GUGGENHEIM

Fourth Quarter 2024

# Fixed-Income Sector Views

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Portfolio Management Outlook

# Tailwinds for Fixed Income

**The fixed-income outlook appears bright as the Fed continues its easing cycle, though risks remain, making sector allocation and credit selection critical.**

Our baseline U.S. economic outlook anticipates a gradual slowdown in growth, and inflation falling near the Federal Reserve's (Fed) 2 percent target. The election outcome tilts our inflation assumptions incrementally higher, while the growth outlook is more uncertain with both upside and downside policy-related risks. Consumer spending remains strong, supported by real income gains and elevated household wealth, and corporate profitability is robust. Still, as immigration slows and high interest rates continue to pressure some segments of the economy, growth is likely to slow from here, but the new administration will be loath for that to occur immediately on their watch.

The outlook is unusually uncertain given the regime change in Washington. At face value, a pro-tax cut, anti-regulation policy would skew growth and inflation higher. But immigration, tariffs, and the potential for trade wars or other geopolitical escalation are potential headwinds. And, while on balance labor market data still point to an ongoing gradual moderation in labor demand, noisy releases associated with special factors leave open questions about the strength of hiring. Meanwhile, the Fed will continue to recalibrate policy closer to neutral in the coming quarters.

In an environment of moderating growth and continued Fed easing, all-in yields remain attractive, particularly given the backup since September. Credit fundamentals are healthy overall, but somewhat dispersed. While much of the economy prospers, small businesses, low income consumers, and certain sectors of commercial real estate struggle under the weight of sharply higher interest rates. Spreads in most asset classes are back to their YTD tights, but some relationships still have room to compress.

With index spreads tight, our positioning skews defensive. We prefer higher quality credit, which tends to perform well in easing cycles, and structured products, which typically offer excess yield over similarly rated corporates, and wider spreads relative to fundamental risk. We are maintaining healthy cash positions and targeting an average level of credit beta to position our portfolios for potential opportunities.

In terms of duration, the yield curve has steepened significantly since the Fed began lowering interest rates, and we expect it to steepen further as rate cuts continue and the budget deficit grows. In this environment, we maintain a bias toward the belly of the curve given its historical outperformance during easing cycles. We prefer to express duration in this environment using Agency residential mortgage-backed securities (RMBS)—a liquid alternative to Treasurys with yield pickup—and Treasury inflation-protected securities (TIPS).

Historically, higher quality bonds have performed well in soft landings and even better in recessions, outperforming cash and riskier assets like stocks. Nonetheless, in this environment of growing disparity, credit and sector selection are critical—and an advantage for actively managed portfolios.

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

## Macroeconomic Update

# Recent Data Reduces (But Does Not Remove) Downside Risks

### Outlook for a soft landing improves.

While recent economic data releases have bolstered the case for a soft landing of the U.S. economy, mixed readings on the labor market and elevated policy uncertainty cloud the 2025 outlook. The new administration will pursue initiatives to boost growth, but those could come at some cost. The ability to meaningfully expand the fiscal impulse seems unlikely, even with a united government.

Recent revisions to income data have been positive and eased concerns about the durability of the U.S. expansion. Higher income in the annual revision to gross domestic income (GDI) helped assuage concerns that a low saving rate would cause consumers to pull back on spending. The reported saving rate rose from a concerning 2.9 percent to a more normal 4.8 percent, meaning that consumption—the main engine of economic growth—has a longer runway than previously indicated.

Recent labor market data have also showed a gradual cooling, but more abrupt labor market weakness remains a risk to our outlook. While the strong September employment report suggested some stabilization, payroll growth in October was weighed down by the effects of hurricanes and strikes, and the unemployment rate ticked higher, again suggesting an ongoing cooling. With so much noise impacting October payrolls, it is reassuring to see alternative measures holding up, with jobless claims reversing after a hurricane-related jump and surveys suggesting slightly better hiring conditions.

The Federal Open Market Committee's decision in September to begin the easing cycle with a 50 basis point rate cut demonstrated its responsiveness to a shifting balance of risks. Markets are likely to continue to price in further rate cuts following the 25 basis point cut in November and commentary suggesting a continued path toward neutral. With inflation remaining near mandate-consistent levels and downside risks to the growth outlook somewhat elevated, we continue to see the case for a gradual pace of rate cuts.

The outlook for 2025 is uncertain given potential shifts in policy after the election and geopolitical risks. A continued moderation in immigration points to a slowdown in U.S. economic growth, and uncertainty about the path of trade policy could be an additional headwind. However, the potential for further tax cuts, continued appreciation in financial assets, and a potential boost to business sentiment after the election are tailwinds. Fundamentals point to a further easing in inflation, but tariffs could lead to price shifts that interrupt that trend. On balance, the Fed will likely continue to recalibrate policy toward a neutral setting next year, which we estimate at 3.25–3.5 percent.

*By Matt Bush and Maria Giraldo*

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**Concerningly Low Saving Rate Revised Up on Higher Income**

Personal Saving, % of Disposable Income

Source: Guggenheim Investments, Haver Analytics. Data as of 8.31.2024. Gray shaded areas represent recession.

Rates

# Plotting a Path to the Terminal Rate

## Treasury issuance remains at record levels across the yield curve.

With the Fed easing cycle now underway, the market's focus has shifted to where the terminal rate will likely fall and how quickly we will get there. Over the medium-term, the evolution of the employment landscape will likely drive this path forward, although we anticipate detours along the way caused by economic data and macro surprises.

### Sector Commentary

- Resilient data on employment, consumer spending, and above target inflation have moderated Fed easing expectations, causing volatility in Treasury yields and the shape of the yield curve.
- After the Fed delivered its first rate cut this cycle with a 50 basis point ease in September and 25 basis points in November, subsequent strong economic data led the market to revise its expected terminal rate from 2.875 percent to 3.45 percent, more in line with our base case of 3.25–3.5 percent.
- Treasury issuance remains at record levels across the yield curve, and investment funds continue to be the largest buyers in the primary Treasury auctions. Primary dealer bidding also remains significant.
- The impact of higher issuance has led to a greater need to finance Treasury positions. With dealer balance sheets already constrained, intermediation of repo trades is challenging and has pushed financing rates higher.

