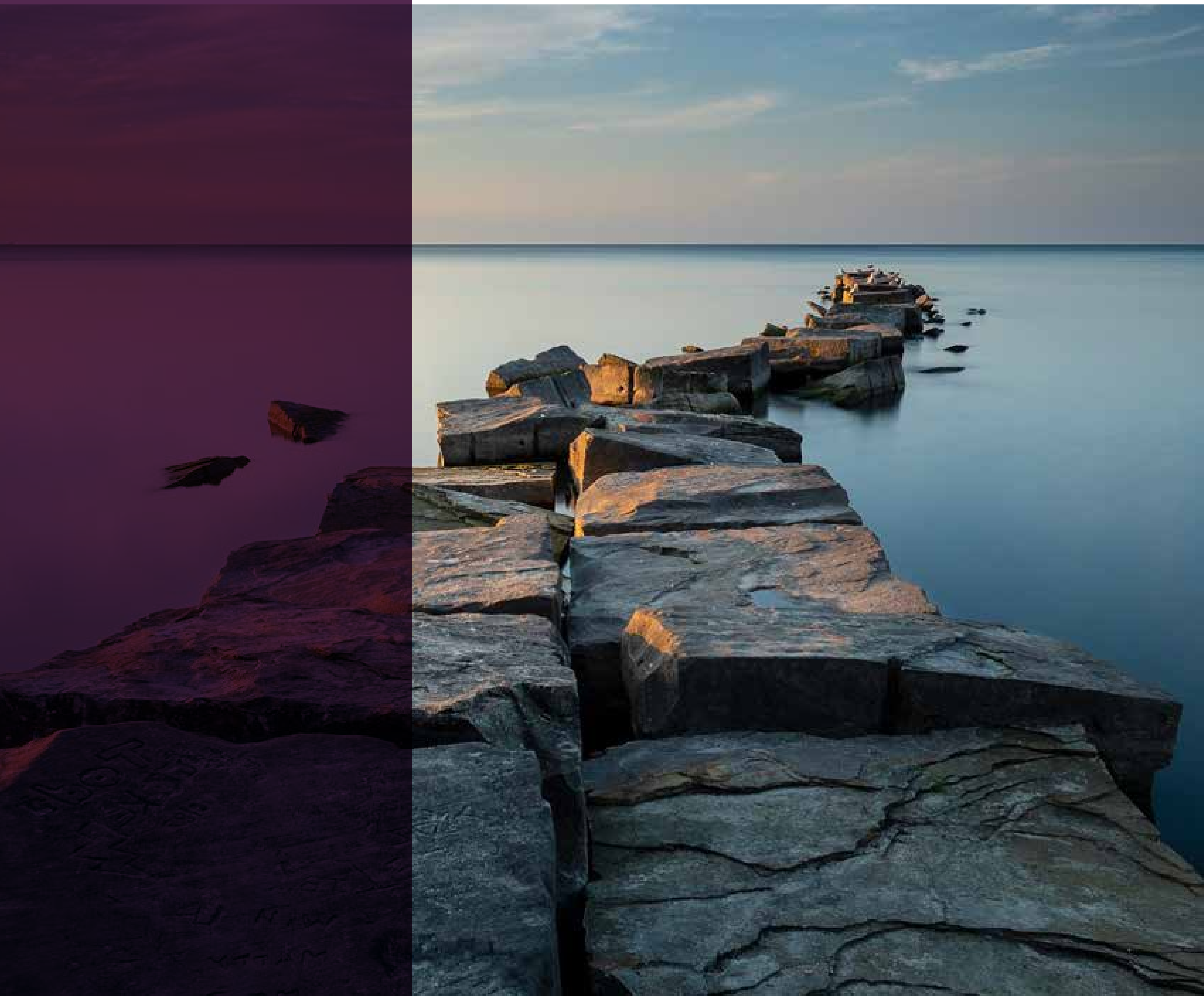
GUGGENHEIM

Third Quarter 2024

Research Spotlight on What's Next

Quarterly Macro Themes



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About Quarterly Macro Themes

Quarterly Macro Themes, a quarterly publication from our Macroeconomic Research and Market Strategy Group, spotlights critical and timely areas of research and updates our baseline views on the economy. Themes are selected from the broad range of issues we are currently analyzing, and demonstrate the type of market and economic topics we address in developing our outlook on the U.S. and global business cycle, market forecasts, and policy views. Our Macroeconomic Research and Market Strategy Group's research is a key input in Guggenheim's investment process, which typically results in asset allocations that differ from broadly followed benchmarks.

Macroeconomic Outlook

With Labor Market Risks Rising, Can Fed Easing Support a Continued Expansion?

The environment ahead favors active fixed income management.

For some time, we have expected tight monetary policy and waning fiscal stimulus to ultimately soften labor market conditions and help ease inflationary pressures. Over the last quarter, economic data have confirmed this view, with core Personal Consumption Expenditures inflation in the four months through July rising just 2.15 percent annualized, and the unemployment rate up about 80 basis points from the 2023 low to 4.22 percent as of August.

