GW&K INVESTMENT MANAGEMENT

INVESTMENT REVIEW
1Q 2022

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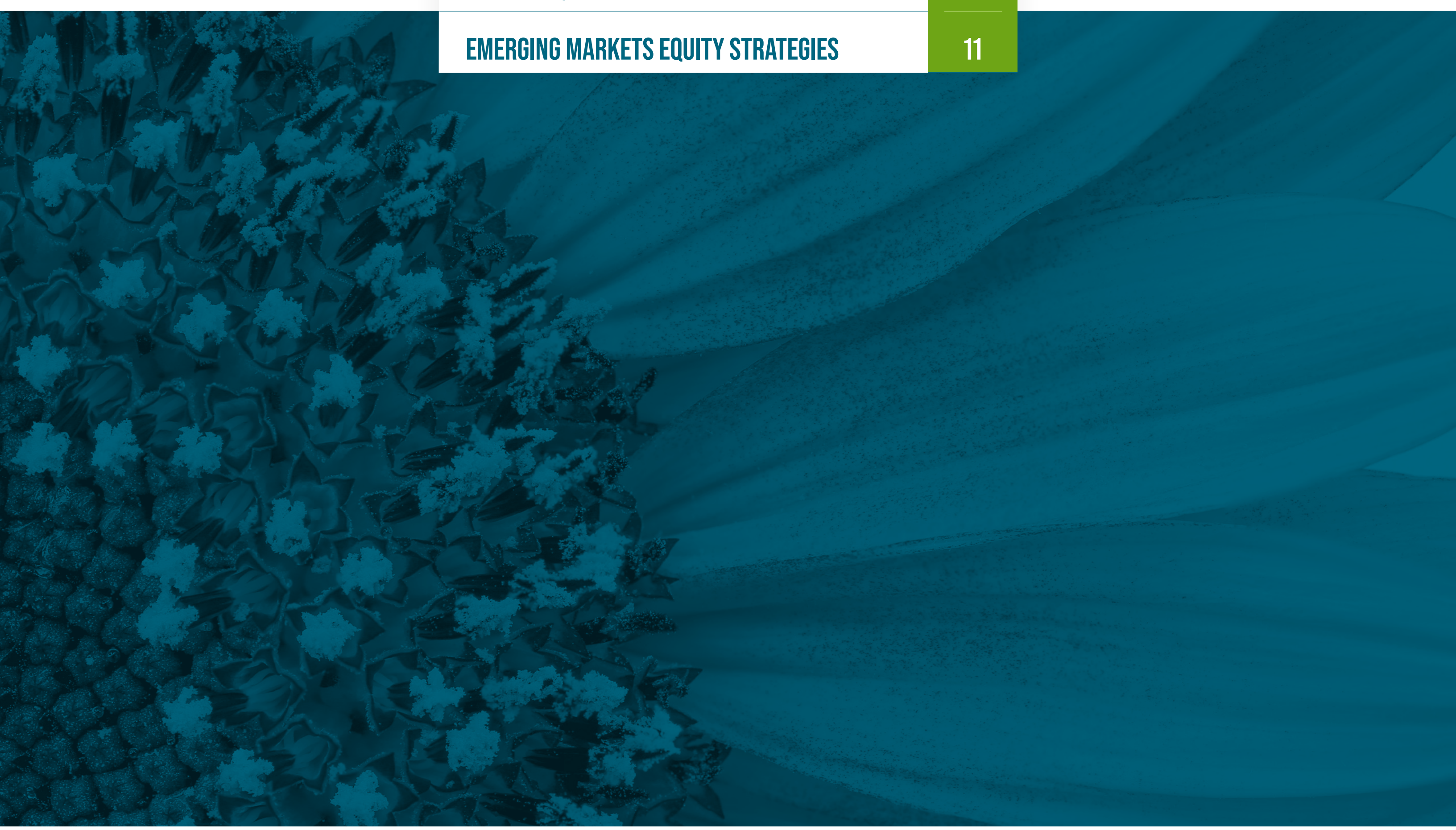

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ECONOMIC COMMENTARY

BY HAROLD G. KOTLER, CFA

GW&K Chief Executive Officer,
Chief Investment Officer

Now what? It feels as though President Vladimir Putin has overplayed his hand and made a drastic mistake. He has unleashed death and destruction on the Ukrainian people and paid for it with the lives of thousands of Russian soldiers. To what end?

He could easily have negotiated a settlement that resulted in a Ukrainian government unaligned with NATO, or one that declared neutrality within the European theatre. If Putin believed that the country would fall and accept the Russian way of life, he was too late—a generation of Ukrainians have felt the spirit and freedom of the West and are not willing to go back to the stark and dark years of Russian oppression.

There is so much irony in the unintended consequences of the invasion. Before the offensive, in the midst of a peaceful Europe, NATO was dying. Defense expenditures of member countries as a percentage of GDP was growing less and less. But now the alliance has awakened. I can't imagine a worse outcome for Russia than to have Germany rearm. For years, Germany had been willing to retreat from the arms race given their long history, but now the economic powerhouse of the continent has reengaged.

