GW&K INVESTMENT MANAGEMENT

TAXABLE BOND
MONTHLY COMMENTARY

SEPTEMBER 2021

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A series of negative catalysts swept through the fixed income market, prompting investors to question the pace of the global recovery and driving a risk-off tone in equities (S&P 500 fell -4.8%). Among the concerns were elevated leverage in the Chinese real estate market, domestic uncertainty surrounding fiscal and monetary stimulus, gamesmanship around the debt ceiling, and the lingering impact of COVID-19 across supply chains. The debate about the persistence of inflationary pressures continued to escalate as well.

The September FOMC meeting saw an uptick in the number of committee members expecting the first 25 basis point hike in 2022. Projections also guided to three hikes in each of the two years thereafter. The futures market shows investors concur on the timing of the first hike, but are far more skeptical in the out years, projecting just four hikes through 2024. QE tapering is essentially a lock to start in the fourth quarter and conclude in the middle of 2022.

The Treasury market traded in an extremely tight range right up until the FOMC signaled it was edging closer to a wind down of its bond buying program. From there, rates sold off sharply and posted one of their worst weeks of the year. Real yields, which are a proxy for growth expectations, led the selloff and took the rate on the 10-year Treasury to its highest level since June. Inflation expectations remained anchored, with the breakeven inflation rate closing only 4 basis points higher on the month. The long end of the yield curve outperformed intermediate tenors, benefiting from lower expectations for global growth and strong demand from overseas.

Despite the choppiness in equities and a record-breaking primary market, corporate bond spreads were remarkably resilient, closing marginally tighter for the month. The relatively strong performance of the sector amid the volatility elsewhere speaks to the robust strength of corporate balance sheets. Demand from investors in both the U.S. and abroad remains extremely supportive as well, informed by expectations of strong profit growth in the third quarter.

Lower interest rate volatility and higher Treasury yields led to moderately tighter spreads in the MBS space. Higher coupons outperformed due to their higher carry and lower duration profile in a rising rate environment. Our view of the sector remains neutral given its negative convexity, the prospect of an eventual end to the FOMC's bond buying program, and spreads near fair value.

U.S. economic growth has likely peaked, yet the outlook for final demand remains firm. Heightened virus concerns and lingering supply-chain issues have continued to weigh on economic momentum, even though both issues appear poised to improve over the intermediate-term. Meanwhile, consumer optimism, an improving labor market, and still-accommodative monetary policy should continue to drive the economic recovery. With respect to inflation, both the bond market and the FOMC seem to be holding to the belief that it will prove transitory, while the upcoming taper and improving supply chains could serve to validate this view. The most likely source of near-term volatility is likely to surround the Fed's efforts to taper its bond purchases without signaling an excessively hawkish view of rates.

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U.S. Treasury Market - September 30, 2021							
	9/30/21	Yield Change (bps)			Performance		
Maturity	Yield	MTD	QTD	YTD	MTD	QTD	YTD
2-year	0.28%	+7	+3	+16	-0.09%	0.10%	-0.03%
5-year	0.97%	+19	+8	+61	-0.88%	-0.15%	-1.92%
10-year	1.49%	+18	+2	+57	-1.81%	-0.07%	-4.24%
30-year	2.05%	+11	-4	+40	-3.31%	0.39%	-8.90%

Source: Bloomberg, FactSet

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

INDEX CHARACTERISTICS AND PERFORMANCE

September 30, 2021	CHARACTERISTICS			PERFORMANCE		
Index	Yield to Worst	OAD (Years)	OAS (bps)	MTD	QTD	YTD
Bloomberg U.S. Aggregate Bond	1.56%	6.71	33	-0.87%	0.05%	-1.55%
U.S. Treasury	1.01%	7.06	0	-1.08%	0.09%	-2.50%
Bloomberg U.S. Government Related	1.39%	6.06	40	-1.02%	-0.10%	-1.29%
Bloomberg U.S. Corporate Investment Grade	2.13%	8.71	84	-1.05%	0.00%	-1.27%
Bloomberg U.S. Mortgage-Backed Securities	1.83%	4.62	27	-0.36%	0.10%	-0.67%
Bloomberg U.S. Asset-Backed Securities	0.62%	2.26	29	-0.15%	0.05%	0.23%
ICE BofA Fixed Rate Preferred Securities	2.47%	4.80	119	-0.05%	0.22%	2.21%
Bloomberg High Yield	4.04%	3.97	289	-0.01%	0.89%	4.53%
Bloomberg High Yield - BB	3.18%	4.76	203	-0.21%	1.09%	3.83%
Bloomberg High Yield - B	4.47%	3.14	327	0.11%	0.61%	3.98%
Bloomberg High Yield - CCC	6.26%	2.75	524	0.52%	0.75%	8.00%
Bloomberg High Yield BB 1-5 Year	2.39%	2.30	182	-0.05%	0.56%	3.44%

Source: FactSet

September 30, 2021	CHARACTERISTICS		
Strategy	Yield to Worst	Current Yield	OAD (Years)
GW&K Short-Term Focused High Income Strategy	2.86	4.95	3.07
Bloomberg High Yield BB 1-5 Year	*2.39*	*5.10*	*2.30*
GW&K Corporate Bond Opportunities Strategy	3.10	4.53	5.53
60% Bloomberg High Yield / 40% Bloomberg U.S. Credit	*3.24*	*4.51*	*5.76*
GW&K Total Return Bond Strategy	2.56	4.16	5.92
60% Bloomberg Govt/Credit / 40% Bloomberg High Yield	*2.49*	*3.52*	*6.14*
GW&K Enhanced Core Bond Strategy	2.06	3.58	6.20
GW&K Core Bond Strategy	1.86	3.23	6.28
Bloomberg U.S. Aggregate Bond	*1.56*	*2.35*	*6.71*
GW&K Intermediate Taxable Bond Strategy	1.60	3.27	4.02
Bloomberg U.S. Intermediate Aggregate Bond	*1.29*	*2.16*	*4.34*
GW&K Short-Term Taxable Bond Strategy	0.91	2.71	2.96
Bloomberg 1-5 Year Govt/Credit	*0.63*	*1.71*	*2.78*

Source: Bloomberg, FactSet

Disclosures

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