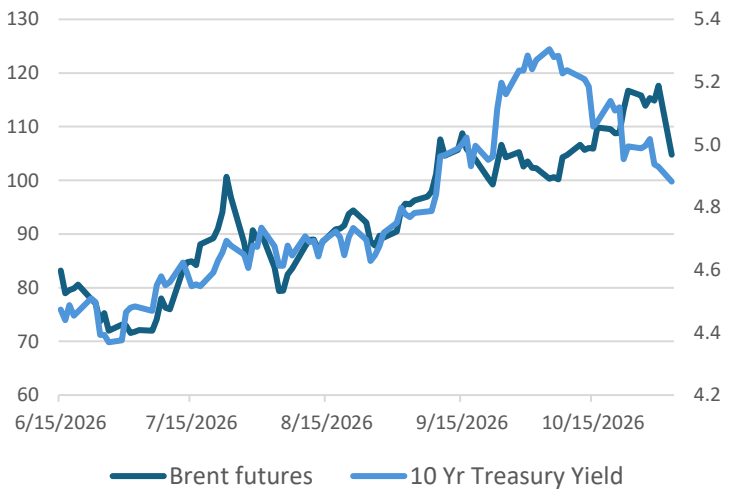
INSIGHTS & OBSERVATIONS

ECONOMIC, PUBLIC POLICY, AND FED DEVELOPMENTS

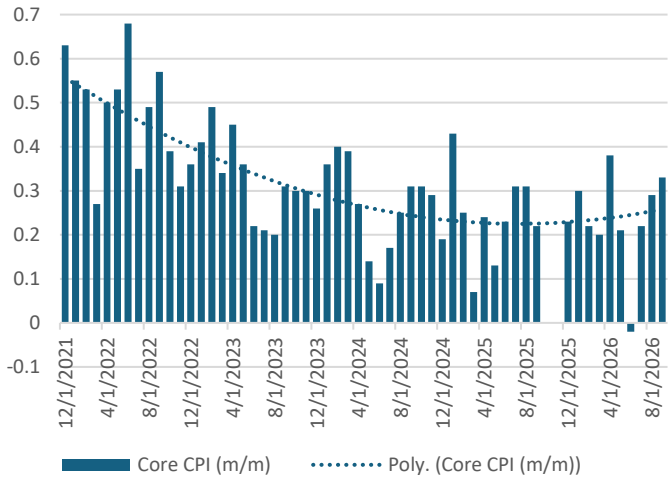
- **Despite some stiff competition, we'd argue the breakdown in correlation between Brent oil and the 10Yr UST was the biggest economic news of the past month.** The treasury curve had been trading tightly with the price of oil since the summer, but after September's runup in rates following a break in technical resistance, a sharp selloff in AI stocks on overinvestment fears caused Treasuries to catch a bid. The 10Yr is sitting back under 5%, and we're reassured to see it behaving in a more normalized manner.
- It would have been more reassuring still had Fed Chair Kevin Warsh not then tried to attribute this return to normalcy to the Fed's September 25bps hike. In his October press conference, Warsh managed to partially undo some of the good he had done in September, in our eyes. **He struck a dovish tone and attributed the above-mentioned normalization in yields to the Fed's intervention, not AI concerns.** He also stressed that he was happy with how the "spoonful of medicine" the Fed had administered was working through the economy, which given the infamous "long and variable lags" of monetary policy stretches plausibility. This follows an appearance in Thailand where he emphasized a stronger push from the press to more closely focus on monetary policy than he felt necessary. **We still believe the Fed will ultimately remain committed to beating inflation, but we think Warsh hurt his credibility and came across a man hoping to change the subject from inflation.**
- This is doubly concerning because inflation continues to surprise to the upside. Core CPI in September beat a tenth, +0.3% vs +0.2%, and came within a fraction of rounding to +0.4%. Inflation readings have been volatile but had been steadily falling into 2025; they appear to have bottomed out early that year, however, and have trended upwards since then, even before the war in Iran. **One of the reasons we expect further Fed Funds hikes is the trend in inflation data suggests monetary policy likely fell below neutral and became accommodative in 2025, and it may be hard to cut below current levels.**
- **The Nonfarm Payrolls report at the start of the month missed, 29k vs. an expected 90k.** The details of the report were more nuanced. The unemployment rate rose, but it was due to an increase in participation and not a fall in employment. Meanwhile, after a long period of bouncing between 34.2 and 34.3 hours, the average workweek has now been at 34.4 hours for two months. We might take all of this as evidence of healthy labor demand despite the headline miss had not the average hourly earnings missed, +0.1% vs. a consensus +0.3%. That's still a reasonably healthy +3.0% on a trailing-year basis, comfortably higher than pre-pandemic norms. Earnings are still trending lower, however, and inflation is also higher than pre-pandemic levels, making nominal strength a little less impressive on a real basis.
- **America voted in the midterm elections on Tuesday the 4th. Most, if not all, of the races have been settled by this time, and we will discuss election implications in future publications.**

