INVESTMENT MANAGEMENT

INVESTMENT REVIEW
4Q 2022

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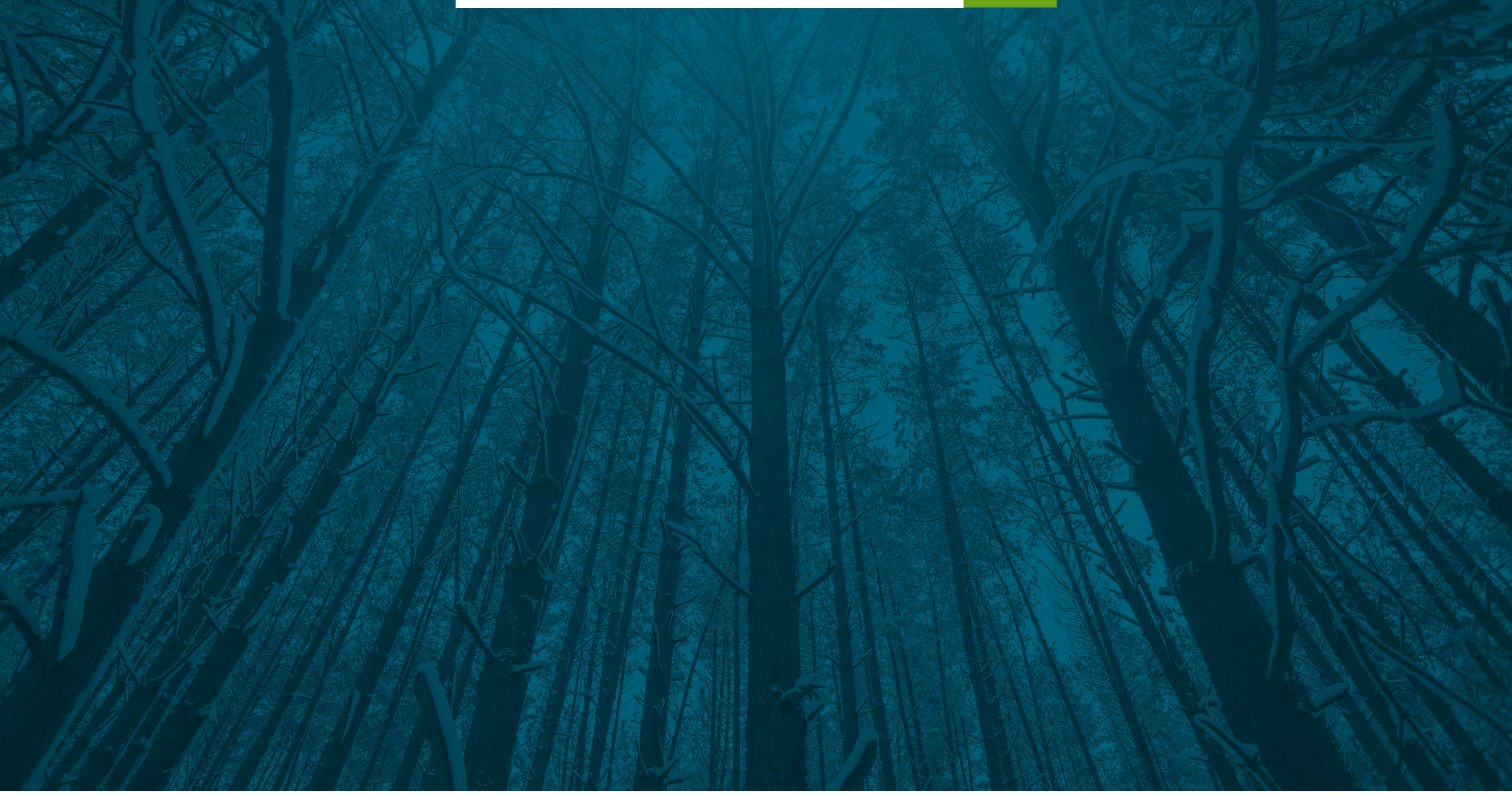

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ECONOMIC COMMENTARY

BY HAROLD G. KOTLER, CFA

Founder-Chairman, Chief Investment Officer

Lately I've been noticing that even news articles with positive headlines that begin as uplifting pieces turn negative. It's as if the editor or writer could not just stay with the best of the article's intent.