### Investment Themes

- Regulatory requirements are pressuring dealers to reduce their capital intensive businesses, such as Treasury securities financing, creating funding pressures on recent heavy settlement and statement dates—a situation likely to occur again around year end.
- Longer term, changes to Basel III and a deregulation push from the new administration could alleviate some of this pain. Post-election, banking stocks rallied materially on those prospects.
- Potential funding pressures could lead to opportunities in other market segments, such as foreign exchange, where investors can create short-dated synthetic dollar-denominated foreign bonds and earn incremental risk-adjusted yield over comparable U.S. money market instruments.
- We expect the yield steepening curve trend to continue. We also think the macro environment favors owning inflation protection, and that TIPS can continue to do well relative to nominal Treasurys.

*By Kris Dorr and Tad Nygren*

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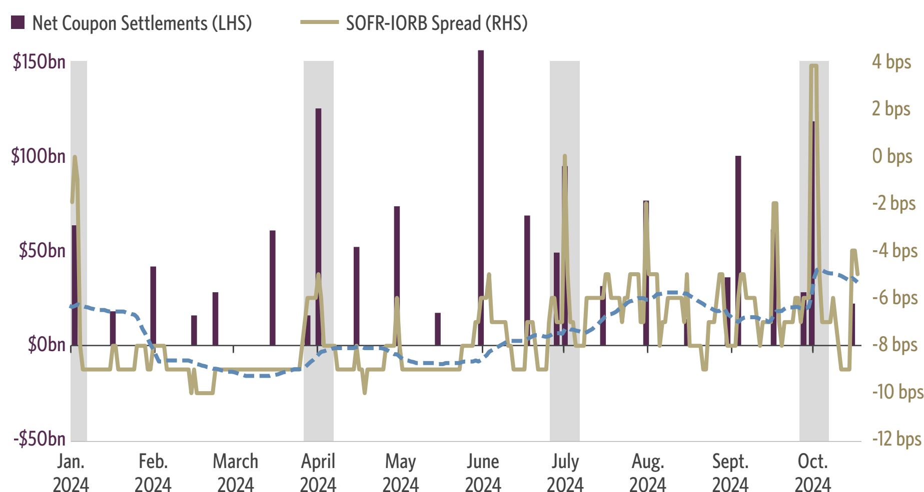
**Funding Pressures Could Lead to Opportunities Around Year End**




Source: Guggenheim Investments, Bloomberg. Data as of 10.17.2024. Gray shaded areas represent periods of funding spikes.

Investment-Grade Corporate Bonds

# Resilient Fundamentals

## The environment remains supportive of investment-grade bonds.

As Bloomberg U.S. Investment Grade Corporate Bond Index spreads flirt with near zero percentile levels, the rally in spreads will likely subside. Still, we believe the sector's all-in yields, which hover around the 60th percentile, will remain attractive to allocators, many of whom are yield-based investors. Furthermore, although spreads are tight, the breakeven total return leaves some cushion for volatility and marginal widening in spreads. Stable fundamentals, easing monetary policy, supportive supply technicals, strong fund inflows, and attractive yields should keep investment-grade spreads rangebound through year end.

### Sector Commentary

- Fourth quarter gross primary supply estimates of $225 billion are a sharp decline from the torrid pace of $400 billion in the third quarter, which broke monthly records for both July and September.
- Net primary issuance will likely be close to flat in the fourth quarter due to upcoming maturities and higher coupon income that will likely be reinvested into investment-grade corporate bonds in the secondary market.
- Fund flows remain a tailwind, with $284 billion of flows into investment-grade bond funds through the third quarter.
- Ratings actions were positive, with a 2.6x upgrade/downgrade ratio in the third quarter. The share of BBB-rated issuers declined to 9.5 percent, the lowest level since the fourth quarter of 2009, highlighting the resilient credit fundamentals within the investment-grade sector.

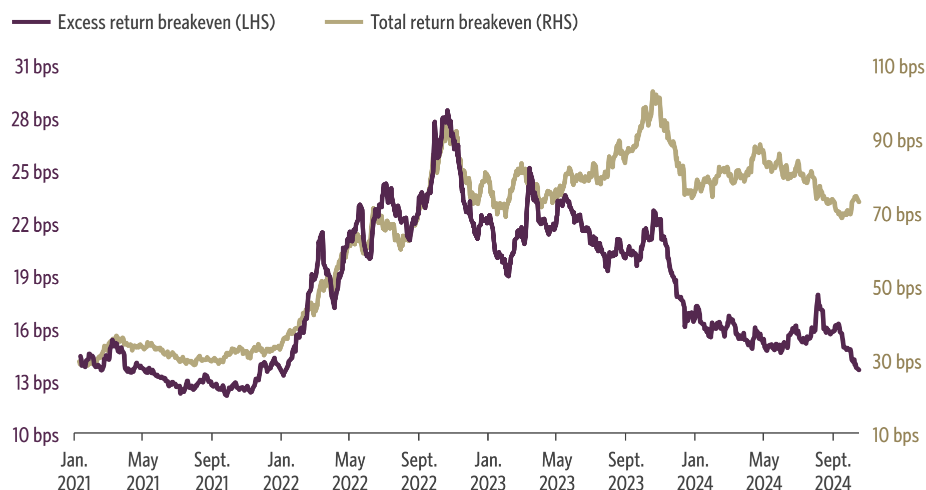
### Investment Themes

- A-rated and BBB-rated bond spreads should continue to compress amid stable credit fundamentals and low credit dispersion.
- Amid geopolitical and economic uncertainty, we favor increasing the liquidity profile in portfolios.
- Preferred securities and hybrids remain attractive on a fundamental and technical basis. We favor securities with short-dated call features and/or higher current coupon securities. Seasonally, we view tax-loss harvesting as a buying opportunity.
- Financials and utilities are still attractive. Insurers, although exposed to commercial real estate, continue to see growth from policy premiums and healthy investment performance.

