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Guggenheim Investments

10 Macro Themes for 2020

January 2020

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10 Macro Themes for 2020

This collection of charts presents 10 of the macroeconomic trends we believe are most likely to shape the investment environment in 2020.

1. Household Net Worth Gains Will Support Consumption
2. Low Rates Will Underpin Housing Despite Valuation Concerns
3. The Pace of Fed Balance Sheet Expansion Will Slow
4. A Tight Labor Market Will Further Depress Corporate Profit Margins
5. Corporate Defaults Will Rise as Debt Burdens Weigh on Credit
6. Credit Rating Downgrades Will Add Headwinds to Business Investment
7. The Fed's Soft Landing Theory Will be Tested
8. Consumer Confidence Will Hinge on the Health of the Labor Market
9. Historic Inequality Will Fuel Support for Unorthodox Policy Proposals
10. The 2020 Election Will Influence the Economy in an Unprecedented Way

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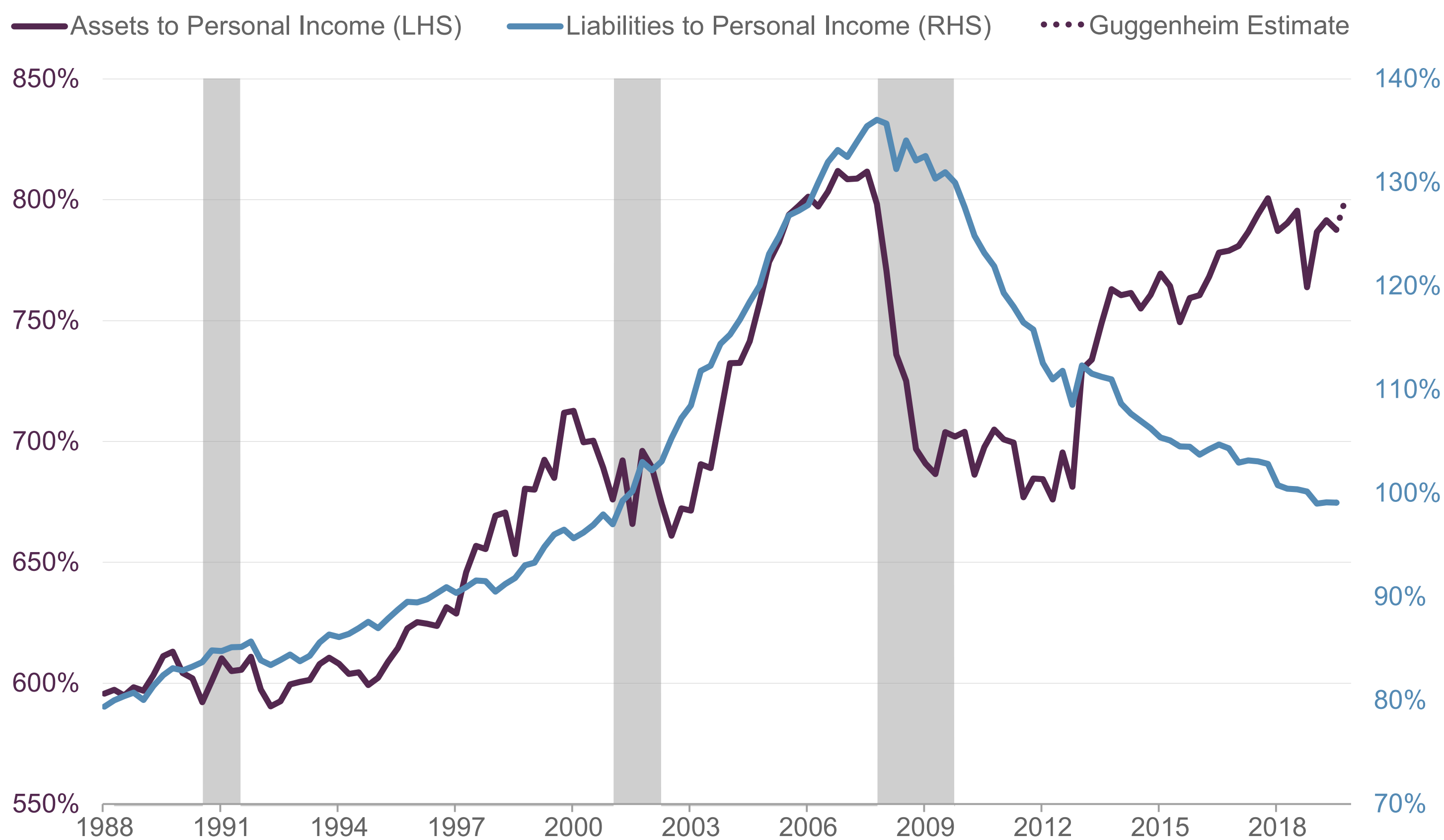
Household Net Worth Gains Will Support Consumption

