GUGGENHEIM

Corporate Credit Quarterly Insights

August 2023

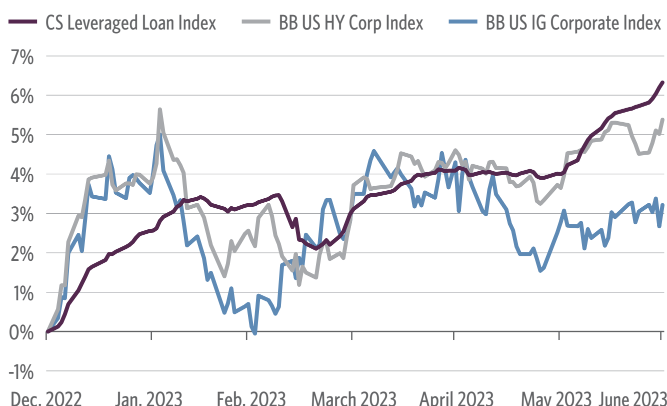
Portfolio Insights

- **High yield returns in the second quarter reflected the impact of rate volatility, but spreads tightened 60 basis points (bps), continuing the trend that has taken place since the start of the year.** The spread tightening trend has continued into Q3 with the market option-adjusted spread (OAS) currently at 385 basis points. There are two factors at play: (1) a positive technical environment with low new issuance by historical standards, and (2) the market more broadly pricing in a 'soft' landing for the economy. While we think fundamentals are generally better today than previous market cycles, we are cautious on current spread levels relative to broader macroeconomic concerns. Compared to where we were to start the year, and given our continued expectation for a recession, we think credit selection is extremely important now, but that there are still attractive relative value opportunities in the market.

- **Bank loans, benefitting from increased coupons that are at or near all-time highs, outperformed high yield in the quarter, and with much less volatility.** Discount margins tightened, but not as significantly as high yield, moving from 596bps to 583bps. While the bank loan market is benefitting from a similar technical backdrop to high yield, there is more concern about the default cycle and recovery rates given comparatively worse overall quality of the bank loan market as well as deteriorating documentation. That being said, stronger fundamentals suggests this default cycle will not be as steep as previous cycles and, even when factoring in lower recovery rates, we see good relative value in loans.

- **In terms of portfolio positioning, we concentrated on secondary market opportunities, continued to review the risk of our existing positions, and used the market rally to exit out of some names which we believe traded tight to fair value.** We sold about half of our real estate (RE) and RE-related holdings in both high yield and bank loan portfolios. Additionally, we added very modest bank loan exposure to our high yield portfolios to take advantage of the increased coupons. We remain cautious of where we are in the cycle and, while the markets have tightened on the prospect of a soft landing, we think credit selection will be particularly important over the next 4-6 quarters.

Returns by Asset Class



Index	1Q23	2Q23	1H23
Credit Suisse Leveraged Loan Index	3.11%	3.12%	6.33%
Bloomberg U.S. Corporate HY Index	3.57%	1.75%	5.38%
Bloomberg U.S. Corporate IG Index	3.50%	-0.29%	3.21%

Source: Credit Suisse, Bloomberg. HY- high-yield. IG - investment-grade. Past performance is no guarantee of future results.

High-Yield Corporate Bond Investment Themes

High-yield corporate bonds generated a total return of 1.75 percent in the second quarter, its third consecutive quarter with positive returns. Consumer cyclicals (2.78 percent) and capital goods (1.94 percent) were among the top performers for the second consecutive quarter. The industrials sector was among the top performers, but represents only a small portion of the Bloomberg U.S. Corporate High Yield Index. Banking, another relatively small portion of the index, lagged, returning

-1.69 percent. Returns by ratings saw increased dispersion in the second quarter: CCC-rated bonds outperformed with returns of 4.18 percent, while single-B rated bonds returned 1.80 percent and BBs lagged but were still positive at 0.89 percent.

