William Blair

Third Quarter 2020

# William Blair Income Fund
# Fund Manager Commentary

## Fund Performance

The William Blair Income Fund (Class N shares) returned +0.93%, net of fees, for the quarter ended September 30, 2020. By comparison, the Fund's benchmark, the Bloomberg Barclays Intermediate Government/Credit Bond Index (the "Index"), returned +0.61%.

Overweight to U.S Government Agency mortgage-backed securities was the largest positive contributor to third-quarter performance. In addition to the sector allocation, security selection was beneficial. Underweight to US Treasuries was the second largest contributor to performance for the quarter. Exposure to TIPS contributed to performance.

Security selection in Treasuries was a slight detractor from attribution as shorter-maturity and floating-rate UST underperformed longer-maturity, fixed-rate treasuries. The strategy's emphasis of shorter-maturity corporates and underweight to BBB-rated names detracted from performance as corporates spreads rallied during the quarter, with BBB-rated and longer-maturity corporates leading the sector.

## Market Overview

The Bloomberg Barclays U.S. Aggregate Index returned +0.62% during the third quarter of 2020. Corporates returned +1.54% during the period while U.S. Treasuries returned +0.17%.

Due to COVID-19 pandemic, there was significant monetary and fiscal stimulus that was announced in the first quarter of 2020. The Fed also expanded their balance sheet ~69.5% year-to-date through open market purchases, targeting U.S. Treasury notes and bonds as well as U.S. Government Agency Mortgage-Backed Securities (MBS). All told, these actions coupled with rate cuts and Fed sponsored lending programs helped stabilize markets, which led to the tightening of spread sectors in the second and third quarters of 2020.

U.S. Treasury Inflation-Protected Securities (TIPS) outperformed the overall Aggregate index during the quarter (+2.41%). The third quarter saw a steady increase in market-implied breakeven inflation rates. On September 30, 2020, the breakeven rate was 1.6327%, approximately the level at the beginning of the year.

U.S. Government Agency mortgage-backed securities underperformed Treasuries by 6 basis points (+0.11% vs +0.17%). Among the index constituents, the lowest coupons (1.5 -2.5) had a positive total return due to Fed support. 3.0% coupons had a negative total return since the Fed is no longer buying them. Higher coupons (30-yr Conventional 6.0s and 6.5s) MBS also earned negative total returns for the MBS Index cohort. However, our specified pool selection produced significant positive returns within these coupon buckets. We attribute these returns to our time-tested strategy of employing the low-loan balance specified MBS pools that typically lead to markedly lower prepayment rates.

## Top 10 Holdings[1] as of 9/30/20

| *Company Name* | *% of Fund* |
|---|---|
| Fannie Mae Pool, 4.00% due - 5/1/35 | 7.1% |
| Fannie Mae Pool, 4.00% due - 2/1/29 | 5.6% |
| Fannie Mae Pool, 5.50% due - 12/1/41 | 5.5% |
| Fannie Mae Pool, 5.50% due - 12/1/48 | 3.0% |
| United States Treasury Note/Bond, 1.13% due - 2/28/27 | 2.8% |
| Fannie Mae Pool, 6.00% due - 1/1/38 | 2.7% |
| United States Treasury Inflation Indexed Bonds, 3.88% due - 4/15/29 | 2.4% |
| Freddie Mac Gold Pool, 6.00% due - 4/1/40 | 2.3% |
| Fannie Mae Pool, 6.00% due - 1/1/42 | 2.3% |
| Fannie Mae Pool, 6.00% due - 1/1/42 | 2.2% |
| **Total Top 10** | **35.9%** |

We believe that higher-coupon segments (30-year MBS coupon rates of 5.5% and above) of the U.S. Government agency MBS market offer compelling value.

Risk premiums on corporate bonds continued to tighten during the quarter as companies adapted to the pandemic and policy makers continued to support market liquidity, with Investment Grade Index spreads moving from +150 to +136 bps. The High Yield Index tightened from +626 bps to +517 bps.

Lower rated corporate bonds (BBB's) outperformed higher quality (AA/A) and high yield (BB- and B-rated) bonds outperformed investment-grade corporate bonds. During the quarter, longer maturity bonds slightly outperformed shorter maturity corporate bonds.

U.S. economic growth projections at the end of September 2020 were negative, but have rebounded from dire projections seen at the end of first quarter 2020. Inflationary pressures are benign, and inflation projections are below the FOMC's longer-term objective of 2.0% - 2.5%.

[1]Listed holdings are presented to illustrate examples of the securities that the Fund has bought and do not represent all of the Fund's holdings or future investments. Information about the Fund's holdings should not be considered investment advice. There is no guarantee that the Fund will continue to hold any one particular security or stay invested in any one particular sector. Holdings are subject to change at any time and are as of the date shown above. Top ten holdings are shown as a percentage of total net assets.

