

INVESTMENT REVIEW

1Q 2026

ECONOMIC COMMENTARY



BY HAROLD G. KOTLER, CFA

Founder-Chairman, Chief Investment Officer

If there's one constant in investing, it's that when markets get challenging, investors reassess their appetite for risk. We've seen this play out over and over again these past 50 years. In those periods, the instinct is always the same: how do I protect my assets? We're seeing that dynamic unfold once again today.



The problem is that investing for “safety” is a false goal. There is no investment that guarantees safety. True safety, in my view, means your investments outpace inflation. If they don't, your purchasing power erodes and your standard of living declines. Just think about what your first house cost and what that same house costs today.


My experience tells me that most investors find the slow erosion of value easier to tolerate than short-term volatility. Volatility is like a winter storm — it rolls in and disrupts everything. It's difficult to watch your assets drop in value. Too often, as investors, we anchor to the highest value we've enjoyed and treat any drop from that level as a “loss.” In reality, that peak was never a permanent baseline and treating it that way is just a head game.

At the end of the day, it comes down to behavior. The fear of loss can be one of the greatest obstacles to wealth creation. The stock market offers something many other assets do not — instant liquidity. You can wake up, read the headlines, and sell immediately. That's not possible with your house, art, or private investments. Easily done. But the

ramifications can be significant and, over time, disastrous. Often, the rationale is, “I can get back in when the market is lower.” But those opportunities only exist when others are selling, not buying. Stepping into a firestorm runs against how most people are wired. Very few investors do it.

There are two primary ways investors lose money: holding too much cash or selling your stocks when fear takes over. What's the alternative? Stay invested. Simple in theory, but difficult in practice. It requires patience and a willingness to accept volatility. But after enough cycles, you realize that the damage is rarely done by the market itself — it's done by how investors respond to it. That's where most people get into trouble.

We see this pattern play out all the time. Experience teaches you that while market cycles change, discipline cannot. No one welcomes a decline in value, but it's an inherent part of investing — and more often than not, those periods are temporary. Through it all, our focus remains on preserving purchasing power.



After patience and discipline, the last key to investment success is diversification. All markets have a day in the sun and a day in the clouds. Trying to predict what will lead next is a fool's game. It's not only difficult, it's unnecessary. If you look at returns over the past 5-10 years across most asset classes, it's amazing how often they moved together.

So here we are in the midst of another firestorm. The events in the Middle East are serious and deserve our attention. The news cycle has stirred strong views and pushed many to imagine worst-case scenarios that leave little room for a more balanced long-term perspective. That is exactly where mistakes get made — and why you rely on us during periods like this. From an investment standpoint, the discipline cannot change. Staying the course is still the right approach.



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MUNICIPAL BOND STRATEGIES

Municipal bonds posted negative returns in the first quarter, as a favorable start gave way to a more challenging rate environment. The year began with markets positioned for eventual Fed easing, which kept risk appetite firm and rate volatility low. In March, however, the tone shifted dramatically after the US and Israel launched military strikes on Iran, sending energy prices soaring. Interest rates rose on mounting inflation concerns and potential supply disruptions. While economic data pointed to slower growth, markets worried that the Fed's hands would be tied by pricing pressure stemming from the standoff in the Strait of Hormuz. By quarter-end, Treasury yields had risen meaningfully across the curve, and tax-exempt rates moved in tandem.

For municipal bonds, the March correction stood in stark contrast to how the quarter began. Appetite for bonds was strong out of the gates and supply, while elevated, was manageable and well absorbed. By late February, the market even felt grabby, with buyers stepping in aggressively and spreads grinding tighter. That dynamic did not hold. When war drove broader rates higher, pressure built on municipal bonds just as seasonal technicals began to fade. Fund flows, which had been strong to start the year, slowed to a trickle before turning to outflows by quarter end. Even so, credit fundamentals held up well, with spreads largely unchanged. The curve continued to normalize, with a flatter front end beginning to steepen while the very steep long end flattened modestly. Ratios moved higher over the quarter, providing needed relief after testing historically rich levels earlier in the year.