This behavior is an example of what seems to be occurring in our society and economy. It seems difficult for many to smell the roses and understand how far we've come in the last three years. When Covid first hit, it was hard to imagine that our economy and society would be as healthy as they are now.

Reflecting on this widespread pessimism, it almost feels like Americans are dealing with post-traumatic stress, and that Covid has taken away some of our optimism for the future. That feeling of vulnerability is real even now, as friends and relatives continue to be struck with the virus. This fear probably impacts many of our behaviors. The need to live life to the fullest drives our need to socialize and have fun. Certainly restaurants, airlines, and hotels are benefiting from the spirit of "let's live." Part of that is the need and ability to enjoy a normal life. That psychology has also affected the workplace. Many never returned to work or chose a simpler lifestyle. But even those who have come back want to enjoy flexibility in scheduling, whether it be days at home or flexible hours. When I reflect on my life, I see three events that have caused a major change in national behavior and attitude — Vietnam, 9/11, and Covid — in each case, the country turned (for better or worse). Those seismic events could not help but change behaviors. Our confidence in the future was challenged. Our previous way of life seemed to be no longer possible. But it also meant that it was critical to understand the changes and adapt.

As to our present circumstances, we are trying to move forward as a community and society. Much has been done to reinforce our stamina. We had a clean midterm election, we now have a more consistent foreign policy — particularly our full commitment to the Ukrainian people — and finally we are talking to our adversaries with respect. But even if the backdrop is becoming more stable and maybe healthier, we still are fighting our personal demons.

> *"As Covid dissipates and our confidence in the medical industry continues to grow, I believe we may be laying the groundwork for a new bull market."*

I believe the stock market is a reflection of this national attitude. We know the ultimate worth of equities is based on confidence in the company and country. Valuation is then a matter of what the investor is willing to pay. It is that simple. The more excited you are about the future, the more you will pay, and vice versa. As Covid dissipates and our confidence in the medical industry continues to grow, I believe we may be laying the groundwork for a new bull market. The base may take a year or two to

Continued on next page

strengthen, but I think there will be a shift from pessimism to optimism. Rates will decline in a year or two. Lessons learned from the pandemic will become part of a new model, i.e., less dependence on supply or need for inventory. Smaller is better. Employees are getting their share of profits, all within the framework of a new awareness and ability to adapt.

Monetary and fiscal policies enacted during the Covid period may have been required (that can be debated), but appropriate or not, they created excesses that needed to be squeezed from the system. We are in a period of reset, for assets and behavior. It is a complicated time, but, as is often the case, it is a healthy correction.

It is important to understand that what the Federal Reserve may or may not do will not be relevant in a couple of years. Short-term rates will go higher, but as the economy softens, they will also be lowered. We may have a recession, or we may not — but even if we do, it will be temporary. Inflation will decline to an acceptable level. The drumbeat will change as the economy finds its way back to some level of normalization. This temporary slump in values provides an opportunity for investors to buy assets at an attractive level. It is as true for bonds, which finally look competitive, as it is for stocks and other risk assets. Think of this year as a healthy and necessary reset of valuations from unsustainable levels. And be patient as the turbulent transition unfolds.

Harold G. Kotler, CFA
Founder-Chairman, Chief Investment Officer

GW&K NEWS

GW&K RECOGNIZED AS A BEST PLACE TO WORK IN MONEY MANAGEMENT FOR THE SECOND CONSECUTIVE YEAR!

Pensions&Investments
BEST PLACES TO WORK
IN MONEY MANAGEMENT
★★ 2022 ★★
MULTIYEAR WINNER
2022 ★ 2021

Pensions & Investments, the global news source of money management, conducts this annual survey and recognition program to identify and recognize the best employers in the money management industry. We are thrilled to announce this is the second consecutive year that GW&K has participated and been recognized with this honor in the 100-499 employee category.

As a firm that prides itself on the strength of our relationships, our goal has always been to create an environment where our employees — our most valuable asset — feel they have opportunities to grow, succeed, and advance. Having an environment where people enjoy the work they do and feel supported, trusted, and empowered, is critical to the success of GW&K and to our clients. We believe that the highest levels of client service and employee productivity come from creating an environment of trust and respect and we continue to invest in our people to help support and maintain that strong culture.

We look forward to continued success and building long-term, mutually rewarding relationships with our clients, employees, and broader community.

