GUGGENHEIM

Second Quarter 2023

Fixed-Income Sector Views

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Portfolio Management Outlook

Opportunity in Fixed Income Rises With Uncertainty

Mounting headwinds are spooking many investors, creating attractive entry points.

The first quarter edition of our Fixed-Income Sector Views was posted on Feb. 22, 2023. Less than three weeks later markets faced down an unexpected banking crisis that has continued to permeate. We are not in the business of predicting black swans but we are in the business of preparing our portfolios for a range of outcomes, and as we headed into the week of Silicon Valley Bank's (SVB) downfall we were already positioning for late-cycle market activity, a time when unwanted market surprises are more likely to occur. For several quarters we have been rotating portfolios to be more defensive by reducing certain exposure and increasing credit quality, conservative positioning that we believe will continue to help our clients weather the storm. With the subsequent fall of additional banks in the United States, and of global systemically important bank Credit Suisse, we are reminded that the SVB episode was not an isolated, idiosyncratic incident. It also shined a light on one of the most fundamental tenets of investing—the importance of diversification, whether at the sector or the issuer level.

Markets are still facing uncertainties regarding the impact of the Federal Reserve's (Fed) aggressive rate hikes and quantitative tightening, a potential economic slowdown, and the likelihood of other unforeseen consequences of financial disintermediation. However, it remains one of the most attractive times in the post-GFC era to be invested in U.S. fixed income, particularly relative to other more volatile asset classes. With continued elevated yields and spreads, debt holders are taking a greater share of the economics than equity holders and this trend seems unlikely to end soon. This portends continued opportunities across credit and more negotiating leverage for creditors to influence pricing and terms.

Throughout this edition of Fixed-Income Sector Views, our Sector teams acknowledge the many headwinds facing credit investors, including rising default and downgrade risk, the decline in new issuance volume in many sectors, and signs of pre-recession weakening in corporate and municipal credit performance. Markets like these represent opportunity for active fixed-income asset managers. For example, we are taking advantage of any moves higher in Treasury yields at the short end of the yield curve and are positioning for greater spread dispersion between sectors and across the quality spectrum. While the risk of defaults is rising in corporate credit on an aggregate basis, some issuers and sectors may be oversold, creating potentially attractive entry points from a portfolio perspective. The same is true in structured credit, where certain commercial ABS sectors continue to offer discounted dollar prices and wider spreads compared to similarly rated corporate credit alternatives.

With high yields available on relatively lower risk assets within credit, it is a good time to be defensive and maintain elevated levels of liquidity. This posture is designed to help protect our portfolios against late-cycle uncertainty, and position us to be rewarded as a provider of capital down the road.

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

Macroeconomic Update

The Economic Cycle Is Reaching a Turning Point

Leading signals are flashing red as the debt ceiling takes center stage.

First quarter real gross domestic product (GDP) growth was solid, with GDP excluding inventory swings growing at 3.4 percent annualized. The details showed that growth was bolstered by a sizable contribution from private consumption, which bounced back after a weak fourth quarter. Solid economic momentum was corroborated by other data, with the April purchasing manager indexes registering their strongest readings in several months. The labor market continues to hold up, with payroll job gains averaging 284,000 this year and the unemployment rate staying low at 3.4 percent as of April.

Below the surface, however, concerning signals are mounting. Jobs in cyclically sensitive industries are now falling, the leading economic index is in recessionary territory, continuing jobless claims have risen by 40 percent, and surveys of hiring plans point to a further slowdown in jobs growth. And this is all before the impact of a looming bank credit crunch has fully been felt and had time to flow through to the economic data.

Beyond the headwinds brought about by banking sector stress, we see several fundamental reasons to expect an economic slowdown as many growth tailwinds are also fading: the backfilling of jobs is winding down as the labor shortage eases; a construction backlog is clearing which should lead to headcount reduction; the growth boost from warm winter weather is over; excess savings are being drawn down, leading to rising reliance on borrowing to maintain consumption; and services consumption is back to trend. We still see a recession beginning in the second half of this year.

We do not expect the coming recession will be overly severe, as growth will likely be supported by housing bottoming as mortgage rates fall, auto production continuing to rise due to a multiyear backlog, and a better global growth picture aided by China's reopening. Encouraging news on inflation means the Fed is likely on hold for the next few months as it assesses the cumulative impact of its rate hikes. Finally, the needed labor market rebalancing has so far been painless—with job openings down, quits down, and the labor force participation rate up—signaling that the ultimate increase in unemployment needed may be smaller than it appeared to be one year ago.

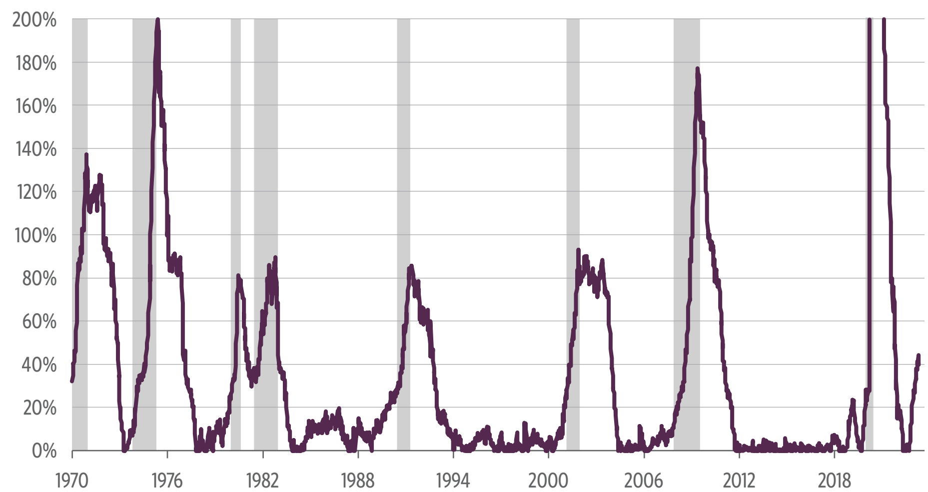
Markets are now turning their focus on the debt ceiling drama unfolding in Washington. While we don't expect the worst-case scenario, the ongoing uncertainty and posturing around the deadline will keep investors on edge with tail risk becoming more elevated as the date approaches. A resolution or kicking of the can would be met with positive market reaction.

