GUGGENHEIM

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High-Yield and Bank Loan Outlook

A Ripe Environment for Strong Credit Performance

Investment Professionals

Scott Minerd
Chairman of Investments and
Global Chief Investment Officer

Kevin H. Gundersen, CFA
Senior Managing Director,
Portfolio Manager

Thomas J. Hauser
Senior Managing Director,
Portfolio Manager

Brian Smedley
Senior Managing Director,
Head of Macroeconomic and
Investment Research

Maria M. Giraldo, CFA
Managing Director,
Investment Research

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Summary

Our 2021 economic outlook remains positive, owing to a highly supportive monetary policy and a second round of COVID-19 relief, with more planned by the incoming administration, plus the rollout of a successful vaccine distribution. Within credit sectors, we expect a decline in default volumes, an improvement in rating migration, and a recovery in corporate earnings that will facilitate a reduction in leverage ratios. While this is a welcome environment for credit investors, we face a greater challenge in 2021. Corporate bonds are priced to perfection, leaving little room for disappointment on the recovery that remains dependent on the population vaccination rate, consumer behavior, and actions taken by the incoming administration.

In this report we discuss the state of leveraged credit issuer fundamentals and our views on what lies ahead for below investment-grade companies. All things considered, we find that company-level performance was better than expected through the third quarter of 2020. This review of fundamentals and the outlook concludes that while spreads are tight, the environment is ripe for strong credit performance and spreads remaining near current levels for an extended period.

Report Highlights

- A continued U.S. recovery, significant aid from Congress, and accommodative monetary policy form the basis of our constructive credit views. Corporate fundamentals should recover this year as consumer spending begins to normalize with the deployment of COVID-19 vaccines.
- Although leveraged credit issuer leverage ratios spiked in 2020 and interest coverage fell, other data was not as negative. As of the third quarter of 2020, year-over-year revenues had declined by only 2.8 percent on a median basis and net debt growth was only 1.8 percent.
- Importantly, leveraged credit issuers saw a 60 percent increase in cash and cash equivalents, assets that they will surely put to work in 2021 as maintaining excess liquidity becomes less urgent for companies and undesirable by investors.

Leveraged Credit Scorecard
As of 12.31.2020

High-Yield Bonds

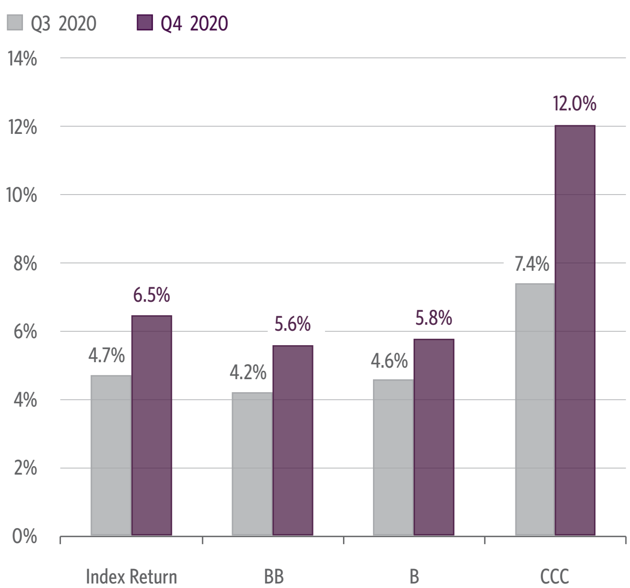
	December 2019		October 2020		November 2020		December 2020	
	Spread	Yield	Spread	Yield	Spread	Yield	Spread	Yield
ICE BofA High-Yield Index	372	6.0%	537	6.1%	439	5.3%	392	5.0%
BB	214	4.4%	388	4.6%	311	4.0%	281	3.8%
B	374	6.1%	578	6.4%	475	5.7%	425	5.4%
CCC	964	12.0%	1,121	11.9%	917	10.2%	802	9.3%

Bank Loans

	December 2019		October 2020		November 2020		December 2020	
	DMM*	Price	DMM*	Price	DMM*	Price	DMM*	Price
Credit Suisse Leveraged Loan Index	461	96.51	583	92.87	522	94.76	486	95.73
BB	262	99.81	372	96.84	333	98.06	305	98.88
B	470	97.67	555	96.14	501	97.65	469	98.55
CCC/Split CCC	1,365	80.14	1,403	79.10	1,213	83.46	1,167	84.28

