



**Mary F. Kane, CFA**  
Partner  
Taxable Bond Portfolio Manager

## HIGHLIGHTS

- Risk assets snapped back sharply and safe havens lost their appeal on positive economic data and accommodative language from the Fed.
- Investment grade spreads more than retraced the widening they experienced in December, while high yield saw its best start to a year since 2009.
- “Patience” was the dominant theme in January’s Fed speak, initially with respect to further hikes and then ultimately with the pace of balance sheet run-off.

## RATES

Interest rates started the year with a strong rally, as disappointing factory data out of both China and the U.S. compounded fears of a global slowdown. But risk aversion abruptly turned to risk appetite in response to exceptionally strong payroll data, and a steady stream of upbeat news flow further lifted sentiment from there. Haven demand receded as the month progressed, but a more accommodative stance from the Fed drove rates lower in the closing days. The yield on the 10-year Treasury ultimately fell 6 basis points.

The Fed’s increasingly dovish posture became clear with the release of the December minutes, which placed heavy emphasis on being patient, and moving gradually. A slew of Fed speakers pushed this narrative further, raising the possibility of a pause in the hiking cycle. Finally, at their January meeting, the FOMC made the dovish pivot official, holding rates steady and indicating a willingness to alter the size and composition of the Fed’s balance sheet if conditions warranted. The futures market immediately ruled out any further hikes in 2019 and assigned a roughly 20% probability to a cut.

### U.S. Treasury Market - January 31, 2019

Maturity	1/31/19	Yield Change (bps)			Performance		
	Yield	MTD	QTD	YTD	MTD	QTD	YTD
2-year	2.46%	-3	-3	-3	0.27%	0.27%	0.27%
5-year	2.44%	-7	-7	-7	0.52%	0.52%	0.52%
10-year	2.63%	-6	-6	-6	0.73%	0.73%	0.73%
30-year	3.00%	-2	-2	-2	0.61%	0.61%	0.61%

Source: Bloomberg, FactSet

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

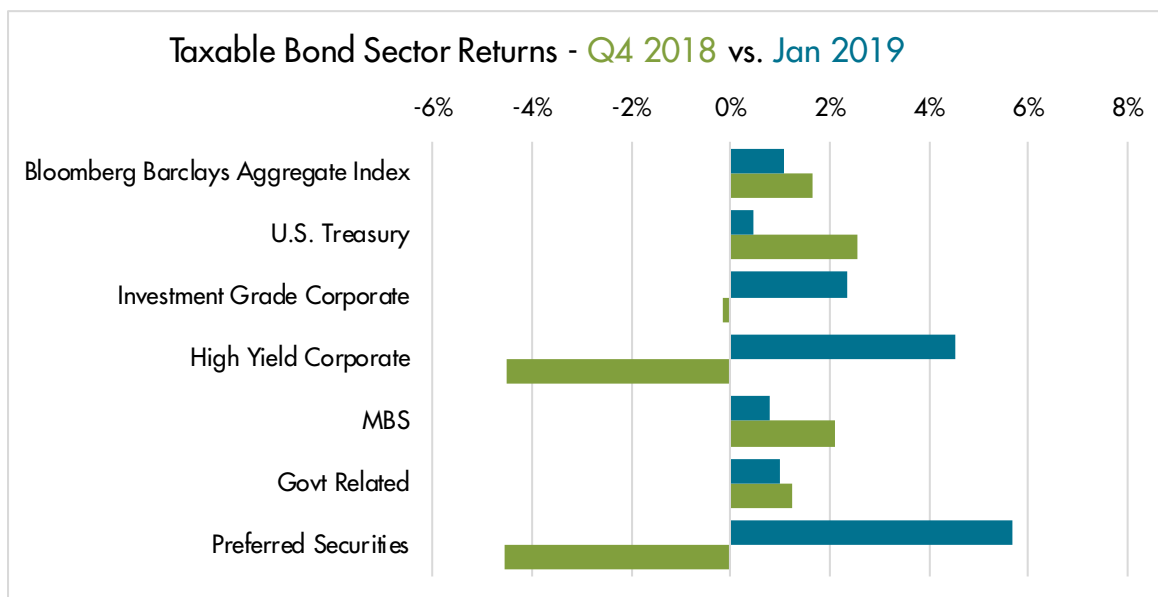
GW&K Investment Management  
222 Berkeley Street  
Boston, MA 02114

617.236.8900  
www.gwkinvest.com

## CREDIT

Corporate bonds rebounded dramatically from their December lows. In addition to a dovish Fed, they benefited from signs of a possible resolution to the trade war and a surprisingly decent start to fourth quarter earnings. Oversold conditions at the end of last year set the stage for investment grade's best month since 2016, as spreads tightened 25 basis points to mid-November levels. High yield, which had its best month in more than seven years with a strong 4.5% return, benefited from an 18% surge in crude prices. Preferred securities were the most significant beneficiary of the risk-on trade, returning 5.7%.