U.S. Household Assets and Liabilities, % of Disposable Personal Income

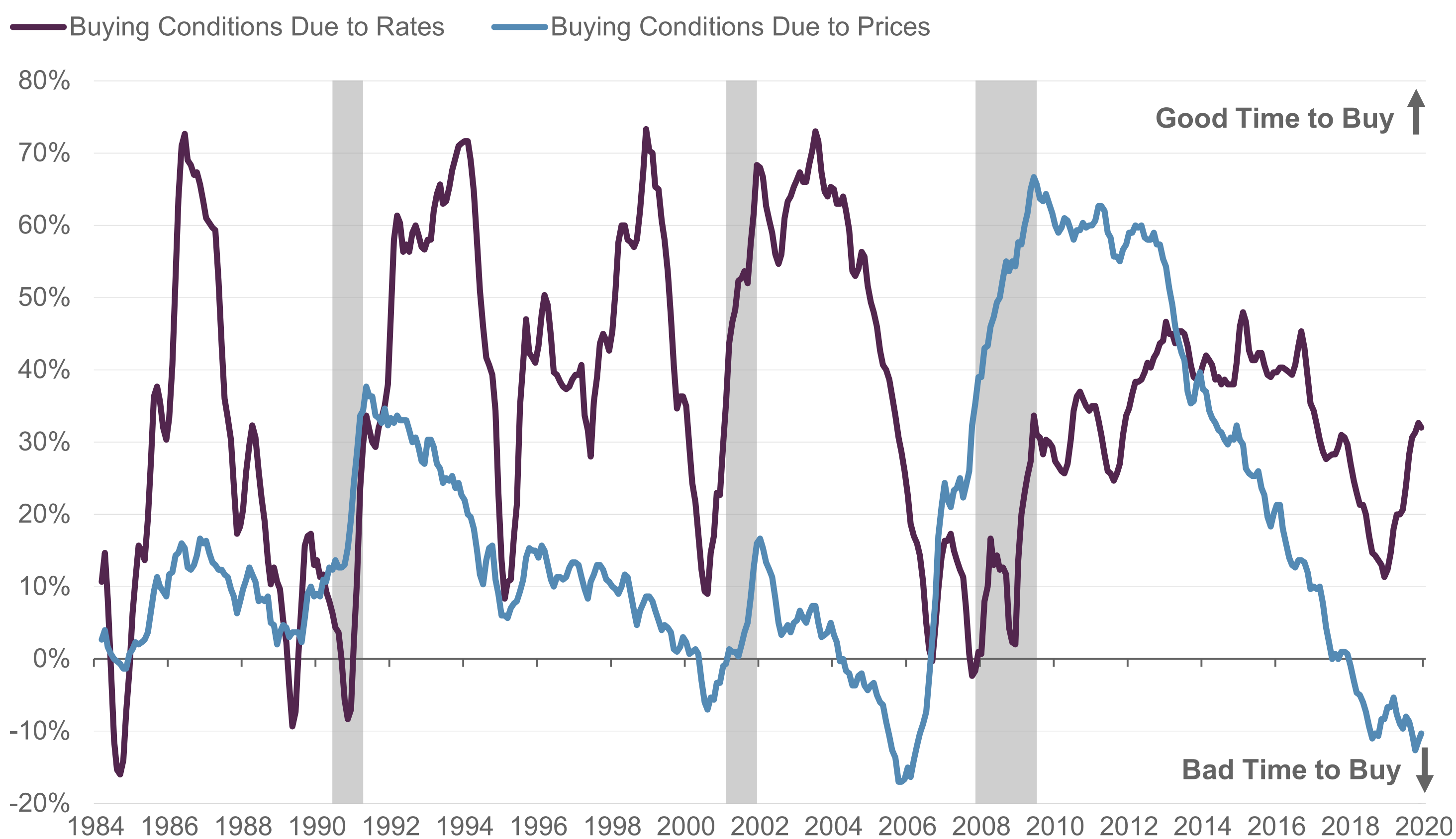


- Personal consumption continues to be the main driver of the U.S. economy, helping to spur economic growth in 2019 even with business investment contracting and the manufacturing sector experiencing a recession.
- One reason for the resiliency of consumption has been the health of consumer balance sheets.
- Post-crisis deleveraging has brought down household debt burdens, while the bull market in stocks and steady home price gains have lifted assets to near all time highs relative to income.
- The 2019 stock rally should support a positive wealth effect, helping consumption cushion the economy even as a variety of headwinds mount.

Source: Guggenheim Investments, Haver Analytics. Data as of 9.30.2019, estimate shown for Q4 2019 as the data was not yet available at the time of print. Due to the unpredictability of financial markets, there is no guarantee that the estimate shown will prove to be correct.

Low Rates Will Underpin Housing Despite Valuation Concerns

University of Michigan Consumer Sentiment Survey: Buying Conditions for Houses By Reason, Net % Balance

