First Quarter 2021

Fixed-Income Outlook

Staying on Offense

GUGGENHEIM

From the Desk of the Global CIO

Staying on Offense

One must acknowledge that the world has fundamentally changed over the past year. The spread of the coronavirus has had profound consequences for humanity and governments around the world, and the global policy response and the transformation of economic policy management will have long-term implications for international trade, national defense, and the proper functioning of free markets.

That does not mean the world is going to stay the way it is right now, but it will never go back to the way it was before the pandemic. The U.S. government has a much heavier hand in controlling the economy, either via the Federal Reserve (Fed) or direct White House and congressional intervention. We spend a great deal of time analyzing the impact of these changes and how they may affect default risk in corporate credit, and asset allocation more broadly, because it is more important than ever to be alert to investment risks and opportunities. It will be easy to be lulled to sleep as markets rise with the distribution of a vaccine and the tailwind of policymakers' response to economic challenges.

Even with these risks, we may be entering what I have called a golden age for credit. Economic growth in 2021 will likely far exceed potential, which should boost corporate earnings. Meanwhile, many companies have been raising cash balances, and default rate expectations are ratcheting down. Credit markets have responded and spreads have tightened significantly in recent months.

Throughout this report our portfolio managers and sector teams discuss how we have been approaching our responsibilities during this period. We first went on offense for our clients during the March 2020 market plunge and took advantage of a multitude of opportunities. By way of illustration, as of Dec. 31, 2019, our Core Plus and Multi-Credit strategies were positioned defensively, allocating just 9 percent and 29 percent to corporate credit investments including investment-grade and high-yield bonds, and bank loans, respectively. By Sept. 30, 2020, those allocations stood at 52 percent and 57 percent, respectively. Even today, we continue to play offense.

The recurring theme in these pages is best stated by our portfolio management team (see page 2): "Even as credit spreads have narrowed considerably off their widest levels, further value remains as the global search for yield has motivated investors to allocate to investment grade and high-yield corporate bonds."

The Investment Grade team (see page 8) states that "with much good news priced in, we expect credit spreads to trade in a narrow range. Barring a monetary policy misstep or a dramatic increase in interest rate volatility, the near-term path for spreads appears tighter."

The High Yield team (see page 10) points out that spreads have continued to tighten, driving the yield on the ICE BofA High Yield Index to the lowest on record. "In each of the last four cycles," the team writes, "high yield bonds have pierced through the previous cycle's lowest yield, and this cycle is proving to be no different....owing to the vast amount of policy support that continues to buttress financial conditions and, in turn, has decreased default projections."

The Fed's new policy framework, as our Macroeconomic and Investment Research Group writes (see page 4), is designed to overshoot traditional notions of full employment and the 2 percent inflation target, likely ensuring that the fed funds rate will be kept at zero for several years and anchoring the front end of the curve. Regular asset purchases will also enable the Fed to influence market prices in longer maturities as well.

Market support is coming not just from the Fed, but from global investors hungry for the relatively higher yields—even on a currency-hedged basis—that can be found in the United States. "There is simply too much cash in investor coffers and too few high-yielding alternatives," writes the ABS team (see page 14). In this environment, our investment focus is on creditworthy investments that can perform through this pandemic as well as future exogenous events.

In "normal" times I would be wary of such a Pollyannaish view of risk assets given how far we have come and the dramatic appreciation since March. Nevertheless, in many ways the world has changed. Washington has become more accustomed to activist monetary and fiscal policies. In the long run there will be severe consequences for profligate finances and endless monetary accommodation, but not yet. Credit spreads and risk assets have been pricier before by numerous measures. Such conditions have been maintained for years whether through continued easy market conditions, yield curve control, or policies designed to stimulate the economy and promote social justice. The larger risk is that the party may just be getting started.

Predicting a peak in long-term rates could prove a fool's errand. History points to lower rates ahead. An attempt to pick a top in rates has been a tricky business, just as it was in 2013 and again in 2018. Markets can revert quickly. As long-term yields have reached the value zone a neutral or overweight position may very well prove to be the low-risk choice.

On another note, our thoughts and prayers continue to be with those who are suffering during this resurgence of the coronavirus with deep gratitude for those fighting and serving on the front lines of this battle—the healthcare professionals, delivery workers, social services providers, and first responders. May they continue to have the strength to carry on. The end of this aberrant period may not be in hand, but it is in sight.

Scott Minerd
Chairman of Investments and Global Chief Investment Officer

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Portfolio Management Outlook

Finding Long-Term Value

Anne B. Walsh, JD, CFA
Chief Investment Officer,
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Portfolio Manager

Adam Bloch
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Even as credit spreads have narrowed considerably from their widest levels, further value remains.

After navigating the pitfalls and taking advantage of the opportunities in 2020, we believe our strategies are well positioned for 2021. Additional fiscal stimulus, healthy consumer balance sheets, and accommodative Fed policy have created a constructive macroeconomic backdrop for risk assets. Even as credit spreads have narrowed considerably off their widest levels, further value remains as the global search for yield motivates investors to allocate to investment grade and high-yield corporate bonds.

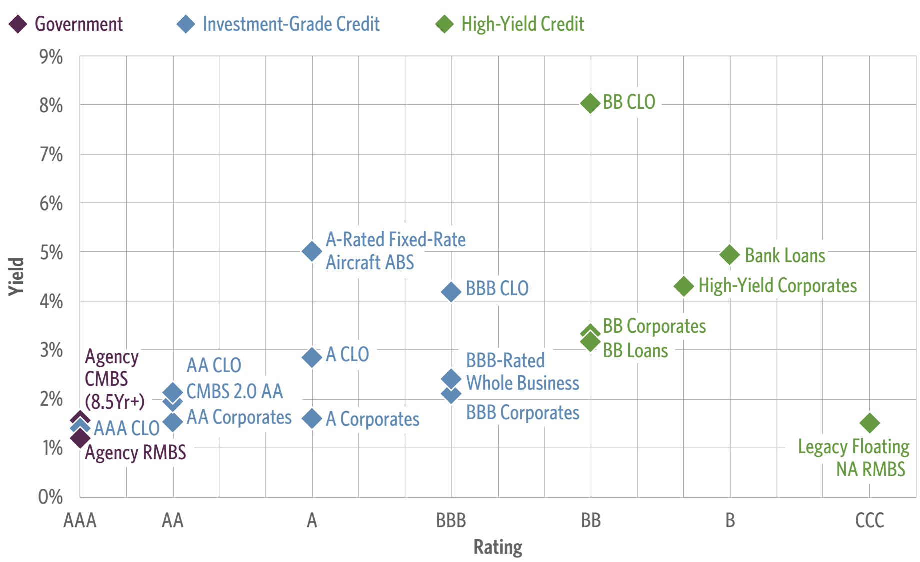
With a few exceptions, structured credit spreads have largely recovered from the COVID downdraft. In particular, even as global air traffic remained curtailed as a result of the pandemic, the most senior tranches of aircraft ABS have rallied because of positive vaccine news and expectations for pent-up travel demand in the second half of 2021. More generally, the yield advantage of structured products, whose spreads generally react more slowly to market changes, continues to make the space attractive. We expect spreads to further compress into 2021 as investors take advantage of the higher carry offered in the asset class. Similarly, CLO spreads have rallied sharply. Senior loan prices rose, and prices across the CLO capital structure recovered, with the product thus far surviving another default wave unscathed. The new CLO creation pipeline is set to continue the strong pace experienced in the second half of 2020, which should further fuel demand for senior loans. Despite this supply pressure, CLO spreads will likely rally tighter as investors search for yield.

While spreads continue to compress, our fundamental and technical outlook for investment-grade corporates remains positive for the first quarter of 2021. While new supply is likely to abate from the historic levels of 2020, the demand for credit should remain strong. Relatively higher absolute yields of U.S. corporate bonds, even net of currency hedging costs, are still compelling for international investors. Additional fiscal stimulus and a dovish monetary policy stance further provide support for corporates. Although the Fed's corporate bond purchase program was not extended past the end of 2020, the precedent it set has reassured investors that similar programs could be initiated in the future if needed.

Positions in non-Agency RMBS benefitted from resilient mortgage credit performance in recent months. While delinquencies are expected to remain elevated due to a challenging job market and continued COVID-19 disruptions, their impact is largely reflected in the current trading levels and other dynamics in the mortgage sector are very supportive. Rising home prices, low housing inventory and limited non-Agency supply paint a constructive picture for non-Agency RMBS assets.

We are also sanguine on below investment-grade opportunities in corporate bonds and loans due to improving economic data and accommodative monetary policy globally. Since prices bottomed in March, we have opportunistically added exposure to the asset class. High yield corporates, which experienced greater credit stress from COVID-driven shutdowns, should continue to benefit as the economy reopens.

While Yields Have Fallen Considerably, Value Remains



Source: Guggenheim Investments, Credit Suisse, Bloomberg, Citi. Data as of 1.26.2021. Representative Indexes: Bank loans: Credit Suisse Leveraged Loan Index; High-Yield Corporate Bonds: Bloomberg Barclays U.S. High-Yield Corporate Index excluding energy; Investment-Grade Credit and A, BB Corporates: Bloomberg Barclays U.S. Corporate and A, BBB subsets; BB Corporates: Bloomberg Barclays U.S. High-Yield Index (BB subset); Agency RMBS: Bloomberg Barclays U.S. Aggregate Index (Agency RMBS subset); CLOs: J.P. Morgan CLOIE Index (A, AA, AAA, and BBB subsets), CMBS 2.0 AA: Bloomberg Barclays CMBS 2.0 Index (AA subset), Agency CMBS: U.S. Aggregate Index (Agency CMBS subset); Bloomberg Barclays Agg: Bloomberg Barclays U.S. Aggregate Index; Legacy Floating NA RMBS and fixed-rate aircraft are based on Guggenheim's trading desk's indicative levels.

Even as credit spreads have improved considerably off their widest levels, further value remains as the global search for yield has motivated investors to allocate to investment grade and high-yield corporate bonds. Within structured credit, we continue to favor senior tranches.

Macroeconomic Outlook

The Best and Worst of Times

Brian Smedley
Head of Macroeconomic and Investment Research

Maria Giraldo, CFA
Managing Director

Matt Bush, CFA, CBE
Director

Pandemic deaths continue to mount, but vaccine deployment and massive policy support will lift growth in 2021.

The U.S. economic recovery continued in the fourth quarter even as new COVID-19 cases surged, with real gross domestic product (GDP) increasing at an annual rate of 4.1 percent. As of January 2021, U.S. real GDP had retraced 85 percent of the decline that occurred in March and April of 2020, while employment had retraced 67 percent of its decline through February. Nevertheless, output and employment remained 3.6 percent and 5.4 percent below their February peaks, respectively, much worse than during the first year of past downturns (see chart, top right).

