

ECONOMIC COMMENTARY

By Harold G. Kotler, CFA

Not since the United States' engagement in the Vietnam War have there been public demonstrations of the scope and size we are seeing today. The need for Massachusetts Governor Baker to activate 1,000 soldiers in the National Guard reminds me of the riot control training I was given in 1970. The tension that is created when soldiers face a civilian population is overwhelming on both sides. The divide between citizen soldiers and civilians highlights the tremendous divide that exists today in our country.

During the Vietnam War, the tensions, rallies and demonstrations were led by the younger generation. They had one defined issue, "Stop U.S. involvement in Vietnam's civil war." Today's struggle is far more diffuse and affects all of us in one way or another. Black Lives Matter, Trump versus Biden, Supreme Court nominations, "haves" versus "have nots," public/large companies versus private mom-and-pop businesses—all of these issues are taking place during a global pandemic. The swirl of issues and emotions makes the present time overwhelmingly difficult and, for many, almost impossible to navigate.

How can a rational person cope with these stresses and manage their financial responsibilities? The questions that clients ask again and again are, "Why has the stock market recovered from the lows of last March?" and "Where do we go from here?" Although the recovery has not been uniform, major equity indexes are up nearly 50% from their March lows, with some, like the S&P 500, in positive territory for the year to date. Critical to the recovery in values were the rapid reactions of Congress and the Federal Reserve, which added immense

aid and liquidity to the system. The policy response was quick and decisive, much different than in 2008–2009, enabling us to avoid a depression-like scenario.

The U.S. economy was able to find its footing in large part through the transmission mechanism of incredibly low interest rates. Companies' ability to access the public debt market, either for new money or to roll over existing loans, provided them a windfall of opportunity. While this formula could not protect every business or industry, it went a long way toward stabilizing the system as a whole.

We may look back at the pandemic's squeeze as a kind of fast-forwarding of the economy, *five years' change in six months*. Businesses that could have stayed viable for a few more years will suddenly be out of business this year. Companies that needed time to reflect on how to adapt to an evolving landscape don't have years to figure out a new, modern approach. They are faced with the necessity of making those decisions today. The good news is that many of them are figuring it out on the fly. GDP is on track to grow 35% in the third quarter and another 5–10% in the fourth quarter. Unemployment has already been cut in half. While the economy may not be healthy, it is healing.

So, given all these factors, how does one invest capital? Once a family has enough liquidity for its everyday needs, the investable portion needs to be productively diversified. There was a time that bonds and stocks complemented each other. Bonds provided a stable return with minimum volatility and stocks provided a more favorable return with higher volatility.

INDEX PERFORMANCE

9/30/20

	QUARTER	YEAR TO DATE
Bloomberg Barclays 10-Year Municipal Bond Index	1.27%	3.77%
Bloomberg Barclays Aggregate Bond Index	0.62%	6.79%
Bloomberg Barclays High Yield Index	4.60%	0.62%
Dow Jones Industrial Average	8.22%	-0.91%
S&P 500 Index	8.93%	5.57%
Russell 2000 Index	4.93%	-8.69%
MSCI EAFE Index	4.80%	-7.09%
MSCI World Small Cap ex USA Index	10.12%	-4.05%
MSCI World Index	7.93%	1.70%
MSCI Emerging Markets Index	9.56%	-1.16%

GW&K UPDATE

9/30/20

TOTAL ASSETS UNDER MANAGEMENT	\$47.1 billion
TOTAL EMPLOYEES	156
TOTAL INVESTMENT PROFESSIONALS	56

SPOTLIGHT ON GW&K'S TAXABLE BOND STRATEGIES

GW&K's Taxable Bond Strategies surpassed \$5 billion in total assets under management for the first time in the third quarter. Our Taxable Bond suite of products has expanded over the years and now includes a broad range of actively managed Strategies across multiple bond market sectors. Part of this expansion includes ESG-focused Strategies, as well as our Short-Term Focused High Income Strategy, which just achieved a three-year track record. For more information on any of our Strategies, please contact your GW&K client service representative.