Credit must be given to the U.S. and most of the world for creating a line in the sand. Not only have governments been supportive of Ukraine, but maybe more importantly, the private sector has pulled the plug on Russian commerce. The free world, public and private, is as united as it has been since World War II. This was not Putin's plan.

As an isolated dictator Putin has made a huge mistake, a not so infrequent result for those who rule with absolute authority. Whether it be Hitler invading the Soviet Union and creating a war on two fronts, which in the end was his downfall, or Saddam Hussein convincing the world he had weapons of mass destruction, which we now know he did not, even the most ruthless of despots fail without a team of strategic advisors. The old Soviet system had a Politburo and internal rivals, but, like Stalin, Putin is alone at the top and it seems his decision to invade went unchallenged. The Russian army is top heavy and unable to adjust to events on the ground. Putin believed that simply throwing waves of soldiers and armaments into the arena would win battles. But we have seen in other military theaters how dramatically the style of fighting has changed. Technology, force coordination capabilities, and contingency planning are all key to success. A lumbering army approach, as in World War II, is antiquated.

> *"If the war doesn't end quickly, rising energy prices combined with rising interest rates will have a meaningful impact on economic growth. The Federal Reserve is quite aware of these compounding factors and will likely raise rates slower if oil and gas prices climb from here."*

By now, it seems clear that Russia will not defeat Ukraine. The Ukrainian people are not going to give in or give up. It could be another Afghanistan for the Russian army, but it seems more likely that there will be some kind of settlement. Body bags have a way of forcing resolutions, as we saw in Vietnam. The cost to the Russian economy is real and probably unsustainable. While

Continued on next page

Putin made the mistake, the West now needs to figure out a way that he can save face. He believed he needed to stop Ukraine from joining NATO. That's easy—Ukraine does not join NATO. Maybe a few of the eastern provinces join the Russian sphere. The world needs to find the right formula for the war to end. Maybe a UN armistice line will be required. Ukraine, Russia, and NATO need to find a negotiable solution.

Then there are the other issues staring investors in the face—interest rates, inflation, and China's policy toward the conflict. If the war ends and the price of oil and gas retreats, it will take a lot of pressure off the economy and monetary policy. I always have argued that rising commodity prices produce deflationary pressure as consumers see their available discretionary spending get squeezed. Unlike other goods and services, it is difficult to substitute for oil and gas. We can drive less or adjust thermostats, but we need what we use. The U.S. has come a long way since the 1973 oil embargo, making strides in productivity and efficiency standards, but the price of fuel is still a critical input cost for the economy.

If the war doesn't end quickly, rising energy prices combined with rising interest rates will have a meaningful impact on economic growth. The Federal Reserve is quite aware of these compounding factors and will likely raise rates slower if oil and gas prices climb from here.

One last thought: I believe the Chinese government will give lip service to Putin but will stay out of Russia's fight. China needs Russia to be an opponent of the West so Beijing is not isolated, but they will not throw away 40 years of progress and risk U.S. economic retaliation for sending arms to Russia. The Chinese population has reaped the benefits of Western trade and although the U.S. and China are the two largest global economies, theirs will be a commercial and technological battle, not a clash between militaries.

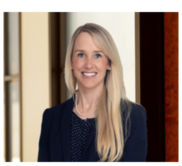
My conclusion is that the West has woken up. An armed land war, almost inconceivable a few months ago, will remind the world of its terrible costs. I thought COVID had taught us that we were all in this together; Putin didn't get the message then, but he has now. The world will tolerate competing economic combat, but with exception of local skirmishes, hot wars are off the table. Nations across the world will unite against the aggressors. What a great lesson, which gives me real hope that some good will come from this mess and that the European people can once again enjoy the benefit of global trade, technology, and ingenuity.

In short, this too shall pass. Keep the faith and stay invested.

Harold G. Kotler, CFA
GW&K Chief Executive Officer, Chief Investment Officer

GW&K NEWS

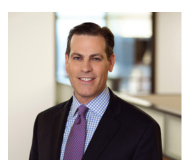
KARA SOUTH JOINS GW&K'S MUNI TEAM



Kara M. South, CFA, Principal
Municipal Bond Portfolio Manager

Kara is a seasoned fixed income manager with deep knowledge of the market, including experience managing taxable municipal bonds and ESG strategies. Kara will draw on her extensive research and management expertise in the evaluation of market risks, opportunities and strategic portfolio positioning for all of our municipal bond strategies. As our municipal bond assets grow, we continue to add skilled professionals to our investment team. We welcome Kara to GW&K and look forward to her contributions to the company and the municipal bond team.

GW&K ANNOUNCES NEW PARTNER



Brian T. King, CFA, Partner
National Sales Manager

Brian has spent more than a decade at GW&K in sales and service roles, and several years at our partner firm, AMG Funds LLC, where he focused specifically on supporting GW&K strategies. With over two decades of experience building trusted partnerships with both advisors and clients, this promotion underscores our commitment to client focus, partnership, and investment success. We are fortunate to have a professional of Brian's caliber help us provide a broad spectrum of top-tier investment solutions and resources for our clients. We look forward to Brian's continued success.