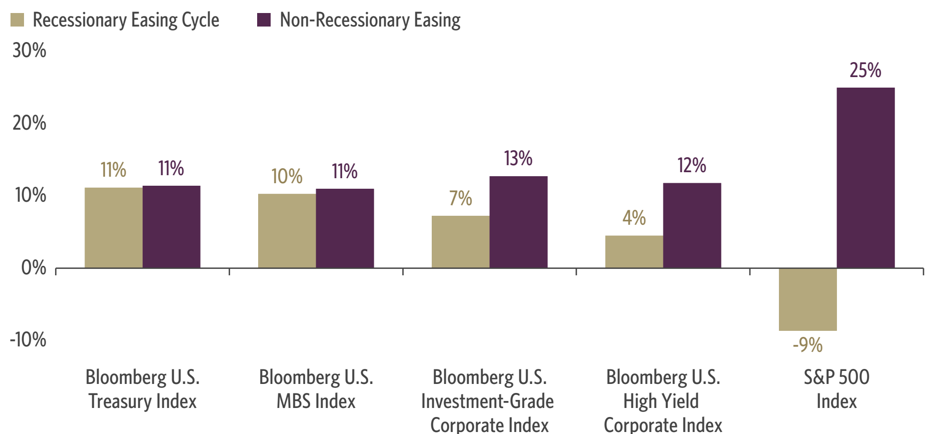
Our baseline view continues to call for gradually slower growth ahead, with risks skewed toward a sharper slowdown. As we highlight, downside risks to the labor market are growing and slower immigration and waning fiscal stimulus are likely to weigh on near term growth, irrespective of the election outcome in November.

The question is whether Federal Reserve (Fed) easing can reduce pressure on the economy and support continued growth. The September Federal Open Market Committee meeting made it clear the Fed has shifted from worrying about rising inflation to worrying about a weakening labor market. Fed Chair Jerome Powell characterized the 50 basis point rate reduction as a "good, strong start" to the easing cycle designed to be seen as a "commitment not to get behind" emerging signs of economic slowing.

When economic growth is slower but positive, higher quality fixed income is positioned to perform well. While spreads remain tight, overall corporate fundamentals are strong, and falling rates should support returns. In a deeper downturn, higher quality credits have typically outperformed, particularly compared to riskier assets.

Higher Quality Fixed Income Has Outperformed in Past Slowdowns and Recessions

Annualized Returns During Fed Easing Cycles Since 1984



Source: Guggenheim Investments, Bloomberg. Data as of 9.12.2024. Indexes shown are Bloomberg. Past performance does not guarantee future results. Recessionary easing cycles are easing cycles that coincided with a recession, while non-recessionary easing cycles do not.

Given underlying sources of resilience in the economy, the Fed may be successful in moderating any growth slowdown with appropriate policy easing. Although there is still significant bifurcation across the economy, with low income consumers and small businesses under stress, in aggregate, profit growth appears healthy—helped by elevated profit margins, modest labor costs, and low debt service.

We believe the environment ahead favors active fixed-income management. When economic growth is slower but positive, higher quality fixed income is positioned to perform well. While spreads remain tight, overall corporate fundamentals are strong, and falling rates should support returns. In a deeper downturn, higher quality credits have typically outperformed, particularly compared to riskier assets.

Theme 1

Growing Risks from the Labor Market

Further Fed action will be needed to prevent a more damaging labor market slowdown.

The labor market plays a critical role in supporting consumption and broader economic activity. However, recent employment data have given a mix of signals. Unemployment rate increases triggered a widely followed recession indicator and large downward revisions to past payrolls showed a slower overall employment trend. Nonetheless, jobless claims and layoff activity remain low, suggesting more limited labor market weakness.

Cutting through these mixed signals, we see risks to the labor market increasing as the pool of laid off workers grows. Some analysts view the Sahm Rule—which suggests a recession typically follows an increase in the three-month average unemployment rate by more than 50 basis points—as less relevant in the current environment because much of the recent rise in unemployment has been due to new labor force entrants, including immigrants. However, what benign interpretations miss is that even excluding these labor force entrants and temporary layoffs, we have still seen a notable rise in the unemployment rate from people who have permanently lost their jobs.