In addition to an improved fundamental backdrop, credit markets benefited from a solid technical environment. Investment grade issuance was 24% lower than last year due to a significant decline in issuance from financials, while demand, particularly from overseas buyers, remained robust. The high yield primary market reopened after a complete shutdown in December, and demand from supply-starved investors was so great that most new issues were 3-4 times oversubscribed and priced at the lower end of talk.



Source: FactSet

## MORTGAGES

The MBS Index had its best monthly excess return since balance sheet normalization was announced in September 2017. The Fed's dovish pivot triggered a drop in rate volatility to nearly the lowest levels in five years, allowing MBS spreads to continue to retrace much of their fourth quarter widening. Higher overseas demand, combined with range-bound rates and a low volatility environment, aided technicals and improved the sector's outlook versus Treasuries.

## OUTLOOK

Our outlook for the U.S. economy has been generally constructive, given that most economic indicators continue to suggest little near-term risk of a recession. The recent softening in the Fed's posture only serves to increase our conviction on this front, now that it seems even less likely the Fed will commit a policy error. We also see attractive value in the corporate space, where even after recent tightening, spreads sit wide of where they spent most of 2018. Recent volatility has created more opportunities than we have seen in some time, and we have been taking advantage of dislocations to swap into high quality names that continue to trade at attractive spreads. Our allocation to MBS is slightly overweight, as we have become more constructive on the space in light of the Fed's recent commentary on its balance sheet. Our bias remains in favor of higher coupon, shorter duration pools, which offer higher carry in the current environment.

## INDEX CHARACTERISTICS AND PERFORMANCE

January 31, 2019	CHARACTERISTICS			PERFORMANCE		
	Yield to Worst	OAD (Years)	OAS (bps)	MTD	QTD	YTD
Bloomberg Barclays U.S. Aggregate Bond	3.15%	5.86	47	1.06%	1.06%	1.06%
U.S. Treasury	2.57%	6.09	0	0.47%	0.47%	0.47%
Bloomberg Barclays U.S. Government Related	3.25%	5.38	69	1.00%	1.00%	1.00%
Bloomberg Barclays U.S. Corporate Investment Grade	3.91%	7.24	128	2.35%	2.35%	2.35%
Bloomberg Barclays U.S. Mortgage-Backed Securities	3.28%	4.56	32	0.79%	0.79%	0.79%
Bloomberg Barclays U.S. Asset-Backed Securities	2.94%	2.12	46	0.47%	0.47%	0.47%
ICE BofAML Fixed Rate Preferred Securities	4.29%	4.76	127	5.67%	5.67%	5.67%
Bloomberg Barclays High Yield	6.90%	3.67	423	4.52%	4.52%	4.52%
Bloomberg Barclays High Yield - BB	5.32%	4.05	264	4.24%	4.24%	4.24%
Bloomberg Barclays High Yield - B	6.86%	3.41	418	4.49%	4.49%	4.49%
Bloomberg Barclays High Yield - CCC	11.03%	3.24	843	5.29%	5.29%	5.29%
Bloomberg Barclays High Yield BB 1-5 Year	4.71%	2.23	212	3.22%	3.22%	3.22%

Source: FactSet

### Disclosures

This represents the views and opinions of GW&K Investment Management. It does not constitute investment advice or an offer or solicitation to purchase or sell any security and is subject to change at any time due to changes in market or economic conditions. The comments should not be construed as a recommendation of individual holdings or market sectors, but as an illustration of broader themes.

Investing in securities or investment strategies, including GW&K's Investment Strategies presented in this document, involves risk of loss that clients should be prepared to bear. No investment process is free of risk; no strategy or risk management technique can guarantee returns or eliminate risk in any market environment. There is no guarantee that GW&K's investment processes will be profitable, and you therefore may lose money. Past performance is no guarantee of future results. The value of investments, as well as any investment income, is not guaranteed and can fluctuate based on market conditions. Diversification does not assure a profit or protect against loss. GW&K's active management styles include equity and fixed income strategies that are subject to various risks, including those described in GW&K's Form ADV Part 2A, Item 8. GW&K's Form ADV Part 2A may be found at <https://adviserinfo.sec.gov/Firm/121942> or is available from GW&K upon request.

Indexes are not subject to fees and expenses typically associated with managed accounts or investment funds. Investments cannot be made directly in an index. Index data has been obtained from third-party data providers that GW&K believes to be reliable, but GW&K does not guarantee its accuracy, completeness or timeliness. Third-party data providers make no warranties or representations relating to the accuracy, completeness or timeliness of the data they provide and are not liable for any damages relating to this data. The third-party data may not be further redistributed or used without the relevant third-party's consent. Sources for index data include: Bloomberg ([www.bloomberg.com](http://www.bloomberg.com)), FactSet ([www.factset.com](http://www.factset.com)), ICE ([www.theice.com](http://www.theice.com)), FTSE Russell ([www.ftserussell.com](http://www.ftserussell.com)), MSCI ([www.msci.com](http://www.msci.com)) and Standard & Poor's ([www.standardandpoors.com](http://www.standardandpoors.com)).