Interest rate vehicles like bonds still equip portfolios with a necessary stabilizing force, but their ultra-low yields currently provide minimal returns. As a result, the growth component of portfolios will be ever more dependent upon the equity allocation. Despite the "black swan" events that can throw the stock market off course, equities represent the future earning power of a company, and as such, in the long term will provide a growth opportunity complementary to bonds.

For every decline in the stock market there has been a meaningful recovery within an

acceptable time period. The only exception was the 1928–1932 crash, when government exacerbated the problem rather than help an ailing economy along. Today's stock market knows that the pandemic's effect on the world economy will not be permanent, and discounts the time that it will take economies to "normalize." There will be a lot of stop-and-go, but the only real question is when, not if, there will be a recovery. Since this part of the market-value equation is guesswork, there will necessarily be volatility based on hope and fear.

Continued on next page

Volatility will cause many to struggle with the idea of investing in the stock market at this time, but if we anchor our investment decisions in tried-and-true methodologies we can come out on top. There are three components of successful stock investing: having a decent investing horizon (3–5 years), accepting volatility, and emphasizing diversification. We are in the midst of a stock picker's market. Finding the right companies, those that will thrive in a fast-evolving world, will be the key to successful diversification.

For Americans, diversification has traditionally meant balancing large companies, small companies, growth companies, etc. My belief is that this attitude is much too provincial. The U.S. has greatly enjoyed the benefits of a global economy. We kept U.S. inflation at bay by manufacturing in countries where the cost of production was low. This was also a win for the world's economies. It gave millions of workers access to jobs and wages that improved their lives, resulting in a fast-developing middle class around the world. In the same way that the unions of the early 20th century enabled a

whole class of people in the U.S. to become consumers, globalization has empowered factory workers around the world to become the consumers of the future. U.S. industries will benefit from this wave, but so will the companies of other developed nations. Everyone will win from this worldwide growth.

Globalization cannot be stopped. Though we may have economic tiffs, those are far better than bullets and bombs. Because of all this, "traditional" diversification is no longer enough. Stock positions today need to reach out

across the globe because entrepreneurs will seek opportunities wherever they exist.

Take a deep breath. Know there will be a vaccine and life will return to a new normal just as it did after 9/11. Look forward with optimism knowing full well that the U.S. and our nation's economy bends, but does not break.

Stay safe and healthy.



Harold G. Kotler, CFA
CEO, Chief Investment Officer

THIRD QUARTER 2020

ECONOMY

- After a historic shutdown, the country continued to reopen in Q3, potentially ending the briefest, but most severe recession the country has ever experienced. An ultra-accommodative Fed, fiscal stimulus, improved virus backdrop, and rallying markets contributed in lifting the economy from its darkest days.
- Pent-up demand from consumers and reopened businesses drove sales activity back to pre-pandemic levels. The Atlanta Fed indicates 34.6% GDP for Q3, which would be the largest expansion on record.
- Manufacturing rebounded considerably, and spent the last four months in growth territory. The services sector expanded for three straight months. The labor market continued to improve, albeit at a slower pace. The economy added 3.9 million jobs during Q3, while the unemployment rate fell from 11.1% to 7.9%. Still, YTD there have been a net 10.3 million job losses.

FED ACTION

- The FOMC projected that the fed funds rate would remain at its 0.00%–0.25% range through at least 2023.
- The central bank said it would continue to buy Treasuries and

agency MBS in amounts of at least \$80 billion and \$40 billion per month, respectively.

- The Fed updated its policy framework, saying that before increasing rates, inflation will need to reach and exceed 2% for some time to make up for periods when it has remained below that threshold. Additionally, the central bank wants the economy to return to full employment before tightening. The Fed's growth and unemployment forecasts improved, yet it continued to offer caution on the outlook, noted "considerable risks," and appealed for further fiscal stimulus.

BOND MARKETS

- Fixed income was remarkably subdued in Q3, trading in an extremely narrow range despite major economic advances and significant developments epidemiologically and politically.
- Treasuries did little more than earn their coupons. Yields across the curve were essentially static, with the front end grinding a few basis points lower and maturities farther out a couple basis points higher.
- After a fierce rebound in Q2, credit momentum stalled in Q3. Spreads ended only slightly tighter and were remarkably stable throughout, even as stocks rallied to a record high,

tested correction territory, and then rallied again.

