

Balancing Attractive Yields and Tight Spreads

Even as they tighten, spreads in high grade sectors remain wide relative to fundamental risk.

Tighter monetary policy has weighed on the U.S. economy, but a broad recession has thus far been avoided primarily due to deficit fueled fiscal spending associated with the COVID-19 pandemic. This has created a resilient consumer, helped to fortify corporate balance sheets, and contained more widespread economic weakness, even as high interest rates created a “rolling recession” dynamic. Although expanding economic capacity allowed inflation to fall quickly in 2023 even with strong growth, progress stalled in the first quarter with three consecutive months of elevated prints. The Federal Reserve (Fed) responded by reinforcing a higher-for-longer policy stance that has incited some volatility in the markets. While volatility can be unnerving, we are mindful that the pause phase of the Fed’s monetary policy cycle creates an environment that is constructive for fixed income and more specifically for active management in the credit markets.

A common theme across our sector team reports this quarter is that while spreads have been grinding tighter, yields remain high and attractive, particularly relative to post-Global Financial Crisis (GFC) norms. Even as they tighten, spreads in high grade sectors remain wide relative to fundamental risk. Credit fundamentals are healthy overall, but we are still seeing bifurcation between the larger issuers with better access to capital and an ability to pass along higher costs to customers, and smaller and lower quality issuers that are struggling with higher interest expense. We expect growth to moderate in 2024, with increasing dispersion under most scenarios.

Opportunities across fixed income remain broad based, even in categories that we have traditionally underweighted like Agency RMBS. Broadly we are prioritizing high carry and shorter duration instruments. Favored categories include non-Agency RMBS, senior CLOs, commercial ABS, current coupon RMBS, syndicated loans, high quality high yield and certain parts of the investment-grade corporate market. In thinking about spread valuations, the most attractive sectors remain primarily in securitized products, both Agency RMBS and non-Agency structured credit. Even as we take advantage of market conditions to invest at these levels, and the growing new issue pipeline, we are all also maintaining dry powder and taking a high-quality bias for future optionality.

The retracement in yields higher to start the year has cheapened certain parts of the yield curve. We find the front end and belly of the curve look most attractive as Fed easing expectations have been pushed back, which aligns with our longer-term expectation that the curve will bull-steepen as these expectations start to move toward rate cuts.

The current investment environment should reward a balanced approach. Our preferred strategy is to preserve diligent underwriting standards, prioritize carry and maintain diversification across sectors and issuers.

By Anne Walsh, Steve Brown, Adam Bloch, and Evan Serdensky

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.

Investing involves risk, including the possible loss of principal. In general, the value of a fixed-income security falls when interest rates rise and rises when interest rates fall. Longer term bonds are more sensitive to interest rate changes and subject to greater volatility than those with shorter maturities. During periods of declining rates, the interest rates on floating rate securities generally reset downward and their value is unlikely to rise to the same extent as comparable fixed rate securities. 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, and GS GAMMA Advisors, LLC.

© 2024, 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. GPIM 61514