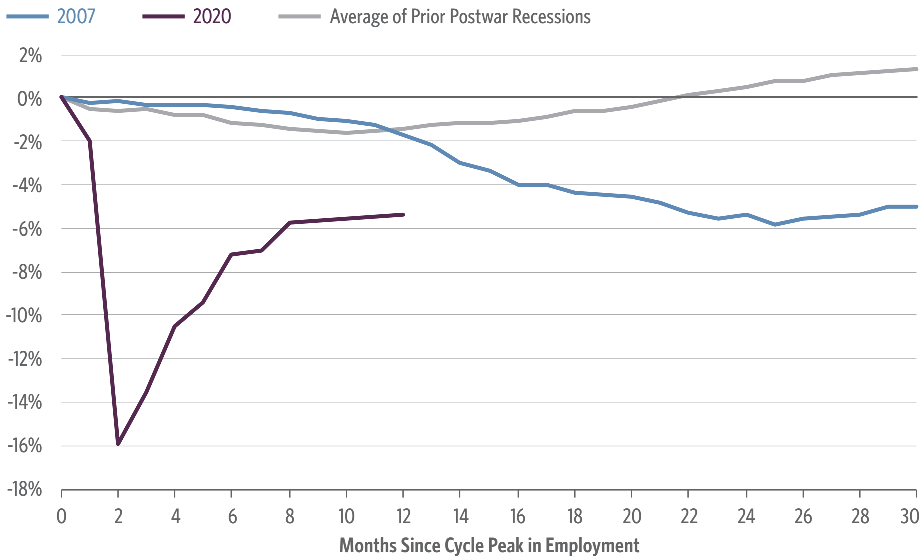
The good news is that several highly effective COVID-19 vaccines have begun to be distributed in the United States and elsewhere. With herd immunity likely attainable this summer, we expect the beleaguered service sector to experience a strong recovery in 2021 as the need for social distancing gradually diminishes. In addition, consumers—already holding excess savings of roughly $1.8 trillion—are seeing a further boost to disposable income as the $900 billion stimulus bill passed in December shows up in the data. Nearly $1.9 trillion in additional stimulus is set to be passed imminently. The combination of progress in the fight against COVID-19, massive fiscal stimulus, and extremely easy financial conditions should boost real GDP growth to 6–7 percent in 2021, the strongest since 1984.

We expect the Fed to do its part to support the recovery, guided by a new and more dovish policy framework. The Fed will no longer aim to cool an overheated labor market but will instead strive to overshoot the 2 percent inflation target in order to compensate for past periods of below-target inflation. While headline inflation is certain to rise in coming months due to sizable base effects, policymakers' focus is on the much weaker underlying inflation trend in place. As core inflation lags real GDP by about 18 months, more sequential downside is ahead over the next several quarters, and the experience of the last expansion suggests the Fed will struggle to achieve its 2 percent inflation target, let alone exceed it on a sustained basis, based on globalization, demographics, and technological trends (see chart, bottom right).

These conditions virtually ensure that the Fed will keep its policy rate at zero for at least the next several years while maintaining an aggressive pace of Treasury and Agency MBS purchases well into 2022. Our expectations for the path of Fed policy in coming years translate into a fair value estimate for 10-year Treasury yields of 0.85 percent, indicating that yields have risen too far too fast, aided by bearish seasonals. We see a constructive near-term backdrop for credit markets as deeply negative real interest rates and low FX hedging costs will spur a reach for yield. A key risk to our bullish view on credit is the emergence of several new strains of COVID-19, which raises the prospect of a much longer and deadlier battle against the coronavirus.

Employment Remains Considerably Below Pre-Covid Levels

U.S. Employment During Recessions, Cumulative Change From Cycle Peak

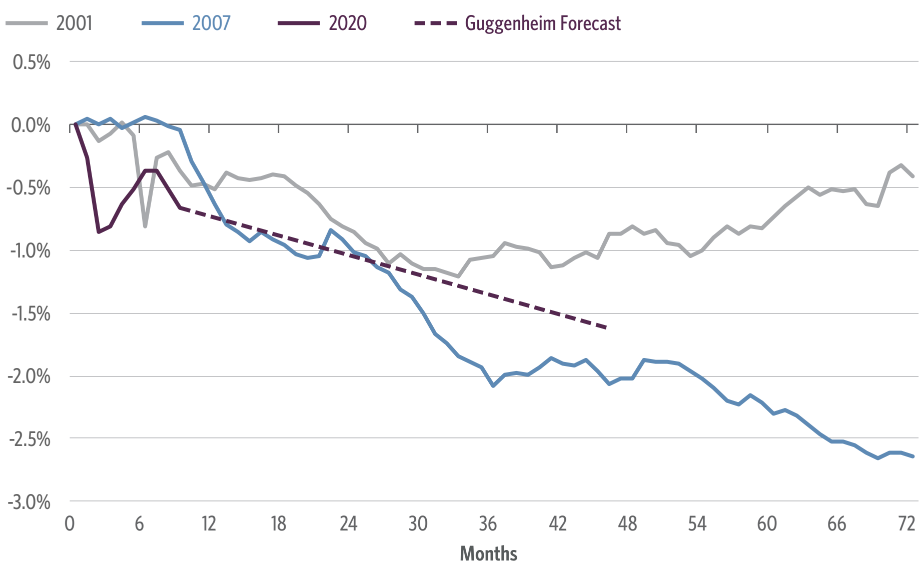


Source: Guggenheim Investments, Haver Analytics, BLS. Data as of 2.28.2021.

As of January 2021, U.S. real GDP had retraced 85 percent of the decline that occurred in March and April of 2020, while employment had retraced 67 percent of its decline through February. Nevertheless, output and employment remained 3.6 percent and 5.4 percent below their February peaks, respectively, much worse than during the first year of past downturns.

Fed Is Likely to Maintain Maximum Accommodation as Inflation Falls Short

Cumulative Core PCE Inflation Shortfall From 2 Percent Target Since Business Cycle Peak



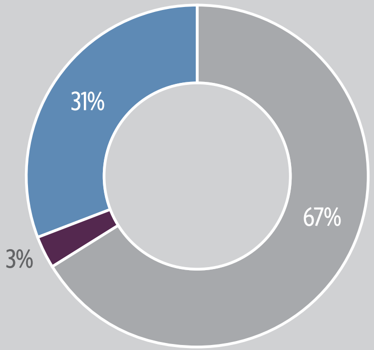
Source: Guggenheim Investments, Haver Analytics. Data as of 11.30.2020. Note: Dotted purple line shows Guggenheim forecast for cumulative core PCE shortfall at the end of 2023 rather than the precise forecast path.

As core inflation lags real GDP by about 18 months, more sequential downside is ahead over the next several quarters, and the experience of the last expansion suggests the Fed will struggle to reach 2 percent, let alone exceed it on a sustained basis, based on globalization, demographics, and technological trends.

Portfolio Strategies and Allocations

Guggenheim Fixed-Income Strategies

Bloomberg Barclays U.S. Aggregate Index[1]



Governments and Agencies:
Treasurys 37%, Agency Debt 2%, Agency MBS 27%, Municipals 1%

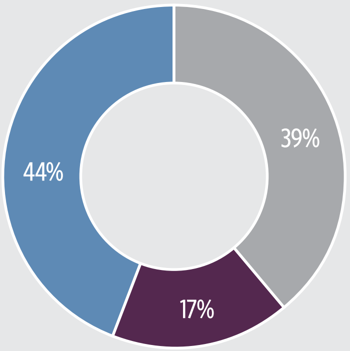
Structured Credit:
ABS 0%, CLOs 0%, Non-Agency CMBS 3%, Non-Agency RMBS 0%

Corporate Credit/Other:
Investment-Grade Corp. 27%, Below-Investment Grade Corp. 0%, Bank Loans 0%, Commercial Mortgage Loans 0%, Other 4%

The Bloomberg Barclays Agg is a broad-based flagship index typically used as a Core benchmark. It measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasurys, government-related and corporate securities, MBS (Agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (Agency and non-Agency). The bonds eligible for inclusion in the Barclays Agg are weighted according to market capitalization.

1. **Bloomberg Barclays U.S. Aggregate Index:** Other primarily includes 1.5% supranational and 1.2% sovereign debt. **Please see disclosures at the end of the document. Totals may not sum to 100 percent due to rounding.**

Guggenheim Core Fixed Income[2]



Governments and Agencies:
Treasurys 0%, Agency Debt 6%, Agency MBS 22%, Municipals 12%

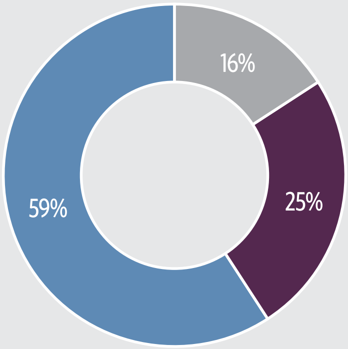
Structured Credit:
ABS 10%, CLOs 5%, Non-Agency CMBS 2%, Non-Agency RMBS 0%

Corporate Credit/Other:
Investment-Grade Corp. 22%, Below-Investment Grade Corp. 2%, Bank Loans 2%, Commercial Mortgage Loans 7%, Other 11%

Guggenheim's Core Fixed-Income strategy invests primarily in investment-grade securities, and delivers portfolio characteristics that match broadly followed core benchmarks, such as the Bloomberg Barclays Agg. We believe investors' income and return objectives are best met through a mix of asset classes, both those that are represented in the benchmark, and those that are not. Asset classes in our Core portfolios that are not in the benchmark include non-consumer ABS and commercial mortgage loans.

2. **Guggenheim Core Fixed Income:** Other primarily includes 4.8% private placements, 2.3% preferreds, 1.4% LPs, and 0.6% sovereign debt. **Please see disclosures at the end of the document. Totals may not sum to 100 percent due to rounding.** Sector allocations are based on the representative account of each Guggenheim strategy. Compositions may vary between accounts and are subject to change.

Guggenheim Core Plus Fixed Income[3]



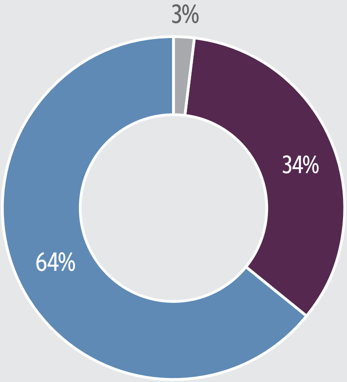
■ **Governments and Agencies:**
Treasurys 4%, Agency Debt 3%, Agency MBS 7%, Municipals 2%

■ **Structured Credit:**
ABS 7%, CLOs 8%, Non-Agency CMBS 3%, Non-Agency RMBS 6%

■ **Corporate Credit/Other:**
Investment-Grade Corp. 36%, Below-Investment Grade Corp. 7%, Bank Loans 6%, Commercial Mortgage Loans 0%, Other 11%

Guggenheim's Core Plus Fixed-Income strategy employs a total-return approach and more closely reflects our views on relative value. Like the Core strategy, Core Plus looks beyond the benchmark for value. Core Plus portfolios have added flexibility, typically investing up to 30 percent in below investment-grade securities and delivering exposure to asset classes with riskier profiles and higher return potential. CLOs and non-Agency RMBS are two sectors we consider appropriate for our Core Plus strategies, in addition to more traditional core investments such as investment-grade corporate bonds.

