GUGGENHEIM

Portfolio Management Outlook

Prudent Investing Calls for a Steady Hand

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Staying the course in a time of increasing uncertainty.

The theme of avoiding the fate of '98, which we discussed last quarter, continues to resonate as we shift gears for 2020. The 1998 experience saw the Fed's easing efforts helped to delay the oncoming recession, but also propelled a bubble in tech stocks. By not participating in a liquidity-driven rally that lacked fundamental support, the prudent investor would have avoided a 78 percent drawdown in tech stocks and a wave of corporate defaults that left many participants with less wealth than when the Fed first started lowering interest rates in 1998.

As our Global CIO Scott Minerd writes in his introduction to this quarter's Fixed-Income Outlook, the Fed's mid-cycle adjustment appears to have successfully staved off recession as it did in 1998. The expansion will likely continue in the near term with the help of global monetary easing efforts that are helping to drive risk assets higher. Year-to-date performance across different asset classes shows rates and cyclical equities both delivering better returns than credit (see chart, bottom right), although the Fed's easing will likely allow risks to build in certain areas of the credit markets. For now, we continue to focus on income and capital preservation.

Our primary portfolio allocation strategy within Core Plus has been to focus on credit loss-remote investments that will exhibit minimal spread volatility and stable returns under a variety of credit and rate environments. We remain underweight investment-grade corporate credit, overweight high-quality asset-backed securities, and are maintaining positions in Agency commercial mortgage-backed securities and Treasurys. Over the past several years, we have increased the average portfolio credit quality from BBB+ at the start of 2016 to AA- as of the most recent quarter, while generating more yield than the subcomponents of comparable quality in the Bloomberg Barclays U.S. Aggregate Bond index (Agg).

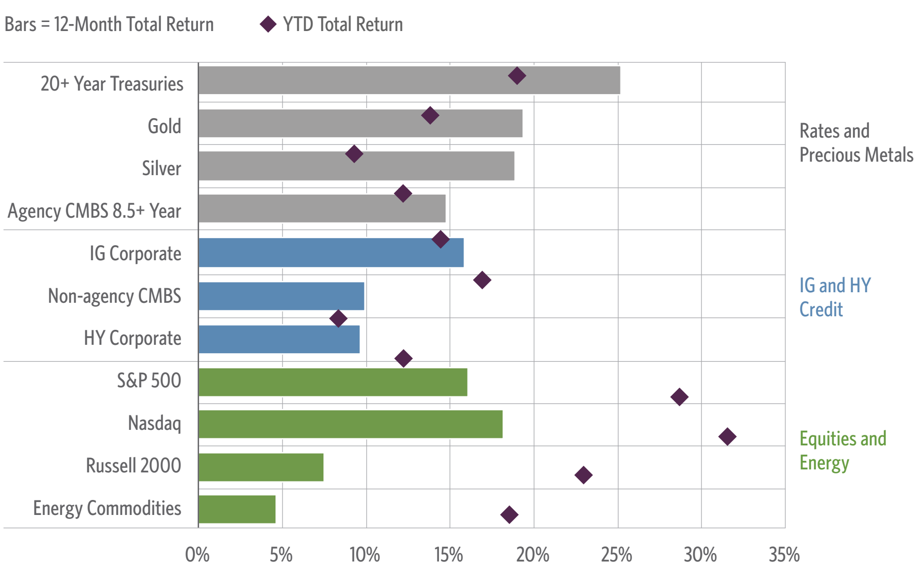
We have been gradually increasing the average quality of our Multi-Credit strategy as well, from BB+ at the start of 2016 to BBB+ as of the most recent quarter. Our largest allocations in this strategy are high-quality asset-backed securities, short-tenor investment-grade corporate credit, and investments at the front end of the curve that still carry well. Those short-term investments include FX-hedged short-tenor sovereign debt exposure that have the potential to generate an attractive yield for the portfolio.

Our duration strategy across both Core Plus and Multi-Credit positions the portfolios to benefit from a steeper yield curve. As accommodative Fed policy prolongs the business cycle akin to 1998, this should increase inflation expectations and term premium and steepen the yield curve.

While recession risk has receded for the time being, clouds linger on the economic horizon. As the Fed, along with the European Central Bank and Bank of Japan, once again are engaged in synchronous balance sheet expansion, history shows that in time the current liquidity risk in markets and the economy will ultimately come to an untimely end, and the forces driving the current excesses will dissipate once the liquidity spigots are turned off. It is only a matter of time.

Our conservative approach has resulted in positive returns, but trailed many benchmarks that have reflected a higher risk profile over the past year. While these short-term results may disappoint, the discipline of behavioral finance will caution against short-term tactical bets at the expense of long-term performance. As discussed by our Global CIO, the risk/reward tradeoff still favors caution.

Market Returns Reflect a Tension in the Economic Outlook



Source: Guggenheim Investments, Bloomberg. Data as of 11.30.2019.

Returns across different asset classes reflect a tension in the macroeconomic outlook, with rates and equities both delivering better returns than credit.