GUGGENHEIM

First Quarter 2025

Fixed-Income Sector Views

Table of Contents

Portfolio Management Outlook 2
Macroeconomic Update 3
Rates 4
Investment-Grade Corporate Bonds 5
High Yield Corporate Bonds 6
Bank Loans 7
Private Debt 8
Asset-Backed Securities and CLOs 9
Non-Agency Residential Mortgage-Backed Securities (RMBS) 10
Commercial Mortgage-Backed Securities (CMBS) 11
Municipal Bonds 12
Agency Mortgage-Backed Securities (MBS) 13
Commercial Real Estate (CRE) 14

Portfolio Management Outlook

2025 Looks Bright for Prudent, Active Fixed-Income Management

We prefer higher quality credit, particularly within structured products.

Entering 2025, we expect moderate U.S. economic growth supported by mild real wage growth, healthy consumer and business balance sheets, and increased optimism over potential deregulation and tax cuts. Disinflation has stalled, though fundamentals point to further progress. At the same time, potential policy shifts from the incoming administration add a significant layer of uncertainty that will likely contribute to ongoing heightened interest rate volatility.

With this backdrop, our investment approach is informed by several important market dynamics: Yields remain elevated with spreads near historic tights. Investor demand is brisk, with primary credit markets oversubscribed. Credit fundamentals are generally strong, but they mask a range of idiosyncratic risks in widely dispersed credits, many of which continue to suffer under the weight of elevated interest rates.

This is broadly a constructive environment for credit, and we maintain a diversified allocation across asset classes that prioritizes carry. We prefer higher quality credit, particularly within structured products, which typically offer a less competitive market, opportunity for excess yield over similarly rated corporates, and wide spreads relative to fundamental risk. We are prioritizing high carry, shorter duration instruments, particularly non-Agency residential mortgage-backed securities (RMBS), senior collateralized loan obligation (CLO) tranches, and commercial asset-backed securities (ABS). We also favor select higher quality high yield corporate bonds with relatively strong fundamentals and attractive yields. With interest rate volatility elevated, we are maintaining healthy cash positions and targeting an average level of credit beta to position our portfolios for further spread compression.

From a duration perspective, we expect the 10-year Treasury yield to stay range bound over the next few months, with yields currently near the range's upper end. Longer term, we expect the yield curve to steepen, led by Fed rate cuts on the front end and potentially heavier Treasury issuance to fund growing fiscal deficits. Tactically this means adjusting duration targets as yields move from one end of the range to the other. We prefer to express duration in this environment using Agency RMBS, which offer the potential for yield pickup, and Treasury inflation-protected securities (TIPS).

Attractive 5 percent-plus yields for high quality fixed income could bode well for investors, as starting yields have been highly correlated with forward returns. Elevated policy uncertainty, interest-rate volatility, and widely dispersed credit risks make security selection critical—which we believe makes it an ideal environment for active fixed-income management.

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

Macroeconomic Update

Fundamentals Are Solid, but Policy Uncertainty Is Elevated

We see moderate growth in the U.S. economy in 2025.

The U.S. economy has good momentum heading into 2025, but the policy outlook from Washington elevates uncertainty. Recent economic data have been solid, with fourth quarter real gross domestic product (GDP) on track for about 2 percent annualized growth. The outlook for consumer spending remains positive, supported by healthy growth in inflation-adjusted labor income and a wealth effect driven by rising asset prices. Financial conditions have also turned more supportive as credit growth is reaccelerating, and optimism about artificial intelligence induces a positive outlook for capex. Disinflationary progress has stalled a bit in recent months, but fundamentals point to a further slowdown in inflation as wage pressures and housing inflation ease further.

With the new administration taking office, we expect a boost to both consumer and business sentiment, aided by expectations of deregulation and further tax cuts. Post-election surveys have already shown increased optimism about the outlook, which could support consumption, investment, and hiring in coming months.

Looking beyond the immediate sentiment boost, the outlook becomes more uncertain and depends on the ultimate policy mix of the new administration. Extension of the Tax Cuts and Jobs Act (TCJA) would prevent a fiscal drag, but we see limited scope for new tax cuts as the fiscal backdrop has worsened.

Some of the administration's proposed policies—such as tariffs and immigration—could weigh on growth if fully implemented. Tariffs slow growth by increasing business uncertainty and lowering real incomes. Broad implementation of tariffs could also threaten to push up prices, complicating the Fed's task of returning inflation to 2 percent and potentially slowing the pace of rate cuts. Ultimately, we expect more targeted tariffs will be used to negotiate favorable terms for the United States. Immigration activity at the border is already down over 70 percent from its 2023 peak, which should slow both labor supply and consumption in coming quarters. Our expectation is that additional new policies will slow immigration modestly further than the current trajectory.

All together, we see moderate growth in the U.S. economy in 2025 as these policy shifts play out. Economic fundamentals remain solid, with strong household and corporate balance sheets. The Fed will likely ease policy further toward a neutral setting, but tariffs could slow the pace of rate cuts by interrupting the disinflationary trend. The U.S. economy should remain a global outperformer, though we expect continued bifurcation across sectors, particularly as new policies begin to have an impact.

By Matt Bush and Maria Giraldo

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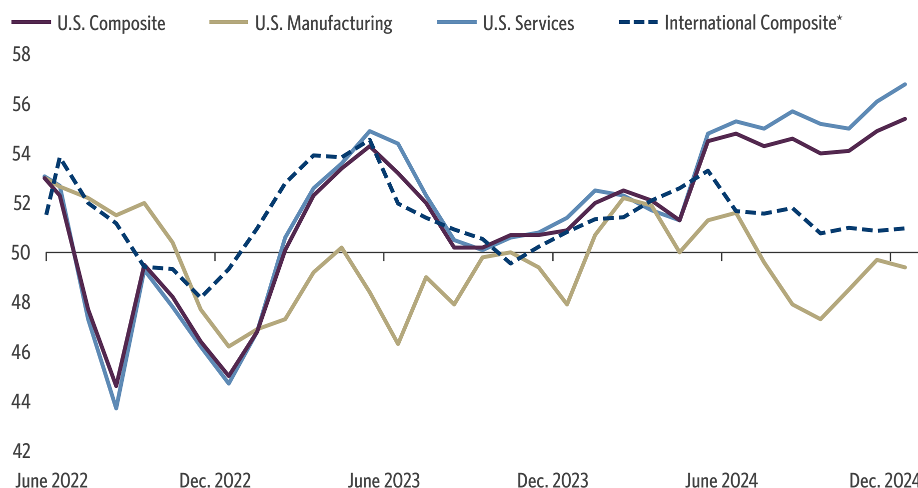
U.S. Growth a Bright Spot, Led by Strong Services Sector

S&P Global PMIs



Source: Guggenheim Investments, S&P Global, Bloomberg. Data as of 12.31.2024. *International is a simple average of China, Eurozone, Japan, and Emerging Markets. PMI = Purchasing Managers Index

Rates

Fed Rate Cuts Provide Opportunities

We expect TIPs to continue to outperform Treasurys in 2025.