Guggenheim Multi-Credit Fixed Income[4]



■ **Governments and Agencies:**
Treasurys 0%, Agency Debt 0%, Agency MBS 2%, Municipals 1%

■ **Structured Credit:**
ABS 13%, CLOs 14%, Non-Agency CMBS 1%, Non-Agency RMBS 6%

■ **Corporate Credit/Other:**
Investment-Grade Corp. 9%, Below-Investment Grade Corp. 19%, Bank Loans 28%, Commercial Mortgage Loans 1%, Other 7%

Guggenheim's Multi-Credit Fixed-Income strategy is unconstrained, and heavily influenced by our macroeconomic outlook and views on relative value. As one of Guggenheim's "best ideas" strategies, our Multi-Credit portfolio allocation currently reflects a heavy tilt toward fixed-income assets that we believe more than compensate investors for default risk. Our exposure to riskier, below investment-grade sectors is diversified by investments in investment-grade CLOs and commercial ABS debt, which simultaneously allow us to limit our portfolio's interest-rate risk.

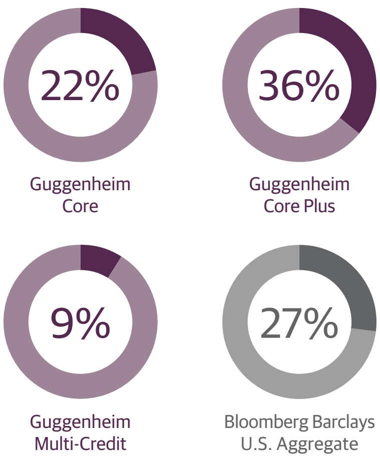
3. **Guggenheim Core Plus Fixed Income:** Other primarily includes 2.6% preferred stock, 1.1% private placements. **Please see disclosures at the end of the document. Totals may not sum to 100 percent due to rounding.** Sector allocations are based on the representative account of each Guggenheim strategy. Compositions may vary between accounts and are subject to change.

4. **Guggenheim Multi-Credit Fixed Income:** Other primarily includes 4.0% preferred stock and 2.5% private placements. **Please see disclosures at the end of the document. Totals may not sum to 100 percent due to rounding.** Sector allocations are based on the representative account of each Guggenheim strategy. Compositions may vary between accounts and are subject to change.

Investment-Grade Corporate Bonds

Spreads Are Likely to Tighten Further

Portfolio allocation as of 12.31.2020



Justin Takata
Managing Director

Technical indicators suggest that the rally we experienced in the fourth quarter has more room to run.

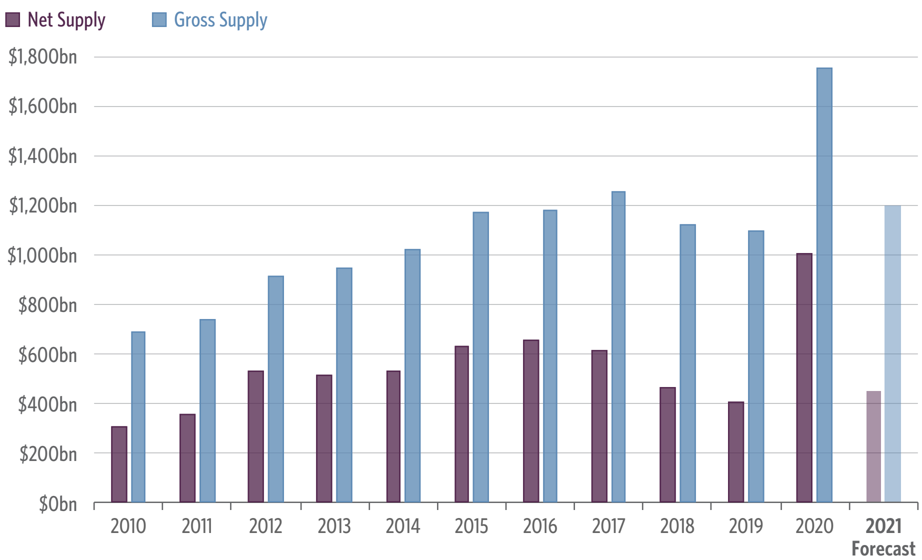
Investment-grade spreads have tightened to pre-COVID levels, driven largely by progress on the development of COVID vaccines, support from ongoing fiscal and monetary stimulus, and resolution of the political drama of the contentious presidential election. We witnessed an impressive rally in the fourth quarter as the Bloomberg Barclays U.S. Corporate Bond Index tightened to 96 basis points from 135 basis points on an option-adjusted spread (OAS) basis. Furthermore, technicals continue to lead the narrative for what we believe will result in further spread tightening in the first quarter of 2021.

Gross investment-grade primary issuance reached almost $1.8 trillion, and net issuance neared $1.0 trillion through the first three quarters of 2020 (see chart, top right). However, the fourth quarter saw virtually flat net issuance. We believe 2021 primary issuance will see a reversion to the mean closer to $1.2 trillion on a gross basis, providing further technical support to credit spreads. Foreign demand has continued to pick up at the margin as well, which contributed to nearly $55 billion of inflows to investment-grade corporate bond mutual funds in the fourth quarter.

As investment-grade corporate spreads currently sit near decade tights (see chart, bottom right), and with much good news priced in, we expect credit spreads to trade in a narrow range. Barring a monetary policy misstep or a dramatic increase in interest rate volatility, the near-term path for spreads appears tighter. We believe the negative headwinds for both equities and credit, in the form of election unrest and aggressive COVID-19 lockdown policies, have subsided. That said, we expect to see bouts of volatility around COVID-19 mutation fears and vaccine efficacy and distribution. We anticipate risk selloffs to be shallow and present buying opportunities, with compression among the lower-rated cyclical credits relative to higher-rated, larger capital structure credits.

Looking past the first quarter, the market will need confirmation the economic recovery is taking shape in order to support performance. Orderly rate back-ups due to additional stimulus will be welcomed by the market but a prolonged or aggressive jump in yields could cause some rotation out of corporate bonds.

Investment-Grade Supply Is Expected to Decrease in 2021



Source: Guggenheim Investments, J.P. Morgan. Data as of 1.31.2021.

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Investment-Grade Corporate Bond Spreads Are Likely to Tighten Further

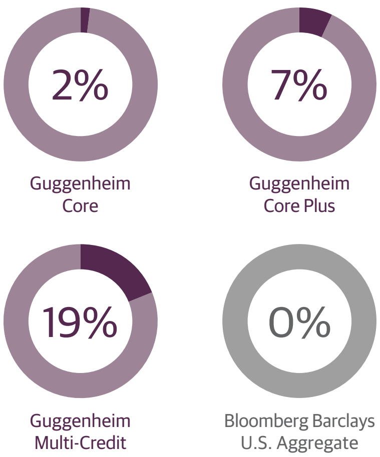
Source: Guggenheim Investments, Bloomberg. Data as of 1.26.2020. Shaded areas represent recession.

As investment-grade corporate spreads currently sit at near decade tights, and with much good news priced in, we expect credit spreads to trade in a narrow range. Barring a monetary policy misstep or a dramatic increase in interest rate volatility, the near-term path for spreads appears tighter.

High-Yield Corporate Bonds

Ongoing Shift Toward Lower Quality

Portfolio allocation as of 12.31.2020



Thomas Hauser
Senior Managing Director

Rich de Wet
Director

The lowest quality corporate bonds gain as investors stretch for yield.

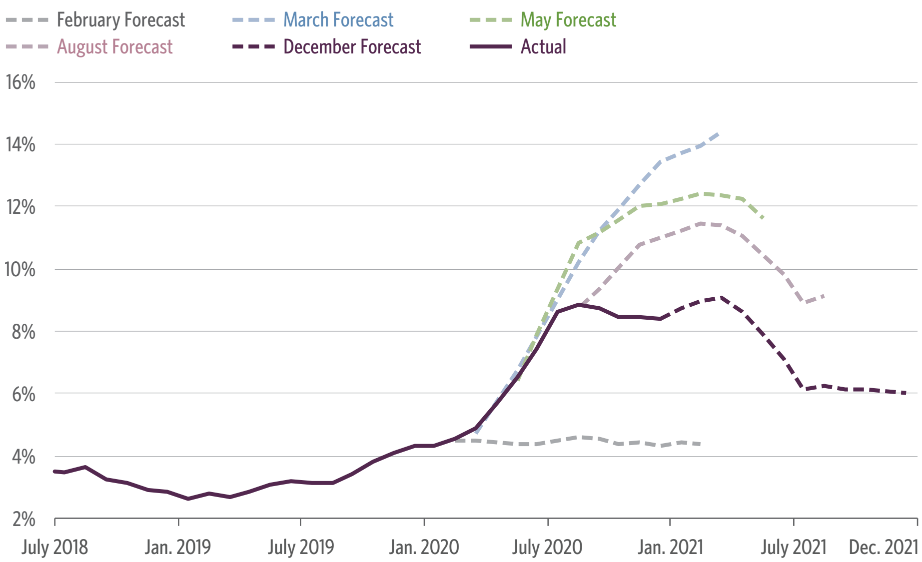
High-yield corporate bond spreads continued to tighten as investors gained confidence that the economy will eventually make a full recovery. The ICE BofA High Yield index yield fell to historical low of 3.9 percent during the first quarter of 2021 before rising back above 4.0 percent. It was previously thought that the floor on high-yield corporate bond index yields was 5 percent. In each of the last four cycles, bonds have pierced through the previous cycle's lowest yield, and this cycle is proving to be no different, even if the record low has arrived much sooner than normal. This is owing to the vast amount of policy support that continues to buttress financial conditions and, in turn, has decreased default projections.

Moody's now expects the speculative-grade default rate to fall to 6.0 percent in 2021 compared to 8.4 percent in 2020 (see chart, top right). We expect Moody's will continue to downgrade its default rate forecast as the U.S. economy grows well above potential, and as access to capital remains easy. In the first month of 2021, the high-yield corporate bond market saw $52 billion in debt issuance, a 36 percent increase from last January's total and the third largest monthly issuance volume dating back to January 2005. The makeup of January issuance also reflects a continued move toward lower quality, with 16 percent of high-yield corporate bond issuance rated CCC or below. This is a significant shift from 2020, when CCC or below issuance represented only 5.8 percent of the primary market.

