ECONOMIC COMMENTARY

By Harold G. Kotler, CFA

And this too shall pass.

Easy to say, very difficult to believe as we experience these turbulent times. It would be hard to imagine that one could encounter so many disruptive events simultaneously; but here we are. Those who are fortunate, with investable capital, need to determine how to navigate these times.

Not only is the political and economic backdrop difficult, so are the investment choices. With interest rates on high grade corporate bonds, government bonds, tax-exempt bonds, money market funds, and CDs—all historic safe havens—all near historically low yields, we are forced to make incredibly complicated financial decisions. We can choose to either totally protect capital (no fear of loss), or accept volatility, in the hope of earning a positive return.

I have often wondered why volatility is such an inhibitor to investing. The loss of market value at any given time is temporary if one invests in quality assets. Losses only become real when capital is needed at inopportune times. It is for the unforeseen moments that liquidity should always be maintained, with investments in the safe havens noted above. But beyond that need, capital volatility still seems to weigh on the mind. It triggers fear, which causes many to make rash decisions at the precise time investment discipline is most critical.

Studies have proven time and time again that individuals' fear of losing market value is far more distressing than any enjoyment they experience from capital appreciation. People feel at risk when portfolios decline, even if they understand intellectually that it is only temporary.

Given the psychology of the investor, how can we encourage a long-term investment approach that does not cede ground to fear? We know that there will eventually be a medical solution to the coronavirus, though the timing of that is still uncertain. We also know that the saber-rattling in world trade is political, and momentum will be regained over time. The world economies have become too interdependent for it to be otherwise. We further know that sooner or later the politics of the haves and have-nots will need to be addressed. Yet, even with all these uncertainties, it is hard to believe that our American experience of democracy and capitalism is at risk, as some fear. Of course it will change, as it has throughout history, sometimes for the better, other times not. The great American experiment bends, but does not break.

INDEX PERFORMANCE *6/30/20*

	QUARTER	YEAR TO DATE
Bloomberg Barclays 10-Year Municipal Bond Index	2.88%	2.47%
Bloomberg Barclays Aggregate Bond Index	2.90%	6.14%
Bloomberg Barclays High Yield Index	10.18%	–3.80%
Dow Jones Industrial Average	18.51%	–8.43%
S&P 500 Index	20.54%	–3.08%
Russell 2000 Index	25.42%	–12.98%
MSCI EAFE Index	14.88%	–11.34%
MSCI World Small Cap ex USA Index	21.66%	–12.87%
MSCI World Index	19.36%	–5.77%
MSCI Emerging Markets Index	18.08%	–9.78%

GW&K UPDATE *6/30/20*

TOTAL ASSETS UNDER MANAGEMENT	$44.3 billion
TOTAL EMPLOYEES	155
TOTAL INVESTMENT PROFESSIONALS	55

STRATEGY SPOTLIGHT

GW&K's Diversified Equity Strategy offers investors a high conviction portfolio with 20 to 25 growing, competitively-advantaged businesses. Principal and Portfolio Manager, Aaron C. Clark, CFA, joined the firm in early 2015 bringing his expertise in larger-cap and dividend-oriented investing. Since joining, Aaron has helped the Diversified Equity Strategy outperform over a five-year period as of June 30. This Strategy is suitable for clients looking for exposure to quality businesses with sustainable competitive advantages and growth outlooks. Our long-term view allows for the power of compounding to take hold and limits portfolio turnover which is tax efficient for clients. To learn more, please contact your client service associate.

It is unusual in economic or investment discussions to use the word "faith." I truly believe that is what we need today. Not faith in any particular group or person—that is too binary. But faith in our collective way of life.

If we live with the approach that we must stay invested in the economic drivers of the world, then the words *overvalued, undervalued, high, low, now,* and *later,* are simply

Continued on next page

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words—they have no context. Investment timing—when to put capital to work—is impossible to determine with so many variables at play. How do we move forward, in faith, believing that our way of life, even if ever-changing, will survive? How do we continue to be active participants in that change through our behavior, charity and investments? To sit and wait for the right time is dangerous. There is no right time. There is only today and tomorrow. So we need to have faith that these times too will change.