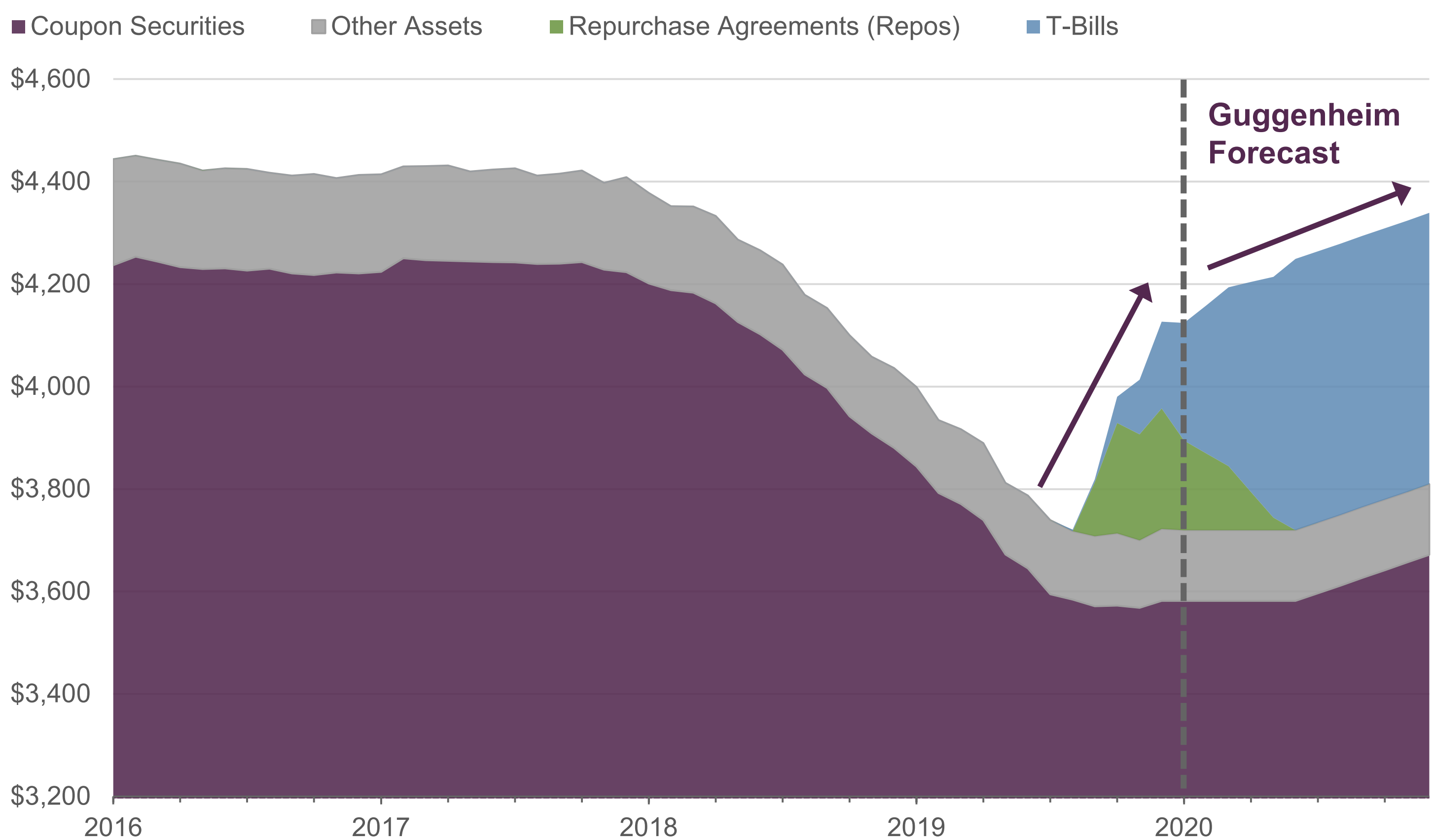


- We expect the housing market to contribute positively to U.S. economic growth.
- Mortgage rates have come down a full percentage point over the past year, helping home sales and construction recover, a trend which will continue into 2020.
- Consumers are highly sensitive to mortgage rates, with a big turnaround underway in the share of consumers citing interest rates as a good reason to buy a house now.
- However, the rebound will be limited, as high home prices are denting home buying perceptions, offsetting some of the benefits of lower mortgage rates.

Source: Guggenheim Investments, Bloomberg, University of Michigan. Data as of 12.31.2019. Note: three-month moving average.

The Pace of Fed Balance Sheet Expansion Will Slow

Federal Reserve Assets, in USD Billions

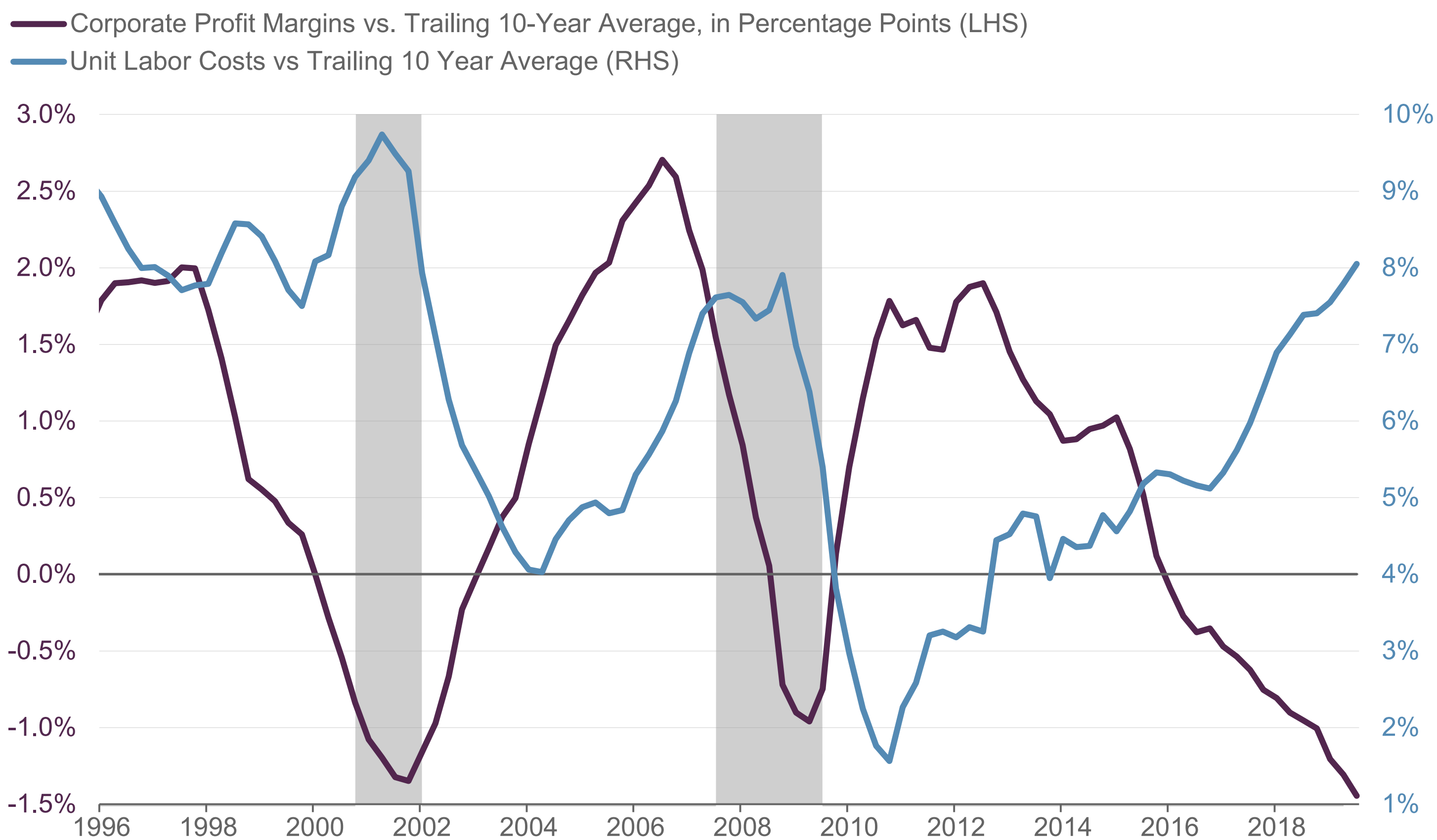


Source: Guggenheim Investments, Haver Analytics, Federal Reserve Board. Data as of 12.31.2019. Coupon securities include Treasury notes and bonds, Agency debentures, and Agency mortgage-backed securities. Due to the unpredictability of financial markets, there is no guarantee that the forecast shown will prove to be accurate.