By Brian Smedley, Maria Giraldo, and Matt Bush

Concerning signals are mounting. Jobs in cyclically sensitive industries are now falling, the leading economic index is in recessionary territory, continuing jobless claims have risen by 40 percent, and surveys of hiring plans point to a further slowdown in jobs growth.

Jobless Claims Remain at Low Levels But are Rising Quickly

Continuing Jobless Claims, Increase from Trailing Three-Year Low



Source: Guggenheim Investments, Bloomberg. Data as of 4.29.2023.

Rates

Positioning for a Policy Transition

We expect the Treasury curve will steepen when the Fed pauses.

2023 has been remarkable in terms of interest rate volatility and continual changes in market sentiment. In January, market participants had concluded that a Fed pivot was close at hand, and Treasury yields and terminal rate pricing moved lower across the curve. Then in February, employment and inflation data came in stronger than expected, and Treasury yields and terminal rate pricing moved sharply higher again. This trend continued into the first part of March, with terminal rate expectations reaching as high as 5.6 percent before the regional banking crisis led to a substantial drop in the expected path for fed funds. April saw a return to more normal markets but yields still well off the highs.

The Fed continued on its path of fighting inflation with another 25 basis point hike in May, thereby increasing front-end rates further and modestly flattening the curve. The decision came with a notable change in tone that the markets interpret to mean an increased chance of a pause from here, which could keep the curve flat for an extended period. However, we believe that the yield curve will bull steepen—i.e. short-term rates fall faster than long-term rates, increasing the spread between the two—as the eventual easing cycle comes into play next year.

Boosted by heightened interest rate volatility and the Treasury market flight to quality created by banking sector turmoil, Treasury yields declined by 30–40 basis points across the curve, and produced market returns of 3.0 percent during the first quarter. Longer maturity Treasurys fared even better, returning 6.5 percent over the same period. Looking forward, we expect Treasury returns will be positive and primarily driven by coupon income as rates remain relatively rangebound for the next few months with the Fed on hold. A pause by the Fed would be positive for sentiment as a pause is typically followed by an eventual easing cycle, which leads to lower yields and steeper curves.

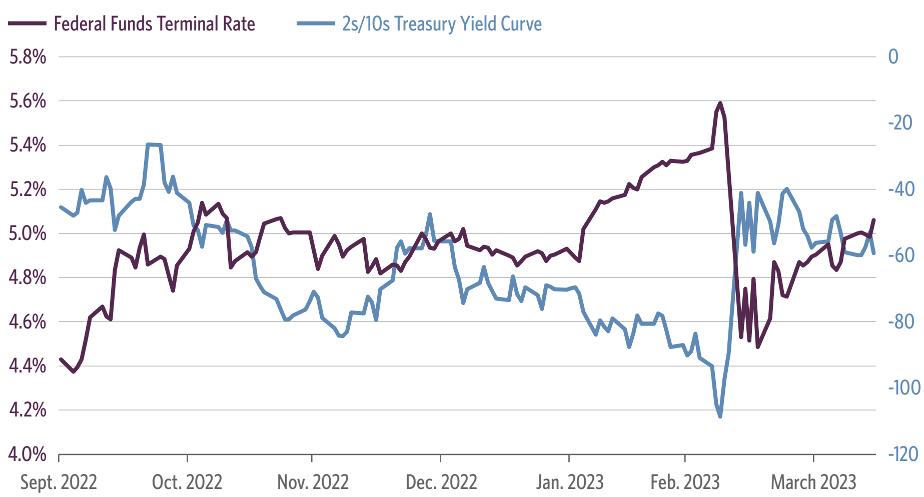
We continue to take advantage of any moves higher in Treasury yields at the short end and intermediate parts of the yield curve, reducing existing underweight positions there and smoothing duration exposure across the yield curve. Additional moves higher in volatility and interest rates may also present opportunities to buy callable Agency bonds at attractive levels, although ongoing uncertainty around the debt ceiling will likely lead to elevated volatility and continued kinks in the yield curve. Significant bill issuance would likely follow any resolution.

By Kris Dorr and Tad Nygren

Terminal rate expectations reached as high as 5.6 percent in March before the regional banking crisis led to a substantial drop in the expected path for fed funds.

Large Swings in the Market-Implied Terminal Fed Funds Rate in the First Quarter

Market-Implied Fed Funds Terminal Rate vs 2/10 Treasury Yield Curve



Source: Guggenheim Investments, Bloomberg. Data as of 4.14.2023.

Investment-Grade Corporate Bonds

Higher Yields and Lack of Issuance Drive Demand

While financials look relatively attractive in the wake of the banking crisis, near-term caution is prudent.

