GUGGENHEIM

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Portfolio Strategy
Fixed Income Is Now a Buyer's Market

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The tightening cycle has brought about a regime shift that we believe is likely to continue to benefit fixed-income investors for the foreseeable future. The era of low levels of interest rates and borrowing terms favoring shareholders over lenders seems behind us. The subsequent recapturing of economics and negotiating leverage by creditors is just beginning. The shift in this dynamic, combined with wide spreads and higher yields, has dramatically improved the value proposition of credit investments.

Last year's selloff was mostly technical in nature, driven by the radical changes in the level and shape of the yield curve, and it spared virtually no sector. Now disparate fundamental trends are taking center stage, which means we are likely to see more dispersion in returns across sectors, industries, and ratings. If our view is correct that the Fed's tightening cycle is essentially over, the future trend of rates could become more one-sided.

U.S. Investment-Grade and High-Yield Corporate Bond Yields

Source: Guggenheim Investments, Bloomberg U.S. Investment-Grade Corporate Index, ICE BofA U.S. High-Yield Index. Data as of 5.23.2023.

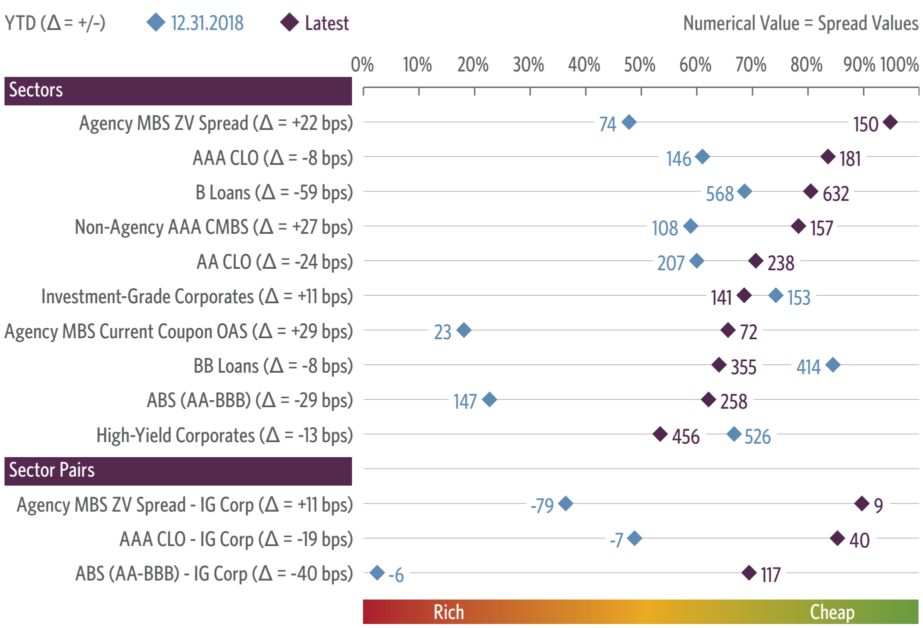
Investment-grade and high-yield corporate bond yields are off the highs from 2022, but they are still at levels we haven't seen since 2009/2010. Investment-grade bonds are yielding over 5 percent and high-yield bond yields are over 8 percent on average, according to the Bloomberg U.S. Investment-Grade Corporate Index and the ICE BofA High-Yield index, respectively. The inverted yield curve is driving meaningful opportunities to diversify portfolios across sector and duration profile, particularly in investment-grade floating rate assets, and namely structured credit.

The uncertainty related to this hiking cycle, which is now handing off to uncertainty related to the severity of a potential recession, has created a similar story in credit spreads (the difference in yield between credit sectors and Treasurys). High grade spreads are on the wide side of their own history, and investment-grade securitized credit is particularly attractive with spreads having been wider only 20–30 percent of the time dating back to pre-2008 financial crisis.

Comparing to a similar point in history in 2018 when fears of overtightening caused the Fed to pause its rate-hiking cycle, yields are significantly higher now and spreads are wider in most sectors, as shown in our chart. Like 2018, the Fed has vowed to continue with quantitative tightening. But the fundamental picture is arguably better today. Net leverage is lower and interest coverage is higher across most rating categories relative to prior downturns, due to strong nominal profit growth and lower interest expense. Balance sheet liquidity, while not evenly distributed, remains robust at the index level with high cash-to-debt ratios.