59 INVESTMENT PROFESSIONALS

23 AVERAGE YEARS EXPERIENCE

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FIRST QUARTER 2022

ECONOMY

- The U.S economy added 1.7 million jobs in the first quarter, but faces rising headwinds from surging inflation, ongoing supply-chain and labor constraints, and tightening financial conditions.
- Although the Omicron wave has largely been contained, its influence along with inflation pressures helped restrain first-quarter GDP growth to a sluggish 1.5% according to a Bloomberg survey.
- Higher energy prices triggered by Russia's invasion of Ukraine added to inflation pressures and curbed real income growth, with the Consumer Price Index for February up 7.9% from a year earlier.
- Post-Omicron reopening, robust corporate profit growth, strong household balance sheets, and a very tight labor market should support continuing economic expansion in 2022, albeit at a slower pace than seen in 2021.

BOND MARKETS

- Fixed income markets experienced their worst quarter in more than four decades amid an extraordinary confluence of economic and geopolitical shocks.
- The Treasury market declined almost 10% on a total return basis since its 2020 peak. Rates across the yield curve jumped in response to persistently high inflation and the likely policy actions necessary to tame it.
- Corporate bonds declined significantly, though most of this weakness was the result of the selloff in rates. On a spread basis, credit experienced only modest widening that was largely technical in nature.
- The volatility in Treasuries had a destabilizing effect on municipal bonds, which posted the worst quarter of performance in 40 years. Mutual funds experienced over $20 billion of outflows, a sharp reversal from the strong technical environment of 2021.

FED ACTION

- In response to surging inflation, Fed officials initiated a new tightening cycle in March with a quarter-point rate hike. They also ended the asset-purchase program and set the stage for future balance-sheet reduction.
- The Fed's latest action brings the federal funds target range to 0.25%–0.50%, with a series of rate hikes likely projected at future meetings of the FOMC.
- The market is now pricing in nearly 225 basis points of additional rate hikes this year, including several half-point hikes, with the federal funds rate seen peaking at around 3% in 2023.
- The Fed's new focus on being "nimble" means it could hike rates either more quickly or more slowly than investors now expect, depending on the future path of growth and inflation.

	3/31/22	
	QUARTER	YEAR TO DATE
Bloomberg 10-Year Municipal Bond Index	-6.23%	-6.23%
Bloomberg Aggregate Bond Index	-5.93%	-5.93%
Bloomberg High Yield Index	-4.84%	-4.84%
Dow Jones Industrial Average	-4.10%	-4.10%
S&P 500 Index	-4.60%	-4.60%
Russell 2000 Index	-7.53%	-7.53%
MSCI EAFE Index	-5.91%	-5.91%
MSCI World Small Cap ex USA Index	-7.23%	-7.23%
MSCI World Index	-5.15%	-5.15%
MSCI Emerging Markets Index	-6.97%	-6.97%

DOMESTIC EQUITY MARKETS

- U.S. equity markets closed the quarter lower amidst a rapidly changing macro environment with heightened uncertainty and volatile trading. Concerns around rising interest rates, inflation, and the conflict in Russia/Ukraine led to a selloff in risk assets and a repricing of growth, despite still strong corporate earnings results and U.S. economic strength fueled by reopening.
- Large-cap stocks, as measured by the S&P 500, declined -4.6% and outpaced small and mid-cap stocks for the quarter.
- Energy, Utilities, and Consumer Staples were the best performing sectors as commodity prices surged and investors sought defensive equity exposure. Communication Services, Consumer Discretionary, and Information Technology suffered the steepest losses.
- Value stocks meaningfully outperformed Growth. Investors demonstrated a mixed preference for quality factors.

GLOBAL EQUITY MARKETS

- Non-U.S. developed markets (DM) declined in volatile trading, as Russia invaded Ukraine amid an already challenging inflationary backdrop. Europe was especially weak due to its trade ties with Russia and proximity to the conflict. Commodity prices surged in response to potentially harsh sanctions on the resource-rich country.
- The MSCI World ex USA Index dropped -4.8%; the MSCI World Small Cap ex USA Index fell -7.2%.
- The MSCI Emerging Markets (EM) Index was down -7.0%, though performance was mixed geographically. Commodity producers such as South Africa, Latin America, and Persian Gulf countries advanced, while larger Asian markets, particularly China (-14.2%), weakened.
- DM Energy, and DM and EM Materials were top performers. However, EM Energy fell sharply due to Russia's equity market collapse.

INVESTMENT STRATEGIES

DOMESTIC EQUITY

We develop a deep understanding of the companies in which we invest through disciplined and intensive fundamental research. Our focus is on finding well-managed, quality companies, which are resilient.

GLOBAL EQUITY

We take advantage of market inefficiencies to find quality growth companies that may be undervalued, underappreciated, or under-researched. Our rigorous, bottom-up process focuses on a company's upside potential and downside risk.

