GW&K INVESTMENT MANAGEMENT

TAXABLE BOND
MONTHLY COMMENTARY

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Will act as appropriate to sustain the expansion

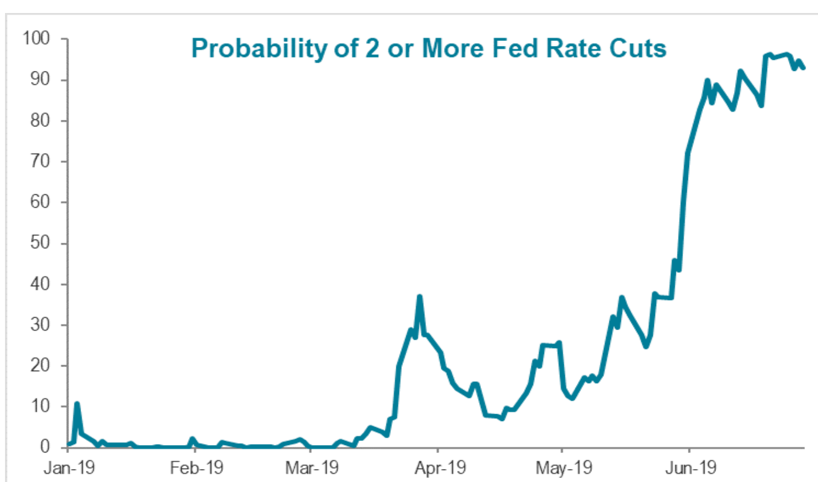
HIGHLIGHTS

- Ongoing concerns around weakening global growth, low inflation and trade risks had investors clamoring for immediate and multiple rate cuts.
- While holding rates steady at 2.25-2.50%, the Fed cited increased uncertainty about the economic outlook and signaled a willingness to cut rates if conditions warrant.
- The notion that key central banks around the globe were once again prepared to sustain the economic expansion caused risk assets to rally sharply.

INTEREST RATES

The Treasury market continued its 8-month rally and rates collapsed across most of the curve on evidence of weakening manufacturing data, a crack in consumer confidence and a continued undershoot in inflation. Short maturity bonds rallied the most, as the Fed dropped their "patient" stance and signaled a willingness to cut rates should the data warrant. Longer rates were essentially unchanged. Key portions of the Treasury curve remain inverted, most notably the closely watched relationship between the 3-month T-Bill and 10-year bond. Excluding the very front end, we are seeing a steeper slope in the 2s/10s and 2s/30s curve than where they started the year.

Markets are convinced that the Fed will begin cutting rates in July, pricing in a total of three cuts through the end of the year. This is in stark contrast to the May 1 FOMC meeting, where the implied probability of even one rate cut in 2019 was a mere coin flip.



Source: Bloomberg

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U.S. Treasury Market - June 30, 2019							
	6/30/19	Yield Change (bps)			Performance		
Maturity	Yield	MTD	QTD	YTD	MTD	QTD	YTD
2-year	1.76%	-17	-51	-73	0.50%	1.37%	2.36%
5-year	1.77%	-14	-47	-74	1.00%	2.80%	4.71%
10-year	2.01%	-12	-40	-68	1.44%	4.22%	7.44%
30-year	2.53%	-4	-29	-49	1.37%	6.76%	12.08%

Source: Bloomberg, FactSet

Performance represents total returns of the Bloomberg Barclays U.S. Treasury Bellwethers Index for the maturities shown

CREDIT

Investment grade corporate bonds rallied 13 basis points, nearly offsetting the spread widening we saw in the prior month. The technical picture remains robust, as near record inflows have been met with modest supply. Despite the rally, spreads remain wide of cycle tights, offering fair value. The high yield market rallied along with equities, which reached all-time highs. BB-rated securities led the way, signaling investors continued preference for more defensive holdings at this point in the cycle. The rally in the corporate sector this year has led to particularly strong returns, with both investment grade and high yield posting gains of almost 10%.

Ultimately, we believe the combination of stable growth and low interest rates creates a constructive setup for credit. The profit outlook remains favorable and the potential resolution of trade tensions with China could serve as catalyst for further tightening.

SECURITIZED

The mortgage-backed securities (MBS) sector underperformed the broader fixed income rally. A 25 basis point decline in mortgage rates fueled concerns around an acceleration in prepayment speeds, now that 40% of mortgages could be profitably refinanced. Option adjusted spreads widened to their highest level since 2013. Specified pools with higher coupons remain in favor, as they offer better protection against the sector's rising negative convexity. Particularly following its recent underperformance, the asset class represents an attractive, high-quality way to earn carry versus Treasuries.

OUTLOOK

Trade and tariff issues have put some downward pressure on the U.S. manufacturing sector, raising concerns about a potential soft patch for the economy. Given this backdrop, an "insurance policy" cut in July may be warranted. Outside of manufacturing, economic growth appears steady, underpinned by a tight labor market, still-solid consumer confidence and a Fed that is ready to sustain the economic cycle. The U.S.-China trade dispute arguably remains the biggest threat to global economic growth, but we believe a trade deal will be struck in due course. We are following these negotiations and labor market developments closely. Even if the bond market rally of 2019 has largely run its course, the weaker global growth backdrop should keep a cap on Treasury yields.

INDEX CHARACTERISTICS AND PERFORMANCE

June 30, 2019	CHARACTERISTICS			PERFORMANCE		
Index	**Yield to Worst**	**OAD (Years)**	**OAS (bps)**	**MTD**	**QTD**	**YTD**
Bloomberg Barclays U.S. Aggregate Bond	2.49%	5.73	46	1.26%	3.08%	6.11%
U.S. Treasury	1.92%	6.38	0	0.92%	3.01%	5.18%
Bloomberg Barclays U.S. Government Related	2.57%	5.59	64	1.13%	2.97%	6.18%
Bloomberg Barclays U.S. Corporate Investment Grade	3.16%	7.64	115	2.45%	4.48%	9.85%
Bloomberg Barclays U.S. Mortgage-Backed Securities	2.70%	3.15	46	0.72%	1.96%	4.17%
Bloomberg Barclays U.S. Asset-Backed Securities	2.21%	2.15	41	0.42%	1.67%	3.17%
ICE BofAML Fixed Rate Preferred Securities	2.94%	4.04	64	1.37%	3.02%	11.97%
Bloomberg Barclays High Yield	5.87%	3.23	377	2.28%	2.50%	9.94%
Bloomberg Barclays High Yield - BB	4.36%	3.59	227	2.65%	3.08%	10.51%
Bloomberg Barclays High Yield - B	5.99%	2.89	385	2.30%	2.66%	10.06%
Bloomberg Barclays High Yield - CCC	10.14%	3.04	812	1.06%	0.29%	7.46%
Bloomberg Barclays High Yield BB 1-5 Year	3.66%	1.88	163	1.68%	2.00%	7.26%

Source: FactSet