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40% EMPLOYEES WITH 10+ YEARS AT GW&K

$47 BILLION TOTAL ASSETS UNDER MANAGEMENT

FOURTH QUARTER 2022

ECONOMY

- The economy was surprisingly resilient in the second half of 2022, with the Atlanta Fed estimating consumer-led GDP growth of 3.9% for 4Q following an upwardly revised 3.2% for the previous quarter.
- Inflation also moderated in recent months thanks to lower energy and goods prices. The Consumer Price Index (CPI) was up 7.1% over the year ended November 2022 after having posted a peak gain of 9.1% in June.
- Aggressive monetary tightening by the Fed has raised the risk of a recession and higher unemployment in 2023 led by interest-rate sensitive sectors like housing and consumer durables.
- Most economists expect a mild recession since inflation pressures have been easing and household and corporate balance sheets remain generally healthy.

FED ACTION

- In response to surging inflation, the Fed raised rates in 2022 at the fastest pace in four decades, hiking the upper range of the federal funds rate from 0.25% in March to 4.5% in December.
- Aggressive Fed tightening included four consecutive jumbo-rate hikes of 0.75% at the June through November FOMC meetings followed by a 0.5% rate hike in December.
- Underscoring its resolve to bring inflation back to 2%, the Fed in December communicated a "higher for longer" message on rates and projected a 5.0%-to-5.25% range for the federal funds rate in 4Q 2023.
- Markets are pricing in close to even odds that the funds rate will peak in the 5.0%-to-5.25% range by mid-year, but also project at least one 0.25% rate cut later this year.

BOND MARKETS

- Fixed income markets posted mixed results amid growing confidence that central banks have succeeded in slowing inflation and will be able to pursue less restrictive policy. For the year, the bond market endured its worst ever performance and an unprecedented second consecutive year of losses.
- Treasuries posted a small gain, as three months of income was more than enough to offset a slight bear flattening of the curve. Short rates moved higher, while rates further out were generally contained.
- Corporates rallied with broader risk markets, as spreads tightened across the quality spectrum. Investment grade reflected a benign outlook for credit, closing at its tightest levels since April, while high yield spreads compressed for a second straight quarter.
- Municipal bonds posted their strongest quarterly performance in over a decade, partially erasing what still amounted to the worst annual loss in 40 years.

INDEX PERFORMANCE

12/31/22

	QUARTER	YEAR TO DATE
Bloomberg 10-Year Municipal Bond Index	4.49%	-6.57%
Bloomberg Aggregate Bond Index	1.87%	-13.01%
Bloomberg High Yield Index	4.17%	-11.19%
Dow Jones Industrial Average	16.01%	-6.86%
S&P 500 Index	7.56%	-18.11%
Russell 2000 Index	6.23%	-20.44%
MSCI EAFE Index	17.34%	-14.45%
MSCI World Small Cap ex USA Index	15.21%	-20.58%
MSCI World Index	9.77%	-18.14%
MSCI Emerging Markets Index	9.70%	-20.09%

DOMESTIC EQUITY MARKETS

- US equity markets closed 4Q higher, capping a dismal year for stocks with the S&P 500 and Nasdaq logging their worst calendar years since 2008. Cooling inflation data fueled a rally in risk assets in October and November, but expectations for a near-term Fed policy pivot faded in December causing stocks to retreat from intra-quarter highs and concerns of economic slowdown to worsen.
- Large cap stocks, as measured by the S&P 500, rose 7.6% in the quarter and outpaced small and mid-cap stocks.
- Energy, Industrials, and Materials were the best performing sectors. Consumer Discretionary and Communication Services were the only sectors to generate a negative return.
- Value outpaced Growth for 4Q and the full year. Investors also demonstrated a preference for high-quality factors.

GLOBAL EQUITY MARKETS

- Non-US developed markets (DM) finished the year on a positive note, supported by softer inflation readings in several countries and receding fears of an energy shortage in Europe. The MSCI World ex USA Index gained 16.2%, while the MSCI World Small Cap ex USA advanced 15.2%.
- Currency had a major impact — the positive shift in risk sentiment helped trigger a -7.7% fall in the US Dollar Index.
- Emerging markets (EM) rebounded as mounting social and economic pressure forced China to eliminate Covid restrictions and Eastern Europe rallied on the continent's improving energy situation. The MSCI Emerging Markets Index rose 9.7%.
- Sector performance was broadly positive with standout performance in DM Financials, Materials, and Industrials and EM Communication Services, Health Care, and Industrials.

