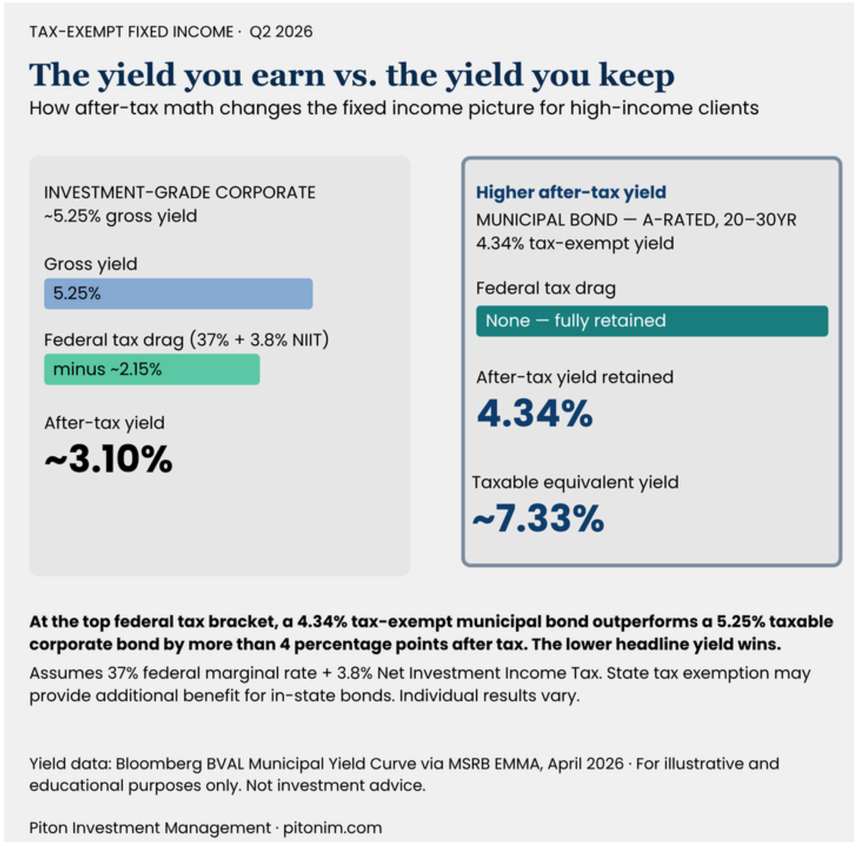
Tax-Exempt Bonds in 2026: The After-Tax Yield Advantage High-Income Clients Cannot Afford to Ignore

For investors in the highest federal tax brackets, the fixed income conversation often begins and ends with yield. What is the coupon? What is the duration? What is the credit rating? These are reasonable starting points, but they are incomplete without one additional calculation: what is the yield once income taxes are accounted for?



A municipal bond portfolio rated single-A or better in the 20-to-30-year maturity range can generate a federal tax-free yield of at least approximately 4.34%, which equates to a taxable equivalent yield (what a taxable bond would need to yield to match it after tax) of approximately 7.33% for an investor in the top federal tax bracket who is also subject to the 3.8% Net Investment Income Tax.[1] That figure reflects current market conditions as of late April 2026.

For context, investment-grade corporate bond yields for one-to-ten-year maturities closed at approximately 4.8% as of April 10, 2026.[2] An investor in the top tax bracket holding that corporate bond is earning less on an after-tax basis than they would in a tax-exempt portfolio, while taking on comparable or greater credit risk.

This gap is the core argument for why tax-exempt municipal bonds deserve a serious, dedicated allocation in the portfolios of your highest-income clients. And the 2026 environment makes that argument more compelling than it has been in some time.

The 2026 Municipal Market: A Favorable Setup

Municipal bonds enter the second quarter of 2026 with several things working in their favor.

Investor demand has been strong and consistent. Municipal bond ETFs gathered $12 billion in net new assets during the first quarter of 2026, with $4.4 billion arriving in March alone.[3] When measured across both mutual funds and ETFs, total municipal fund inflows for Q1 2026 reached $26 billion, including $15 billion into mutual funds and $11 billion into ETFs.[4] That level of sustained demand, even through equity market volatility, reflects the structural role tax-exempt bonds play in income-oriented portfolios.

The underlying credit quality of municipal bond issuers remains strong. According to NASBO, the median state rainy day fund balance reached an all-time high of 14.6% of general fund expenditures in fiscal 2024, and 32 states are projecting increases in their rainy day fund balances in fiscal 2026.[5] That level of reserves provides meaningful cushion against short-term fiscal shocks. The federal tax bill passed in 2025 preserved the tax-exempt status of municipal bond income, resolving a significant source of uncertainty that had weighed on market sentiment during 2024 and early 2025.[6] With that uncertainty removed, investors can evaluate the asset class on its merits.

