GW&K INVESTMENT MANAGEMENT

TAXABLE BOND
MONTHLY COMMENTARY

MARCH 2020

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HIGHLIGHTS

- Concerns around the growing impact of COVID-19 on the U.S. economy, alongside a plunge in oil prices, drove an exodus from risk assets and wide-scale deleveraging as investors and corporations sought the safety and liquidity of U.S. dollars.
- Extreme selling pressure caused unprecedented volatility and major liquidity challenges across every sector of the fixed income spectrum, including even traditional havens such as Treasuries, commercial paper, municipals, and mortgage-backed securities.
- The policy response was prompt and decisive. The Federal Reserve cut rates to the zero bound, announced unlimited quantitative easing, and created several targeted programs to relieve stress at the most troubled points within the financial system. Congress followed suit with a record $2 trillion fiscal stimulus package.

INTEREST RATES

Despite overnight rate cuts of 150 basis points to the zero bound and substantial Fed purchases, Treasuries suffered severe episodes of volatility. Touching an all-time intraday low of 31 basis points, the 10-year Treasury traded within a 96 basis points range before finally settling at 0.67%. This type of volatility, rarely seen in the marketplace, was driven by investors selling the highest quality assets on hand to raise cash, while also growing concerned about the expected supply to fund the enormous fiscal stimulus package. The Fed later upsized its purchase program, and, in a sign that their efforts had succeeded, caused rates to settle substantially lower. The yield curve steepened dramatically with stimulus from the Fed anchoring the short end, at the same time as fiscal stimulus and inflation concerns weighed on the long end.

U.S. Treasury Market - March 31, 2020

	3/31/20	Yield Change (bps)			Performance		
Maturity	Yield	MTD	QTD	YTD	MTD	QTD	YTD
2-year	0.25%	-67	-132	-132	1.32%	2.82%	2.82%
5-year	0.38%	-56	-131	-131	2.73%	6.78%	6.78%
10-year	0.67%	-48	-125	-125	4.11%	11.93%	11.93%
30-year	1.33%	-35	-106	-106	7.56%	25.80%	25.80%

Source: Bloomberg, FactSet

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

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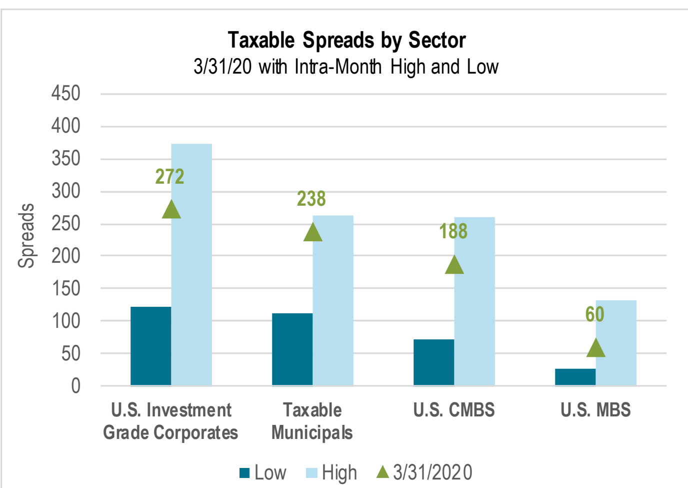
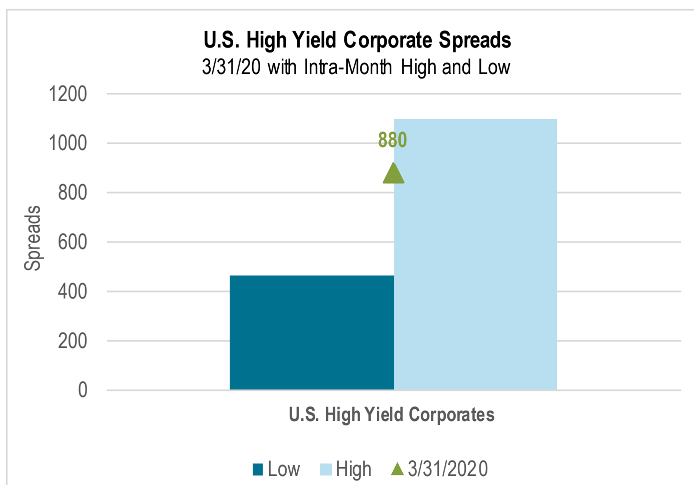
CREDIT

The corporate market saw its second worst month on record, surpassed only in the depths of the Great Financial Crisis (GFC). Spreads jumped wider on coronavirus-related fears of increased financial distress as companies began to lower or suspend guidance and drastically reduce spending plans. And with regulatory restrictions limiting the size of broker-dealer balance sheets, traditional buyers were largely forced to sit on the sidelines, causing spreads to quickly rise to recessionary levels. The investment grade credit market saw some of the largest redemptions on record, essentially experiencing what amounted to a run on the bank. For the first time in its history, the Fed intervened with liquidity facilities that allowed for the purchase of investment grade corporate bonds in both the primary and secondary markets in huge quantities (through 5 year maturities). A massive rebound in spreads ensued, reversing 40% of the recent spread widening. With the Fed now established as the buyer of last resort for high quality paper, a flood of issuers looking to raise cash entered the market and sold paper at record levels to investors eager to absorb the new supply.

