Fourth Quarter 2019

Fixed-Income Outlook

Risk and Reward of Successful 'Mid-Cycle' Rate Cuts

GUGGENHEIM

From the Desk of the Global CIO

Risk and Reward of Successful 'Mid-Cycle' Rate Cuts

In July, after the Federal Reserve (Fed) made its first rate cut in a decade, Fed Chair Jerome Powell referred to the first cut as a brief “mid-cycle” rate adjustment, as opposed to the beginning of a lengthy cutting cycle. This distinction was critical, because it spoke to the Fed’s mixed track record of using rate cuts to stave off recession. The central bank had successfully staved off recession using a similar adjustment in 1998, but it was not effective in several other late cycle scenarios.

In all likelihood, Powell’s hopes have been realized and the Fed has successfully staved off recession and extended the expansion. Weakness in manufacturing data has bottomed out, the consumer is in good shape, and the labor market remains extraordinarily resilient. The recovery in the U.S. is also helping to drive a pickup in global economic activity.

This is all good economic news, but the rhyming of history reminds us to consider how the 1998 scenario played out. The Fed’s accommodation helped sustain the expansion, but it also led to large amounts of malinvestment and excesses building up in the stock market. The Fed’s 1998 mid-cycle adjustment resulted in a liquidity-driven rally that caused the Nasdaq index to double within a year before the bubble finally burst. It also led to a significant widening of credit spreads.

Today, current spreads reflect just how little upside there is in credit even as the expansion continues. As I write this letter, investment grade bonds stand at a spread of 96 basis points, just 23 basis points from their historical tights, and 514 basis points from their historical wides. For every basis point of upside to the historic tight, there are about 22 basis points of downside to the historic wide. The story is similar for high-yield bonds: They currently stand at a spread of 322 basis points over the Treasury curve, which is 105 basis points from their historical tights and 1,626 basis points from their historical wides, or about 15 basis points of potential downside (widening) for every basis point of potential upside (tightening). It is clear there is far more downside risk than upside potential in credit.

In terms of total return, using high-yield as an example, the asymmetry of returns is stark. If a strong bull market brought spreads to their historical tights, the excess return over Treasurys would be about 9 percent (factoring in coupon income of 6.3 percent and spread return). Contrast that with a bear market scenario that brought spreads to their historic wides. In this case, the excess return would be about -43.8 percent (again factoring in coupon income and spread return). Again, 9.0 percent is upside to historic tights, and -43.8 percent is downside to historic wides. Put another way, a widening in high-yield spreads of just 207 basis points would entirely offset coupon income. Investors are not being adequately compensated for the outsize risk they are taking on in the current market.

Throughout this report, our portfolio managers and sector teams underscore the reasons why we continue to upgrade credit quality and reduce spread duration risk in our portfolios. On page 2, our portfolio management team describes how we continue to increase credit quality and minimize spread volatility. On page 8, our investment-grade corporate bond team cites various reasons why credit spreads may tighten over the coming months—none of them fundamental. Meanwhile, our asset-backed securities team on page 14 discusses how investors are not getting compensated to assume the additional credit and spread duration risk of subordinated CLO tranches.

Taken together, conditions today are characteristic of those that precede a Minsky Moment, in which excessive speculation and taking on additional credit risk during stable markets leads to a tipping point that leads to a period of instability. How long can this phase last? As John Maynard Keynes famously noted, the market can remain irrational longer than you can remain solvent. Thus, while the Fed has prolonged the expansion, the reality is that it is also the start of silly season in risk assets. By heeding the lessons of the past we continue to position defensively so that we can preserve capital and be prepared to take advantage of opportunities when asset prices inevitably reset.

While we very well may miss the short-term returns offered by speculative madness, our goal is always to maximize long-term returns and preserve capital for when opportunity presents itself.

Scott Minerd
Chairman of Investments and Global Chief Investment Officer

Contents

Portfolio Management Outlook

Prudent Investing Calls for a Steady Hand

Anne B. Walsh, JD, CFA
Chief Investment Officer, Fixed Income

Steve Brown, CFA
Portfolio Manager

Adam Bloch
Portfolio Manager

Staying the course in a time of increasing uncertainty.

The theme of avoiding the fate of '98, which we discussed last quarter, continues to resonate as we shift gears for 2020. The 1998 experience saw the Fed's easing efforts helped to delay the oncoming recession, but also propelled a bubble in tech stocks. By not participating in a liquidity-driven rally that lacked fundamental support, the prudent investor would have avoided a 78 percent drawdown in tech stocks and a wave of corporate defaults that left many participants with less wealth than when the Fed first started lowering interest rates in 1998.

As our Global CIO Scott Minerd writes in his introduction to this quarter's Fixed-Income Outlook, the Fed's mid-cycle adjustment appears to have successfully staved off recession as it did in 1998. The expansion will likely continue in the near term with the help of global monetary easing efforts that are helping to drive risk assets higher. Year-to-date performance across different asset classes shows rates and cyclical equities both delivering better returns than credit (see chart, bottom right), although the Fed's easing will likely allow risks to build in certain areas of the credit markets. For now, we continue to focus on income and capital preservation.

Our primary portfolio allocation strategy within Core Plus has been to focus on credit loss-remote investments that will exhibit minimal spread volatility and stable returns under a variety of credit and rate environments. We remain underweight investment-grade corporate credit, overweight high-quality asset-backed securities, and are maintaining positions in Agency commercial mortgage-backed securities and Treasurys. Over the past several years, we have increased the average portfolio credit quality from BBB+ at the start of 2016 to AA- as of the most recent quarter, while generating more yield than the subcomponents of comparable quality in the Bloomberg Barclays U.S. Aggregate Bond index (Agg).

