

INVESTMENT REVIEW

3Q 2025

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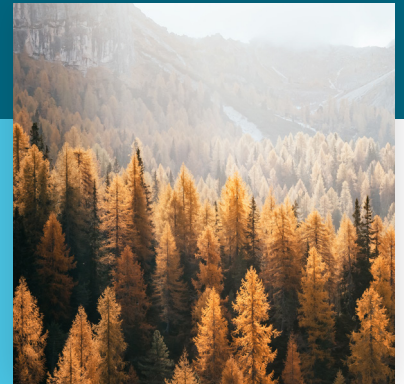
ECONOMIC COMMENTARY



BY HAROLD G. KOTLER, CFA

Founder-Chairman, Chief Investment Officer

The stock market continues to rise in spite of the steady stream of negative headlines around presidential policies. Maybe, just maybe, it is rising because of all that press? An old adage is proving true: “Markets climb walls of worry.” Why? Because when investors are fearful of “what comes next,” they tend to hold back, leaving more money uninvested, as we are seeing today.



As the market continues to rise, those same skeptics begin to invest until they are fully committed, at which point the market is vulnerable to a serious correction.

I don’t need to detail the sources of angst in the market and in the whole system. What I want to discuss is why the stock market is rising. As I see it, there are three basic forces propelling it: First, the level of interest rates; second, the AI revolution, and third, the sense that capitalism is regaining ground.

“Markets climb walls of worry.’ Why? Because when investors are fearful of ‘what comes next,’ they tend to hold back, leaving more money uninvested, as we are seeing today.”

When it comes to interest rates, there is little doubt that short-term rates will likely decline over the next two years. When and how fast is impossible to predict, but the stock market only cares about direction, and the direction for short-term rates is down. Many believe long-term rates stay elevated, pointing to inflation and large federal budget deficits. But I believe that view misses a critical factor: psychology. The Federal Reserve lowering short-term rates signals concern for the economy, which in turn

stokes fear of recession or stagflation. Yes, the economy is slowing, which is why long-term rates should also move lower. Any decline in long-term rates would benefit housing as well as the smaller businesses that rely on bank debt. If short-term rates fall 2% over the next two years, long-term rates would likely drop by 1%. Both moves could stimulate growth and help steer the economy away from recession.

The AI revolution is in the first inning. We can’t yet grasp its full significance. We can see the vast sums of money being invested, but the efficiencies to come are beyond our ability to evaluate. What we should realize is that AI will bring significant changes to the workforce, accelerate profit margins, and in turn boost corporate earnings. Past economic transitions have reshaped industries and careers—many of our parents’ jobs no longer exist. Even in our time, the shifts have been tectonic. Jobs will change, opportunities will emerge, but differently. Most importantly, productivity gains from AI will be deflationary, pushing down costs for consumers and lifting margins for businesses. It would be a mistake to underestimate AI, despite the disruptions.

Finally, government regulation. Recognizing the need for oversight, we also know regulation has gone too far—at the city, state, and federal levels. Efforts may be

well-intentioned, but the result has too often been to slow progress. I am not capable of parsing which rules are useful and which are not, but I do know that the overall burden is heavy. Greater efficiency on this front would help economic growth.

So, while the political environment feels unsettled, there are real positives at work. We are not naive enough to say all is well, but we do recognize that all is not bad. Try to see the good that is happening and maintain an optimistic outlook.

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

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\$52.0
BILLION

TOTAL ASSETS
UNDER MANAGEMENT

181

EMPLOYEES

51

INVESTMENT
PROFESSIONALS

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THIRD QUARTER 2025

ECONOMY

- ▶ Economic data for Q3 portrayed an economy on solid footing. The Atlanta Fed is projecting 3.9% for the quarter on the heels of GDP growth of 3.8% in Q2.
- ▶ Although trade volatility from tariff-related stockpiling distorted underlying trends, data for the first half showed a two-speed economy: AI-related investment grew 27% annualized, while non-AI activity grew only 0.1%.
- ▶ Labor markets have cooled with August adding just 22,000 jobs and unemployment reaching 4.3%. Core PCE inflation held steady at 2.9% year-over-year in August while headline PCE ticked up to 2.7%.
- ▶ The narrow foundation for growth—concentrated in tech spending—alongside weakening employment and tariff drags raised sustainability concerns, but monetary easing and coming tax cuts should help promote broad-based growth in 2026.