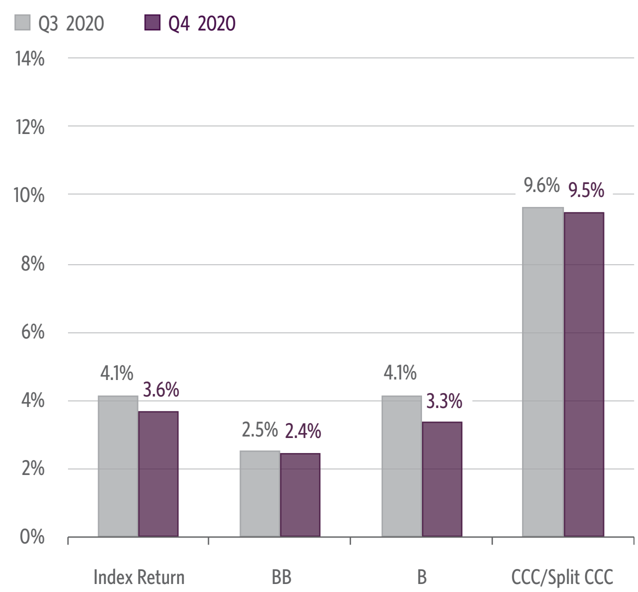
Source: ICE BofA, Credit Suisse. *Discount Margin to Maturity assumes three-year average life. Past performance does not guarantee future results.

ICE BofA High-Yield Index Returns



Source: ICE BofA. Data as of 12.31.2020. Past performance does not guarantee future results.

Credit Suisse Leveraged Loan Index Returns



Source: Credit Suisse. Data as of 12.31.2020. Past performance does not guarantee future results.

Macroeconomic Overview

> "Given the new paradigm after the Fed corporate bond purchase program, we could continue to see credit spreads tighten, perhaps even to historic lows.
>
> – Scott Minerd,
> *Chairman of Investments and Global Chief Investment Officer*

Relief, Relief, and More Relief

Our 2021 economic outlook remains positive, owing to a highly supportive monetary policy and a second round of COVID-19 relief, with more planned by the incoming administration, plus the rollout of a successful vaccine distribution. The new package, titled the Coronavirus Response and Relief Supplemental Appropriations Act, delivers a $900 billion injection into the economy, bringing total COVID-related aid to over $3.5 trillion including the 2020 bill, or roughly 8.5 percent of 2020–2021 gross domestic product (GDP). By this measure, it is already 3.5x more than the stimulus delivered in the five years following the financial crisis.

We expect that the latest round of fiscal stimulus will cause a surge in personal income during the first quarter, and a significant percentage of the population should be vaccinated by mid-2021. It is likely that local governments will be able to begin to relax restrictions before herd immunity is reached since hospitalizations would fall once the elderly are vaccinated. As we move through the year, we expect a normalization of consumer spending, spurred on by elevated personal savings and strong gains in household net worth. Elsewhere, the housing market will continue to benefit from tight supply and low interest rates, and business investment should rebound as corporations look to put to work record levels of precautionary cash. As a result, we expect real GDP growth to be well above potential for the year.

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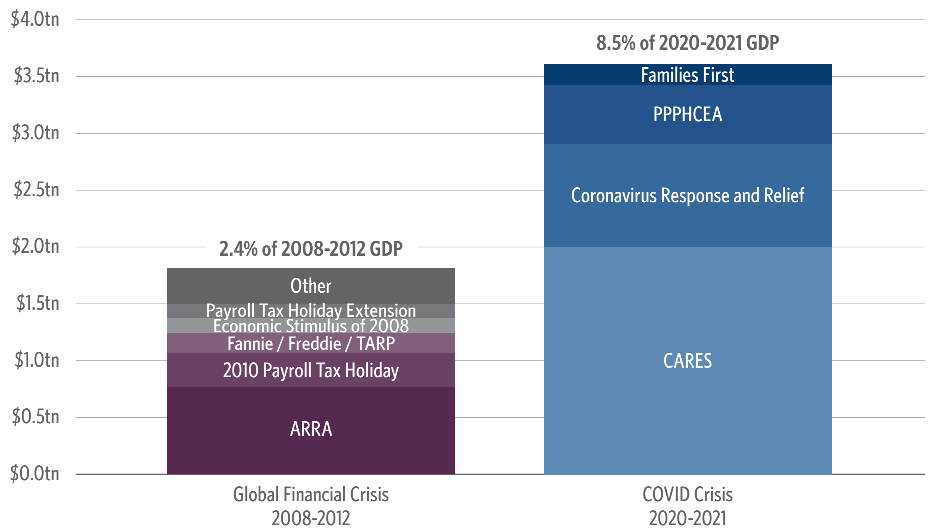
A Larger and Faster Response to COVID-19 Than to the Financial Crisis

Fiscal Responses to the Financial Crisis and COVID-19



Source: Guggenheim Investments, Committee for a Responsible Federal Budget, CBO. Figures show five-year cost estimates.