- Despite modest rate increases in September, municipals posted solid returns for Q3. While the technical backdrop has been supportive, volatility could increase as supply is building and demand tapering with investors taking a more cautious approach.

DOMESTIC EQUITY MARKETS

- U.S. equity markets notched strong gains in Q3, with the S&P 500 Index gaining +8.9%, driven by the continued reopening of the economy, monetary stimulus, better-than-feared corporate earnings results, signs of improving consumer demand, and progress around therapeutic and vaccine developments for COVID-19. Markets weakened in September, though, as fears around a potential second wave, uncertainty regarding additional fiscal stimulus, and the upcoming election weighed on sentiment. Large cap stocks outpaced small caps during the period (Russell 2000 Index +4.9%).
- Most large cap sectors delivered positive returns with Consumer Discretionary, Materials, Industrials, and Information Technology performing best. Energy was the only sector to lose value. Interest-rate sensi-

tive groups such as Real Estate, Financials, and Utilities lagged on a relative basis.

- Growth stocks maintained their leadership over Value, and market volatility reemerged in September.

GLOBAL EQUITY MARKETS

- Developed international markets further advanced in Q3, though finished off their best levels as the rally faded in September. Currency strength was a key factor—the U.S. Dollar Index shed –3.6%.
- The MSCI World ex USA Index advanced +4.9%. Small cap stocks were standout performers. The MSCI World Small Cap ex USA Index gained +10.1%, with Australia, New Zealand, and Nordic markets in the lead.
- Asia delivered another strong quarter for emerging markets. Taiwan, India, China, and South Korea dominated performance. The MSCI Emerging Markets Index was up +9.6%, despite losses in Latin America and mixed results in Europe, the Middle East, and Africa (EMEA).
- Sector highlights include continued strength in emerging markets Information Technology and a global rally in Consumer Discretionary stocks. Energy pulled back against volatility in crude oil prices.

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 solid returns in the third quarter, extending a post-crisis rebound on the back of a robust technical environment. Over the first six weeks of the period, tax-exempt yields rallied to all-time lows across the entire curve. The major catalyst was a flood of money pouring into the market, driven by a combination of seasonally high reinvestment demand and attractive valuations versus taxable alternatives. Industry mutual funds took in \$26 billion of net new cash, the highest quarterly inflows on record. Supply, on the other hand, was relatively modest. Headline volumes were actually well above average, but those numbers were inflated by a record jump in taxable issuance. Tax-exempt supply remained at more manageable levels. In addition, dealer inventories dropped to all-time lows, setting the stage for a supply/demand dynamic that favored sellers. Lower rated credits continued to outperform, benefiting from a

better-than-expected outlook for state finances and a still heavy appetite for incremental yield. Over the second half of August and into September, investors turned more cautious amid a building forward calendar and uncertainty over federal relief aid, pushing rates up off their lows, but still down for the quarter.

In the broader markets, the backdrop was one of relative calm. The Federal Open Market Committee (FOMC) laid out a new policy framework to allow for inflation overshoots without corresponding hikes in rates. Member forecasts signaled that rates would remain on hold through the end of 2023. Meanwhile, the recovery continued at a solid clip, highlighted by upbeat results for the consumer, housing and manufacturing. The labor market added jobs in all three months bringing the unemployment rate down below 8% from a peak of nearly 15% in April. Sentiment around a so-called Phase 4 stimulus package waxed and waned, but an agreement ultimately proved

out of reach as the quarter came to a close. Fears surfaced of a resurgence in COVID-19 cases and potential new shutdowns, particularly in Europe. And as we drew nearer to Election Day, concerns increased that a prolonged vote count could delay results and destabilize social order. Through it all, however, Treasury yields traded in a narrow range and finished the quarter essentially unchanged.

As we enter the final stretch of the year, the picture in the municipal bond market is still fairly bright. The yield curve, which had been stubbornly flat the last few years, has steepened back closer to historical averages, offering better return potential from the additional roll. Relative value ratios remain historically cheap, particularly at the 10-year spot, which finished the quarter well above 100%. While uncertainty surrounding the election looms, certain results could favor municipal bonds, including a Democratic sweep or any outcome that results in higher taxes, more aid to states or a rethink on the SALT deduction and/or the tax-exempt advanced refunding ban. Even so, the technical picture that boosted returns in recent months is likely to become a headwind, with increased supply and heightened investor caution.