FED ACTION

- ▶ The Federal Open Market Committee (FOMC) cut the federal funds rate by 25 basis points in September to a range of 4.0%-4.25%, its first cut since December 2024.
- ▶ The vote was 11-to-1, with newly appointed Governor Stephen Miran dissenting in favor of a larger 50-basis-point cut.
- ▶ The FOMC's September projections revised up 2025 GDP growth to 1.6%, while the updated dot plot projected two additional 25-basis-point cuts in Q4, with only one cut anticipated in 2026.
- ▶ Inflation projections were also revised upward, with core PCE now expected to reach 3.1% by year-end 2025. Chair Powell emphasized the dual mandate challenges, noting that while the weakening labor market justifies easing, elevated inflation requires continued vigilance.

BOND MARKETS

- ▶ Q3 opened with solid job and growth data, giving the Fed room to hold steady on rates. But a weak July jobs report shifted momentum—raising expectations for Fed rate cuts as concerns about rising unemployment outweighed worries about stubborn inflation.
- ▶ The shift in focus supported another strong quarter for fixed income, with the Bloomberg Aggregate Bond Index gaining just over 2.0%—keeping 2025 on track for its strongest year since 2020. Credit outperformed, with spreads narrowing across corporates and securitized sectors.
- ▶ Rates rallied, driven by shifting Fed expectations. Front-end yields dropped more than 35 basis points, while 2-10-year yields declined by 5-10 basis points. The long end was little changed, anchored by fiscal concerns and debt-sustainability risks.
- ▶ Municipal bonds posted strong returns in the third quarter, led by September's sharp move at the long end.

INDEX PERFORMANCE

	9/30/25	
	QUARTER	YEAR TO DATE
Bloomberg 10-Year Municipal Bond Index	3.03%	4.10%
Bloomberg Aggregate Bond Index	2.03%	6.13%
Bloomberg High Yield Index	2.54%	7.22%
Dow Jones Industrial Average	5.67%	10.47%
S&P 500 Index	8.12%	14.83%
Russell 2000 Index	12.39%	10.39%
MSCI World Small Cap ex USA Index	7.24%	29.54%
MSCI World Index	7.27%	17.43%

DOMESTIC EQUITY MARKETS

- ▶ US equity markets advanced steadily in Q3. Robust AI demand, strong corporate earnings results, still solid US economic data, and a September Fed rate cut with expectations of further easing fueled market gains, offsetting concerns about a cooling labor market and above target inflation.
- ▶ Small cap stocks, as measured by the Russell 2000, rallied 12.4%, supported by lower interest rates and attractive relative valuations, and outpaced large caps (S&P 500, +8.1%).
- ▶ Within large caps, growth sectors led. Information Technology, Communication Services, and Consumer Discretionary performed best, while Consumer Staples, Real Estate, and Materials lagged.
- ▶ Markets broadened in Q3 with small cap outperformance, but leadership within major indices remained concentrated. Investors demonstrated a strong preference for low-quality factors within the small cap market.

GLOBAL EQUITY MARKETS

- ▶ Non-US equity markets advanced for the third consecutive quarter this year, supported by ongoing investment flows and tariff relief as the US struck trade deals with Japan and the EU.
- ▶ Large caps, as measured by the MSCI World ex USA Index, gained 4.8%; while the MSCI World Small Cap ex USA Index outperformed with a 6.6% return. The US Dollar Index was up 0.9%.
- ▶ Asia and North America were the top performing regions, with Japan reaching new highs and Canada rallying on strong metal prices. European markets were mixed following last quarter's notable gain.
- ▶ Sector leaders for the quarter included large cap and small cap Materials, Energy, and Financials, while large cap Consumer Staples and small cap Health Care and Communication Services finished lower.