We also see investors continuing to move decisively toward lower quality in the secondary market as they reach for higher total return potential. In the fourth quarter of 2020, CCC-rated bonds delivered more than twice the total return of the higher-rated BB and B-rated categories, with a return of 12.2 percent in a single quarter, leaving CCC-rated corporates yielding an average of only 8.7 percent, the lowest on record (see chart, bottom right). We think some of the rally in CCC looks overextended and would look for better value in the single B rated or higher space, where fewer deeply distressed situations exist. Broadly speaking, we continue to view selloffs as an opportunity to add to risk.

Accommodative Policies Support a Decline in Default Expectations

Moody's 12-Month Speculative-Grade Default Rate Forecasts

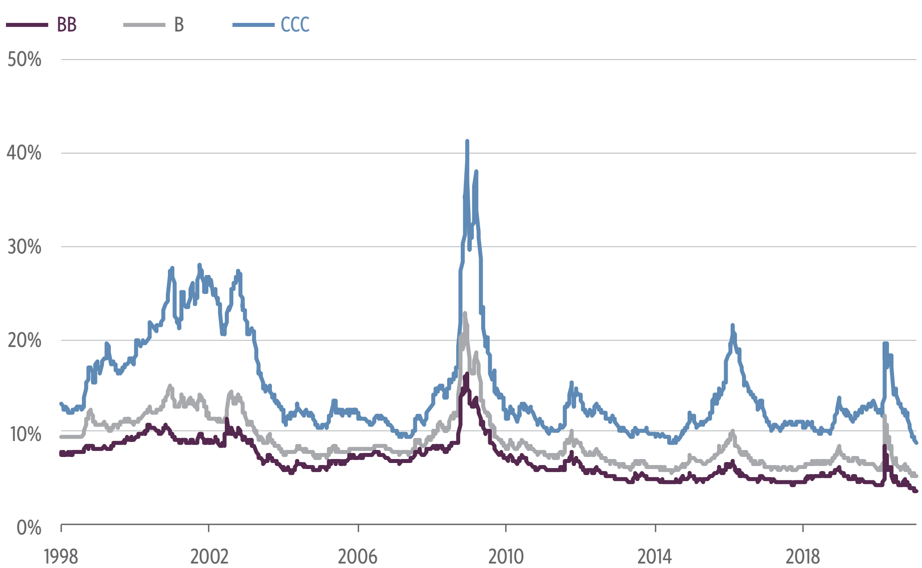


Source: Guggenheim Investments, Moody's. Data as of 12.31.2020.

Moody's now expects the speculative-grade default rate to fall to 6.0 percent in 2021 compared to 8.4 percent in 2020. We expect Moody's will continue to downgrade its default rate forecast as the U.S. economy grows well above potential, and as access to capital remains easy.

CCC-Rated High-Yield Corporate Bond Yields Hit Record Lows

Index Yields by Rating



Source: Guggenheim Investments, ICE Index Services. Data as of 1.22.2021.

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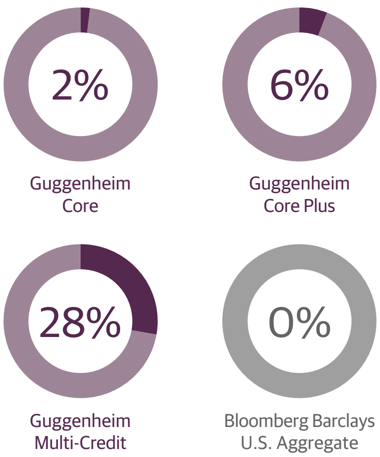
Bank Loans

Watch Refi Risk as Prices Improve

Portfolio allocation as of 12.31.2020



Thomas Hauser
Senior Managing Director

Christopher Keywork
Managing Director

We believe loans offer attractive value to income seekers, but refinancing risk could resurface in 2021.

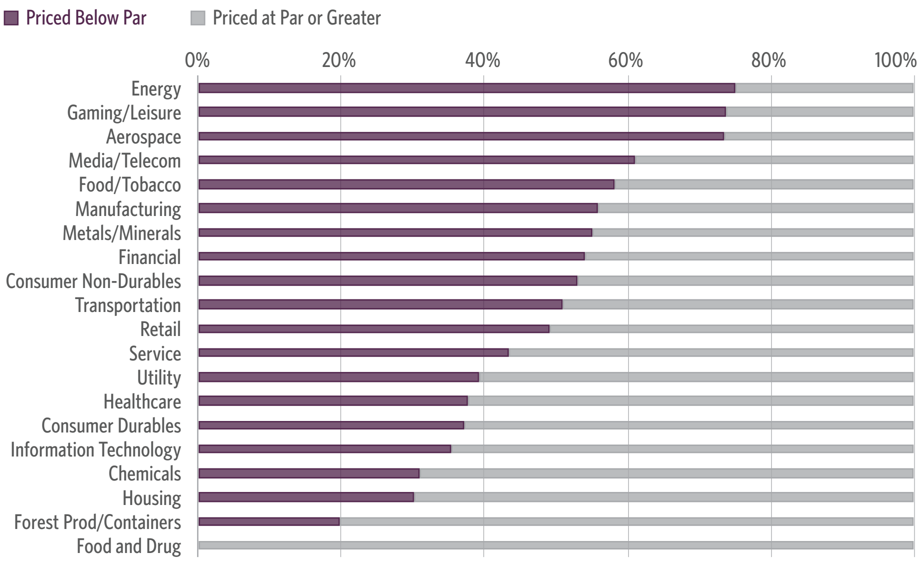
The leveraged loan sector delivered a total return of 2.8 percent in 2020 as Fed rate cuts lowered coupon rates and downgrades pushed prices lower. Bank loans should be better positioned for stronger performance this year with price discounts in some industries (see chart, top right), and the recent increase in Treasury yields renewing interest for duration protection among investors. Issuance in the collateralized loan obligation (CLO) market is also forecast to be a robust $100 billion, not including refinancing and reset volumes.

Loan investors will need to watch out for refinancing risk in favored industries such as healthcare, technology, and food and drug, where most loans are trading at or above par. There is a strong correlation between refinancing activity and the share of loans trading above par (see chart, bottom right). By comparing secondary loan spreads and pricing in the new issue loan market over the last four months, we found around $90 billion of single B loans that are "in the money" to be refinanced later this year, with 101 basis points in potential spread savings to the borrower. The aforementioned favored sectors comprised roughly $40 billion of this refinancing risk.

Downward credit migration has notably eased. The three-month ratio of loans downgraded versus upgraded fell to only 1.1x in the fourth quarter, compared to 43x earlier in the year. In its wake, negative rating migration left behind a loan market with the highest exposure to CCCs or below since 2010, and 19 percent of loans rated B-, the highest ever. This credit profile presents some downside risk given that the average CLO portfolio rating profile is worse than before the pandemic, which gives them less room to absorb more downgrades. But a strong economic recovery should buoy corporate earnings, and possibly restore some ratings to their previous level. Barring an unexpected economic shock, we believe the current rating profile will not weigh on the market's performance. And while discount margins have tightened from a March 2020 peak of 1,275 basis points to only 455 basis points , we see more room for further spread compression as spreads remain above the post-2008 tights of 381 basis points and pre-2008 tights of 230 basis points.

Discounted Loans Mostly Found in Energy, Leisure, Aerospace

Share of Index Trading at a Discount to Par, by Industry Loan Outstanding



Source: Guggenheim Investments, Credit Suisse, Bloomberg. Data as of 1.27.2021.

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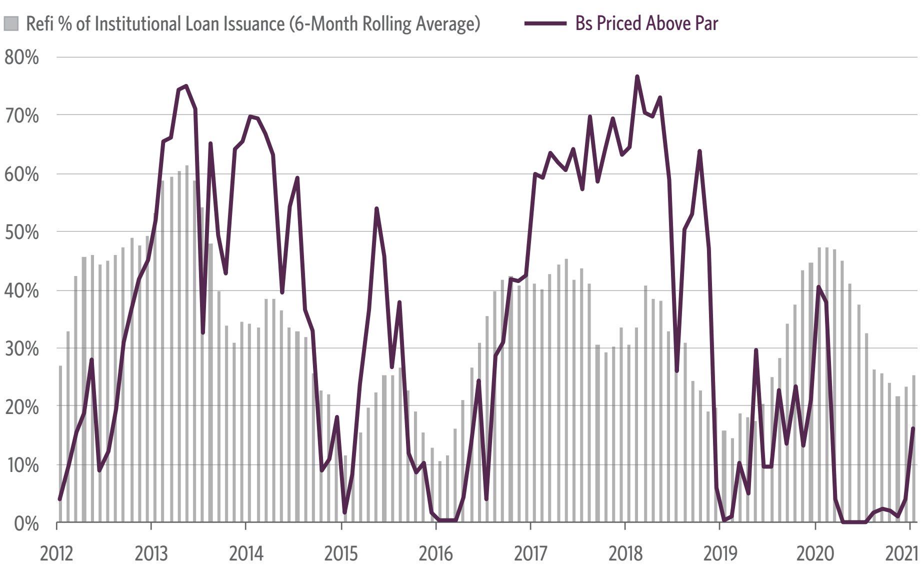
Market Is Heating Up as Investors Bid Loans to Par or Above

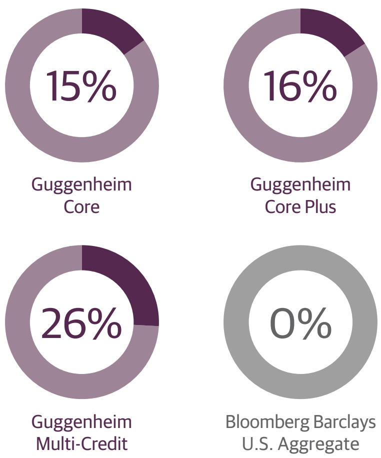


Source: Guggenheim Investments, S&P LCD, Credit Suisse. Data as of 1.27.2021.

There is a strong correlation between refinancing activity and the share of loans trading above par. By comparing secondary loan spreads and pricing in the new issue loan market over the last four months, we found around $90 billion of single B loans that are "in the money" to be refinanced later this year, with 101 basis points in potential spread savings to the borrower.