At GW&K, we do not allow ourselves to be driven by indeterminable psychological variables. We rely on fundamental research and investment discipline. No big bets. Just an investment approach of patience, intelligence and diversification.

Stay well and safe.

Harold G. Kotler, CFA
CEO, Chief Investment Officer

SECOND QUARTER 2020

ECONOMY

- The economy entered a recession in February, ending the longest expansion (10+ years) in history. The unprecedented shuttering and subsequent reopening of the economy drove the U.S. to its deepest, but perhaps shortest, recession of all time.
- Businesses closed and consumers retrenched in the midst of the pandemic. GDP plunged, going from +2.1% in Q4'19 to –5.0% in Q1'20, the worst reading since the 2007–2008 Global Financial Crisis. The Atlanta Fed indicates –39.5% GDP for Q2, which would be the largest contraction on record.
- Manufacturing slowed considerably, but bounced back to expansion territory in June. The magnitude of job losses was historic, nearly –21 million in April, but 7.5 million were added back in the last two months. The unemployment rate decreased, but remained an elevated 11.1%.

FED ACTION

- The fed funds rate remained at its all-time low of 0.00%–0.25%, and the Fed and market expect near zero rates through at least 2022.
- The central bank said it would continue to buy Treasuries and agency MBS in amounts of at least $80B and $40B per month, respectively.
- Among its numerous liquidity and market support programs, the central bank purchased corporate ETFs and since moved to purchases of individual bonds in the secondary market. The Fed reiterated its concern over the economy, warned that the labor market may not fully recover for years, and consistently stated it would do what is necessary to help the economy through these difficult times.

BOND MARKETS

- Fixed income enjoyed a second straight quarter of gains, benefiting from ongoing support from the Fed and investor optimism amid the country's reopening.
- In contrast to the rebound that risk assets enjoyed, interest rates barely budged. The yield curve steepened slightly, as speculation around potential yield curve control anchored rates at the short end and drove the yield on the 5-year Treasury to a record low.
- Corporates experienced an extraordinary rebound from their March lows. Companies strengthened their credit positions by raising liquidity, lowering interest expenses and extending maturities.
- Municipals have come a long way since the selloff, due to a favorable technical environment as investors poured money into the space. Though the fundamental picture remains cloudy, the federal government has provided critical aid to states with the chance of additional relief.

DOMESTIC EQUITY MARKETS

- U.S. equity markets rebounded sharply in Q2, with the S&P 500 Index gaining +20.5%, driven by the phased re-opening of the economy, a faster-than-expected economic recovery, massive fiscal and monetary stimulus, and optimism around therapeutic and vaccine developments for COVID-19. Small cap stocks outpaced large caps during the period, with the Russell 2000 Index up +25.4%.
- All large cap sectors notched positive returns though sector performance varied dramatically. Consumer Discretionary, Information Technology, Energy and Materials performed best, while defensive and interest-rate sensitive groups, such as Utilities, Consumer Staples, Financials and Real Estate, lagged on a relative basis.
- Growth stocks maintained their leadership over Value, and market volatility persisted. Style factors were mixed with investors favoring companies with low leverage, high return on equity, high beta and non-earners.

GLOBAL EQUITY MARKETS

- Similar to U.S. markets, both developed Non-U.S. and emerging markets rebounded in Q2 from deep Q1 losses, despite periods of volatility, as several countries successfully contained the virus and resumed economic activity. Aggressive monetary and fiscal stimulus provided further support.
- On the developed market front, the MSCI World Index advanced +19.4%, while the MSCI World Small Cap Index returned +24.6%.
- Emerging markets also delivered widespread gains, led by Latin America, which rallied off a sharp first quarter decline. China, South Korea and Taiwan have proved resilient throughout the crisis and remained top performers YTD as the quarter closed.
- The MSCI Emerging Markets Index was up +18.1%. Commodity prices, particularly crude oil, also recovered on better supply/demand dynamics.