We would usually expect the U.S. Federal Reserve (Fed) to referee economic growth when it exceeds potential to prevent overheating. If the unemployment rate continues to fall at its current place and inflation picks up with its usual 6-quarter lag behind economic activity, we would pencil in a Fed hiking cycle as early as late-2022. However, the change in the Fed's playbook will keep it sidelined for years as it looks to make up for shortfalls related to its 2 percent inflation target. We expect the Fed to keep rates at zero for several years beyond the late-2023 liftoff currently priced into the bond market. Similarly, we would place low odds on a tapering of the Fed's bond purchases in 2021.

The government response to the pandemic was necessary and appropriate, and the cost is debatable. Fixed-income investors are already paying some price with much lower investable yields due to the Fed's aggressive relaunch of quantitative easing (QE). There is no way around the market's new modus operandi to take risk as long as more fiscal support is underway and while fixed-income investors perceive that the Fed is willing to backstop credit market activity to support financial conditions. Fortunately, this is positive for leveraged credit issuers. For credit investment managers, tight spreads limit the scope for bad selections, raising the importance of the expertise that a credit manager brings to minimize default situations and preserve capital while earning positive real returns.

Market Outlook

2020 Market Recap

History books will show contradictory trends in 2020 that will be hard to appreciate for those that did not live through it. The economy experienced an abrupt and unprecedented decline in output, corporate leverage spiked, and default volume and negative rating migration were the worst in over a decade. In contrast, equity indexes touched new highs, corporate bond yields set record lows, and primary credit issuance saw record volumes. The ICE BofA High-Yield Index delivered a total return of 6.2 percent, and the Credit Suisse Leveraged Loan index returned 2.8 percent.

It is hard to estimate the volume of defaults, restructurings and personal bankruptcies that global policy support helped prevent. Nevertheless, there was still $150 billion in total U.S. defaulted corporate debt, mostly in energy, but also in cable/satellite, retail, and services. Given that the peak-to-trough decline in U.S. economic activity was 3.8 times that of the last financial crisis, defaults could easily have been more than double were it not for the tidal wave of government liquidity that turned this shock into a V-shaped recovery. Moody's speculative-grade 12-month default rate ended the year at 8.0 percent for bonds and 7.1 percent for loans. In the index-eligible universe, the par-weighted default rate for the S&P LSTA Leveraged Loan Index was 4.4 percent, and 7.0 percent for the ICE BofA High Yield Index.

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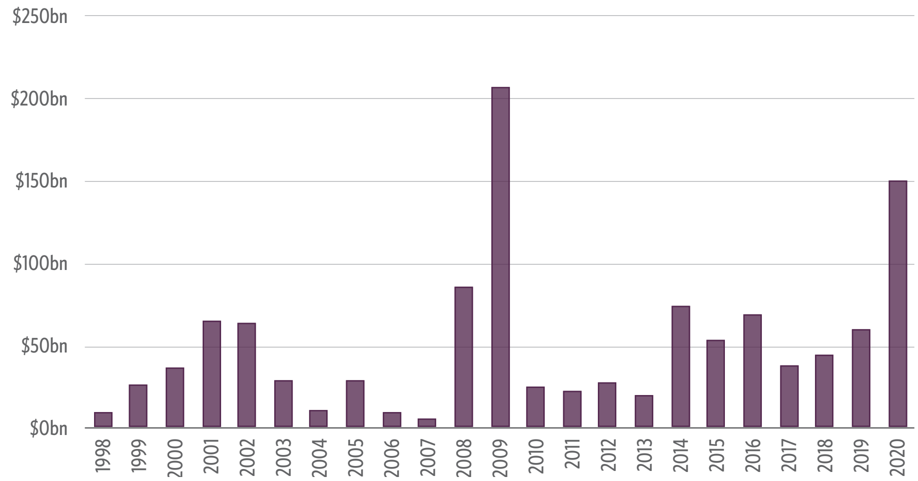
Highest Default Volume in Over a Decade



Source: Guggenheim Investments, J.P. Morgan. Data as of 12.31.2020.