The Bloomberg U.S. Investment-Grade Corporate Index yield remains historically attractive: we haven't seen yields consistently above 5 percent since the Global Financial Crisis. That said, demand for investment-grade corporate bonds is likely to wane if yields drop below the 5 percent level. While we continue to believe higher quality corporates outperform on a relative basis, tightening financial conditions, deteriorating credit fundamentals, and recession risk mean that this cohort is unlikely to replicate first quarter performance. Although financials underperformed in the wake of the banking crisis and look relatively attractive, near-term caution is the prudent path given continued uncertainty. First quarter earnings have eased some concerns over deposit outflows, however commercial real estate exposure, decreases in net interest margins and short selling in equity markets continue to add to investor angst. Consumer and technology issuers should see slower growth, lower revenues, and stubbornly high input costs that continue to shrink their margins as well.

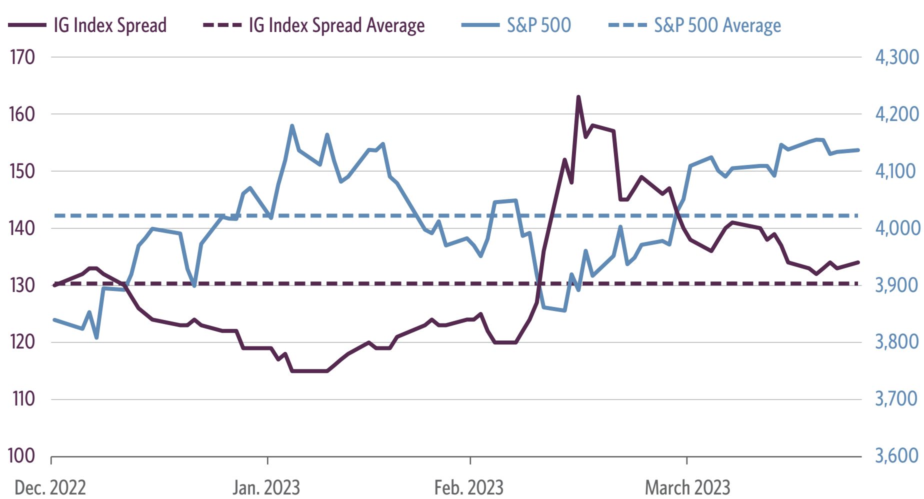
Technicals remain a positive tailwind as the lack of primary issuance will likely continue throughout the second quarter. Supply was already below 2021 levels prior to SVB's default but further declined into the end of the quarter, lower on both a gross (-15 percent) and net (-24 percent) basis vs. the first quarter of 2022. The dearth of long duration supply, down 24 percent, also helped buoy 30-year spreads despite the rally in U.S. Treasury yields. Fund flows provided further support for investment-grade spreads, with around $62 billion of inflows in the first quarter, according to J.P. Morgan data.

The spread relative to the risk-free rate for the Bloomberg U.S. Investment-Grade Corporate Index widened by just 7 basis points in the first quarter to 138 basis points, while the all-in yield dropped by 22 basis point to 5.17 percent. However, dispersion increased materially, with financials underperforming by 25 basis points while the industrial sector remained unchanged. We do not expect to see spread compression in regional banks relative to money center banks, as regional spreads remain around 100 basis points wider than pre-SVB levels, while money center banks have held steady and industrials have tightened on the year. Year to date, though, investment-grade spread levels look attractive compared to both investment-grade derivatives and equities.

By Justin Takata

Technicals remain a positive tailwind as the lack of primary issuance will likely continue throughout the second quarter. Year to date, investment-grade spread levels look attractive compared to equities.

Low Supply and High Demand Provide Tailwinds in Investment Grade



Source: Guggenheim Investments, Bloomberg. Data as of 4.8.2023.

High-Yield Corporate Bonds

High-Yield Returns Boosted by Duration

While default risk is rising, the sector's performance should continue to benefit from being higher quality relative to history and positive technicals from lack of new issuance.

High-yield returns are strong to start the year despite ongoing volatility. We remain defensive and are staying up in quality in our portfolios, but as we explained in the second quarter High-Yield and Bank Loan Outlook, the expression of this theme does not always translate into a preference for higher credit ratings. The rating agencies have been cutting credit ratings at a faster pace than they are raising them, which makes current ratings less reliable. Proprietary credit views are crucial in this environment. We are focusing on debt seniority, cash flow stability, strong interest coverage, and business profile, among a variety of other metrics, all of which can make a B-rated credit more attractive than a BB-rated credit in this environment. A continued lack of primary issuance should provide a technical tailwind.

Attention has turned to the Fed's quarterly Senior Loan Officer Opinion Survey on Bank Lending Practices, which asks if banks are tightening or easing underwriting standards on loans made to a variety of borrowers. This survey already showed before the banking crisis in March that a net 45 percent of banks have tightened underwriting standards for large/medium commercial and industrial loans, the most since the height of the COVID pandemic in 2020. Tighter lending standards historically lead a rise in the default rate among high-yield corporate bond issuers, so while credit spreads are 21 basis points tighter from the start of the year at 448 basis points, they had widened to as much as 535 basis points over the back half of March.

We share concerns over the default outlook as we move toward recession, which we expect to begin in the second half of 2023, but it is important to balance these views against market expectations. At current spread levels, we believe the implied default rate of the high-yield index is 4.3 percent. Since the market tends to overshoot, spreads could widen further as liquidity conditions worsen and as other calendar events, such as the debt ceiling debate, increase implied volatility in options markets across rates and equities. However, an acceleration in default volumes is priced in already, and some issuers and sectors may be oversold.

