GW&K INVESTMENT MANAGEMENT

TAXABLE BOND
MONTHLY COMMENTARY

NOVEMBER 2018

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HIGHLIGHTS

- Volatility remained firmly in place for much of the month amid concerns around global growth, as rising rates, falling crude prices, and ongoing trade worries drove investors away from risk assets.
- Equity markets dipped further into correction territory, investment grade credit spreads reached new multi-year highs, and year-to-date gains in the high yield sector were erased.
- At the end of the month, Fed Chairman Powell delivered a prepared speech that struck an unexpectedly dovish tone, driving a rally in both rates and risk assets.

RATES

Interest rates briefly reached new multi-year highs to start the month in response to unexpectedly strong payroll data and average hourly earnings that grew at their fastest pace in nine years. This selloff in rates proved to be short-lived. Trade war concerns, plunging commodity prices, and a slew of negative idiosyncratic events stoked worries around global growth and inspired a decisive flight to safety. The yield on the 10-year Treasury ultimately fell 16 basis points, closing the month just below the psychologically significant 3% threshold.

Expectations for further tightening from the FOMC were revised lower in the closing days of the month. Fed Chairman Powell seemed to soften his language with respect to current policy, suggesting rates are "just below" rather than "a long way" from neutral, as he had indicated in October. The futures market adjusted accordingly, reducing the expectation from two hikes in 2019 to just one. The dovish shift had the most pronounced effect on intermediate maturities, which outperformed short rates and brought the 2s/10s curve back to its flattest level in a decade.

U.S. Treasury Market - November 30, 2018

	11/30/18	Yield Change (bps)			Performance		
Maturity	Yield	MTD	QTD	YTD	MTD	QTD	YTD
2-year	2.79%	-8	-3	+90	0.33%	0.47%	0.59%
5-year	2.81%	-17	-15	+60	0.86%	0.93%	-0.43%
10-year	2.99%	-16	-7	+58	1.46%	0.84%	-2.92%
30-year	3.29%	-10	+8	+55	1.95%	-1.74%	-8.17%

Source: Bloomberg, FactSet

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

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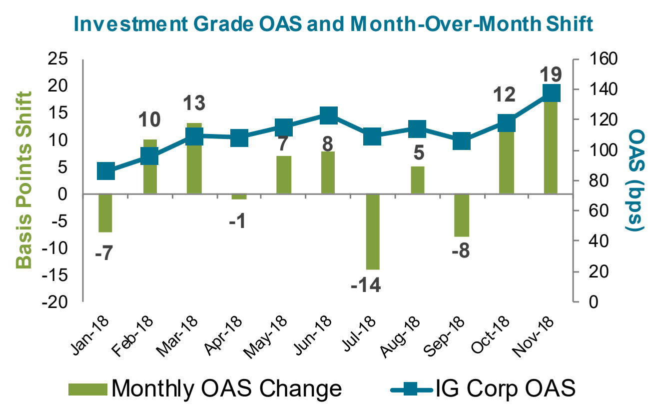
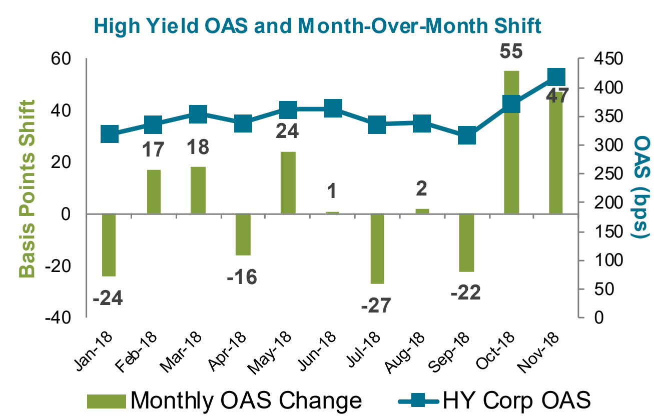
CREDIT

For the second month in a row, corporate bonds experienced significant volatility and saw spreads widen meaningfully. Escalating trade rhetoric, negative earnings forecasts from several corporate bellwethers, and ratings downgrade anxiety compounded fears of a market selloff. High yield spreads jumped to a two-year high as crude oil experienced a record-setting downturn. Investment grade spreads had their worst month since early 2016 on concerns about refinancing risks and rising debt levels, specifically among BBBs. Preferred securities fared particularly badly in the risk-off environment, given their low seniority within the capital structure.

The prevailing risk-off sentiment caused lower-quality credits to lead the market wider, especially in the worst performing Energy sector. Company-specific narratives rattled investors as well, as trouble at a few high profile BBB-rated issuers sparked concerns about possible downgrades to high yield (e.g., GE, Ford, PG&E).



Source: FactSet



Source: FactSet

MORTGAGES

Mortgage spreads hit a 19-month high as negative technicals and rate volatility weighed on investor sentiment. However, the Fed's late month dovish pivot and the subsequent rate rally helped mortgage spreads tighten and brought excess returns back to flat for the month. The technical picture has improved recently, as money manager exposure to the sector has climbed to its highest levels since 2014 in anticipation of a seasonal mortgage supply shortage heading into year end.

OUTLOOK

With economic data continuing to exhibit strength and the Fed adopting a more cautious stance, we remain constructive on the U.S. economy. Corporations generally continue to pursue prudent financial policies and we see select opportunities in recent spread widening. Nevertheless, we are focused on gradually shifting up in quality as the credit cycle advances, favoring less capital intensive and more highly-rated credits. Rates seem likely to be range-bound as policy nears the Fed's neutral level and data remains solid. As such, we are keeping portfolio duration close to neutral. Our allocation to mortgage-backed securities remains market weight, though with a bias toward older-vintage pools that we expect to outperform as the Fed's balance sheet runs off.

INDEX CHARACTERISTICS AND PERFORMANCE

November 30, 2018	CHARACTERISTICS			PERFORMANCE		
Index	**Yield to Worst**	**OAD (Years)**	**OAS (bps)**	**MTD**	**QTD**	**YTD**
Bloomberg Barclays U.S. Aggregate Bond	3.54%	5.97	50	0.60%	-0.20%	-1.79%
U.S. Treasury	2.93%	5.97	0	0.89%	0.41%	-1.27%
Bloomberg Barclays U.S. Government Related	3.61%	5.24	69	0.49%	-0.39%	-1.32%
Bloomberg Barclays U.S. Corporate Investment Grade	4.37%	7.05	137	-0.17%	-1.62%	-3.92%
Bloomberg Barclays U.S. Mortgage-Backed Securities	3.65%	5.30	35	0.90%	0.26%	-0.81%
Bloomberg Barclays U.S. Asset-Backed Securities	3.28%	2.20	47	0.38%	0.45%	0.98%
ICE BofAML Fixed Rate Preferred Securities	5.59%	6.00	193	-2.10%	-3.68%	-3.46%
Bloomberg Barclays High Yield	7.22%	3.90	418	-0.86%	-2.45%	0.06%
Bloomberg Barclays High Yield - BB	5.79%	4.33	275	-0.25%	-1.62%	-1.12%
Bloomberg Barclays High Yield - B	7.21%	3.62	416	-0.75%	-2.20%	0.90%
Bloomberg Barclays High Yield - CCC	11.12%	3.35	809	-2.84%	-5.23%	0.45%
Bloomberg Barclays High Yield BB 1-5 Year	5.24%	2.50	230	0.05%	-0.76%	1.14%

Source: FactSet

Disclosures

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