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Our trading activity in the first quarter focused more on relative value opportunities than any broad shift in positioning. New issue supply opened the year matching 2025's record pace and when rates moved rapidly higher in March, issuance accelerated rather than pulling back. A number of mega-deals already on the calendar decided to price even amid the sloppy conditions. The heavy volume needed sizeable concessions to attract buyers and we stepped in aggressively on the most compelling deals. To fund those purchases, we trimmed positions in shorter callable bonds and intermediate bullets where spreads had compressed, focusing on high-tax specialty states that in-state residents were still paying up for. Many of those sales were executed at spreads through the AAA scale. In that way, spotty liquidity proved a positive, with the

17 MUNICIPAL INVESTMENT PROFESSIONALS

21 AVERAGE YEARS EXPERIENCE

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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

weaker pockets offering attractive entry points while the better bid segments allowed us to exit tighter positions. Trading activity picked up as the quarter progressed, reaching near-record levels in March. Duration extended modestly, a result we were comfortable with given the backup in rates.

Looking ahead, the market appears to have reset to a healthier place. First and foremost, yields are back to six-month highs and that should not be taken for granted. Remember, we went more than a decade following the financial crisis and rarely saw these levels. As importantly, ratios have cheapened and the curve has taken on a more normal shape. The long end, in particular, held in well during the correction and continues, we believe, to offer the most attractive value. At current levels, further weakness would likely begin to draw crossover demand, as we saw during similar periods last summer and the fall prior. As always, the path forward will depend in large part on broader macro conditions and how events in the Middle East filter through to global growth and inflation. For now, the municipal bond market feels well balanced, with a more typical pattern in rate movements and valuations that better compensate investors for the risks involved.

TAXABLE BOND STRATEGIES

In January and February, interest rates declined and the yield curve flattened as softer economic data increased market expectations for Fed rate cuts later in the year. At the same time, companies continued to deliver revenue and earnings growth, though many revised guidance lower for the balance of 2026. Concerns also began to build around the potential impact of AI on business models, emerging issues in private credit, and rising geopolitical tensions.

By March, geopolitics took center stage. The war in Iran drove oil prices sharply higher, reigniting inflation concerns and prompting a repricing of the Fed's expected rate path. The FOMC held rates steady at both its January and March meetings, noting uncertainty around the economic implications of developments in the Middle East.

While early optimism around rate cuts supported a solid start to the year, \$100 per barrel oil ignited further inflation fears and economic uncertainty ended up reversing those gains in March. The Bloomberg Aggregate Bond Index finished the first quarter slightly negative, down -0.05%. Risk assets weakened as credit spreads widened across sectors, resulting in negative absolute and excess returns for both investment-grade and high-yield bonds. Securitized products were the exception, posting positive returns across MBS, ABS, and CMBS.

Fundamentally, corporate credit markets entered the year well positioned, with both investment-grade and high-yield spreads briefly reaching cycle tights in late January before increased volatility pushed spreads wider. With spread measures historically tight, the market remained vulnerable in the short term as investors priced in greater uncertainty. AI-driven job market friction and private credit concerns that had already been building were compounded by renewed tariff uncertainty, heightened geopolitical tensions, and inflation fears. Investment-grade spreads ended the quarter at 89 bps, widening 11 bps, resulting in a -0.5% decline. The high-yield market performed only slightly better, as higher carry and shorter duration helped offset more substantial spread widening.

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Within high yield, higher quality outperformed. BBs ended the quarter 32 bps wider, while CCCs ended 110 bps wider. Although credit fundamentals remain solid and investor demand has held up well through the recent volatility, corporate credit markets are likely

13 TAXABLE INVESTMENT PROFESSIONALS

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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

to remain vulnerable to continued private credit liquidity fears and geopolitical events in the near term.

Securitized products outperformed credit and Treasuries in the first quarter, with Agency MBS leading early on strong technical demand following the Federal Housing Finance Agency's directive for government-sponsored enterprises (GSEs) to purchase \$200 billion of MBS. Some of this outperformance reversed later in the quarter as rates moved higher and rate volatility increased sharply amid tensions in the Middle East. CMBS and ABS outperformed over the period, benefiting from crossover demand from MBS investors in January, while their lower sensitivity to rate volatility supported relative spread performance. The securitized sector generated 16 bps of excess return and 40 bps of total return for the quarter. The outlook remains constructive, supported by constrained supply and steady demand from GSEs and bank deregulation on the horizon.