We believe that the FOMC will be very patient in moving away from the Zero Low Bound (ZLB), with Chair Powell stating, "The path forward will depend on keeping the virus under control, and on policy actions taken at all levels of government,".

U.S. Treasury Inflation-Protected Securities (TIPS) have market-implied breakeven inflation rates that are below the FOMC's Flexible Average Inflation Targeting

(FAIT) of 2%. We believe TIPS are an attractive alternative to fixed-rate Treasuries to mitigate the effects of rising rates driven by accelerating inflationary pressures.

We believe that spread sectors remain relatively attractive to Treasuries over the intermediate-to-long term. Corporate risk premiums are still wide to their pre-pandemic levels and yield-hungry investors continue to buy corporate bonds. We believe security selection will be critical going forward as certain industries and business models are more adapted to successfully navigating the post-pandemic environment than others.

We believe that higher-coupon segments (30-year MBS coupon rates of 5.0% and above) of the U.S. Government agency MBS market offer compelling value. These segments of the MBS market offer attractive spreads and a defensive duration profile. Prepayment protection is critical in this lower interest rate environment. We continue to mitigate this risk by focusing on specified pools comprised of borrowers that do not have the economic incentive to refinance their loans: seasoned low-loan balance pools.

| **Investment Performance (%) Periods Ending 9/30/20** | **Qtr** | **YTD** | **1 Y** | **Annualized 3 Y** | **5 Y** | **10 Y** |
|---|---|---|---|---|---|---|
| William Blair Income Fund (Class I) | 0.86 | 4.11 | 4.78 | 3.20 | 2.78 | 2.74 |
| William Blair Income Fund (Class N) | 0.93 | 4.10 | 4.61 | 2.98 | 2.55 | 2.52 |
| Bloomberg Barclays Intermediate Govt./Credit Index | 0.61 | 5.92 | 6.32 | 4.43 | 3.39 | 2.91 |

**Performance cited represents past performance. Past performance does not guarantee future results and current performance may be lower or higher than the data quoted. Returns shown assume reinvestment of dividends and capital gains. Investment returns and principal will fluctuate with market and economic conditions and you may have a gain or loss when you sell shares. For the most current month-end performance information, please call +1 800 742 7272, or visit our Web site at www.williamblairfunds.com. Class N shares are available to the general public without a sales load. Class I shares are available only to investors who meet certain eligibility requirements.**

| **Expense Ratios (%)** | **Gross Expense** | **Net Expense** |
|---|---|---|
| Class I | 0.74 | 0.70 |
| Class N | 0.98 | 0.85 |

Expenses shown are as of the most recent prospectus. The Fund's Adviser has contractually agreed to waive fees and/or reimburse expenses to limit fund operating expenses until 4/30/21.

## IMPORTANT DISCLOSURES

The Fund's returns will vary, and you could lose money by investing in the Fund. As interest rates rise, bond prices will fall and bond funds become more volatile. The Fund is subject to credit risk. The Fund's net asset value and total return may be adversely affected by the inability of the issuers of the Fund's securities to make interest payments or payment at maturity. The Fund's investments in obligations issued or guaranteed by U.S. Government agencies or instrumentalities may not be backed by the full faith and credit of the United States and may differ in the degree of support provided by the U.S. Government. The Fund is also subject to interest rate and foreign investments risk. Foreign investments often involve additional risks, including political instability, differences in financial reporting standards and less stringent regulation of securities markets. Rule144A securities are not registered for resale in the general securities market and may be classified as illiquid. It may not be possible to sell or otherwise dispose of illiquid securities both at the price and within a time period deemed desirable by the Fund. Investments with longer maturities, which typically provide higher yields than securities with shorter maturities, may subject the Fund to increased price changes resulting from market yield fluctuations. The Fund's investments in collateralized mortgage obligations are subject to prepayment and extension risk. Prepayment of high interest rate mortgage-backed securities during times of declining interest rates will tend to lower the return of the Fund and may even result in losses to the Fund if the prepaid securities were acquired at a premium. Slower prepayments during periods of rising interest rates may increase the duration of the Fund's mortgage-backed securities and asset-backed securities and reduce their value.

The Bloomberg Barclays Intermediate Government/Credit Bond Index indicates broad intermediate government/ corporate bond market performance. The Index is unmanaged, does not incur fees or expenses, and cannot be invested in directly.

This content is for informational and educational purposes only and not intended as investment advice or a recommendation to buy or sell any security. Investment advice and recommendations can be provided only after careful consideration of an investor's objectives, guidelines, and restrictions.

***Please carefully consider the Fund's investment objectives, risks, charges, and expenses before investing. This and other information is contained in the Fund's prospectus and summary prospectus, which you may obtain by calling +1 800 742 7272. Read the prospectus and summary prospectus carefully before investing. Investing includes the risk of loss.***

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