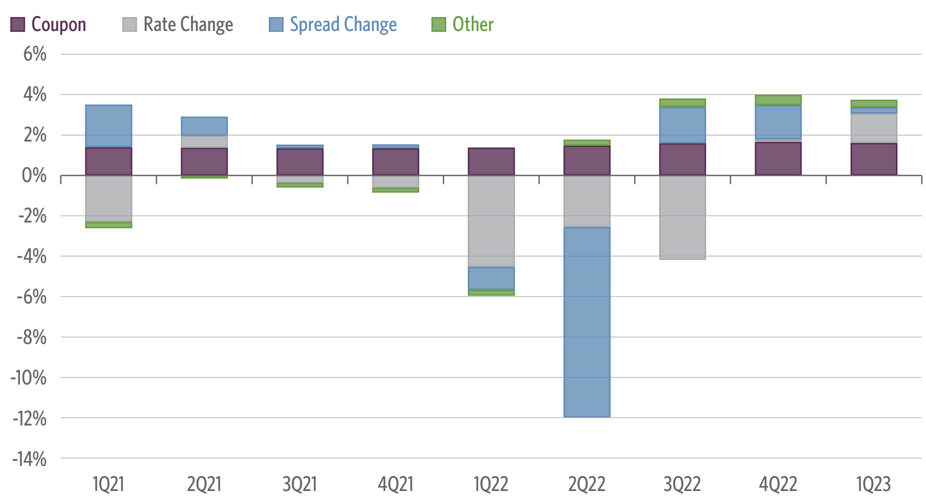
The sector is likely to continue to benefit from duration in a risk-off environment. Despite growing concerns over the default outlook at the start of 2023, the ICE BofA U.S. High-Yield Index gained 4.2 percent through April 24 as curve changes boosted returns by 1.2 percent on top of returns attributable to coupon, amortization, and spread tightening. Given our view that duration will benefit the sector while coupons continue to help cushion returns, we believe high-yield corporate bonds are attractive to income seekers with yields remaining near 8.5–9 percent.

By Thomas Hauser and Maria Giraldo

The sector is likely to continue to benefit from duration in a risk-off environment, while coupons help cushion returns.

Coupons and Duration Have Supported Total Returns in 2023

ICE BofA U.S. High-Yield Index Quarterly Total Return Attribution by Factor



Source: Guggenheim Investments, ICE Index Services. Data as of 4.24.2023. Past performance does not guarantee future results.

Bank Loans Are Off to a Solid Start

Positioning for rising defaults as macroeconomic challenges mount.

The leveraged loan market is experiencing a solid start to the year despite the March turmoil driven by regional bank failures. Returns have been strong, helped by good credit performance, a slowdown in new deal activity and secondary market activity. Through April 21, the Credit Suisse Leveraged Loan Index Total Return index is up 4 percent, the strongest return over the same period since 2019. This positive performance was led by B-rated loans (4.7 percent), followed by CCC-rated loans (3.6 percent) and then BB-rated loans (2.9 percent). Three-year discount margins tightened year to date to 595 basis points from 650 basis points.

Loan prices took a hit in March, falling to as low as 92 percent of par before bouncing back to 93, and this price volatility caused borrowers to step back from new issuance to await calmer markets. Less than half as many deals were launched in March as in February, and for just 40 percent of the volume: Just $10 billion in institutional loans were issued in March versus $28 billion the prior month. Virtually all issuance year to date has come from BB and B-rated loans as investor demand shifted toward higher quality, and 63 percent has been for refinancing activity. Issuers have been pushing upcoming maturities further out into the future, with a large portion of BB and B-rated loans coming due in 2028. However, due to the lack of activity in CCC-rated loans, the maturity wall for this cohort is more evenly distributed over the next several years, with 18 percent of CCC loans coming due before 2025, compared to just 1 percent for split BBBs/BBs and 3 percent for split BB/Bs. We have been focused on secondary market opportunities given the slow new issue market.

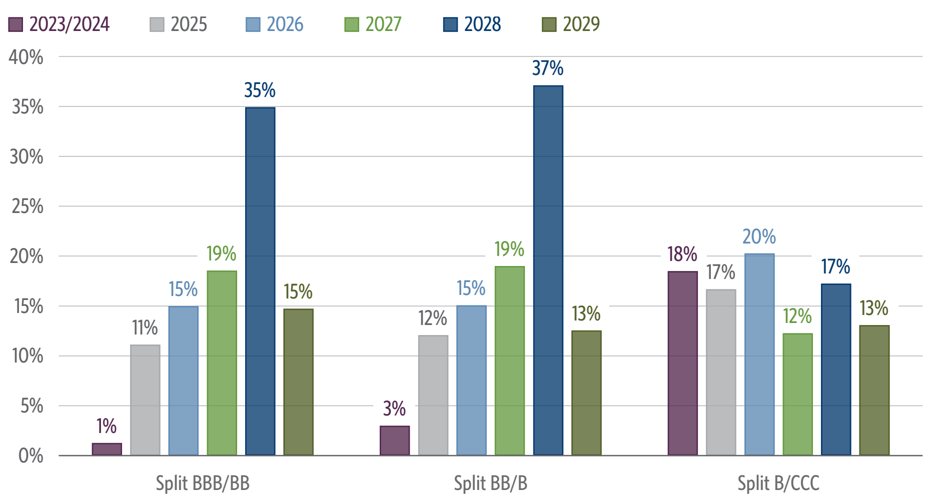
The 12-month trailing par-weighted default rate is just 1.3 percent as of March 2023, below the historical average of 2.7 percent dating back to 1999, but it is trending upwards. Last year the default rate troughed around 0.2 percent. As CCC-rated loans face upcoming maturities in a more challenging credit environment characterized by slowing corporate earnings growth and tighter lending standards, we continue to expect the default rate to increase. As our strategy in this environment remains more defensive in nature, we have been focused on re-underwriting our existing portfolio companies and evaluating relative value in the wake of current macroeconomic conditions.

