Carret Credit Insights

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Firm AUM (6/30/26)

$3.737 Billion

Inflation… No Easy End In Sight

On a recent June evening in New York City, U.S. Treasury Secretary Scott Bessent told a crowd at the Economic Club of New York's 250th Celebration dinner that "the bond market has taken out more governments than howitzers." Was the Treasury Secretary sending a message to the political leadership in DC to get the fiscal house in order? We find it interesting that the Treasury Secretary was addressing DC's spending problems. We are glad he did.

We have been proactively discussing the ballooning domestic debt / deficit problem as we travel the country talking to our institutional clients. It's our #1 thesis on why we anticipate interest rates will stay elevated for longer (absent a recession – which is not on our horizon). With a $2 Trillion annual deficit and nearly $40 Trillion in debt, we are keenly aware of the fiscal challenges facing the U.S. and the fact that the U.S. bond market can force change – the howitzer: higher rates, escalating financing costs and in turn, more debt.

Trump's plan of generating $500B of tariff revenues, coupled with $500B of interest savings by pushing the Federal Reserve (FED) to lower short rates (so our debt can be financed at lower rates with short maturity bonds – a risk in itself), potentially could have trimmed $1 Trillion from the annual deficit, almost halving the annual deficit.

With tariffs being reset as a result of court challenges, less than half of the expected tariff revenue is being collected ($158 Billion in the 1st H of 2026 – with some refunds expected). Thus, the focus on lowering interest rates becomes even more important, explaining Trump's pressure on both former FED Chairman Jerome Powell and now Kevin Warsh. Recall that on January 1st, the market was anticipating 1-2 rates cuts this year; HOWEVER, elevated inflation is wreaking havoc on Trump's plan. Inflation remains WELL above the FED's 2% target and investors are now anticipating 1-2 rate HIKES this year - a result of many items, but we will focus on oil / energy prices and Artificial Intelligence (AI) capital expenditures (CapEx) for now.

Oil induced inflation pain (elevated prices at the pump impacting affordability) has become one of Iran's primary counter-attacks against Trump. No one knows more than the Iranian leadership (whoever that is) that the U.S. has mid-term elections in November. We do not see a return to sustained oil prices below $70 per barrel until the Strait of Hormuz is opened with safe and fluent passage without tolls. We do not think this is an easy task to accomplish anytime soon, which will keep inflation elevated into the mid-term elections and the remainder of the year. As we have stated, we will view the war as being "over" when The Strait is open.

Key Market Levels	6.30.26	12.31.25	6.30.25
Fed Funds Rate	3.50% – 3.75%	3.50% – 3.75%	4.25% – 4.50%
3 Month U.S. T-Bill	3.82%	3.63%	4.29%
10 Yr U.S. Treasury Bond	4.44%	4.17%	4.23%
5 Yr AAA Municipal Bond	2.59%	2.43%	2.79%
5 Yr A Corporate Bond	4.88%	4.43%	4.64%
iBoxx USD Liquid High Yield Index	7.21%	6.84%	7.12%

Source: Municipal Market Data (MMD) and FactSet

AI CapEx by the hyperscalers is creating "chipflation" as insatiable demand for all things AI (chips, servers, data centers, electricity, concrete, etc.) is causing higher prices for businesses and consumers. For example, Apple recently raised prices on most of its consumer products. We have never witnessed the pure dollar amount of CapEx from corporate America as we are seeing now. Estimates over the next five years (including 2026) are for a projected $3 Trillion of new CapEx by just the five domestic hyperscalers (AMZN, GOOG, META, MSFT, ORCL)[1]. The speed at which this is occurring is putting a strain on resources and adding to inflation in the U.S. as well as globally. As data center construction ramps up (there are currently 3,000 new centers under construction or planned in the U.S.), we anticipate AI will have an inflationary effect before it becomes deflationary.

With $2 Trillion a year of estimated deficits by the U.S. Government, coupled with an estimated $1.5+ Trillion of new bond issuance by the hyperscalers over the next 5 years (including 2026), an estimated $11.5 Trillion of new bond supply will need to be sold – this is almost equivalent to the entire investment grade (IG) corporate bond market today. We expect interest rates will have to stay elevated to attract investors.