Treasury yields were largely driven in 2024 by the changing monetary policy outlook, which moved from the 150 basis points of easing that was priced in early in the year to the Fed delivering just 100 basis points by year end. Looking forward, the number of catalysts that could impact Treasury yields have increased: Anticipated changes to regulatory and fiscal policy, burgeoning Treasury supply, and a less dovish Fed all have the potential to create attractive investment opportunities.

Sector Commentary

- Treasury yields increased 50–75 basis points in 2024 in the intermediate and longer end of the curve as Fed pricing evolved. Yields now sit at the higher end of their recent trading range.
- Any immigration reform and tariff increases implemented early in the Trump administration could create short-term pricing pressures.
- A more favorable regulatory environment could make Treasurys an attractive investment for banks, increasing demand from these market participants that have been mostly absent over recent years.
- Treasury stripping activity is likely to remain robust in 2025, with attractive long-end rates and healthy pension funding ratios after strong equity market performance in 2024.

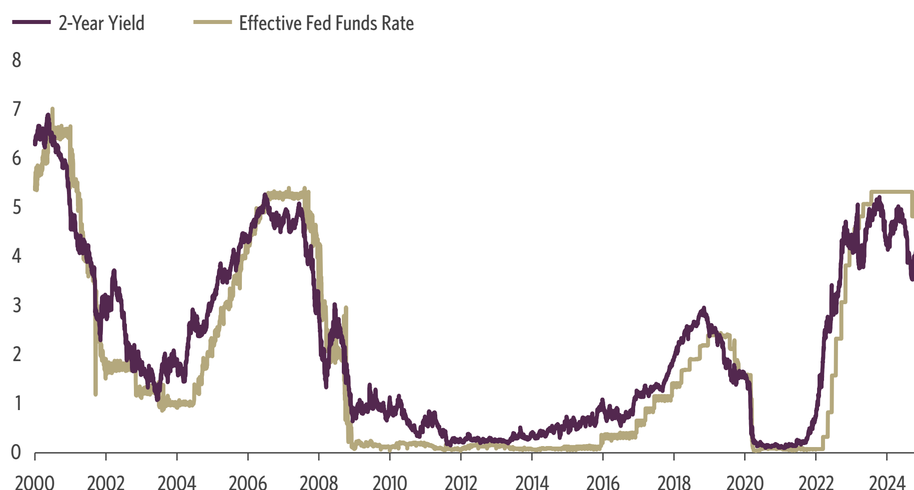
Investment Themes

- TIPS outperformed Treasurys by 125 basis points in 2024, and we believe they will continue to do well in 2025 and will look to opportunistically increase exposure.
- Further cuts in the fed funds rate are likely this year as the Fed moves closer to a neutral policy rate. With shorter-duration Treasury yields trading close to the current fed funds rate, we see potential price appreciation in owning shorter-duration Treasurys.
- The Treasury yield curve should steepen as the Fed continues to lower short-term interest rates and Treasury coupon supply increases, moving the term premium higher.
- As brisk Treasury stripping continues, the spread between coupon and principal strips could widen further, creating attractive relative value opportunities in zero coupon Treasury space.

By Kris Dorr and Tad Nygren

Further cuts in the fed funds rate are likely this year as the Fed moves closer to a neutral policy rate. With shorter-duration Treasury yields trading close to the current fed funds rate, we see potential price appreciation in owning shorter-duration Treasurys.

We See Potential Price Appreciation in Owning Shorter-Duration Treasurys



Source: Guggenheim Investments, Bloomberg. Data as of 12.31.2024.

Investment-Grade Corporate Bonds

Volatility Creates Opportunity in IG

Sector fundamentals should counter political and market uncertainty.

We expect volatility to increase as the new administration takes control in Washington, D.C., the Fed enacts changes to monetary policy, and front-loaded primary supply pushes spreads wider in January, but we view uncertainty as an opportunity to allocate to higher quality, liquid risk in investment-grade (IG) corporate bonds. A more benign economic backdrop, manageable net primary supply, a deregulatory environment, and attractive all-in yields should keep spreads rangebound in the latter part of the first quarter.

Sector Commentary

- After a dearth of primary supply in December, we expect gross new issue supply to expand in January to a potential record-breaking $200 billion.
- Heightened M&A activity will likely increase bond supply but will be more impactful in the second quarter.
- Investment-grade corporate spreads remain at historical tights. Yet, yields on the Bloomberg U.S. Investment-Grade Corporate Bond Index are around 5.35 percent versus the five-year average of 3.94 percent, which will continue to attract investors.
- Despite starting the third year of above-average funding costs for fixed income, the investment-grade market is well positioned to handle higher rates relative to high yield markets.
- The upgrade/downgrade ratings ratio hit a record 4.7x in 2024. Although we expect this ratio to be positive in 2025, we anticipate it to normalize to a longer-term run rate.