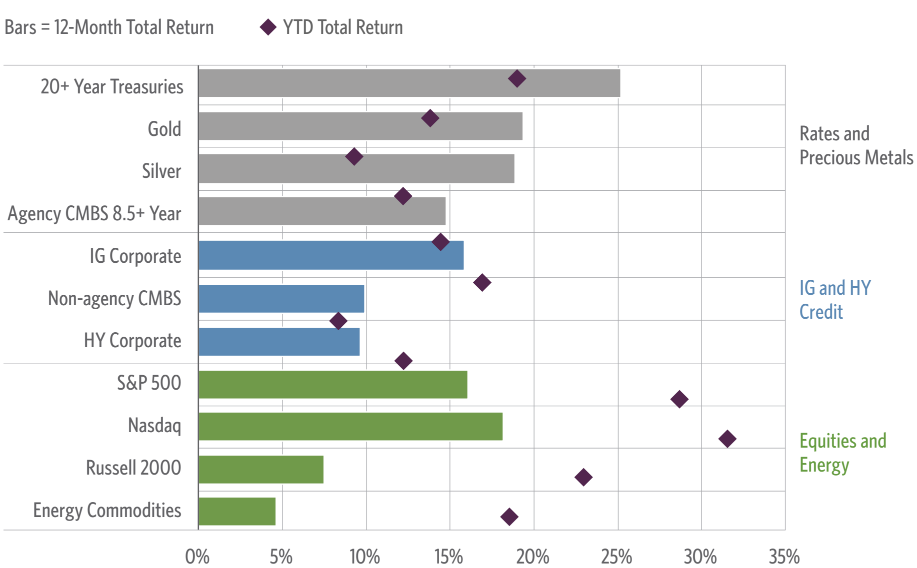
We have been gradually increasing the average quality of our Multi-Credit strategy as well, from BB+ at the start of 2016 to BBB+ as of the most recent quarter. Our largest allocations in this strategy are high-quality asset-backed securities, short-tenor investment-grade corporate credit, and investments at the front end of the curve that still carry well. Those short-term investments include FX-hedged short-tenor sovereign debt exposure that have the potential to generate an attractive yield for the portfolio.

Our duration strategy across both Core Plus and Multi-Credit positions the portfolios to benefit from a steeper yield curve. As accommodative Fed policy prolongs the business cycle akin to 1998, this should increase inflation expectations and term premium and steepen the yield curve.

While recession risk has receded for the time being, clouds linger on the economic horizon. As the Fed, along with the European Central Bank and Bank of Japan, once again are engaged in synchronous balance sheet expansion, history shows that in time the current liquidity risk in markets and the economy will ultimately come to an untimely end, and the forces driving the current excesses will dissipate once the liquidity spigots are turned off. It is only a matter of time.

Our conservative approach has resulted in positive returns, but trailed many benchmarks that have reflected a higher risk profile over the past year. While these short-term results may disappoint, the discipline of behavioral finance will caution against short-term tactical bets at the expense of long-term performance. As discussed by our Global CIO, the risk/reward tradeoff still favors caution.

Market Returns Reflect a Tension in the Economic Outlook



Source: Guggenheim Investments, Bloomberg. Data as of 11.30.2019.

Returns across different asset classes reflect a tension in the macroeconomic outlook, with rates and equities both delivering better returns than credit.

Macroeconomic Outlook

Signs of Life in Global Manufacturing

Brian Smedley
Head of Macroeconomic and Investment Research

Maria Giraldo, CFA
Managing Director

Matt Bush, CFA, CBE
Director

The beleaguered manufacturing sector is showing signs of improvement.

U.S. real gross domestic product (GDP) growth held roughly steady at 2.1 percent annualized in the third quarter versus 2.0 percent in the second quarter. The data showed a moderation in government spending and personal consumption expenditure growth, which came in at 3.1 percent annualized after an unsustainably strong 4.6 percent reading in the prior quarter. However, this was largely offset by a smaller drag from inventories and net exports.

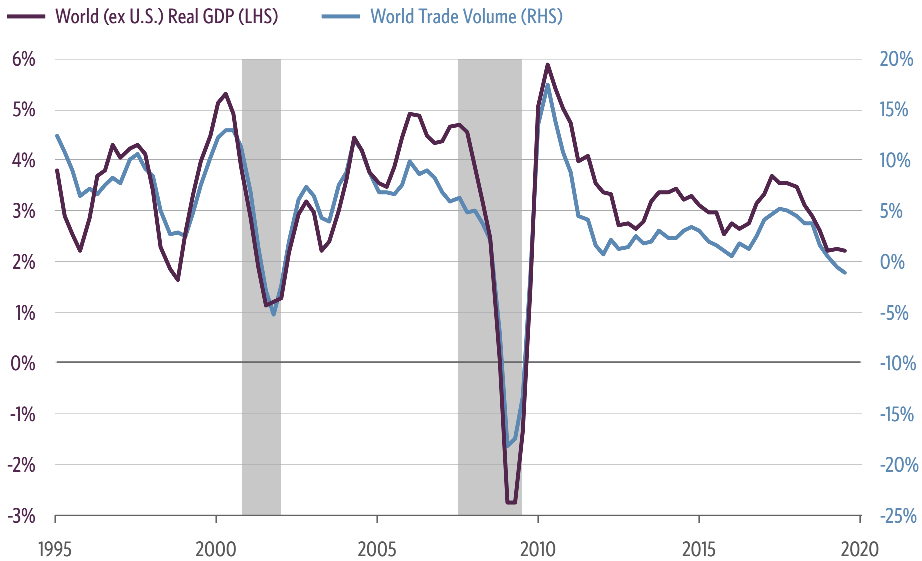
Despite the pullback in consumer spending growth, the U.S. household sector has remained a bright spot as clouds have gathered over the global economy. The manufacturing sector has borne the brunt of the escalation in U.S.-China tariffs, while also contending with headwinds in the form of U.S. dollar appreciation and weakness in foreign demand. Beyond the United States, the trade war and China's ongoing financial deleveraging have detracted from global trade volumes, which are contracting on a year-over-year basis for the first time since 2009 (see chart, top right). The global trade recession has weighed on GDP growth in economies that are particularly trade- and investment-oriented. Real GDP growth in China slowed to 6.0 percent year over year in the third quarter, the slowest pace in several decades, while German GDP grew by just 0.3 percent annualized in the third quarter after contracting by 1.0 percent in the prior quarter.