The FED does need to get inflation under control and fortunately, they can tackle this problem in a strong economic environment featuring low unemployment and a soaring stock market fueled by record revenues, margins, and earnings. We believe the FED will want to stay politically neutral heading into the mid-term elections, therefore, our "best guess" at this point is that the FED will simply hold rates steady and work to implement other policy levers to restrain inflation – think QT.

With interest rates close to 20 Yr highs, we are extending towards a neutral to slightly longer duration stance across all strategies as the 5 Yr U.S. Treasury Bond (UST) provides a protective balance between interest rate risk (driven by inflation) and economic growth while the bond market digests / reassess the new FED chair's policy path. With all fixed-income securities "spread" against UST, we believe the 5 Yr UST at 4.20% at mid-year to be attractive.

So where does this leave us? For investors, higher interest rates create long-term investment opportunities. We remain high quality, diversified, tax-sensitive, and focused on adding value. We truly appreciate the trust and confidence you continue to place in our efforts. Enjoy the remainder of 2026!

U.S. Government Bond Market Update

The U.S. Treasury market underwent a notable steepening shift during the first half of 2026. This shift was driven by persistent inflation as the conflict in the Middle East triggered significant volatility in energy and commodity prices, alongside continued high government spending and elevated UST issuance that sustained federal deficit concerns, as well as resilient U.S. labor market data. Despite the FED leaving its benchmark policy target rate range unchanged at 3.50%-3.75% during the first half of the year, ultra-short UST interest rates rose as market sentiment changed to price in the possibility of rate hikes. The 3 MO UST yield rose 19 bp to close the first half of 2026 at 3.82% while the 6 MO UST finished the half at 3.98%, representing an increase of 37 bp. Yields on longer-dated USTs rose as well, effectively normalizing the shape of the UST yield curve by eliminating long-standing curve inversion. The 5 Yr UST rose 47 bp and the 10 Yr UST rose 27 bp, ending the 1st half at 4.20% and 4.44%, respectively.

The primary driver of this market shift was the reality of stubborn inflation coupled with diminishing expectations for a ceasefire in the Middle East. Additionally, the markets grappled with uncertainty surrounding the transition in FED leadership following the confirmation of Kevin Warsh as Chairman in May. While both Warsh and his predecessor, Jerome Powell, remained committed to achieving the FED's 2% inflation objective, markets anticipated that Warsh would be more willing to lower interest rates. However, aforementioned factors effectively nixed expectations for near-term easing. As a result, investors scaled back expectations for the pace and magnitude of rate cuts and instead prepared for the potential for hikes, reinforcing a higher-for-longer yield environment heading into the second half of the year.

Municipal Bond Market Update

Municipal Bonds had a solid 1st H of 2026 against a backdrop of global volatility and uncertainty. Supply remained elevated, with issuance reaching record levels and running 11% above last year's pace. Demand has remained exceptionally strong, reaching the second highest level in the past decade, allowing the market to absorb elevated supply while supporting positive returns. We believe elevated supply trends will continue. The combination of higher project

[1] *References to specific issuers are for illustrative purposes only and do not constitute recommendations to buy or sell securities*

costs (due to inflation), aging infrastructure, and federal funding policy uncertainties will drive issuance higher. We expect total issuance in 2026 to be roughly $600 billion and generally remain in balance with the demand side.

The AAA 2-10 Yr curve steepened slightly, in sharp contrast to the Treasury curve, which notably flattened. The Muni-to-Treasury yield ratio richened across the curve as Treasury yields rose more than muni yields during 1st half of 2026. Credit spreads are relatively tight compared to historical averages. Looking ahead, we expect spreads to remain rangebound with 2nd H of 2026 total return driven by coupon cash flows and reinvestments.

Our municipal strategy YTM of 3.62% translates to a tax-equivalent yield of 7.00% for investors in the 48.3% tax bracket. Yields remain elevated by historical standards and currently sit in the 78th percentile over the past decade. We expect yields to remain higher for longer as inflation remains elevated and the potential for FED rate cuts has turned to potential rate hikes.

Muni credit fundamentals remain solid. Our municipal strategy continues to be structured with diversified ratings, maturities, coupons, and sectors. State tax collections and fund reserves continue to be robust, supported by healthy economic growth. Rating trends show upgrades outpacing downgrades by a wide margin for the muni market over the past 12 months.