We continue to take a cautious approach in this environment both in terms of credit and duration. Our purchases have generally focused on high quality, solid state general obligation names as well as revenue bonds in essential service sectors such as education, toll roads, health care and water and sewer. We also found some value in the airport sector where spreads remained relatively wide. Our approach here was conservative, concentrating on the largest, most critically important hubs in the nation's transportation network, which have strong cash cushions to deal with declines in passenger traffic. As the curve steepened toward the end of the quarter, we looked to accumulate bonds in the 7-10 year range where the roll characteristics were markedly improved. In many cases, the value of the roll exceeded the absolute purchase yield, a reminder of the importance of curve analysis. Moving forward, we are fully aware of the potential volatility ahead with the upcoming election, ongoing credit deterioration and weakening technicals. As such, we have maintained our historically short duration and allocation to the very front end of the curve, providing necessary flexibility should a market shift warrant action.

“As we enter the final stretch of the year, the picture in the municipal bond market is still fairly bright. The yield curve, which had been stubbornly flat the last few years, has steepened back closer to historical averages, offering better return potential from the additional roll.”

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

13 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 were remarkably subdued in the third quarter, trading in an extremely narrow range despite major economic advances and significant developments epidemiologically and politically. For much of the period, this calm was striking for its apparent insensitivity to the steady progress of the U.S. recovery. The consumer continued to display astonishing resilience, the housing sector soared, and the labor market made major strides in its path back to normalcy. Encouraging results in the hunt for a COVID-19 vaccine and improved outcomes for those infected also seemed to have little impact. Toward the end of the quarter, this muted trading was all the more notable, considering the looming uncertainty investors face heading into year end. Signs have already begun to emerge that the coronavirus' second wave is forming. Negotiators appear to be far apart in their efforts to agree on

a second round of stimulus; and there is increasing concern that a protracted vote count could result in a weeks-long delay in determining the outcome of the election. Yet the bond market exited the quarter essentially where it started. Of course, the cause of this apparent tranquility is no mystery: the Federal Reserve remains absolutely dominant across all corners of the fixed income market. And as its influence continues to overwhelm fundamentals and distort pricing mechanisms, it has become increasingly challenging and all the more important for investors to be discerning in their yield curve positioning and sector allocation.

Treasuries did little more than earn their coupons. Yields across the curve were essentially static, with the front end grinding a few basis points lower and maturities farther out a couple basis points higher. The short end is effectively flat for the next several years, reflecting the market's

expectation that the Fed will be on hold through at least late-2023. Farther out, the shape of the curve is more typical of an economic expansion and is sitting at the steeper end of a multi-year range. The long end has been under pressure not only in anticipation of elevated supply to fund stimulus, but also on the possibility that the Fed will eventually achieve its inflation target. In fact, the one standout performer in the Treasury market was TIPS, which rallied as breakeven expectations continued to normalize following their first quarter collapse. Real rates remain pinned near -1%, near post-World War lows. Mortgage-backed securities performed in line with Treasuries, as prepayment speeds stabilized and the Fed remained an active participant in the market, purchasing 40% of supply.

After a fierce rebound in the second quarter, credit momentum stalled in the third. Spreads ended only slightly tighter and were remarkably stable throughout, even as stocks rallied to a record high, tested correction territory, and then rallied again. On the positive side, corporates cheered the broad economic rebound, unexpectedly solid second quarter earnings, and upbeat management commentary—to say nothing of a steady flow of capital into the asset class. But offsetting these bright spots was an onslaught of new issuance from companies taking advantage of record-low yields and worries of potential dislocations heading into year end. Ultimately, as with the Treasury

market, any potential flare-ups of volatility were smothered by the presence of the Fed and price action was consequently muted. The default rate has continued to decline in recent months, but the pipeline of potential candidates is significant and remains an overhang. Though these distressed names are largely concentrated in sectors most exposed to COVID-19 and do not suggest systemic risks, a meaningful uptick could nevertheless weigh on sentiment.