By Christopher Keywork and Maria Giraldo

Due to the lack of activity in CCC-rated loans, the maturity wall for this cohort is more evenly distributed over the next several years, with 18 percent of CCC loans coming due before 2025, compared to just 1 percent for split BBBs/BBs and 3 percent for split BB/Bs.

Nearly 20% of CCC Loans in the Index Mature Before 2025

Share of Debt Coming Due by Schedule Maturity Year and Rating



Source: Guggenheim Investments, Credit Suisse. Data as of 4.21.2023.

Municipal Bonds

Managing Through a Slowing Credit Cycle

Technical support may not be enough to sustain municipals' momentum as the economy slows.

Municipal credit fundamentals have improved for the last three years, thanks to double-digit growth in income taxes and sales taxes, but these tailwinds are unsustainable, and we see signs that the upswing in the municipal credit cycle is nearing its end. Some states have reported a decline in tax receipts and lowered revenue estimates as a result of the cooling economy. Counterintuitively, another sign that the credit cycle is nearing its end is the recent rating upgrades for high beta states Illinois and New Jersey. High beta credits such as these are the last to get upgraded in an upcycle because of their checkered histories—volatile revenue performance, inconsistent fiscal management, rating agency skepticism, etc.—and the first to get downgraded going into a downcycle for the same reason.

Nevertheless, tax exempt municipals have started strong in 2023 after a rollercoaster ride over the last year. Tax exempts returned 4 percent year to date through mid-April and have moved into positive territory on a trailing 12-month basis. Technical support played a big role in this performance. Tax exempt mutual funds experienced outflows for most of the quarter, but these outflows were offset by a 24 percent decline in new issuance through the end of March. Municipal obligors, dealing with both record tax receipts and unspent pandemic stimulus funding, have been reluctant to access the public markets. While seasonal factors should drive issuance higher going into the summer months, those same factors also increase principal and interest payments that are reinvested in the municipal market, buffering the impact from new deal volumes. Secondary trading conditions remain orderly as there are few signs of selling pressure. For example, dealer holdings of bonds maturing beyond 10 years have declined 25 percent versus the prior year and stayed well below the five-year average for most of the last 12 months. Bid wanted volumes—a barometer for mutual fund liquidity needs—declined by as much as 52 percent year-over-year during some days in March and April.

Due to positive technical support, the ratio of tax-exempt yields to Treasury yields has stayed rich—for example, the 10-year ratio is 68 percent, the low end of the 12-month range of 60–105 percent. Amid signs of a slowing credit cycle, we advise caution. In this environment, tax exempt investors should remain focused on reducing negative convexity while upgrading into higher-quality bonds.

By Allen Li and Michael Park

Due to positive technical support, the ratio of tax-exempt yields to Treasury yields has stayed rich—for example, the 10-year ratio is 68 percent, the low end of the 12-month range of 60–105 percent.

Lack of Muni Issuance Has Supported Sector Richness Relative to Treasurys

Tax Exempt Yield/Treasury Yield Ratios

Source: Guggenheim Investments, Bloomberg. Data as of 4.11.2023.

Sound Fundamentals Counter External Pressures

Pent-up demand for long-term ABS financing will likely result in increased issuance over 2023–2025.

Credit fundamentals remain sound across most of commercial ABS, but we expect higher borrowing costs and recession-related reductions in consumer spending and corporate investment to pressure asset values and debt coverage parameters on certain deals. Certain commercial ABS sectors, such as triple net lease and data centers, continue to offer discounted dollar prices and higher spread versus similarly rated corporate credit alternatives. Whole business quick service restaurant franchises (QSR), also currently offer income enhancement opportunities compared to investment-grade corporate bonds.

The drop-off in commercial ABS issuance has been a major market dynamic year-to-date, but we expect this trend to change course. Issuance declined by 15.8 percent in the first quarter, but excluding resurgent issuance of utility ABS, commercial ABS issuance declined by 31.4 percent year over year. The decline is due in large part to issuers having access to alternative sources of financing, such as warehouse lines and revolvers, and being strategic about issuance timing. While we expect high all-in costs of debt to keep commercial ABS issuance subdued for the short-term, pent-up demand for long-term ABS financing will likely result in increased issuance over 2023–2025. This could provide an attractive opportunity to add to exposure in more meaningful size.