Tax reform is becoming a key municipal credit issue, as affordability concerns drive proposals to reduce, eliminate, or restructure state revenue sources. While tax relief may be politically popular, credit outcomes depend on whether lost revenue is replaced with durable, predictable, recurring, and timely funding. At this point, states are entering this debate from a position of relative strength. Broad taxing authority, spending control, and budget flexibility help states manage policy shifts and economic cycles compared to local municipalities that have less autonomy to raise taxes/fees. The passage of the One Big Beautiful Bill and other proposals have pointed to a federal effort to shift more operational and financial responsibility to states and localities. In our opinion, tax reform should be evaluated based on revenue resilience and implementation risk. Measures supported by recurring, diverse, and economically reliable replacement revenues are less likely to pressure credit. Proposals relying on temporary state aid, volatile tax streams, voter-approved funding, or unidentified replacement revenues are more likely to weaken credit fundamentals.

Elevated supply balanced by strong demand, compelling tax-equivalent yields, and stable credit quality are key supporting factors setting up for a positive 2nd H of 2026.

Corporate Bond Market Update

AI has maintained its grip on investors' focus, headlines, and news stories alike throughout the 1st half of 2026. Between data center buildouts, mind-bending projected CapEx, and questions of future profitability – not to mention the SpaceX IPO launch and subsequent $25 Billion debt offering – it is no wonder AI demands so much attention. When analyzing the effect on the corporate bond market, it is clear that AI will have a significant impact. Analysts project a collective $1.5+ Trillion in AI debt issuance by the hyperscalers over the next five years. For reference, as of today, the entire corporate bond market is just under $12 Trillion in total market value – just this projected new issuance will grow the market by 10%. Already in 2026, the technology sector has accounted for 20%+ of all IG new issuance. We expect that spreads on AI issuers will widen as the market demands additional yield to absorb this dramatic increase in supply. While there are certainly unknowns and risks long term in this sector, we see an opportunity in shorter term bonds (less than 10 years to maturity) that offer attractive yields. The majority of the debt issued thus far has a long duration/maturity schedule, meaning that the companies have 10+ years before the bill comes due. We expect this trend to hold as more debt is brought to the market over the coming years. Looking ahead, we will continue to monitor the AI market for the opportunities and risks that will unfold in this new frontier.

Short-maturity IG corporate bond spreads above UST fell in the 1st H of the year while mid- and long-term spreads widened marginally. Despite 1st H survey results indicating investor concern about credit default risks rising, spreads remain near historically tight levels. We favor the opinions of the market – where investors allocate actual dollars – over survey data; however, we note the caution that investors are seeing on the horizon. In our opinion, today's corporate environment remains solid. We are seeing record S&P 500 earnings, strong net profit margins, projected global growth continuing, improving interest coverage ratios, and positive upgrade/downgrade ratios.

High Yield (HY) spreads, as measured by BB rated credits, remain near record tight levels, indicating investors perceive less credit risk in today's HY market. We were able to take advantage of war induced volatility in the 1st half of 2026 to rotate into bonds at attractive yields but still believe that HY investors should remain short duration focused and defensive in nature.

We have discussed in past writings the credit rating downgrade of the U.S. Government below AAA by the three major rating agencies. As noted, the ongoing debt issuance and rapidly growing U.S. Government debt load that we expect will demand higher market rates and can therefore "squeeze" spreads. We ask the question: are UST bonds still a "risk-free" asset class or should we be valuing credit risk (spreads) by another metric?

Returns had a volatile first half of 2026 – IG returns, as measured by the Bloomberg Intermediate Gov't Credit Index, settled at a positive 0.4% total return at the end of June after experiencing a 182 bp spread between peak and trough. The HY market, as measured by the iBoxx High Yield Index, experienced a 328 bp spread between peak and trough before finishing the half at 1.8%. The volatile half was a push/pull between the uncertainty derived from the Iran War and the record earnings from corporate America, as measured by the S&P 500 index. As we enter the second half of 2026, we are focused on quality investments, preservation of principal, and income to drive total returns. We will continue to invest across asset classes, economic sectors, and issuers to manage risk and provide steady cash flow and diversification.