Stable economic growth, future rate cuts by the Fed, supportive administration and fiscal policy, and falling volatility in capital markets all supported our view entering 2026 of a positive environment for credit and securitized markets. The war in Iran and the subsequent increase in oil prices has driven volatility and interest rates higher and spreads for fixed income sectors wider, given the increased uncertainty about the impact to both inflation and economic growth. We believe the reaction in the market has been a “risk-rotation move,” as opposed to “risk-off event,” based on fund flows and trading activity. Unless the war were to drag on for several months and oil prices remain elevated for an extended period of time, we would expect this to continue to be the case. As such, active management and our positioning in corporates and high-quality securitized product should leave us well positioned to manage through this current period of increased volatility.

DOMESTIC EQUITY STRATEGIES

The market's string of consecutive quarterly gains ended at three, with Operation Epic Fury and its related shock to energy prices resulting in an official correction from late February's highs. The S&P 500 posted a decline of -4.33% for the quarter. The lack of a quick resolution to the conflict weighed on equity markets, as did the resulting backup in inflation expectations and interest rates. Private credit issues and worries about AI-driven disruption also pressured markets during the quarter. The Supreme Court's ruling overturning Trump's tariffs did not impact markets as it was quickly followed by replacement tariff initiatives under other legal authorities. With oil prices topping \$100 per barrel, Energy stocks soared, gaining 38%. Solid gains were also registered by an eclectic mix of sectors including precious metals-heavy Materials, and defensive Utilities and Consumer Staples. Financials were weak on both higher interest rates and AI disruption fears, while Information Technology wasn't far behind on similar AI concerns.

The broadening of equity market returns was evident in the quarter, as the Russell 2000 eked out a gain of just 0.89% for the quarter. However, its drop from January highs also put it in correction territory. Energy was also the top performer among smaller cap constituents, with its 38% return right in line with large caps. While defensive sectors also posted gains, they were outmatched by returns in Materials and Industrials, both driven by industries that should benefit from the massive buildout of AI infrastructure. The Information Technology sector posted losses driven by continued quantum-computing weakness as well as AI disruption fears impacting software names, while losses in Consumer Discretionary were driven primarily by disappointing earnings among smaller retailers. Style factors had a mixed impact on smaller cap names, with a slight benefit to higher-quality attributes.

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Large cap value stocks had a huge performance advantage over growth to start the year, outperforming by nearly 12 percentage points. Value stocks in all market sectors outperformed their growth counterparts, although the largest impacts were driven by the value-heavy Energy sector's huge gains and the growth-heavy IT sector's broad losses. Among small cap stocks, the differential was not quite as dramatic at nearly 8 percentage points, with Energy and IT again having the biggest impacts.

14 | EQUITY INVESTMENT PROFESSIONALS

27 | AVERAGE YEARS EXPERIENCE

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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

While we were correctly optimistic on the broadening of stock market returns entering the new year, and on the positive outlook for earnings, we surely did not anticipate the war in Iran and its impact on energy prices, inflation, interest rates, economic growth, or geopolitical stability. The ultimate timing of any resolution of the conflict, or even a de-escalation in rhetoric and normalization of traffic through the Strait, will likely be the primary driver of both the economic and stock market outlook. We have no better insight than that of the many pundits we hear from every day. So rather than speculate where we are going, let's summarize where we stand. The economy is in surprisingly decent shape. Despite labor worries, the job market remains healthy. ISM survey work shows expansion in not only services, but, for three months now, in manufacturing as well. Consumer data remains mixed, with anxiety levels rather high but spending still resilient. Corporate earnings remain solid, with expectations still calling for double-digit earnings growth despite the conflict. Corporate and personal balance sheets remain flush with cash, with good support for stock buybacks, dividends, and asset purchases. And despite all the worries about AI losers, we are only starting to see the productivity benefits of the broad adoption of AI. Were it not for Iran, stock markets would likely still be reaching new highs. The key is the duration of this war. A rather swift resolution from here would suggest we have not derailed the economy. Markets could quickly return to their winning ways. A slower resolution would have a more pronounced impact on all that matters to investors: profits, growth, inflation, interest rates, and uncertainty.

