-Equivalent Yields (%)

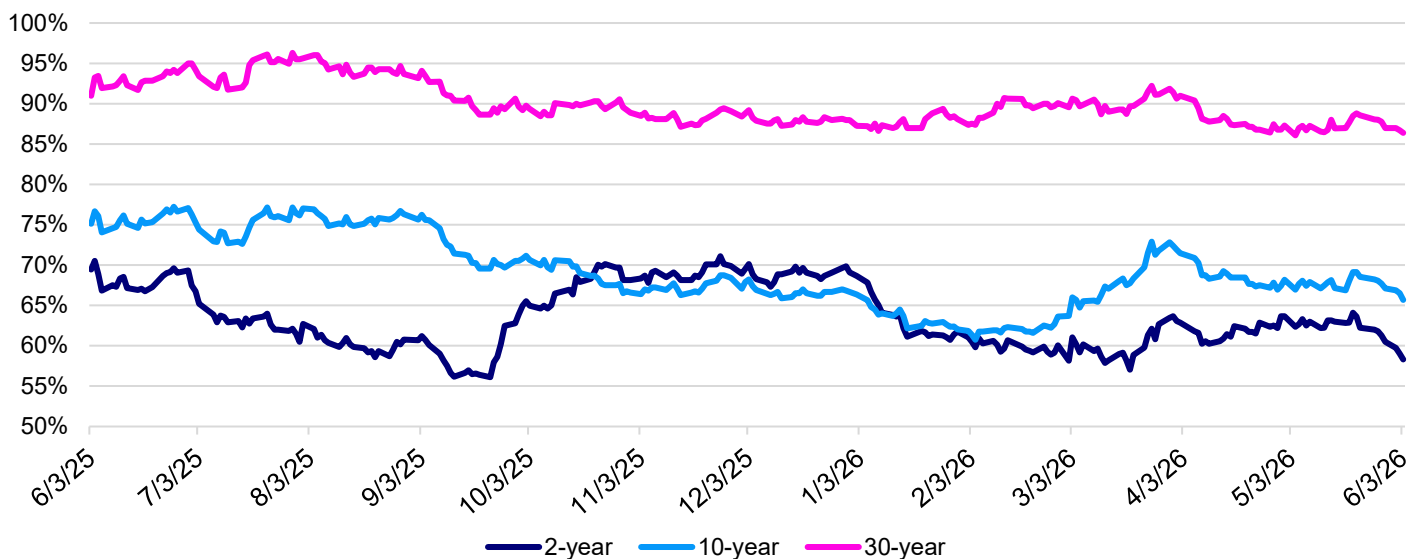


Term	US Treasury (UST)	Muni AAA	Muni A	Muni TEY AAA	Muni TEY A	Muni UST Ratio	Muni TEY UST Ratio
2 year	4.10	2.39	2.81	4.03	4.75	58.3%	98.4%
5 year	4.22	2.52	3.03	4.25	5.13	59.6%	100.7%
10 year	4.51	2.92	3.54	4.93	5.98	64.7%	109.3%
20 year	5.04	3.85	4.55	6.50	7.69	76.3%	128.9%
30 year	4.99	4.22	4.90	7.13	8.28	84.7%	143.0%

Source: Bloomberg, as of June 3, 2026. TEY = Tax-Equivalent Yield. UST = United States Treasury. US Treasury is represented by the public obligations of the US Treasury. Treasuries are backed by the full faith and credit of the US government as to the timely payment of principal and interest, while legislative or economic conditions could affect a municipal securities issuer's ability to make payments of principal or interest. Muni AAA is represented by the Municipal AAA GO bond yield, a Municipal Market Data proprietary yield curve of AAA-rated state general obligation bonds, based on the institutional block size of \$2million-plus market activity in both the primary and secondary bond market. The Muni TEY AAA is the Tax-Equivalent Yield is assuming a top tax rate of 40.8% of the Muni AAA yield. Muni A is the Bloomberg Municipal Bond A Index is an unmanaged index of the A-rated municipal bond market. The Muni TEY A is the Tax-Equivalent Yield is assuming a top tax rate of 40.8% of the Muni A yield. The Muni UST Ratio is the comparison of the Muni AAA vs. the yield on the US Treasury. The Muni TEY UST Ratio is the Tax-Equivalent Yield is assuming a top tax rate of 40.8% of the Muni UST Ratio. An investment cannot be made directly into an index.

Tax-equivalent yield assuming a top 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.

Municipal/Treasury Ratio



Source: Thomson Reuters TM3, as of June 3, 2026. US Treasury is represented by the public obligations of the US Treasury. Treasuries are backed by the full faith and credit of the US government as to the timely payment of principal and interest, while legislative or economic conditions could affect a municipal securities issuer's ability to make payments of principal or interest. The Municipal AAA GO bond yield is represented by the Municipal Market Data proprietary yield curve of AAA-rated state general obligation bonds, based on the institutional block size of \$2million-plus market activity in both the primary and secondary bond market. Past performance does not predict future returns. An investment cannot be made directly into an index.

A basis point is a unit that is equal to one one-hundredth of a percent.

Fundamentals refer to the forces of supply and demand in determining price.

Sources:

1. Morgan Stanley, as of May 18, 2026.
2. Barclays, as of November 21, 2025. Latest data available.
3. Bloomberg, L.P., as of June 1, 2026. Prepaid gas ratings: 33.3% rated AA, 60.8% rated A, 5.8% rated BBB, 0.1% below BBB or non-rated. Bloomberg gas prepay index is represented by the Bloomberg Municipal Gas Forward Revenue Index, sub-index of the broader Bloomberg Municipal Bond Index, with the "Gas Forward" classification capturing municipal bonds issued by gas utility entities structured as forward revenue obligations. The Bloomberg Municipal Bond Index is an unmanaged index considered representative of the tax-exempt bond market. An investment cannot be made into an index. 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. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice. NR indicates the debtor was not rated and should not be interpreted as indicating low quality. 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
4. Bloomberg, L.P., as of May 11, 2026.
5. Bloomberg, L.P., as of May 26, 2026.

About risk

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.

Junk bonds involve greater risk of default or price changes due to changes in the issuer's credit quality.

Any reference to a rating, ranking or an award is not a guarantee of investment performance and is not constant over time.

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. The values of junk bonds fluctuate more than those of high-quality bonds and can decline significantly over short time periods.

All fixed income securities are subject to two types of risk: credit risk and interest rate risk. Credit risk refers to the possibility that the issuer of a security will be unable to make interest payments and/ or repay the principal on its debt. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa.

Municipal bonds are issued by state and local government agencies to finance public projects and services. They typically pay interest that is tax-free in their state of issuance. Because of their tax benefits, municipal bonds usually offer lower pre-tax yields than similar taxable bonds.

All data as of June 3, 2026, unless otherwise stated.

All data provided by Invesco unless otherwise noted.

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