Data as of June 30, 2026	**Municipal Fixed Income**	**Taxable Fixed Income**	**Opportunity Fixed Income**	**Enhanced Cash**
Maturity	10.0	5.7	3.6	0.4
Duration / Dur to Worst	7.6 / 4.8	4.8	3.1	0.4
YTM / YTW	3.62% / 3.22%	4.85%	5.74%	4.08% [3]
Taxable Equiv. YTM/YTW	7.00% / 6.23% [1]			4.26% [1,2,3]
Coupon	4.54%	4.46%	5.92%	1.89%
Credit Rating	AA	A	BB+	A+
Sector Allocations:				
U.S. Treasury		15%	1%	55%
Government Agency		11%		9%
Corporate - Inv Grade	1%	68%	20%	35%
Corporate - High Yield			70%	
Preferreds		5%	7%	
Convertible				
Municipal	98%			
Cash	1%	1%	2%	1%

Source: Carret / Bloomberg

[1] Assumes a combined federal and state effective tax rate of 48.30%. Taxable Equivalent Yield is illustrative. Actual investor tax rates differ. Results may vary by state, AMT, and investor circumstance [2] Assumes a state tax rate of 7.50% [3] Yield on Invested Assets

Municipal Fixed Income Strategy

- The Municipal Fixed Income Strategy outperformed the Bloomberg Municipal Managed Money Intermediate Index during the first half of 2026, with a gross return of 1.30% and a net return of 1.10% versus the index's return of 1.08%.
- Strategy returns were driven by a slight decline in yields combined with coupon driven cash flows. Representative AA rated 5 Yr Municipal Bond yields fell 11 bp during the 1st H of 2026. The benchmark's YTM began the year at 2.70% and ended June at 2.59%. During 1st H of 2026, 5 Yr UST yields rose by 47 bp to 4.20%.

Past performance does not guarantee future results. Performance reflects a specific historical period.

- The 2 Yr-to-10 Yr municipal spread steepened during first half of 2026, providing clear rationale for duration extension. The 5-10 Yr segment (the "belly") of the curve experienced the greatest amount of steepening during the period.
- Record issuance of municipal bonds in 2025 has carried over to 2026. At the mid-point of 2026, the market has produced almost $280 Billion in new supply which keeps the market on pace to meet or surpass last year's record. 94% of 2026 issuance has been in tax exempt municipals (compared with taxable municipal bonds). 85% of the 2026 issuance has been for new projects compared to refunding prior issues. Net new issuance was positive for the 1st H of 2026 as new issue supply levels were greater than maturity-driven demand.
- The Strategy's duration-to-worst was 4.8 and the duration-to-maturity was 7.6 in the first half of 2026. The Bloomberg Municipal Managed Money Intermediate Index duration-to-worst was 5.4 and the duration-to-maturity was 6.7 at the end of the first half of 2026. We continue to extend maturity and have opportunistically lengthened our duration-to-maturity from 6.2 to 7.6 over the past 12 months.
- Average portfolio quality remains AA. The strategy continues to be anchored in high-quality Essential Purpose Revenue and General Obligation (GO) credits.
- In our opinion, municipals continue to offer compelling relative yields. For example, our strategy average Yields to Maturity was 3.62% which equates to a Taxable Equivalent Yield of 7.00% for investors in the 48.3% combined tax bracket. Our Yield to Worst was 3.22% which equates to a Taxable Equivalent Yield of 6.23% for investors in the 48.3% combined tax bracket. The Crossover Rate (the tax rate where an investor would be indifferent between owning a municipal or a corporate bond) was 43.4% on June 30th.
- We will continue to diligently evaluate credits and market fundamentals against the backdrop of the evolving global economic and geopolitical landscape.

