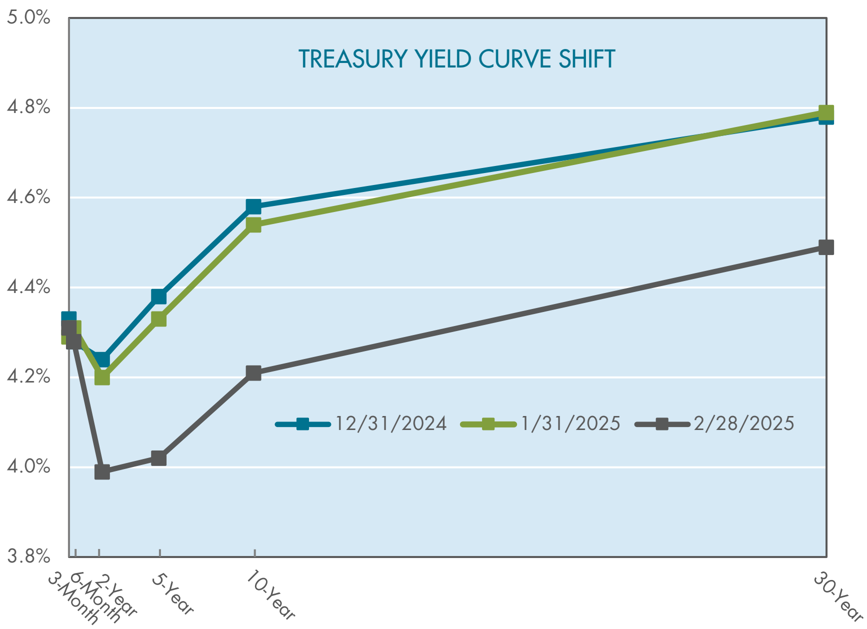
GW&K INVESTMENT MANAGEMENT

TAXABLE BOND
MARKET REVIEW & OUTLOOK

KEY TAKEAWAYS

- Signs of weakening US consumer confidence and spending, and a slowing service sector and housing market, all signaled slower than expected growth and — combined with elevated inflation and policy uncertainty — stirred concerns of stagflation in the market.
- The Fed's favored inflation metric cooled to a 2.6% annualized pace, but remains well above the Fed's target rate. Slow progress on taming price pressures overall should keep policymakers cautious on further easing.
- The bond market saw a significant rally on renewed growth concerns. Interest rates ended the month at their lowest levels of the year.

TAXABLE BOND MARKET UPDATE & OUTLOOK



Sources: FactSet and Bloomberg

US TREASURY YIELDS

	12/31/24	1/31/25	2/28/25	MTD Change (bps)	YTD Change (bps)
3-Month	4.33%	4.29%	4.31%	+2	-2
6-Month	4.28%	4.31%	4.28%	-3	0
2-Year	4.24%	4.20%	3.99%	-21	-25
5-Year	4.38%	4.33%	4.02%	-31	-36
10-Year	4.58%	4.54%	4.21%	-33	-37
30-Year	4.78%	4.79%	4.49%	-30	-29

FIXED INCOME SECTOR PERFORMANCE

	MTD	YTD	Yield to Worst
Bloomberg Aggregate Index	2.20%	2.74%	4.58%
US Treasuries	2.16%	2.68%	4.14%
Investment Grade Corporates	2.04%	2.60%	5.08%
Mortgage-Backed Securities	2.55%	3.07%	4.85%
Asset-Backed Securities	0.97%	1.30%	4.55%
Taxable Municipal Bonds	3.25%	3.56%	5.14%
High Yield Corporate Bonds	0.67%	2.05%	7.15%

- Declining consumer confidence, a big miss in retail sales, softer services data, and slower housing starts with lower builder confidence have dampened the outlook for Q1 GDP growth. DOGE, and the consequences of a shrinking US federal footprint, are also weighing on growth sentiment.
- The labor market report was a bit weaker than expected, but an uptick in average hourly earnings and positive revisions struck just the right note to allow the Fed to stay on the sidelines and remain vigilant in the fight against inflation. Jobless claims have ticked up in recent weeks but can be traced to seasonal-adjustment factors.
- The yield curve saw a significant bull flattening, as 10-year and 2-year Treasuries rallied 28 and 15 bps, respectively. The 2s/10s yield spread relationship sits at its tightest level since mid-December. The 3-month/10-year relationship moved back into negative territory, from its recent high of 47 bps in mid-January.
- The futures market is pricing in 2.75 rate cuts (68 bps) for 2025, with the first full cut coming in June.
- Reduced risk sentiment drove investment grade (IG) and high yield (HY) spreads wider by 8 and 20 bps, respectively. This marks the weakest monthly spread performance for IG since June 2024, and the widest spread level since early October. HY spreads reached their widest level since early January. Despite the rate rally, yields in the corporate sector remain attractive on a post-global financial crisis (GFC) basis.
- The securitized sector outperformed comparable-duration Treasuries, primarily fueled by the strength in mortgage-backed securities. Although rate volatility posed a challenge, spreads tightened as the market welcomed a cautious tone from administration officials on government-sponsored enterprise (GSE) reform. Asset-backed securities slightly underperformed overall; however, larger auto and credit card sectors delivered positive excess returns for the month.