INVESTMENT STRATEGIES

MUNICIPAL BOND

We combine a rigorous, research intensive, credit selection process with active management. Our goal is to take advantage of market inefficiencies and find opportunities across the yield curve to protect and grow principal and income.

TAXABLE BOND

Our multi-sector approach takes advantage of the relative valuation among distinct bond sectors and the increased opportunities to generate income and capital appreciation. We build diversified yield advantaged portfolios that generate steady, incremental income and provide downside risk protection.

DOMESTIC EQUITY

We develop a deep understanding of the companies in which we invest through disciplined and intensive fundamental research. Our focus is on finding well-managed, quality companies, which are resilient.

GLOBAL EQUITY

We take advantage of market inefficiencies to find quality growth companies that may be undervalued, underappreciated, or under-researched. Our rigorous, bottom-up process focuses on a company's upside potential and downside risk.

MUNICIPAL BOND STRATEGIES

Municipal bonds posted their strongest quarterly performance in over a decade, partially erasing what still amounted to the worst annual loss in 40 years. With a struggling Treasury market providing little direction, returns were instead powered by a combination of scant supply and building demand. New issue volume for the fourth quarter declined 40% on a year-over-year basis, creating a scarcity premium that was turbo-charged by the need for investors to reinvest seasonally high coupon and maturity redemptions. Although mutual funds continued to experience significant outflows, likely exacerbated by year-end tax-loss selling, the bid-side remained strong and picked up steam as the quarter progressed. In fact, after a modest selloff in October, tax-exempt yields staged a breathtaking turnaround, plummeting 70-90 basis points through mid-December. Even with that rally, however, rates were still up 1.6% to 2.3% from January's historically low starting point, leaving no escape from the sharply negative annual performance that materialized across the entire curve.

Although municipal bonds outperformed Treasuries over the quarter, they were still directionally influenced by the underlying forces driving the broader market. Early in the quarter, interest rates shot up due to still-elevated inflation, tight labor markets, and hawkish saber rattling from central banks. By October 28, the yield on the 10-year Treasury had risen 40 basis points for the month to close at 4.24%, its highest level since 2008. From there, however, sentiment turned as the lagged effects of contractionary policy seemed to take hold. Key prints on inflation decelerated from their peaks, creating a sense that the worst may be over. A pullback in manufacturing and a softening in unit labor costs were also contributing factors. And while the Fed continued to talk tough on keeping policy restrictive, a downshift to a 50 basis-point hike in December after four consecutive 75 basis-point increases lent further credibility to the slowdown narrative. The futures market even started pricing in a couple of rate cuts for the back half of 2023. From its October high, the 10-year Treasury yield dropped 36 basis points the rest of the way, ending December more than 50 basis points below the yield on the two-year, the steepest inversion of that segment of the curve since the early 1980s.

Don't be fooled by all the hand-wringing over what a terrible year 2022 was for bonds. In fact, long-term investors should be grateful for what transpired. Make no mistake, ultra-low interest rates are a threat to savers, especially those artificially manufactured by well-intentioned governments. It was critical to break out of that destabilizing cycle and mark-to-market losses were a small price to pay to get there. Municipal bonds enter 2023 in much better shape. Yields that began the year at 1% are now far more attractive, in many instances topping 5% on a tax-equivalent basis. The technical backdrop should continue strong, with issuance remaining low due to a decline in refunding opportunities. The outflow cycle that plagued 2022 will likely lose steam in the face of better yields and less tax-loss selling. States are better positioned to withstand the effects of a potential recession, having made prudent use of windfall tax collections to build record reserves. To be sure, challenges still exist. More economically-sensitive sectors will need closer scrutiny and a historically flat yield curve alters the risk/return calculus. But these issues are considerably less difficult to navigate than central banks pinning rates near zero. And we look forward to taking advantage of the gift handed to us by the 2022 market.

For most of the year, we had aggressively pushed out duration, taking advantage of a historic rise in rates that brought significant value back to the market for the first time in years. The shift paid off in the fourth quarter as interest rates plummeted across the curve. Calendar year 2022 will be remembered for the sharp increase in yields that left historic losses in its wake. But we believe some of the moves we executed during the worst of the selloff could have positive ramifications for our client portfolios for years to come. As we turn the corner to 2023, there is sure to be more volatility. We will be ready to adjust our positioning accordingly.