*By Justin Takata*

Although spreads are tight, the breakeven total return leaves some cushion for volatility and marginal widening in spreads.

**Breakeven Spreads Remain Above 2021 Levels**




Source: Guggenheim Investments, Bloomberg. Data as of 9.30.2024.

## High Yield Corporate Bonds

# Spreads are Nearing Historical Lows

**Driven by low net issuance and strong demand, high yield credit spreads continue to tighten towards the lows last seen in 2021.**

High yield spreads experienced a brief bout of volatility in early August triggered by concerns over a weakening labor market, but this quickly turned around as buyers found spread levels and all-in yields to be at an attractive re-entry point. Credit fundamentals and rating migration continue to support the view that default rates will remain below average. With credit spreads approaching their historical tights, however, we remain selective.

### Sector Commentary

- Spreads on the ICE BofA U.S. High Yield Master II Constrained Index continued to tighten over the quarter, led by lower quality bonds. Earlier this year, higher quality BB-rated and B-rated credit spreads traded tighter than their 2021 lows, indicating that lower quality bond spreads are catching up.
- CCC-rated credit spreads are approaching their 2021 tights of 444 basis points, as the start of the Fed easing cycle and recent strength in economic data continue to drive growing expectations of a soft landing scenario. We are underweight.
- Growth opportunities related to artificial intelligence fueled a rally in CCCs as the market outlook improves for struggling sectors like cable and wireline. The communications sector's rebound follows negative returns in the first half of the year.
- Rating agency upgrades outpaced downgrades for the second consecutive quarter, with 130 upgrades versus 76 downgrades.

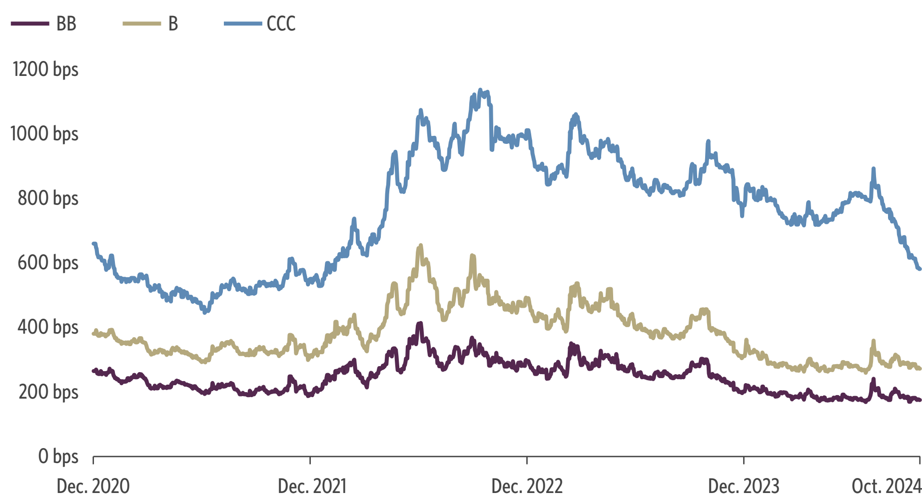
### Investment Themes

- Yields averaged 7 percent in mid-October, providing attractive loss-adjusted income given low default expectations. Spreads declined to 287 basis points, nearing their 2021 lows.
- Refinancing has driven 72 percent of this year's primary market activity, a pace of issuance unlikely to continue.
- Issuer net leverage and interest coverage credit ratios were flat in in the second quarter, slightly better than long term averages.
- The high yield last-12-month default rate of 1.4 percent declined slightly relative to last quarter and remains well below its long-term average of 4 percent. The distress rate decreased to 5.1 percent from 7.3 percent in June due to the rally in CCCs.
- We prefer higher quality high yield bonds (rated B or above) due to their stronger fundamentals and lower default risk, but careful credit selection remains important.

*By Thomas Hauser and Maria Giraldo*

CCC-rated credit spreads are approaching their 2021 tights of 444 basis points, as the start of the Fed easing cycle and recent strength in economic data continue to drive growing expectations of a soft landing scenario.

**CCC Spreads Are Approaching Their 2021 Low**




Source: Guggenheim Investments, Bloomberg. Data as of 10.21.2024. HY BB represented by the Bloomberg Ba U.S. High Yield Average option-adjusted spread (OAS); HY B represented by the Bloomberg B U.S. High Yield Average OAS; and HY CCC represented by the Bloomberg Caa US High Yield Average OAS.

Bank Loans

# Strong Loan Returns with Tail Risk Considerations

## Concerns remain over defaults and elevated interest burdens.

The Fed's 50 basis point rate cut in September marked the end of a two-and-a-half year rate hike cycle. The Credit Suisse Leveraged Loan Index returned a cumulative 21.8 percent over this period, benefitting from rising income associated with the floating rate coupons on loans. Through the end of 2025, additional rate cuts and continued repricing activity should help relieve some pressure on loan borrowers. Although some concerns over elevated interest burdens and defaults persist, the income opportunity in loans remains strong. With careful credit selection, loans offer attractive risk-adjusted returns and insulation from rate volatility.

### Sector Commentary

- Loans delivered strong performance of 2.1 percent in the third quarter and 6.6 percent year to date. High all-in coupons and low duration should continue to support performance in the near term.
- The three-year discount margin on the Credit Suisse Leveraged Index ended the third quarter at 498 basis points with the yield around 8.2 percent.
- A high share of loans continues to trade above par, ending September around 42 percent of the index. This suggests more contractual loan spreads may reprice lower, saving borrowers interest expense ahead of additional Fed rate cuts, but also moderating investor returns.
- Primary market activity picked up near the end of the third quarter. Almost $50 billion, or 38 percent, was non-refinancing related in September, the highest monthly reading since 2022, driven by an uptick in both M&A and dividend recapitalization volume.