- In September 2019, it became clear that the Fed had drained too many excess reserves, as evidenced by the spike in overnight funding rates. Since then, the Fed has added liquidity through repos and Treasury bill purchases.
- While the Fed has sought to dispel the notion that this was QE in disguise, many investors have pointed to Fed balance sheet growth as a catalyst for strong risk asset performance in recent months.
- We forecast further Fed balance sheet growth in 2020, but at a much slower pace, which could undercut the “QE-lite” market narrative.
- We expect an IOER hike of 5 basis points in the first quarter and tapering of bill purchases in the second quarter.

A Tight Labor Market Will Further Depress Corporate Profit Margins

U.S. Corporate Pre-Tax Profits* and Unit Labor Costs

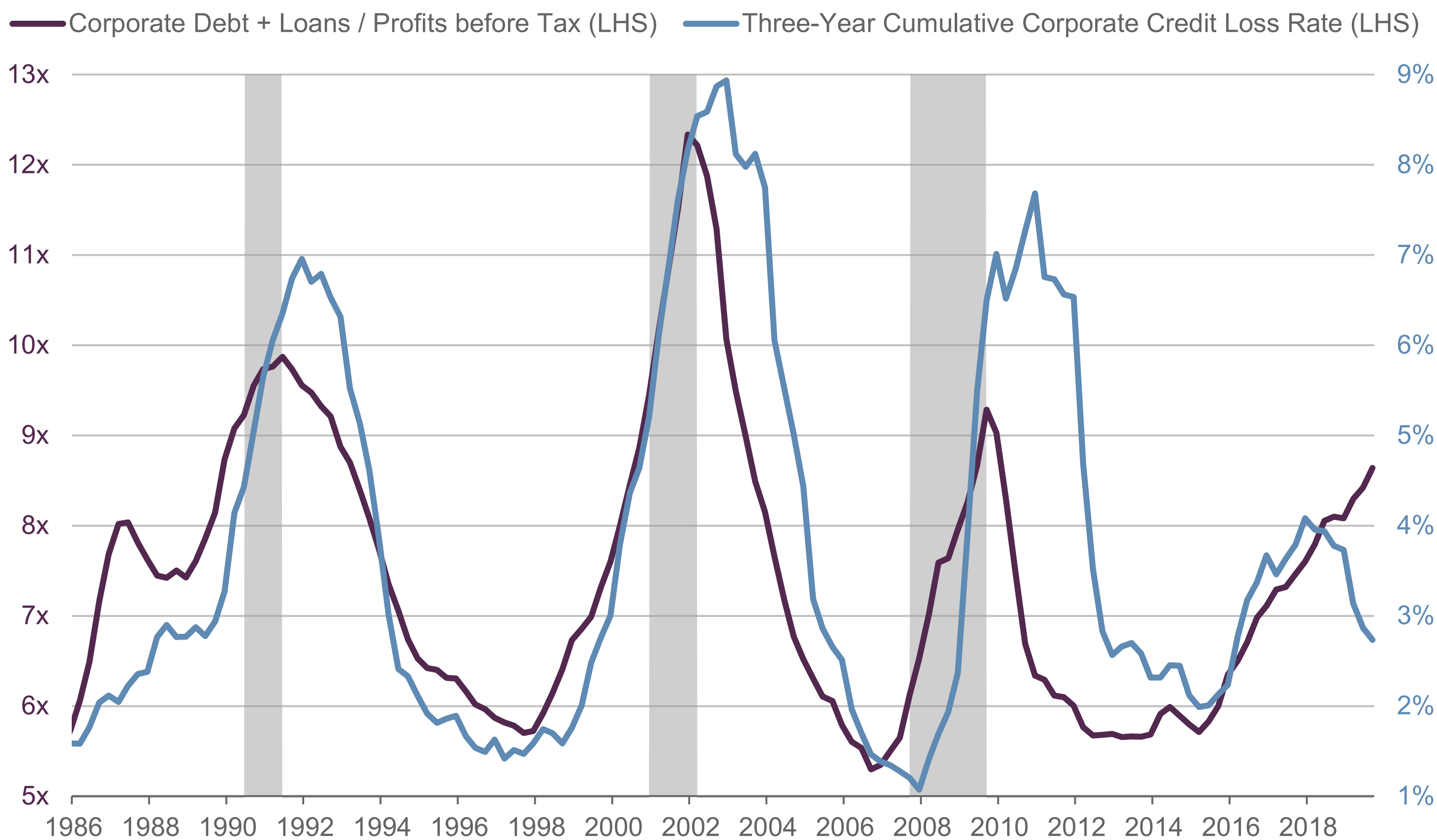


- A tight labor market has increased the bargaining power of workers, as the number of job openings now exceeds the number of unemployed workers. This dynamic has pushed up wage growth.
- At the same time, and despite a recent uptick, productivity growth has remained sluggish, in part due to lack of sufficient business investment during this expansion. The net result is rising unit labor costs.
- In an environment of limited pricing power, businesses are struggling to pass on higher labor costs, leading to a steady erosion of profit margins.
- We expect declining profitability to weigh on firms' hiring and investment plans in 2020.

Source: Guggenheim Investments, Haver Analytics. Data as of 9.30.2019. *Note: Profits with inventory valuation and capital consumption adjustments expressed as a percent of GDP. Four quarter moving average.

Corporate Defaults Will Rise as Debt Burdens Weigh on Credit

U.S. Nonfinancial Corporate Business Leverage and Three-Year Cumulative Corporate Credit Loss Rates