23 AVERAGE YEARS EXPERIENCE

16 MUNICIPAL INVESTMENT PROFESSIONALS

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
Kara M. South, CFA	Principal, Portfolio Manager

GW&K MUNICIPAL BOND STRATEGIES

SHORT-TERM MUNICIPAL BOND

2–8 YEAR ACTIVE MUNICIPAL BOND

2–8 YEAR ACTIVE MUNICIPAL BOND ESG

MUNICIPAL BOND

MUNICIPAL BOND ESG

MUNICIPAL ENHANCED YIELD

> *"Don't be fooled by all the hand-wringing over what a terrible year 2022 was for bonds. In fact, long-term investors should be grateful for what transpired."*

TAXABLE BOND STRATEGIES

Fixed income markets rose in the fourth quarter amid growing confidence that central banks have succeeded in slowing inflation and will soon be able to pursue less restrictive policy. This modest rally nevertheless ended up being too little, too late to help the bond market avoid its worst annual performance on record and an unprecedented second consecutive year of losses. Sentiment among both investors and consumers may have reached an inflection point, but data continue to justify some measure of caution: inflation is still stubbornly above the Fed's target, the labor market shows few signs of loosening, and corporations have yet to see a meaningful deterioration in earnings. Only the rate-sensitive housing market really stands out as a casualty of the Fed's tightening campaign to this point. Whether the end of the cycle is imminent is likely to remain an open question, especially as investors await the realization of the "long and variable lag" that has yet to be fully reflected across so many segments of the economy.

The Treasury market posted a small gain, as three months of income was more than enough to offset a slight bear flattening of the yield curve. The FOMC raised the overnight rate 125 basis points during the quarter, concluding a year that saw it rise a total of 425 basis points. The Committee provided a hawkish update to its Summary of Economic Projections (SEP), raising the median estimate for 2023 by 50 basis points. In his post-meeting press conference, Powell highlighted structural labor market shortages and offered commentary consistent with the "higher for longer" narrative. For the period, short rates moved higher on the revised terminal rate projection, while rates further out the curve were generally contained. Inflation breakevens rose slightly, reflecting a lower implied probability of a policy error, while real yields were little changed.

Corporate credit rallied along with broader risk markets, as spreads tightened across the quality spectrum. The investment grade market reflected a benign outlook for credit, closing the quarter at its tightest levels since April and well inside its long-term average. High yield spreads compressed for a second straight quarter, but this strength wasn't enough to avoid the sector's worst annual performance since 2008. Credit metrics remain solid, with moderate leverage, debt service coverage near historical highs and manageable near-term funding needs. The default rate remains low, with idiosyncratic rather than systemically significant incidents driving a small uptick. Mortgages outperformed Treasuries amid a drop in rate volatility. Technicals in the space improved, as higher mortgage rates and slower seasonal activity produced lower origination and slower runoff of the Fed's portfolio.

The disconnect between the Fed's projections and market pricing has widened following the most recent SEP. The median estimate of FOMC participants for the overnight rate at the end of 2023 is 5.125%, up from 4.625% in September; the fed funds futures market sees a terminal rate of nearly 5% in June of 2023 and then two cuts by year end. There has also been a small but not insignificant chorus of economists calling for the FOMC to raise its target inflation to 3% from 2%, prompting objections that this would undermine the Fed's hard-earned credibility. These are just two sources of tension in the rates market, and their resolution could have significant implications for both the level and the shape of the yield curve.

Our fundamental view of credit is broadly constructive, and we believe balance sheets in general are sound and liquidity is sufficient. But we recognize the potential for macroeconomic forces to alter this landscape and we don't believe all these risks are adequately reflected in valuations. Consequently, our allocation to corporate credit is at the lower end of its historical range. Within the space, we see the best value at the front end, where higher quality credits in less rate-sensitive sectors offer attractive yields and compelling breakevens. We have also been able to identify names that we believe can improve their credit profiles independently of a challenging macro backdrop. Our exposure to mortgages is neutral, as we believe the benefits of lower originations and potentially lower rate volatility are offset by event risks surrounding quantitative tightening and middling spread levels.