### Investment Themes

- Loan demand remains strong, driven by CLO issuance, which is more than offsetting retail fund outflows over the past few months.
- While secondary loan prices have stabilized, the yield-to-maturity (YTM) remains above historical averages, offering investors an opportunity to capture attractive yields even as the Fed cuts rates.
- Rate cuts should help borrower fundamentals, but the impact will be gradual and tilted toward issuers already on solid footing.
- We remain concerned over the tail risk in the loan market given the impact of high rates on issuers' interest costs. We also expect loan recoveries to remain lower due to weaker documentation on loans issued in recent years and anticipate defaults will remain slightly elevated for an extended period.
- Distressed situations remain challenging to navigate, with liability management exercises (LMEs) the new norm.

*By Christopher Keywork and Maria Giraldo*

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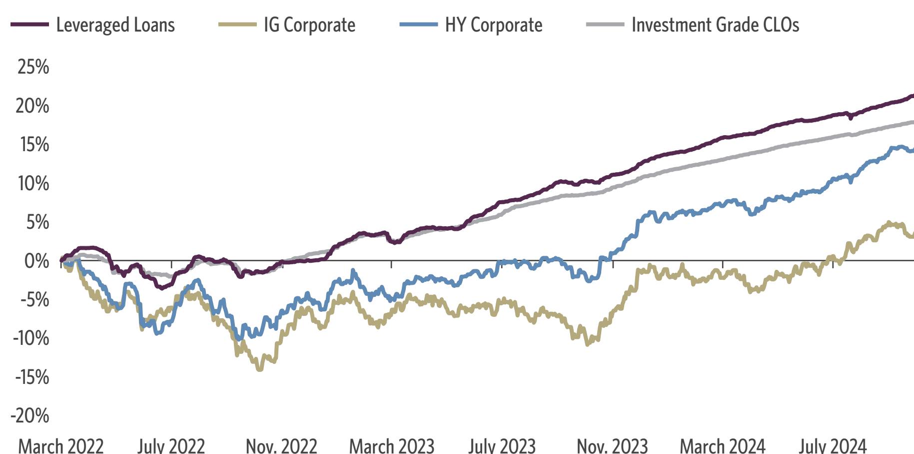
**Leveraged Loans Returned a Cumulative 21.8% since the Fed Started Hiking**

Cumulative Sector Return Since Start of 2022 Fed Rate Hikes




Source: Guggenheim Investments, Bloomberg, JP Morgan. Data as of 10.21.2024. Leveraged Loans represented by the Credit Suisse Leveraged Loan Total Return; IG Corporate represented by the Bloomberg U.S. Corporate Bond Index; HY Corporate represented by the Bloomberg U.S. Corporate High Yield Total Return Index; and Investment-Grade CLOs represented by the JP Morgan CLOIE Investment-Grade Total Return.

Private Debt

# Positive Outlook for Private Debt

## We expect a robust deal market in 2025 driven by falling rates and higher M&A volumes.

Spreads for new private debt originations contracted for the sixth consecutive time in the third quarter, pressured by increased competition for deals. Continued pressure on spreads is a factor that underscores the need for a focus on downside protections, tight documentation, and high selectivity. We are encouraged by meaningfully higher M&A activity in the third quarter and expect to see a robust deal market in 2025 driven by the prospect of falling rates and higher M&A volumes.

### Sector Commentary

- Spread compression continues to manifest across all deal sizes, driven by increased competition for deals. While private debt spreads have tightened, levels remain attractive relative to the broadly syndicated market.
- Covenant-lite deals are on the rise. Nearly 24 percent of all direct lender deal activity reviewed lacked traditional financial maintenance covenants, compared to just 12 percent for the entirety of 2023. We remain focused on sourcing deals with downside protections for our clients.
- We anticipate increased dispersion of returns among private credit managers, largely due to higher rates and default levels, highlighting the importance of strong credit selection.
- Leveraged buyout volume increased in the third quarter amid optimism about Fed policy, more agreement among sponsors on valuations, and continued pressure to return capital to investors.

### Investment Themes

- Private credit spreads offer an attractive yield and illiquidity premium against the broadly syndicated loan (BSL) market on both an absolute and risk-adjusted basis. Spreads for new private credit originations have moved largely in line with the BSL market.
- We favor the upper middle market and emphasize the importance of originating deals with defensively positioned companies in well-defined market niches, with sustainable profitability and cash flow, experienced management, and strong managerial controls.
- We continue to avoid commoditized deals with falling spreads, weaker documents, and increased flexibility for borrowers that in our view do not offer a compelling risk-adjusted return.
- We remain constructive on private credit, especially as the supply of deals increases, fueled by M&A activity. We believe that there is attractive relative value within certain industries and pockets that are perhaps overlooked, such as non-sponsored deals.

*By Joe McCurdy, Joe Bowen, Mark Pridmore, and Zac Huwald*

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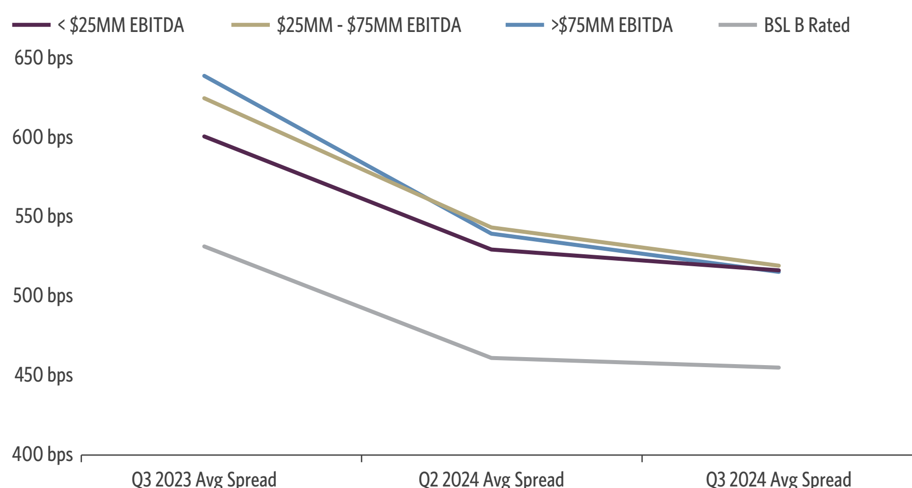
While private debt spreads have tightened, levels remain attractive relative to the broadly syndicated market.