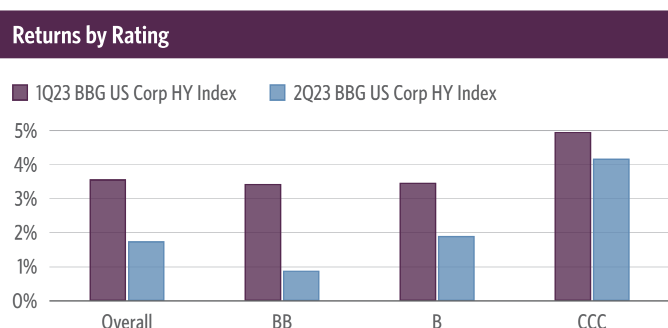
Bond yields remained relatively flat across the Bloomberg U.S. Corporate High Yield Index in the second quarter, only moving 2 basis points lower to 8.50 percent at the end of June amid tighter credit spreads and higher Treasury yields. These levels are still higher than the 2006–2022 monthly average yield of 7.54 percent. Overall, yields remain at an attractive entry point with BB-rated bonds yielding 7.08 percent, single-Bs yielding 8.66 percent, and CCCs yielding 12.88 percent.

Bloomberg U.S. Corporate High Yield Index spreads ended June at 390 basis points, 65 basis points lower than the prior quarter. Spreads were tighter than historical averages for higher quality bonds, BBs by 42 percent, Bs by 43 percent, and CCCs by 56 percent.

High-yield corporate bond new issuance volume totaled $53 billion in the second quarter, more than double the prior year, and year-to-date issuance has almost reached full year 2022 issuance.

Reflecting the changing technical dynamics, about 60 percent of issuance for the quarter came in the form of secured bonds, compared to an average of 28 percent over the last six years. This was partially driven by issuers with loans outstanding refinancing in the bond market as a cheaper alternative.

Returns by Rating



Source: Guggenheim Investments, Bloomberg. Data as of 6.30.2023. Past performance is no guarantee of future results. S&P bond ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest). For the purposes of this chart, when different ratings are available from more than one Nationally Recognized Statistical Organization (NRSRO), the lowest rating is used. Guggenheim Investments converts ratings to the equivalent S&P rating.

Public filings indicate that high-yield fundamentals experienced slight deterioration but remain solid overall. Net leverage and interest coverage metrics continue to be better than historical levels. At 2.4 percent, the high yield default rate over the last twelve months (LTM) remains below its long-term average of 4 percent. The distress rate ticked lower to 7.8 percent at the end of June from 9.5 percent in March. Issuers face limited near-term financing needs given manageable maturities over the next 18 months: $10 billion in 2023 and $42 billion in 2024, just 4 percent of par value of the ICE BofA U.S. High Yield Index.

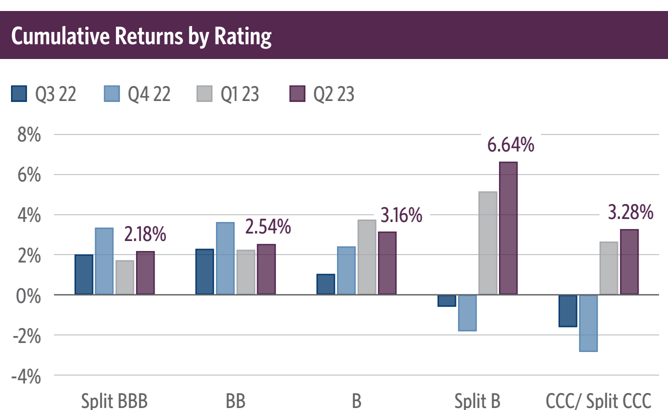
Leveraged Loan Investment Themes

The CS Leveraged Loan Index returned 3.12 percent for the second quarter, basically flat to the first quarter, with returns remaining positive across all sectors of the market. The top two performing industries were gaming and leisure (4.36 percent) and consumer durables (4.36 percent), while the two worst performers were retail (2.17 percent) and healthcare (2.30 percent). Lower-rated segments continued to outperform in the second quarter, with split Bs up 6.64 percent and CCCs up 3.28 percent, benefitting from their higher coupons. Bs were slightly behind at 3.16 percent, while BBs continued to lag at 2.54 percent.

All leveraged loan ratings segments remained above their 50th spread percentile as of the end of June, meaning spreads have been tighter over 50 percent of the time. Both B and CCC-rated loans finished above their 65th historical spread percentile, though down slightly from the first quarter.