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, that 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 strong returns in the third quarter, led by September's sharp move at the long end. July and August returns were dominated by curve steepening rather than broad price gains, with retail demand pinned to the front end while value built further out the curve. By September, the opportunity was too compelling to ignore. After months of record supply, a decelerating new-issue calendar met renewed demand from traditional buyers and cross-over accounts, with long maturities seeing the most interest. Mutual fund inflows, steady all year, accelerated alongside the rally. Under the surface, spreads were steady as the market rewarded liquidity and clean structures. September's long-end gains unwound most of the steepening from July and August, but the quarter still closed with the curve far steeper than where it began the year.

Broader rates also fell over the quarter, though only by single digits. A weaker labor picture gave the Fed room to cut by 25 basis points in September but an upgraded outlook for growth and inflation kept a more aggressive rally in check. Deficit worries and the prospect of heavier Treasury issuance continued to weigh on the back end, even as benign inflation prints and a late-month safe-haven bid provided support. The prevailing sentiment seemed to rest on a resilient economy, driven by a healthy consumer and a labor market that is holding up but showing signs of strain. The political noise around Fed independence and government shutdowns has kept uncertainty at the forefront, as has evolving tariff policy, the ultimate effects of which are proving difficult to predict. Heading into the fourth quarter, markets are pricing in a slightly more aggressive easing path than the Fed's own projections, but a range of crosscurrents will determine how that plays out.

We continued a year-long trend of heavy trading activity in the third quarter as we looked to take advantage of the sharp steepening of the municipal bond yield curve. An unexpectedly large new issuance calendar in July and August provided us with the opportunity to execute these trades while also exploiting significant new issue concessions. The payoff was instantaneous as September brought a furious rally, especially out past 10 years. As yields fell and the curve flattened in September, we dialed back on extending further.

"Municipal bonds enter the fourth quarter in excellent shape. Nominal yields remain well above their 10- and 20-year averages, and the curve is still steep enough to offer meaningful expected return from roll."

Municipal bonds enter the fourth quarter in excellent shape. Nominal yields remain well above their 10- and 20-year averages, and the curve is still steep enough to offer meaningful expected return from roll. Technicals are mixed in the near term. Supply has eased from its torrid pace but is still running more than 10% ahead of last

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MUNICIPAL INVESTMENT
PROFESSIONALS

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AVERAGE YEARS
EXPERIENCE

INVESTMENT TEAM

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Brian T. Moreland, CFA	Partner, Portfolio Manager
Kara M. South, CFA	Partner, Portfolio Manager
Martin R. Tourigny, CFA	Partner, 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 BOND PLUS

MUNICIPAL ENHANCED YIELD

year's record, while reinvestment flows should remain muted until December. Ratios at the front end are stretched, leaving less cushion if broader yields back up, but value persists in intermediate and longer maturities, where roll and carry do more of the work. Credit fundamentals remain sound. States continue to budget conservatively and maintain elevated reserves, even as some have begun modest draws on rainy-day funds. Policy shifts in higher education and health care bear watching, but our exposure remains concentrated in larger, better-capitalized systems. The market enters October on solid footing, and we would look to use any near-term volatility as an opportunity to add at improved levels.