**Private Credit Spreads Offer an Attractive Yield Premium Against the BSL Market**




Source: Guggenheim Investments, Wells Fargo. Data as of 9.30.2024. BSL B-Rated Spread: Credit Suisse Liquid Leveraged Loan Index Discount Margin 3 Year Single B.

Asset-Backed Securities and CLOs

# Attractive Relative Value Amid Brisk New Supply

## We favor senior commercial ABS and CLO tranches.

ABS continues to offer relative value with excess yield compared to similarly rated corporate bonds, and upside price potential if that relationship compresses. We expect new commercial ABS supply to remain elevated, as digital infrastructure will require continued capital investment to fund high growth needs. Meanwhile, both middle market (MM) and broadly syndicated loan (BSL) CLOs offer attractive absolute yields (similar to bank loans), and relative value compared to other credit categories. Net supply remains muted, which is a favorable technical backdrop.

## Sector Commentary

- **ABS:** The spread difference between ratings-matched ABS and corporate bonds currently ranks at its 78th percentile, suggesting attractive relative value for commercial ABS sectors. New issuance has been biased toward whole business securitizations and capital-intensive growth sectors such as fiber internet.
- **CLOs:** We saw elevated levels of both new issuance and refinancing activity in the third quarter, which was met with strong investor demand. As spreads tightened throughout 2024, the arbitrage between asset spreads and the cost of debt has improved, leading to increased interest among investors in CLO equity. CLO managers continue to improve the credit quality of their portfolios, reducing CCC concentrations to about 6.1 percent in the third quarter from 6.6 percent in the same period last year. Minimum overcollateralization cushions—which determine when cash flows are diverted away from junior tranches—are at healthy levels of roughly 4.2 percent.

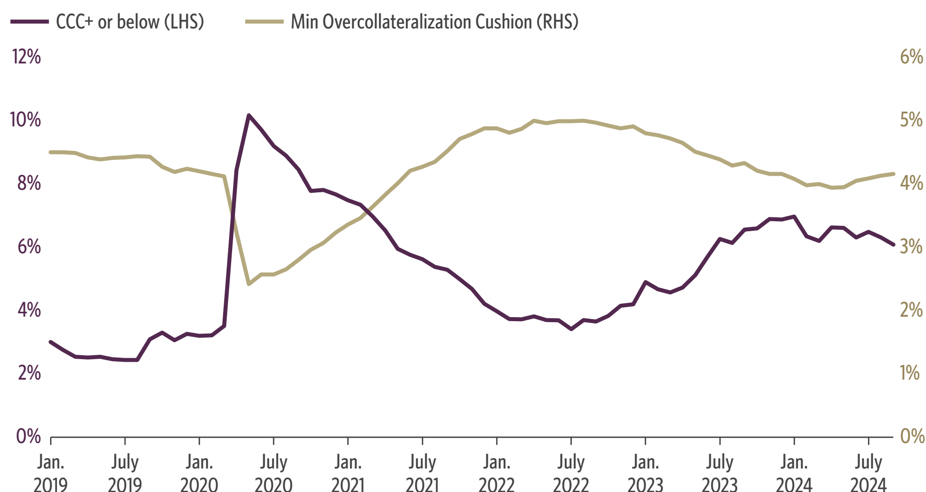
## Investment Themes

- **ABS:** We favor senior exposures in longer duration opportunities backed by high quality commercial collateral such as franchise royalties, fiber networks, and containers. Additional areas of focus are in senior positions in esoteric consumer ABS with conservative levels of credit enhancement.
- **CLOs:** We believe both senior and mezzanine tranches offer an attractive spread pickup compared to similarly rated corporate debt. While the basis between MM and BSL CLO tranches continues to remain at historically tight levels, the absolute carry profile is attractive for both. Manager and credit selection remain important as we anticipate increasingly divergent performance going forward.

*By Michael Liu, Scott Kanouse, and Pooja Shendure*

CLO managers continue to improve their portfolios, reducing CCC concentrations to about 6.1 percent in the third quarter from 6.6 percent in the same period last year. Minimum overcollateralization cushions—which determine when cash flows are diverted away from junior tranches—are at healthy levels of roughly 4.2 percent.

### CLO Portfolio Quality Has Improved Over the Last Year and Particularly in Q3




Source: Guggenheim Investments, Intex. Data as of 9.30.2024.

## Non-Agency Residential Mortgage-Backed Securities

# Gross Issuance to Remain Tepid

### Market conditions set the stage for steady mortgage credit performance.

We remain constructive on the non-Agency RMBS sector amid its limited new issue volume and positive credit fundamentals. Despite the year-to-date decline in mortgage rates, new origination volume and home sales activity are expected to remain muted as borrowers remain locked-in to their existing low mortgage rates, although existing home supply is ticking up slightly. Tight lending standards, accumulated home equity, and a stable labor market provide favorable conditions for mortgage credit performance.

### Sector Commentary

- New issue volume through October 2024 of $100 billion is exceeding the full-year 2023 total of $78 billion. Nevertheless, the projected total for 2024 is still expected to be near the lowest level since 2020 due to low overall home purchase activity.
- Housing market fundamentals continue to benefit from limited supply. The most recent Case-Shiller Index reading, July 2024, showed 5.9 percent year-over-year price growth. Combined with a stable consumer credit profile, these conditions lay the foundation for steady mortgage credit performance.

### Investment Themes

- We continue to favor transactions with structures that limit extension risk and can withstand a deterioration of credit performance that would reflect severe economic conditions.
- Opportunities include investment-grade securities from non-qualified mortgage (non-QM) transactions and senior securities from closed-end second (CES) lien and home equity line of credit (HELOC) transactions, which offer attractive valuations relative to their credit risks.