Loan issuance for second quarter was light at $49.4 billion, down from $52.4 billion in the first quarter, with M&A-related issuance remaining light. Refi-related issuance nearly doubled year over year through the second quarter, rising to $67.2 billion, or 66 percent of total issuance year to date through June. Another $34.4 billion of loans were extended via amendment over the same period, more than double the full year tally for 2022.

Cumulative Returns by Rating



Source: Guggenheim Investments, Credit Suisse. Data as of 6.30.2023. Past performance is now guarantee of future results. S&P bond ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest). For purposes of this chart, when different ratings are available from more than one Nationally Recognized Statistical Organization (NRSRO), it's shown as a split rating and the highest rating is used. Guggenheim Investments converts ratings to the equivalent S&P rating.

The technical backdrop for leveraged loans remains balanced, with measurable demand—from collateralized loan obligation (CLO) issuance plus net retail flows—continuing to outpace the tepid net new loan supply. CLO issuance dropped off in June to

$4.3 billion, bringing second quarter issuance to $21.3 billion. Year-to-date issuance volume was $54.8 billion, trailing last year's tally by 25 percent. CLO issuance more than offsets the retail fund outflows.

Leveraged loan issuer fundamentals were mostly unchanged quarter over quarter, with interest coverage ratios and revenue growth decelerating slightly. First quarter year-over-year revenues and EBITDA rose 7 percent and 5 percent, respectively, the first quarter of single-digit growth after eight consecutive months of double-digit growth. Leverage remained unchanged for the fourth consecutive quarter at 5.5x, still below the historical average of 5.8x. Interest coverage decreased to 4.6x in June from 5.0x in the fourth quarter of 2022, though still above the historical average of 4.0x. The loan default rate increased to 1.71 percent in June from 1.32 percent in March, still below the long-term average of 2.70 percent. The distress ratio (loans priced under 80 par) stood at 6 percent as of June, down from 6.27 percent in March and 7.36 percent for full year 2022.

Macro Review

Inflation has cooled off somewhat but continues to run well above target. And while near term disinflation should continue, inflationary risk will remain with the labor market remaining as tight as it currently is. As a result, the Fed continues to try to weaken the economy, a strategy it believes is required to get inflation back to target and stay at target.

We expect Fed policymakers will deliver a final rate hike in September as they try to limit an undue easing of financial conditions that could risk a resurgence in inflation. Quantitative tightening will likely continue at least into early 2024. Despite the abrupt tightening of Fed policy seen over recent quarters, growth of real gross domestic product has been resilient, aided by significant fiscal expansion and easing inflation pressures that have boosted real personal consumption.

Indeed, headline personal consumption expenditures (PCE) inflation has slowed to 2.5 percent on an annualized basis in the three months ending in June from 7.4 percent in the corresponding period a year earlier, helping to lift real income growth and support consumer spending.

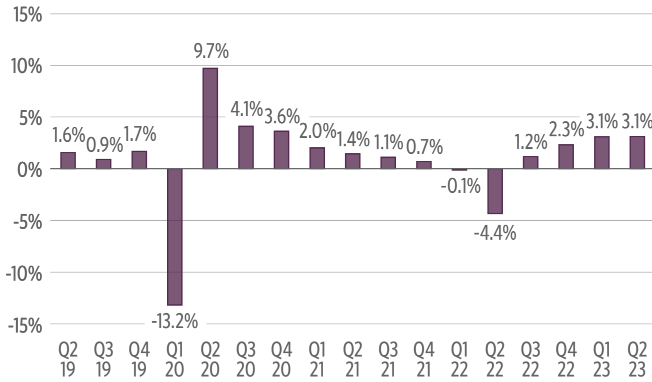
Notwithstanding recent stronger-than-expected economic activity, we continue to believe the Fed will be successful in its quest for a higher unemployment rate, ultimately leading to a recession starting by early next year. A range of leading indicators—including the low unemployment rate, inverted yield curve, declining leading economic index, and tightening bank lending standards—suggest a downturn is in the pipeline.

