

# Q1 2026 Newsletter

Market and Credit Insights from Belle Haven's Investment Team



## The Middle East Conflict Was Not on Our Market Bingo Card

### Market Insights

Q1 2026 was an eventful quarter with lots of volatility. Given this, we believe it is important to consider how municipal credit may be affected, and why municipals can serve as a strong foundation within an investment portfolio. March's -2.32% return of the broad municipal market<sup>1</sup> following the February 28th attack on Iran reflected rising interest rates and technicals related to new issue supply. **It did not reflect credit concerns.** While some credits may experience incremental pressure, we believe the risk of material or widespread downgrades remains limited at this time. It is also important to remember the incredibly low default rate of investment-grade municipal bonds.

<sup>1</sup> Bloomberg Municipal Bond Index MTD Total Return as of March 31, 2026

### What's inside our latest issue:

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#### Market Insights

- The Manic Quarter
- Looking Ahead
- Belle Haven's Approach

#### Credit Insights

- Tax the Rich: What does it actually mean for your muni portfolio?

## Municipal Bonds Historically Have Low Default Rates

15-year Average Cumulative Default Rates

Credit Quality	Municipal	U.S. Corporate
AAA	0.00%	1.10%
AA	0.04%	1.34%
A	0.13%	2.39%
BBB	0.96%	5.34%
BB	5.07%	16.26%
B	10.84%	27.63%
CCC/C	37.80%	57.70%
Investment-grade	0.22%	3.31%
Speculative-grade	8.32%	25.46%

Source: U.S. corporate defaults 1981-2024, S&P Global Ratings Credit Research & Insights and S&P Global Market Intelligence's CreditPro. March 2025. Municipal 1986-2024, Excludes housing. Source: S&P Global Ratings Credit Research & Insights. May 2025.

### The Manic Quarter

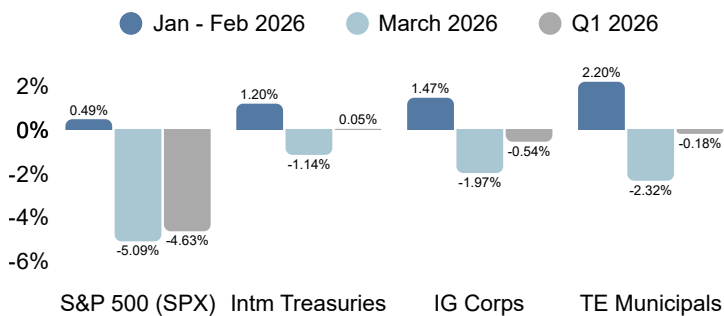
The quarter told two very different stories: an early period of steady gains followed by a sharp shift in sentiment that reversed performance across markets.

The quarter opened with fixed income returns in the first two months ranging between 1 - 3%, extending the momentum seen in the second half of 2025. Economic data did not clearly indicate a need for the FOMC to act in either direction, and the market was not pricing in rate cuts until the mid-to-late part of the year. The primary question centered on how the FOMC would respond under new leadership when Jerome Powell's term ends in May.

However, on February 28, market sentiment shifted quickly. The prevailing narrative changed, and performance turned negative across sectors.

### One Quarter, Two Stories

The majority of change took place in the last month of the quarter



Source: Bloomberg, 3/31/2026

Equity markets shifted from focusing on potential Fed leadership changes to the risk that an oil-driven inflation spike could push the FOMC toward a more hawkish stance. The rates market initially viewed the move in oil as transitory, expecting policymakers to look through energy-related inflation at the March 17 meeting. That perception changed after the press conference, where questions centered on whether the Fed truly viewed the shock as temporary and how it would balance inflation risks with maximum employment.

Chair Powell's responses were interpreted as hawkish, and rates quickly moved higher. Some viewed the messaging as jawboning to tighten financial conditions without action. By quarter-end, markets were not pricing a clear directional move, with little conviction around cuts or hikes over the next two meetings.

The municipal market entered March already facing seasonal weakness, with some investors raising cash for tax payments, a heavy calendar, and rich MMD-to-Treasury ratios. The Iran conflict magnified these pressures, triggering an aggressive sell-off with 5- and 10-year high-grade yields rising approximately 60-66 bps. Intermediate maturities and longer-duration 4% coupon bonds, including short-call structures, underperformed, while shorter-duration bonds experienced only modest declines. These moves pushed returns negative year-to-date and normalized curve steepness inside 20 years, while the long end remains extremely flat due to expectations for heavy issuance.