*By Karthik Narayanan and Roy Park*

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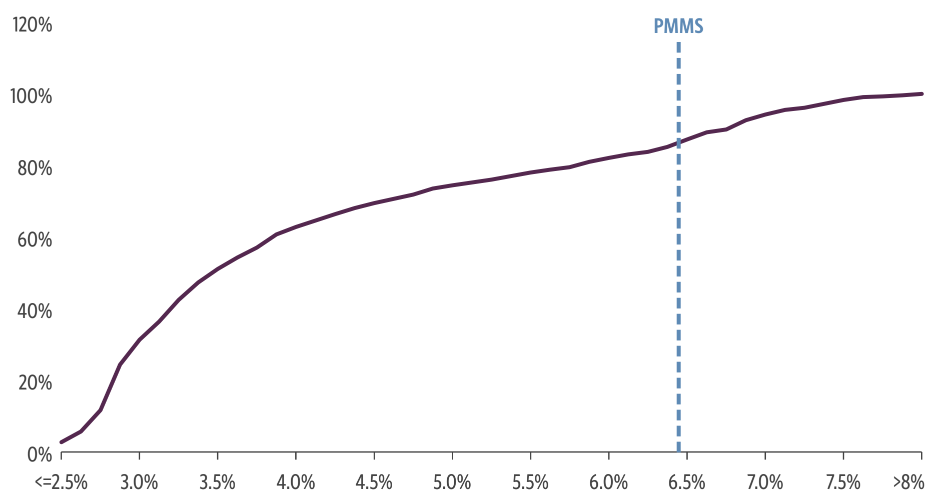
While the average 30-year fixed mortgage rate declined 78 basis points from its peak in May, only 15 percent of borrowers have an economic incentive to refinance. Therefore, the recent rate move is not expected to significantly increase refinance activity or new issue volume.

**Just 15% of Mortgages Have Interest Rates Above the Current 30-Year Fixed Rate**

Cumulative Percentage of Outstanding Balance




Source: Guggenheim Investments, eMBS, Freddie Mac, and Goldman Sachs Global Investment Research. Data as of 10.17.2024. PMMS = Freddie Mac's Primary Mortgage Market Survey.

## Commercial Mortgage-Backed Securities

# Healthy Volumes Overshadow Credit Fundamentals

### Maintaining caution and discipline in a technical rally.

Powered by healthy annuity and fixed-income fund flows, demand for credit-enhanced structured products such as CMBS continues to increase. While CMBS new issuance has recovered from the trough of 2023, investor demand has recovered even more strongly. As fundamental challenges persist across commercial real estate (CRE) sectors, we remain cautious in CMBS as we see limited opportunities to secure attractive risk-adjusted returns amid this technical rally.

### Sector Commentary

- Year-to-date CMBS issuance of $83 billion exceeds the $32 billion issued in 2023 over the same period but lags the $92–$105 billion totals seen in 2022 and 2021.
- Over $50 billion of 2024 issuance has been via single asset/single borrower (SASB) transactions financing specific, high quality properties or portfolios, with a heavy concentration to industrial, multifamily, and lodging property types.
- Just 64 percent of conduit CMBS loans were refinanced on time, meaning over one-third of loans scheduled to repay this year are in some state of workout. Less than 40 percent of CMBS office loans have been repaid on time.
- Performance issues, including weak demand for office space, will continue to weigh on CRE performance and could expose CMBS to heightened risk, especially if macroeconomic conditions worsen. The 60-plus day delinquency rate currently stands at 5.9 percent.

### Investment Themes

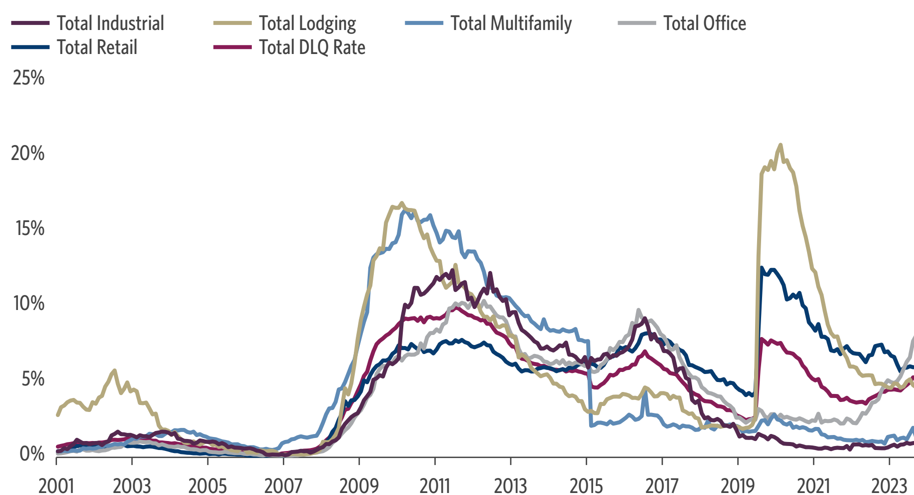
- We maintain a preference for senior securities with higher credit enhancement, capable sponsorship, and limited office exposure.
- Select SASB transactions and CRE CLOs continue to offer the potential for attractive risk-adjusted returns.
- Conversely, we continue to find that most mezzanine and junior bonds across CMBS subsectors fail to appropriately compensate investors at current levels.

*By Tom Nash and Hongli Yang*

Performance issues, including weak demand for office space, will continue to weigh on CRE performance and could expose CMBS to heightened risk, especially if macroeconomic conditions worsen.

**Office and Retail Sectors Lead CMBS Delinquencies**

Delinquency Rate by Property Type (%)




Source: Guggenheim Investments, JP Morgan, Trepp. Data as of 9.30.2024.

Municipal Bonds

# Positioning for Technical Headwinds

## We prefer non-index taxables due to tight valuations in tax-exempt munis.

Both tax-exempt and taxable municipal bonds continue to perform well on a total return basis, but we expect tax-exempt valuations to widen as technical headwinds increase. State budget deficits are widening as federal COVID-related stimulus funding winds down.