The desultory tone of the rates market highlights the extent to which the Treasury sector has become a policy tool rather than a useful means of price discovery—particularly at the front end, where the effects of the Fed's intervention are most apparent. The signal farther out is a little clearer and there is some evidence that inflation concerns have begun to influence trading at the long end, but the overall level and shape of the curve nevertheless reflect broad-based skepticism around the 2% target.

Considering neither rates nor spreads have moved appreciably in recent months and the recovery continues to unfold, we remain constructive on credit relative to Treasuries. The duration of the Treasury market reached yet another record length while its yield continues to sit near a record low. We believe this combination remains an unattractive value proposition. Credit, meanwhile, is well positioned to benefit from both constructive fundamentals and Fed largesse, while spreads continue to sit well wide of recent lows.

“Fixed income markets were remarkably subdued in the third quarter, trading in an extremely narrow range despite major economic advances and significant developments epidemiologically and politically.”

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

Equity markets started the quarter very strong, with July and August registering solid gains. This early quarter optimism was driven by the same factors we saw the prior quarter, namely massive levels of fiscal and monetary stimulus, the slow but steady reopening of the economy leading to sequentially improving employment, spending and consumption trends, and continued progress developing COVID-19 treatments and vaccines. Yet markets ended the quarter with a thud in September, ending five consecutive months of gains, due to a slowing in economic activity as a second virus wave stalled the reopening trend and hopes for a next round of fiscal stimulus faded. Growing civil unrest, election uncertainty and continued strained relations between the U.S. and China only exacerbated matters. Nonetheless, stock markets around the globe held on to solid mid to high single-digit gains for the quarter.

Large cap stocks, as measured by the S&P 500 Index, actually had their best Q3 performance in a decade, gaining +8.9%. The quarter's gain has now put this Index firmly in the black for the year to date, with an advance of +5.6%. All sectors, save Energy, were up for the quarter, with economically sensitive and organic-growth sectors Consumer Discretionary, Materials, Industrials, and Information Technology leading the way. Laggards for the quarter included Energy, which declined nearly -20% and is off almost -50% for the year, and the interest-rate sensitive and pandemic-impacted sectors of Real Estate and Financials.

The Russell 2000 Index of small cap stocks posted a respectable gain of +4.9% for the quarter, yet this was not enough to lift the Index into positive territory for the year-to-date period. While winning and losing sectors were generally the same from large cap to small, the one exception was Information Technology which, lacking the inclusion of

“The key here for equity investors is whether the world returns to normalcy in the first half of 2021, making our earnings forecast achievable. We believe it will, but need to watch such progress carefully.”

the mega-cap IT winners, was a more mediocre performer among smaller caps.

Large caps resumed their winning ways versus small caps this quarter. Strength in Information Technology's large cap names and weakness in the small cap bank stocks explained the vast majority of this performance difference. Growth stocks expanded their already sizable advantage over Value in the quarter, despite Value names catching a bid in September. The strong performing Information Technology and Consumer Discretionary sectors possess higher weights in Growth benchmarks, while the poorly performing Energy and Financials sectors have a greater weighting in the Value benchmarks.

The generally optimistic tone reflected in the market's stunning move off the bottom has begun to sound a little flat. Expectations of another stimulus package have faded, as Democrats and Republicans instead focus their attention on the upcoming Supreme Court confirmation battle. A resurgence in COVID-19 cases has slowed the economic recovery as reopening schedules are rolled back. Election anxiety has ratcheted up under the fear of a contested election or a less-than-peaceful transfer of power. Tensions between the U.S. and China have not eased. Civil unrest related to issues of racial inequality seems only to get worse. These concerns are real, even as excesses in the stock market were becoming evident.

But while these risk factors regularly and incessantly make the nightly news (or is it Twitter?), the economy continues to show signs of improvement. The labor market continues to improve, albeit at a slower pace, while the unemployment rate has now dropped for five months in a row. Consumer Confidence, ISM Manufacturing and ISM Services surveys have all returned to expansionary territory. Housing data is nothing short of robust. Inflation remains well controlled, while interest rates remain near record low territory. And, of course, it is only a question of when, not if, the pandemic will become but a distant memory.