It was hard to escape credit rating downgrades. There were 5.7x more downgrades than upgrades in the bank loan market, and 5.5x more downgrades than upgrades in high yield corporates. But the year also generated opportunities for an active credit manager to move up in quality. BB-rated bonds comprised the largest share of issuance at 40 percent, followed by 33 percent of B-rated issuance and only 4 percent of CCC or below. Approximately 31 percent of new high-yield bond issuance was secured, which is typical in years when lenders become more conservative. Some of the secured issuance was by loan issuers crossing over, which provided us an opportunity to seamlessly transition from one debt instrument to another for the same issuer.

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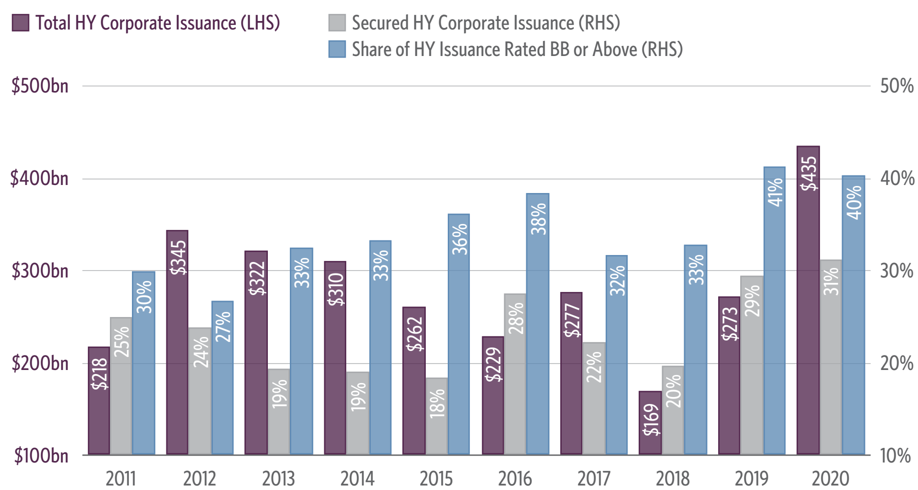
Conservative Trends Despite Record High-Yield Issuance



Source: Guggenheim Investments, S&P LCD. Data as of 12.31.2020.

Similarly, Guggenheim's analysts cover credit by industry and not by debt type or rating, which meant that fallen angels presented an opportunity as much as a portfolio risk. There was $250 billion in USD-denominated fallen angel volume, $122 billion of which entered the high-yield benchmark. The ICE BofA Fallen Angel Index delivered exceptional total return performance of 15 percent.

As we look ahead to the other side of this pandemic, we see opportunities to take a little more risk. Our high-yield portfolios have gradually shifted toward consumer-oriented sectors over the past few quarters, focused on secured positions. This year is expected to see continued improvement in cyclical sectors and a stronger recovery for service sectors that were directly hurt by the pandemic. But a lot still depends on consumers' willingness to spend excess savings, as well as on vaccine distribution and acceptance trends, ongoing virus mutations and actions taken by the incoming Biden administration.

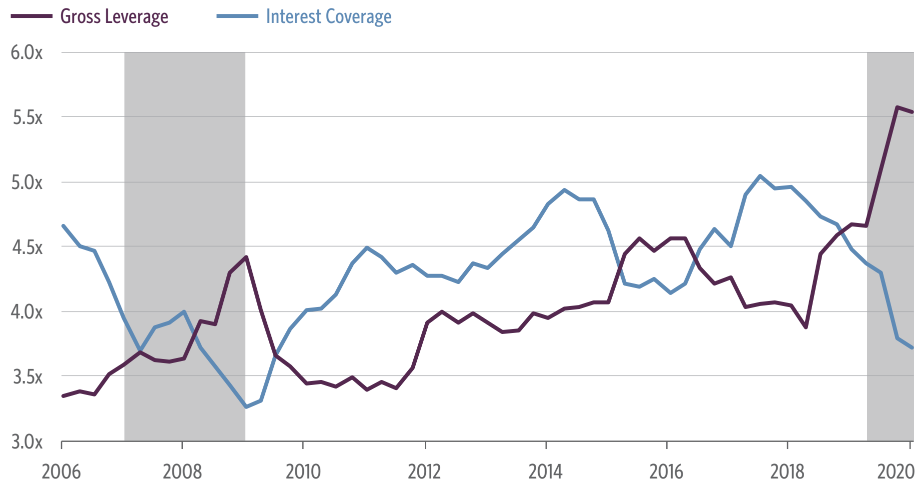
While the backdrop is positive, a challenge for credit investors is that corporate bond prices are already discounting a strong recovery. High-yield corporate bond spreads at cycle tights of only 384 basis points as of Jan. 31, 2021, increase the importance of credit selection to earn a positive loss-adjusted return in high-yield credit this year. Consistent with our macroeconomic outlook, our corporate fundamental outlook for the high-yield universe is positive as well but a look at some fundamental data offers more clarity on this point.