### Sector Commentary

- Municipals returned 1.4 percent for the year through mid-November despite a 45 percent increase in new issuance. Tax exempt/Treasury yield ratios are lower over the last 12 months.
- We are entering the seasonal lull for principal and interest payments, averaging $47 billion per month from October–December compared to $64 billion during the summer.
- New issues have averaged more than $10 billion per week since early September. We expect net supply growth to push tax exempt/Treasury yield ratios wider from current levels.
- Taxable municipal spreads continue to grind tighter but have lagged investment-grade corporate bonds. At the index level, taxable spreads are 18 basis points tighter on the year, resulting in a 1.9 percent total return through mid-November. Issuance increased 6 percent year over year to $30 billion, and demand for quality long duration paper remains steady.

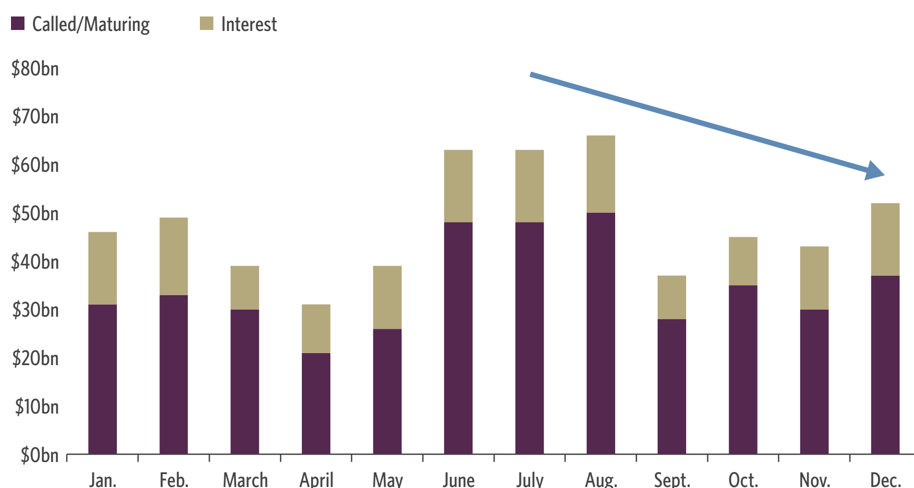
### Investment Themes

- At current ratios and spreads, we prefer non-index taxables over tax exempts due to tight valuations in exempts. We caution against focusing solely on the high taxable equivalent yields, as current valuations provide limited buffer against technical headwinds.
- Federal COVID stimulus funding to state and local governments has wound down, exposing budget deficits at issuers that allocated the nonrecurring money for recurring expenses. The financial shortfall at Chicago Public Schools, and the accompanying discussions about taking out a short-term loan to pay for salary and benefits, demonstrate the need for prudent long term planning. We expect more issuers to weigh tough tradeoffs in the next 12–18 months.

*By Allen Li and Michael Park*

We are entering the seasonal lull for principal and interest payments, averaging $47 billion per month from October–December compared to $64 billion during the summer.

**Munis Are Entering a Seasonal Lull for Principal and Interest Payments**




Source: Guggenheim Investments, Bank of America. Data as of 9.30.2024.

Agency Mortgage-Backed Securities

# Opportunity Within One of the Cheapest Sectors

## We favor income over price appreciation, specifically production coupons that offer the widest spreads and highest yields in the sector.

The Bloomberg U.S. MBS Index posted total and excess returns of 5.44 percent and 0.75 percent during the third quarter interest rate rally, pushing both measures into positive territory for the year. Positively convex index coupons (2.5–3.5 percent), which are insulated from prepayment concerns, outperformed higher coupon MBS. Recent underperformance of newly produced MBS with 5.5–6 percent coupons leaves them with the highest spreads and yields in the sector.

### Sector Commentary

- Refinancing concerns resurfaced for the first time in recent memory as primary mortgage rates temporarily breached 6 percent. While we expect elevated prepayments are likely temporary, moving exposure into specified pools in premium coupons mitigates some risk.
- Bloomberg U.S. MBS Index year-to-date excess returns briefly exceeded those of the Bloomberg U.S. Investment-Grade Corporate Bond Index in early August during a sharp risk-off move. Since then, this move has largely reversed as a string of healthy economic data has greatly alleviated hard landing concerns. If this trend continues, we anticipate some rotation out of corporates and into other fixed-income sectors, including Agency MBS.

### Investment Themes

- Looking ahead, we continue to favor income over price appreciation, specifically production coupons that offer the widest spreads and highest yields. This segment of the market will benefit if the rates market holds the low end of the current range or retraces above 4 percent on 10-year Treasurys.
- The steepening of the yield curve along with the richness of 15-year MBS valuations have revitalized short-duration, fixed-rate collateralized mortgage obligations. Sequential deals off production coupons provide banks with improved current income relative to legacy lower-coupon holdings and limit extension risk. The corresponding long duration structures also offer value, with significantly higher yields than long duration Agency CMBS alternatives.

*By Louis Pacilio*

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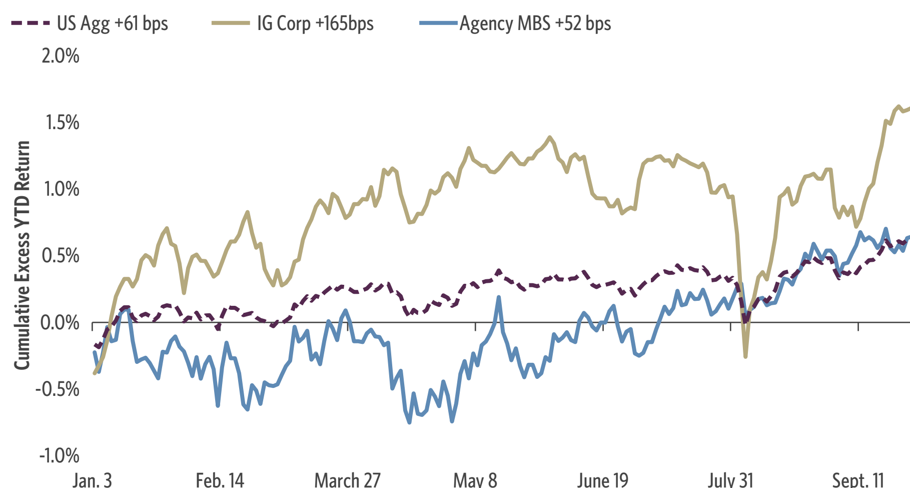
Bloomberg U.S. MBS Index year-to-date excess returns briefly exceeded those of the Bloomberg U.S. Investment-Grade Corporate Bond Index in early August during a sharp risk-off move. Since then, this move has largely reversed as a string of healthy economic data has greatly alleviated hard landing concerns.