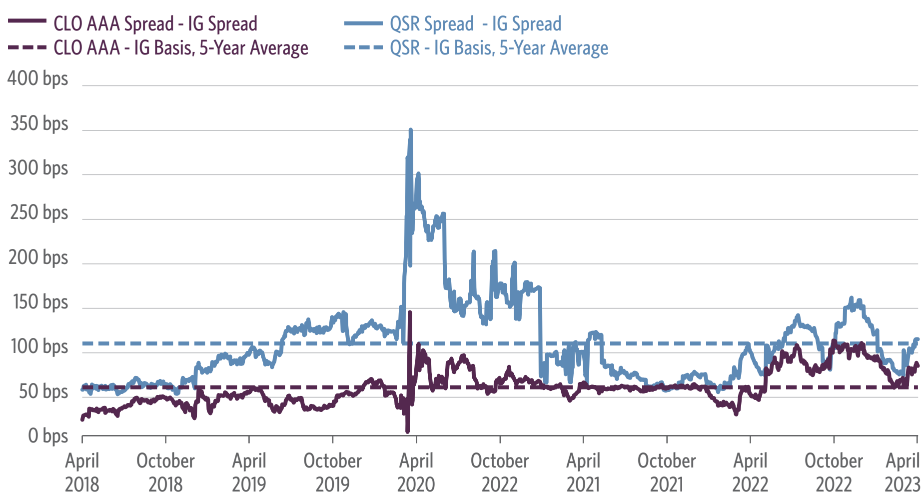
The indirect effects of tighter bank lending standards may result in tighter credit conditions in CLOs, particularly for smaller-sized borrowers typically outside the scope of inclusion as CLO collateral. New issuance in the first quarter was the second-highest on record with $33.4 billion of supply. We expect issuance to slow as macroeconomic uncertainty lingers, warehouse balances are pared, and CLO creation economics are challenged. Managers have been focused on upgrading portfolio quality and trading out of CCC and weaker B- names. We believe that there will be increasing dispersion in performance as managers who can avoid credit losses outperform. CLO spreads remain historically elevated, which means existing deals are unlikely to be called in the near term. AAA–A CLOs offer attractive income potential with less risk. Junior debt tranches are more susceptible to credit losses and we anticipate that there will be better entry points.

By Michael Liu, Scott Kanouse, and Dominic Bea

Whole business quick service restaurant (QSR) franchises currently offer income enhancement opportunities compared to investment-grade corporate bonds. AAA–A CLOs offer attractive income potential with less risk.

Whole Business QSR and Senior CLO Tranches Look Attractive

CLO and QSR vs. IG Corporate Spreads



Source: Guggenheim Investments, J.P. Morgan, Barclays. Data as of 4.9.2023. Note: QSR = quick service restaurant.

Non-Agency Residential Mortgage-Backed Securities

Constructive on Non-Agency RMBS

Low new-issue volume will limit supply and provide positive technical tailwinds for the sector.

The performance for non-Agency RMBS in the first quarter reflected broader market dynamics. Due to the macro volatility related to financial difficulties of regional banks, RMBS valuations experienced some softening to end the quarter. For instance, non-qualified mortgage (non-QM) AAA tightened by 40 basis points to start the year only to retrace all the tightening by the end of March. RMBS 1.0 and RMBS 2.0 subsectors—RMBS issued pre- or post-Global Financial Crisis (GFC)—posted 0.8 percent and 1.5 percent returns, respectively, in the first quarter, according to Citigroup data. Markets have trended with less volatility in the second quarter.

From a credit perspective, headwinds created by negative price moves in the housing market after June 2022 and an impending recession are meaningfully cushioned by conservative mortgage underwriting and more than a decade of underinvestment in housing relative to population growth in the United States. Additionally, tentative indications that home prices are near a bottom further reinforce the strength of the credit profile of RMBS. The latest CoreLogic reading for the month of February showed a 0.8 percent increase in home prices nationwide. It was the first positive reading since June of 2022. The price increase comes after several months of progressively smaller declines, which reached a peak of -1.1 percent in August of 2022. If the reversal continues, the improving housing market should modestly boost housing turnover-related prepayments which in turn provide an opportunity for capital appreciation for RMBS 1.0 and re-performing MBS deals that currently trade below par.

We remain constructive on RMBS credit, and the low new-issue volume will limit supply and may provide positive technical tailwinds for the sector. We see value in non-QM RMBS 2.0 mezzanine and senior tranches with investment-grade, typically stable weighted average life profiles, and RMBS 1.0 backed by loans with significant home equity. While typically carrying a low likelihood of principal loss, current investment-grade RMBS valuations reflect spreads wider than the long-run averages. These subsectors currently offer 5.5–6.5 percent yields and routinely trade at discount dollar prices.

By Karthik Narayanan and Roy Park

The latest CoreLogic reading for the month of February was the first positive reading since June of 2022, coming after several months of progressively smaller declines. If the reversal continues, the improving housing market should modestly boost housing turnover-related prepayments which in turn provide an opportunity for capital appreciation for RMBS 1.0 and re-performing MBS deals that currently trade below par.

Home Price Growth Turned Positive After Months of Declines

CoreLogic Single-Family Price Change (MoM)

Source: Guggenheim Investments, J.P. Morgan, CoreLogic. Data as of February 2023.

Commercial Mortgage-Backed Securities

Bank Failures Portend Capital Rationing in CRE

Increasing dispersion in CMBS as fundamental pressures mount.

CMBS underperformed investment-grade corporate bonds and other structured sectors as spreads widened precipitously following the failures of Silicon Valley and Signature banks. The benchmark 10-year conduit AAA spread widened from 130 basis points to 179 basis points in the first quarter. We are skeptical of the view that recent spread widening presents a technical buying opportunity in the second quarter and believe that the CMBS market's reaction to these bank events reflects an appropriate and evolving fundamental re-valuation of commercial real estate (CRE) risk. Broadly, we continue to maintain minimal exposure but are game planning to be opportunistic should conditions warrant.