The tale of the high yield market was quite different. The sector was left out of the latest round of Fed stimulus and the primary market was essentially shuttered. A wave of fallen angels lined up to potentially overwhelm the market. The sector was also particularly affected by the collapse in oil prices as OPEC talks broke down. Default rate expectations for the next twelve months nearly tripled to 10%, with most of the anticipated defaults coming from the energy sector (6%-ex-energy). Despite near-term challenges, we see longer-term value in the sector. Historically, valuations at these levels have been associated with strong returns over the subsequent 12-36 months. Since the recent wides, various stimulus measures have driven a rally that has retraced a third of the recent selloff.





Source: Bloomberg

TAXABLE MUNICIPALS

The Taxable municipals experienced their worst month of excess returns on record, widening 127 basis points and posting a loss of 8.94%. Rising concerns about the financial strength of state and local issuers amid the COVID-19 pandemic weighed heavily on sentiment and contributed to massive outflows from the space. In an environment with constrained market liquidity, the sharp shift in sentiment contributed to a significant downdraft.

SECURITIZED

The initial pace of Fed purchases did little to help spreads which at one point reached levels not seen since the GFC (132 OAS). But a later commitment to buy in "amounts needed to support smooth market functioning" proved to be a game changer, and spreads whipsawed back to close the month at an OAS of 60. This strong technical tailwind, alongside a slowdown in near-term mortgage originations, should continue to help stabilize the sector over the longer term. A promise to purchase Agency CMBS also underpinned the bounce back from the wide levels seen in that sector from a peak of 260 OAS to 188.

OUTLOOK

The extraordinary steps taken by both fiscal and monetary authorities have gone a long way toward stabilizing financial markets. That said, we still have an economic crisis of unknown magnitude and a market structure that will continue to struggle to manage it. While the economic and fundamental impact is difficult to frame, and we prepare for the biggest one-quarter GDP drop on record, we remind ourselves that a path for recovery still exists. We have seen the strongest policy intervention, probably ever, and we are going to see more. Valuations are already priced for a recessionary outcome. The negative headlines on the COVID-19 front will no doubt keep market volatility in the forefront, but when the tide of investor sentiment turns, and it will, we expect to see substantial spread compression in the credit space. Recognizing that selectivity is key, we remain focused on finding compelling relative value opportunities in the higher quality segments of the taxable bond market.

INDEX CHARACTERISTICS AND PERFORMANCE

March 31, 2020	CHARACTERISTICS			PERFORMANCE		
Index	Yield to Worst	OAD (Years)	OAS (bps)	MTD	QTD	YTD
Bloomberg Barclays U.S. Aggregate Bond	1.59%	5.69	95	-0.59%	3.15%	3.15%
U.S. Treasury	0.58%	7.02	2	2.89%	8.20%	8.20%
Bloomberg Barclays U.S. Government Related	1.91%	5.62	138	-3.09%	0.47%	0.47%
Bloomberg Barclays U.S. Corporate Investment Grade	3.43%	7.98	272	-7.09%	-3.63%	-3.63%
Bloomberg Barclays U.S. Mortgage-Backed Securities	1.34%	1.67	60	1.06%	2.82%	2.82%
Bloomberg Barclays U.S. Asset-Backed Securities	2.40%	2.07	213	-2.07%	-0.21%	-0.21%
ICE BofAML Fixed Rate Preferred Securities	5.65%	6.00	373	-7.09%	-8.82%	-8.83%
Bloomberg Barclays High Yield	9.44%	4.06	880	-11.46%	-12.68%	-12.68%
Bloomberg Barclays High Yield - BB	7.24%	4.41	654	-9.27%	-10.15%	-10.15%
Bloomberg Barclays High Yield - B	9.15%	3.82	856	-11.58%	-12.97%	-12.97%
Bloomberg Barclays High Yield - CCC	17.54%	3.36	1704	-18.37%	-20.55%	-20.55%
Bloomberg Barclays High Yield BB 1-5 Year	7.96%	2.43	735	-8.23%	-9.17%	-9.17%

Source: FactSet

March 31, 2020	CHARACTERISTICS		
Strategy	**Yield to Worst**	**Current Yield**	**OAD (Years)**
GW&K Short-Term Focused High Income Strategy	7.26	5.32	2.54
Bloomberg Barclays High Yield BB 1-5 Year	*7.96*	*5.59*	*2.43*
GW&K Corporate Bond Opportunities Strategy	6.12	5.07	5.39
60% Bloomberg Barclays High Yield / 40% Bloomberg Barclays U.S. Credit	*6.96*	*5.58*	*5.51*
GW&K Total Return Bond Strategy	4.06	4.27	5.56
60% Bloomberg Barclays Govt/Credit / 40% Bloomberg Barclays High Yield	*4.77*	*4.22*	*5.96*
GW&K Enhanced Core Bond Strategy	2.64	3.73	5.55
GW&K Core Bond Strategy	2.02	3.33	5.45
Bloomberg Barclays U.S. Aggregate Bond	*1.59*	*2.87*	*5.69*
GW&K Intermediate Taxable Bond Strategy	1.89	3.25	3.15
Bloomberg Barclays U.S. Intermediate Aggregate Bond	*1.33*	*2.75*	*3.22*
GW&K Short-Term Taxable Bond Strategy	1.54	2.88	2.45
Bloomberg Barclays 1-5 Year Govt/Credit	*1.02*	*2.30*	*2.66*