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
Brian T. Moreland, CFA	Partner, Portfolio Manager
Martin R. Tourigny, CFA	Partner, Portfolio Manager
14 Municipal Investment Professionals	**22** Average Years Experience

GW&K MUNICIPAL BOND STRATEGIES

SHORT-TERM MUNICIPAL BOND

2–8 YEAR ACTIVE MUNICIPAL BOND ESG

2–8 YEAR ACTIVE MUNICIPAL BOND

MUNICIPAL BOND ESG

MUNICIPAL BOND

MUNICIPAL ENHANCED YIELD

The municipal bond market posted impressive returns in the second quarter, completing a remarkable turnaround from the most tumultuous selloff in its history. Tax-exempt yields fell sharply across the curve, dropping back near all-time lows and narrowing a gap against Treasuries that had recently ballooned to all-time highs. The path toward normalcy passed many markers along the way. Short-term financing costs, which had spiked in March, dropped to record lows by June. Mutual funds not only stemmed the tide of massive net redemptions, but also began seeing a surge of inflows. The new issue market, which was effectively closed in March and most of April, eventually kicked into high gear, providing much needed price discovery and reflecting a growing confidence that the worst may have passed. The healing was broad based but not quite universal. Credit quality took on new importance as investors became more skeptical of certain issuers and sectors perceived as vulnerable to the pandemic fallout. And states are beginning to fear that additional federal aid may become a casualty of election-year politics, an outcome that could spell trouble in some corners of the municipal bond space.

Meanwhile, in the broader markets, risk assets soared as governments around the world provided unprecedented stimulus in the form of grants, loans and backstops. The Federal Reserve declared "no limit" to the amount of support it could provide, and backed that up with a dizzying array of programs designed to ensure an ample flow of credit to households, corporations and governments. A large-scale easing of lockdown restrictions, as well as progress made on virus treatments and vaccine trials, fed optimism that a swift rebound was possible, a notion that was reinforced by a blowout jobs report for May. Equity markets gained back much of their losses from the first quarter (the tech-heavy NASDAQ made new highs) and oil prices recovered from a historic plunge below zero to top $40 per barrel for the first time since the early days of March. While the need for safe havens diminished, Treasuries mostly firmed, driven by dovish guidance from the Fed, along with hints that yield curve controls were coming later this year. As the quarter came to an end, sentiment turned more cautious as coronavirus outbreaks in several states threatened to disrupt the economic momentum of the prior weeks.

While not all the way back to normal, the municipal bond market has come a long way since the breathtaking selloff in March. Once again, the lobbying power of the states proved critical, as much of the recovery was due to the extraordinary intervention by the federal government. And with another $3 trillion stimulus bill before the Senate (having already passed the House), there could be more relief on the way. In addition, the market stands to benefit from strong summer technicals, as supply is scheduled to lag demand, thanks to a pipeline of seasonally heavy coupon and maturity redemptions, as well as a potential rebalancing toward bonds in response to the powerful run-up in stock prices. Also keep in mind that states entered this crisis in relatively good condition, with reserve balances at record highs on a cumulative basis. Even so, we advise caution moving forward. The fundamental picture for many sectors remains uncertain and hardly justifies any reach-for-yield, signs of which have already begun to resurface. Incremental returns are not yet high enough to justify the risk of dipping down in quality or reaching further out the curve. At this point in the cycle, we still see the best "value" as accepting marginally lower yields to responsibly insulate portfolios from unwelcome outcomes.

As the market recovered throughout the quarter, we stayed defensive and took the opportunity to exit certain credits where we had lower long-term conviction. Our defensive positioning was also evident in duration, which we kept short to reflect still-record low yields and a relatively flat curve. A barbelled allocation to the very front end should provide the flexibility we need to take advantage of future volatility. We expect more disruptions to surface in the months ahead, particularly given the uncertainty of the virus outlook and the unpredictable swings in the election cycle, providing attractive entry points in the second half of the year.

> "While not all the way back to normal, the municipal bond market has come a long way since the breathtaking selloff in March.…We expect more disruptions to surface in the months ahead, particularly given the uncertainty of the virus outlook and the unpredictable swings in the election cycle, providing attractive entry points in the second half of the year."