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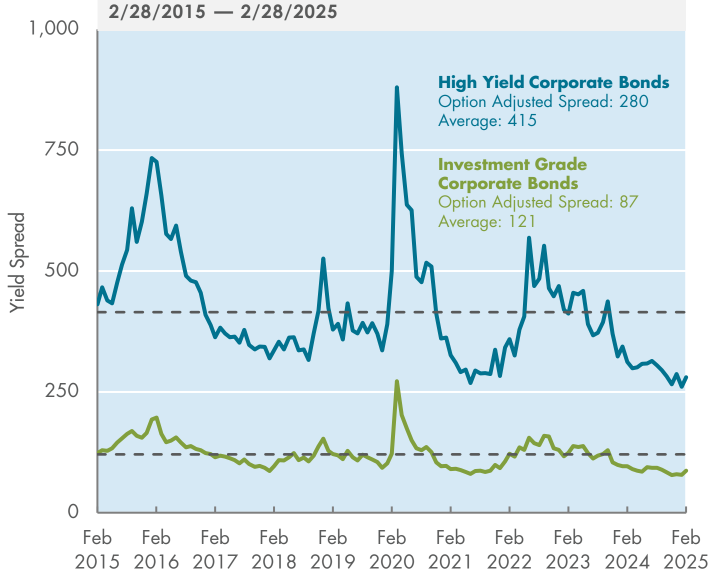
SECTOR ALLOCATION	POSITIONING
DURATION & YIELD CURVE	We are neutral duration. Higher inflation alongside recent weakness in the growth outlook complicates the Fed's dual-mandate mission. For now, the market seems content that the disinflationary process will continue, allowing the Fed to support the economy in the event of downside growth or policy missteps. The administration's policies around tariffs and DOGE adds further uncertainty to the market.
TREASURIES	Despite the recent rally, rates remain attractive relative to post-global financial crisis (GFC) history. However, we favor capturing that yield in spread products rather than Treasuries in this attractive carry environment.
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 are overweight the corporate bond sector. Solid growth, 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. We continue to have an up-in-quality bias.
SECURITIZED	We are overweight 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 going forward. Asset-backed securities remain a good source of income in low-duration, high-quality bonds.

HIGH YIELD & INVESTMENT GRADE CORPORATE BOND SPREADS

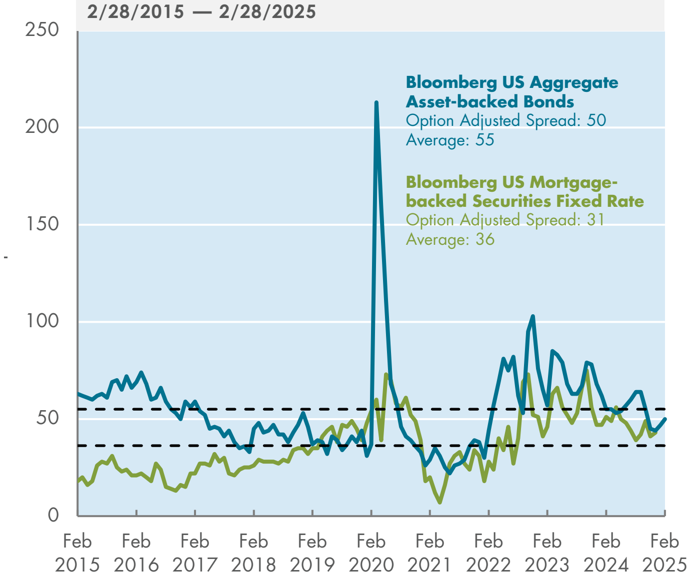
2/28/2015 — 2/28/2025



Source: Bloomberg

ASSET- & MORTGAGE-BACKED SPREADS

2/28/2015 — 2/28/2025



Source: Bloomberg