Leveraged Credit Corporate Fundamentals

All things considered, below investment-grade credit issuers performed better than expected in a very challenging year. Combining nonfinancial high-yield corporate bond and leveraged loan issuers under one umbrella, and aggregating ticker level data, annual revenues fell only 2.8 percent year over year on a median basis and 6.5 percent in aggregate. But margins suffered as earnings before interest, taxes, depreciation and amortization (EBITDA) declined by 9.0 percent on a median basis and 18 percent in aggregate. Many investors are also rightly concerned with leverage ratios, which jumped to 5.5x on a gross basis as of the third quarter of 2020 from 4.7x at the end of 2019, while net leverage ratios jumped to 4.6x from 4.0x over the same period.

Median total debt growth was only 1.3 percent year over year, which means that the increase in leverage was almost entirely driven by the decline in earnings. The economic recovery and associated improvement in consumer spending should help cure that. This also applies to interest coverage, since the decline in the ratio was due to earnings and not an increase in interest expense.

Striking Increase in Leverage Ratio and Decline in Coverage Ratio



Source: Guggenheim Investments, S&P Capital IQ. Data as of 9.30.2020. Shaded areas represent periods of recession.

Leverage ratios are likely to improve in 2021. Median total debt growth was only 1.3 percent year over year, which means that the increase in leverage was almost entirely driven by the decline in earnings. The economic recovery and associated improvement in consumer spending should help cure that. This also applies to interest coverage, since the decline in the ratio was due to earnings and not an increase in interest expense. With regard to the implications for default risk, a large mitigating factor is that holdings of cash and cash equivalents increased 60 percent year-over-year on a median basis and 72 percent in the aggregate—evidence of efforts to shore up balance sheet liquidity.

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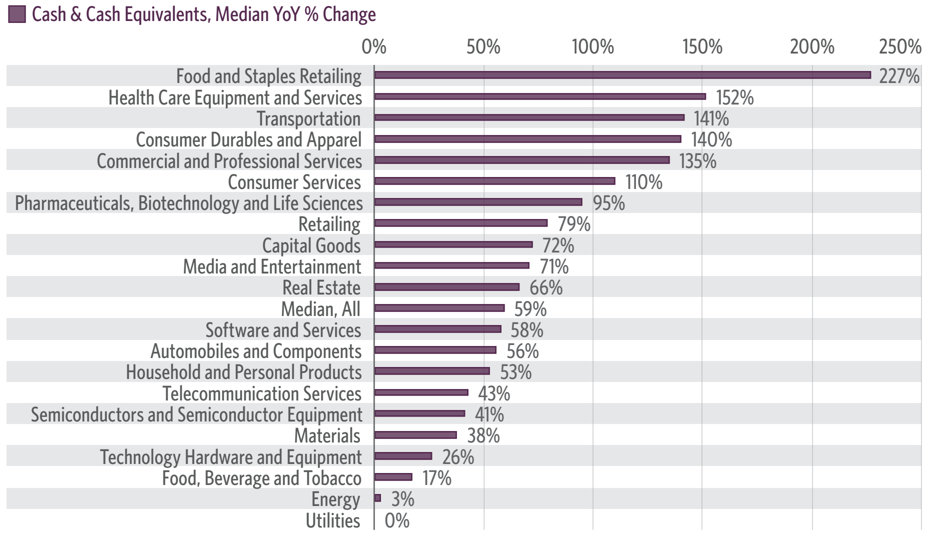
Cash and Equivalent Holdings of the 2020 High-Yield Universe

Source: Guggenheim Investments, S&P Capital IQ. Data as of 9.30.2020 based on issuers rated high-yield by S&P as of 1.1.2020.

We expect most companies to use some portion of their precautionary cash balances to pay debt down and reduce leverage ratios in order to protect their credit ratings from further downgrades.