The good news is that the manufacturing sector represents only 11.0 percent of U.S. GDP and 8.4 percent of nonfarm payrolls. We see encouraging signs of an upturn in goods production, which a tentative U.S.-China trade truce should support. Meanwhile, growth in the much larger services sector has moderated, with real personal spending on services having softened over the past year. Also noteworthy to us was the decline in the employment diffusion index of the IHS Markit purchasing managers index (PMI) for services, which fell to 47.5 in October before rebounding in November and December. Global PMIs also showed a sequential improvement in labor market conditions in November (see chart, bottom right).

Fiscal policy is estimated to have boosted U.S. real GDP growth by about 0.6 percentage point in 2019. This substantial fiscal support should fade in 2020, resulting in no contribution to growth (a -0.6 percentage point shift in the growth impulse). We expect Fed policy to remain on hold in the near term, with monetary policymakers having indicated that the bar is high for further rate changes. This message has since been reinforced by the Fed's senior leadership, who have noted that "monetary policy is in a good place." The recent rally in stocks and bear steepening of the yield curve suggests that markets agree.

Global Growth Has Slowed, With Trade Volumes Now Contracting

Percent Change Y/Y

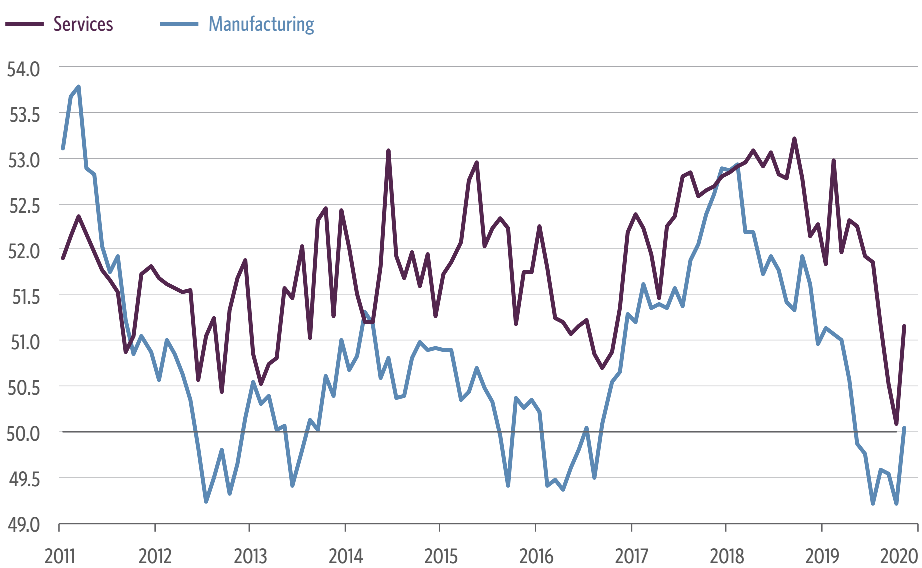


Source: Guggenheim Investments, Haver Analytics, Federal Reserve Bank of Dallas, Netherlands Bureau for Economic Policy Analysis. Trade data as of 6.30.2019; GDP data as of 9.30.2019. Shaded areas represent recession.

The U.S.-China trade war has harmed global trade volumes, which contracted on a year-over-year basis in the second quarter for the first time since 2009.

Global Labor Market Conditions Improved in November

JP Morgan Global PMIs: Employment Diffusion Indexes



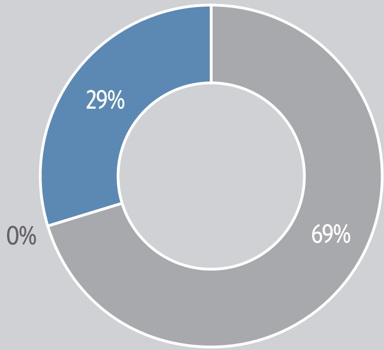
Source: Guggenheim Investments, Haver Analytics, JP Morgan/IHS Markit. Data as of 11.30.2019. Note: Readings above 50 denote expansion.

Global PMIs show softening labor market conditions across services as well as manufacturing.

Portfolio Strategies and Allocations

Guggenheim Fixed-Income Strategies

Bloomberg Barclays U.S. Aggregate Index[1]



Governments and Agencies:
Treasurys 40%, Agency Debt 1%, Agency MBS 27%, Municipals 1%

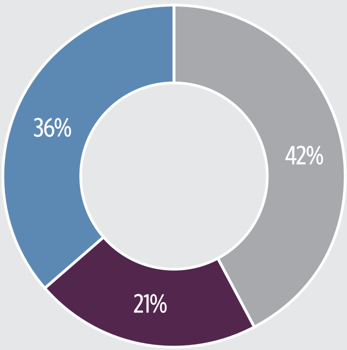
Structured Credit:
ABS 0%, CLOs 0%, Non-Agency CMBS 0%, Non-Agency RMBS 0%

Corporate Credit/Other:
Investment-Grade Corp. 25%, Below-Investment Grade Corp. 0%, Bank Loans 0%, Commercial Mortgage Loans 0%, Other 4%

The Bloomberg Barclays Agg is a broad-based flagship index typically used as a Core benchmark. It measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasurys, government-related and corporate securities, MBS (Agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (Agency and non-Agency). The bonds eligible for inclusion in the Barclays Agg are weighted according to market capitalization.