TAXABLE BOND STRATEGIES

The quarter began with solid jobs data and growth signals that allowed the Fed to be patient on moving rates due to inflation concerns, but momentum flipped after a weak July employment report exposed real signs of labor market softening. That shift quickly became the market's focal point, fueling expectations for a rapid Fed cutting cycle. Inflation pressures remained sticky, but took a backseat to the risk of rising unemployment in the eyes of the market and the Fed. At Jackson Hole, Chair Powell reinforced that shift, stressing labor market risks and preparing the market for easing. The Fed delivered a September cut as expected, but Powell stopped short of committing to a more aggressive path. The message balanced still-firm growth data with the need to protect employment. Looking ahead, both markets and the Fed appear aligned that the primary concern is preventing further labor market deterioration, with inflation viewed as being broadly on track.

That pivot in focus supported another strong quarter for fixed income markets. The Bloomberg Aggregate Bond Index returned just over 2.0%, keeping 2025 on pace for its best year since 2020. Credit once again led the way, with spreads grinding tighter across corporates and securitized sectors. Rates also rallied, driven by shifting Fed expectations. Front-end yields fell by more than 35 basis points as markets priced in greater conviction around Fed rate cuts, while 2-10-year yields fell by 5-10 basis points. Long-end yields were little changed, with the 30-year anchored by fiscal concerns and debt-sustainability risks. These rate moves pulled the Treasury curve to its steepest of the year before partially retracing in September as markets refocused on softer labor data and the looming risk of a government shutdown.

Credit extended its months-long rally in the third quarter, supported by strong technicals and shifting Fed expectations. Investment grade spreads tightened from multi-year wides in April to multi-decade lows by September, ending nine basis points lower at 74 basis points. High yield followed suit, narrowing 23 basis points, with CCCs leading performance. Resilient corporate fundamentals, benign macroeconomic data, and still-compelling all-in yields combined to keep demand for credit strong and fuel the rally. Importantly, the market absorbed record September issuance with ease as net supply lagged robust demand. These favorable technicals drove positive excess returns as both investment grade and high-yield sectors saw returns greater than 2.5% despite spreads starting the quarter near their tightest levels in years. With Fed policy easing and a broadly cooperative macro backdrop, flows should remain constructive into year-end, limiting the scope for material spread widening.

Beyond corporates, securitized products also outperformed comparable-duration Treasuries during the quarter, led by strength in agency mortgage-backed securities (MBS). The outlook for MBS improved as the curve steepened, interest-rate volatility eased, and prepayment risk remained muted. These factors boosted investor demand and compressed spreads. The MBS market also priced in potential positive adjustments to quantitative tightening (QT),

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TAXABLE INVESTMENT
PROFESSIONALS

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AVERAGE YEARS
EXPERIENCE

INVESTMENT TEAM

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Mary F. Kane, CFA	Partner, Portfolio Manager
Brett Kozlowski, CFA	Principal, Portfolio Manager

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

pushing spreads to multi-year lows ahead of the September FOMC meeting. With no changes announced to date, however, modifications to QT or other government sources of demand remain only speculation. Commercial mortgage-backed securities and asset-backed securities also benefited from the risk-on tone, supported by solid demand across the front to intermediate portions of the yield curve. Overall, securitized markets continue to be well supported by favorable technicals and strong collateral fundamentals, offering compelling relative value in the current market environment.

“Despite uncertainty over the rate path, monetary and fiscal support remain in place. At the same time, productivity gains from technological advancements and solid consumer balance sheets provide additional tailwinds.”

Political efforts to influence or reshape the Federal Reserve have not succeeded so far, but market fears about potential policy interference remain valid and have promoted a steeper yield curve. Despite uncertainty over the rate path, monetary and fiscal support remain in place. At the same time, productivity gains from technological advancements and solid consumer balance sheets provide additional tailwinds. Together, these factors create a constructive backdrop for spread product, particularly default-remote corporates and high-grade securitized products and lead us to position ourselves accordingly.