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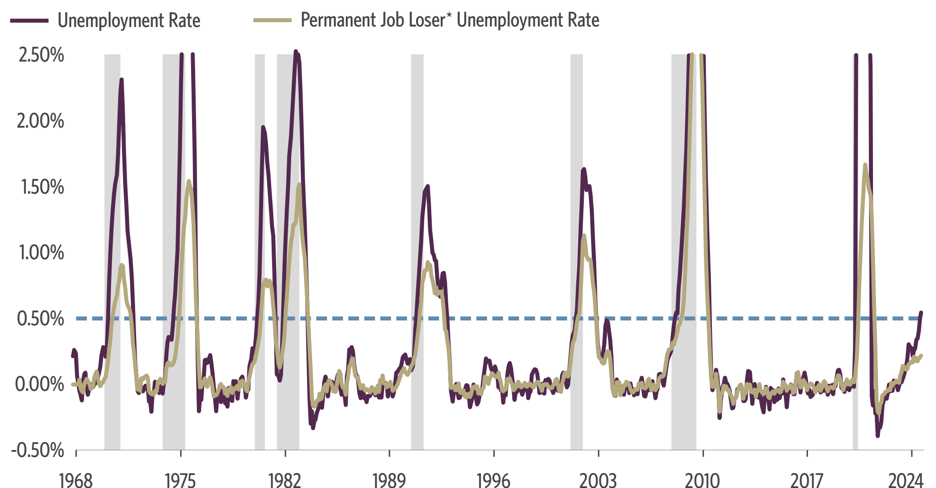
Labor Force Growth Helped Trigger Sahm Rule, But Trend in Permanent Layoffs Still Signals High Risk

Sahm Rule: 3-Month Average Unemployment Rate Less Prior 12 Month Minimum



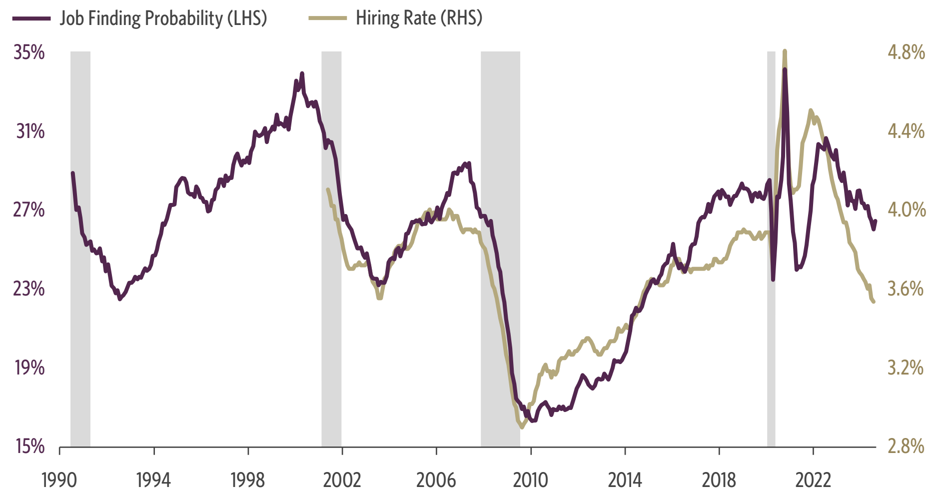
Source: Guggenheim Investments, Haver. Data as of 8.31.2024. *Note: includes temporary jobs. Gray areas represent recession.

This rise in laid off workers seems at odds with a variety of data indicating layoff activity remains low. However, unemployment has both inflows and outflows, and while inflows (e.g. layoffs) remain relatively low, outflows are slowing as the hiring rate has fallen meaningfully from its 2022 peak. The result is a steadily increasing pool of unemployed workers, which both weighs on income growth and increases perceptions from both consumers and businesses that economic conditions are cooling.

Hiring rates often slow leading into a recession—something we are currently observing—while layoffs typically don't pick up until after a recession has already begun.

Reduced Hiring Has Led to Lower Job Finding Probability for the Unemployed, Pushing up the Unemployment Rate Even with Low Layoffs

6-Month Moving Averages



Source: Guggenheim Investments, Haver. Data as of 8.31.2024 for job finding, 7.31.2024 for hiring. Gray areas represent recession.

Current data do not indicate an inevitable recession, but simply looking at layoffs remaining low or dismissing the rise in the unemployment rate may understate the labor market risks. Hiring rates often slow leading into a recession—something we are currently observing—while layoffs typically don't pick up until after a recession has already begun.

Fed officials also seem to have absorbed this downside risk. While Powell's Jackson Hole speech acknowledged increased labor supply as lifting unemployment and noted the low level of layoffs so far, he also observed, "Even so, the cooling in labor market conditions is unmistakable." Fed Governor Christopher Waller, speaking the day the August employment report was released, echoed this concern and said, "The current batch of data no longer requires patience, it requires action." Powell's September press conference acknowledged the labor market data was the driving factor behind the decision to cut 50 basis points. We believe it will take further decisive Fed action to prevent a more damaging labor market slowdown.

Theme 2

Massive Fiscal Support of Growth Is Waning

Reduced fiscal spending is likely to add to economic headwinds.