Yet, all of this uncertainty has not changed our investment focus. Yes, on the margin we have repositioned modestly to take into account volatile stock price movements and evolving views of both the conflict and our AI-driven future. But at our core we remain committed to investing in companies that are well positioned in their sectors, and best managed to take us through challenging periods and come out stronger on the other side.

GLOBAL EQUITY STRATEGIES

Global equity markets began 2026 with strong momentum. That strength reversed abruptly in March as the outbreak of war involving Iran caused a sharp deterioration in investor sentiment. For the quarter, the MSCI World ex USA Index declined -0.94%, underperforming the MSCI World ex USA Small Cap Index, which fell -0.37%. The magnitude of the market shift is best illustrated by small caps: an -11.18% decline in March erased gains of 6.10% in January and 5.72% in February. Over the same period, the US dollar strengthened modestly, ending the quarter approximately 1.7% higher.

If not for the war the focus this quarter would likely have been on precious metal strength (now weakness), sell-off in AI 'losers' (still ongoing), notably software and some business services, and private credit concerns (getting worse, although much less of a risk outside the US). These issues have not gone away but are currently overshadowed by the war and its impact on the petrochemical industry.

It has not gone unnoticed that the EU and Asia, neither region directly involved in the war, will see a greater impact than North America. Asia is likely to see the brunt of the damage as the region sources a large portion of their oil and petrochemical needs from the Persian Gulf. While oil is a concern, the real risk is a potential shortage of refined products such as naphtha, diesel, and jet fuel. Asia also sources much of its natural gas from the region which will likely be replaced by coal, as it was in 2022. Using the 2022 disruption in energy markets as a guide tells us that increasing feedstock prices will have a short-term negative impact on company profits in the coming quarters, at least until contract pass-through mechanisms take effect. However, unlike 2022, the risk of shortages, regardless of price, is higher and will have unpredictable but clearly negative repercussions for the global economy.

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Europe faces similar challenges, though with some mitigation. While alternative natural gas sources exist, they are likely to be secured only at higher prices, further straining an already under pressure chemical sector. Ultimately, the duration of the Strait of Hormuz disruption will be the key determinant of economic impact. A reopening within weeks would likely result in manageable, albeit visible, damage. A prolonged closure would raise the risk of widespread shortages cascading across global supply chains.

9 EQUITY INVESTMENT
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GW&K GLOBAL EQUITY STRATEGIES

GLOBAL SMALL CAP

INTERNATIONAL SMALL CAP

In such a scenario, developed markets would likely see renewed inflationary pressures. North America, while relatively insulated from direct supply effects, would not be immune to the indirect consequences of global shortages over time.

Against this backdrop, higher interest rates and renewed inflation risk have reentered the market conversation. Even prior to the conflict, yields had begun moving higher in Australia and Japan. These dynamics may also help explain recent weakness in precious metal prices. Meanwhile, sentiment around AI remains broadly constructive, though investors continue to debate the durability and ultimate profitability of the current investment cycle. From our perspective AI capabilities have advanced meaningfully over the past six months, driving rapidly rising adoption and spending across industries. At the same time, current pricing structures appear heavily subsidized, raising important questions about eventual return economics and long-term competitive winners.

So much change, so fast, usually means significant opportunity. However, higher energy prices are an absolute negative for many companies and product shortages are even worse. As in past periods of market stress, our high-quality bias and focus on companies with strong balance sheets should position us well in the current environment. Prior to the war the markets were very strong, and we would expect that strength to return when traffic in the Strait normalizes. In the meantime, we have been active in adjusting the portfolio's positioning to emphasize our highest conviction investments, selling out of businesses we see at risk, and adding new positions that meet our, recently elevated, criteria.

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