Asset-Backed Securities and CLOs
No Bond Left Behind

Portfolio allocation as of 12.31.2020



Peter Van Gelderen
Managing Director

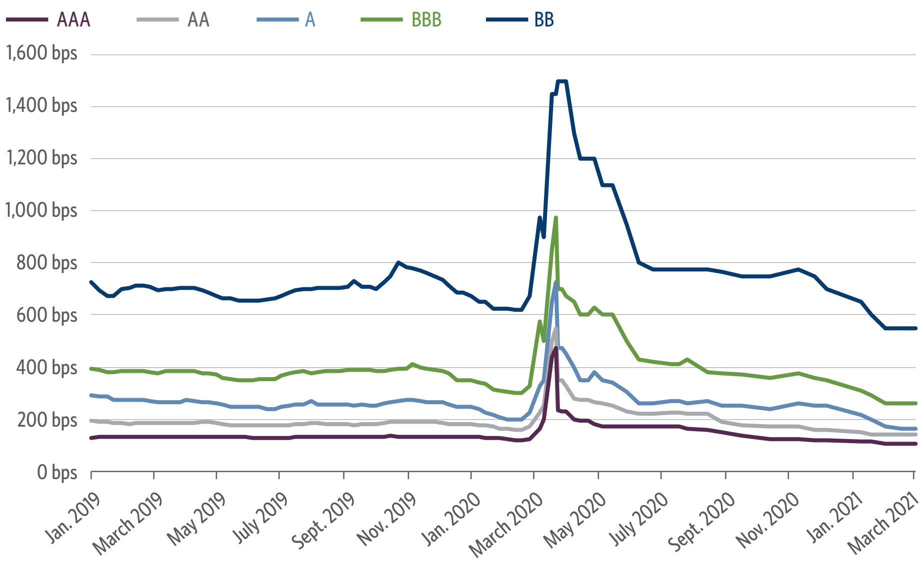
The Fed's QE "vaccine" has left investors flush with cash but few yielding investment alternatives.

The recovery in credit markets that occurred following March did not pass over the CLO market, where prices have fully recovered from the COVID-19 correction. Senior and subordinated CLO tranches both participated in the rally and are currently trading at the tightest spreads in the last two years (see chart, top right). Similarly, leveraged loans, the collateral for CLOs, rallied back to pre-COVID levels and largely avoided the wave of COVID-related defaults many had feared. As a result, rating agencies, which had downgraded a significant number of CLO tranches by mid-2020, have reversed course and now are reviewing many CLO tranches for upgrades. With this constructive backdrop, CLO new issuance surged in the fourth quarter of 2020 and should continue to exhibit considerable strength in 2021 (see chart, bottom right). Further, the rally in CLO spreads and leveraged loan prices has created a favorable environment for CLO refinancing and reset activity. We estimate the combined activity in both new issue and refi/reset will rival levels last observed in 2018. However, investor demand will likely meet the heavy primary market supply in step and keep CLO spreads tight and range-bound for the balance of 2021.

Most ABS subsectors have also fully recovered from the COVID-19 correction. Prices for bonds across all subsectors rose sharply as both interest rates and credit spreads collapsed in the second half of 2020. Many ABS securities now trade at large premium prices that may limit further price upside, though yield advantages versus similarly rated corporates still exist. ABS borrowers and Wall Street underwriters have capitalized on the strong investor demand by both improving execution levels and reintroducing transactions that had failed to launch in 2020. In the fourth quarter of 2020 and the start of 2021, new issue subscription levels have routinely exceeded 3x–5x on offered securities. As a result, borrowers have been able to substantially improve bond pricing execution. In fact, demand has been so strong at the start of 2021 that two separate transactions in rail and real estate that had failed to find enough investor interest in 2020 were successfully reintroduced in January 2021 at spreads that were tighter than the original failed levels. There is simply too much cash in investor coffers and too few high yielding alternatives.

Our current investment focus balances our prioritization of strong, creditworthy investments with a constructive view on macroeconomic conditions. We have recently found compelling risk-adjusted profiles in financial ABS, aircraft sale-leaseback transactions, and subordinated CLO debt investments.

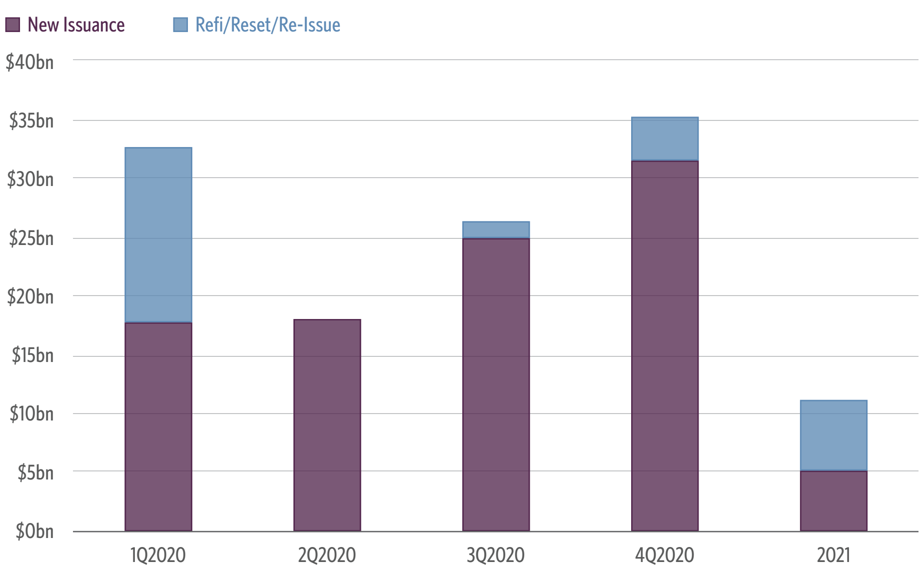
Investment-Grade CLO Spreads Have Tightened From Recent Peaks



Source: Guggenheim Investments, J.P. Morgan. Data as of 3.5.2021.

Senior and subordinated CLO tranches both participated in the rally and are currently trading at the tightest spreads in the last two years. Similarly, leveraged loans, the collateral for CLOs, rallied back to pre-COVID levels and largely avoided the wave of COVID-related defaults many had feared.

Q4 CLO Issuance Rebound Looks Set to Continue in Q1



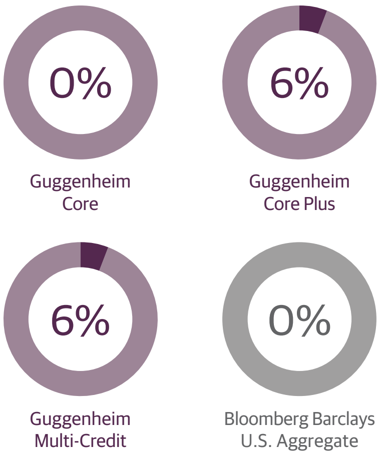
Source: Guggenheim Investments, J.P. Morgan. Data as of 1.22.2021

CLO new issuance surged in the third and fourth quarters as investor demand and pricing spreads recovered from COVID trough levels. In 2021, we expect a continued uptick in primary market activity, especially refinance/reset activity.

Non-Agency Residential Mortgage-Backed Securities

Building Blocks for Recovery

Portfolio allocation as of 12.31.2020



Karthik Narayanan, CFA
Managing Director

Roy Park
Director

Elevated economic risks and credit stress are fully priced and should set the stage for future performance.

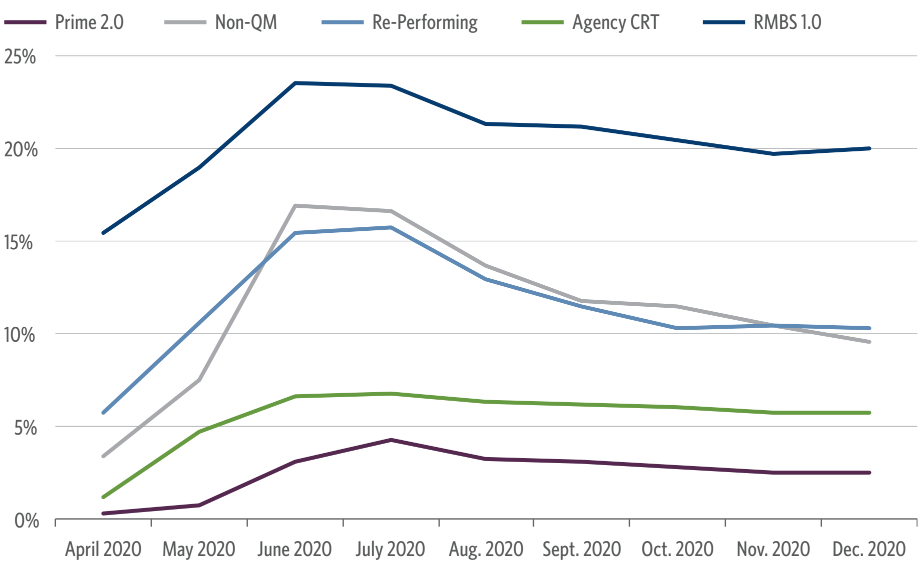
Non-Agency RMBS prices increased over the fourth quarter as broader risk markets continued to recover from their pandemic-induced dislocations. RMBS 1.0 and 2.0 returned 1.8 percent and 1.0 percent in the fourth quarter, respectively, putting returns in positive territory for all RMBS subsectors for 2020. Highly rated RMBS 2.0 bonds have fully retraced their second-quarter selloff, while lower-rated RMBS 1.0 and mezzanine classes have retraced approximately 80 percent of their early 2020 slide.

High unemployment strained homeowners' finances and resulted in elevated mortgage delinquencies, which are now on a slow path to recovery (see chart, top right). Structural changes in loan servicing after the 2008 financial crisis, which strongly favor workouts over foreclosures, and the absence of weakly documented or highly leveraged "affordability mortgages," have kept collateral losses far below those experienced in 2008–2009 and prevented credit deterioration from transmitting adverse feedback to the housing market.

Looking forward, pre-financial crisis originated RMBS 1.0 is emerging as a rare institutional-scale, investable market that has experienced two credit cycles in its history. These cycles have the effect of creating "credit burnout," or positive credit selection, where cycles of stress have forced liquidation or modification of weaker loans, thereby leaving a collateral pool of surviving borrowers who are less sensitive to future economic shocks. RMBS 1.0 loans outstanding today have survived the 10 percent unemployment and 30+ percent home price decline of the financial crisis, as well as the 16 percent peak unemployment experienced in the second quarter of 2020. In addition, loan principal amortization and home price gains have reduced RMBS 1.0 loan-to-value ratios to approximately 55 percent (see chart, bottom right), suggesting significant homeowner equity and incentive to perform.

The combination of a stable housing market, low interest rates, and multi-cycle credit burnout underpin our preference for senior tranches of credit-sensitive RMBS 1.0 deals. For longer investment horizons, RMBS 1.0 has the potential for price appreciation from improving credit performance and bond cash flows. RMBS 2.0 tranches at the senior level offer credit stability and a modest yield pickup to the risk-free benchmarks, while subordinated tranches offer incrementally higher yields supported by the tailwinds of improving credit fundamentals.