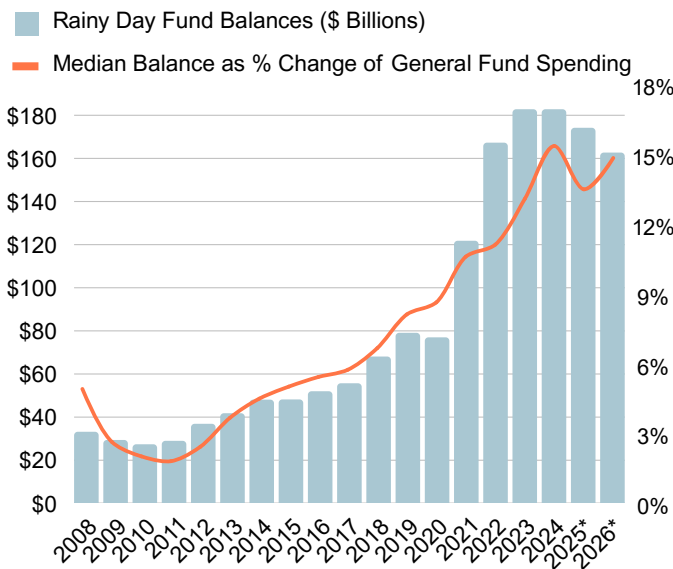
Fund flows also weakened late in the quarter. Municipal funds posted their first outflow in 18 weeks led by high-yield and long-duration funds, while tax-exempt money market funds saw \$760 million of inflows. Heavy issuance added additional pressure, putting 2026 on pace for roughly \$600 billion in supply. Despite this shift, year-to-date inflows remain strong, suggesting demand has not disappeared and valuations have improved.

### Looking Ahead

As we anticipate continued volatility, we remain focused on defensive portfolio structures and credits that have historically demonstrated resilience across market cycles.

We expect local tax-backed and essential service revenue bonds, such as water/sewer and electric utilities, to remain resilient. These issuers typically experience gradual change and tend to be less sensitive to short-term economic volatility. State credits may experience more variability given economically sensitive revenue streams, but financial management has improved since the Great Fiscal Crisis and rainy day funds remain near historical highs.

### State Rainy Day Funds are Near Historical Highs



\*Fiscal 2025 are preliminary actual figures and fiscal 2026 are enacted figures. Source: NASBO, 3/3/2026

The rates markets have adopted a more hawkish tone, but we believe the Fed may remain on hold in the near term. Current policy is already mildly restrictive, and holding rates steady over the next one to two meetings may be sufficient to manage inflation. While an extended oil shock could create short-term inflation pressure, it would likely also slow growth. This dynamic suggests the Fed may ultimately shift focus toward employment risks rather than tightening policy

further, keeping the door open for potential cuts later in the year if growth softens.

### Belle Haven's Approach

The first quarter reinforced our focus on maintaining defensive structures while remaining positioned to take advantage of opportunities created by volatility. With rates repricing, technicals shifting, and supply expected to remain elevated, we believe disciplined credit selection, curve positioning, and structural awareness will be increasingly important in the months ahead.

### Tax-Exempt Strategies

Following the March sell-off, valuations improved across much of the municipal curve, particularly in intermediate maturities where the repricing was most pronounced. With the curve normalizing inside of 20 years but remaining flat further out, where much of the expected supply is likely to price, we see selective opportunities emerging across both the primary and secondary markets.

From a structural standpoint, we continue to favor stable call structures and higher coupon bonds, particularly 5% coupons with longer calls. These structures tend to offer more predictable behavior in volatile rate environments. Conversely, we remain cautious on lower-coupon premium bonds, particularly 3–4% coupons, where extension risk and convexity pressures could increase should rates remain elevated. As volatility persists, we believe structure selection will remain a key driver of performance and risk management.

We also continue to emphasize high-quality credits, particularly local tax-backed and essential service revenue bonds such as water, sewer, and electric utilities. These issuers typically experience gradual fundamental changes and tend to be less sensitive to short-term economic volatility. While state credits may see more variability tied to economically sensitive revenues, balance sheets remain strong and rainy-day reserves near historically high levels, providing an additional layer of stability.

## Taxable Strategies

Taxable municipals continued to demonstrate resilience during the quarter, reinforcing our view that high-quality income streams can provide stability during periods of broader market stress. While March volatility widened spreads across many risk assets, taxable municipal spreads remained relatively stable, highlighting their lower correlation to equity markets and reduced exposure to downgrade risk.