TAXABLE BOND STRATEGIES

INVESTMENT TEAM

Mary F. Kane, CFA	Partner, Portfolio Manager
Stephen J. Repoff, CFA	Principal, 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	**20** Average Years Experience

GW&K TAXABLE BOND STRATEGIES

SHORT-TERM TAXABLE BOND

INTERMEDIATE TAXABLE BOND

CORE BOND ESG

CORE BOND

ENHANCED CORE BOND ESG

ENHANCED CORE BOND

TOTAL RETURN BOND

CORPORATE BOND OPPORTUNITIES

SHORT-TERM FOCUSED HIGH INCOME

Fixed income markets enjoyed a second straight quarter of gains, benefiting from ongoing support from the Federal Reserve and renewed investor optimism amid the country's gradual reopening. Data suggest the bottom is likely in, as green shoots across the economy continue to drive the recovery narrative. The consumer has proven remarkably resilient, with a V-shaped rebound unfolding in the retail, housing and auto sectors. Business activity has also bounced, as manufacturing sentiment and new orders point to a steady pace of progress in returning to pre-pandemic levels. Adding to the turnaround's momentum are expectations of additional fiscal stimulus, which would not only provide an obvious boost to the economy, but also, more importantly, narrow the range of potential adverse outcomes. Despite the unprecedented size and scope of the Fed's intervention, however, alarming news of rising case counts, renewed lockdowns across the country, and uncertain progress on the development of treatments and vaccines tempered the rally in the closing weeks. The potential for a significant second wave in the fall continues to loom as well, posing a serious threat to investor optimism. On the one hand, the Fed's relatively downbeat economic outlook ensures that it is likely to provide necessary support for the indefinite future. On the other hand, it paints a challenging picture for the nation's recovery. The key question facing fixed income markets is which of these two forces will prevail in the coming quarters.

In contrast to the recovery that risk assets have enjoyed, interest rates barely budged in the second quarter. The first quarter rally that brought Treasury yields to record lows was driven by a flight to safety and collapsing inflation expectations, but their resilience since then is more a function of their growing importance as a policy tool. The Fed has purchased a little over 10% of the entire Treasury market since March, and though its pace of buying has slowed, it continues to purchase $80 billion per month. The slope of the yield curve steepened only slightly, as speculation around potential yield curve control anchored rates as far out as the 5-year, which saw its yield fall to a record low in the closing days of the quarter. The Fed has also been an active buyer in the mortgage market, buying $100 billion in June, bringing its total purchases since March to $788 billion.

Corporate credit experienced an extraordinarily strong rebound from its lows in March. The support came from all sides. The Fed began purchasing bonds through ETFs and the secondary market in addition to getting the primary market facility up and running. Investors, encouraged by this support and heartened by signs of recovery in the real economy, flooded the sector with inflows. Companies themselves strengthened their credit positions by taking advantage of these favorable conditions to raise liquidity, lower interest expenses and push out maturities. In a clear sign of just how well functioning credit markets have been, investment grade corporations have already surpassed 2019's record full-year issuance with $1.2 trillion of new paper. That's not to say it has all been smooth sailing. There was a significant uptick in the high yield default rate during the quarter, particularly in the Energy sector, where producers briefly had to contend with negative crude prices. The Consumer sector also dealt with a challenging landscape, especially in retail, where nationwide lockdowns and massive layoffs pushed several companies that were already experiencing distress to officially seek bankruptcy protection. But credit investors have largely treated these sectors as idiosyncratic rather than systemic risks, with minimal read-through to the broader market.

The risk/return profile of the Treasury market has never been as skewed to the downside as it is today. Yields are at record low levels at the same time as the duration of the market is the longest it has ever been. In contrast, credit spreads continue to sit meaningfully wide of their recent lows, offering not only a pickup in yield relative to Treasuries, but also the potential to absorb some portion of a move higher in rates. Though much of the benefit has already been realized, there is still room for credit to outperform as the Fed continues to inject cash into the corporate market—to say nothing of the benefit the sector will enjoy as the economy gradually reopens.

"Fixed income markets enjoyed a second straight quarter of gains, benefiting from ongoing support from the Federal Reserve and renewed investor optimism amid the country's gradual reopening."