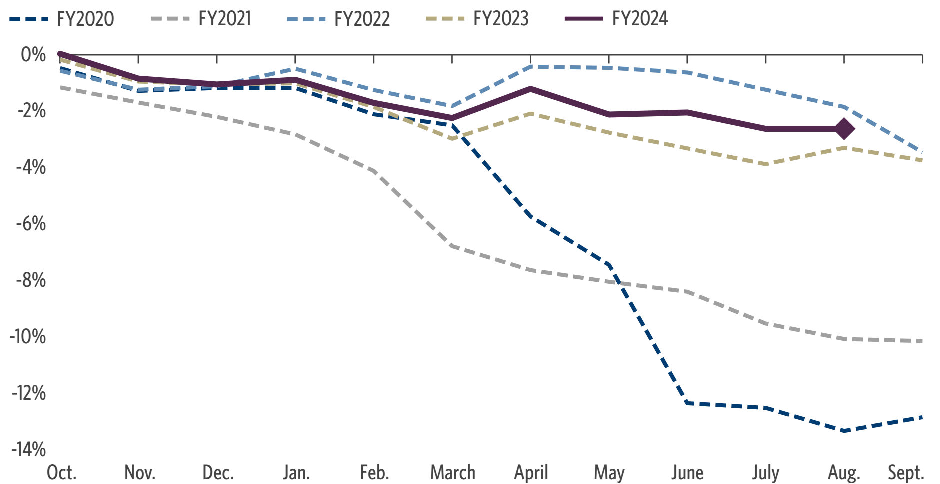
Looking ahead, fiscal spending is likely to be less supportive of near-term growth. Even as the federal deficit remains wide and the longer-term fiscal trajectory worrisome, government expenditures are falling compared to the same period last year, reducing the fiscal impulse to growth.

While overall tax receipts have shown strong growth of around 10 percent, spending has increased by just 5.6 percent from the same period last year. Notably, defense spending has grown at a much slower pace, partly due to the impact of the Fiscal Responsibility Act. Expenditures on Medicaid and other benefit programs have also risen more gradually, in part due to changes in eligibility rules following the expiration of pandemic era programs. Additionally, several fiscal programs, including the 2018 Farm Bill, are set to expire after September. Without extensions, the expiration of these programs could further weaken the impulse on economic growth.

Even as the federal deficit remains wide and the longer-term fiscal trajectory worrisome, government expenditures are falling compared to the same period last year, reducing the fiscal impulse to growth.

Federal Deficit Is Narrowing Compared to Last Year

Federal Primary Deficit (excl. interest) YTD, % of GDP



Source: Guggenheim Investments, Haver. Data as of 8.31.2024.

State and local government spending—a significant driver of growth and employment in recent quarters—also looks likely to slow. For now, state and local government spending remains robust, driven in part by the rush to use pandemic-related fiscal support, such as the Coronavirus State and Local Fiscal Recovery Funds program, before it expires later this year. However, as the deadlines of these programs

approach, the momentum in state and local spending is likely to taper off. State budget proposals project a notable decrease in real expenditures of around 8 percent year over year over the next 12 months. While the slowdown may not be as steep as budgets suggest, reduced fiscal spending is still likely to add to economic headwinds.

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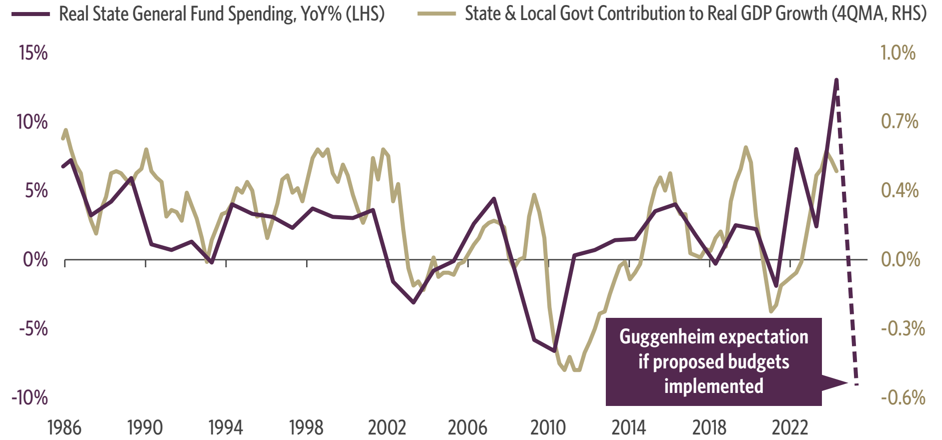
Proposed State Budgets Imply a Sharp Spending Decline