20 AVERAGE YEARS EXPERIENCE

15 TAXABLE INVESTMENT PROFESSIONALS

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

GW&K TAXABLE BOND STRATEGIES

- SHORT-TERM TAXABLE BOND
- INTERMEDIATE TAXABLE BOND
- CORE BOND
- CORE BOND ESG
- ENHANCED CORE BOND
- ENHANCED CORE BOND ESG
- TOTAL RETURN BOND
- CORPORATE BOND OPPORTUNITIES
- SHORT-TERM FOCUSED HIGH INCOME

> *"Our fundamental view of credit is broadly constructive, and we believe balance sheets in general are sound and liquidity is sufficient. But we recognize the potential for macroeconomic forces to alter this landscape and we don't believe all these risks are adequately reflected in valuations."*

DOMESTIC EQUITY STRATEGIES

24 AVERAGE YEARS EXPERIENCE

13 EQUITY INVESTMENT PROFESSIONALS

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

GW&K DOMESTIC EQUITY STRATEGIES

- EQUITY DIVIDEND PLUS
- DIVERSIFIED EQUITY
- SMALL/MID CAP CORE
- SMALL/MID CAP GROWTH
- SMALL CAP VALUE
- SMALL CAP CORE
- SMALL CAP GROWTH

US equities started the fourth quarter with solid mid-teens gains on the back of decent earnings reports, a decline in oil prices, a drop in interest rates, signs of peak inflation, and hopes the Fed's aggressive tightening was about to pause. However, this trend reversed in December as rates rose and the Fed made clear its tightening days were nowhere near done. US equities nonetheless reversed a three-quarter losing streak by posting their first positive quarterly return of the year. Non-US markets posted even stronger quarterly gains, as dollar weakness, a European energy crisis averted, and China re-opening generated investor enthusiasm for these previously lagging markets. For the full year, major equity markets globally provided similar negative returns hovering around -20%.

Domestic large cap stocks, as measured by the S&P 500, gained 7.6% for the quarter. This helped mitigate some of the year's losses, yet the S&P still fell -18.1%. Cyclically-oriented sectors, Energy, Industrials, and Materials posted the strongest relative performance in the quarter, with Consumer Discretionary and Communication Services trailing badly. For the year, Energy was the only sector to post a meaningful positive return, followed by near flat results from the more defensive Utilities and Consumer Staples sectors. Mega-cap dominant Communication Services, Consumer Discretionary, and Information Technology sectors were the year's worst performing sectors.

The Russell 2000 Index of small cap stocks experienced similar monthly ups and downs, posting a gain of 6.2% for the quarter, while its full year decline was a rather dismal -20.4%. Quarterly leaders among small caps echoed those of large, with Energy, Materials, and Industrials leading the way. Energy was the only small cap sector in the black for the full year.

Large cap's relative outperformance versus small in the quarter was driven primarily by the broad strength of larger cap Health Care names, which posted low double-digit returns versus a decline among smaller caps in this sector. For the full year, large cap's relative outperformance was also driven by the more defensive nature of its Health Care names and the meltdown of small cap Biotech stocks.

Value stocks regained the advantage versus Growth in the quarter, adding to their substantial full-year performance lead, as the value-oriented Energy and Financials sectors performed well, while the growth-oriented Consumer Discretionary sector lagged meaningfully. Style factors showed mixed performance results, with smaller caps favoring higher-quality attributes, while large caps had no meaningful style bias.

The Fed has made it abundantly clear it will keep rates higher for longer in order to get inflation in check. Aggressive tightening measures are being undertaken by central banks around the globe, with even final holdout Japan joining the fray. Complicating matters for the Fed is the resilience of the economy, with the unemployment rate staying quite low and wages still showing upward pressure. While monetary policy measures no doubt appear prudent, they act with a sizable lag, making the risk of a policy overshoot a more likely outcome. Thus,

> *"Our continued focus on identifying well-managed companies with leading market positions and solid financial characteristics should serve us well in 2023, as it did in 2022, as it is these challenging economic environments that tend to separate the good from the bad."*

the fear is that central banks may send us into a deeper recession in their quest to control inflation. Interest rates have responded as one might expect with both an increase in rates as well as a rather sizable inversion of the yield curve. Such inversion has been a relatively good predictor of recession in past economic cycles. Indeed, higher rates have started to have the Fed's desired impact on the economy, with higher mortgage rates substantially slowing the housing market, a noticeable uptick in hiring freezes and layoffs, and manufacturing surveys now in contraction territory. Inflation does appear to have peaked, but are the Fed's actions enough yet to get inflation down to the target? Our best guess is that the pressures from the Fed will push us to recession around mid-year, but with the underlying strength of the economy likely keeping a recession rather mild.

These risks have been well articulated by economists, market strategists and the media, with equity markets having drifted down about 20% since hitting their highs over a year ago. Sentiment indicators are already at negative levels that have historically signaled favorable stock market performance.