TAXABLE BOND

Our multi-sector approach takes advantage of the relative valuation among distinct bond sectors and the increased opportunities to generate income and capital appreciation. We build diversified yield advantaged portfolios that generate steady, incremental income and provide downside risk protection.

MUNICIPAL BOND

We combine a rigorous, research intensive, credit selection process with active management. Our goal is to take advantage of market inefficiencies and find opportunities across the yield curve to protect and grow principal and income.

MUNICIPAL BOND STRATEGIES

Municipal bonds suffered their worst quarter of performance in 40 years, getting caught in a Treasury market rout that stemmed from the mounting determination of central banks to combat sustained inflationary pressure. Coming into 2022, the Fed had been projecting only three quarter-point rate hikes for the calendar year, an outlook that was also reflected in the futures market. But as the quarter progressed, labor markets began to overheat and core inflation surged to a four-decade high. Russia's invasion of Ukraine sent energy and grain prices soaring amid a humanitarian crisis with no clear endgame. In response to these developments, Fed rhetoric grew more hawkish and policy projections turned more aggressive. At the March FOMC meeting, after lifting rates for the first time since 2018, committee members raised their forecast to seven total hikes for 2022, and by quarter end the futures market was pricing in nine. Short Treasury yields surged, mirroring the faster pace of hikes, while those out longer increased less, reflecting the possible damage to growth. The combination of those two dynamics led to inversions at key segments of the curve, which raised questions as to whether monetary policy can successfully tame inflation without tipping the economy into recession.

The volatility in Treasuries also had a destabilizing effect on municipal bonds. As a long-only, retail-dominated market, munis are especially vulnerable to a change in sentiment, and, sure enough, the negative returns over the first few weeks of January triggered a self-fulfilling cycle that resulted in a historic selloff. The magnitude of the losses was a function of just how low tax-exempt rates were to start the year, offering little cushion against the swift drop in prices. Of course, one reason rates were so meager to begin with was the historically-rich valuations municipal bonds were trading at in 2021. Last year, mutual funds saw record inflows of $100 billion, creating a feeding frenzy that drove municipal/Treasury ratios to levels that implied marginal tax rates far in excess of reality. In the first quarter of 2022, the mentality of the herd reversed course, to the tune of $22 billion in net redemptions. Suddenly, bid lists were flooding the street and interest in new deals was more measured, often requiring issuer concessions to clear the market. It didn't help that the selling pressure to meet annual tax bills, an issue every March, was particularly acute this time around given the outsized equity gains of 2021.

As we enter the second quarter, volatility and uncertainty make a clear outlook nearly impossible. It is important to keep in mind, however, that credit fundamentals remain a tailwind. Strong public sector revenue growth and the rebuilding of reserves have led to a string of upgrades and positive outlook revisions across the space. The extraordinary amount of federal aid distributed during the pandemic should help shore up finances for years to come and better-funded pension plans reduce a recent source of stress. The backup in rates has left tax-exempt yields looking as attractive as they have been in some time. The 10-year begins April near a three-year high, which is almost 40 basis points above its trailing 10-year average. On a relative value basis, municipals make much more sense, with the 10-year ratio exceeding 90% and the 30-year topping 100%. Recent mark-to-market losses should be viewed as one arbitrary slice of return along a continuum whose effects even out. A bond is a contract that sets a minimum price at a stated time in the future: par at maturity. Stock investors often point to that fact as limiting the chance for extraordinary returns. But it also sets a floor, assuming no credit impairment, and creates a worst-case outcome against which other opportunities can be measured. We have already worked to capitalize on this moment and will continue to do so as the market evolves.

23 AVERAGE YEARS EXPERIENCE

15 MUNICIPAL INVESTMENT PROFESSIONALS

INVESTMENT TEAM

Nancy G. Angell, CFA	Partner, Co-Director of Fixed Income
John B. Fox, CFA	Partner, Co-Director of Fixed Income
Brian T. Moreland, CFA	Partner, Portfolio Manager
Martin R. Tourigny, CFA	Partner, Portfolio Manager
Kara M. South, CFA	Principal, Portfolio Manager

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 ENHANCED YIELD

"As we enter the second quarter, volatility and uncertainty make a clear outlook nearly impossible. It is important to keep in mind, however, that credit fundamentals remain a tailwind."

TAXABLE BOND STRATEGIES

19 AVERAGE YEARS EXPERIENCE

15 TAXABLE INVESTMENT PROFESSIONALS

INVESTMENT TEAM

Mary F. Kane, CFA	Partner, Portfolio Manager
Stephen J. Repoff, CFA	Principal, Portfolio Manager
Nancy G. Angell, CFA	Partner, Co-Director of Fixed Income
John B. Fox, CFA	Partner, Co-Director of Fixed Income

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

Fixed income markets experienced their worst quarter in more than four decades amid an extraordinary confluence of economic and geopolitical shocks. Core inflation jumped to 5.4%, its highest level since 1983, on a broad-based rise in consumer prices. The Fed responded in kind, intensifying their hawkish rhetoric and laying out an aggressive course of hikes to bring inflation back to target. And—in addition to exacting a tragic human toll—Russia's invasion of Ukraine exacerbated already strained supply chains and commodity markets, threatening acute and prolonged shortages of materials vital to the basic functioning of the global economy. But for all this uncertainty and turmoil, there was a notable divergence between the performance of rates and credit; the former extended a historically severe downdraft, while the latter continued to enjoy a remarkably benign trading environment. How this disconnect eventually resolves is the central question before investors, though policy uncertainty and heightened tensions seem unlikely to subside anytime soon.