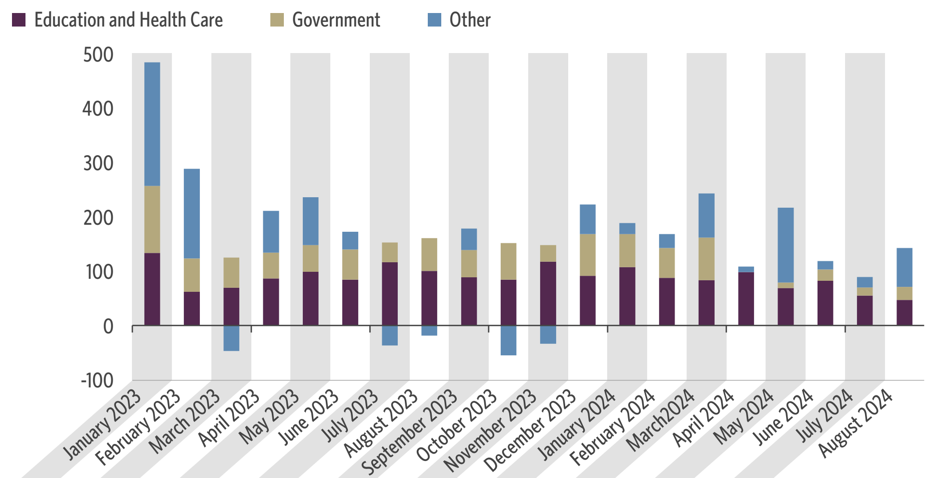
Source: Guggenheim Investments, National Association of State Budget Officers, Haver. Data as of 6.30.2024.

A less supportive fiscal environment could slow payroll growth. For instance, the conclusion of COVID Medicaid enrollment at the end of this year may create a moderate headwind for healthcare consumption, restraining growth in healthcare payrolls. Similarly, the exhaustion of federal COVID-related education funding is expected to

Given the substantial contribution of healthcare and government jobs to overall payroll growth over the past year, a slowdown in these categories could lead to a further deceleration in job gains.

Education, Healthcare, and Government Account for 75%+ of Job Gains Since 2023

Monthly Change in Payrolls Including Preliminary Benchmark Revision (thousands)



Source: Guggenheim Investments, Bureau of Labor Statistics. Data as of 8.3.2024.

weigh on state and local education payrolls. Given the substantial contribution of healthcare and government jobs to overall payroll growth over the past year, a slowdown in these categories could lead to a further deceleration in job gains.

While the upcoming election introduces uncertainty about the policy outlook, most of the major policy proposals from either party would take time to be debated and implemented, with a further delay until the economic effect hits, making the impact unlikely to be felt until late 2025 or early 2026. For the near term, the policy impacts we outline above will be of the most macroeconomic importance.

Theme 3

The Historic Surge in Immigration Is Coming to an End

The decline in immigrant labor supply will likely weigh on growth.

A historic rise in immigration contributed strongly to payroll gains in recent years but is likely to slow sharply as policies that curtail inflows limit employment gains and potential growth. Immigration flows into the U.S. surged in 2022–23, driven by a catchup after the pandemic, strong U.S. economic growth, plentiful jobs, and relatively immigrant-friendly Biden administration policies. The surge was unique in its scale and coincided with a shortfall in labor supply in the United States as businesses struggled to cover staffing needs. Immigrants' ability to meet heightened demand for workers meant that their share of total jobs created increased significantly. Some estimates put the share of jobs created in 2023 going to immigrants at 80 percent.

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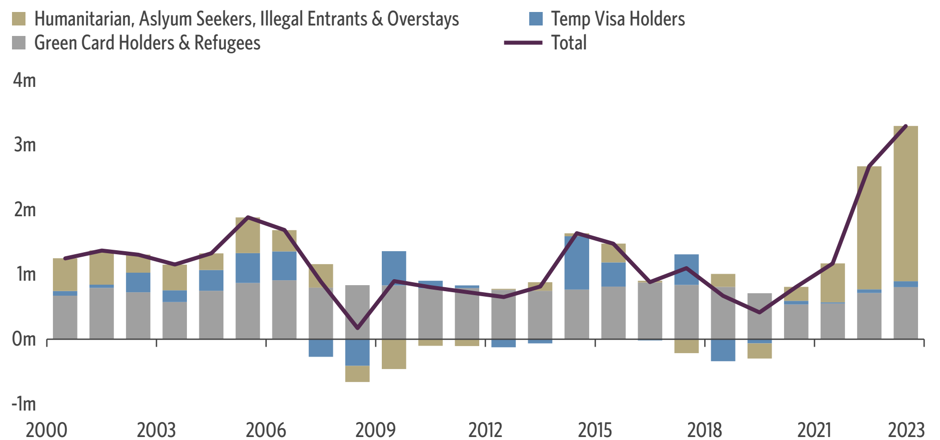
Asylum Seekers Fueled a Surge in Immigration

Estimated annual immigrant flows by category (millions)



Source: Guggenheim Investments, Congressional Budget Office. Data as of 7.31.2024. Annual data as of 12.31.2023.

In response to public concerns about the pace of immigration, the Biden administration put new policies in place that have sharply stemmed the flow. In December 2023, the Mexican government agreed to tighten security along its northern border. In June this year, the president issued an executive order capping the number of asylum seekers each day. Since December 2023, new immigration court cases and apprehensions by Customs and Border Protection officials have plummeted, indicating a rapid deceleration in immigration flows and an abrupt end of the surge.

