

## Portfolio Management Outlook

# Picking Up Pennies in Front of a Steamroller



**Anne B. Walsh, JD, CFA**  
Chief Investment Officer,  
Fixed Income



**Steve Brown, CFA**  
Portfolio Manager



**Adam Bloch**  
Portfolio Manager

Given the compressed credit curve and tight spreads, we remain focused on capital preservation and protecting our clients from downside volatility.

The Indian Summer for risk assets turned out to be much hotter than we had expected after a rocky fourth quarter. High-yield corporates posted their best first quarter on record, and bank loans also delivered their best first quarter since 2010. Even investment-grade corporates saw spreads tighten against falling Treasury yields, propelling further returns. As we anticipated, we have seen volatility increase in the second quarter, with corporate spreads moving wider.

Fanning the flames, the Fed not only left the federal funds rate unchanged at the March Federal Open Market Committee (FOMC) meeting, but also announced that its balance sheet runoff would end in September. The FOMC's "dot plot" now shows the median projection for the fed funds rate is for no change in 2019. We now expect the Fed to remain on hold for most of the year with the possibility of another rate hike in the fourth quarter. While the Fed pause should support risk assets in the near term, we worry about excesses continuing to build via mergers and acquisitions that push leverage ratios to new heights, and initial public offerings that bring unprofitable operations to public hands.

Even if the Fed's pause extends the expansion, adding to credit risk at this point in the cycle is akin to picking up pennies in front of a steamroller. High-yield corporate bond spreads and non-Agency CMBS are below the 50th percentile, representing some risk of retracement given that, historically, spreads have more often been wider than current levels. Investment-grade corporate bond spreads look a little cheaper relative to their own history (see chart, bottom right), but the sector is rife with above-average leverage multiples. Given the compressed credit curve and tight spreads, we remain focused on capital preservation and protecting our clients from downside volatility. Our portfolios have increasingly favored high-quality assets with a preference for government-backed securities. Within credit, we continue to stay up in quality via securitized credit.

We maintain our duration underweight as some of the recent rally may have been overdone and interest rates may rise if economic data improve. We shifted most of the curve positioning out of the barbell to neutral versus the benchmark after the three-month/10-year Treasury curve inverted in March for the first time since 2007.

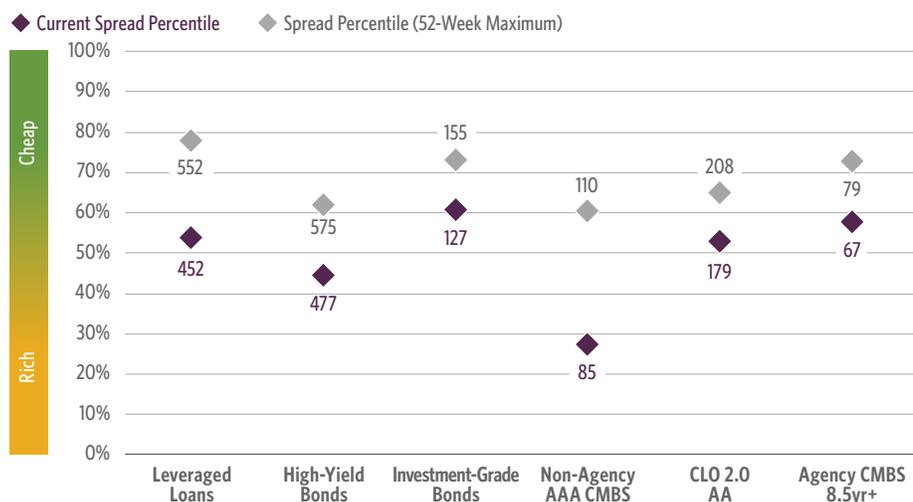
Additionally, as appropriate we have established options positions to take advantage of increased steepening of the curve should the Fed ease or longer-term rates rise in the event that it fails to deliver on the rate cuts currently priced into the yield curve.

We remain underweight investment-grade corporate bonds versus the benchmark, consistent with our capital preservation strategy. Investment-grade corporate bond spreads retraced much of the prior quarter’s widening on the back of a dovish Fed, foreign demand, and a more stable macroeconomic environment. The strongest spread rally over a three-month period since mid-2016 has diminished some of the value that they offered at the end of 2018. We expect spreads to widen later in the year as investors start to price in the possibility of a U.S. economic recession.

Abundant late-cycle signals suggest that the risk-reward of owning credit is unfavorable. We expect risk assets to suffer a severe bear market leading up to and through the next recession. As a result, our multi-asset strategy continues to maintain liquidity buffers that are higher than typical, which will allow us to pick up undervalued credits during more opportune times.

### High-Yield Spreads and Non-Agency CMBS Are Below the 50th Percentile

Numerical Value = Spread Levels



Source: Guggenheim Investments, Credit Suisse. Data as of 5.31.2019. Index Legend: Credit Suisse Leveraged Loan index, Credit Suisse High-Yield Corporate Bond index, Bloomberg Barclays Investment-Grade Corporate Bond index, Bloomberg Barclays U.S. Aggregate index (Agency Bond and Agency RMBS subset), Historical CLO spreads were provided by Bank of America Merrill Lynch, current CLO spreads are based on J.P. Morgan CLOIE Index, Non-agency CMBS spreads were provided by J.P. Morgan Research. Based on all available history for each sector.

High-yield corporate bond spreads and non-Agency CMBS are below the 50th percentile, representing some risk of retracement given that, historically, spreads have more often been wider than current levels. Investment-grade corporate bond spreads look a little cheaper relative to their own history, but the sector is rife with above-average leverage multiples.

Investing involves risk. In general, the value of fixed-income securities fall when interest rates rise. High-yield securities present more liquidity and credit risk than investment grade bonds and may be subject to greater volatility. Asset-backed securities, including mortgage-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 risk. Investments in floating rate senior secured syndicated bank loans and other floating rate securities involve special types of risks, including credit risk, interest rate risk, liquidity risk and prepayment risk. Guggenheim Investments represents the following affiliated investment management businesses of Guggenheim Partners, LLC: Guggenheim Partners Investment Management, LLC, Security Investors, LLC, Guggenheim Funds Investment Advisors, LLC, Guggenheim Funds Distributors, LLC, GS GAMMA Advisors, LLC, Guggenheim Partners Europe Limited and Guggenheim Partners India Management. ©2019, Guggenheim Partners, LLC. No part of this article may be reproduced in any form, or referred to in any other publication, without express written permission of Guggenheim Partners, LLC.