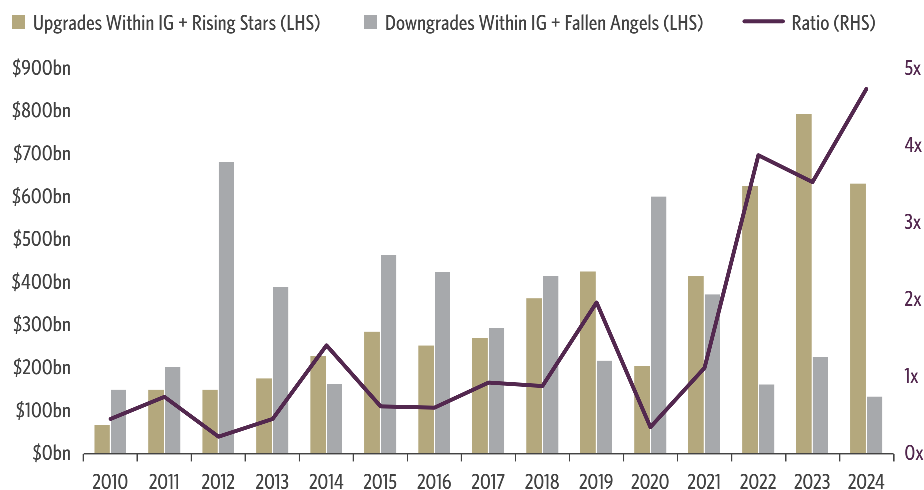
Investment Themes

- Although gross supply will be robust in the first quarter, redemptions and maturities will be strong as well. This will lead to much lower net supply and will support secondary spreads.
- Issuers tend to be higher quality, and focused heavily in financials, implying shorter duration issuance and a flatter credit curve.
- We continue to see value in 30-year paper with 10/30s credit curves at their recent steep levels.
- We also believe industrials look tight relative to financials given likelihood of increased debt funding from M&A activity.
- Preferred and hybrid securities remain attractive, especially for current income investors.
- We expect the 2024 trend of negative net supply in preferreds to continue into the first quarter of 2025, which should support price stability in the asset class.

By Justin Takata

The upgrade/downgrade ratings ratio hit a record 4.7x in 2024. Although we expect this ratio to be positive in 2025, we anticipate it to normalize to a longer-term run rate.

We Expect the Upgrade/Downgrade Ratio to Normalize in 2025



Source: Guggenheim Investments, JP Morgan. Data as of 12.31.2024.

High Yield Corporate Bonds

High Yield Bonds Deliver Solid Returns Amid Tight Spreads

Tight spreads in the high yield market highlight the need for selectivity despite strong fundamentals.

High yield corporate bonds delivered an 8 percent total return in 2024, marking the second-best annual performance in five years and exceeding the 1997–2023 sector average. Expectations of more business-friendly policies, including potential corporate tax cuts, drove significant spread tightening in the fourth quarter, bringing spreads to within 20 basis points of historical lows. While strong credit fundamentals and favorable rating migration trends persist, historically tight spreads underscore the need for careful security selection.

Sector Commentary

- Spreads on the ICE BofA U.S. High Yield Master II Constrained Index fell below 2021 tights around the beginning of the fourth quarter of 2024, ending the year at only 292 basis points, in the 6th percentile of historical levels.
- Despite strong spread performance, the high yield index posted a fourth quarter return of just 0.2 percent—its weakest since the third quarter of 2022—weighed down by rising Treasury yields.
- Healthcare, technology, and transportation led sector performance, with returns of 11.2 percent, 9.6 percent, and 9.6 percent, respectively. Utilities, capital goods, and automative had the weakest, but still solid, returns of 6–7 percent.
- Expectations of a more merger-friendly regulatory environment may be driving spread tightening in CCC-rated credits, with spreads approaching their 2021 tights and remaining within a tight range of 680–770 basis points since October 1.

Investment Themes

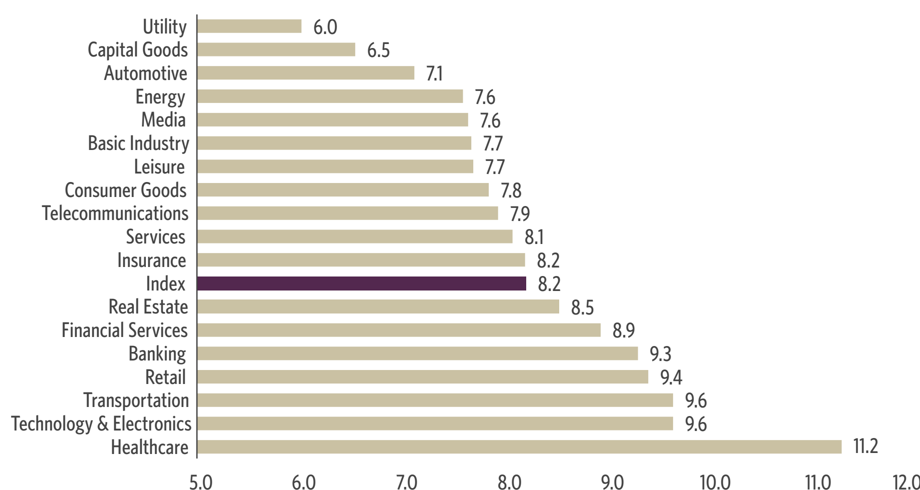
- Despite historically tight credit spreads, high yield bond yields remained above 7 percent during the fourth quarter 2024.
- Last quarter's performance highlighted the impact of Treasury volatility on high yield sector returns. However, strong credit fundamentals suggest that weak periods should be seen as attractive entry points to add yield.
- The trailing 12-month par-weighted default rate ended 2024 at just 1.5 percent, well below the historical average of 4 percent. We expect it to remain below average in 2025.
- Refinancing accounted for over 70 percent of primary issuance in 2024. We anticipate that M&A and general corporate activity could make up a greater share of primary market activity this year.
- We prefer higher quality high yield bonds (rated B or above) due to their stronger fundamentals and lower default risk. We believe these bonds offer attractive yields and relative risk mitigation.

By Thomas Hauser and Maria Giraldo

Healthcare, technology, and transportation led sector performance, with returns of 11.2 percent, 9.6 percent, and 9.6 percent, respectively. Utilities, capital goods, and automative had the weakest but still solid returns of 6–7 percent.

Healthcare, Technology, and Transportation Led Sector Performance in 2024

Annual High Yield Index Return by Industry



Source: Guggenheim Investments, Bloomberg. Data as of 12.31.2024.

Bank Loans

Strong Repricing Activity Is Likely to Persist

Borrowers have opportunistically repriced loans as strong investor demand keeps prices high.

