GW&K INVESTMENT MANAGEMENT

QUARTERLY INVESTMENT REVIEW

2Q 2015

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ECONOMIC COMMENTARY

By Harold G. Kotler, CFA

The summer of 2015 might well be remembered as a time of resolution to the 2008 credit crisis; a time when the clock stopped ticking for the institutions that dragged their feet in finding credit solutions and hoped against hope for a miracle. Greece and Puerto Rico represent the final chapter of the absurd extensions of credit typical of that time frame. This summer, we will also likely see the Federal Reserve create some movement in the cost of money. Keeping interest rates at zero has been a major factor in fueling a rebound, but now the policy needs to reflect an economy that is in a slow recovery. By raising short-term rates ever so slightly over an extended time period, it will signal confidence in U. S. growth and, more importantly, create a return on investment for those who have kept their trillions of dollars in CD's, money market accounts and Treasury bills.

I am not worried that the borrower's cost of money will rise because I believe investors knew

Continued on inside

INDEX PERFORMANCE *6/30/15*	CURRENT QUARTER	YEAR TO DATE
Barclays 10-Year Municipal Bond Index	–1.14%	0.11%
Barclays Aggregate Bond Index	–1.68%	–0.10%
Barclays High Yield Index	0.00%	2.53%
Dow Jones Industrial Average	–0.29%	0.03%
S&P 500 Index	0.28%	1.23%
Russell 2000 Index	0.42%	4.75%
NASDAQ Composite	2.03%	5.90%

SECOND QUARTER 2015

ECONOMY

- The first quarter's –0.2% GDP showed the economy contracted for the first time since Q1'14. Economic growth continues to run at a pace below its long-run average of over 3%.
- Economic indicators marginally improved during the second quarter. Nonfarm payrolls averaged over 221K and the unemployment rate remains low. Housing continued to recover and the service sector reported expansion.
- Oil prices are up from their mid-March lows, but energy prices are still approximately 40% lower than a year ago.
- Inflation appears contained, continuing to run below the Fed's target of 2%.

FED ACTION

- The federal funds target rate remained unchanged at 0–0.25%. The June FOMC meeting was viewed as "dovish" as the Fed revised down its forecasts for 2015 growth, slightly lowered inflation expectations, and cut the expected future path of the federal funds rate 25 bps for both 2016 and 2017.
- Chair Yellen said she wanted to observe "decisive evidence that a moderate pace of economic growth will be sustained" before raising the fed funds rate.
- On average, market participants pushed back their anticipation of the first rate hike from September to December 2015. Even a 25 bp rate hike by year end is not fully priced in, indicating the market expects an even easier rate hike path.

BOND MARKETS

- Fixed income markets came under pressure in the quarter, as rates rose amid a rout in European bond markets and better growth prospects after a poor first quarter. The 10-year and 30-year Treasury rates spiked 43 bps and 58 bps, respectively.
- The high yield sector was flat during the quarter, while investment grade corporates suffered, returning –3.16%, due to the selloff in Treasuries and 16 bps in spread widening.
- Municipals posted their first quarterly loss in two years, hurt by an improving U.S. economy and a large correction in Eurozone bonds.
- A deluge of tax-exempt supply, driven by record refinancings, added to the slide. Swollen inventories forced dealers to cut prices until relief came in June when refunding volume finally slowed under the weight of higher rates.