DOMESTIC EQUITY STRATEGIES

Domestic equities picked up where they left off the prior quarter, with three consecutive months of gains, bringing the winning streak to five months since the April Liberation Day meltdown. Stronger than expected corporate earnings, broadly solid US economic data, resilient consumer spending, continued aggressive AI investment spending, and the first of several expected Fed rate cuts were the primary drivers behind the market's advance. The S&P 500 gained 8.1% for the quarter, pushing year-to-date performance to 14.8%. The S&P 500's gains were relatively narrow, with Magnificent 7- and AI-heavy sectors of Information Technology, Communication Services, and Consumer Discretionary the only three of 11 market sectors to beat the Index.

The Russell 2000 Index of small cap stocks posted an impressive 12.4% gain in the quarter, pushing year-to-date returns back into the double digits at 10.4%. Unlike large caps, returns were much broader among small caps, with eight of 11 sectors posting double-digit gains. Record gold prices had the mining stocks within the Materials sector leading the way, with economically sensitive and AI-heavy sectors of Industrials, Communication Services, and Information Technology not far behind. More speculative names in industries such as nuclear power, quantum computing, cryptocurrencies, and fintech were also very popular among retail investors, again making lower-quality style factors such as non-earners, low ROE, and high beta the strongest parts of the market.

Growth stocks dominated returns among large caps, with Growth beating Value by 5.2%, and extending the year-to-date lead to 5.6%. Yet among small caps, Value held a small 0.4% advantage over Growth given the breadth of the rally across economic sectors. However, small cap Growth still maintains a 2.6% advantage over Value year-to-date.

"The outlook for the economy and the stock market appears better than many expected. Corporate earnings have outpaced Wall Street forecasts, driven by robust AI-related investment and resilient consumer spending, even as confidence surveys remain soft."

The outlook for the economy and the stock market appears better than many expected. Corporate earnings have outpaced Wall Street forecasts, driven by robust AI-related investment and resilient consumer spending, even as confidence surveys remain soft. The impact of tariffs, the big concern earlier this year, has also been quite muted, as companies have found ways to mitigate their impact on both demand and profitability. ISM surveys also show a continued expansionary services economy, albeit a still sluggish manufacturing economy. Lastly, the Fed has finally resumed its path of rate cuts in September, expected to aid in economic growth, with several more cuts expected later this year and into next. The sluggish labor market and somewhat sticky inflation remain the primary fears of market pundits, although neither is yet deteriorating in a manner that would derail the economy.

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EQUITY INVESTMENT
PROFESSIONALS

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AVERAGE YEARS
EXPERIENCE

INVESTMENT TEAM

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Aaron C. Clark, CFA	Partner, Portfolio Manager
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Jeffrey W. Thibault, CFA	Partner, Portfolio Manager
Jeffrey O. Whitney, CFA	Partner, 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

Uncertainty over the duration and impact of the government shutdown will likely keep the market on edge, especially with stocks sitting near all-time highs. With Trump at the helm, it is near impossible to predict how this shutdown will play out. One must recall that the longest prior shutdown took place under his watch during his first administration. Corporate balance sheets remain healthy, providing ample firepower for share buybacks, dividends, and acquisitions. Personal balance sheets also remain strong, no doubt helped by record stock market levels, providing a continued tailwind for spending and investment.

As we move into fall, we turn our attention to 2026. Despite the strong market, the valuation of the S&P 500 has remained steady, as market advances have been offset by earnings growth expectations that could reach double digits in 2026. We remain committed to building portfolios of well-run companies positioned for long-term success that sell at reasonable valuation levels. Market participants, especially retail investors, however, have been focused on a narrower set of more speculative growth companies, willing to pay almost any price for this growth. This is not to say the next generation of corporate success stories won't be found from among these names; just that there is a price above which favorable returns will be difficult to achieve. No doubt this can be a challenge for long-term, quality-oriented investors like us, but it does not change our belief that our clients will be best served by our approach over time.

GLOBAL EQUITY STRATEGIES

The global bull market extended its run as small cap markets advanced for the third consecutive quarter this year, with easing trade tension, a 25-basis-point rate cut by the Fed, and AI enthusiasm among the key takeaways. The MSCI World ex USA Small Cap Index gained 7.2% USD, outperforming the large cap MSCI World ex USA Index which was up 5.3% USD. The US Dollar Index rose 0.9%.