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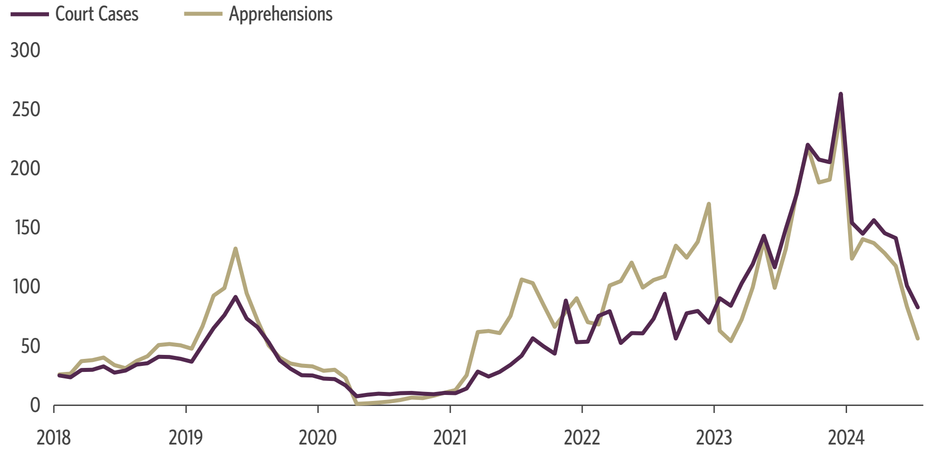
Court Cases and Apprehensions Suggest the Surge in Immigration Is Over

New immigration court cases and Southwest Land Border Apprehensions (thousands)



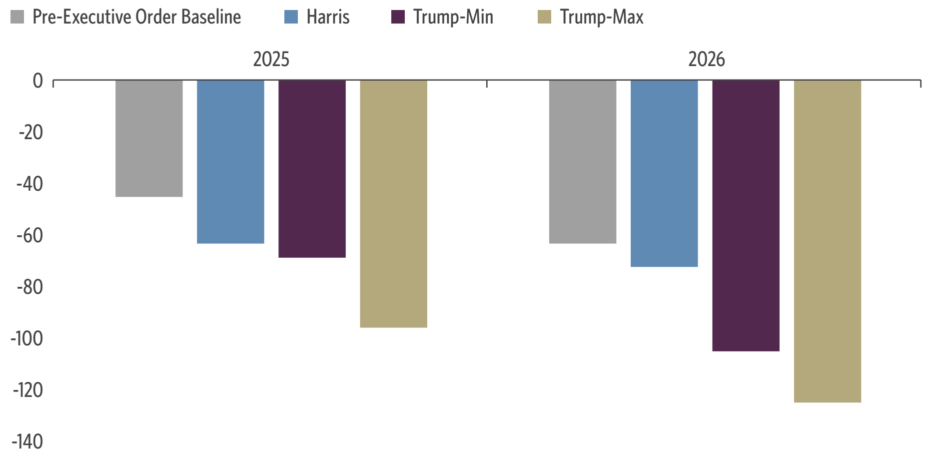
Source: Guggenheim Investments, Haver, Transactional Records Clearinghouse. Data as of 7.31.2024.

Immigration seems unlikely to rebound under a Democratic or Republican administration and additional measures could curb immigration further. Former president Donald Trump has pledged to reduce new entrants and deport immigrants who haven't gained legal residency, which could sharply reduce non-native workers. Vice President Kamala Harris seems likely to retain the Biden executive order, and she has suggested she will strengthen security measures.

As immigration flows decline, so should the related economic impacts. The share of total payrolls filled by immigrants swelled in the midst of the surge, but as flows recede job growth may slow.

Slower Immigration Means Fewer Jobs

Anticipated change in average monthly nonfarm payrolls as a result of lower immigration flows, relative to 2024 baseline (thousands)



Source: Guggenheim Investments, Barclays, Congressional Budget Office. Data as of 7.31.2024.

As immigration flows decline, so should the related economic impacts. The share of total payrolls filled by immigrants swelled in the midst of the surge, but as flows recede job growth may slow. In fact, Bureau of Labor Statistics measures of native-born employment show negative job growth over the past year. Fewer foreign laborers could also put more pressure on small businesses as they struggle to find workers at current wage levels. The construction, agriculture, and manufacturing industries are particularly dependent on immigrant labor. Additionally, immigrant-driven spending on goods and services has likely been an important source of demand, meaning gross domestic product (GDP) growth could also slow.

