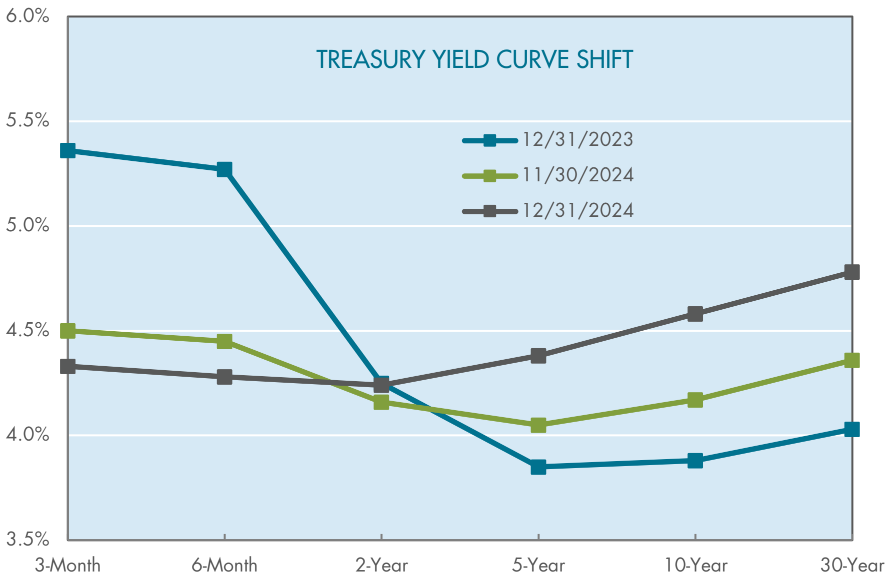
GW&K INVESTMENT MANAGEMENT

TAXABLE BOND
MARKET REVIEW & OUTLOOK

KEY TAKEAWAYS

- The US economy remains resilient heading into 2025, buoyed by a solid job market and strong consumer spending. Core inflation has stalled above the Fed's 2% target and is at its highest point since April.
- Rates sold off sharply across the yield curve as heightened sensitivity to inflation risks and a significant downgrade to the Fed's projected easing path drove Treasury yields toward their 2024 highs.
- All sectors of the Bloomberg US Aggregate Bond Index posted negative returns for December. Duration was the biggest underperformer, with the 30-year Treasury returning -6.1%. In contrast, the 2-year note posted a near breakeven return.

TAXABLE BOND MARKET UPDATE & OUTLOOK



Sources: FactSet and Bloomberg

US TREASURY YIELDS

	12/31/23	11/30/24	12/31/24	MTD Change (bps)	YTD Change (bps)
3-Month	5.36%	4.50%	4.33%	-17	-103
6-Month	5.27%	4.45%	4.28%	-17	-99
2-Year	4.25%	4.16%	4.24%	+8	-1
5-Year	3.85%	4.05%	4.38%	+33	+53
10-Year	3.88%	4.17%	4.58%	+41	+70
30-Year	4.03%	4.36%	4.78%	+42	+75

FIXED INCOME SECTOR PERFORMANCE

	MTD	YTD
Bloomberg Aggregate Index	-1.64%	1.25%
US Treasuries	-1.54%	0.58%
Investment Grade Corporates	-1.94%	2.13%
Mortgage-Backed Securities	-1.65%	1.20%
Asset-Backed Securities	-0.05%	5.02%
Taxable Municipal Bonds	-3.17%	0.09%
High Yield Corporate Bonds	-0.43%	8.19%

- The Fed cut rates 25 basis points (bps) as expected, but in a hawkish shift, signaled a shallower easing path moving forward. Further reductions in the fed funds rate hinge on progress around stubbornly high inflation.
- The market repriced the number of expected rate cuts by the end of 2025 from the three projected at the end of November to just under two cuts.
- Ten-year and 2-year Treasury yields rose 9 and 40 bps, respectively, sending the yield curve to its steepest level since May 2022.
- Investment grade corporates lagged the overall market and rates, given their longer duration profile and modestly wider spreads. Strong corporate fundamentals and the outsized demand for high-quality yield support a near multi-year low in spreads.
- The high yield sector was the best-performing asset class in the taxable bond market given its attractive carry and overall shorter duration. Spreads widened modestly, but at below 300 bps option-adjusted spreads remain firmly below their longer-term average. Yields at 7.5% provide an attractive equity-like return.
- Mortgage-backed securities performed in-line with the overall market. Technicals lean slightly positive with low seasonal turnover and high mortgage rates keeping originations low, providing a tailwind for the sector.
- Asset-backed securities (ABS) marginally outperformed similar duration Treasuries. Excess yield and modest spread tightening drove the outcome.
- The biggest risk to the market is if inflation stays at these higher levels, forcing a higher-for-longer strategy from monetary officials. We also see the potential for wider tail risks under the incoming administration's fiscal policies.