Repricing activity in the leveraged loan market surged in 2024, with over $350 billion in institutional term debt repriced, accounting for more than a quarter of the market. Some borrowers repriced their loans multiple times within the year, as call protection typically lasts only six months, enabling borrowers to reduce interest expense by 53 basis points in contractual spread. As of December 2024, about 62 percent of loans continued to trade above par, suggesting repricing activity will remain brisk in the first half of 2025. With market expectations for rate cuts reduced to just one by midyear, borrowers will likely continue to focus on cutting expenses, further driving repricing activity.

Sector Commentary

- Bank Loans outperformed fixed-rate corporates during the fourth quarter, posting a total return of 2.3 percent, according to BofA Global Research. Performance remains strong, supported by high floating-rate coupons, which help insulate loans from duration risk.
- The three-year discount margin on the S&P UBS Leveraged Loan Index tightened by 23 basis points during the quarter to end the year at 475 basis points. Year-end yield stood at 8.8 percent.
- At the end of December, about 62 percent of loans traded above par, near the year's highest level. This marks the largest share above par since 2018, suggesting that borrowers will prioritize repricing to lower costs.
- The fourth quarter saw roughly $98 billion of new money (non-repricing) issuance, the lowest quarter in 2024. This compares to $278 billion of repricing activity, the highest quarter of 2024.

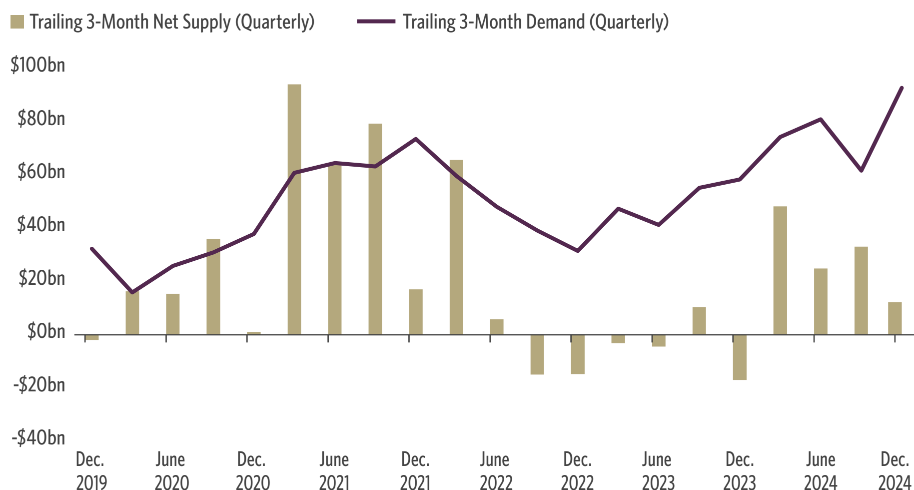
Investment Themes

- A strong technical backdrop will continue given the lack of new supply available to satisfy the steady demand for loans.
- With fewer rate cuts expected in 2025, we anticipate continued demand from fund inflows and baseline support from coupon reinvestment. Additionally, CLOs, the loan market's largest investors, had record issuance during the fourth quarter of 2024 at $48.9 billion.
- All-in yields for the loan market remain attractive and offer investors the opportunity to capture attractive yields even as the Fed cuts rates.
- We remain cautious over the tail risk in the loan market given how elevated rates may weigh on issuers' interest costs. Eventually, rate cuts will become a tailwind to debt servicing. Until that time, credit selection will be paramount as we identify attractive opportunities within the loan market.

By Christopher Keywork and Maria Giraldo

A strong technical backdrop will continue given the lack of new supply available to satisfy the steady demand for loans.

We Expect Demand for Leveraged Loans to Remain High in 2025



Source: Guggenheim Investments, BofA Global Research, EPFR, LCD. Data as of 12.31.2024.

Private Debt

Continued Growth in Private Debt

Lower rates and a meaningful pick up in M&A activity will be catalysts for a robust deal market in 2025.

The private debt market has grown at a record pace in recent years, largely driven by the appeal of contracted yields, defined maturities, and a notable yield premium over the broadly syndicated loan (BSL) market. The high yield and leveraged loan markets have grown substantially both in terms of volume and deal size, restricting many middle-market companies from accessing public market funding. This, coupled with bank retrenchment, has caused many middle market businesses to turn to private credit as their main source of funding.

Sector Commentary

- Private debt assets under management surpassed $1.7 trillion in 2024. Private debt is the second-largest private capital asset class behind private equity at $8.7 trillion, after surpassing real estate in assets under management in 2023, according to Preqin.
- Allocations to direct lending funds have soared over the last decade, peaking in 2021, with over $148 billion of capital closed. Over $130 billion was raised in direct lending strategies through the end of October 2024, compared to just $31 billion in 2014.
- Private credit's fundraising has been disproportionately concentrated within several mega managers. With only a handful of managers sitting on most of the industry's dry powder, we believe that this underscores the need for a selective approach with a strict focus on credit selection that provides compelling relative value for investors.