The Correlation Between Yields and Oil Broke Over the Second Half of September ($ and %)



Source: ICE, Bloomberg

Core Inflation Stopped Falling In Early 2025, But Is Now Rising (monthly % change)



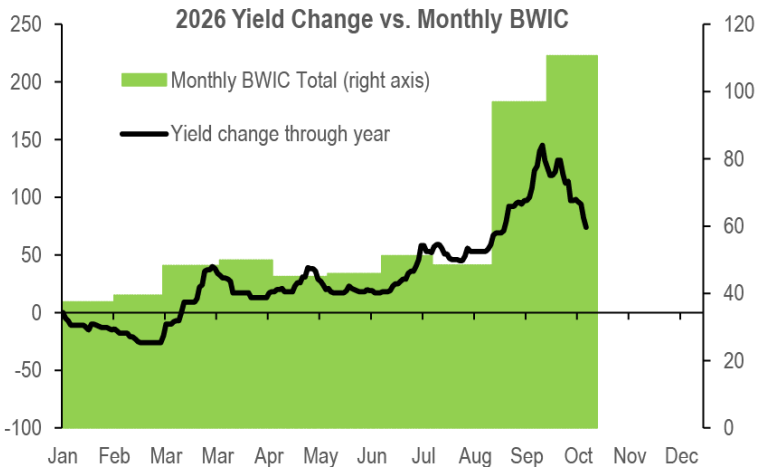
Source: Bureau of Labor Statistics

Sources: Bloomberg, Bureau of Labor Statistics, and Intercontinental Exchange

FROM THE TRADING DESK

MUNICIPAL MARKETS

- After the sharp selloff in September, municipal yields started the month at multi-year highs on the back of record primary and secondary market supply.
- Having demonstrated significant value both on an absolute and relative tax-equivalent basis, **October saw a significant rally in rates, almost fully retracing the yield increase of the prior month.** This produced the best monthly October return since 1980 (JP Morgan) with the Bloomberg Municipal Bond Index gaining +3.85%. Specifically, 1 to 5-yr maturities saw yields drop by 76- 86bps, 7 and 10-yrs by 71bps, 12 to 15-yrs by 64-68bps points, and the long-end closed lower by 32bps.
- **The municipal curve bull steepened dramatically as front-end yields fell by over a factor of 2x relative to the long end** (80bps vs 32bps). Consequently, the 2-10s steepened by 17 bps, and within that range 2-5s accounted for 12 bps of the move. The 2-30s slope steepened by 56 bps to close at 215 bps, prompting many investors to embrace longer-dated maturities.
- Ratios richened substantially, with all points on the curve tightening by at least 2.75% and the front-end experiencing double digit ratio moves. Specifically, the 2-year got richer by 15%, the 3-year by 12.42%, and the 5-yr by over 10%. **Ratios for the 7- and 10-yr portions of the curve fell by 8.7-9% in a descending fashion, and the month closed with most intermediate maturities in the 60-68% range.**
- While net municipal fund flows were solidly positive (+$1.1 - $1.7B weekly), there was significant divergence between ETFs and municipal open-end funds. The former was strongly positive while the latter registered redemptions throughout the month on account of tax-loss harvesting trades.
- **October saw $45B in long term tax-exempt supply, a slowdown of 7% relative to the prior October. However, on a YTD basis, issuance has increased 6% YoY.**