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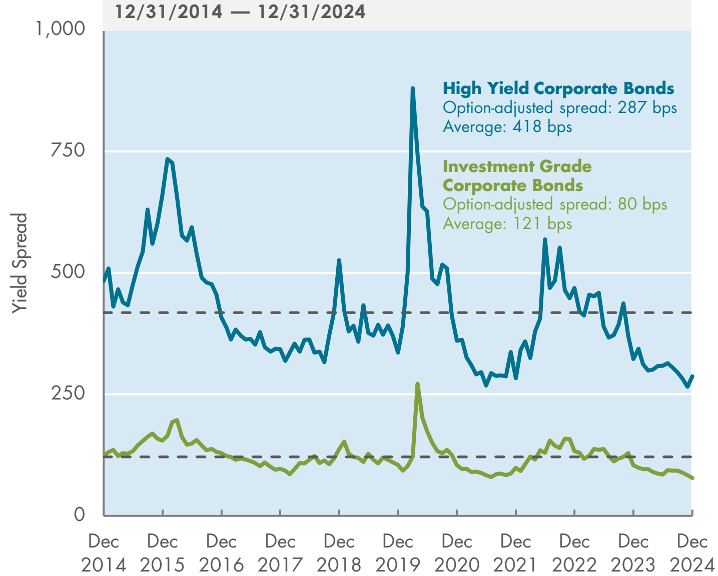
SECTOR ALLOCATION	POSITIONING
DURATION & YIELD CURVE	We are neutral duration. The backup in yields and recalibration of the Fed's policy is discounted, leading us to believe we have likely seen the peak in rates. The Fed remains skewed toward an easing path as inflation normalizes. This backdrop should help anchor the short-to-intermediate part of the yield curve, while investor appetite for absolute yield should continue to limit further weakness in longer maturities.
TREASURIES	We favor spread product over Treasuries in this attractive carry environment. Rates remain attractive relative to post-global financial crisis (GFC) history. Further significant weakness is likely to be capped by investors seeking compelling absolute yields.
GOVERNMENT RELATED	We are overweight in taxable municipal bonds given the strong fundamentals and recession-resistant characteristics offered by the asset class.
CORPORATE BONDS	We continue to be overweight in the corporate bond sector. The ongoing strength of the US economy, gradually moderating inflation, and some of the highest yields seen in the bond market post-GFC offer a compelling setup for risk assets to be emphasized for the positive carry.
SECURITIZED	We are overweight in the securitized sector. Low refinance activity and slow seasonal housing turnover have led to benign supply, offering a tailwind to the sector. Spreads remain above historical levels and the sector should benefit from a positive technical environment in 2025. Asset-backed securities remain a good source of income in low-duration, high-quality bonds.

HIGH YIELD & INVESTMENT GRADE CORPORATE BOND SPREADS

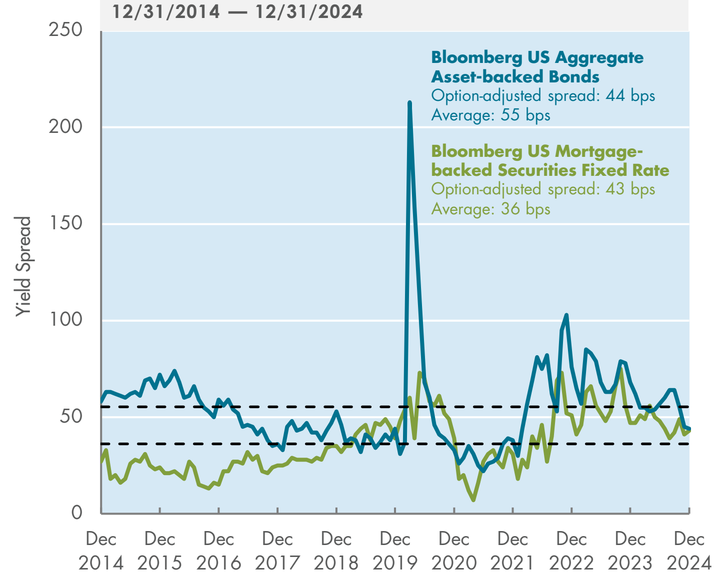
12/31/2014 — 12/31/2024



Source: Bloomberg

ASSET- & MORTGAGE-BACKED SPREADS

12/31/2014 — 12/31/2024



Source: Bloomberg