Although corporate credit fundamentals generally remain stable, market performance continues to be driven more by macro uncertainty, geopolitical risks, and policy ambiguity than issuer-level credit deterioration. Ongoing stress in private credit, elevated leverage in certain sectors, and tight spreads in lower-quality credit reinforce our cautious stance toward areas where compensation for risk remains limited.

Against this backdrop, we remain focused on higher-quality segments of the market, particularly taxable municipals, where we continue to see attractive income supported by strong fundamentals. We believe this positioning allows portfolios to generate compelling yields without reaching into lower-quality credit or increasing sensitivity to equity-like volatility.

## Belle Haven Strategy Performance: Q1 2026

Gross of Fees\*

	<b>Trailing 12-Month Total Return (gross of fees)</b>
<b>Taxable</b>	<b>Taxable PLUS<sup>®</sup></b> <span style="float: right;"><b>5.51%</b></span>
	Bloomberg U.S. Agg <span style="float: right;">4.35%</span>
<b>Tax-Exempt</b>	<b>Taxable Ladder PLUS<sup>®</sup></b> <span style="float: right;"><b>5.32%</b></span>
	Bloomberg Int Gov/Credit <span style="float: right;">4.41%</span>
<b>Tax-Exempt</b>	<b>Muni PLUS<sup>®</sup></b> <span style="float: right;"><b>5.27%</b></span>
	Bloomberg MM 1-17 Yr <span style="float: right;">4.53%</span>
<b>Tax-Exempt</b>	<b>Ladder PLUS<sup>®</sup></b> <span style="float: right;"><b>4.59%</b></span>
	Bloomberg MM 1-10 Yr <span style="float: right;">4.08%</span>
<b>Tax-Exempt</b>	<b>3-17 Year Ladder<sup>®</sup></b> <span style="float: right;"><b>4.69%</b></span>
	Bloomberg MM 1-17 Yr <span style="float: right;">4.53%</span>

\*All returns and valuations are calculated using U.S. Dollars and are based on trade date accounting. Performance is calculated gross of all advisory fees and management fees deducted from the account using a time-weighted total return methodology. Actual Performance results may differ from composite returns, depending on the size of the account, investment guidelines and/or restrictions, inception date and other factors. A complete list of Belle Haven Investment's composite descriptions and policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request by contacting [service@bellehaven.com](mailto:service@bellehaven.com).

\*Performance data presented includes comparisons to Bloomberg Municipal Bond Indices. These indices are unmanaged and do not reflect the deduction of advisory fees, trading costs, or other expenses. They are shown for informational and comparative purposes only. Investors cannot invest directly in an index. Please note that differences in portfolio construction, investment strategy, risk tolerance, and client-specific guidelines can result in significant performance variances relative to any benchmark or index. The referenced index or indices have been selected either by your advisor or by Belle Haven to provide a relevant point of comparison, based on similarities in portfolio characteristics to your investment strategy. For additional details regarding performance calculations and risk considerations, please refer to the full disclosures at the end of this report.



## Tax the Rich

### *What Does It Actually Mean for Your Muni Portfolio?*

#### CREDIT INSIGHTS

Headlines around higher taxes on wealthy residents in states like New York, California, Washington, and Michigan have become a recurring theme, while migration trends have provided a tailwind for lower-tax states such as Florida and Texas. For muni investors, the instinctive question is: what does this mean for credit quality, market technicals, and portfolio positioning? The reality is more nuanced than the loudest voices on either side would suggest.

#### **Do Higher Taxes on the Wealthy Actually Raise Revenue?**

The short answer is yes, and often by more than expected. Recent examples from Massachusetts and New Jersey offer the most instructive guidance. Massachusetts' Fair Share Amendment, which imposed a surtax on incomes above \$1 million, generated billions more in new revenue than initial projections. In New Jersey, both temporary and permanent millionaire tax increases have historically produced revenues that substantially outpaced forecasts.<sup>1,2</sup> This reflects a structural reality: high earners already account for a disproportionate share of state income tax receipts, so even modest rate increases produce outsized near-term gains.

However, this revenue concentration introduces a critical tradeoff that every credit analyst should flag: greater reliance on a narrower, more economically sensitive tax base. States like California and New York are already highly exposed to capital gains and market-driven income, a dynamic that can amplify both budget surpluses in good times and shortfalls in downturns.

<sup>1</sup> The Boston Globe, "Massachusetts Millionaires Tax Revenue," August 2025.