Our continued focus on identifying well-managed companies with leading market positions and solid financial characteristics should serve us well in 2023, as it did in 2022, as it is these challenging economic environments that tend to separate the good from the bad.

GLOBAL EQUITY STRATEGIES

23 AVERAGE YEARS EXPERIENCE

9 EQUITY INVESTMENT PROFESSIONALS

INVESTMENT TEAM

Daniel L. Miller, CFA	Partner, Director of Equities
Reid T. Galas, CFA	Partner, Portfolio Manager
Karl M. Kyriss, CFA	Partner, Portfolio Manager

GW&K GLOBAL EQUITY STRATEGIES

GLOBAL SMALL CAP

INTERNATIONAL SMALL CAP

Global equities closed a weak year with a very strong quarter. The large cap MSCI World ex USA Index advanced 16.2%, its best quarter since 2009. The MSCI World ex USA Small Cap Index also gained 15.2%, but did not set any multi-decade records. For the full year the markets were still down, although well off the lows earlier in the year, with large cap falling -14.3% and small cap down -20.6%. Similarly, the US Dollar Index declined -7.7% in the quarter, but still finished the year up 8.2%.

Looking across both regions and sectors, the theme for the quarter appeared to be 'relief rally' as all the concerns earlier in the year turned out to be not quite as bad as feared. The MSCI World ex USA Small Cap Index saw double-digit returns in all major regions, but Europe was the strongest. Clearly the worst-case scenarios of energy shortages and a hollowing out of the industrial base have not yet come to pass and the markets adjusted accordingly. All sectors were higher with the worst, Real Estate, 'only' up 9.0%. The Financials sector, up 22.1%, was best as it rallied off the bottom on higher interest rates and still muted credit concerns. Consumer Discretionary and Industrials were also very strong, likely for similar, relief-rally reasons. For the full year, however, Energy remained the only sector higher, with significant weakness in prior Covid beneficiaries — Health Care, Communication Services, and Information Technology.

We fully grasp the futility of forecasting macro events so what follows is not a forecast. Rather, we'll lay out some important events from the fourth quarter of 2022 and how we think they will likely impact the market in 2023.

This quarter the Bank of Japan (BOJ) expanded the interest-rate band around which the 10-year Japanese Government Bond (JGB) trades. The BOJ would strongly argue that this was not an interest-rate hike, but the market sees it for what it is: the start of the long-awaited Japanese rate hikes. In financial markets, danger does not lurk in volatility, but instead within instruments that should be volatile, yet are not. Years of Yield Curve Control by the BOJ will probably come to an end in the spring of 2023 and the market will finally learn the correct price for JGBs. We expect, given that JGBs have been a premier funding currency for global carry trades, that something in the global financial system will break, but it will likely be something different than most expect (i.e. outside of Japan). In fact, as we have previously discussed, we believe there is a strong bull case for Japanese equities if, and when, Japanese interest rates finally move higher.

China finally ended their ridiculous zero-Covid policy and they did it by replacing it with "zero" Covid policies. All at once they ended testing, surveillance, travel restrictions, and quarantines. In addition, the government has decided to take a dramatic about-face and reverse many of their recent nonsensical policies: new video games are being approved, the tech crackdown is loosening, real estate support is coming from the central government, and they are even showing signs of trying to improve their tattered reputation with the West. Many issues remain that we believe are not easily fixed. However, after a period of intense Covid spread, the Chinese economy should see a sharp rebound just as North America and Europe are entering recession. This global divergence in economic cycles should be a tailwind to active equity performance.

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North America and Europe have avoided the worst-case fears from earlier this year. However, higher costs, especially labor, and higher rates, which may last longer than the market currently expects, will put pressure on historically high margins. Some type of consumer-spending led recession remains likely, even if highly forecast. Somewhat offsetting these concerns, equity investors should see a tailwind from FX, China reopening benefits, and easing of supply-chain constraints.

On balance we are bullish on our global equity strategies in 2023. Many long-term problems remain, which are far from fixed, but we also believe there are some amazing developments in technology and opportunities for growth. Our focus for the next year remains constant: finding companies which can help address the former, and take advantage of the latter, while maintaining a diversified, active, and differentiated portfolio.