1. **Bloomberg Barclays U.S. Aggregate Index:** Other primarily includes 1.3% supranational and 1.0% sovereign debt. **Please see disclosures at the end of the document. Totals may not sum to 100 percent due to rounding.**

Guggenheim Core Fixed Income[2]



Governments and Agencies:
Treasurys 0%, Agency Debt 9%, Agency MBS 23%, Municipals 10%

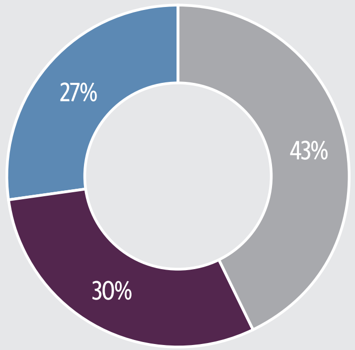
Structured Credit:
ABS 12%, CLOs 7%, Non-Agency CMBS 2%, Non-Agency RMBS 1%

Corporate Credit/Other:
Investment-Grade Corp. 17%, Below-Investment Grade Corp. 1%, Bank Loans 1%, Commercial Mortgage Loans 8%, Other 9%

Guggenheim's Core Fixed-Income strategy invests primarily in investment-grade securities, and delivers portfolio characteristics that match broadly followed core benchmarks, such as the Bloomberg Barclays Agg. We believe investors' income and return objectives are best met through a mix of asset classes, both those that are represented in the benchmark, and those that are not. Asset classes in our Core portfolios that are not in the benchmark include non-consumer ABS and commercial mortgage loans.

2. **Guggenheim Core Fixed Income:** Other primarily includes 3.7% private placements, 1.8% preferreds, 1.5% LPs, and 0.6% sovereign debt. **Please see disclosures at the end of the document. Totals may not sum to 100 percent due to rounding.** Sector allocations are based on the representative account of each Guggenheim strategy. Compositions may vary between accounts and are subject to change.

Guggenheim Core Plus Fixed Income[3]



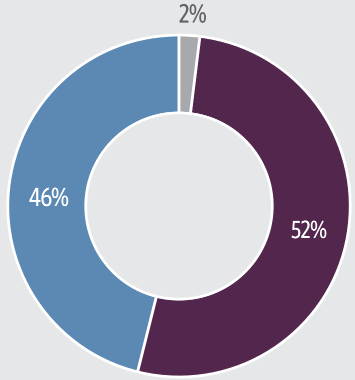
■ **Governments and Agencies:**
Treasurys 20%, Agency Debt 5%, Agency MBS 18%, Municipals 1%

■ **Structured Credit:**
ABS 9%, CLOs 9%, Non-Agency CMBS 2%, Non-Agency RMBS 11%

■ **Corporate Credit/Other:**
Investment-Grade Corp. 8%, Below-Investment Grade Corp. 0%, Bank Loans 1%, Commercial Mortgage Loans 0%, Other 19%

Guggenheim's Core Plus Fixed-Income strategy employs a total-return approach and more closely reflects our views on relative value. Like the Core strategy, Core Plus looks beyond the benchmark for value. Core Plus portfolios have added flexibility, typically investing up to 30 percent in below investment-grade securities and delivering exposure to asset classes with riskier profiles and higher return potential. CLOs and non-Agency RMBS are two sectors we consider appropriate for our Core Plus strategies, in addition to more traditional core investments such as investment-grade corporate bonds.

Guggenheim Multi-Credit Fixed Income[4]



■ **Governments and Agencies:**
Treasurys 1%, Agency Debt 0%, Agency MBS 1%, Municipals 0%

■ **Structured Credit:**
ABS 17%, CLOs 17%, Non-Agency CMBS 3%, Non-Agency RMBS 15%

■ **Corporate Credit/Other:**
Investment-Grade Corp. 20%, Below-Investment Grade Corp. 1%, Bank Loans 8%, Commercial Mortgage Loans 0%, Other 17%

Guggenheim's Multi-Credit Fixed-Income strategy is unconstrained, and heavily influenced by our macroeconomic outlook and views on relative value. As one of Guggenheim's "best ideas" strategies, our Multi-Credit portfolio allocation currently reflects a heavy tilt toward fixed-income assets that we believe more than compensate investors for default risk. Our exposure to riskier, below investment-grade sectors is diversified by investments in investment-grade CLOs and commercial ABS debt, which simultaneously allow us to limit our portfolio's interest-rate risk.

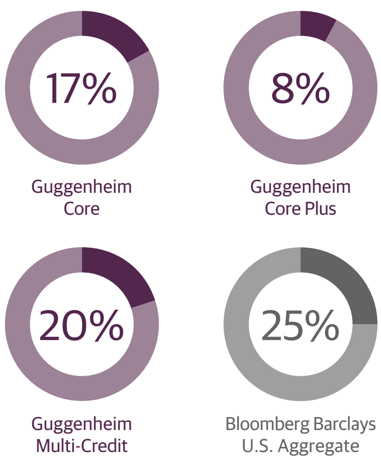
3. **Guggenheim Core Plus Fixed Income:** Other primarily includes 18.1% cash. **Please see disclosures at the end of the document. Totals may not sum to 100 percent due to rounding.** Sector allocations are based on the representative account of each Guggenheim strategy. Compositions may vary between accounts and are subject to change.

4. **Guggenheim Multi-Credit Fixed Income:** Other primarily includes 15% cash and 2.4% private placements. **Please see disclosures at the end of the document. Totals may not sum to 100 percent due to rounding.** Sector allocations are based on the representative account of each Guggenheim strategy. Compositions may vary between accounts and are subject to change.

Investment-Grade Corporate Bonds

Walking the Tightrope

Portfolio allocation as of 9.30.2019



Jeffrey Carefoot, CFA
Senior Managing Director

Justin Takata
Managing Director

Demand for investment-grade corporate bonds should remain strong.