EQUITY MARKETS

- The equity market closed the quarter with mixed performance as geopolitical concerns, unremarkable corporate earnings, and high absolute valuations weighed on sentiment. Small cap stocks slightly outpaced large caps and lead performance year to date.
- In a continuation of first quarter trends, the Health Care sector posted the strongest quarterly returns followed by Consumer Discretionary and Financials. Utilities was the worst performing sector for the second quarter in a row as interest rates ticked higher.
- Growth stocks widened their year-to-date lead over value in all market segments. This trend was particularly striking in the small cap market and driven by Biopharma's unprecedented run.
- While volatility ticked higher, low interest rates, continued low inflation, and global easing moves all supported the equity market.

the time would come when the cost of borrowing would rise and most have planned accordingly. I believe when the fed funds rate liftoff does occur, it will be like Y2K. Remember in December 1999 when there was widespread fear the new millennium would cause computer crashes around the world, and when January 1 arrived all was quiet? When the rhetoric around the Fed settles and they finally raise rates, it will not result in chaos. It will be a positive event for the capital markets, not a negative one. I also believe that the ability to control inflation is well in hand given our global and technological-driven economies, and therefore intermediate and long-term interest rates will stay muted.

So getting back to my original thought, the summer of 2015 will close the chapter on the financial crisis. There are those who try to stoke fear by using extreme words like *bubble* and *contagion*; the former they apply to the stock market, and the latter to events in Greece and Puerto Rico. In the stock market there are always overvalued segments as well as undervalued segments. As long as emotions drive decisions there will be extremes, but the overall stock market is far from experiencing a bubble. This term has also been used to describe the bond market, which is even more absurd. How can an investment that guarantees an absolute return be a bubble? It can't.

As to contagion—with Greece and Puerto Rico, the world has had years to know that this was going to end ugly. No one was caught off guard—no surprises, therefore no contagion.

This summer has also seen the end of the political food fight over Obamacare and same-sex marriage. The Supreme Court has resolved both issues. Leaders from across the political spectrum should now put these issues aside and debate issues that truly need debating.

In the geopolitical realm this summer, we have seen a restoration of diplomatic relations between the U.S. and Cuba, ending the five decades long standoff brought on by the Cold War. The Obama administration, however, continues to stare down two of their most challenging issues where resolutions have been difficult to attain—Syria and Iran. If Syria begins to use chemical weapons more toxic than chlorine, the U.S. will have no choice but to intervene. President Obama's international credibility was damaged when he backed down from bombing Syria's chemical facilities, hoping the deal with Russia to remove the chemicals would resolve the issue. But when a dictator is pushed to the edge, he will do whatever necessary to survive. What happens next is anybody's guess, but Assad's regime is nearing an end. This summer is his swan song. The negotiations on Iran's nuclear program have encountered many obstacles and talks continue. Neither side wanted to walk away from the table because the consequences were too unpredictable. While President Obama is hoping for a resolution this summer, there is the possibility that the parties will not be able to reach a deal. This is a problem that could potentially linger.

As I write this letter reflecting on the many issues that have been resolved, I say it is about time. We all know in our own lives that the sooner we face reality, the better the situation becomes. So now we can stop looking over our shoulders at the 2008 crisis, fearing that another financial shoe will drop. There is no other shoe. The financial world—banks, markets and corporations—have become healthy, and we can look to the future with optimism.

We have seen this before. After OPEC nationalized the oil supplies in 1973, most feared a dreadful decline for the West's economies and 40 years of ever-rising inflation and interest rates. But within a decade, Fed chair Volcker addressed the new reality head on, and inflation and interest rates declined steadily for the next thirty years.

We invest for the reality of tomorrow not yesterday, so don't look back, look forward. Sure the world isn't peaches and cream, but there's no point in worrying about tomorrow's problems—they are unknowable. What I do know is that tomorrow's problems will have nothing to do with yesterday's issues.

Enjoy the summer.

Harold G. Kotler, CFA
CEO, Chief Investment Officer

GW&K UPDATE 6/30/15

TOTAL ASSETS UNDER MANAGEMENT	$25.4 Billion
TOTAL EMPLOYEES	112
TOTAL INVESTMENT PROFESSIONALS	38

GW&K WINS INDUSTRY ACCOLADE FOR ENHANCED CORE BOND STRATEGY

Our firm has been named the 2015 Separately Managed Account Manager of the Year in the fixed income category by Investment Advisor magazine and Envestnet | PMC. This is the second time in the last three years GW&K has received this award for our Enhanced Core Bond Strategy. GW&K has been recognized in previous years for our Municipal Bond and Small/Mid Cap Core Strategies. The quality of our firm, investment process, performance, people, and customer service all factored into this selection.