**Agency MBS Excess Returns Lagged IG Corporates in 2024's Risk-On Environment**

Cumulative Excess YTD Returns




Source: Guggenheim Investments, Bloomberg. Data as of 9.30.2024.

Commercial Real Estate

# Divergent Performance in Commercial Real Estate

## Office properties continue to suffer, but all other sectors see positive price growth.

In the first half of 2024, only the industrial and apartment sectors had cumulative price growth that exceeded the average loss rate. Conversely, the office sector sustained losses that significantly outweighed price growth. We expect performance across asset classes to diverge for the next couple of years while the market adjusts to post-pandemic tenant preferences.

### Sector Commentary

- Following the severe impact of COVID pandemic shutdowns on hotel and retail properties, both asset classes have displayed resilience and maintained positive price growth.
- While loss numbers appear elevated, the retail loss numbers include malls, which accounted for half of the top six retail trades.
- Office properties continue to face weak demand as hybrid work schedules remain sticky post-pandemic. Tenants also continue to favor newer offices with better amenities over older properties that require significant capital improvements.

### Investment Themes

- We expect continued losses on office properties for the near term as borrowers face a mountain of upcoming loan maturities.
- Low levels of new supply, coupled with interest rate declines, should support real estate prices.
- Loan maturities remain a pressure point. Even performing loans may face refinancing challenges as commercial banks remain largely on the sidelines.
- This situation with banks may not lead to payment defaults by cash flowing loans but will require patience as lenders weigh the risks of extending maturity versus loan enforcement.

*By Jennifer A. Marler and Karen Karwoski*

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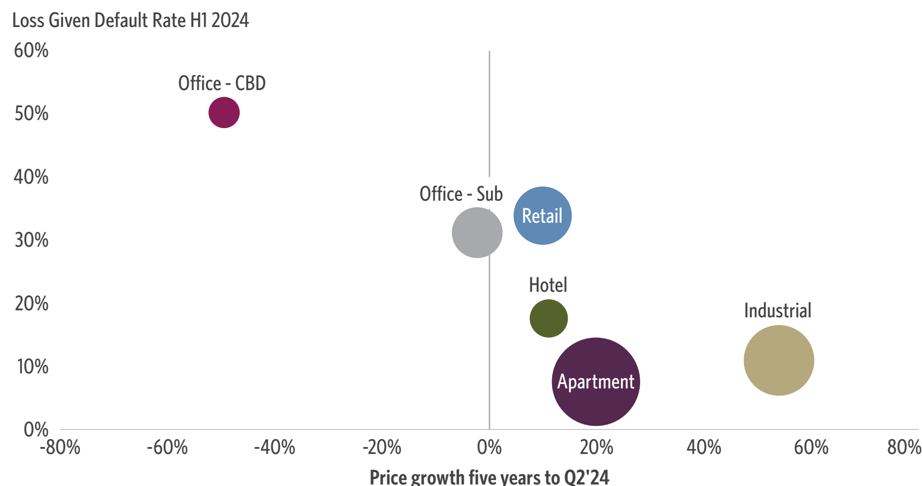
We expect performance across asset classes to diverge for the next couple of years while the market adjusts to post-pandemic tenant preferences.

**Property Price Growth and Loan Loss Rates Vary Materially by Sector**




Source: Guggenheim Investments, RCA Analytics. Data as of 6.30.2024.

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One **basis point** is equal to 0.01 percent. Likewise, 100 basis points equals 1 percent. **Beta** is a statistical measure of volatility relative to the overall market. A positive beta indicates movement in the same direction as the market, while a negative beta indicates movement inverse to the market. Beta for the market is generally considered to be 1. A beta above 1 and below -1 indicates more volatility than the market. A beta between 1 to -1 indicates less volatility than the market. **Carry** is the difference between the cost of financing an asset and the interest received on that asset. **Dry powder** refers to highly liquid assets, such as cash or money market instruments, that can be invested when more attractive investment opportunities arise. Duration is a measure of sensitivity of a price of a bond to a change in interest rates. In general, the higher the duration, the more the bond's price will change with interest rate movements.

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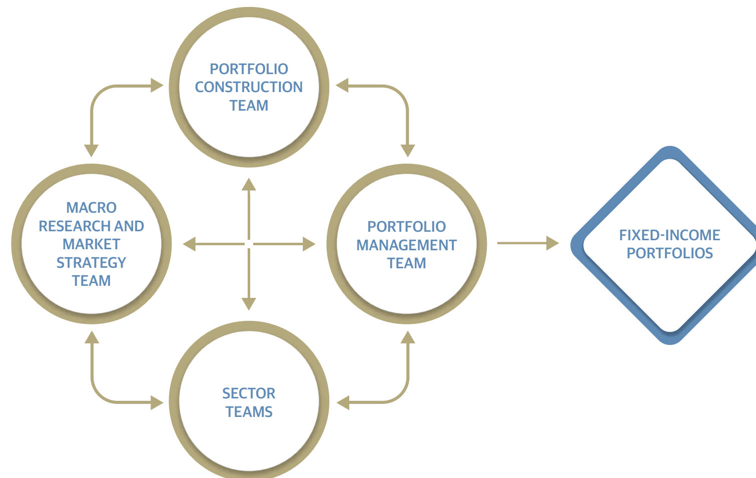


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## Guggenheim Partners

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### For more information, visit GuggenheimInvestments.com.

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