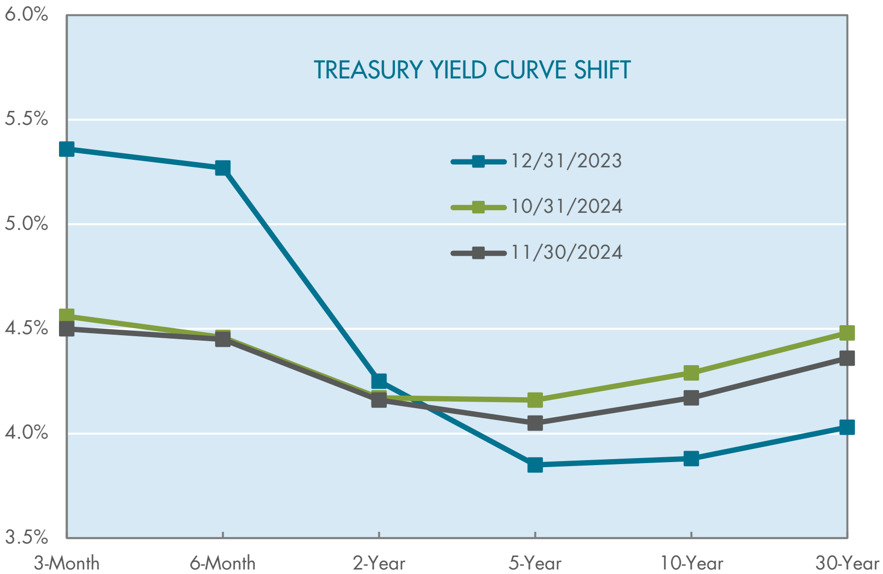
GW&K INVESTMENT MANAGEMENT

TAXABLE BOND
MARKET REVIEW & OUTLOOK

KEY TAKEAWAYS

- Interest rates finished marginally lower in a volatile month with a market captivated by the much-anticipated election and related investment implications.
- As widely expected, the US Federal Reserve (Fed) cut the funds rate by 25 bps to a target range of 4.50% – 4.75%, bringing cumulative cuts for this cycle to 75 bps. Fed Chair Powell signaled they were in no hurry to lower rates further.
- The biggest risk to the economy is inflation staying at these higher levels just as the labor market is cooling. This could force a higher-for-longer strategy from monetary authorities that could tip the economy into a downturn. We also see the potential for wider tail risks under the new administration's policies.

TAXABLE BOND MARKET UPDATE & OUTLOOK



Sources: FactSet and Bloomberg

US TREASURY YIELDS

	12/31/23	10/31/24	11/30/24	MTD Change (bps)	YTD Change (bps)
3-Month	5.36%	4.56%	4.50%	-6	-86
6-Month	5.27%	4.46%	4.45%	-1	-82
2-Year	4.25%	4.17%	4.16%	-1	-9
5-Year	3.85%	4.16%	4.05%	-11	+20
10-Year	3.88%	4.29%	4.17%	-12	+29
30-Year	4.03%	4.48%	4.36%	-12	+33

FIXED INCOME SECTOR PERFORMANCE

	MTD	YTD
Bloomberg Aggregate Index	1.06%	2.93%
US Treasuries	0.78%	2.15%
Investment Grade Corporates	1.34%	4.14%
Mortgage-Backed Securities	1.33%	2.89%
Asset-Backed Securities	0.70%	5.07%
Taxable Municipal Bonds	1.88%	3.37%
High Yield Corporate Bonds	1.15%	8.66%

- The yield curve moved to a flat position with longer-term 10-year Treasury yields declining 11 basis points (bps) to 4.17%, while the 2-year Treasury yield closed only 2 bps lower at 4.16%.
- Following the decisive outcome of the election, interest-rate volatility declined significantly from its one-year peak, toward the bottom-end of its year-to-date trading range.
- The Bloomberg US Aggregate Bond Index returned approximately 1%, with all sectors of the market delivering positive total returns. The bond market has eked out close to a 3% return year to date.
- The economy continued to show remarkable resilience with the Federal Reserve Bank of Atlanta's Q4 GDPNow model estimating a solid 2.7% growth pace. The US economy remains supported by a confident consumer and a strong labor market.
- Inflation remained sticky with the Fed's favored measure running at 2.8% year-over-year, still well above its 2% target range.
- At the end of November, the futures market was pricing a 3.75% fed funds rate by the end of 2025, where in September it once saw 2.75%.
- Investment grade and high yield corporate bonds saw modest spread tightening of 6 and 17 bps, respectively, offering modest excess returns relative to Treasuries. The sector continues to benefit from solid corporate earnings and strong investor demand for high-quality yield.
- Agency mortgage-back securities outperformed similar duration Treasuries, reversing all the underperformance seen in the prior month. The sector benefited from lower volatility and the potential for reduced bank regulation under the new administration.