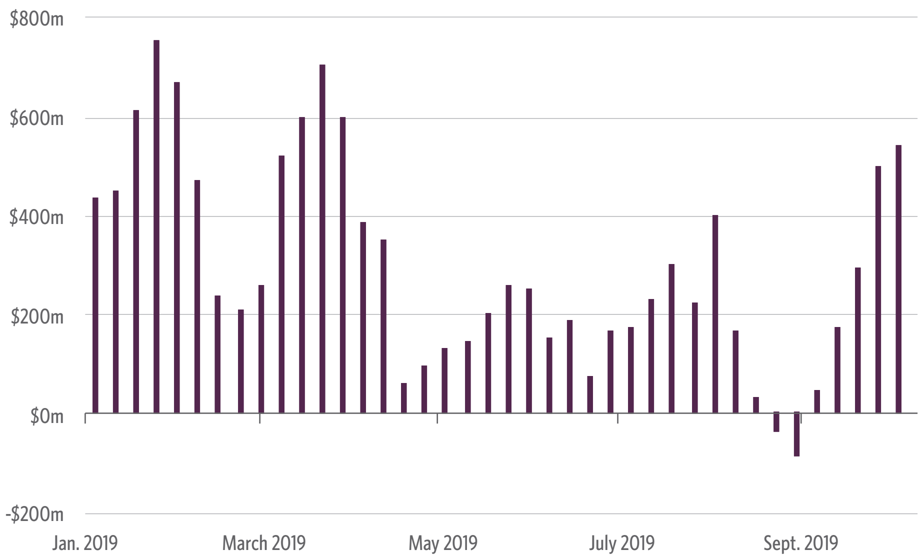
Investment-grade corporate bond gross issuance was heavy in the third quarter, with September's total issuance of $148 billion making it the biggest September and fifth largest month on record. Despite the heavy volume of primary supply, geopolitical tensions, escalating recession fears, and strong technical factors combined to help investment-grade corporate bond spreads end the third quarter only 2.5 basis points wider than the end of the second quarter. The yield on the Bloomberg Global Investment-Grade Corporate Bond index decreased to 2.91 percent from 3.17 percent over the same timeframe, resulting in 13.0 percent year-to-date total return.

Corporate spreads found technical support from steady investment-grade corporate bond fund inflows, net supply dynamics, foreign demand for 30-year corporates, and a buildup of cash from domestic buyers. According to EPFR fund data, investment-grade fund flows reached $71 billion over the third quarter. Bloomberg trade flow data confirms broker-dealers sold around $4.9 billion in corporate bonds over the quarter on a net basis. Despite strong gross issuance in the quarter, year-to-date net issuance remains negative, down -7.2 percent compared to 2018, as September saw $81 billion of bond redemptions and October redemptions are expected to top $60 billion. Inflated FX hedging costs stymied the shorter-dated buy programs in Asia, but domestic buy programs looking to park cash filled this void with ease. Foreign investors have been net buyers of long-dated corporate bonds for most of the year. This relatively steady stream of demand was complemented by traditional U.S. insurers and asset managers adding risk in the secondary market (see chart, top right).

We expect investment-grade corporate spreads to remain rangebound amid an abundance of caution. With investment-grade 10s/30s credit curves at the steeper end of the range and continued appetite from foreign and domestic buyers, we should see strong support for longer-dated, high-quality bonds (see chart, bottom right). Investors are conservatively positioned going into the end of the year, which further decreases the probability of corporate spreads widening. While investors are likely to play it safe in the fourth quarter, demand for investment-grade bonds should remain robust given the sector's substantial 13 percent year-to-date performance on a total return basis.

International Demand for Long-Dated Corporate Bonds Has Picked Up

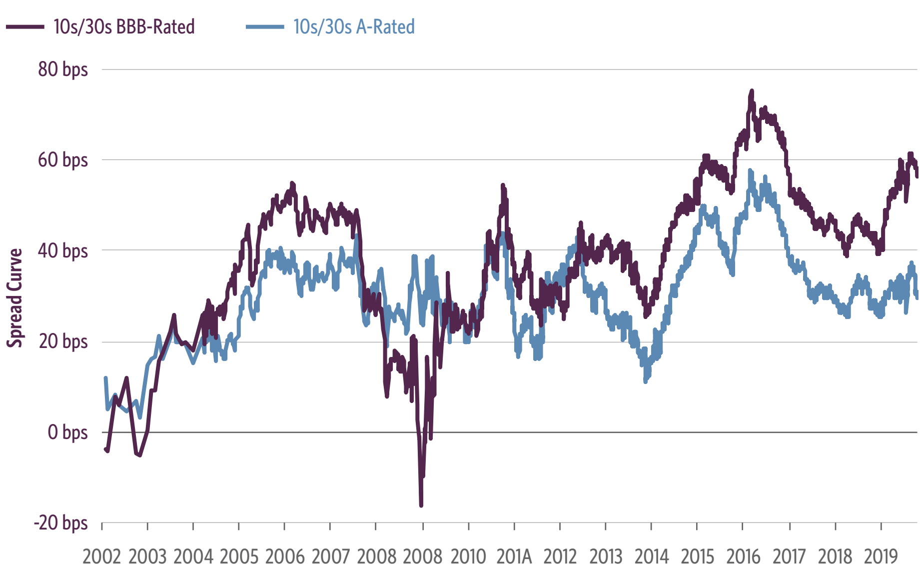
Weekly Net Affiliate Buying of 12yr+ IG Corp Bonds (four-week moving average)



Source: Guggenheim Investments, TRACE, Bloomberg Barclays Indexes, Barclays Research. Data as of 10.4.2019.

Foreign investors have been net buyers of long-dated corporate bonds for most of the year. This relatively steady stream of demand was complemented by traditional U.S. insurers and asset managers adding risk in the secondary market.

Positive Spread Curve Supports Demand at the Long End



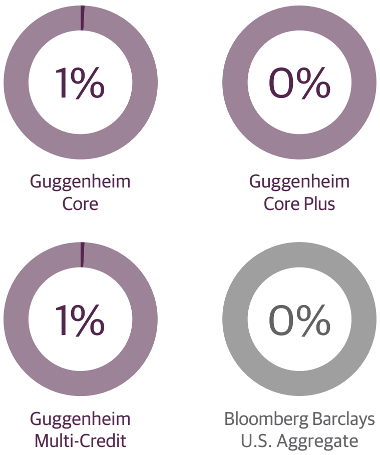
Source: Guggenheim Investments, BofA Merrill Lynch Global Research. Data as of 9.30.2019.