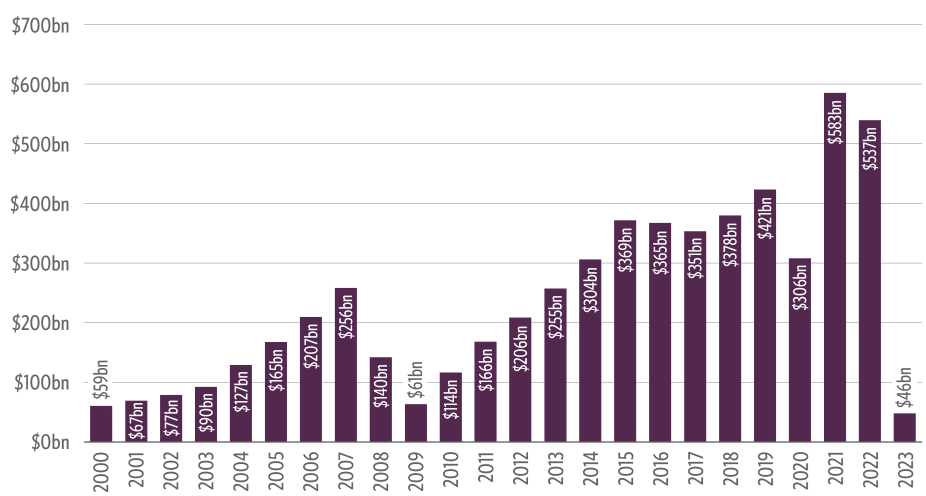
Regional banks comprised around 20 percent of all CRE lending in recent years and have held disproportionate market share in construction lending. In previous commentaries, we have cited the risk related to bank lenders failing to support the CRE lending market given interest rate pressures. Subsequent bank failures and the economic and regulatory fallout are material negative catalysts during already challenged times. Transaction volumes remain historically low, with few willing sellers, and arguably even fewer willing buyers. More sellers of CRE loans and properties will emerge in coming months, likely at lower prices, as capital is rationed away from out-of-favor property types. Over $400 billion of CRE loans are scheduled to mature in 2023, providing some price discovery for financing rates and valuations. Property prices are down roughly 5 percent year to date, and 9.5 percent from their peak in July 2022, and market expectations are for meaningful further declines in highly impacted property types, such as Class B office and retail.

Consistent with our post-COVID strategy, we continue to favor senior and near-senior CMBS securities for their high credit enhancement. We remain cautious on structurally subordinated CMBS bonds because of their inherent sensitivity to adverse selection or binary outcomes in the underlying collateral pool. CMBS yields are near post-GFC highs, and our preferred senior and near-senior tranches trade in the 6.5–8.5 percent yield range. With rising economic uncertainty and market complexity, we expect that investable situations with attractive loss-adjusted yields will continue to emerge in coming quarters as the drop in competition for CRE credit flows through capital markets.

By Tom Nash and Hongli Yang

Transaction volumes have been historically low, with few willing sellers, and arguably even fewer willing buyers. With rising economic uncertainty and market complexity, we expect that investable situations with attractive loss-adjusted yields will continue to emerge in coming quarters as the drop in competition for CRE credit flows through capital markets.

Commercial Real Estate Sales Volumes Have Been Depressed This Year



Source: Guggenheim Investments, Barclays, CoStar, JP Morgan. Data as of 5.3.2023.

Agency Mortgage-Backed Securities

Short-Term Headwinds Prevail For Now

Lower rate volatility is a key to the long-term value proposition.

The Agency MBS market has many short-term crosscurrents to contend with, but there are reasons to be positive longer term and our strategies have broadly increased their exposure to the sector given attractive valuations. In the short term, volatility headwinds abound. Market consensus for terminal fed funds rate was thrown into question in the first quarter due to persistent inflation and strong employment data. This uncertainty weighed on mortgages with the Bloomberg U.S. MBS Index posting total and excess returns of 2.53 percent and -0.50 percent, respectively, in the first quarter. The banking sector turmoil helped put a lid on terminal rates but then introduced the headwind of portfolio sales, which has driven mortgage spreads to nominal levels only seen a handful of times in the last decade.

With regard to the FDIC portfolio sale, we expect passthrough sales to go smoothly due to the large, structural underweight of index-tracking funds. As these sales will come in deep discount coupons, we prefer MBS exposure via production coupon passthroughs (new securities based on the current mortgage rate) that are not directly impacted. In contrast, we remain cautious on the collateralized mortgage obligations and Agency CMBS subsectors due to both the lack of natural index-tracking buyers for FDIC portfolio bonds and limited dealer capacity to warehouse risk of this magnitude.

We also see a headwind in the structural shift in the buyer base of the mortgage market. This year will mark the first time in over a decade that neither the Fed nor banks are actively buying. While this is undoubtedly a negative, current spread levels and the Agency-backed nature of the sector should be enticing to crossover buyers from the corporate debt space. This is especially true for investors like us who are concerned about the mounting risk of recession. Our long-run bull case for mortgage spreads revolves around a normalization of interest rate volatility. We believe that clarity around the Fed's terminal rate will be the biggest driver of a reduction in rate volatility. As this becomes clear to the market, it will favor production coupon passthrough securities that are priced at par and have higher option costs embedded in their high current yields.

By Aditya Agrawal and Louis Pacilio

The banking sector turmoil helped put a lid on terminal rates but then introduced the headwind of portfolio sales, which has driven mortgage spreads to nominal levels only seen a handful of times in the last decade. Current spread levels and the Agency-backed nature of the sector should entice crossover buyers from the corporate debt space.

Portfolio Sales Drive Nominal Mortgage Spreads Higher Relative to Treasurys

30-Year Mortgage Nominal Spreads

Source: Guggenheim Investments, Bloomberg. Data as of 3.31.2023.

Commercial Real Estate

Cash Is King

With property values under stress, prepared real estate investors can find opportunity.