EMERGING MARKETS EQUITY STRATEGIES

28 AVERAGE YEARS EXPERIENCE

15 EQUITY INVESTMENT PROFESSIONALS

INVESTMENT TEAM

Daniel L. Miller, CFA	Partner, Director of Equities
Nuno Fernandes, CFA	Partner, Portfolio Manager
Thomas A. Masi, CFA	Partner, Portfolio Manager
Bradley J. Miller, CFA	Partner, Portfolio Manager
Pablo Salas	Partner, Portfolio Manager
William P. Sterling, Ph.D.	Global Strategist

GW&K EMERGING MARKETS EQUITY STRATEGIES

EMERGING MARKETS

EMERGING WEALTH

After five consecutive quarterly declines, emerging market (EM) equities finally posted a relatively robust gain of 9.7% in the fourth quarter, which still left the asset class down -20.1% for the year. That compared to a fourth-quarter gain of 9.8% for the MSCI World Index, which left the developed markets (DM) benchmark down by -18.1% for the year. Both EM and DM equities were buffeted in 2022 by a few common factors, including surging global inflation, synchronized central bank tightening, and the major geopolitical shock of Russia's invasion of Ukraine. However, despite broadly similar returns, the dynamics of EM and DM equities were quite distinct with the rise and fall of China's zero-Covid policy playing a major role in EM.

Central banks maintained their hawkish tilt going into the new year, with the Fed and the European Central Bank (ECB) raising their policy rates respectively to 15-year and 13-year highs, while the Bank of Japan (BOJ) started to back away from its years-old Yield Curve Control policy. That said, some of the bounce in global equity values in the quarter appeared to be based on optimism that the Fed was getting close to pausing its rate-hiking cycle thanks to recent reports showing a moderation in inflation. Some European nations also began to report softer inflation, aided by a drop of nearly 50% in European natural gas prices in response to warmer weather and full gas storage tanks to cope with severely curtailed gas supplies from Russia.

China's equity market experienced major gyrations in 2022. After falling -44% for the year through October, from that point China's market rallied by 35% through the year end to finish the year with a decline of -21.9%. There were multiple factors behind the weakness through October, most notably the severe property market credit crunch and the economic stagnation due to the zero-Covid policy and rolling lockdowns. Capital flows to China also appear to have been dampened by China's geopolitical embrace of the Russian pariah state and the drift to authoritarianism and heavy-handed state control under the supreme leader Xi Jinping. The key factor in the year-end reversal appears to have been the government's nearly complete abandonment of the zero-Covid policy, which sets the stage for a strong reopening recovery beginning as early as March or April.

EM Asia was the strongest performing EM region in the quarter, supported largely by a gain for MSCI China. South Korea, Thailand, Malaysia, and the Philippines also powered Asia with strong double-digit gains. India was a laggard with a gain of only 2% as monetary policy continued to tighten. The EM region of Europe, the Middle East, and Africa (EMEA) was the weakest performing region in the quarter, weighed down by declines in the Middle East markets in response to falling energy prices. Turkey was the standout performer in EMEA for the quarter and the year, with gains of 62.9% and 90.4%, respectively. The EM region of Latin America also had a disappointing quarter, despite a 12.5% gain in Mexico on optimism that inflation was peaking. Index-heavyweight Brazil was up only 2.3% as investors gave a tepid welcome to cabinet appointments by incoming President Lula. On net, EM Latin America rose by 5.7% in the quarter, which still left it as the best-performing EM region for the year with a gain of 8.9%.

> *"It is too early to tell whether the positive turn in EM equities in the fourth quarter was a decisive break to the upside. But history shows that EM has troughed ahead of the S&P 500 in four of the 10 prior bear markets and on the same date as the S&P 500 on three occasions."*

All major EM sectors posted gains in the fourth quarter. The EM Growth and Value Indexes recorded identical gains of 9.7% in the quarter, although for the year-to-date period, EM Growth declined by -23.8%, while EM Value declined by a more modest -15.6%.

It is too early to tell whether the positive turn in EM equities in the fourth quarter was a decisive break to the upside. But history shows that EM has troughed ahead of the S&P 500 in four of the 10 prior bear markets and on the same date as the S&P 500 on three occasions. Although global central bank tightening still provides potential headwinds to global equity markets, the prospect of sustained Asia and EM outperformance appears to be the highest in years based on attractive valuations and exceptional earnings prospects. Indeed, China's decisive about-face on Covid suppression and its clear pivot toward generating consumption-led growth highlight the very different cyclical positions of the main EM nation compared to key DM nations which are still focused on fighting inflation.

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