The Treasury market declined almost 10% on a total return basis since its 2020 peak. Rates across the yield curve jumped in response to persistently high inflation and the likely policy response necessary to tame it. At the start of the quarter, the futures market was pricing in three 25-basis point hikes for 2022—by the end of the quarter, it was projecting more than nine. This stark revision followed a more forceful articulation of policy from Chair Powell as well as a chorus of Fed officials, some of whom went so far as to endorse a series of shock-and-awe 50-basis point hikes. The resulting selloff in rates, particularly at the front end, was fierce and caused key segments of the yield curve to invert. Real rates rose, but nevertheless remain in negative territory and inflation breakevens climbed to record levels, suggesting lingering investor skepticism that financial conditions have tightened enough to limit further upside in prices. Mortgage-backed securities lagged Treasuries on fears that impending balance sheet normalization will be a technical headwind, though fundamentally the sector benefited from slowing prepayment speeds as mortgage rates jumped.

Corporate bonds declined significantly in absolute terms, though most of this weakness was the result of the selloff in rates. On a spread basis, credit experienced only modest widening that was largely technical in nature. Investment grade borrowers continued to flock to the primary market ahead of a potential increase in borrowing costs resulting from tighter monetary policy or geopolitical strife. Borrowers in the high yield market, meanwhile, largely moved to the sidelines amid the heightened volatility. Credit fundamentals across the quality spectrum remain solid, as profit margins show resilience, debt service levels are robust, and liquidity is ample. Companies' near-term funding needs are also historically low, further limiting the potential adverse impacts of a tighter monetary policy regime. Default rates sit close to zero and companies have demonstrated little appetite for aggressive shareholder returns or M&A. Among the best performing industries have been those levered to energy and basic materials, while the more rate-sensitive and consumer-oriented sectors have fared the worst.

> *"Despite elevated uncertainty on several fronts, we have a constructive outlook for corporate credit and expect valuations to fluctuate more on technical drivers than fundamentals."*

Against the backdrop of a hawkish FOMC and an extremely steep path of anticipated rate hikes, financial conditions are set to become far more restrictive and the implications for the shape of the yield curve are significant. Given the likely pace and magnitude of near-term policy moves, we expect the impact to be most visible at the front end. Farther out the curve, the picture is less clear, as investors have already begun to price in the next easing cycle and caused several key segments of the curve to invert.

Despite elevated uncertainty on several fronts, we have a constructive outlook for corporate credit and expect valuations to fluctuate more on technical drivers than fundamentals. Lackluster global growth and fears of policy—or conflict-induced systemic shocks are likely to constrain risk appetite and temper ambitious growth plans, thereby leaving management teams to replenish liquidity buffers or direct excess cash flow to debt repayment. Additionally, with spreads continuing to sit wide of recent lows, corporates offer a cushion against further weakness in rates.

DOMESTIC EQUITY STRATEGIES

23 AVERAGE YEARS EXPERIENCE

13 EQUITY INVESTMENT PROFESSIONALS

The first quarter had us on a roller coaster ride, registering a sizable decline by mid-March amid concerns over the Russia-Ukraine war, energy prices, inflation, supply-chain issues, waning consumer confidence, higher interest rates and Fed tightening, only to turn up meaningfully the last two weeks of the quarter. Reasons for the rally are less clear, perhaps no more than a rebound from oversold positions. Sentiment had become decidedly negative, and the more volatile high growth and speculative names that had declined the most then had the greatest recovery.

With the late quarter rally, domestic large cap stocks, as measured by the S&P 500, declined a rather modest -4.6%, although at their trough the drop had been -15% from early January highs. Only two sectors posted gains for the quarter: Energy, driven by the 35% rise in crude oil prices and the 50% gain in natural gas, and the defensive Utilities sector. Laggards included the higher growth Communication Services, Consumer Discretionary, and Information Technology sectors.

Smaller cap stocks fell by an even greater percentage, with the Russell 2000 declining -7.5%. As with large caps, Energy and Utilities proved to be the only sectors with gains for the quarter. The lagging sectors, all down in the mid-teens, were also the Consumer Discretionary and Information Technology sectors, with the addition of Health Care, weighed down by a significant decline in Biotech stocks. The relative advantage of large caps over small can be primarily attributed to this drop in the more speculative small cap biotech names which dropped, on average, by over 20% for the quarter.

Value stocks registered a sizable performance advantage over Growth in the quarter. The quarter's best performing sectors were those with heavier Value benchmark weights such as Energy, while the weaker sectors were those discussed above with heavier exposure in the Growth benchmarks.