Supply is elevated, which creates opportunity. According to SIFMA, municipal bond issuance through April 2026 reached $182.3 billion, up 5.7% year over year, with the full-year consensus projection at approximately $600 billion — what would be a third consecutive record year.[7] Heavy supply has historically pushed bond prices lower temporarily, even for strong issuers. For active managers who can identify bonds trading below their true value, that creates a buying opportunity.

The Tax Planning Conversation That More Advisors Should Be Having

The 2025 federal tax legislation created several changes that directly affect how high-income clients should think about fixed income. Advisors who understand the intersections have a genuine opportunity to add value in client conversations.
The SALT deduction cap was raised to $40,000, but phased out at certain income levels.[8] Municipal bond income is not included in modified adjusted gross income for purposes of certain deductions, a distinction that affects how clients calculate their true taxable income and which deductions they can fully utilize. For clients who are Medicare recipients, muni income is counted in calculations that affect Medicare IRMAA surcharges, which requires careful planning around the amount and timing of tax-exempt income. For clients with qualified business income or those subject to the Alternative Minimum Tax, the planning math requires a thorough review before simply increasing muni exposure.

None of this is to suggest that municipal bonds are the right choice for every client in every account. The calculation depends on the specific client, their filing status, their full income picture, and their account type. What it does mean is that advisors who run that analysis for their high-income clients, rather than assuming that the headline yield looks low and moving on, often discover that a lower-yielding municipal bond puts more money in their client's pocket than a higher-yielding taxable alternative.

Why Active Management Is the Right Structure for the Municipal Market

Municipal bonds are structurally different from equity markets or corporate credit in ways that make active management particularly valuable.

The municipal market is large, fragmented, and thinly traded in ways that create persistent gaps between what a bond is worth and what it actually trades for. New bond issuance in 2026 is projected at approximately $600 billion, well above historical averages, and current yield levels represent one of the most attractive after-tax return opportunities for investors in the last decade.[9] That kind of market rewards managers who can identify where value is being mispriced, not those who simply hold whatever the index owns.

Supply dynamics compound the opportunity for active managers. When heavy issuance hits the market across multiple weeks, prices on existing bonds can temporarily soften as dealers work to place new inventory. Passive funds are stuck holding through those periods with no ability to act. Active managers can use those windows to buy bonds at more favorable prices, improving the portfolio's long-term income.

The shift toward active management in the municipal space is visible in fund flow data. Active municipal ETFs have seen strong inflows in 2026, with investors seeking professional credit selection rather than index replication.[3] Municipal separately managed accounts have also experienced substantial asset growth in recent years as high-net-worth investors have moved toward vehicles that offer greater transparency, tax-loss harvesting capability, and portfolio customization than fund structures provide.[10]

The Case for a Municipal Separately Managed Account

For clients with meaningful assets in taxable accounts, a tax-exempt SMA offers several capabilities a fund vehicle cannot replicate.

State-specific customization. Investors in high-tax states such as New York or California benefit most from bonds issued within their home state, which are typically exempt from both federal and state income tax. A broadly diversified national fund holds bonds from all fifty states. An SMA can be structured with a deliberate tilt toward the home state, increasing after-tax income without sacrificing meaningful diversification.

Tax-loss harvesting. Individual bonds in a separately managed account can be sold when they are trading below their adjusted cost basis, allowing the client to realize a tax loss that offsets gains elsewhere in their portfolio. This capability is not available in a fund structure, where the investor owns units of a pool rather than individual securities.

Cash flow alignment. An SMA can be structured around a client's specific income needs and financial milestones. Bonds can be selected with maturities that align with planned expenditures, retirement income schedules, or estate planning timelines. That level of customization is not possible within a pooled vehicle.

Full position transparency. Clients in a separately managed account can see exactly which bonds they own, why those bonds were selected, and how the portfolio is positioned relative to the overall market. For advisors who place a premium on the ability to explain client portfolios clearly, that transparency is a meaningful advantage.

Sector Awareness: Not All Municipal Credits Are Equal in 2026

The broad strength of municipal bond credit quality at the market level should not obscure the fact that not all municipal bonds carry the same risk. Advisors who treat the asset class as one undifferentiated category will miss important distinctions. Transportation infrastructure and essential service utilities, including water, sewer, and power systems, are generally well-positioned given stable, need-driven revenue streams. General obligation bonds backed by property taxes in fiscally sound jurisdictions continue to offer strong credit profiles.