GW&K'S SMALL CAP VALUE STRATEGY ACHIEVES STRONG THREE-YEAR TRACK RECORD

We developed this Strategy in 2012 to offer our clients an additional opportunity to participate in the small cap market segment. Similar to our other small cap Strategies, our value approach has a quality bias, maintains a long-term focus, and aims to participate in rising markets while protecting returns when the market declines. Managed by Jeff Whitney and Dan Miller, who have a combined 55 years of investment experience, the Strategy emphasizes stocks trading at low valuation levels where early fundamental improvement appears sustainable, and is not yet recognized by the market.

DIVERSIFIED EQUITY STRATEGY BENCHMARK CHANGE

Effective June 30, we will no longer show the Russell 2000 Index as a point of reference for this Strategy. We will continue to use the S&P 500 Index as our primary benchmark as it is an excellent proxy for the overall market. The Diversified Equity Strategy is a core approach that emphasizes well-managed companies with sustainable earnings growth. The Strategy continues to have the flexibility to invest across the market cap spectrum, though there are no specific allocation targets for investing in small or mid cap stocks.

Visit **www.gwkinvest.com** for more information.

MUNICIPAL BOND STRATEGIES

INVESTMENT TEAM

Nancy G. Angell, CFA	Partner, Co-Director of Fixed Income
John B. Fox, CFA	Partner, Co-Director of Fixed Income
Martin R. Tourigny, CFA	Partner, Portfolio Manager
Brian T. Moreland, CFA	Principal, Portfolio Manager

14 Municipal Investment Professionals	**18** Average Years Experience	**13** Average Years with Firm

"As a long-only market dominated by Mom and Pop's hunger for dependable tax-exempt income, municipal bonds aren't nearly as susceptible to the wild swings of the globally-sensitive Treasury market."

GW&K MUNICIPAL BOND STRATEGIES

SHORT-TERM MUNICIPAL BOND	Seeks to earn higher after-tax returns than money market funds while managing risk
FIVE-YEAR MUNICIPAL BOND	High-quality active approach aims to preserve and enhance capital and targets an average maturity of five years
MUNICIPAL BOND	High-quality intermediate approach with goal to preserve and enhance capital emphasizes research and active management
MUNICIPAL ENHANCED YIELD	Long-term approach that includes an allocation to higher yielding bonds with a goal to produce high after-tax income

Municipals posted their first quarterly loss in two years, hurt by an improving U.S. economy and a vicious correction in Eurozone bonds. For much of the quarter, a deluge of tax-exempt supply, driven by record refinancings, only added to the slide. Swollen inventories forced dealers to cut prices in the secondary market until relief came in June when refunding volume finally slowed under the weight of steadily higher rates. Only then did muni/Treasury ratios drop back below parity and finish at three-month lows. The higher yields also weighed on demand for mutual funds, which finished the quarter with eight straight weeks of net redemptions. The magnitude of the outflows was modest, however, and indications point to renewed strength as we head into the strong technical environment that normally accompanies the summer months.

So much of the focus this year has been on Europe. In the first quarter, we witnessed the tail end of a breathtaking rally in Eurozone debt. Fears of a debilitating deflationary spiral pushed yields across the continent into negative territory, helping to keep a lid on U.S. interest rates. But when signs emerged in April that fears were overdone, European yields began to climb. In the first week of June, the correction turned into a rout, wiping out the entire year's gains in a few trading sessions. The turmoil spilled over to the U.S. market. Already dealing with signs of a strengthening domestic economy and the anticipation of the first tightening cycle in a decade, Treasuries sold off across the curve. It might have been worse if not for the crisis in Greece, which spurred heavy demand for safe haven assets. Even so, these crosscurrents drove rate volatility toward recent highs leaving investors with few indications that stability is around the corner.