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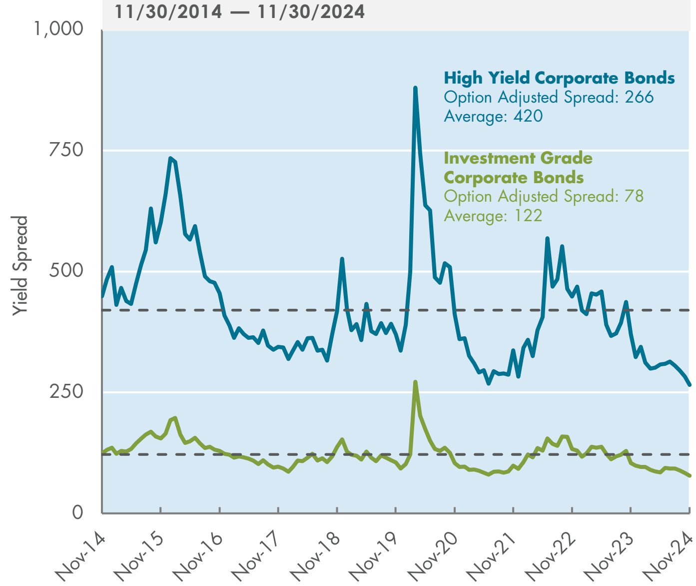
SECTOR ALLOCATION	POSITIONING
DURATION & YIELD CURVE	We are neutral duration. With the Fed recalibrating before declaring total victory on inflation, and with fiscal policy still aggressively stimulative, the yield curve could see longer rates sell off. We are focused on the intermediate part of the yield curve where we find the best risk-adjusted value in the spread sectors.
TREASURIES	We are underweight Treasuries, favoring spread product in this attractive carry environment. Rates remain attractive relative to post-GFC history. Further significant weakness is likely to be capped by investors seeking compelling absolute yields.
GOVERNMENT RELATED	We are overweight taxable municipal bonds given strong fundamentals and the recession-resistant characteristics offered by the asset class.
CORPORATE BONDS	We continue to overweight the corporate bond sector. A soft- or no-landing scenario is a supportive setup for risk assets and their positive carry. However, spreads are historically tight and further moves lower from here are likely limited.
SECURITIZED	We are overweight the securitized sector. Valuations for mortgage-backed securities look attractive at these levels. Technicals should improve with increased bank demand amid deregulation and if rate volatility falls further. Asset-backed securities are structurally protected from losses and offer attractive spreads at the front end of the curve.

HIGH YIELD & INVESTMENT GRADE CORPORATE BOND SPREADS

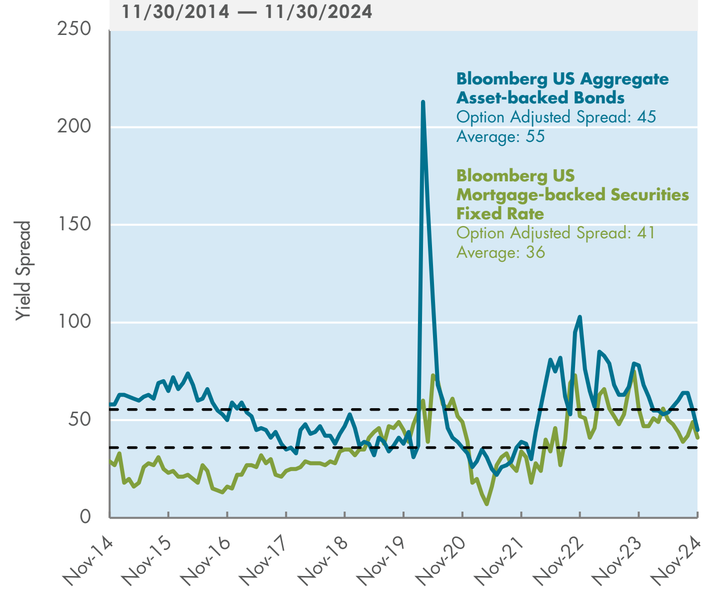
11/30/2014 — 11/30/2024



Source: Bloomberg

ASSET- & MORTGAGE-BACKED SPREADS

11/30/2014 — 11/30/2024



Source: Bloomberg