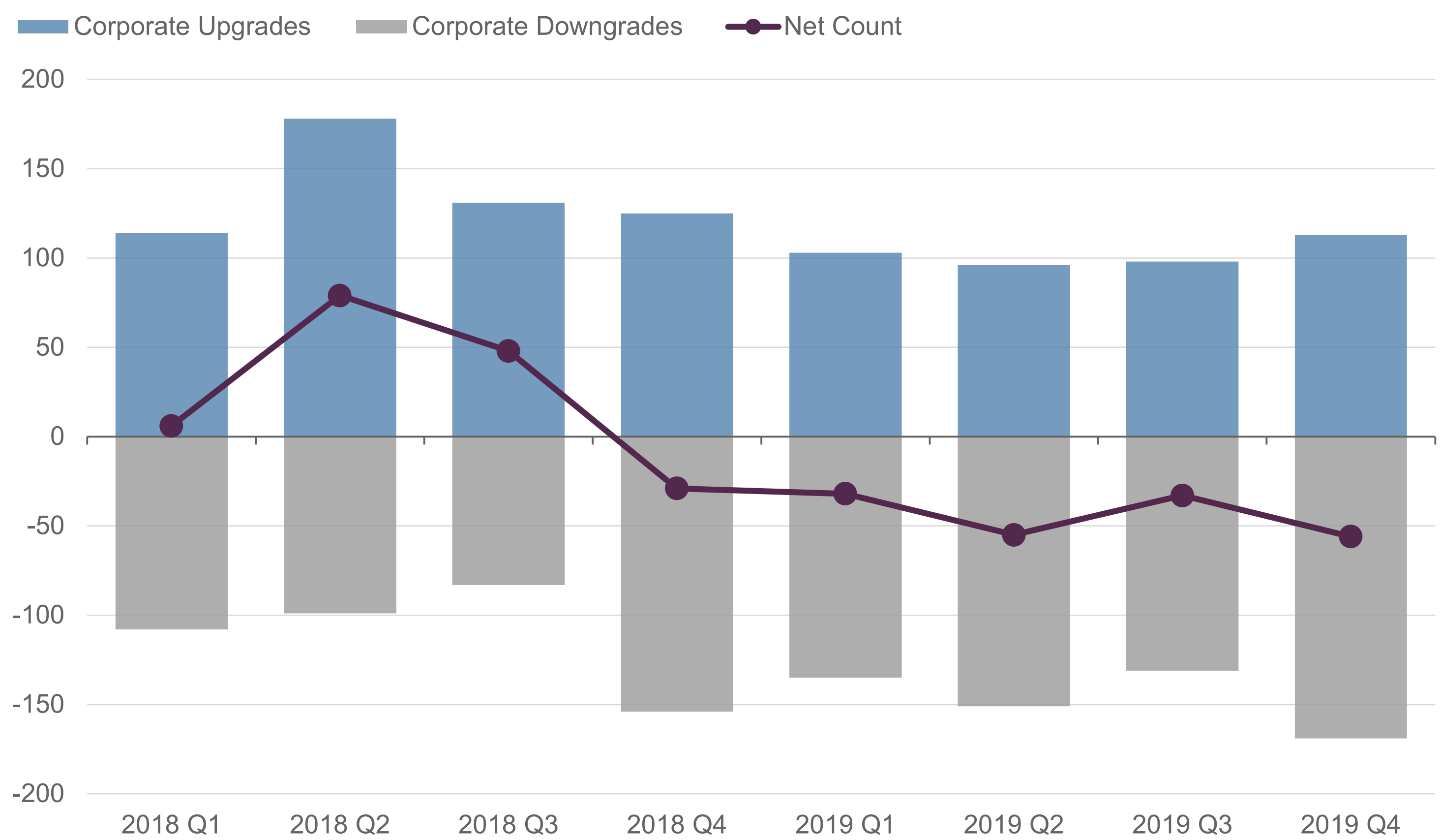


Source: Guggenheim Investments, Haver Analytics, Moody's. Data as of 9.30.2019. The three-year cumulative corporate credit loss rate is calculated using monthly credit loss rates, which are estimated by Guggenheim using a combination of monthly and annual default and recovery data.

- Since the high yield market came into existence in the mid-1980s, rising leverage has tended to coincide with an increase in defaults and, ultimately, credit losses for investors.
- Today's corporate credit markets include more below-investment grade-rated debt and more BBB-rated debt (the lowest IG rating) than ever before.
- The fundamental outlook for corporates is not good: earnings growth is weak, margins are falling, and companies are being downgraded by the credit rating agencies.
- In our view, it is unsustainable for firms to operate with historically high leverage without a rise in defaults. Tight credit spreads suggest to us that the market is being complacent about this risk.

Credit Rating Downgrades Will Add Headwinds to Business Investment

Moody's Upgrades and Downgrades for U.S. Investment-Grade and High-Yield Credits, Count