The potential impact on total nonfarm payrolls varies by under different policy assumptions, but is likely to be sizable. Average monthly nonfarm payrolls would have declined even without the Biden executive order as flows declined to historical averages (i.e. the baseline scenario). But immigration measures will have an additional negative impact. We estimate that average monthly payrolls will be lower than the 2024 baseline projection by 65,000 per month in 2025 and 75,000 per month in 2026 under a Harris administration, largely due to the impact of the Biden executive order, and 95,000 per month and 125,000 per month under different Trump measures ("Trump-Min" and "Trump-Max" scenarios). The decline in immigrant labor supply and other related factors will in turn weigh on potential GDP, with the most restrictive scenarios lowering potential growth by around a percentage point.

The impact on inflation is less straightforward, as immigrants contribute to both aggregate supply and aggregate demand. However, their impact on supply likely prevails given their relatively low income, high propensity to save, high labor force participation rates (once they attain work authorization), and their tendency to remit a portion of their income abroad. In our view, then, lower immigration points to lower nominal GDP growth and lower interest rates, as the negative hit to output growth far outweighs any inflation impacts.

Theme 4

Strong Corporate Profits Suggest Still Healthy Growth

Healthy profits should help the corporate sector weather slower economic growth.

Even as several factors suggest slower growth ahead, the corporate sector is entering this period with relatively healthy profits and balance sheets, which may cushion against a downturn. Nonetheless, these statistics are prone to revision and uncertainty that make distinguishing slowdowns from recessionary periods more challenging.

Statistics derived from the Bureau of Economic Analysis' (BEA) aggregate data series on U.S. corporate fundamentals show a resilient picture. Because these data include a broad range of corporations, including those with no debt or public equity, we also monitor metrics of investment-grade and high-yield companies more representative of the markets in which we invest.

In terms of balance sheet health, nonfinancial corporate leverage ratios are near their 20-year average as many companies have been disciplined in their debt management in a challenging credit environment. This sector is covering net interest expense by 27x, the highest since 1964. The high ratio is due to strong cash flows stemming from record profits, and record interest income derived from high cash holdings and short-term interest rate levels, which offsets some interest expense.

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Corporate Fundamentals Are Generally Healthy

Q1 2024 Nonfinancial Corporate Data

	Nonfinancial Corporations	Investment-Grade Corporations	High Yield Corporations
Total Debt ($bn)	$13,751	$9,145	$1,439
Gross Leverage	2.8x	2.3x	3.6x
Gross Leverage 20-Year Average	**2.8x**	**1.9x**	**3.9x**
Net Leverage	2.0x	1.8x	3.0x
Net Leverage 20-Year Average	2.2x	1.4x	3.3x
Interest Coverage	27.6x	10.6x	4.6x
Interest Coverage 20-Year Average	**11.1x**	**11.4x**	**4.3x**
EBITDA Margin	35%	22%	16%
Cash / Debt	27%	18%	12%

■ Better Than Average ■ Worse Than Average

Source: Guggenheim Investments, Federal Reserve Financial Accounts. Data as of 3.31.2024. Nonfinancial corporations includes a broad range of companies, including those with no debt or public equity.

Investment-grade metrics are modestly worse than the historical average but overall healthy, with annual cash flow covering interest expense by more than 10x. The high-yield sector shows resilience with better than average interest coverage and leverage, as borrowers have been more disciplined with debt growth in a challenging environment.

Even as risks to growth are emerging, after-tax corporate profit growth of 11 percent in the first quarter of 2024 suggests that the corporate sector overall is not currently experiencing a downturn. History shows that profit growth averaged less than 2 percent when a recession was beginning, which is much lower than current levels.

However, future revisions may alter our understanding of the current landscape. The BEA's corporate profit data is often revised. Using data available at the time it was reported would have shown profit growth rate of 7 percent even as the economy entered a recession, which is closer to current levels. Therefore, investors should be cautious about extrapolating current profit trends.

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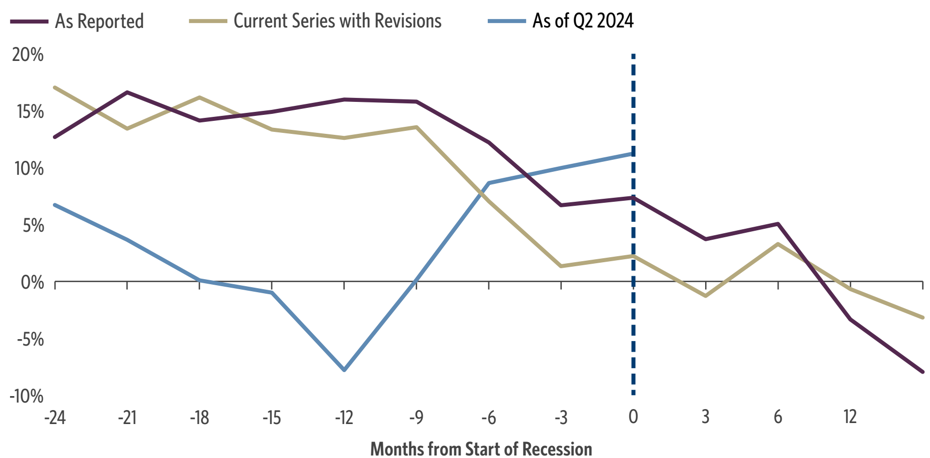
After-Tax Corporate Profits of 11% Exceed Recessionary 2% Average