The stock market continues to sell at a rather lofty multiple of 27x pandemic-impacted 2020 earnings, but this figure now becomes quite irrelevant as our attention turns to forward earnings. For 2021, we expect earnings to approach levels reached in 2019, thus reflecting a market multiple of 21x earnings. The key here for equity investors is whether the world returns to normalcy in the first half of 2021, making our earnings forecast achievable. We believe it will, but need to watch such progress carefully.

Such divergent views of the economic, political and social outlook is, of course, what makes markets. We find it difficult to keep our personal views from swaying too much every day. But what does not change is our investment philosophy and process.

GLOBAL EQUITY STRATEGIES

INVESTMENT TEAM

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

GW&K GLOBAL EQUITY STRATEGIES

GLOBAL SMALL CAP

INTERNATIONAL SMALL CAP

Global developed markets continued their rally in the third quarter, putting in a good year's performance in a single quarter. The MSCI World ex USA and MSCI World Small Cap ex USA Indexes finished up +4.3% and +10.1%, respectively. The latter remains below its pre-COVID highs, but has rallied impressively from the lows in March despite a modest pause in September. Meanwhile, the U.S. dollar continued to weaken, falling -3.5% on a trade weighted basis.

Global small cap markets were broadly higher with every region and sector advancing, although several countries fell slightly. Geographically, Europe (+10.9%) was the best region, but was followed closely by all the others: Middle East (+10.0%), Asia (+9.5%), and North America (+8.7%). The Nordics took the top three slots with Sweden (+23.7%), Finland (+22.9%), and Denmark (+15.3%). And just in case you were curious, Norway tied New Zealand for the fourth spot at +13.3%. Portugal (-5.0%) and Ireland (-3.2%) were the only countries with negative returns during the quarter, while Austria was also a laggard at +1.6%. On a sector basis, Communication

Services (+20.4%), Consumer Discretionary (+14.6%), and Information Technology (+11.3%) continued to put up strong returns, while Energy (+0.7%), Financials (+5.6%), and Real Estate (+7.8%) remained laggards.

Last quarter we discussed the opportunity in our investment universe, and while there were strong returns this quarter, we believe the rebound in equities is just getting started. After unprecedented stimulus, in both timeliness and quantity, we are seeing early signs that governments have kick started a cyclical recovery. In the short to medium term a resumption of trade, massive inventory restocking of supply chains, and pent-up demand should drive an economic recovery. Remember that in the U.S. consumer income actually rose during this recession (a first), and on a relative basis major non-U.S. markets have provided even greater fiscal and monetary support. Sentiment may also surprise to the upside as markets have been pricing in political risks, which we believe are actually falling.

This is not to say everything will revert to pre-pandemic norms. Permanent job losses and changes to industry structures are just beginning. We fear what is

“While we remain upbeat about the near-term potential of global equities, we are also cautious about current valuations if the expected recovery falters.”

being called the “90% economy,” where business demand recovers, but only to approximately 90% of pre-COVID levels in many industries. Given high enough fixed costs, a company (or industry) which thrives at 100% of capacity could be a loss-making company at 90%. Our focus has shifted to maintaining a balance between the new secular winners and high-quality companies with visible demand. Despite this concern, it appears investors may be paying too much to invest in well-known “story” stocks and not taking advantage of the opportunity in economically sensitive but high-quality businesses. Europe and Japan have traditionally been highly exposed to consumer and industrial companies that would benefit from a potentially epic recovery, especially when combined with low expectations as the starting point.

Speaking of low expectations, Japan has been quietly rallying for several years. Its stock market remains well off the high hit in 1989, but the Nikkei Index is approaching levels not seen in a generation. Those investing in the 1980s may remember the Japanese stock bubble as the biggest bubble (in terms of valuation) of all time. This time, however, the

market is inexpensive, corporate governance is much improved, balance sheets are the best in the world, and companies are now accustomed to operating in a deflationary environment. A strong, global, cyclical recovery could be just the catalyst they need to break out. Europe also has a potential catalyst. The current crisis has brought together the European Union (EU) with all the major economies, including prior holdout Germany, now in favor of increased stimulus. This may prove troublesome in the long-term but for now it could stoke asset price inflation.