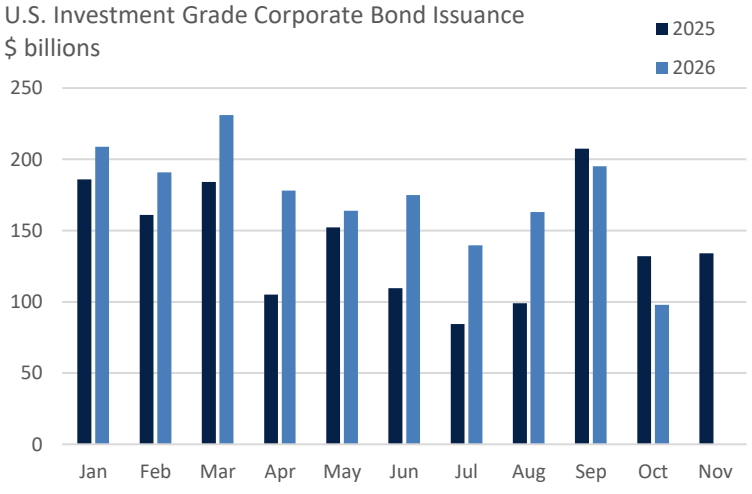


BWIC = Bid Wanted in Competition in finance

Source: JP Morgan

CORPORATE AND TREASURY MARKETS

- Stronger oil prices, persistent above-target inflation, and deficit concerns drove a September US Treasury sell off that spilled into October. That carryover was short lived as the October 7th FOMC minutes release confirmed a unanimous expectation of hiking rates further before the end of the year. A rate rally slowly ramped up mid-month with a rally fully in play to close out October. Intermediate and longer rates fell 30 - 35bps, well above the 7–16bps 1yr and in on the month. At one point the 10Yr benchmark bond broke through a resistance of 5%, and it has held in ever sense. **We expect an additional hike in December and see potential for the curve to steepen over the 2 to 10Yr maturity range.**
- The US Investment Grade market saw some spread widening amid a sizable UST rally. The Bloomberg US IG Corporate Index posted a positive total net return for the month and the best performing month YTD. Lower UST yields was a big factor, offsetting +7 bp OAS of spread widening. **Despite credit underperforming USTs, investment grade fundamentals remained intact regardless of Fed policy uncertainty, inflation pressure, geopolitical risk, and higher energy prices.**
- **The primary market set an annual issuance record of $1.76 trillion even as mid-month volatility forced multiple borrowers to stand down.** Even though new issuance is expected to slow somewhat, as fatigue from the AI boom is now impacting buyers, we anticipate a degree of further spread widening as year-end approaches.



Source: Bloomberg

Sources: Bloomberg, Bond Buyer, Barclays, JP Morgan, and Lipper Inc.

PUBLIC SECTOR WATCH

CREDIT NOTES

Bond Measures and Ballot Initiatives in the Recent Election

There were several sizable bond measures and impactful ballot initiatives on the ballot that deserve attention in the midterm elections. Looking first at bond measures, over **$133B of bonds were on the ballot for approval** in this election. This total is up over 11% from 2024, largely driven by population growth in the major issuers along with persistent inflation that has increased the cost of financed projects. **Texas and California remain the primary drivers of new issuance**, accounting for 47% and 38% of the total, respectively.

Turning our attention to ballot initiatives, **various measures could have impact on municipal credit**, with the most pertinent summarized below. The research team will monitor these and other initiatives and will periodically update our credit opinions.

Ballot Initiative	Purpose	Impact	Outcome
Florida Amendment 3	Increases the current $50K homestead exemption to $150K in 2027 and $250K in 2028, with the exemption indexed to inflation going forward	Lost tax revenue state-wide is estimated at $8.7B by 2029, forcing local governments to seek new revenue streams or significant expense cuts to balance operations	Passed
California Prop 40	Imposes a one-time 5% wealth tax on taxpayers with assets over $1B	The tax is estimated to raise upwards of $100B, but could risk driving more high earners out of the state	Uncalled with NO leading
California Prop 3	Makes permanent the current tax rate for high earners that is set to expire in 2031	Would remove the risk the tax rates expire in 2031, maintaining the estimated $15B in revenue generated from the higher rate	Passed
Colorado Amendment 87	Replaces the state's flat 4.4% income tax rate with a progressive tax system, with rates ranging from 3.7% to 8.4% for high earners	The amendment would cut taxes for approx. 97% of filers and is estimated to generate over $2B in additional revenue	Too close to call
Washington Initiative 645	Repeals the 9.9% income tax on incomes over $1MM set to begin on 1/1/28, while also prohibiting the state from imposing an income tax in the future	Would eliminate the estimated $8.3B in revenue expected to be raised through the first two years of collections, while also limiting the state's revenue raising flexibility going forward	Uncalled with NO leading
North Carolina Income Tax Amendment	Reduces the constitutional cap on the state's income tax rate from 7% to 3.5%	No impact in the near term given the estimated 3.49% income tax rate in 2027, but it would limit the state's revenue raising flexibility going forward	Passed
North Carolina Property Tax Amendment	Amends the state constitution to require the state legislature to pass laws limiting the growth rate of local property taxes	Little impact in the near term but would limit local governments revenue-raising flexibility going forward	Passed
Oklahoma State Question 847	Reduces the annual growth limit of the fair value of property from 5% to 4% and reduces the annual growth limit of the value of property that qualifies for a homestead exemption from 3% to 1.75%	Little impact in the near term but would limit local governments revenue-raising flexibility going forward	Failed
Iowa Amendment 1	Amends the state constitution to require a 2/3rds majority of both chambers of the state legislature to raise and/or create new personal and corporate income taxes	Would limit the state's revenue raising flexibility going forward given the difficulty in achieving this higher bar for approval	Uncalled with YES leading

**Outcomes are generally unofficial and based upon the most recent data available.

Sources: https://ballotpedia.org/, California Secretary of State, Texas Bond Review Board, JP Morgan Research, Morgan Stanley Research, BondBuyer

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