DOMESTIC EQUITY STRATEGIES

INVESTMENT TEAM

Daniel L. Miller, CFA	Partner, Director of Equities
Joseph C. Craigen, CFA	Partner, Portfolio Manager
Jeffrey W. Thibault, CFA	Partner, Portfolio Manager
Jeffrey O. Whitney, CFA	Partner, Portfolio Manager
Aaron C. Clark, CFA	Principal, Portfolio Manager
12 Equity Investment Professionals	**22** Average Years Experience

GW&K DOMESTIC EQUITY STRATEGIES

EQUITY DIVIDEND PLUS

DIVERSIFIED EQUITY

SMALL/MID CAP CORE

SMALL CAP VALUE

SMALL CAP CORE

SMALL CAP GROWTH

> "The market has priced in a fair amount of good news over the past three months. Some would argue it is warranted by the ultimate improvement in the global economy, driven by heavy and likely continued doses of fiscal and monetary support. Others would say the optimism is warranted by anecdotal or statistical evidence of economic improvement…."

In response to massive fiscal and monetary stimulus, markets bounced strongly off their lows to start the second quarter. The rally continued into early June among optimism around development of COVID-19 treatments and vaccines, hopeful economic data putting the worst of the recession already behind us, and the job surge tied to the reopening of the economy. Then the market rally paused as investors began to worry about a second wave of the virus derailing reopenings, political fighting over a next stimulus bill, election fears of higher taxes and regulation, and further heightening tensions between the U.S. and China. Nonetheless, markets posted a slight gain in June to cap off one of the strongest quarters of performance in over two decades, albeit from the COVID-induced bear market of the prior quarter.

Large cap stocks, as measured by the S&P 500 Index, registered their strongest quarter since 1998, gaining 20.5%. While not enough to offset the first quarter's meltdown, the Index sits only about –10% from its all-time highs of February, and is down only –3.1% for the first half. While all market sectors posted quarterly gains, the more defensive and interest-rate sensitive sectors of Utilities, Consumer Staples, Financials and Real Estate lagged meaningfully, while commodity and organic-growth oriented sectors such as Consumer Discretionary, Information Technology, Energy and Materials posted strong gains.

The Russell 2000 Index of small cap stocks posted an even more impressive quarterly gain, up 25.4%, a number not matched since 1991. Yet, from its deeper hole, small caps remain down –13.0% for the first half. Sector strength and weakness was generally the same down cap, with the addition of Health Care's strong performance driven by surging stock prices among its biotech, health tech and pharma industries.

Small caps finally beat their large cap brethren this quarter, with particular relative strength in Health Care and consumer cyclicals. Growth stocks remained comfortably ahead of Value stocks for both the quarter and the year-to-date period, as the strong performing Information Technology and Health Care sectors possess higher weights in Growth benchmarks, while poorly performing Financials have a greater weighting in Value.

The market has priced in a fair amount of good news over the past three months. Some would argue it is warranted by the ultimate improvement in the global economy, driven by heavy and likely continued doses of fiscal and monetary support. Others would say the optimism is warranted by anecdotal or statistical evidence of economic improvement: reopening of business, surprisingly strong jobs creation, an improving consumer confidence index, ISM survey data pushing very close to expansionary readings, and new housing sales all point to an improvement off the bottom. Still other bulls would say it is only a matter of time until we find more effective treatment options and ultimately a vaccine. There are naysayers who believe we have opened up the economy too soon, overwhelming us with new coronavirus cases and risking pushing us back into recession. Others say the markets are ignoring critical political issues, whether between the U.S. and China on global trade and political issues, or domestically between Democrats and Republicans on the election, stimulus, taxes and regulation. Still others argue we are borrowing from our future to prop up our present.

Perhaps all are right. Conceivably this discord is why markets are more likely to go sideways in the near term. Often we turn to valuation when markets are looking inconclusive. Here too the evidence is contradicting. In 2020, the market sells at a rather expensive 25x multiple of depressed earnings. But the market is a discounting mechanism. When will we return to a more normalized level of earnings? If it is in 2021, the market is arguably cheap at 19x earnings, especially against a backdrop of record low interest rates. But would we take the risk of paying these prices for stocks if earning don't return to prior peak levels until 2022 or 2023? Probably not.

This is our dilemma. Each side makes strong arguments for both the economic and the stock market outlook. Yet, in many ways we don't have to pick sides. We just have to stick to our fundamental investment process with the goal of identifying well-run companies with strong financial characteristics, which can survive troubled times and are well positioned for market success regardless of the economic outlook.