While we remain upbeat about the near-term potential of global equities, we are also cautious about current valuations if the expected recovery falters. The potential for negative surprises, such as inflation or various geopolitical flare ups, remains. We have been able to successfully navigate a very uncertain year by preparing in advance with a diversified portfolio of strong businesses; an approach we intend to maintain.

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 a strong rebound in the second quarter, emerging market (EM) equities posted a robust return of +9.6% in the third quarter, despite faltering somewhat in September along with developed market (DM) equities. The rebound still left the MSCI Emerging Markets Index down by -1.2% for the year-to-date period, compared to gains of +1.7% and +5.6% for the MSCI World and the S&P 500 Indexes, respectively.

In the third quarter, both emerging and developed market equities continued to benefit from the massive economic policy responses to the pandemic-led downturn, supported by broad-based evidence that the global downturn bottomed in April. The recovery was reflected in relatively stable oil prices, as well as a gain of nearly 10% in the Commodity Research Bureau (CRB) Raw Industrials Index of commodity prices. In addition, a basket of MSCI Emerging Market currencies was stable in the quarter, while still being down 3.8% for the year-to-date period.

EM currencies benefited from the Fed's dovish shift toward average inflation targeting, which provided cover for EM central banks to continue to ease their monetary policies in the third quarter. Rate cuts of 25 basis points or less were seen in Brazil, Colombia, Hungary, Malaysia, Mexico, Indonesia, Russia, and South Africa. Many other EM central banks remained in a wait-and-see mode regarding further rate cuts, while Turkey hiked rates by 200 basis points in late September in response to pronounced currency weakness.

A key trend, that has been visible in both economic data and equity market performance, has been the relative resilience of EM Asia amid the pandemic-led global downturn. Much of this resilience appears related to the robust public health measures taken by countries like China, South Korea, and Taiwan to successfully curb the virus. J.P. Morgan estimates that GDP in EM Asia this year will decline only 0.5%, compared to a decline of 5.5% projected for DM nations. In addition, EM Asia is

projected to grow 8.7% in 2021 compared to only 3.7% for DM nations.

In contrast, the EM regions of Latin America and Europe, the Middle East, and Africa (EMEA) are expected to experience economic declines this year comparable or worse than DM nations, along with more subdued recoveries in 2021. The differences in regional economic prospects has been reflected in equity market performance with EM Asia gaining 11.9% in the third quarter and 8.0% for the year-to-date period. In contrast, the EM Latin America and EMEA regions recorded lackluster returns for the third quarter, while posting losses of -36.1% and -19.2%, respectively, for the year-to-date period.

The so-called "K-shaped" recovery, where some sectors thrive while others still struggle, is clearly evident both within many equity markets and across nations as well. Beyond the contribution of successful public health measures, EM Asia's relative resilience can also be attributed to its leadership role in information technology industries, which have generally thrived this year. Those industries are especially important drivers of growth in countries like China, South Korea, and Taiwan, which together account for nearly 70% of the MSCI Emerging Markets Index.

The performance of EM equity sectors remained divergent in the third quarter. Information Technology, Consumer Discretionary, and Materials recorded solid double-digit gains, reflecting selective optimism about growth prospects; while more challenged sectors like Energy, Financials, and Utilities posted modest declines. Health Care remains the strongest sector in EM for the year-to-date period, although it posted lackluster returns in the third quarter.

A number of factors that contributed to global equity market jitters in September seem likely to continue in the fourth quarter. These include: fading hopes for another round of U.S. fiscal stimulus, fears that a second wave of the pandemic will curb the recovery, and some evidence from high-frequency data that economic momentum is fading in many EM and DM nations. In addition, concerns about a potentially contested U.S. election are now part of the mix.

That said, we still think continued global economic recovery is the most likely scenario for the next several years, along with a secular decline in the dollar as the U.S. tries to finance massive deficits at near-zero interest rates. If history is any guide, EM equities are well positioned to benefit from both economic recovery and potential dollar weakness.

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Boston Headquarters

222 Berkeley Street
Boston, Massachusetts 02116
617 236 8900
www.gwkinvest.com

Other Locations

New York, New York
Winter Park, Florida

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