About Corporate Credit Quarterly Insights

Corporate Credit Quarterly Insights (CCQI), prepared by Guggenheim Investments' Corporate Credit Group, provides insights on the market for high-yield corporate bonds and leveraged loans, including fundamental and technical drivers of performance, portfolio positioning, and areas of opportunity going forward. Our Corporate Credit Group utilizes a bottom-up approach to credit selection as the primary driver of alpha and leverages a deep pool of credit research analysts, organized by industry teams, to maximize risk-adjusted return potential.

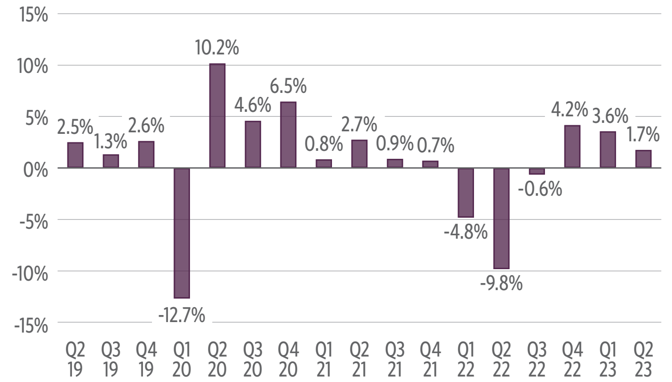
Corporate Credit Snapshot

Leveraged Loan Returns



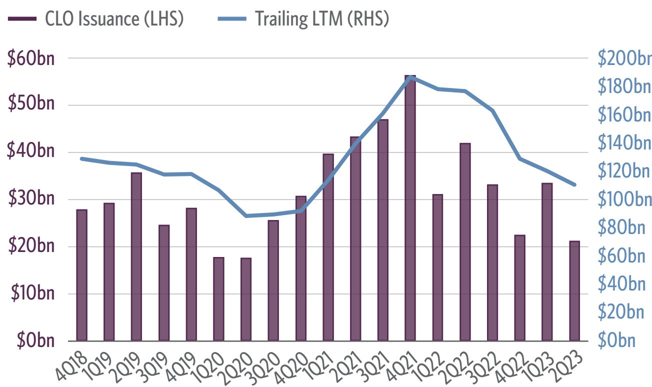
Source: Credit Suisse Leveraged Loan Index. Past performance is no guarantee of future results.

High-Yield Returns



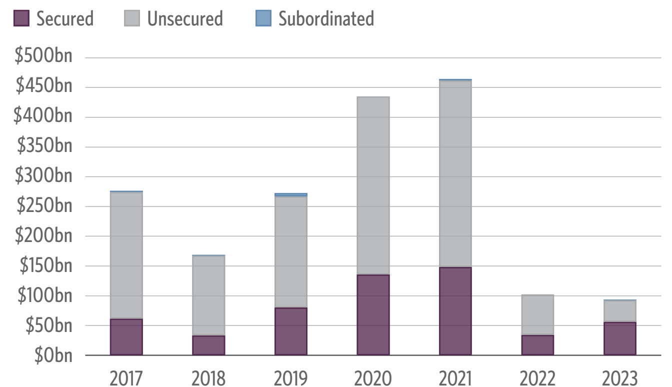
Source: Bloomberg U.S. Corporate HY Index . Past performance is no guarantee of future results.

U.S. CLO Issuance



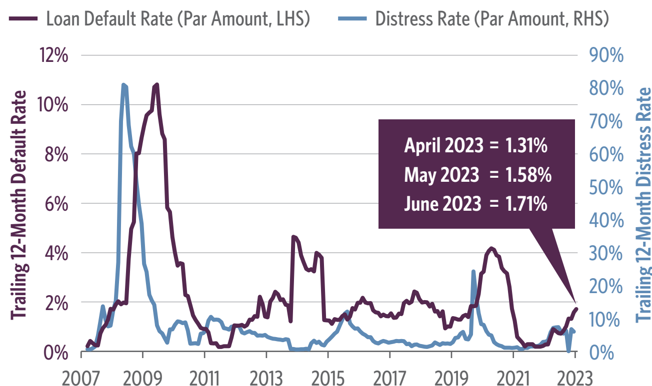
Source: S&P LCD. As of 6.30.2023.