<sup>2</sup> Wealth Management, "New Jersey Reaches Deal for Millionaire Tax." September 2020.

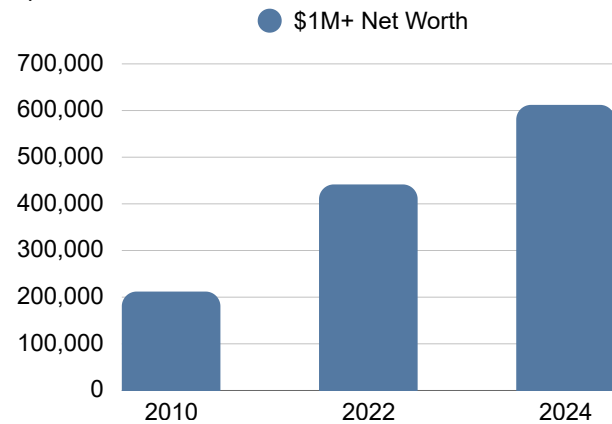
### The Migration Question: Real, But Overstated

The narrative of mass exodus following tax increases makes for compelling headlines but holds up poorly under scrutiny. Empirical research consistently shows that only 2–3% of millionaires relocate across state lines in any given year<sup>3</sup>, and tax policy is rarely the primary driver. Migration decisions are shaped by retirement timing, housing costs, employment opportunities, and family considerations. Research points to high housing costs as the most significant factor in interstate moves.<sup>4</sup>

Notably, many high earners who do leave high-tax states relocate to other high-tax states, not exclusively to low- or no-tax jurisdictions. In Massachusetts, IRS data does show net outflows of adjusted gross income in recent years, but a closer examination reveals that outmigration trends predated the recent tax changes, that much of the decline reflects retirees rather than active earners, and that the total number of high-net-worth individuals in the state has continued to grow.<sup>5</sup>

### Massachusetts Is Minting Millionaires

Massachusetts' millionaire population has nearly tripled since 2010



Source: Institute for Policy Studies "Wealth Expands After Higher State Taxes on High-Income Earners." April 2025

The bottom line is this: migration risk exists but is modest, and states with strong institutional anchors, such as world-class universities, technology clusters, and financial centers, tend to retain their high-earning base even as tax rates rise.

*Tax policy influences behavior, but it is rarely the dominant driver of migration or economic performance.*

### Tax Regime Has Had Little Impact on Muni Returns

Comparisons between high-tax and low-tax states do not show consistent or statistically significant differences in economic growth trajectories or pre-tax investment returns.<sup>6</sup> The table below illustrates the point with S&P Municipal State Index data:

State	Tax Regime	3-Year Return	5-Year Return	Duration
California	High-Tax	2.88%	0.88%	5.88 years
New York	High-Tax	2.95%	1.00%	6.21 years
New Jersey	High-Tax	3.35%	1.45%	5.47 years
Texas	No income tax	2.88%	0.79%	6.40 years
Florida	No income tax	3.34%	1.25%	6.20 years

Source: S&P Municipal State Indices as of 3/31/2026. Index maturity ranges and duration profiles differ from Belle Haven strategies; therefore, returns are not directly comparable and are shown for illustrative purposes only.

High-tax states delivered an aggregate three-year annualized return of 3.07% versus 3.14% for no-income-tax states, a difference that is essentially statistical noise. From a total return standpoint, the tax regime has not been a meaningful differentiator. After-tax returns for individual investors in high-tax states will, of course, diverge, which is precisely why tax-exempt munis from those states carry pricing power and consistent demand.

### The Real Credit Question: Stability, Not the Tax Rate

From a credit perspective, the more important question is not whether a state raises taxes but how it deploys and manages the resulting revenue. Higher millionaire taxes can be genuinely credit-positive when the additional revenues are used to build or maintain rainy-day reserves, fund long-term

<sup>3</sup> Tax Policy Center, "Do High State Taxes Drive Away Millionaires? Not Really."

<sup>4</sup> Cristobal Young, "Millionaire Migration and State Taxation." National Tax Journal, 2018; CBPP, "State Taxes Have a Minimal Impact on People's Interstate Moves."

<sup>5</sup> IPS, "Wealth Expands After Higher State Taxes on High-Income Earners."

<sup>6</sup> Urban Institute, "The Relationship Between Taxes and Growth at the State Level."

investments in education and infrastructure, and reduce reliance on deficit financing during downturns.