The outlook has become complicated, as the world is once again experiencing a ground war, making its ultimate conclusion and its impact on the global economy impossible to predict. While most of the following issues were known at the start of the year, they have only been exacerbated by the war. Energy prices are through the roof, with sanctions and supply issues making the pricing outlook only more difficult to predict. The release of oil from the U.S. strategic reserve eases some of the short-term pressure, but can only be sustained for so long. Inflationary pressures were already evident in most commodities, also made worse and potentially of longer duration by war-related supply constraints. Wage inflation and labor shortages are also impacting production and pushing up prices. The Fed's anticipated hawkish pivot appears to have been accelerated by these factors, pushing up interest rates more quickly than anticipated. These pressures are starting to show their impact on consumer confidence and housing affordability.

INVESTMENT TEAM

Daniel L. Miller, CFA	Partner, Director of Equities
Joseph C. Craigen, CFA	Partner, Portfolio Manager
Jeffrey W. Thibault, CFA	Partner, Portfolio Manager
Jeffrey O. Whitney, CFA	Partner, Portfolio Manager
Aaron C. Clark, CFA	Principal, Portfolio Manager

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

> *"We continue to believe that the economy has enough momentum to stay clear of a recession this year. Inflation likely stays elevated, at least until supply-chain issues resolve much later this year."*

Yet despite these issues, the U.S. recovery remains intact, as COVID fades and reopening plays boost the economy. In addition, the employment picture is very solid, with low unemployment, a growing labor force and wage gains allowing consumers to absorb higher prices. The oft-quoted ISM Services and Manufacturing surveys remain in expansion territory, albeit at a slightly slower pace. And lastly, substantial liquidity from the Fed's monetary stimulus, high levels of consumer savings and net worth are also supporting both the economy and equity markets.

So how do these opposing factors balance out? What happens to the economy from here? Will the Fed actions bring down inflation without putting us in recession? How high will rates go? Are equity markets attractively valued given higher interest rates? As always, the questions are easier to determine than the answers. We continue to believe that the economy has enough momentum to stay clear of a recession this year. Inflation likely stays elevated, at least until supply-chain issues resolve much later this year. There are some early signs inflation may be peaking already, although we are not expecting it to go back to levels experienced in recent years. Interest rates may drift up somewhat further from here, but increases will likely be limited by fear that too high an increase will push us into recession. Even with rates having risen, stocks still sell at an earnings yield of just over twice that of bonds; modestly attractive compared to historical trends.

GLOBAL EQUITY STRATEGIES

25 AVERAGE YEARS EXPERIENCE

8 EQUITY INVESTMENT PROFESSIONALS

INVESTMENT TEAM

Daniel L. Miller, CFA	Partner, Director of Equities
Reid T. Galas, CFA	Partner, Portfolio Manager
Karl M. Kyriss, CFA	Partner, Portfolio Manager

GW&K GLOBAL EQUITY STRATEGIES

GLOBAL SMALL CAP

INTERNATIONAL SMALL CAP

The first quarter saw a broad global selloff to start the year, although it moderated somewhat towards the end of the quarter. The MSCI World ex USA Index fell -4.8%, while the MSCI World ex USA Small Cap Index declined -7.2%. A portion of this decline was due to currency impact, as the U.S. dollar strengthened 2.5%. Particular notice should be taken of the Japanese yen which continued to weaken after breaking out of a long-term trading range, ending the quarter down -5.4%. This is partly due to the continued dovishness of the Bank of Japan during a period where most central banks are tightening monetary policy.

All sectors were lower this quarter except for traditionally defensive Utilities and commodity inflation beneficiaries, Materials and Energy. Health Care, Consumer Discretionary, and Information Technology sold off about 15% or more. On a geographic basis Europe was the weakest market, down almost -12%, as you would probably expect given the war in Ukraine, while North America was up 6%, as commodity and energy stocks gained in Canada. Asia was down about -5% with both Japan and Hong Kong weak, and only partially offset by gains in Singapore and resource-rich Australia.

There are several topics to address this quarter, but we will focus our discussion on the more impactful and less discussed issues facing global markets.

During the most recent earnings season, the revision ratio fell in most regions, signaling that there were less upgrades to analyst earnings forecasts. While not unusual, it does contrast to the post-pandemic recovery period that saw an abnormally high number of upgrades, which in turn provided a substantial tailwind to global equity markets. However, it appears to be occurring earlier than expected in this cycle and could indicate less robust market performance in the near term. The culprits are two-fold, higher than expected costs hurting margins and supply-chain issues hurting sales. Management teams were almost universal in reporting higher input prices (energy, labor, commodities, and transportation) and continued difficulties in sourcing materials. Even when companies were able to obtain all resources, supply-chain volatility had a negative impact on production efficiency. However, it is important to note that not all regions are reporting the same issues. The International Monetary Fund (IMF) reports that labor is a major component of inflation in the U.S. and UK, but is broadly missing from Europe and other advanced economies. Instead, they are dealing with much higher energy costs. Rising wages are seen as the most 'sticky' inflation component and the most likely component to require higher interest rates to alleviate. The implication for markets may be higher than expected rates in certain markets like the U.S., and less persistent inflation, assuming energy prices moderate, in other markets like Europe and Japan.