U.S. High-Yield New Issuance Volume



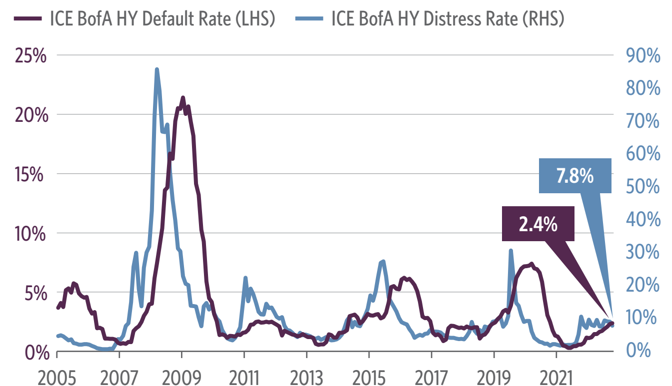
Source: S&P LCD. As of 6.30.2023.

Trailing 12-Month Default and Distress Rates



Source: S&P LCD. Default rate of full LCD Index as of 6.30.23.

High Yield LTM Default and Distress Rates



Source: ICE, Bank of America. Note distress rate includes bonds trading at OAS greater than 1,000bps.

GUGGENHEIM

Innovative Solutions.
Enduring Values.®

IMPORTANT NOTICES AND DISCLOSURES

This material is distributed or presented for informational or educational purposes only and should not be considered a recommendation of any particular security, strategy or investment product, or as investing advice of any kind. This material is not provided in a fiduciary capacity, may not be relied upon for or in connection with the making of investment decisions, and does not constitute a solicitation of an offer to buy or sell securities. The content contained herein is not intended to be and should not be construed as legal or tax advice and/or a legal opinion. Always consult a financial, tax and/or legal professional regarding your specific situation.

This material contains opinions of the authors, but not necessarily those of Guggenheim Partners, LLC or its subsidiaries. The opinions contained herein are subject to change without notice. Forward-looking statements, estimates, and certain information contained herein are based upon proprietary and non-proprietary research and other sources. Information contained herein has been obtained from sources believed to be reliable but are not assured as to accuracy. Past performance is not indicative of future results. There is neither representation nor warranty as to the current accuracy of, nor liability for, decisions based on such information.

The **Credit Suisse Leveraged Loan Index** is designed to mirror the investable universe of the USD-denominated leveraged loan market. The **Bloomberg US Corporate Bond Index (IG)** measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers. The **Bloomberg US Corporate High Yield Bond Index** measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

Basis point: one basis point is equal to 0.01%. **M&A:** Mergers and acquisitions. **EBITDA:** Earnings before interest, taxes, depreciation, and amortization.

Investing involves risk, including the possible loss of principal. Investments in fixed-income instruments are subject to the possibility that interest rates could rise, causing their values to decline. High yield and unrated debt securities are at a greater risk of default than investment grade bonds and may be less liquid, which may increase volatility. Investors in asset-backed securities, including mortgage-backed securities and collateralized loan obligations ("CLOs"), generally receive payments that are part interest and part return of principal. These payments may vary based on the rate loans are repaid. Some asset-backed securities may have structures that make their reaction to interest rates and other factors difficult to predict, making their prices volatile and they are subject to liquidity and valuation risk. CLOs bear similar risks to investing in loans directly, such as credit, interest rate, counterparty, prepayment, liquidity, and valuation risks. Loans are often below investment grade, may be unrated, and typically offer a fixed or floating interest rate.

Guggenheim Investments represents the following affiliated investment management businesses of Guggenheim Partners, LLC: Guggenheim Partners Investment Management, LLC, Security Investors, LLC, Guggenheim Funds Distributors, LLC, Guggenheim Funds Investment Advisors, LLC, Guggenheim Partners Advisors, LLC, Guggenheim Corporate Funding, LLC, Guggenheim Partners Europe Limited, Guggenheim Partners Japan Limited, GS GAMMA Advisors, LLC, and Guggenheim Partners India Management.

©2023 Guggenheim Partners, LLC. All Rights Reserved. No part of this document may be reproduced, stored, or transmitted by any means without the express written consent of Guggenheim Partners, LLC.