With investment-grade 10s/30s credit curves at the steeper end of the range and continued appetite from foreign and domestic buyers, we should see strong support for longer-dated, high-quality bonds.

High-Yield Corporate Bonds

Cracks Are Forming

Portfolio allocation as of 9.30.2019



Thomas Hauser
Senior Managing Director

Rich de Wet
Director

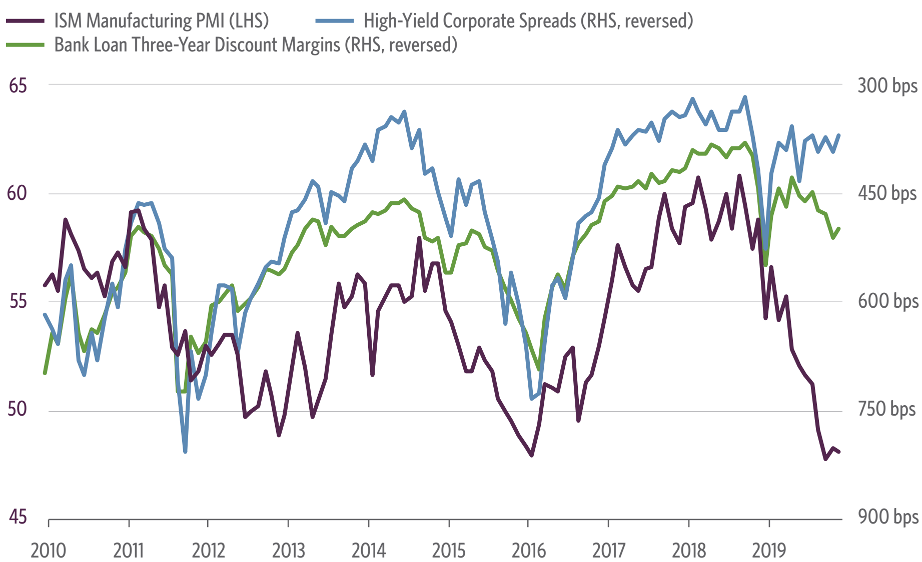
Investors should continue to limit exposure to CCCs despite recent cheapening because of the asymmetry of potential spread outcomes.

A decline in U.S. manufacturing activity in recent years has coincided with widening high-yield credit spreads, but that has not been the case this year at the index level. High-yield spreads tightened 5 basis points over the third quarter of 2019 and as of Oct. 18 are 122 basis points tighter since the start of the year. Meanwhile, the U.S. manufacturing sector is clearly in recession, with two consecutive months of ISM Manufacturing PMI prints below 50 (see chart, top right). Similar slumps in manufacturing activity have resulted in spread widening, but that has not been the case this year. Spreads have widened for securities carrying the lowest rating (CCCs), however, signaling rising concern about credit.

The ICE BofA Merrill Lynch High-Yield Constrained index delivered a return of 1.2 percent in the third quarter, bringing total returns to 11.5 percent year to date. The best year-to-date performance has come from BBs, with a total return of 13.0 percent, followed by single Bs with a return of 11.2 percent, and finally CCCs, trailing with a total return of 6.0 percent. For the quarter, CCCs lost 2.4 percent, while BBs and Bs held on to positive returns of 2.1 percent and 1.1 percent, respectively.

Averaging almost 1,000 basis points in the third quarter, CCC spreads appear to be on a path similar to late 2015, when spreads ultimately peaked at 2,000 basis points. Current CCC spreads might look appealing to those who do not foresee a repeat of 2015–2016, but research suggests spreads are more likely to widen than tighten from here. Weighing the upside potential of spreads tightening against the downside that they may widen another 1,000+ basis points, we believe the value offered in CCCs does not justify the risk (see chart, bottom right). Instead, we continue to find value in BBs, and especially single Bs, which are not trading as much above par as BBs.

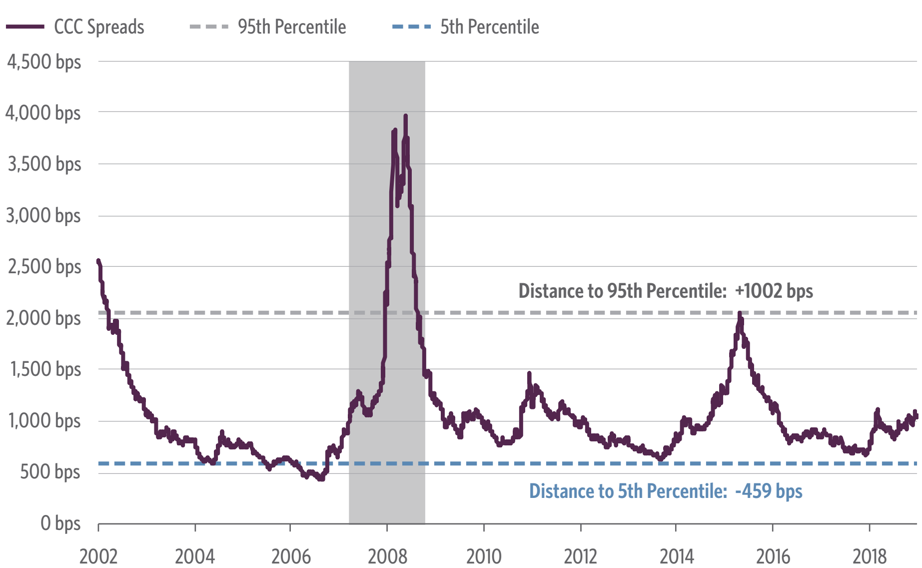
Spreads Resist the Slowdown in Manufacturing Activity



Source: Guggenheim Investments, Bloomberg, Bloomberg Barclays Indexes, Credit Suisse. Data as of 11.30.2019.

The U.S. manufacturing sector is in recession, with several consecutive months of ISM Manufacturing PMI prints below 50, but credit spreads remain tight at the index level. Similar slumps in manufacturing activity have resulted in spread widening, but that has not been the case this year.