"The implication for markets may be higher than expected rates in certain markets like the U.S., and less persistent inflation, assuming energy prices moderate, in other markets like Europe and Japan."

Another consideration is the impact of safety stock levels on demand. A (very) simplistic explanation of safety stock is the amount of product a company needs to hold in order to meet expected demand during the reorder period. As supply chains become disrupted, and the normal 10 days suddenly becomes 20, a company will need to increase its orders to bring safety stock levels in line with new supply-chain realties. Of course, the supplier suddenly seeing a surge in demand tells the customers that it will now take 30 days, and a spiral of increasing orders results. This demand is real, but not desired or in sync with true end-customer demand. The longer the disruptions and supply/demand imbalances last, the more likely companies will view them as permanent and make investments accordingly. If this engenders excess capacity, lower prices and margins will eventually result.

We have a healthy internal debate about current imbalances and which conflicting forces will win out over the next couple of years. There is evidence for a variety of different views, but watch out for a standard business-cycle recession resulting from central bank induced slowdown combined with falling earnings and inventory destocking. Commodity-linked assets have been the clear winners for the last few quarters but there are deflationary forces at work as well. Our preferred approach remains to own profitable, value-added companies that can grow their earnings over the cycle.

EMERGING MARKETS EQUITY STRATEGIES

For the fifth quarter in a row, emerging market (EM) equities underperformed developed market (DM) equities amid a volatile quarter for most major equity markets. Surging inflation pressures and hawkish pivots by major central banks put downward pressure on many global equity markets in the quarter, as did Russia's unprovoked invasion of Ukraine. The MSCI EM Index fell by -7.0% in the quarter, compared to a decline of -5.4% for the MSCI World Index of developed market (DM) equities. That put EM equities 20.7% behind DM equities over the trailing four quarters, with a loss of -11.1% for the MSCI EM Index compared to a gain of 10.6% for MSCI World.

EM's weakness in the quarter reflected two major factors. First, Russian equities were removed from the MSCI EM Index due to "non-fulfillment of market accessibility requirements." Russian equities had represented 3.6% of the MSCI EM Index at the end of 2021 and were effectively written down to zero in the EM benchmark as of March 9. Second, China posted a decline of -14.2% in the first quarter. That had a larger impact on the EM benchmark than the removal of Russia in the quarter given China's large weight of 30% in the benchmark.

Chinese equities were down by -32.0% over the trailing four quarters, reflecting a combination of dampening factors including rolling COVID lockdowns, property market weakness, a series of regulatory clampdowns, and investor concerns about China's strategic partnership with Russia. The China drag on EM equities would have been more severe had it not been for a 22.5% surge in MSCI China from mid-March through the end of the quarter. That was prompted by a pledge from China's top financial policy body to ensure stability in capital markets, support overseas stock listings, resolve risks around property developers and complete the crackdown on Big Tech "as soon as possible."

Concerns about the supply impact of the Russia-Ukraine war helped push commodity prices sharply higher in the quarter, with the price of Brent crude oil rising 36% to $108/barrel while the overall Bloomberg Commodity Price Index rose by 26%. Surging inflation pressures contributed to a spree of rate hikes among EM central banks, with Brazil, Chile, Mexico, Poland, Czech Republic, Peru, Korea, Taiwan, and Hungary all raising rates. Despite the Fed commencing a rate-hiking cycle in the first quarter, a basket of MSCI EM currencies fell by only -0.9%. Pronounced weakness in currencies of Argentina, Egypt, and Turkey were offset by an impressive 13.5% gain in commodity-sensitive Latin American currencies.

Latin American equities were also the big winner from the commodity price surge, with the MSCI EM Latin American Index up by 27.3% in the quarter. Mideast oil-producing nations like Qatar, the UAE, and Saudi Arabia also posted robust gains. That said, the EM region of Europe, the Middle East, and Africa (EMEA) was the weakest EM region due to the Russia factor and related weakness in neighboring countries like Hungary and Poland.

28 AVERAGE YEARS EXPERIENCE

17 EQUITY INVESTMENT PROFESSIONALS

INVESTMENT TEAM

Daniel L. Miller, CFA	Partner, Director of Equities
Nuno Fernandes, CFA	Partner, Portfolio Manager
Thomas A. Masi, CFA	Partner, Portfolio Manager
Pablo Salas	Partner, Portfolio Manager
Bradley J. Miller, CFA	Partner, Portfolio Manager
William P. Sterling, Ph.D.	Global Strategist

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> *"Although the Fed's current hawkish posture and war-related risks could continue to challenge EM equities, much depends on the outlook for Chinese equities."*

EM sector returns varied widely in the quarter, with Materials and Financials posting positive returns, while Information Technology, Communication Services, Consumer Discretionary, Health Care, and Energy posted double-digit declines. The Energy sector's decline of -20.8% can be largely attributed to the write-downs of related Russian securities because other Energy securities generally did well in the quarter. China's overall weakness in the quarter had a major impact on sector returns as well, including the weakness noted in Information Technology, Communication Services, Consumer Discretionary, and Health Care.