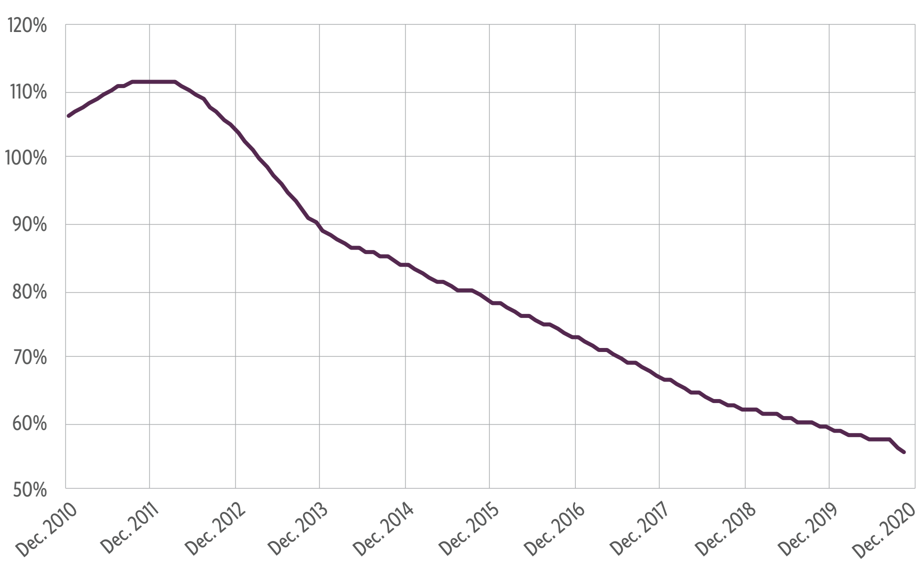
Mortgage Delinquencies Are Slowly Declining



Source: Guggenheim Investments, J.P. Morgan. Data as of 12.31.2020.

High unemployment strained homeowners' finances and resulted in elevated delinquencies, which are now on a slow path to recovery.

RMBS 1.0 Mortgage Loan-to-Value Ratios Declined to 55 Percent



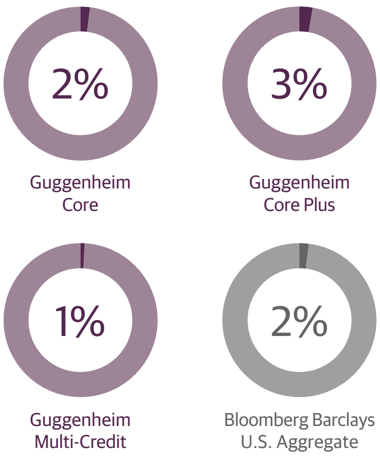
Source: Guggenheim Investments, Intex. Data as of 12.28.2020. Chart shows ratio of amortized outstanding mortgage loan balance to estimated updated home price for 2005-2007 vintage and subprime loans.

Loan principal amortization and home price gains have reduced RMBS 1.0 loan-to-value ratios to approximately 55 percent, suggesting significant homeowner equity and incentive to perform.

Commercial Mortgage-Backed Securities

Increasing Supply in 2021

Portfolio allocation as of 12.31.2020



Peter Van Gelderen
Managing Director

Phil Hoehn
Vice President

Property performance remains under pressure, but senior CMBS have fully recovered from the COVID selloff.

CMBS spreads have tightened significantly since the COVID-19 selloff in March 2020 (see chart, top right), and demand for CMBS remains high. Several factors have led to high demand and tighter spreads, including reduced volumes of new issuance, lower concentrations of retail and hospitality loans within pools, improving macroeconomic conditions, and rollout of the vaccine.

In 2020, new issuance within CMBS fell by 45 percent—conduit down 37 percent, single asset/single borrower (SASB) down 48 percent, and CRE-CLO down 56 percent—due to lower loan volumes from issuers as pandemic uncertainty persisted (see chart, bottom right). Furthermore, investor demand for lower concentrations of retail and hospitality loans within securitizations constrained issuers even further as risks associated with those property types remain elevated.

We expect increased issuance in 2021 as optimism from issuers and investors grows due to stable market conditions, the rollout of COVID-19 vaccines, and a settled election offering clarity around policy related to commercial real estate. As we evaluate opportunities in both primary and secondary markets, we remain cautious and selective regarding which deals to pursue for two reasons. First, some pools will likely have incrementally higher concentrations of retail and hospitality loans. Even with the rollout of vaccines and positive economic trends, we believe these property types will experience some interruptions in cash flows through the next few years. Second, relief for borrowers through temporary loan covenant forgiveness and debt service forbearance is partially responsible for sustaining performance in the near term. Once these measures run out, the status of some loans marked as current could shift to delinquent.

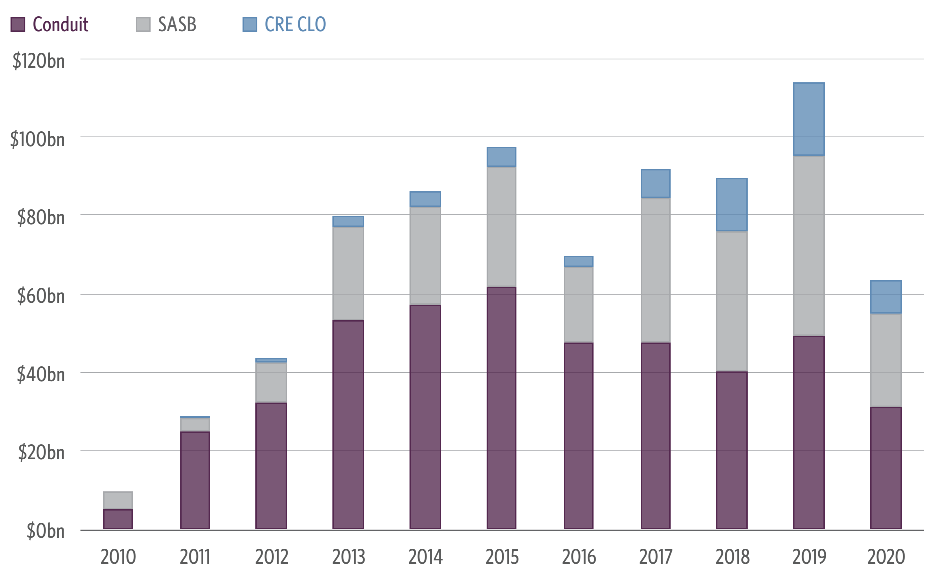
One of the areas we are targeting in secondary markets is subordinate CRE-CLO bonds. CRE-CLO transactions, collateralized by short-term, floating rate, transitional commercial real estate loans, feature low loan-to-value ratios and remain money good in our stress analysis. These securities offer compelling carry, but because current prices are also at discounts to par, there is additional upside potential in the event of early loan payoffs and spread tightening.

CMBS Spreads Are Likely to Continue to Tighten in the First Quarter

Source: Guggenheim Investments. Data as of 1.15.2021.

CMBS spreads have tightened significantly since the COVID-19 selloff in March 2020, and demand for CMBS remains high.

Issuance Should Bounce Back in 2021 as Investor Confidence Recovers



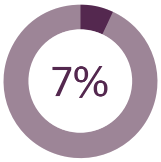
Source: Guggenheim Investments, J.P. Morgan. Data as of 12.31.2020

In 2020, new issuance within CMBS fell by 45 percent—conduit down 37 percent, SASB down 48 percent, and CRE-CLO down 56 percent—due to lower loan volumes from issuers as pandemic uncertainty persisted. However, we expect higher issuance in 2021 over 2020 as optimism from issuers and investors grows.

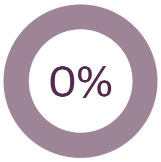
Commercial Real Estate Debt

Expect a Protracted Recovery in Hotels

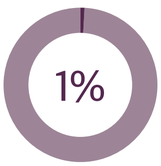
Portfolio allocation as of 12.31.2020



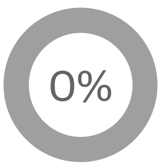
Guggenheim Core



Guggenheim Core Plus



Guggenheim Multi-Credit



Bloomberg Barclays U.S. Aggregate

Jennifer A. Marler
Senior Managing Director

Margot Latham
Managing Director

COVID-19 is exacting a heavy toll on the U.S. hospitality industry.

Given the pandemic's social distancing guidelines, shelter-at-home directives, and restrictions on business travel and conferences, it was no surprise that the U.S. hotel sector was hit particularly hard in 2020. The low point for hotels was in the week ending April 11, just weeks after the number of confirmed COVID-19 cases began to accelerate. While there has been a modest recovery, by the end of December 2020 revenue per available room (RevPAR) was still down roughly 50 percent year over year (see chart, top right). Weekly room demand has only recovered to $11.9 million per week, well below the pre-COVID level (see chart, bottom right). All hotel markets felt some degree of distress, though some were less affected than others. Drive-to markets fared better than denser urban markets, which are more dependent on air travel and conference business. Likewise, extended stay hotels have weathered the downturn better than other types of hotels, and economy hotels have fared better than luxury properties.

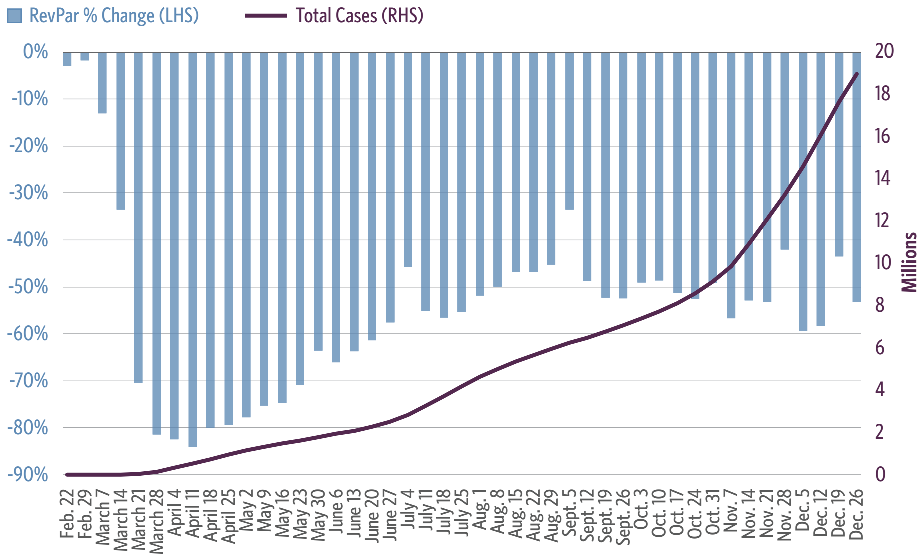
The impact of the hotel downturn on outstanding hotel debt is still to be determined. Since April 2020 hotel borrowers have been asking their lenders for relief to bridge a period of low occupancy. Hotel borrowers have also been actively taking advantage of Paycheck Protection Program (PPP) loans. Some lenders have started to sell distressed hotel debt, but with very few post-COVID transactions trading in the market to date, it is uncertain how much further hotel prices may fall this year. RevPAR recovery will be closely linked to efforts to contain the virus and the return of both business and leisure travel. Without this assurance, it is unlikely that RevPAR will see a quick bounce back. A protracted recovery for the U.S. hotel industry will demand patience from both investors and lenders.