The Asymmetry of Potential Spread Outcomes Looks Unappealing



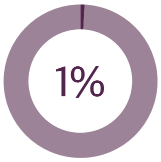
Source: Guggenheim Investments, ICE Index Services. Data as of 10.18.2019. Shaded area represents recession.

Weighing the upside potential of spreads tightening against the downside that they may widen another 1,000+ basis points, CCC spreads do not compensate investors for the risk.

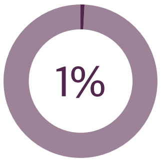
Bank Loans

Ratings Migration Signals Trouble Ahead

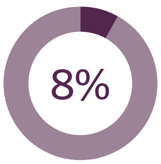
Portfolio allocation as of 9.30.2019



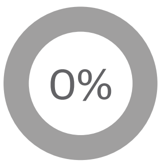
Guggenheim Core



Guggenheim Core Plus



Guggenheim Multi-Credit



Bloomberg Barclays U.S. Aggregate

Thomas Hauser
Senior Managing Director

Christopher Keywork
Managing Director

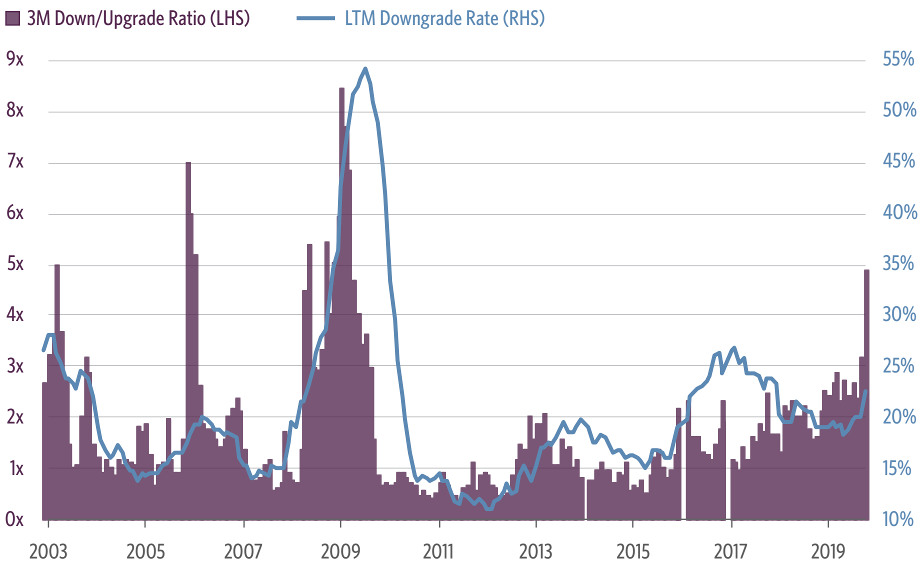
The worrisome pace of downgrades in the leveraged loan market is likely to continue.

Some 102 loans were downgraded between June 2019 and September 2019, according to S&P LCD, representing 7.2 percent of the LSTA Leveraged Loan index. Only 21 loans in the index were upgraded over the same period, resulting in a downgrade-to-upgrade ratio of 4.9x—the highest since 2009 (see chart, top right). The downgrades are not focused on any specific industry. Companies operating in commercial services, retail, technology, healthcare, consumer products, media, energy, and several other subindustries have seen loans downgraded, leaving loan investors few places to hide.

Amid the accelerating pace of downgrades and rate cuts by the Fed, the Credit Suisse Leveraged Loan index delivered a total return of 0.9 percent, losing steam from the second quarter, which delivered a return of 1.6 percent. Lower-rated loans weighed on index performance, with split B and CCC loans losing 3.2 percent and 1.3 percent, respectively. Higher-quality BB loans held on to positive returns of 1.6 percent for the quarter as many fewer BB-rated loans were downgraded compared to the single B or below category. Unfortunately, with a weighted average rating of approximately B+, the market is comprised of more single B loans and fewer BBs (see chart, bottom right). More specifically, the rising share of single B- loans is of concern given that a one-notch rating downgrade drops them to CCC+.

Heavy CCC-rated volume, whether due to downgrades or issuance, would likely be met with very limited demand. Collateralized loan obligations (CLOs), a large buyer of loans, have a limit on their exposure to CCC-rated loans. Intex data suggest that CLOs may be able to absorb about $25–30 billion in CCC loans in aggregate before reaching their limit. Within the Credit Suisse Leveraged Loan index alone, $175 billion par value, or 266 loans, are rated single B- by S&P, of which $28 billion also have a negative outlook. Among the remaining buyers of loans—retail funds, banks, and hedge funds—only the hedge fund group may have appetite for CCC loans. But loans may have to clear at lower prices and wider spreads for hedge funds to absorb the potential volume of single B loans that could get downgraded to CCC. As such, we continue to emphasize an up-in-quality theme.

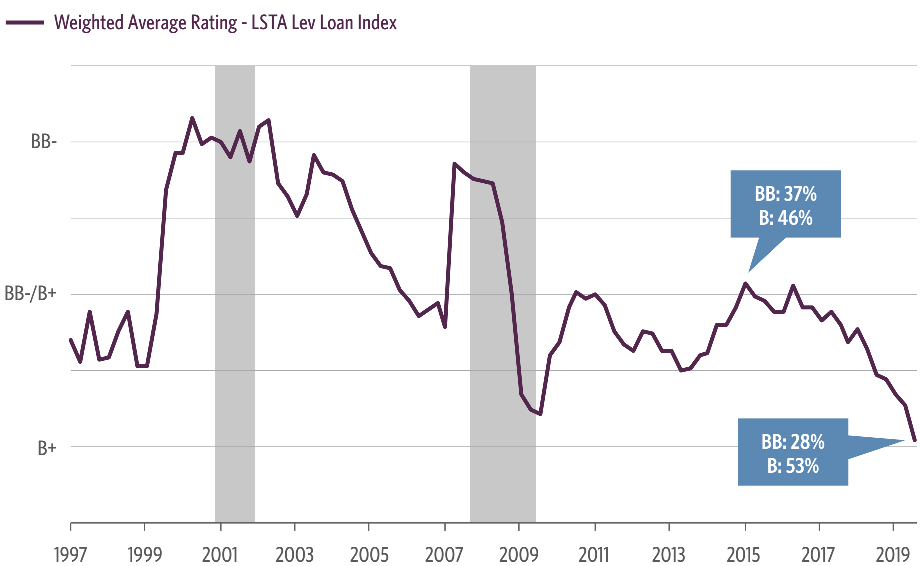
The Number of Downgrades Far Outweighed Upgrades in Q3



Source: Guggenheim Investments, S&P LCD. Data as of 9.30.2019.