Taxable Fixed Income Strategy

- The Taxable Fixed Income Strategy posted a gross return of 1.1% and net return of 1.0% during the 1st H of 2026, more than doubling the Bloomberg Intermediate Gov't Credit Index return of 0.4%.
- The strategy's overweight allocation to corporate bonds boosted relative performance to the index as additional yield and cash flow provided a buffer against rising market interest rates.
- IG spreads, as measured by the 3-5 Yr A rated FactSet Index, widened slightly by 1 bp during the 1st H, increasing from 58 bp to 59 bp.
- IG spreads, as measured by the 3-5 Yr BBB rated FactSet Index, tightened by 2 bp during the 1st H, decreasing from 94 bp to 92 bp.
- Mid-year strategy duration, at 4.8 Yrs, was extended slightly through the 1st H from 4.7 Yrs on December 31st, 2025. The inflation induced rise in interest rates has provided an opportunity to capture historically attractive yield levels and increase average strategy duration.
- Average portfolio quality was upgraded from A- at year end to A during the 1st H.
- The strategy's Yield to Maturity (YTM) increased from 4.46% on December 31st, 2025 to 4.85% on June 30th, 2026.
- The top economic sectors within the strategy are Financials, Energy, and Utilities.
- The strategy's 5% allocation to preferred securities provides higher yields and aims to capture incremental cash flows.
- During the 1st H, despite multiple maturities and calls, exposure to U.S. Agencies and UST remained steady at 11% and 15% respectively. U.S. Agency bond valuations are attractive, boasting healthy spreads above UST. Despite historically tight corporate market spreads, we continue to find attractive absolute value in corporate credits with an allocation of 68%.
- Given the current interest rate environment, the strategy will continue to reinvest along the sweet spot of the yield curve to capture attractive yield while utilizing active duration management.

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Opportunity Fixed Income Strategy

- The Opportunity Fixed Income Strategy outperformed the Bloomberg Intermediate Gov't Credit Index during the 1st H of 2026, generating a gross return of 1.9% and a net return of 1.5% compared to the index's return of 0.4%. On a gross basis the Strategy also outperformed the iBoxx HY Index which returned 1.8% over the same period. Compared to the iBoxx High Yield Index, the Strategy maintained a higher credit quality, with 23% of the portfolio invested in investment grade securities, while also maintaining greater liquidity and a shorter duration thus, lower credit and interest rate risk compared to the index. The Strategy outperformed as a result of credit management and duration extension at opportune times.
- HY rates, as measured by the iBoxx HY Index, increased from 6.85% on December 31st, 2025, to 7.21% at mid-year, an increase of 36 bp, while the 5 Yr UST increased 47 bp.
- HY spreads, while volatile as a result of the War, tightened during the 1st H of 2026, decreasing from 312 bp on December 31st, 2025 to 301 bp at mid-year, a tightening move of 11 bp.
- IG spreads, as measured by the 3-5 Yr BBB rated FactSet Index, tightened by 2 bp during the 1st H of the year.
- The strategy's YTM increased from 5.29% on December 31st, 2025 to 5.71% on June 30th, 2026.
- The top economic sectors within the strategy are Consumer Discretionary, Financials, Materials, and Energy.
- The strategy's duration lengthened slightly during the 1st H of 2026 starting the year at 3.0 Yrs and ending the 2nd Q at 3.1 Yrs.
- Average portfolio quality remained constant at BB+ during the first half of 2026. Investment grade positions comprise 23% of the portfolio.
- As we enter the back half of 2026, we are focused on higher-quality high-yield given the geopolitical turmoil and high valuations (tight spreads). We believe the fragile ceasefire could create additional inflationary pressures, which in turn, could create greater opportunities in the 2nd H of 2026. We have ample flexibility to add value with roughly 23% of the strategy holdings maturing in the next 12 months.

Enhanced Cash Strategy

- YTD, the Enhanced Cash Strategy achieved a gross return of 1.8% and a net return of 1.4%, outperforming the ICE BofA 0-1 Yr US Treasury Index, which saw a return of 1.6% over the same period.
- Entering 2026, the resounding expectation from market participants was for the FED to continue its trend of gradual easing of the policy rate as inflation continued to moderate and economic growth slowed. The outlook for monetary policy shifted during the first half of the year as investors weighed resilient labor market conditions, sticky inflation, and heightened geopolitical uncertainty. During 1st H of 2026, the consensus for the FED policy rate shifted from rate cuts to the possibility of hikes later in the year.
- The Yield on the 6 MO UST rose from 3.61% at the beginning of the year to 3.98% at the end of June, marking a 37 bp increase during the 1st H of 2026. The Yield on the 3 MO UST rose 19 bp during the 1st H, ending June at 3.82%.
- IG spreads, as measured by the ICE BofA 0-1 Yr A-AAA U.S. Corp Index relative to the ICE BofA 0-1 Yr UST Index, tightened moderately during the first half of the year, decreasing from 40 bp to 36 bp. Tightening spreads, coupled with the strategy's 36% allocation to IG corporate bonds, resulted in price appreciation.
- Average portfolio quality remained constant over the first half of the year, with an average rating of A+.
- Average duration of the strategy increased during the 1st H. As the ultra-short portion of the yield curve normalized to a positively sloped shape, investors were compensated for extending duration, as reflected in the average duration of the strategy increasing from 0.2 Yrs to 0.4 Yrs over the course of the 1st H of 2026.
- The YTM of the strategy increased 28 bp in the 1st H of 2026, ending June at 4.08%.
- With the move higher in ultra-short rates in the first half of year, coupled with the increasing expectation for FED rate hikes in the second half, the outlook for Enhanced Cash remains positive. With ultra-short yields remaining elevated relative to historical norms, the strategy continues to generate attractive returns relative to cash.