Hotels have been hit hard by the pandemic, but no property type has been unscathed. The pandemic has accelerated the shift to online shopping, and the retail sector is experiencing distress from tenants unable (or unwilling) to pay rent. Elevated unemployment will likely result in rising apartment rent delinquencies. Some office tenants are choosing to retain cash in lieu of paying rent. The full impact of the pandemic on office vacancy will likely not be understood until mid-2021 as office tenants are deferring making decisions on long-term leases. And, although less directly affected, the industrial sector will not be spared either.

As the virus continues to infect commercial real estate, we are closely monitoring COVID-19's impact on cash flows and resulting effects on property values in 2021. Our recent investments have been focused in the industrial distribution sector, as companies accelerate investments in real estate assets critical to the supply chain delivering goods to consumers. These properties have continued to perform well, often backed by long-term net leases guaranteed by investment-grade tenants.

RevPar Recovered Some Lost Ground, but Remains Low

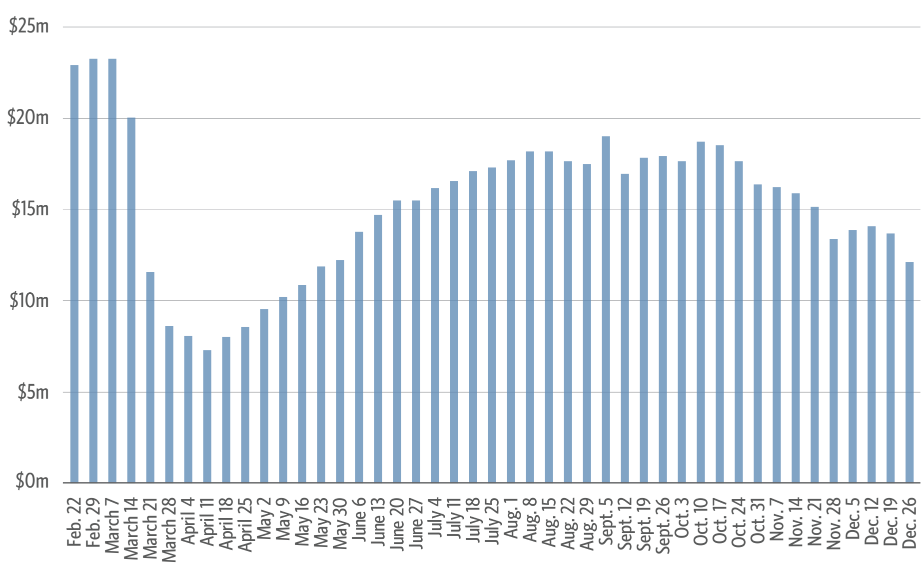
RevPar % Change and Number of COVID-19 Cases by Week



Source: Guggenheim Investments, STR 2020/2021, Bloomberg. Data as of 12.26.2020.

While there has been a modest recovery, by the end of December 2020 RevPAR was still down roughly 50 percent year over year.

Hotel Room Demand Is Up, but Below Pre-COVID Levels



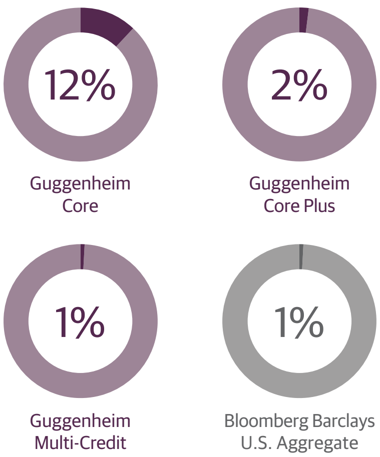
Source: Guggenheim Investments, STR 2020/2021. Data as of 12.26.2020.

Weekly room demand has only recovered to $18.5 million per week, well below the pre-COVID level.

Municipal Bonds

Sky High Supply

Portfolio allocation as of 12.31.2020



Allen Li, CFA
Managing Director

Michael Park
Vice President

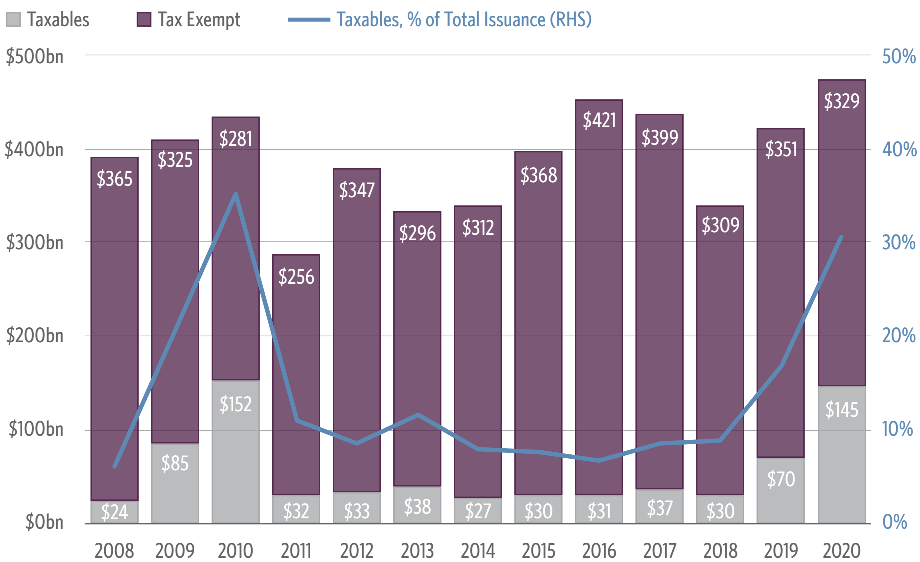
Supply in 2021 is likely to exceed 2020's record $474 billion in new issuance.

2020 was a banner year for municipal market supply with approximately $474 billion of total new issuance, an increase of 13 percent year over year. Taxable bonds accounted for 31 percent of total issuance, compared to an average of 11 percent for the prior three years (see chart, top right). The surge in taxable supply was met by appetite from crossover buyers such as banks and insurance companies looking for attractive risk-adjusted relative value versus similarly rated corporate bonds. With expectations for a prolonged low-rate environment, municipal market dealers widely forecast another record-setting supply year for 2021.

Accommodative monetary policy and optimism for more fiscal stimulus drove performance in 2020, with the Bloomberg Barclays Municipal Bond Index returning 5.21 percent for the year. As of January 2021, 10-year and 30-year municipal bond yield ratios rallied to new record lows of 64.4 percent and 78.3 percent, respectively, only nine months after spiking to near-record highs in March 2020 (see chart, bottom right). Despite outflows of $43 billion in March 2020 alone, the municipal market ended the year with $38 billion of cumulative net inflows. Policy uncertainty has been reduced with Democrats now in control of the White House and Congress, with the prospect of increased federal fiscal support for municipal issuers underpinning the market's bullish tone to start 2021. Moreover, the possibility of higher income taxes should increase demand for tax-exempt investment products.

Despite economic challenges brought by the pandemic and new credit paradigms, municipal bond valuations have returned to near pre-COVID levels. While credit quality has suffered across fixed-income asset classes, many municipal issuers' intrinsic essentiality and durability have been illuminated. Understanding that full economic recovery will neither be a short nor easy road, we continue to emphasize security selection. While the initial Coronavirus Aid, Relief, and Economic Security Act and its sequels provide vitally needed relief for municipal issuers, we do not view one-time liquidity injections as a panacea for the long term. Rather than relying on policymakers to apply funding Band-Aids, we focus on structural creditworthiness that can endure this pandemic as well as future exogenous events.

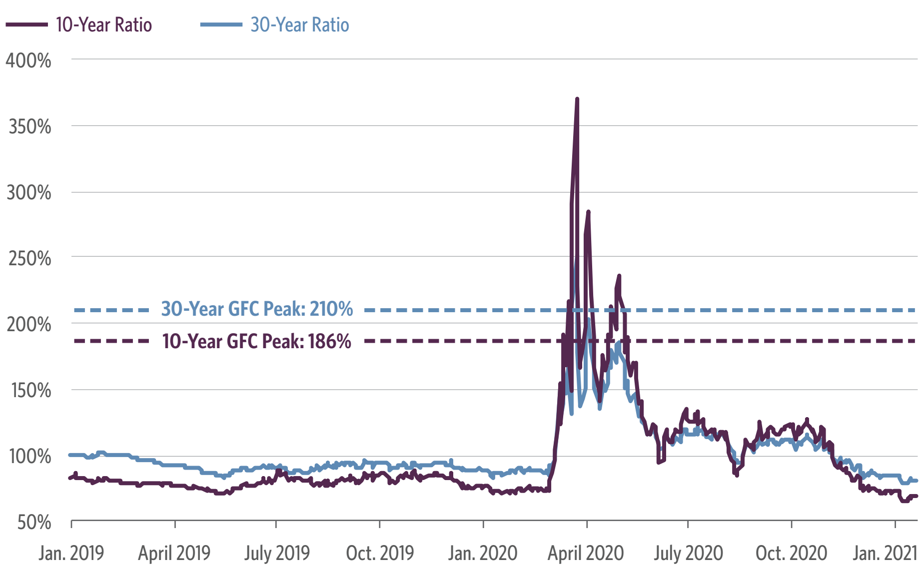
Investor Demand Absorbs Surging Taxable Muni Bond Issuance
Annual New Issuance



Source: Guggenheim Investments, Bond Buyer. Data as of 12.31.2020.

Taxable bonds accounted for 31 percent of total issuance, compared to an average of 11 percent for the prior three years. The surge in taxable supply was met by appetite from crossover buyers such as banks and insurance companies looking for attractive risk-adjusted relative value versus similarly rated corporate bonds.

Muni Yield Ratios Spiked Above Financial Crisis Levels, Then Rallied to New Lows



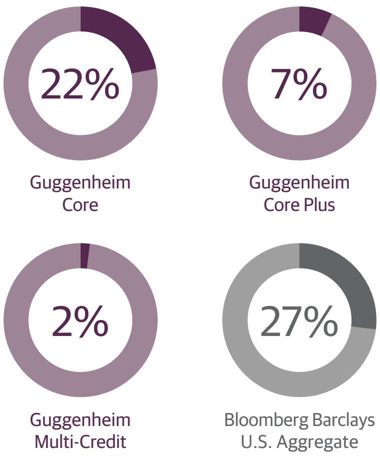
Source: Guggenheim Investments, Thomson Reuters, Bloomberg. Data as of 1.19.2021.

As of January 2021, 10-year and 30-year municipal bond yield ratios rallied to record lows of 64.4 percent and 78.3 percent, respectively, only nine months after spiking to near record highs in March 2020.

Agency Mortgage-Backed Securities

Fed Leads the Way

Portfolio allocation as of 12.31.2020



Aditya Agrawal, CFA
Director

Louis Pacilio, CFA
Vice President

Fed stabilizes MBS sector despite record low mortgage rates.