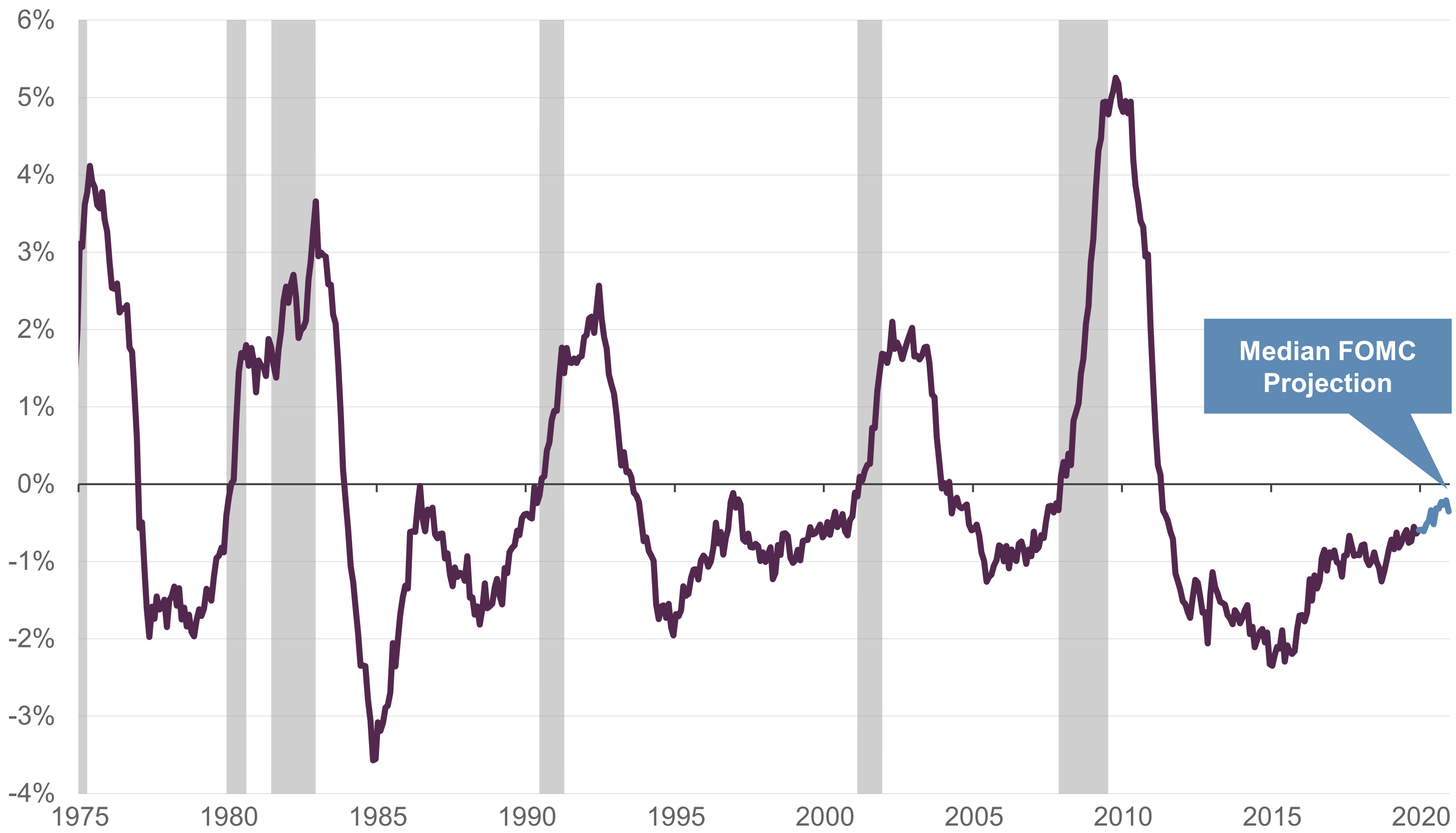


- Although credit spreads tightened throughout 2019 for both investment grade and high-yield bonds, the fundamental picture for corporate credit worsened.
- Weak earnings growth and a continued increase in leverage has resulted in more credits being downgraded than upgraded by the ratings agencies.
- Lower ratings in the aggregate are a reminder that corporate debt is becoming riskier. Firms have less cushion to withstand external shocks that could cause a decline in earnings.
- Lower credit ratings will make it more costly to take on additional debt, and pressure to deleverage will curtail business hiring and investment, resulting in a drag on the real economy.

Source: Guggenheim Investments, Bloomberg, Moody's. Data as of 12.31.2019.

The Fed's Soft Landing Theory Will be Tested

Two-Year Change in the U.S. Unemployment Rate, in Percentage Points

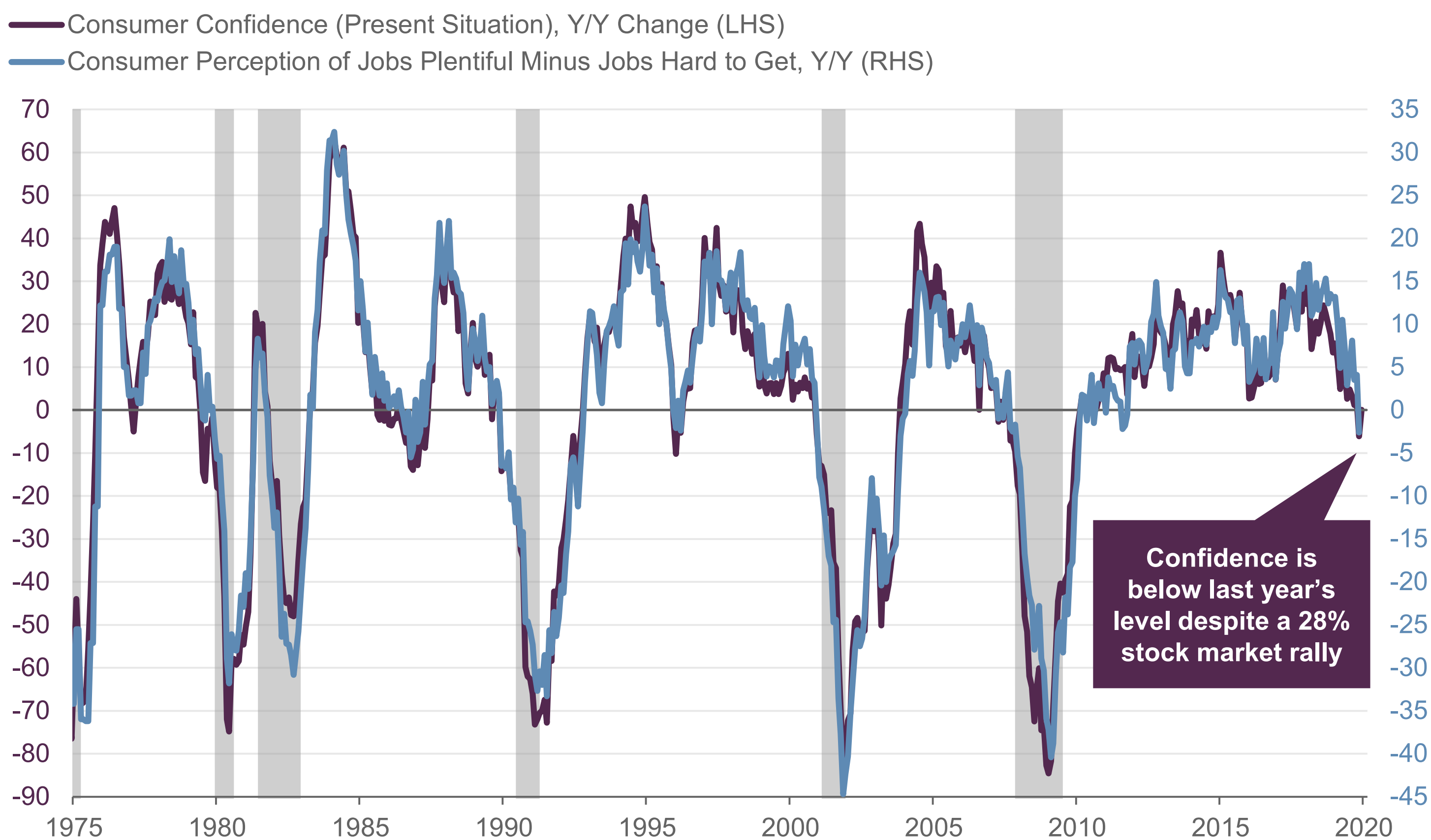


Source: Guggenheim Investments, Haver Analytics, Federal Reserve. Actual data as of 12.31.2019. FOMC projections as of 12.11.2019. Federal Open Market Committee (FOMC) projections are economic projections of Federal Reserve Board members and Federal Reserve Bank presidents under their individual assessments of projected appropriate monetary policy.