Many Credit Sectors Are Still at the Wide End of Historical Ranges

Fixed-Income Spread Percentiles (% of Time Spent at or Below Current Spreads Historically)

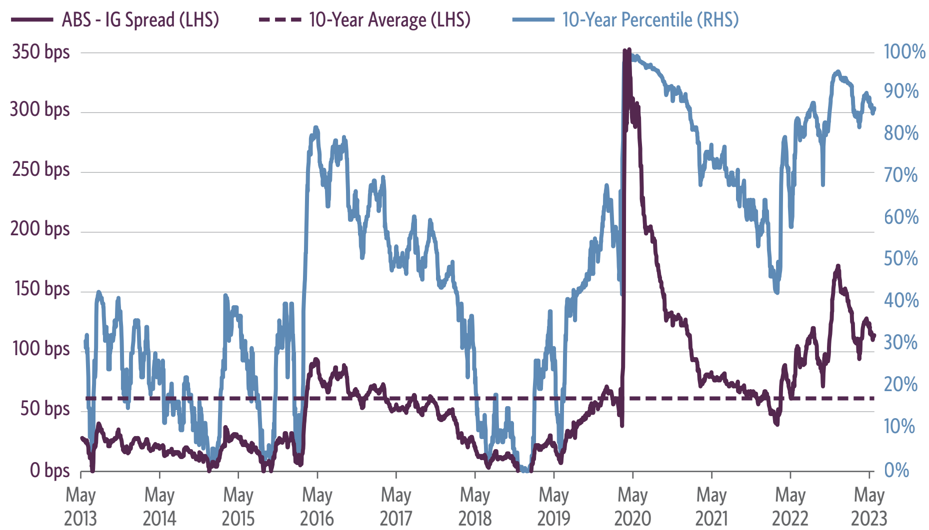


Source: Guggenheim Investments. Credit Suisse, Bloomberg, ICE BofA. Data as of 5.23.2023. Index Legend: Credit Suisse Leveraged Loan Index, CreditSuisse High-Yield Corporate Bond Index, Bloomberg Investment-Grade Corporate Bond Index, Bloomberg US Aggregate Index (Agency Bond subset), Historical CLO spreads provided by Bank of America Research, current CLO spreads based on JP Morgan CLOIE Index, Non-agency CMBS spreads provided by JP Morgan Research, ICE BofA AA-BBB US Asset-Backed Securities.

The spread between investment-grade securitized credit and similarly rated corporate credit has also rarely been wider. Structured credit excess yields exist, in part, because of the sector's complexity premium, and that premium today is pronounced. Therefore, the value in high grade credit is not just a yield story, but one of adequate risk premiums that compensate for credit risk and offer an opportunity to monetize complexity.

Structured Credit Spreads Remain Wide to Investment-Grade Corporates

10-Year Trailing: IG ABS vs. IG Corporate Spread



Source: Guggenheim Investments, Bloomberg. Data as of 5.23.2023. IG Corporate index is the ICE BofA US Corporate Index. IG ABS index is the ICE BofA AA-BBB US ABS Index. There are four days in March 2020 and one day in April 2020 where the spread differential exceeded 350 basis points; these data points are hidden from the graph but are included in the percentile and average calculations.

We believe that the credit sector in the aggregate has the strength to weather a potential recession that could come as soon as the second half of this year. However, the credit markets are likely to be in for a longer period of heightened idiosyncratic risk where deep fundamental analysis and credit selection will be key. Among many idiosyncratic credit concerns ahead are debt maturity and refinancing risks, which vary greatly across issuers and industries, but other factors could trigger defaults as evidenced by the turmoil among regional banks this year.

The experience in the banking system this year caused significant dispersion, or market differentiation, in spreads of different finance companies and banks, with tiering between large and small issuers and within capital structures. However, we have not yet seen the same kind of pronounced dispersion in other industries, and there is still limited credit tiering within rating categories. We believe this will change over time and investors will need to be on alert for those firms that will underperform due to cyclical or other reasons. The dispersion in bank credit this year demonstrated just how quickly this tiering can happen, and it serves as a good reminder of the importance of diversification within industries and across sectors.

With today's heightened uncertainty, now is the time to prioritize quality. Quality can take many forms, including sector preference, seniority in capital structure, and prioritizing certain lending terms. The good news is that a defensive posture does not mean sacrificing returns because of the negotiating leverage of creditors and the attractive yields and spreads available, particularly in high grade, underfollowed categories of credit. We believe that for most sectors, there is enough excess spread to compensate for potential costs of rising credit risk.

Our portfolio allocations are shifting to reflect the up-in-quality playbook. We are using market strength as an opportunity to rotate, seeking diversification and adding structured credit exposure that we find attractive. Higher yields at the short end of the curve have lowered the opportunity cost of short-term investments; building our allocation to such holdings not only maintains our return profile, but it also provides the necessary dry powder for us to become a source of opportunistic capital at the appropriate time

IMPORTANT NOTICES AND DISCLOSURES

Dry powder refers to highly liquid assets, such as cash or money market instruments, that can be invested when more attractive investment opportunities arise.

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