Higher education and certain hospital systems face more complexity. Moody's Investors Service has assigned a Negative sector outlook to higher education, citing enrollment pressure, rising costs, and reduced federal support.[11] On the healthcare side, the Congressional Budget Office projects federal Medicaid spending reductions of $698 billion over 2026 to 2034 under the One Big Beautiful Bill Act, with safety-net hospitals and those serving high shares of Medicaid patients facing the most direct revenue pressure, according to research published by the Robert Wood Johnson Foundation and the Commonwealth Fund.

This kind of differentiation is exactly where active management earns its role in a municipal portfolio. A passive index fund owns all of these sectors in proportion to their representation in the index. An active manager can concentrate in stronger issuers, avoid those under pressure, and find bonds that are priced more attractively than their credit quality warrants.

The Opportunity for Independent Advisors

The municipal bond conversation in 2026 is simultaneously a yield conversation, a tax efficiency conversation, and a credit quality conversation. Each of those dimensions is working in the same direction for high-income clients.

After-tax yields are at the high end of their historical range. The federal tax bill has stabilized the structural appeal of the asset class by preserving the exemption. The shift toward separately managed accounts and active management is accelerating as advisors and their clients seek greater control, transparency, and tax efficiency than pooled fund vehicles can offer.
For advisors who want a more substantive fixed income conversation with their highest-income clients, the municipal market in 2026 is where it starts.

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Fixed Income Perspectives

Tax-Exempt Bonds in 2026:

The After-Tax Yield Advantage High-Income Clients Cannot Afford to Ignore

How Piton Manages Tax-Exempt Fixed Income

Piton's Tax-Exempt strategy provides independent advisors with access to customized, actively managed municipal bond portfolios built around each client's specific tax situation, state of residence, and income objectives.

Our team analyzes each bond issuer individually, managing exposure across sectors and maturities with the goal of maximizing after-tax income while maintaining the credit quality and liquidity standards our clients require. We build each portfolio with full transparency into every bond held, and we provide the kind of direct portfolio manager communication that is simply not available through fund structures.

For advisors who want to put their highest-income clients in the best possible tax-adjusted fixed income position, Piton provides the infrastructure, the expertise, and the management to do it.

Brian Lockwood is the Chief Investment Officer of Piton with over 20 years of fixed income portfolio management experience. He has managed fixed income strategies for HSBC, Ramius Capital Group, and DLJ/Credit Suisse Asset Management. He holds the Chartered Financial Analyst® designation.

Kris Konrad is a founding partner of Piton with over 20 years of fixed income experience specializing in Agency Mortgage-Backed Securities. He has managed one of the largest levered Agency MBS portfolios, with over $140 billion in assets at its peak. He previously served as Co-Chief Investment Officer at Annaly.

About Piton Investment Management

Piton Investment Management is a fixed income asset manager serving financial advisors, RIA firms, family offices, and institutional and individual investors. We specialize in constructing customized separately managed accounts (SMAs) across traditional fixed income and structured notes, drawing on over 90 years of combined industry experience.

Our approach is built on the belief that fixed income portfolios should be tailored to each client's objectives, not adapted from a standard model. Every account is managed with direct oversight, with a focus on generating alpha, managing risk, and maintaining transparency throughout.

Our Strategies

- **Yield Enhanced** – income-focused portfolios with defined risk parameters
- **Conservative Total Return** – balancing income generation with capital preservation
- **Cash Management** – liquidity-driven, low-risk solutions
- **Tax-Exempt** – municipal bond strategies for tax-sensitive investors

It's not what we do that makes us different. It's how we do it.

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Sources

[1] Bloomberg BVAL Municipal Yield Curve (US General Obligation A+/A/A- BVAL Yield Curve), sourced via the Municipal Securities Rulemaking Board (MSRB) Electronic Municipal Market Access (EMMA) platform, emma.msrb.org, April 2026. The BVAL curve is populated with pricing from uninsured A+, A, and A- rated General Obligation bonds, 20-to-30-year maturity range, yield to worst of approximately 4.34%. Taxable equivalent yield of approximately 7.33% assumes 37% federal marginal rate plus 3.8% Net Investment Income Tax, consistent with IRS Publication 550 (Investment Income and Expenses) tax rate guidance. If callable bonds are not called, yield to maturity increases to 4.71%, equating to a taxable equivalent yield to maturity of approximately 7.95%.

[2] Bloomberg Index Services, Bloomberg US Corporate Bond Index (investment-grade, one-to-ten-year maturities), as reported via SIFMA (Securities Industry and Financial Markets Association), sifma.org, April 10, 2026. Corporate investment-grade bond yields in the one-to-ten-year range were approximately 4.8%, up 28 basis points year-to-date.