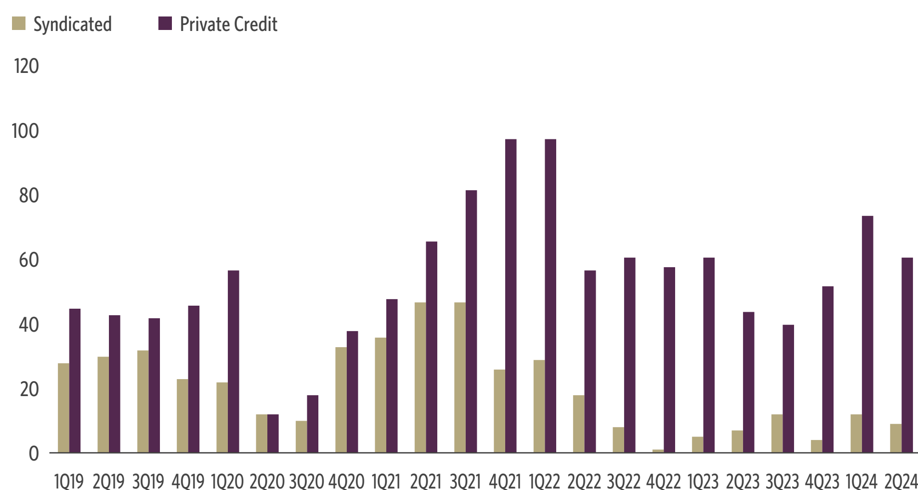
Investment Themes

- The direct lending deal market is robust and volumes remain elevated, as the number of loans reviewed in the fourth quarter increased 38 percent year over year and 20 percent quarter over quarter, according to Wells Fargo Research.
- There is a meaningful distinction in the market between transactions competing with the BSL market and more traditional private debt transactions that deliver a yield premium. While overall spreads flattened in the fourth quarter, spreads on mega-sized transactions continued to compress.
- With nearly $1.2 trillion of corporate debt maturing in 2026 alone, the pending maturity wall will also drive demand for private credit. Roughly 80 percent of leveraged loan activity in 2024 was driven by refinancing and repricing.
- Lower rates, private equity dry powder, and increased M&A activity should all support a strong deal market in 2025.

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

Lower rates, private equity dry powder, and increased M&A activity should support a strong deal market in 2025.

Number of LBOs Financed by Private Credit Dwarfs Broadly Syndicated Loans



Source: Guggenheim Investments, Pitchbook LCD U.S. Credit Markets Quarterly Wrap July 2024. LBO = leveraged buyout.

Asset-Backed Securities and CLOs

Robust Issuance Expected in 2025

Despite tighter spreads, the outlook for structured credit remains attractive.

While the yield advantage of ABS over similarly rated corporate bonds has shrunk recently, we believe the sector continues to offer opportunities to earn excess yield. We expect 2025 commercial ABS supply to exceed that of 2024 due to tighter spreads, Fed rate cuts, and continued growth in capital-intensive digital infrastructure sectors. CLO issuance should remain robust in 2025 as demand from a range of buyer types has been strong.

Sector Commentary

- **ABS:** The ABS-corporate spread basis compressed after the presidential election, and it now ranks at its 58th percentile over the last ten years. In whole business securitization, sales figures reflect sustained labor and commodity inflation. Challenging fundamentals have weighed on equity valuations and invited private equity activity and associated ABS issuance.
- **CLOs:** Spreads have tightened across the capital stack as elevated repricing activity and limited new loan supply have pushed prices higher, making it challenging for managers to build par. Liability Management Transactions, or LMTs, continue to be a market focus, as recovery outcomes for the same loan could vary depending on the manager.

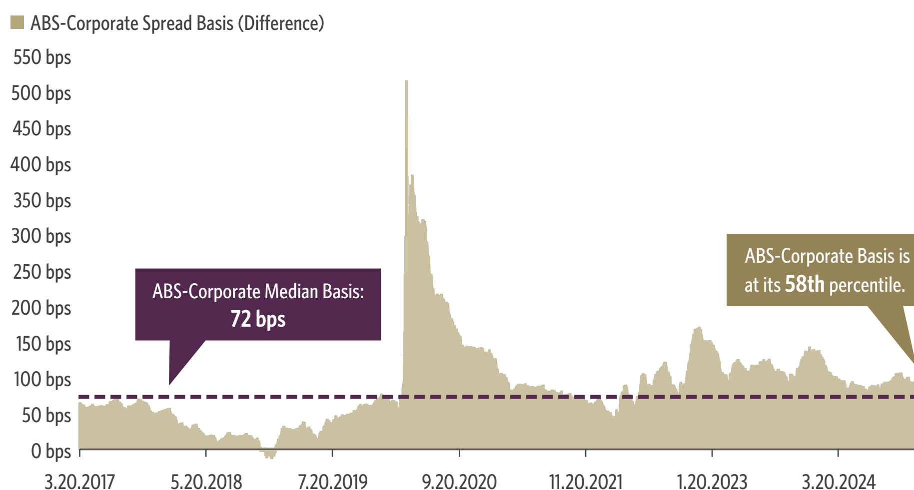
Investment Themes

- **ABS:** We favor senior exposures in longer duration commercial ABS backed by high quality collateral such as franchise royalties, fiber networks, and shipping containers. The new administration is expected to boost investments, further supporting consumers' excess savings. Still, uncertainty surrounding policies such as student loan repayment could strain individual borrowers. For this reason, we focus on subsectors such as home improvement loans, which offer exposure to high quality borrowers with structural downside protection via amortization and credit enhancement.
- **CLOs:** Both senior and mezzanine tranches are offering attractive value relative to similarly rated corporate debt. The basis between private credit (PC) and broadly syndicated loan CLO tranches remains historically tight despite elevated PC CLO issuance, but we expect this basis to normalize. Manager and credit selection are paramount, as attractive high level portfolio metrics may mask the true credit risk within these deals.

By Michael Liu, Scott Kanouse, and Pooja Shendure

While the yield advantage of ABS over similarly rated corporate bonds has shrunk recently, the sector continues to offer opportunities to earn excess yield.

Commercial ABS Spreads Remain Attractive vs. Similarly Rated Corporates



Source: Guggenheim Investments, Bloomberg, ICE BofA. Data as of 12.31.2024.

Non-Agency Residential Mortgage-Backed Securities

Opportunities in an Elevated Rate Environment

Higher rates for an extended period should benefit securities that offer income potential.

We find the non-agency RMBS sector attractive due to its positive credit fundamentals and potential to provide robust investment income. Tight lending standards, significant home equity gains, and a stable labor market provide favorable conditions for mortgage credit performance. The reversal in mortgage rates makes a refinance wave and pickup in prepayment activity unlikely in the near future. Additionally, higher-for-longer interest rates should benefit higher coupon, income-producing securities.

Sector Commentary

- New issue volume for 2024 was $155 billion—almost double 2023's $80 billion—and the second highest since 2007, according to JP Morgan. Spread performance was strong, with most subsectors ending the year at or near their tightest levels of the year.
- The most recent Case-Shiller Index reading in October 2024 showed 3.6 percent year-over-year home price growth, continuing a slowing trend since March. Favorable demand and supply dynamics, however, combined with stable consumer credit should support steady mortgage credit performance.
- The average 30-year fixed mortgage rate declined to 6.1 percent in September, 1.2 percentage points off its May 2024 peak, before rising nearly 0.8 percentage points by year end. The backup in rates raised concerns that interest rates will remain high longer than expected and limit prepayment activity even for mortgages originated in 2023 and 2024.