In such an environment, municipals should prove an attractive choice. As a long-only market dominated by Mom and Pop's hunger for dependable tax-exempt income, municipal bonds aren't nearly as susceptible to the wild swings of the globally-sensitive Treasury market. And while Puerto Rico is sure to stoke negative headlines with its increasingly confrontational negotiations with creditors, the island remains an extreme outlier whose debt has largely migrated away from traditional holders of municipal bonds. The vast majority of the municipal market has instead been steadily improving, enjoying solid revenue growth, paying down debt and rebuilding reserves.

The Illinois Supreme Court's ruling in May that struck down state pension reform highlights the one area of concern for municipal bonds. Continuing a string of judgments that has favored retirees over bondholders, the decision sparked spread widening not only in state and local authorities in Illinois, but also in a handful of states that have struggled with their own pension overhangs. But pension issues are manageable over time and virtually every state has passed some sort of reform in the last few years to address growing liabilities. A careful review of pension obligations is an integral part of credit analysis as every plan is unique and each state has its own applicable laws. We are confident in our ability to avoid pitfalls and identify stable to improving situations that offer suitable value.

As rates rose and the curve steepened during the quarter, we responded by pushing duration out modestly. Specifically, we sold bonds with maturities inside five years and moved out on the curve to the ten-year area. In essence, we harvested gains on bonds that had performed relatively well while adding 115 basis points in yield and boosting expected return from the more attractive roll of longer paper. An added benefit was positioning for the strong technical environment likely to play out this summer as we anticipate a significant decrease in supply coupled with a heavy period of coupon and maturity reinvestment. With the potential for volatility in the broader markets, possibly triggered by Fed rate hikes or other exogenous factors, a significant portion of the Strategy is still held in shorter-than-benchmark securities. These act as a defensive hedge that can be sold and redeployed out longer should rates rise.

We also continued to upgrade credit quality in the Strategy. Over the past year, we have been selling issues where we believed the market was not pricing in the appropriate downside risk. We are constantly evaluating our existing holdings versus bids in the marketplace and looking to swap when better opportunities present themselves.

TAXABLE BOND STRATEGIES

INVESTMENT TEAM

Mary F. Kane, CFA	Partner, Lead Portfolio Manager
Nancy G. Angell, CFA	Partner, Co-Director of Fixed Income
John B. Fox, CFA	Partner, Co-Director of Fixed Income

12 Taxable Investment Professionals	**16** Average Years Experience	**8** Average Years with Firm

GW&K TAXABLE BOND STRATEGIES

SHORT-TERM TAXABLE BOND	Through research and diversification, seeks to outperform money market funds while managing portfolio volatility
CORE BOND	A core multi-sector bond strategy that offers a more conservative profile by selecting only investment grade securities
ENHANCED CORE BOND	Offers broad market exposure across multiple bond sectors, including high yield bonds, while seeking to provide strong income
TOTAL RETURN BOND	This multi-sector approach takes advantage of relative valuation among distinct bond sectors and seeks to generate high income and capital gain
CORPORATE BOND OPPORTUNITIES	Seeks to maximize current income and longer-term capital appreciation by focusing on both high grade and high yield corporate bonds

Fixed income markets were under significant pressure in the second quarter, but rather than signaling the start of a prolonged downturn, the selloff felt more like the typical downdraft of a volatile market. Rates rose amid a rout in European bond markets and broadly improved U.S. economic readings. However, this steady march higher in yields was off a low base and ultimately did little more than reverse the gains we saw in the first quarter. Investors remain cautious and the economy is still sensitive to the effects of higher borrowing costs, so fixed income markets are likely to trade in a fairly narrow range in the second half and the severity of any further increases in rates is therefore likely to remain limited.