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Separately Managed Account Strategies

Municipal: Carret's Municipal Bond Strategy seeks to maximize tax efficiency through opportunistic portfolio management while preserving principal through practical portfolio structuring and fundamental credit analysis. We actively manage investment grade portfolios with a diversified blend of issuers, sectors, and maturities aimed at delivering consistent, risk adjusted returns with an emphasis on tax-efficient cash flows. Carret uses a value approach when buying and selling bonds. This method recognizes the inefficiencies of the municipal marketplace and enables clients to benefit from our expertise and market knowledge.

Our high-quality, intermediate-maturity bias is intended to balance preservation of principal, total return, and tax-exempt cash flows. We opportunistically add value through credit research, bond structuring, and yield curve positioning. Our municipal bond portfolios are actively managed as either state-specific or state-focused (general market in approach, otherwise). Essential service revenue bonds and high-quality general obligation bonds make up the framework of our municipal bond portfolio strategy. The strategy's primary focus is on high-quality, investment-grade, intermediate duration municipal bonds.

Taxable: Carret's Taxable Bond Strategy seeks to achieve above-average total returns with an emphasis on preservation of capital and consistent cash flow. We utilize investment grade fixed income securities and shift across bond sectors based on changing market conditions. Our intermediate duration approach seeks to identify the sweet spot on the yield curve and structure maturities accordingly. Active management of the strategy includes forecasting the long-term direction of interest rates and credit spreads. Our fundamental credit research and active portfolio management process has provided consistent and attractive risk adjusted returns.

Opportunity: Carret's Fixed-Income Opportunity Strategies seeks to generate a higher level of current income with a secondary focus on long term capital appreciation. We utilize various types of higher yielding fixed income securities and shift among types based on changing market conditions. We actively manage risk, respond quickly to market movements, and utilize interest rate hedges to limit duration risk. We focus on high quality high yield and low-quality investment grade bonds, and couple them with preferreds and broken convertibles to try to generate above average levels of cash flow.

Our intermediate duration approach seeks to identify the sweet spot on the yield curve and structure maturities, accordingly. Active management of the strategy includes forecasting the long-term direction of interest rates and credit spreads. Our fundamental credit research and active portfolio management process has provided consistent and attractive risk adjusted returns.

Leveraged Opportunity: Carret's Fixed Income Leveraged Opportunity Strategy seeks to utilize low cost leverage and favorably negotiated release rates to potentially enhance our existing Opportunity Strategy returns. We actively manage leverage to augment opportunities within the high yield and investment-grade sectors of the fixed income market.

Enhanced Cash: Carret's Enhanced Cash Strategy seeks to provide excess returns above those offered by cash equivalents, while focusing on capital preservation and liquidity. The strategy invests in ultra-short-duration investment grade. Our custom, tailored approach opportunistically utilizes a thoughtful mix of Investment Grade Corporate debt, U.S. Treasury and Agency securities, as well as taxable and tax-exempt Municipal bonds to enhance overall after-tax returns.

Mutual Fund Strategy

Kansas Tax-Exempt: The Carret Kansas Tax-Exempt Bond Fund seeks to preserve capital while producing current income that is exempt from both Federal and Kansas state taxes. The Fund seeks to generate monthly income and principally invests in investment-grade bonds of intermediate maturity.

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