GUGGENHEIM

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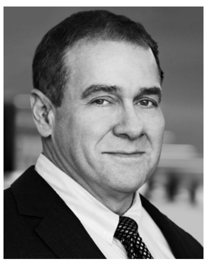
Global CIO Outlook
Necessary But Not Adequate



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What do you think of the actions the Federal Reserve (Fed) has taken?

- I would categorize what the Fed has done to this point as necessary but not adequate.
- As an example, the Commercial Paper Funding Facility buys A1/P1 commercial paper. There's about $450 billion of A1/P1 commercial paper and about $500 billion of A2/P2 paper which they can't buy.
- The A2/P2 paper is issued by the companies that are weaker and actually are going to need the help to keep going.
- The CP facility is great. I'm glad it's there to backstop the A1/P1 companies, but it's not doing anything for the companies that are the most vulnerable in terms of being cut off from the money markets.
- In fairness, the Fed has its hands tied, especially in the wake of Dodd-Frank and the financial crisis where more restrictions were put on them.
- Given its Congressional mandate, the Fed cannot buy municipal bonds or corporate bonds or equities directly on to its balance sheet. It can only buy U.S. Treasurys, Agencies, and gold, without leadership from the White House to give that authority to the Fed.

What is next for markets?

- Corporate bond spreads have widened a lot.
- But we haven't yet seen capitulation in areas such as securitization. There's a lot of aircraft securitizations out there that are going to be extremely hard hit by airlines shutting down travel, and until we see some forced liquidation, which for the first time today I have a sense we are seeing, we're not going to come to a bottom.
- In the mini recession of 2015–2016, we saw BBB CLOs trading at 60 cents on the dollar. The last trades I saw were around 85 cents on the dollar. I would argue

that what we're in today is a lot more serious than the decline in energy prices we experienced in 2015 and 2016 that caused a credit crunch.

- I'd like to see these CLOs trading closer to 50 cents on the dollar. Aircraft securitizations have been trading at yields of around 7 percent. I think they would be more appropriately priced to yield 15 percent.
- I think we still have downside room in the stock market. There is wholesale panic in the stock market, but even if we hit the next objective I have, which is around 2100–2200 on the S&P 500, we're only going to be down 37 percent. That is not what you would expect in a market like this, you would expect something more like 45–50 percent.

What happens to the industries that are most affected by this economic crisis?

- The publicly traded airlines are going to be a big political debate here.
- Over the last 10 years, in the wake of the financial crisis, airlines have bought back $45 billion of stock. Today the airline industry is asking for approximately $50 billion of aid to bail them out. This creates the potential for a political nightmare.
- The people who thought that the bailout of the big companies was bad in the financial crisis are going to look at this and say, "Why don't we let these people just go bankrupt?"
- The reality is, in a Chapter 11 bankruptcy reorganization, airlines continue to operate. It's not like people aren't going to be able to fly to their destinations.
- I am an avowed capitalist, and there are situations where you have to allow the people that are getting the return for the risk actually bear the risk and not have the government bailing them out.
- It's a question of moral hazard, which has been building ever since the 1930s within the financial system.
- The recommendation I made to Treasury and the Office of Management and Budget is that if we really think that an industry or a company like Boeing is so essential to the U.S. economy, then loan guarantees could be offered, but the borrowers should pay a fee to get them. They should pay the same as if they were getting a letter of credit from a commercial bank.
- And the government should get warrants on the stock for, say, 20 percent of the company. The U.S. government should come to the table as a distressed investor and build transactions that give upside participation to the tax payers who are bearing the burden of this crisis.

How will the proposed emergency plans affect the bond market?

- There is going to be a long-term structural change in the bond market.
- The U.S. Treasury issues approximately $1.2 trillion in securities per year. Domestic savings last year was about $1.2 trillion, corporate savings was about $500 billion, and state and local governments ran deficits of $300–400 billion. So our savings equation was in balance.
- Now, with a $1 trillion emergency program, we will have $2.2 trillion in government borrowing. Corporate savings will be disappearing, and the personal savings rate isn't going to get any better because people are going to use savings to keep their houses and so forth. And state and local governments are going to have to continue to spend or increase spending.
- Since that doesn't balance, we have more than a $1 trillion shortfall in available credit in the financial system that will force the Fed to provide credit to balance the supply of credit with the increased demand.
- Ultimately this is going to be QE5, and I expect about $4.5 trillion in quantitative easing.
- Otherwise, this shortfall in the availability of credit to run businesses will increase and it will further deepen the crisis.