Nearly All Industries Raised Cash in 2020

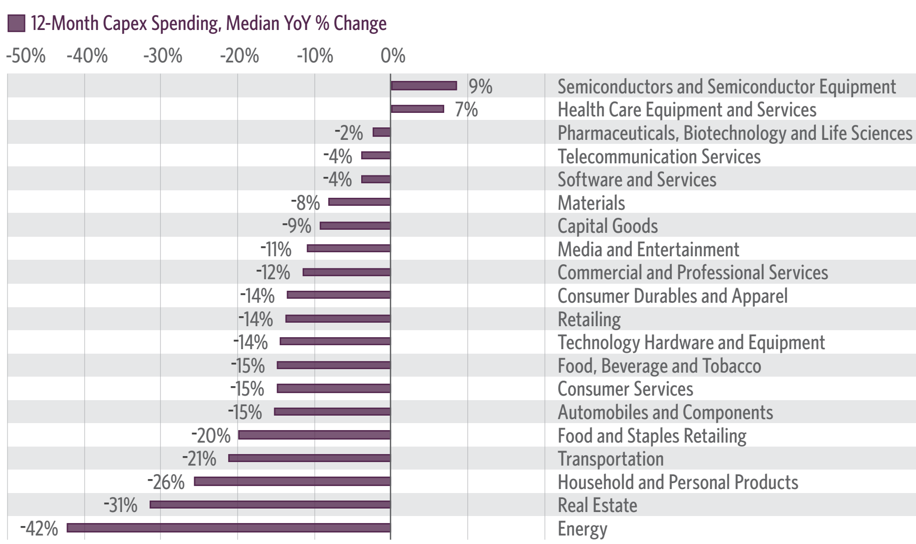


Source: Guggenheim Investments, S&P Capital IQ. Data as of Q3 2020.

Given the market's expectation of an earnings recovery, liquidity is becoming less desirable to companies and to investors. Holding too much precautionary cash can be a drag on performance as it offers no return in the current environment. We expect most companies to use some portion of their precautionary cash balances to pay debt down and reduce leverage ratios in order to protect their credit ratings from further downgrades.

Median capex spending growth was only 6 percent in 2019, down from 14 percent in 2018. Capex and debt reduction are therefore likely to be the top uses of excess cash in 2021.

Strong Need for Business Investment in the High-Yield Universe



Source: Guggenheim Investments, S&P Capital IQ. Data as of Q3 2020.

High-yield companies are also likely to increase capital expenditures (capex) this year. Capex fell 14 percent year over year on a median basis as of the third quarter of 2020, and 26 percent aggregating total capex across all issuers in our data, led by the energy and real estate sectors. There is likely a pent-up need for business investment, especially from capital-intensive industries, as median capex spending growth was only 6 percent in 2019, down from 14 percent in 2018. Capex and debt reduction are therefore likely to be the top uses of excess cash in 2021.

By industry, some of the weaker areas were autos, energy, and transportation which saw year-over-year revenue declines of -15 percent, -22 percent and -32 percent, respectively. These are not surprising given the circumstances last year. Of these weaker sectors, transportation saw significant debt growth, with a median year-over-year growth rate of 22 percent, led by airlines. The sectors with the highest leverage, measured as gross debt/EBITDA, are transportation, consumer services, and retail.

High-yield sectors that stand out as strong 2020 performers are food and staples, household and personal products, and semiconductor companies which saw revenue growth rates of 9.9 percent, 4.3 percent, and 7.8 percent, respectively. These sectors have a higher average rating compared to the index, trade at tight spreads (285 basis points in consumer goods and 319 basis points in technology), and do not offer much price upside. But we believe they carry lower default risk, given stable business performance in a challenging year and low leverage ratios, and therefore investors can look to them for coupon returns.

The Importance of Active Management

The current fixed-income landscape may push some investors to reach for yield, but there are always risks with this strategy. For example, the energy sector had the highest yield at the end of 2019 of 8.5 percent, but the worst total return in 2020 of -6.6 percent, as well as the worst experience in credit migration and defaults. In 2018, the highest-yielding sector was transportation at 10.2 percent, and while its subsequent 12-month performance was strong at 13 percent total return, it underperformed 16 other sectors and the index.