[3] VettaFi / ETF Database, "Muni Bond ETFs: Beyond Tax Season Fundamentals," April 14, 2026. Available at etftrends.com, advisorperspectives.com, and etfdb.com. Municipal bond ETFs gathered $4.4 billion in March and $12 billion in Q1 2026 total.

[4] Investment Company Institute (ICI), Weekly Estimated Long-Term Mutual Fund Flows and Monthly ETF Data, Q1 2026. Available at ici.org. ICI is the primary independent source for U.S. fund flow data across both mutual funds and ETFs. Q1 2026 total municipal fund flows of approximately $26 billion comprised $15 billion in mutual funds and $11 billion in ETFs.

[5] National Association of State Budget Officers (NASBO), Spring 2025 Fiscal Survey of States, nasbo.org; NASBO, "Ten Facts to Know About Rainy Day Funds," March 2026, community.nasbo.org. The median state rainy day fund balance reached an all-time high of 14.6% of general fund expenditures in fiscal 2024, with 32 states projecting further increases in fiscal 2026 based on enacted budgets. Pew Charitable Trusts, "State Rainy Day Fund Growth Slowed in Fiscal 2024," October 2025, pew.org, provides corroborating analysis of state reserve levels.

[6] Bond Buyer, "One Big Beautiful Bill Signed Into Law, Municipal Tax Exemption Preserved," 2025. Available at bondbuyer.com. The Bond Buyer is the independent trade publication of record for the municipal bond market. Confirms the municipal bond tax exemption was left intact under the final legislation, removing a significant source of market uncertainty entering 2026.

[7] SIFMA, US Municipal Bonds Statistics, April 2026, sifma.org. Year-to-date issuance through April 2026 reached $182.3 billion, up 5.7% year over year. Full-year consensus projection of approximately $600 billion reported by Bond Buyer, "Majority of Muni Shops Expect 2026 to Be Third Record Year in a Row," December 10, 2025 (bondbuyer.com), reflecting the market consensus from Municipal Market Analytics, CreditSights, and others. 2025 full-year issuance of $579.9 billion confirmed by LSEG data as reported by Bond Buyer, January 2, 2026.

[8] Internal Revenue Service (IRS), Publication 550, Investment Income and Expenses, 2025 edition, irs.gov. Covers federal income tax treatment of municipal bond interest, Net Investment Income Tax applicability under IRC Section 1411, SALT deduction limitations under the Tax Cuts and Jobs Act as amended by the 2025 tax legislation, and Alternative Minimum Tax treatment of certain private activity bonds under IRC Section 57(a)(5). Medicare IRMAA surcharge thresholds are published annually by the Centers for Medicare and Medicaid Services (CMS) at cms.gov.

[9] MSRB, Municipal Market Summary, Q1 2026, msrb.org; SIFMA, US Municipal Bonds Statistics, sifma.org. Post-financial-crisis average issuance of approximately $417 billion sourced to SIFMA historical data. Current yield attractiveness reflects Bloomberg BVAL Municipal Yield Curve data as published on MSRB EMMA, emma.msrb.org, April 2026. Bond Buyer market commentary, January–April 2026, bondbuyer.com, provides ongoing context for supply and demand conditions.

[10] Cerulli Associates, U.S. Managed Accounts 2025: Separately Managed Accounts and the High-Net-Worth Investor, cerulli.com. Cerulli is an independent investment management research firm. Their managed accounts research documents consistent multi-year growth in fixed income SMA assets driven by high-net-worth investor demand for transparency, tax efficiency, and customized portfolio construction. ETF flow data sourced to Investment Company Institute (ICI), ici.org, Q1 2026.

[11] Moody's Investors Service, US Higher Education Sector Outlook, 2026, moodys.com. Moody's maintains a Negative sector outlook for higher education reflecting enrollment pressure, federal funding uncertainty, and cost inflation. Congressional Budget Office (CBO), Budget and Economic Outlook, 2026, cbo.gov: projects $698 billion in federal Medicaid spending reductions over 2026 to 2034 under the One Big Beautiful Bill Act. Robert Wood Johnson Foundation, "Hospital Revenue Losses and Increased Uncompensated Care If Medicaid Funding Is Cut," rwjf.org, January 2026: estimates hospitals in Medicaid expansion states could face $31.9 billion in revenue losses in 2026 under certain policy scenarios. Commonwealth Fund, "Federal Cuts to Medicaid Could End Medicaid Expansion and Affect Hospitals in Nearly Every State," commonwealthfund.org, May 2025. Pew Charitable Trusts, "New Federal Medicaid Policies Compound State Budget Pressures," pew.org, January 2026.

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