GLOBAL EQUITY STRATEGIES

INVESTMENT TEAM

Daniel L. Miller, CFA	Partner, Director of Equities
Reid T. Galas, CFA	Partner, Portfolio Manager
Karl M. Kyriss, CFA	Principal, Portfolio Manager
8 Equity Investment Professionals	**23** Average Years Experience

GW&K GLOBAL EQUITY STRATEGIES

GLOBAL SMALL CAP

INTERNATIONAL SMALL CAP

> "There remains a great deal of uncertainty about the future direction of the market…. Regardless of which side turns out to be correct, the relative attractiveness of the international markets is the highest we have seen in a decade."

Global developed markets rebounded sharply after the dramatic first quarter selloff. The MSCI World ex USA and MSCI World Small Cap ex USA Indexes finished up 15.3% and 21.7%, respectively. For the small cap Index that is the fourth best quarter on record. The prior three records (Q2 and Q3 of 2009 and Q2 of 2003) all preceded extended periods of strong returns. Meanwhile, the U.S. dollar continues to weaken, falling –1.7% on a trade weighted basis.

Markets were higher across the board with every region, country and sector positive. Geographically, North America led Europe, Asia and the Middle East. Australia, Canada and Sweden benefited from their pro-cyclical sector exposures while Israel, Austria and Hong Kong lagged. On a sector basis, Materials, Information Technology and Consumer Discretionary were well ahead of traditionally defensive sectors, Real Estate and Consumer Staples, while Financials could not keep up in such a strong rally. The majority of the rebound took place in April and while all monthly returns were positive the pace of the rebound has been slowing.

There remains a great deal of uncertainty about the future direction of the market. A compelling case can be made for both continued upside as well as significant downside risk. The bearish case revolves around a negative reaction to the closure of major parts of the economy, a second wave of the virus, and worsening relationship between the U.S. and China. Meanwhile, the bullish case focuses on unprecedented monetary and fiscal spending and a belief that the worst economic impacts are already past. Regardless of which side turns out to be correct, the relative attractiveness of the international markets is the highest we have seen in a decade.

The case begins with valuation. Over the last decade the operating profits of the non-U.S. developed small cap markets have increased about 35% more than those of the U.S. Yet, the U.S. markets have significantly outperformed resulting in an operating profit valuation 3.7 times higher than their international peers. However, it is not a question of quality as the international companies also have better margins and return profiles as well as stronger balance sheets and less debt. With valuation, growth, margins, returns and balance sheets all in favor of international, it clearly is not the fundamentals so let's examine other possibilities.

Other than perhaps the U.K, the U.S. has been the least effective in controlling COVID-19. While cases in the U.S. hit new highs, most of Europe seems to be improving, while countries like Australia, New Zealand and Japan clearly have the upper hand and may be successful in full eradication. The other major geopolitical issue is the cold war between the U.S. and China. This will be a major concern for years and while non-U.S. developed markets will be negatively impacted it is hard to argue that they will be more impacted than the U.S. The one way to make that case is to note that the U.S. is the least trade exposed major economy in the world and therefor a collapse in global trade would simply impact the U.S. less than other countries. However, the counter argument is that if the global economy improves the U.S. would benefit the least.

On monetary policy the major central banks not only forgot to take the punch bowl away, but have clearly been guzzling from it. U.S. monetary stimulus has been unprecedented, but because the U.S. dollar is critical globally, international markets also benefit when dollar liquidity improves. At the same time, the European Central Bank, as well as others, are actually increasing money supply at an even faster rate. On the fiscal front, government pocketbooks are open. Though, the U.S. faces a sharp partisan divide during an election year and potentially dramatic tax increases depending upon the result. Overseas markets do not have this problem. This leaves us with the final driver, a potentially weaker U.S. dollar. Traditionally overseas markets do well when the dollar weakens. The dollar last bottomed in 2009 and while it could continue to strengthen, this cycle is getting long in the tooth.

As always, we continue to focus our investment process around fundamental business analysis and valuation, while keeping an eye on the environment.