Increases in interest rates have caused the pace of commercial real estate sales to fall sharply because it has led to higher cost of capital, tighter credit standards from lenders, and increases in operating costs. For borrowers of floating rate mortgages, the cost to hedge against the risk of further interest rate increases can be prohibitive. But certain credit metrics, like loan-to-value ratios on newly originated commercial loans, are now near the conservative levels last seen during the Global Financial Crisis.

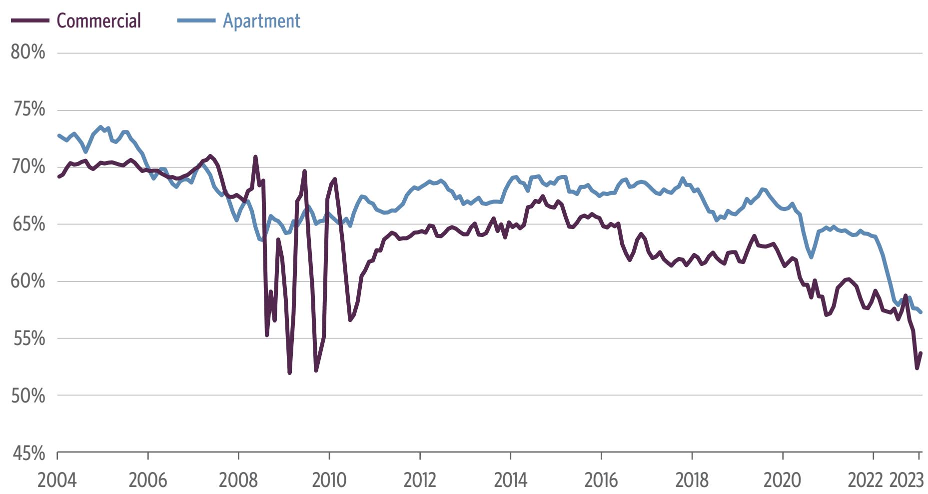
Investors who do not have to sell real estate or refinance mortgage loans are generally on the sidelines. But market stress often leads to opportunity, as some investors may be forced to sell or refinance in the current environment. This means investors with dry powder may be able to acquire properties at lower prices, and lenders will see opportunities to improve their position when borrowers seek short-term extensions with hopes of a bridge to a better rate environment. Investors and lenders have used these requests to require borrowers to pay down loans, increase coupons to market rates, establish new covenants or cash sweep protections, and provide credit enhancement for operating and capital shortfalls. Because we see the current environment as driven primarily by the rising cost of capital and not by a fundamental supply/demand disconnect in commercial real estate, we expect these opportunities will wane as interest rates begin to moderate.

In both real estate debt and equity investments, we are focused on defensive strategies in the current market. We look for properties with strong cash flows backed by sponsors that have the liquidity needed to cover potential operating shortfalls and capital needs. These sponsors typically have the ability to be patient and defer a sale or refinance until a more favorable market returns. Our focus continues to be on sectors with strong demand drivers: multifamily, logistics/warehouse, neighborhood retail, and hospitality in undersupplied markets. We continue to be cautious on office investment, where tenant demands for rent concessions and costly improvements are high.

By Jennifer A. Marler and Farris Hughes

Certain credit metrics, like loan-to-value ratios on newly originated commercial loans, are now near the conservative levels last seen during the Global Financial Crisis.

Mortgage Lending Standards Have Tightened to GFC Levels



Source: Real Capital Analytics. Data as of 1.31.2023. Note: chart represents newly originated commercial property loan LTV ratios.

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S&P bond ratings are measured on a scale that ranges from **AAA** (highest) to **D** (lowest). Bonds rated **BBB-** and above are considered investment-grade while bonds rated **BB+** and below are considered speculative grade.

One **basis point** is equal to 0.01 percent. Likewise, 100 basis points equals 1 percent.

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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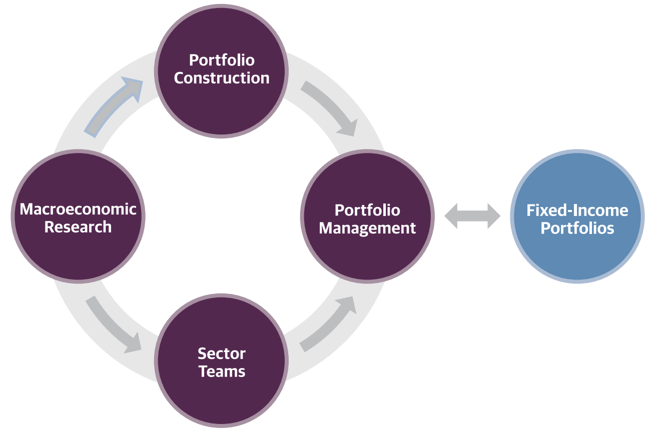

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Guggenheim Investments is the global asset management and investment advisory division of Guggenheim Partners, with more than $224 billion[1] in total assets across fixed income, equity, and alternative strategies. We focus on the return and risk needs of insurance companies, corporate and public pension funds, sovereign wealth funds, endowments and foundations, consultants, wealth managers, and high-net-worth investors. Our 250+ 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

Guggenheim Partners is a diversified financial services firm that delivers value to its clients through two primary businesses: Guggenheim Investments, a premier global asset manager and investment advisor, and Guggenheim Securities, a leading investment banking and capital markets business. Guggenheim's professionals are based in offices around the world, and our commitment is to deliver long-term results with excellence and integrity while advancing the strategic interests of our clients. Learn more at GuggenheimPartners.com, and follow us on LinkedIn and Twitter @GuggenheimPtnrs.

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