Mortgage spreads continued to tighten over the fourth quarter as the Fed and heavy bank demand offset prepayment concerns due to mortgage rates hitting all-time lows. Option-adjusted spreads ended the quarter at 41 basis points, 22 basis points tighter quarter over quarter and effectively unchanged year over year (see chart, top right). The Bloomberg Barclays U.S. MBS Index fourth quarter total return and excess return were 0.22 percent and 0.34 percent, respectively. Agency MBS 2020 total returns totaled 3.84 percent, which lagged all other subsectors of the Bloomberg Barclays U.S. Aggregate Index. Notably, Agency CMBS—which offer better convexity and capped issuance—posted fourth quarter and 2020 total returns of 0.50 percent and 8.92 percent, respectively.

Since the start of QE4, mortgage spread performance has been bifurcated between production coupons buoyed by over $1 trillion in Fed purchases and "non-Fed" coupons exposed to primary rates at all-time lows (see chart, bottom right). Fed purchases remove the most negatively convex bonds and boost the carry profile of "to-be-announced" (TBA) securities, which has resulted in the outperformance of lower coupons versus the mortgage index. Given the small percentage of the index that lower coupons comprise and the Fed's stated intention to continue with $40 billion of monthly net purchases, this is a trend we expect to continue. Primary rates remain near all-time lows at well below 3 percent despite the recent rates selloff, leading call-protected subsectors of the market, including specified pools and Agency CMBS, to enjoy some of their best relative performance in recent memory. Heading into 2021, we expect heightened prepay concerns to remain as mortgage originators increase capacity to meet demand and capitalize on record profitability.

Against this longer-term outlook, we favor investments where either the collateral or structure offers some cash flow stability. We find select subsectors—especially those not directly purchased by the Fed—attractively priced in the current environment, including off-the-run Agency CMBS, select specified pools, and locked-out collateralized mortgage obligation structures. These investments enjoyed strong performance prior to Fed intervention, and we expect similar results when the Fed eventually reduces the pace of its Agency MBS purchases and the market's focus returns to cash flow fundamentals.

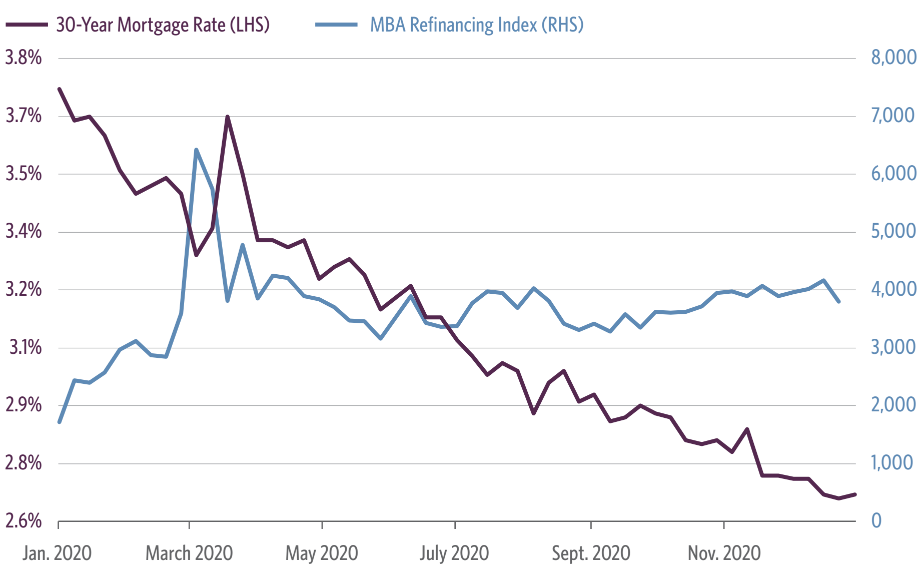
Fed Intervention Helped Stabilize Mortgage Spreads

Bloomberg Barclays Agency MBS Index OAS

Source: Guggenheim Investments, Bloomberg. Data as of 12.31.2020

Option-adjusted spreads ended the quarter at 41 basis points, 22 basis points tighter quarter over quarter and effectively unchanged year over year.

Historically Low Mortgage Rates Boost Agency MBS Relative Performance



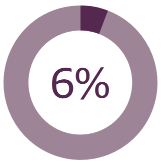
Source: Guggenheim Investments, Bloomberg. Data as of 12.31.2020

Since the start of QE4, mortgage spread performance has been bifurcated between production coupons buoyed by over $1 trillion in Fed purchases and "non-Fed" coupons exposed to primary rates at all-time lows.

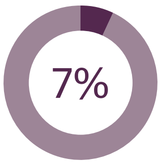
Rates

Positioned for a Dovish Fed

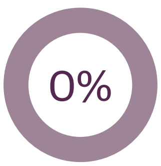
Portfolio allocation as of 12.31.2020



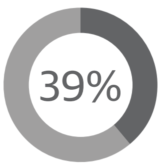
Guggenheim Core



Guggenheim Core Plus



Guggenheim Multi-Credit



Bloomberg Barclays U.S. Aggregate

Kris Dorr
Managing Director

Tad Nygren, CFA
Managing Director

Anticipated fiscal stimulus could push 10-year rates above current levels and would present a buying opportunity.

Following a year that will be remembered for the devastating human and economic effects of the global pandemic and domestic political uncertainties, 2021 began with some clarity and perhaps even a touch of optimism. While elevated COVID-19 infections and virus mutations around the world continue to signal that the pandemic is far from over, the development and emergency approval of several effective vaccines provided the much-needed hope that the pandemic's end could possibly be in sight. In addition to the positive vaccine developments, market participants were also buoyed by the Fed's ongoing commitment to support the recovery through accommodative monetary policy. Furthermore, the election of a Democratic government majority in the United States reassured the market that additional large-scale fiscal stimulus was likely to be on the way. As positive news evolved, the prospects for increased global growth propelled equities to near all-time highs, moved longer term Treasury yields higher, and lifted market-implied inflation expectations.

While the fourth quarter experienced a bear steepening of the Treasury curve (see chart, top right) with yields increasing 20–25 basis points in the long end, policy easing by the Fed during the first half of the year drove an overall bull steepening for the year, driving yields lower by 75–145 basis points across the curve. This led to significant gains for the Treasury market, with the index delivering a total return of 8.0 percent in 2020. The longer end of the Treasury market experienced even stronger returns, with the Treasury 20+ year index generating an 18.1 percent total return for the year.

Looking ahead, we expect a new round of fiscal stimulus of roughly $1.9 trillion to be passed imminently, which will require higher net Treasury issuance than would have otherwise been the case. This stimulus has boosted growth and inflation expectations and could push 10-year rates to as high as 1.75–2.00 percent, which we would see as a buying opportunity. While we do not expect a broad-based or sustained spike in inflation, inflation expectations have risen, resulting in a steeper yield curve (see chart, bottom right). We believe the Fed's policy of flexible average inflation targeting—in which the Fed will seek to achieve inflation above 2 percent to make up for periods of below-target inflation—will translate into a longer period of short-term rates at zero than the market is currently pricing in. As such, we see attractive carry and roll-down opportunities in the front end and belly of the yield curve.

Note: "Rates" products refer to Treasury securities and Agency debt securities. Treasury and Agency returns are represented by the Bloomberg Barclays Treasurys index and the Bloomberg Barclays U.S. Agency index, respectively.

Fed Policy Easing Led to a Steeper Treasury Yield Curve

U.S. Treasury 5-Year/30-Year Yield Curve

Source: Guggenheim Investments, Bloomberg. Data as of 1.29.2021.

While the fourth quarter experienced a bear steepening of the Treasury curve with yields increasing 20–25 basis points in the long end, policy easing by the Fed during the first half of the year drove an overall bull steepening, driving yields lower by 75–145 basis points across the curve.

Market Implied 10-Year Inflation Expectations Have Recovered

10-Year Treasury Inflation-Protected Securities Breakeven Rate

Source: Guggenheim Investments, Bloomberg. Data as of 1.15.2021.

While we do not expect a broad-based or sustained spike in inflation, inflation expectations have risen, resulting in a steeper yield curve. We believe the Fed's policy of flexible average inflation targeting—in which the Fed will seek to achieve inflation above 2 percent to make up for periods of below-target inflation—will translate into a longer period of short-term rates at zero than the market is currently pricing in.

Important Notices and Disclosures

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2. Guggenheim Partners assets under management are as of 12.31.2020 and include consulting services for clients whose assets are valued at approximately $70bn.

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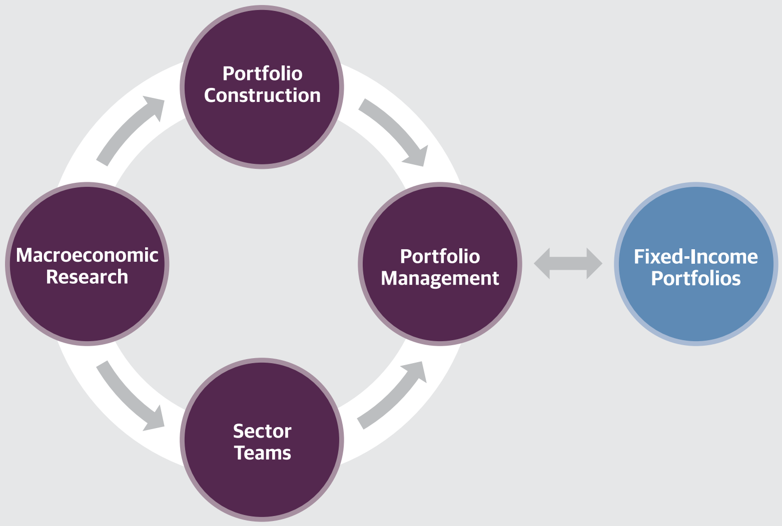
Guggenheim's fixed-income portfolios are managed by a systematic, disciplined investment process designed to mitigate behavioral biases and lead to better decision making. Our investment process is structured to allow our best research and ideas across specialized teams to be brought together and expressed in actively managed portfolios. We disaggregated fixed-income investment management into four primary and independent functions—Macroeconomic Research, Sector Teams, Portfolio Construction, and Portfolio Management—that work together to deliver a predictable, scalable, and repeatable process. Our pursuit of compelling risk-adjusted return opportunities typically results in asset allocations that differ significantly from broadly followed benchmarks.



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Guggenheim Investments is the global asset management and investment advisory division of Guggenheim Partners, with more than $246 billion[1] in total assets across fixed income, equity, and alternative strategies. We focus on the return and risk needs of insurance companies, corporate and public pension funds, sovereign wealth funds, endowments and foundations, consultants, wealth managers, and high-net-worth investors. Our 300+ investment professionals perform rigorous research to understand market trends and identify undervalued opportunities in areas that are often complex and underfollowed. This approach to investment management has enabled us to deliver innovative strategies providing diversification opportunities and attractive long-term results.

About Guggenheim Partners

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