The Treasury curve experienced a significant bear steepening, with rates at the short end rising 9 basis points in anticipation of a second half rate hike and the long end rising 59 basis points in sympathy with a sharp selloff in European debt. The Treasury sector returned –1.58%, 10 basis points ahead of the Barclays Aggregate Index's –1.68%. Taxable municipals stood out as the worst-performing sector within the taxable market due to their long duration, returning –4.01%. Mortgages, on the other hand, benefited from their short duration and outperformed the majority of the market at –0.75%.

Investment grade corporates returned –3.16% due to a combination of a selloff in Treasuries and 16 basis points of spread widening that saw the premium investors demand over Treasuries reach its highest level in two years. The weakness was fairly uniform across the investment grade universe. High yield, meanwhile, benefited from its spread advantage and managed to be the only sector to avoid a loss (it broke even at 0.00%). Energy led the relative outperformance, returning 2.18%, while Basic Materials and Communications lagged, returning –1.82 and –1.43%, respectively.

We expect volatility to remain elevated in the second half of the year, as investors shift their focus from the timing of the first rate hike to the pace of subsequent hikes thereafter. And unlike the relatively straightforward exercise of parsing commentary from various Fed officials, the task now before investors is attempting to handicap the consequences of an end to unprecedented monetary easing and years of near-zero interest rates. We believe upside in interest rates will ultimately be limited by the sensitivity of the U.S. economy to higher borrowing costs and the relative attractiveness of yields on U.S. debt. We also maintain our positive outlook on spread product, which should continue to benefit from sound corporate fundamentals and attractive valuations.

Our Strategies are essentially neutral-weight with respect to duration and curve positioning. We see a bias to the upside in rates amid improving economic data and upward pressure from the Fed, but believe this pressure will be mitigated by international demand for comparatively high yielding U.S. debt and underlying risk aversion due to the possibility of tail risks (e.g., a Greece exit, a significant slowdown in China, turmoil in the Middle East).

We think corporate bonds continue to offer an attractive value relative to Treasuries at current spreads and remain overweight the sector. We expect U.S. corporations to benefit from positive revenue growth and robust profit margins while exhibiting discipline with respect to their balance sheets. Corporates also provide a buffer against the risk of rising rates, given the potential for spread compression to absorb any moves in rates. Within investment grade, we continue to believe that the incremental spread available in BBBs relative to A-rated bonds is more than adequate for the additional risk being assumed.

We are constructive on the high yield space as well and remain overweight in all eligible Strategies. Our preference for high quality energy companies informs our largest overweight, and we continue to see value in basic materials as well. Our allocation to mortgages is market weight, despite our neutral outlook for spreads, because they have relatively low sensitivity to rising interest rates while offering a defensive alternative to credit. Within the mortgage space we see the best value among the seasoned pools with high coupons.

"We believe upside in interest rates will ultimately be limited by the sensitivity of the U.S. economy to higher borrowing costs and the relative attractiveness of yields on U.S. debt."

EQUITY STRATEGIES

INVESTMENT TEAM

Daniel L. Miller, CFA	Partner, Director of Equities
Jeffrey W. Thibault, CFA	Partner, Portfolio Manager
Jeffrey O. Whitney, CFA	Principal, Portfolio Manager
Aaron C. Clark, CFA	Vice President, Portfolio Manager
Joseph C. Craigen, CFA	Vice President, Portfolio Manager

11 Equity Investment Professionals	**18** Average Years Experience	**7** Average Years with Firm

GW&K EQUITY STRATEGIES

EQUITY DIVIDEND PLUS	Income oriented strategy that invests in companies paying above-average dividends and with the required balance sheet strength needed to sustain dividend payouts
DIVERSIFIED EQUITY	Combines growth & value disciplines and diversifies across large, mid, and small capitalization stocks
SMALL/MID CAP CORE	A core strategy that invests in both small and medium sized companies that offer sustainable earnings growth
SMALL CAP VALUE	Employs fundamental research and proprietary screening methods to identify well-managed small cap value companies with attractive valuations and improving fundamentals.
SMALL CAP CORE	Focuses on small companies with sustainable earnings growth in niche markets with lasting growth potential
SMALL CAP GROWTH	Utilizes fundamental research and quantitative screening to identify small companies with sustainable, above-average earnings growth in niche markets