- The unemployment rate has fallen to just 3.5 percent, a 50-year low, and below most estimates of the sustainable natural rate.
- The Fed expects to guide the unemployment rate slightly higher in the coming years, the so called "soft landing from below."
- We expect that momentum in the labor market will continue to fade, with economic growth near potential and further labor market gains constrained by limited slack.
- Historically, once the two-year change in the unemployment rate turns positive, the economy enters a recession.
- The historical record shows it is difficult to keep a lid on rising unemployment, calling into question the Fed's soft-landing theory.

Consumer Confidence Will Hinge on the Health of the Labor Market

Conference Board Consumer Confidence Index, Y/Y Change

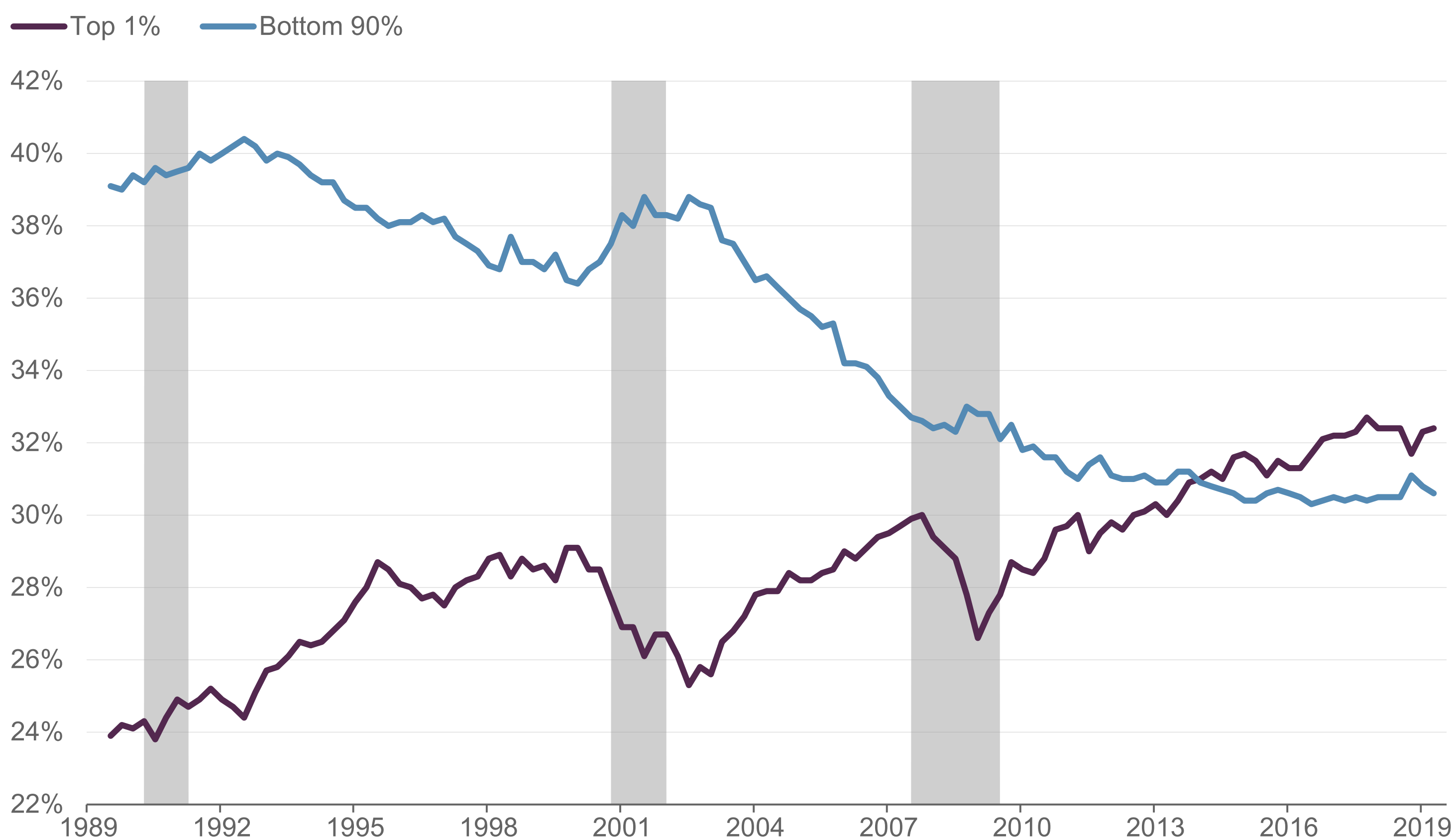


Source: Guggenheim Investments, Haver Analytics, Conference Board. Data as of 12.31.2019. Shaded areas represent periods of recession.

- The rate of change in consumer confidence has proven to be a reliable indicator of our position in the business cycle.
- Despite a 28 percent stock market rally in 2019, December's "present situation" consumer confidence reading was essentially unchanged from a year ago.
- This puts the year-over-year change at a level that has preceded past recessions by just six months, on average.
- For confidence to rise from here, the economy will need to create jobs at a faster pace in 2020, which seems like a tall order given a fading fiscal impulse and an unemployment rate at a 50-year low.
- While household net worth gains should support spending, any deterioration in the labor market would cause consumers to become more downbeat.