As of the end of 2020, transportation is in the spotlight again for its enticing yields. The sector offered the highest spread of the high-yield corporate bond index at 642 basis points and the highest yield of 6.7 percent. Although we expect 2021 to differ from 2020 in many important ways, there are at least a few risks to consider in reaching for this yield. Transportation represents only 1.5 percent of the index, equating to just $22 billion in index-eligible bonds, one of the smallest sectors in the index with only few issuers available in which to invest. It offers the highest yields because most public companies in this space had negative 12-month EBITDA on a median basis. Using a smoothed eight-quarter average for each company, the median leverage ratio is 11x, ranking highest among the 21 sectors in our data set.

In common with other sectors, transportation saw a 141 percent year-over-year median increase in cash and equivalents. This liquidity boost serves as a mitigating factor to near-term default risk. Faster-than-expected vaccine availability helps as well given the direct impact from the ongoing global pandemic. But the transportation sector is largely comprised of airlines, and a full recovery in air traffic and earnings is years away according to the International Air Transport Association's latest forecast, which projects that global passenger traffic will not return to pre-COVID-19 levels until 2024.

There are too many other considerations to cover in this brief report. As with all industries in this environment, the airline sector requires single name analysis to assess liquidity runways and growth opportunities. Although we are not avoiding any sector entirely, including transportation and airlines, there are many opportunities in the middle of the stack of fundamentals and valuations without extending risk significantly. Some sectors are consumer cyclical products, business services, metals and mining, financials, media, pharmaceuticals, and manufacturing, to name a few. These are sectors that can ride the rising tide of the economic recovery with fewer extreme situations like in transportation. All sectors have "problem children," so our credit work combined with trading team reviews of cross-sector valuations allow us to find the best value.

Investment Implications

Corporate bond prices have recovered to pre-COVID levels already despite the fact that the path to recovery still lies ahead, but these valuations are supported by low Treasury yields. History shows there is more room for credit spreads to compress against Treasurys, with spreads still between the 20th and 30th percentile of historical observations dating back to 1998.

History has shown that after recessions, there is an extended period when spreads can persist at low levels for several years, even well after the Fed has begun tightening monetary policy.

History Shows Extended Periods of Spreads Near Current Levels

Source: Guggenheim Investments, Credit Suisse, ICE Index Services. Data as of 12.31.2020. Shaded areas represent periods of recession.

Furthermore, history has shown that after recessions, there is an extended period when spreads can persist at low levels for several years, even well after the Fed has begun tightening monetary policy. Given the expectation for consumer spending to normalize and business investment to increase, we think history is set to repeat itself. Although there may be short-lived pullbacks in markets this year, we expect the current cycle has some time to run and would welcome those opportunities to buy at better prices.

Important Notices and Disclosures

INDEX AND OTHER DEFINITIONS

The referenced indices are unmanaged and not available for direct investment. Index performance does not reflect transaction costs, fees or expenses.

The **Credit Suisse Leveraged Loan Index** tracks the investable market of the U.S. dollar denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/ BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries.

The **Intercontinental Exchange (ICE) Bank of America Merrill Lynch High-Yield Index** is a commonly used benchmark index for high-yield corporate bonds.

The **S&P 500 Index** is a capitalization-weighted index of 500 stocks, actively traded in the U.S., designed to measure the performance of the broad economy, representing all major industries.

A **basis point (bps)** is a unit of measure used to describe the percentage change in the value or rate of an instrument. One basis point is equivalent to 0.01%.

Spread is the difference in yield to a Treasury bond of comparable maturity.

EBITDA, which stands for earnings before interest, taxes, depreciation and amortization, is a commonly used proxy for the earning potential of a business.

RISK CONSIDERATIONS

The potential impacts of the COVID-19 outbreak are increasingly uncertain, difficult to assess and impossible to predict, and may result in significant losses. Fixed-income investments are subject to credit, liquidity, interest rate and, depending on the instrument, counter-party risk. These risks may be increased to the extent fixed-income investments are concentrated in any one issuer, industry, region or country. The market value of fixed-income investments generally will fluctuate with, among other things, the financial condition of the obligors on the underlying debt obligations or, with respect to synthetic securities, of the obligors on or issuers of the reference obligations, general economic conditions, the condition of certain financial markets, political events, developments or trends in any particular industry. Fixed-income investments are subject to the possibility that interest rates could rise, causing their values to decline.

Bank loans are generally below investment grade and may become nonperforming or impaired for a variety of reasons. Nonperforming or impaired loans may require substantial workout negotiations or restructuring that may entail, among other things, a substantial reduction in the interest rate and/or a substantial write down of the principal of the loan. In addition, certain bank loans are highly customized and, thus, may not be purchased or sold as easily as publicly-traded securities. Any secondary trading market also may be limited, and there can be no assurance that an adequate degree of liquidity will be maintained. The transferability of certain bank loans may be restricted. Risks associated with bank loans include the fact that prepayments may generally occur at any time without premium or penalty. High-yield debt securities have greater credit and liquidity risk than investment grade obligations.