Investment Themes

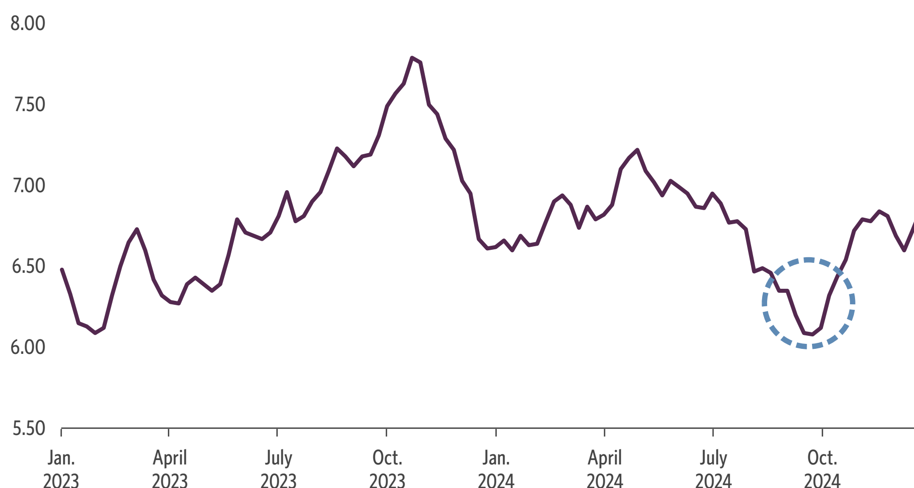
- Should rates remain elevated for an extended period, income is expected to take precedence over price movement. High coupon securities that offer wider spreads and higher yields should benefit in an elevated rate environment with low prepayment expectations.
- We favor those transactions that offer solid carry income with structures that limit extension risk and can withstand a wide range of credit stresses.
- 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

The average 30-year fixed mortgage rate declined to 6.1 percent in September, 1.2 percentage points off its May 2024 peak, before reversing course and rising nearly 0.8 percentage points by year end, tempering expectations of a refinance wave.

Average 30-Year Fixed Mortgage Rate Closed 77 Basis Points Higher in 2024 Than Its Year Low

Cumulative Percentage of Outstanding Balance



Source: Guggenheim Investments, J.P. Morgan, Freddie Mac, and Bloomberg. Data as of 12.31.2024.

Commercial Mortgage-Backed Securities

Demand Exceeds Supply in CMBS

Fundamental challenges remain, requiring careful security selection.

Demand for CMBS from yield-focused buyers remains elevated, while supply is struggling to keep up as secular changes—especially in the office sector—and still-elevated interest rate volatility complicate underwriting. These technical forces are tightening spreads across the sector, which should encourage more issuance of real estate debt in CMBS format, including from data center owners amidst the AI boom. Active management and security selection will remain paramount as fundamental challenges persist.

Sector Commentary

- 2024 CMBS issuance of $112 billion more than doubled the $46 billion printed in 2023.
- Given challenges in the office sector and other subsectors, such as lower-tier regional malls, CMBS investors are increasingly reluctant to extend credit on diversified pools.
- Instead, they are more inclined to "credit pick" bonds backed by single assets or portfolios collateralized by in-favor property types, including lodging, multifamily, industrials, and even data centers.
- Over $70 billion of 2024 issuance came from single asset/single borrower (SASB) transactions, a trend we believe will continue given the bifurcation across real estate fundamentals.

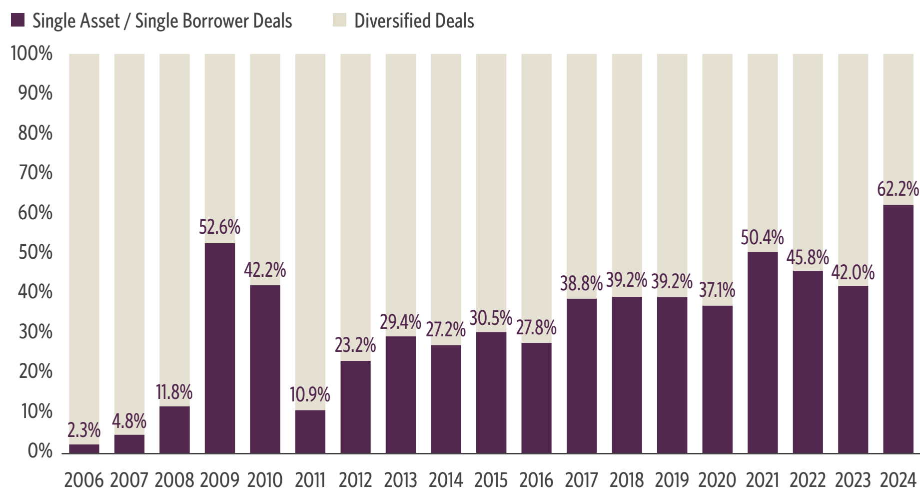
Investment Themes

- We prefer senior securities with higher credit enhancement, capable sponsorship, and limited exposure to legacy real estate problems, especially in the office sector.
- Select SASB and CRE CLO transactions offer potentially attractive risk-adjusted returns, with spreads still wide relative to more liquid corporates.
- 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

Over $70 billion of 2024 issuance came from SASB transactions, a trend we believe will continue given the bifurcation across real estate fundamentals.

We Expect SASB Deals to Continue to Dominate Over Diversified Deals in 2025



Source: Guggenheim Investments, JP Morgan. Data as of 12.31.2024.

Municipal Bonds

Challenging Conditions for Munis

Tight ratios and spreads provide limited buffer against a market dislocation.

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. Look for bargains among esoteric credits as traditional higher quality sectors remain richly valued.