Asia was the top-performing region with Japanese equities hitting new highs as second quarter GDP came in at 1.0% versus expectations of 0.4%. Foreign investment flows into the market accelerated on easing tariff concerns and ongoing corporate governance reform. Results were mixed across Europe as most markets lagged the Index following last quarter's notable gain. Washington's surprise 39% tariff announcement weighed on Switzerland; Sweden declined due to weak local business activity; and the UK was down on persistently high inflation. Canada and Australia were standouts thanks to sizable gains in mining stocks. On a sector level, Information Technology, led by equipment and semiconductors; Materials, mainly mining; and Utilities were the top performers. Consumer Staples was the only sector to end the quarter lower.

The list of risks beyond the equity markets looks much the same as in prior quarters. From France's fiscal challenges to the ripple effects of US tariffs—spurring trade diversion and secondary tariffs between China and regions such as Mexico and the EU—along with ongoing geopolitical tensions and currency and bond market pressures, few issues appear close to resolution. This month, however, we set those concerns aside to focus solely on equity markets.

On the surface the strong returns in 2025 should be pleasing, but the foundation of the market rally is becoming worrisome. Increasingly, returns are being driven by a group of narrowing themes: Canadian and Australian precious metal miners rallying on the gold price, European defense companies seeing order books explode higher, or Japanese IT firms catching the AI spending wave. However, we're concerned that the market is not worried enough about the macroeconomic factors driving this growth, nor the long history of companies failing to translate rapid revenue growth into shareholder friendly cash flow and earnings. Gold prices hitting records due to concerns about fiat currencies and fiscal profligacy, spreading global conflict, and deterioration in post-war security guarantees driving defense spending, and a massive spending campaign by a historically cyclical industry without any clear revenue model all seemed to be “mixed” blessings, at best. It is not that the individual company stock price rallies are irrational, just that the drivers of those rallies might not prove sustainable or even positive in the long term.

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PROFESSIONALS

26 | AVERAGE YEARS
EXPERIENCE

INVESTMENT TEAM

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GW&K GLOBAL EQUITY STRATEGIES

GLOBAL SMALL CAP

INTERNATIONAL SMALL CAP

We have taken a different path. There are attractive businesses being ignored by this bull market, although most are still generating solid absolute returns. These companies may seem “boring” because they don't align easily into the current market zeitgeist or boast an exciting growth story. Looking for stable revenue from necessary and repeatable products or services, managements focused on investor-friendly capital allocation and shareholder returns, and valuations which allow investors to meet their own required return hurdles should never be “out of favor” but on a relative basis that is clearly the case currently. However, rather than a negative, this is exciting. Great companies are being “left behind” by the Index but are still providing returns in excess of our underwriting assumptions. For investors struggling with FOMO and feeling they are “forced” into keeping up, this may be one of the most difficult market environments we have experienced in a generation. Our advice is to stick to the fundamentals, accept the solid absolute returns, and avoid the trap of short-term relative gains turning into long-term regret.

“Although international small cap markets are on track for a very good 2025, many companies that fall into today's preferred investment themes have a high level of price and business risk. While the market seems to be willing to accept this risk, we are not.”

Although international small cap markets are on track for a very good 2025, many companies that fall into today's preferred investment themes have a high level of price and business risk. While the market seems to be willing to accept this risk, we are not. Although this creates a relative performance challenge in the near term, we are confident that over the long term, strong business fundamentals will result in greater stock price performance.

Our passion for providing thoughtful and highly disciplined investment strategies, combined with a deep commitment to personal service, results in long-term relationships built on trust. We believe accessibility, a willingness to listen, and a desire to educate can be just as important as investment acumen. With more than 50 years' experience managing assets for individuals and families, we are a partner you can trust.

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