High-yield debt securities are generally unsecured and may be subordinated to certain other obligations of the issuer thereof. The lower rating of high-yield debt securities and below investment grade loans reflects a greater possibility that adverse changes in the financial condition of an issuer or in general economic conditions, or both, may impair the ability of the issuer thereof to make payments of principal or interest. Securities rated below investment grade are commonly referred to as "junk bonds." Risks of high-yield debt securities may include (among others): (i) limited liquidity and secondary market support, (ii) substantial market place volatility resulting from changes in prevailing interest rates, (iii) the possibility that earnings of the high-yield debt security issuer may be insufficient to meet its debt service, and (iv) the declining creditworthiness and potential for insolvency of the issuer of such high-yield debt securities during periods of rising interest rates and/ or economic downturn. An economic downturn or an increase in interest rates could severely disrupt the market for high-yield debt securities and adversely affect the value of outstanding high-yield debt securities and the ability of the issuers thereof to repay principal and interest. Issuers of high-yield debt securities may be highly leveraged and may not have available to them more traditional methods of financing.

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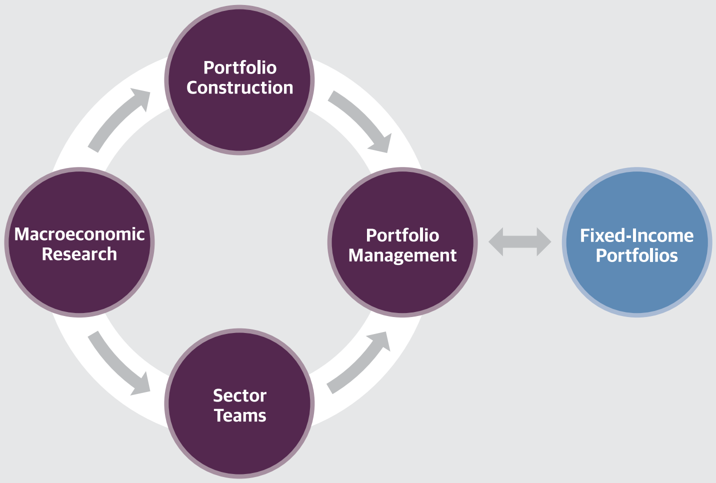
1. Guggenheim Investments assets under management are as of 12.31.2020. The assets include leverage of $13.7bn for assets under management. Guggenheim Investments represents the following affiliated investment management businesses of Guggenheim Partners, LLC: Guggenheim Partners Investment Management, LLC, Security Investors, LLC, Guggenheim Funds Distributors, LLC, Guggenheim Funds Investment Advisors, LLC, Guggenheim Corporate Funding, LLC, Guggenheim Partners Europe Limited, GS GAMMA Advisors, LLC, and Guggenheim Partners India Management.

2. Guggenheim Partners assets under management are as of 12.31.2020 and include consulting services for clients whose assets are valued at approximately $70bn.

Guggenheim's Investment Process

Guggenheim's fixed-income portfolios are managed by a systematic, disciplined investment process designed to mitigate behavioral biases and lead to better decision-making. Our investment process is structured to allow our best research and ideas across specialized teams to be brought together and expressed in actively managed portfolios. We disaggregated fixed-income investment management into four primary and independent functions—Macroeconomic Research, Sector Teams, Portfolio Construction, and Portfolio Management—that work together to deliver a predictable, scalable, and repeatable process. Our pursuit of compelling risk-adjusted return opportunities typically results in asset allocations that differ significantly from broadly followed benchmarks.



Guggenheim Investments

Guggenheim Investments is the global asset management and investment advisory division of Guggenheim Partners, with more than $246 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 300+ 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

Guggenheim Partners is a global investment and advisory firm with more than $310 billion[2] in assets under management. Across our three primary businesses of investment management, investment banking, and insurance services, we have a track record of delivering results through innovative solutions. With 2,400+ professionals based in offices around the world, our commitment is to advance the strategic interests of our clients and to deliver long-term results with excellence and integrity. We invite you to learn more about our expertise and values by visiting GuggenheimPartners.com and following us on Twitter at twitter.com/guggenheimptnrs.

For more information, visit GuggenheimInvestments.com.

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