Sector Commentary

- Tax exempts closed 2024 on a sour note as valuations remained tight while liquidity dried up. Municipals returned negative 1.5 percent in December, reducing full year returns to 1 percent. Front-end tax-exempt-to-Treasury-yield ratios generally moved higher over the last 12 months, although the 30-year ratio tightened as traditional buyers extended their interest rate exposure.
- January principal and interest payments tend to generate positive momentum that peters out by mid-February. Expectations of a large new issue calendar driven by fears of tax regime changes in 2025 and their potential impact on municipal issuers' access to tax-exempt financing may present headwinds.
- Bloomberg U.S. Municipal Taxable Bonds Index spreads continue to tighten on the back of light supply. At the index level, taxable spreads tightened 18 basis points during 2024, resulting in a 1.6 percent total return through year end.

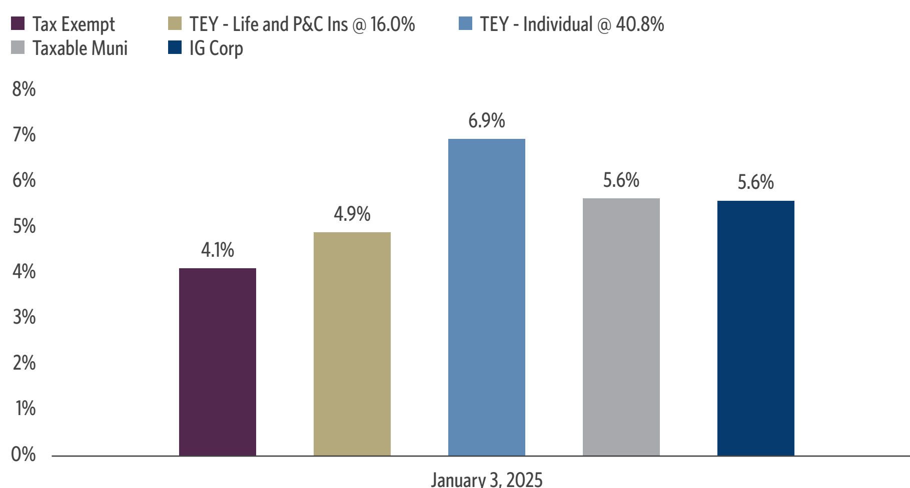
Investment Themes

- At current ratios and spreads, we prefer taxables for institutional investors due to tight valuations in exempts. For retail investors, we caution against focusing solely on the high taxable equivalent yields as current valuations provide limited buffer against a market dislocation.
- Traditional high quality sectors such as general obligation property tax bonds and utilities do not offer attractive risk/reward characteristics at current muni/Treasury ratios. Instead, we are looking for solid credits within higher beta sectors, including affordable housing, charter schools, and continuing care retirement communities.

By Allen Li and Michael Park

Taxable municipal spreads continue to tighten on the back of light supply. At the index level, taxable spreads tightened 18 basis points during 2024, resulting in a 1.6 percent total return through year end.

Taxable Muni Yields Have Kept Pace with IG Corporates



Source: Guggenheim Investments, Bloomberg, TM3. Data as of 1.3.2025.

Agency Mortgage-Backed Securities

Compelling Income Potential in Agency MBS

Regulatory uncertainty, especially GSE reform, will be a focus for 2025.

The Bloomberg U.S. Agency MBS Index posted total and excess returns of 1.20 percent and 0.37 percent, respectively, for 2024. Agency mortgages lagged corporate bonds, which benefited from a resilient economy. Looking ahead, the bear steepening of the Treasury curve in late 2024 has enhanced the income potential of Agency MBS—which are tied primarily to the 10-year—while historically elevated spreads provide a reasonable entry point for the sector in 2025.

Sector Commentary

- Inflows to fixed-income funds over 2024 favored lower index coupons in the 2.5–3.0 percent range, while bear steepening of the Treasury term structure favored shorter-duration, higher coupon MBS of 5.0 percent and above. Notably, 30-year government sponsored enterprise-backed (GSE) MBS outperformed Ginnie Mae MBS by 60 basis points as money managers replaced banks as marginal buyers.
- Market uncertainty around the Fed's rate path and the policies of the incoming administration have kept longer-dated interest rate volatility elevated and nominal spreads remain well wide of their historical average, offering both attractive spreads and all-in yields.
- We favor mortgage bonds priced at a slight discount in the $95–100 range for their favorable performance profile under modestly lower rates. We expect returns to be driven by income rather than price appreciation until regulatory issues are resolved.

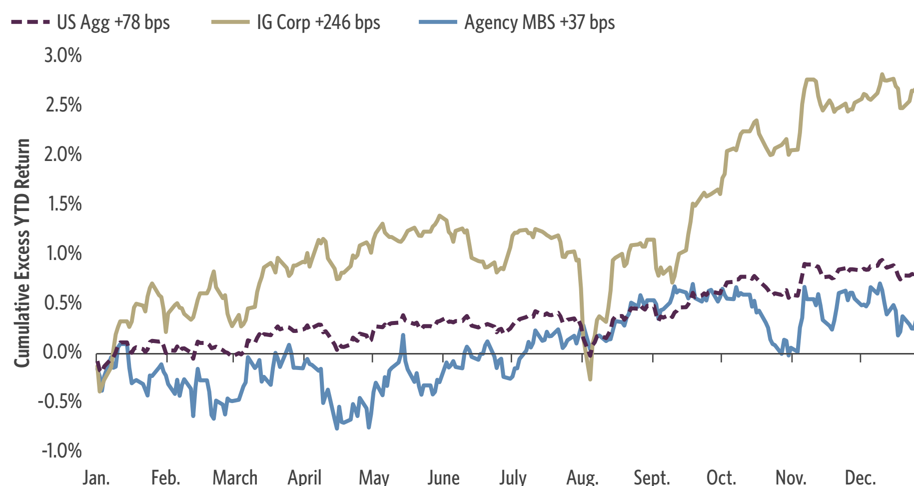
Investment Themes

- Bank regulation, specifically the unresolved status of the Basel III Endgame, remains a drag on demand. The incoming administration will most likely have a deregulatory tilt and scrap the third quarter 2024 proposal. Regardless of the result, regulatory clarity would be a positive for the sector, encouraging greater deployment of bank capital into Agency MBS.
- GSE reform is the other major policy focus. Privatization would require cooperation between the Federal Housing Finance Agency and the Treasury in addition to a significant increase in capital, a process which will take time. For MBS investors, the most important issue remains implicit versus explicit government guarantee. An explicit guarantee would compensate taxpayers for providing a backstop, favoring Fannie and Freddie over Ginnie Mae MBS, whereas an implicit guarantee would create more uncertain outcomes, benefiting Ginnie Mae MBS.