The market began the quarter with a slow and steady climb as signs of better economic growth and low interest rates held sway, culminating in a 3% gain in the S&P 500 Index by mid-May. This upward trend, however, did not last. The market ultimately succumbed to various pressures including rising interest rates, mixed economic data, the crisis in Greece, tensions in Russia and the Middle East, and China's economic and stock market volatility. By quarter's end the market was essentially flat. These modest ebbs and flows of the market have been the norm throughout the first half of 2015 as investors grapple with conflicting data that seems to support both the bulls and the bears.

Large cap stocks, as measured by the S&P 500 Index, posted a gain of 0.28% for the quarter. When combined with the similarly modest gains achieved in the first quarter, the S&P 500 has earned investors a return of 1.2% for the year to date. Performance of the various sectors was quite mixed in the quarter. At the low end, interest rate sensitive stocks such as Utilities and REITs posted sizable mid-high single-digit declines. On the other end of the spectrum, the Health Care sector posted a moderate gain of nearly 3%. There was very little difference in performance between Growth and Value stocks among larger caps this quarter.

Among smaller cap stocks, the Russell 2000 Index eked out a slight gain of 0.42%. Combined with its more respectable performance in the first quarter, the 4.8% gain in this small cap index in the first half of the year has nicely outpaced large caps. Health Care was by far the strongest sector this quarter, gaining 5.8%, led once more by Pharma and Biotech. This area of strength was essentially offset by Utilities, Materials, Industrials and the REIT industry within Financials, all posting mid-high single-digit declines in the quarter. In the small cap universe Growth stocks once more posted substantially better performance than Value.

> "While the economy still struggles to find its footing, our market outlook remains positive for one basic reason. This slow growth, low inflation environment will likely keep interest rates low (regardless of Fed action), making stocks attractive relative to other asset classes."

While the economy still struggles to find its footing, our market outlook remains positive for one basic reason. This slow growth, low inflation environment will likely keep interest rates low (regardless of Fed action), making stocks attractive relative to other asset classes. There are indeed many cross-currents out there. The global headlines remain worrisome, yet data out of Europe, in the midst of its own quantitative easing program, suggests slow improvement. Domestic trends also started the year on a sluggish note. A pickup in consumer spending remains elusive and the industrial economy has also been sluggish, especially noticeable among transportation and export-oriented industries. But as the weather improved and the port strike resolved, there are signs of improvement. The ISM Manufacturing and Services Indexes and the Conference Board Consumer Confidence Index all continue to show expansion. Other positive signs include strengthening housing data, big ticket retail items, the jobs market and the unemployment rate.

Corporate profits remain solid, although earnings expectations did in fact have to be pulled down over the past several months. Yet that is now behind us, and we expect earnings growth to resume in the second half of the year and into 2016. Corporate balance sheet strength is also supportive of our positive market outlook. Share repurchases and dividend payments remain robust, and create more demand for equities. M&A activity is also very strong, as companies acquire other businesses rather than being satisfied with the low returns their cash earns sitting on their balance sheets.

Does the market agree with our favorable prognosis? Perhaps not yet, but we have finally seen money come out of bonds that we believe will ultimately find a home in equities. It is our hope and expectation that the market's appetite for more speculative investments such as Biotech will fade, and there will be a return to our style of investing in higher quality companies with prospects for sustainable and consistent earnings growth. Our investment team continues to look for such companies selling at reasonable valuation levels even as markets hover near their all-time highs.

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