EMERGING MARKETS EQUITY STRATEGIES

INVESTMENT TEAM

Daniel L. Miller, CFA	Partner, Director of Equities
Pablo Salas	Partner, Portfolio Manager
Nuno Fernandes, CFA	Vice President, Portfolio Manager
Thomas A. Masi, CFA	Vice President, Portfolio Manager
Bradley J. Miller, CFA	Vice President, Portfolio Manager
William P. Sterling, Ph.D.	Global Strategist
18 Equity Investment Professionals	**27** Average Years Experience

GW&K EMERGING MARKETS EQUITY STRATEGIES

EMERGING MARKETS EQUITY

EMERGING MARKETS EQUITY ADR

EMERGING WEALTH EQUITY

EMERGING WEALTH EQUITY ADR

After getting hit especially hard in the first quarter, emerging market (EM) equities posted a return of 18.1% in the second quarter, their best quarterly rise in nearly eleven years. The rebound still left the MSCI Emerging Markets Index down by –9.8% for the year-to-date period, compared to declines of –5.8% and –3.1%, for the MSCI World and the S&P 500 Indexes, respectively.

The massive economic policy responses to the pandemic-led recession, along with optimism that the global economy would bounce back quickly as lockdowns ended, drove the second quarter recovery in risk assets. A truce in the Russia-Saudi Arabia oil war helped the price of Brent crude oil recover significantly in the second quarter, back to nearly the $43 per barrel level (+80%). In addition, a basket of MSCI EM currencies strengthened by 1.6% in the quarter.

Aggressive easing by central banks, led by the U.S. Federal Reserve, has certainly dominated much of the narrative about financial market recoveries decoupling from struggling economies. But we would place equal, if not greater, emphasis on the key role that fiscal policy has played in this crisis.

According to the McKinsey Global Institute, the collective response of fiscal authorities to the COVID-19 crisis has been unprecedented, with $10 trillion in economic-stimulus measures announced just in the first two months. That is three times more than the response to the 2008–2009 Global Financial Crisis. The International Monetary Fund, in its June World Economic Outlook, estimated the fiscal policy response at $11 trillion, which is about 12% of global GDP.

This fiscal largesse has helped investors look past the extremely negative data on global economic activity in the first half of 2020. That's because money sent to households or businesses should eventually support corporate profits as it is spent on goods and services.

Investors still need to sort through exactly when and where the fiscal stimulus will show up in corporate earnings. There is unlikely to be a V-shaped recovery in every sector, country or company. However, prospects for large doses of government money to pulse through the global economy help explain why analysts are relatively optimistic about corporate earnings.

Numerous high-frequency data points on items like consumer mobility trends, credit card charges and restaurant reservations suggest that the global economy began to recover in May as economies reopened. The U.S. jobs report for May was notable, with a gain of 2.5 million jobs, blowing past market expectations for a 7.5 million decline. More recently, strong data for retail sales, personal consumption expenditure, and pending home sales all suggest that the U.S. recession, which started in February, ended in May.

Data for other major nations has not been as strong as seen in the U.S., but still supports the thesis that global growth has entered a recovery phase. J.P. Morgan, for example, now forecasts that global GDP will grow at a 20% annual rate in the second half after having declined at an annual rate of 16% in the first half. Since EM equities have historically been a high-beta play on the global business cycle, it makes sense that EM equities began to outperform developed market equites in June as conviction in the global recovery began to grow. Notably, this occurred even as the epicenter of the virus shifted toward EM in the second quarter, with notable growth in new cases throughout Latin America and India.

The performance of EM equity sectors reflected growing confidence in global economic recovery with cyclical sectors like Materials, Energy and Consumer Discretionary outperforming, while defensive sectors like Consumer Staples and Utilities underperformed.

On a regional basis, Latin America led the EM recovery thanks to its sensitivity to commodity prices. Asia and EMEA lagged slightly, although the Asian region remains the strongest performer on a year-to-date basis, thanks to the successful public health measures of China, South Korea and Taiwan. Those three countries account for nearly 65% of the MSCI Emerging Markets Index.

While nothing is certain as the pandemic continues, it looks increasingly likely that April/May period will be seen as the nadir of the Great Lockdown global recession. EM equities should benefit from even an incomplete global economic recovery, as well as from incipient weakness in the U.S. dollar that tends to provide greater policy space for EM stimulus measures.

"This fiscal largesse has helped investors look past the extremely negative data on global economic activity in the first half of 2020. That's because money sent to households or businesses should eventually support corporate profits as it is spent on goods and services."

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