Historic Inequality Will Fuel Support for Unorthodox Policy Proposals

Share of National Net Worth by Percentile Groups

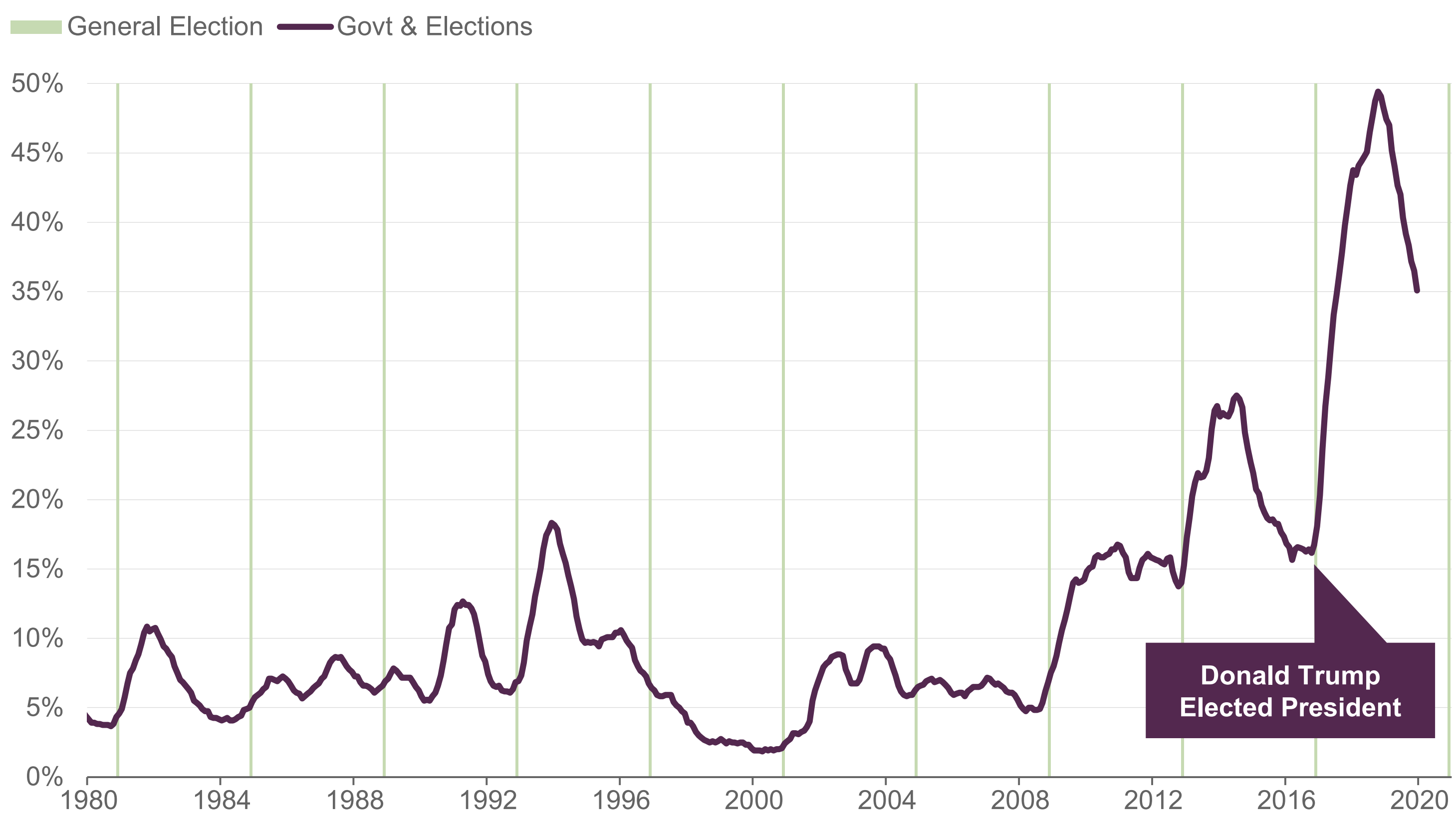


- Despite a 50-year low in the unemployment rate and 10 years of economic expansion, many Americans are struggling to get by and are frustrated with government policy.
- A key reason is income inequality, which sits at multi-decade highs.
- High inequality will fuel popular support for economically disruptive policies such as a wealth tax, higher corporate tax rates, universal basic income, and Medicare for all.
- While the prospects for such policies being implemented is fairly low, more prominence in the public discussion and among presidential candidates will increase policy uncertainty as businesses and consumers assess their likelihood and potential impact.

Source: Guggenheim Investments, Haver Analytics. Data as of 6.30.2019. Shaded areas represent periods of recession.

The 2020 Election Will Influence the Economy in an Unprecedented Way

University of Michigan Consumer Sentiment Survey: Reasons for Opinions on Business Conditions
% of Respondents (12-Month Moving Average)



- Historically, respondents to the University of Michigan's Consumer Sentiment survey have cited the labor market as the dominant factor influencing their view of overall business conditions.
- Over the past several years, the share of respondents citing government policy and elections as driving their perceptions has surged. In the past year it has been the most cited factor.
- Spurred by social media, 24-hour cable news, and high political polarization, this development means that consumers are making economic decisions based on political developments.
- This will make the outcome of November's election more immediately consequential for the economy than in the past.

Source: Guggenheim Investments, Bloomberg, University of Michigan. Data as of 12.31.2019.

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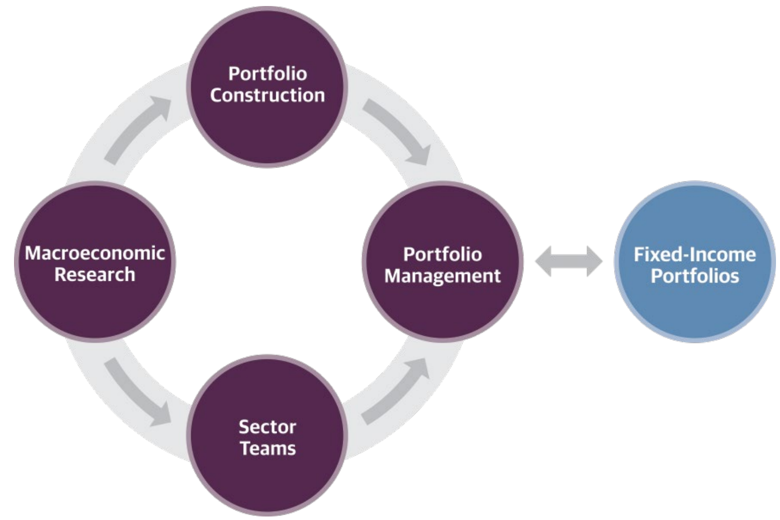

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