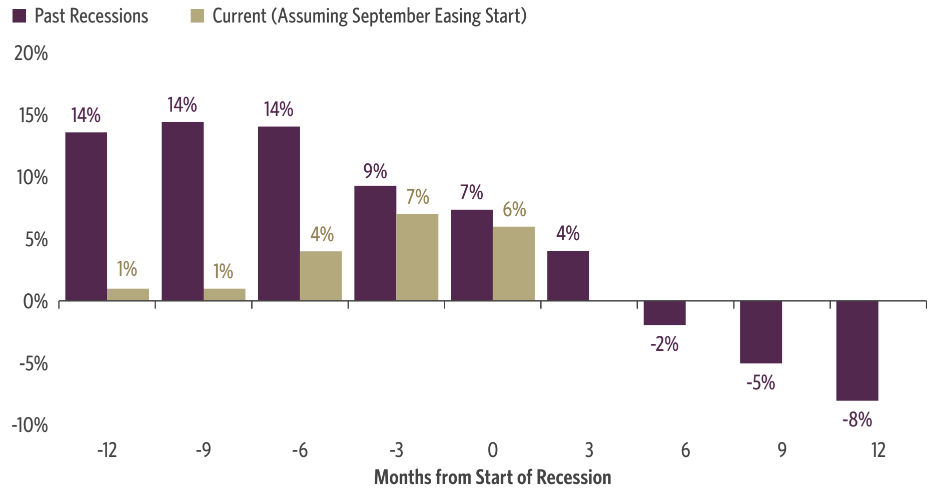


Source: Guggenheim, Bureau of Economic Analysis, Federal Reserve Bank of St. Louis. Data as of 6.30.2024. "As Reported" represents BEA data published in real time. "Current Series with Revisions" factors in subsequent BEA revisions to the historical series. "As of Q2 2024" reflects the most recent available data.

Looking at S&P 500 earnings per share (EPS) growth, which is less prone to revisions, we can see that profit growth typically slows on average going into recessions, but the pattern is not clear until after the recession begins. Trailing 12-month EPS growth averaged 7 percent when the recession started, slowed to 4 percent the following quarter, and finally turned negative two quarters into the recession. This suggests little about the business cycle or future profit trends from the 6 percent year-over-year EPS growth in the second quarter of 2024.

Forecasts for S&P 500 earnings per share suggest continued growth, with projections showing an acceleration from 1 percent in 2023 to 10 percent in 2024 and 15 percent in 2025. While these projections are optimistic, if they materialize, they would support strong performance in credit markets.

S&P 500 YoY Earnings Growth Projections Do Not Signal Recession



Source: Guggenheim Investments, Bloomberg. Data as of 9.8.2024.

Forecasts for S&P 500 earnings per share suggest continued growth, with projections showing an acceleration from 1 percent in 2023 to 10 percent in 2024 and 15 percent in 2025. While these projections are optimistic, if they materialize, they would support strong performance in credit markets. They would also help distinguish the upcoming easing cycle from ones that previously were associated with recessions.

Important Notices and Disclosures

Investing involves risk, including the possible loss of principal. Stock markets can be volatile. Investments in securities of small and medium capitalization companies may involve greater risk of loss and more abrupt fluctuations in market price than investments in larger companies. 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.

One **basis point** is equal to 0.01 percent.

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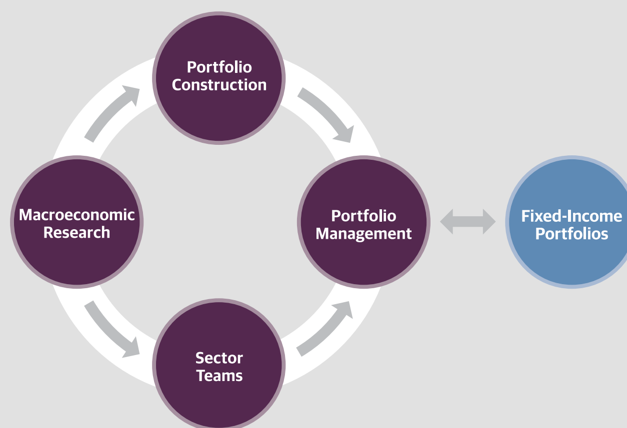
Guggenheim's Investment Process

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 $235 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 235+ 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.

For more information, visit GuggenheimInvestments.com.

1. Guggenheim Investments assets under management as of 6.30.2024 and include leverage of $15.1bn. 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 Corporate Funding, LLC, Guggenheim Partners Europe Limited, Guggenheim Partners Japan Limited, and GS GAMMA Advisors, LLC.

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