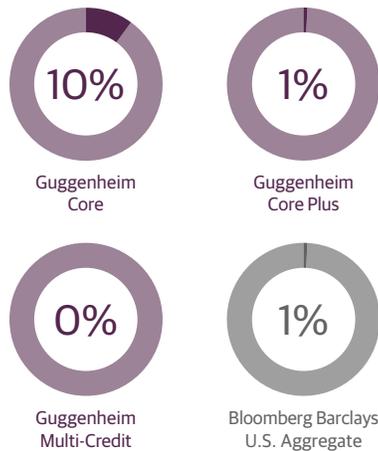


Municipal Bonds Weather Ready



Municipal bonds weathered fourth quarter volatility better than other fixed-income sectors, but careful selection remains key.

The municipal market reasserted itself as a safe haven in the fourth quarter of 2018 amid elevated volatility driven by a wide spectrum of concerns. Municipal bonds have been characterized as low-volatility securities as credit spreads hovered near the trough of post-financial crisis levels (see chart, top right). Unlike Treasuries, municipals did not experience a bear flattening in 2018 and compensated investors who assumed duration risk.

Heading into 2019, implications of the Tax Cuts and Jobs Act and midterm elections help anchor expectations of relative outperformance. In response to lower corporate tax rates, institutional investors executed tax-motivated selling in 2018. Offsetting this reduced demand going forward, the inaugural limit on state and local tax deductions is expected to attract demand from disproportionately impacted states such as California and New York (see chart, bottom right). Meanwhile, the midterm elections produced a divided Congress whose political gridlock will keep federal infrastructure programs (i.e., new supply) on the sidelines and maintain expanded Medicaid funding.

With cautious optimism ahead of the next downturn, we stress the need for diligence to combat the natural information lag of issuers. Municipalities are often afforded a nine-month delay to report financials and an additional year for pension figures. As a result, market performance based on reporting of tax collections and pension health may fail to reflect economic conditions in a timely manner.

While maintaining a defensive position to weather the next recession, we anticipate that idiosyncratic opportunities will emerge as credit spread volatility increases with the reintroduction of Puerto Rico bonds to the indexes. As ensuing political pressure mounts on state and local governments to make hard choices to favor either bondholders, pensioners, or taxpayers, we place a premium on budget flexibility and robust structural protections.



James Pass
Senior Managing Director

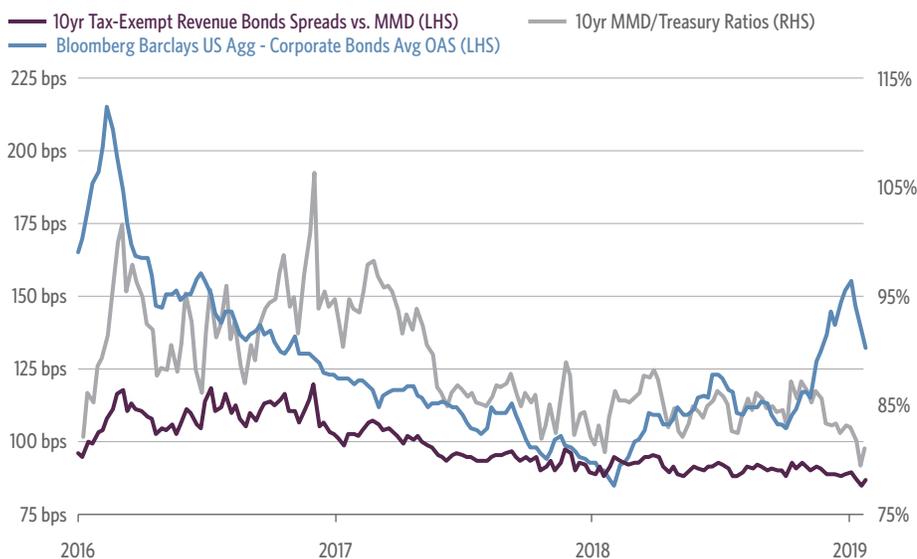


Allen Li, CFA
Managing Director



Michael Park
Vice President

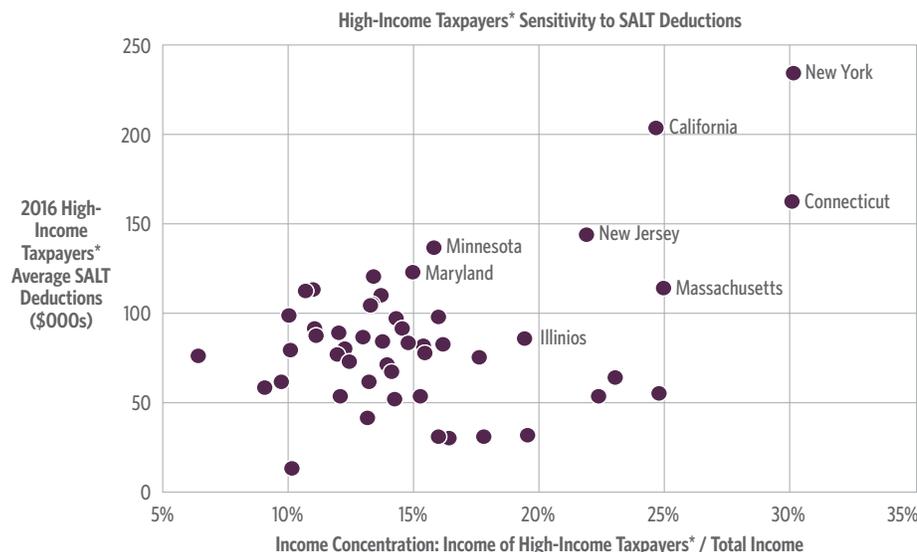
Muni Spreads Tighten to Post-Crisis Lows Despite Broad-Based Volatility



Source: Guggenheim Investments, Bloomberg, Municipal Market Data (MMD). Data as of 1.25.2019.

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SALT Deduction Limits Stem Tax-Motivated Selling in High-Tax States



Source: Guggenheim Investments, Internal Revenue Service. Data as of 12.31.2016. Note: *Tax filers with adjusted gross income greater than \$500,000.

The inaugural limit on state and local tax deductions is expected to attract demand from disproportionately impacted states such as California and New York.

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, Guggenheim Real Estate, LLC, GS GAMMA Advisors, LLC, Guggenheim Partners Europe Limited and Guggenheim Partners India Management. ©2018, 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.