The notable underperformance of EM equities over the past five quarters puts the relative valuation of the asset class in the bottom decile of its trading range relative to the S&P 500 since 1995 on measures like price-to-sales and dividend yields. Although the Fed's current hawkish posture and war-related risks could continue to challenge EM equities, much depends on the outlook for Chinese equities. China still faces near-term challenges from COVID lockdowns, but is one of the few major nations pivoting decisively toward monetary and fiscal policy stimulus, while the rest of the world is moving in the other direction. In our judgement, recent market-supportive signals from the government have the potential to mark the bottom in China's equity bear market, although it remains to be seen if China is willing to play a constructive role in defusing the Russia-Ukraine crisis.

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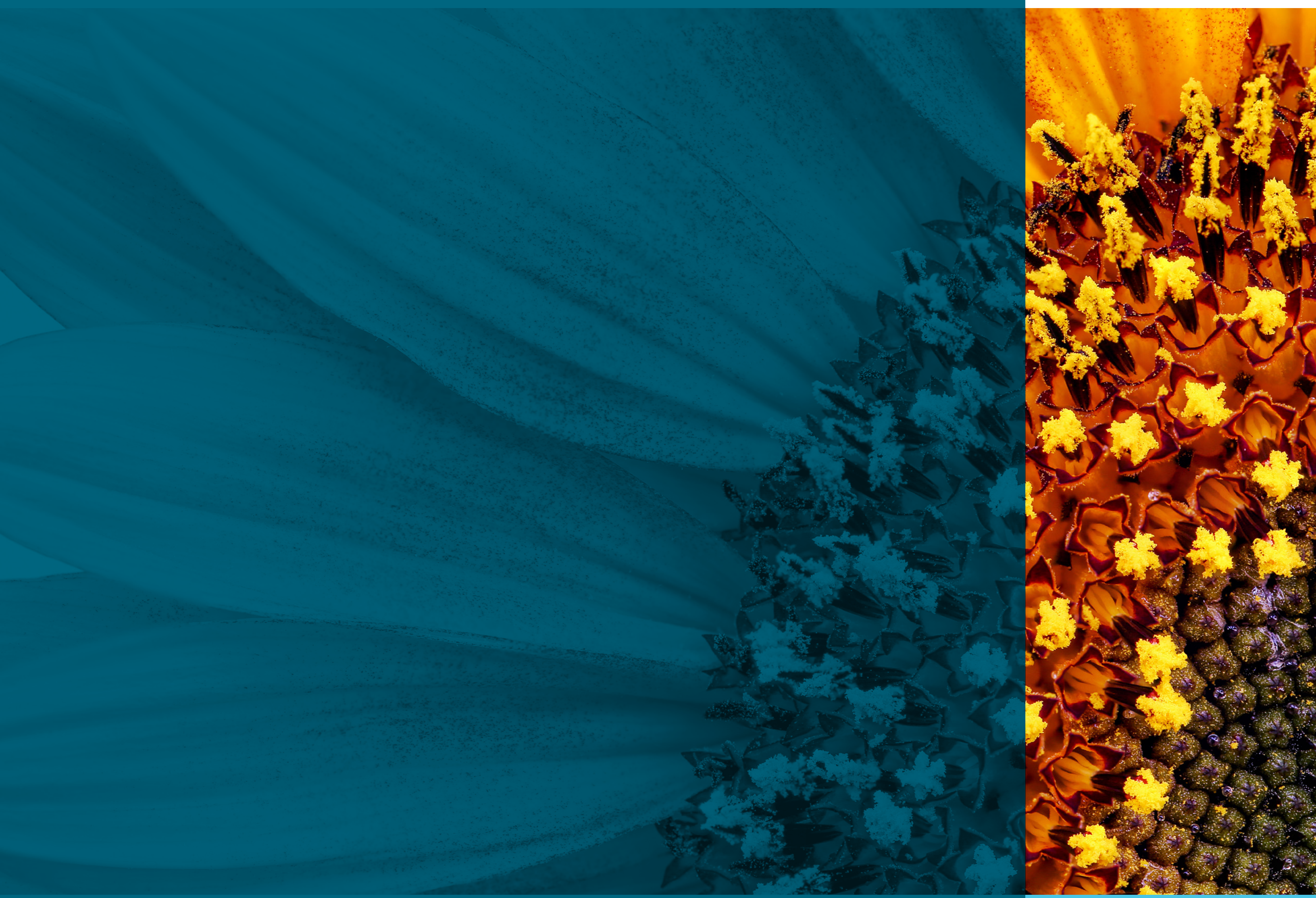

www.gwkinvest.com

GW&K® INVESTMENT MANAGEMENT

Boston Headquarters
222 Berkeley Street
Boston, Massachusetts 02116
617.236.8900

Other Locations
New York, New York
Winter Park, Florida

033122 PER197-AC