The risks, however, are real and worth monitoring:

**Revenue volatility.** Income taxes tied to capital gains and financial market performance can swing dramatically with economic cycles. A state that structures its millionaire surtax without smoothing mechanisms, as Massachusetts wisely did by building in structural guardrails, becomes more exposed to sharp revenue swings in a downturn.

**Concentration risk.** In states like California and New York, the top 1% of taxpayers already account for roughly 40-50% of income tax collections. Additional taxes deepen this concentration, meaning a relatively small behavioral shift among top earners, particularly in a prolonged bear market, can have outsized budget consequences.

**Spending lock-in.** The most damaging credit scenario is when states use cyclical revenue windfalls to fund recurring expenditures. Rating agencies have consistently flagged this pattern as a leading indicator of credit deterioration. A millionaire tax that funds one-time capital investments presents a very different credit story than one used to permanently expand entitlement programs.

Importantly, historical credit rating changes have shown very little direct correlation with the implementation of higher millionaire taxes. Upgrades and downgrades have been driven far more by reserve fund levels, structural budgetary balance, and the quality of fiscal management than by the tax rate itself.

*States that pair higher taxes with disciplined reserve-building tend to see neutral-to-positive credit outcomes. States that expand spending aggressively on cyclical revenue may face pressure in downturns.*

### The Belle Haven View: What to Watch as an Investor

Millionaire tax debates are worth monitoring as leading indicators of state fiscal behavior, not as automatic red or green flags for credit quality. A few key signposts:

**Watch the reserve picture.** State rainy-day funds remain near historical highs across much of the country. States that deploy new millionaire tax revenues into reserves first rather than new spending are demonstrating the kind of fiscal discipline that supports credit stability.

**Evaluate the structural design of the tax.** Surtaxes with thoughtful caps or smoothing mechanisms, like the Massachusetts model, represent a more credit-neutral structure.

**Don't overreact to migration headlines.** The data suggests outmigration risk is real but modest. States with strong economic anchors such as institutional depth, employment diversity, and infrastructure quality have proven resilient even as their high earner populations face higher tax burdens.

**Demand remains a tailwind.** Paradoxically, higher state income taxes in markets like New York and California can increase the appeal of in-state tax-exempt municipal bonds for residents. The greater the tax burden, the more valuable the tax exemption becomes, helping support in-state demand.

**Bottom line:** The narrative of a mass wealthy exodus undermining state finances is overly simplistic. California and New York alone are home to nearly 60 million people combined, so even small percentage shifts can generate eye-catching headlines, while still leaving the vast majority of residents in place. Most high-income taxpayers are not going to relocate, and in higher-tax states the value of tax-exempt income often increases, helping support in-state demand. At the same time, the idea that higher taxes are a durable fiscal cure-all is equally flawed.

For credit-focused muni investors, the key question is not simply whether taxes are raised, but whether the resulting revenue is managed wisely enough to improve, or at least preserve, the credit profile of the issuers we hold.

**Summary: Millionaire Taxes and Muni Credit**

Factor	Belle Haven Assessment
<b>Revenue Impact</b>	Generally positive in near term; revenues often exceed projections
<b>Migration Risk</b>	Present but modest; only 2–3% of millionaires relocate annually
<b>Economic Impact</b>	Largely neutral at the macro level
<b>Investment Performance</b>	Little to no measurable impact on muni returns across tax regimes
<b>Credit Quality</b>	Dependent on fiscal discipline and reserve management, not tax rate alone

## Portfolio Management



**J. Matthew Dalton**  
CEO & CIO  
*Partner*



**Matt Thomas**  
Portfolio Manager  
*Partner*



**Max Christiana**  
Portfolio Manager  
*Partner*

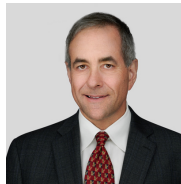


**Lincoln James**  
Portfolio Manager

## Credit Research



**Dora Lee**  
Director of Research  
*Partner*



**James Lyman**  
Senior Vice President,  
Credit Research



**Ryan Ciavarelli**  
Senior Vice President,  
Credit Research



**Michael Luong**  
Vice President,  
Credit Research



**Duwayne Walker**  
Vice President,  
Credit Research

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## Contact

📞 914-816-4633

✉ [service@bellehaven.com](mailto:service@bellehaven.com)

🌐 [www.bellehaven.com](http://www.bellehaven.com)

Belle Haven Investments

800 Westchester Ave. Suite N607

Rye Brook, New York 10573