By Louis Pacilio

Agency mortgages lagged corporate bonds, which benefited from a resilient economy. Looking ahead, the bear steepening of the Treasury curve in late 2024 has enhanced the income potential of Agency MBS—which are tied primarily to the 10-year—while historically elevated spreads provide a reasonable entry point for the sector in 2025.

Agency Mortgages Lagged IG in 2024, But We See Income Potential Ahead
Cumulative Excess YTD Returns



Source: Guggenheim Investments, Bloomberg. Data as of 12.31.2024.

Commercial Real Estate

Industrial Real Estate Poised to Outperform

User demand for new locations and modern buildings continues to support price appreciation.

Major users of industrial, warehouse, and logistics properties have adopted new post-COVID strategies to reach consumers, including enhancing technology and diversifying supply chain networks. Property developers responded to these secular trends by building new product, and even with the new supply, property prices have steadily increased. The increased cost of labor, materials, and debt have depressed the level of new construction starts, which we anticipate will continue to bolster property values for the sector.

Sector Commentary

- The growth of e-commerce and focus on supply-chain resiliency fueled demand for warehouse and logistics properties. According to CBRE, new leasing activity has cooled slightly since the peak in 2022 but remains well above pre-COVID averages.
- Technology also played a role, as occupiers demanded new properties that can accommodate automation, efficiencies, and modern amenities.
- We expect the threat of new tariffs on materials and the potential for further cost increases will continue to weigh on new construction, further supporting the value of existing properties. It could cost materially more to build the same building today than in 2023.

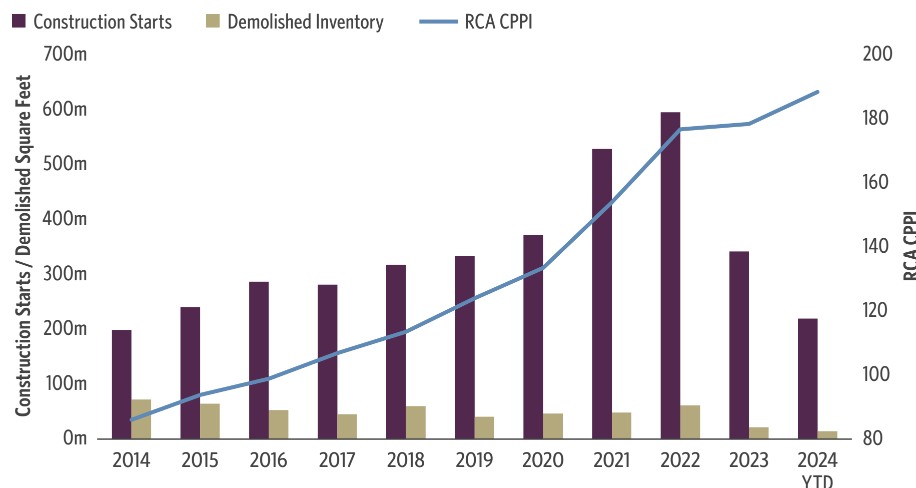
Investment Themes

- We expect demand will remain strong for industrial and warehouse properties as companies adopt onshoring and near-shoring strategies. This trend is creating new emerging industrial markets to support new manufacturing and distribution demand.
- Major retailers such as Amazon have adopted new supply-chain strategies, opting for multiple regional networks rather than one national network to reach consumers faster and limit supply chain dependencies.
- A growing factor in site selection is the availability of power and water. Both are important, as occupiers bring more energy-consuming uses into and around the traditional building core and shell, such as automation, infrastructure for electric vehicles, cooling, and data storage. We expect the growth of artificial intelligence and its insatiable appetite for power will drive demand.

By Jennifer A. Marler and Karen Karwoski

Even with new supply, property prices have steadily increased. Now that new construction starts have fallen, we expect continued support for property values.

Property Prices Have Increased but New Construction Starts Are Declining



Source: Guggenheim Investments, CoStar, MSCI, RCA. Data as of 12.31.2024. CPPI = Commercial Property Price Indexes.

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S&P bond ratings are measured on a scale that ranges from **AAA** (highest) to **D** (lowest). Bonds rated **BBB-** and above are considered investment-grade while bonds rated **BB+** and below are considered speculative grade.

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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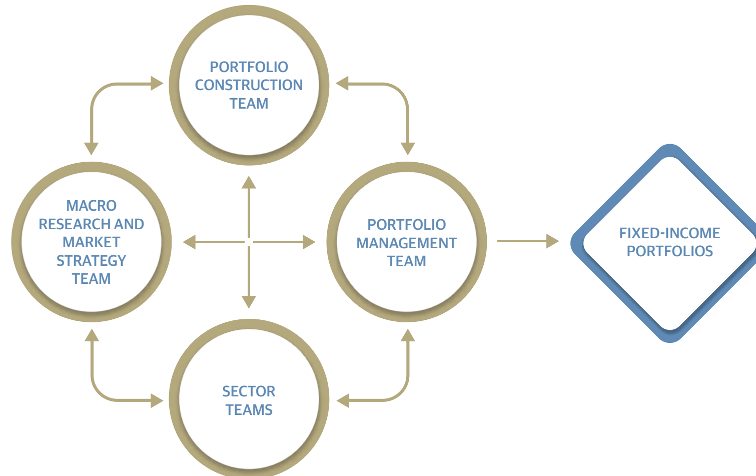

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Guggenheim Investments is the global asset management and investment advisory division of Guggenheim Partners, with more than $249 billion[1] in total assets across fixed income, equity, and alternative strategies. We focus on the return and risk needs of insurance companies, corporate and public pension funds, sovereign wealth funds, endowments and foundations, consultants, wealth managers, and high-net-worth investors. Our 235+ investment professionals perform rigorous research to understand market trends and identify undervalued opportunities in areas that are often complex and underfollowed. This approach to investment management has enabled us to deliver innovative strategies providing diversification opportunities and attractive long-term results.

Guggenheim Partners

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For more information, visit GuggenheimInvestments.com.

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