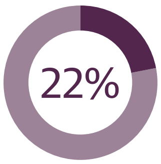
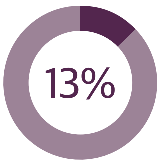


Guggenheim
Core



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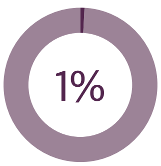
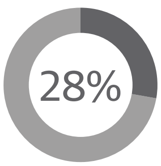
Core Plus



Guggenheim
Multi-Credit



Bloomberg Barclays
U.S. Aggregate

Aditya Agrawal, CFA
Director

Louis Pacilio
Vice President

Agency Mortgage-Backed Securities

Flight to Quality

With solid fundamentals and fair valuations in a period of weak technical factors, select Agency MBS appears relatively attractive.

Agency MBS outperformed other major credit sectors in the volatile fourth quarter of 2018, which ended with lower rates, a flatter 2s/10s yield curve and higher implied interest rate volatility. The Bloomberg Barclays U.S. MBS index posted a 2.1 percent total return for the quarter and 1.0 percent return for 2018. Option-adjusted spreads were 7 basis points wider over the quarter and 10 basis points for the year. Aggregate prepayment speeds continued to slow to historic lows.

Our major themes from last year played out as anticipated, and we are planning for a similar market environment. Fundamentals remain strong, with most borrowers having no rate incentive to refinance. Valuations look reasonable, with current spreads around long-term average levels and wider than post-crisis averages. Supply/demand technicals are likely to remain challenging now that the Fed is no longer an active market participant, and uncertainty remains about who will pick up the demand deficit. So far, it seems MBS funds have picked up at least some of the market's rotation out of corporate credit. One example of this is the iShares MBS ETF (MBB), with $15 billion in assets, which saw $2.9 billion in inflows since the start of October, whereas the iShares iBoxx Investment-Grade Corporate Bond ETF (LQD), with $32 billion in assets, experienced net outflows of $2.4 billion over the same period. Furthermore, any spread widening as a result of the Fed's withdrawal will likely be moderate, since this withdrawal has been well telegraphed and gradual (see chart, top right).

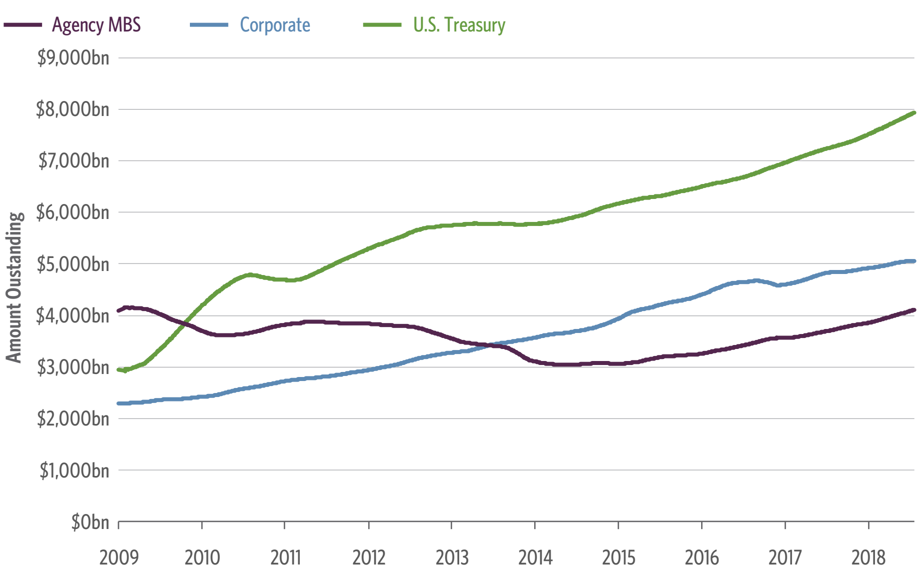
The U.S. Treasury and corporate debt markets have witnessed significantly higher issuance in the past few years compared to Agency MBS (see chart, bottom right). While MBS supply may be higher now and possibly growing further if the recent rally in mortgage rates drives home sales higher, its share of widely followed benchmarks like the Bloomberg Barclays U.S. Aggregate index is still low compared to other major fixed-income sectors. Better relative liquidity may continue to attract more reallocation from credit sectors to Agency MBS as we enter a late-cycle phase. We continue to favor investments in which either the collateral or structure offers some cash flow stability at reasonable spreads. We find select subsectors attractively priced in the current environment, including longer-maturity Agency multifamily bonds, better call-protected pools, and some collateralized mortgage obligation structures.

The Pace of Monthly Net Fed MBS Purchases Has Slowed

Source: Guggenheim Investments, JPMorgan, Federal Reserve. Data as of 1.22.2019.

Any increase in risk premia will likely push MBS spreads wider as the Fed continues to tighten monetary policy. However, any spread widening will likely be moderate as the Fed's withdrawal from the market has been well-telegraphed and gradual.

Agency MBS Issuance Is Increasing, But the Sector Remains Relatively Small



Source: Guggenheim Investments, Bloomberg Barclays. Data as of 1.16.2019. Note: Amount outstanding in the Bloomberg Barclays U.S. Aggregate Bond index, excluding Federal Reserve holdings. Agency MBS: Bloomberg Barclays U.S. MBS Index; Corporate: Bloomberg Barclays Investment-Grade Corporate Bond Index; U.S. Treasurys: Bloomberg Barclays Treasuries Index.

The U.S. Treasury and corporate debt markets have witnessed significantly higher issuance in the past few years compared to Agency MBS. While MBS supply may be higher now, and possibly further if the recent rally in mortgage rates drives home sales higher, its share of benchmarks is still relatively low compared to other major fixed-income sectors.