Some 102 loans were downgraded between June 2019 and September 2019, according to S&P LCD, representing 7.2 percent of the LSTA Leveraged Loan index. Only 21 loans in the index were upgraded over the same period, resulting in a downgrade-to-upgrade ratio of 4.9x—the highest since 2009.

Lower-Rated B Loans Flood the Market



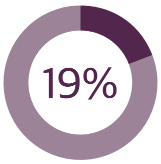
Source: Guggenheim Investments, Loan Syndications and Trading Association. Data as of 9.30.2019. Percentages reflect leveraged loan market composition.

Higher-quality BB loans held on to positive returns of 1.6 percent for the quarter as far fewer BB-rated loans were downgraded compared to the single B or below category. Unfortunately, with a weighted average rating of approximately B+, the market continues to be comprised of more single B loans and fewer BBs.

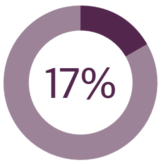
Asset-Backed Securities and CLOs

Focus on High Quality, New Issue

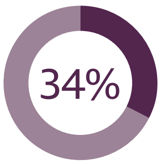
Portfolio allocation as of 9.30.2019



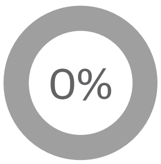
Guggenheim Core



Guggenheim Core Plus



Guggenheim Multi-Credit



Bloomberg Barclays U.S. Aggregate

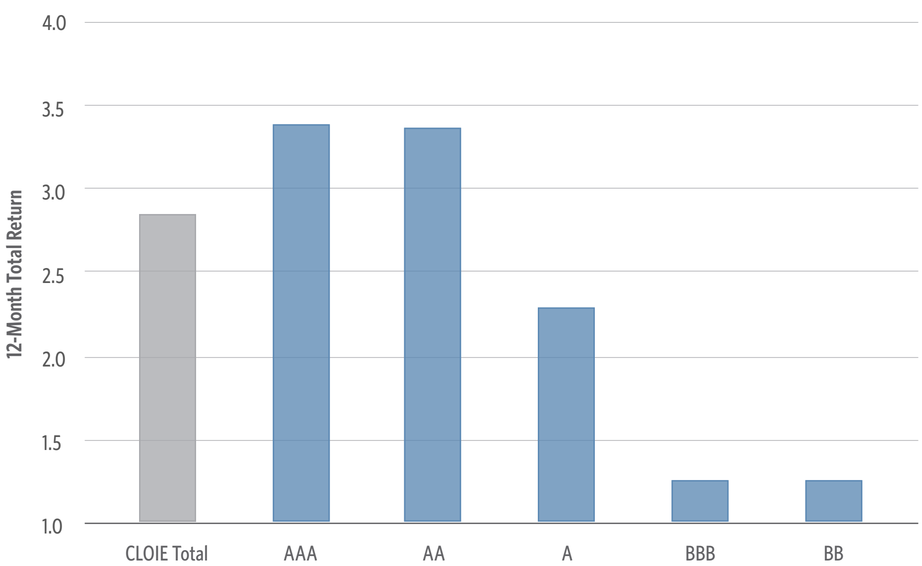
Peter Van Gelderen
Managing Director

We prefer short, senior CLO tranches and new-issue commercial and aircraft ABS.

Ongoing concerns about the longevity of the current credit cycle, memories of the sharp fourth quarter 2018 selloff, and reduced investor interest in floating-rate securities all weighed on CLO spreads during the third quarter. Our thesis over the last 12 months to favor short, senior CLOs has worked as expected: Pricing generally remained steady, but pricing for riskier subordinated tranches weakened by 10–45 basis points in the third quarter. Over the last 12 months AAA CLO tranches returned 3.52 percent, while subordinated BBB and BB securities returned just 2.83 percent and 2.72 percent, respectively (see chart, top right). Investors have not been adequately compensated to assume the additional credit and spread duration risk of subordinated CLO securities. While weakening spreads did not materially impact new issuance volumes in the third quarter ($25 billion) refinance and reset volumes were anemic. We remain cautious on subordinated CLO investments, and believe short, senior CLO tranches have a superior investment profile for the remainder of the year.

Meanwhile, 2019's sharp rate rally (see chart, bottom right) has presented new risks for and meaningfully impacted our investment strategies in esoteric ABS. With relatively long open periods, or timeframes in which borrowers can refinance existing ABS without any prepayment penalty, esoteric ABS are prone to call and reinvestment risk in sharp interest rate rallies. These risks were particularly acute in 2019. Seasoned esoteric ABS have drifted toward premium dollar prices over the year, and when combined with short non-call periods and long open periods, the spread and yield profiles vary widely on a yield-to-call and a yield-to-maturity basis. To address these concerns, we have focused our investment activity on new issuance and shied away from premium-priced secondary offers. Par-priced new issuance avoids the skewed return profiles and offers extended call protection compared to more seasoned premium priced securities. Our investment focus remains on bespoke opportunities and new issue commercial ABS and aircraft ABS.

Senior CLO Tranches Outperformed Subordinate Tranches in the Past Year



Source: Guggenheim Investments, JP Morgan. Data as of 10.31.2019.

Senior CLO tranches have outperformed subordinate tranches on a nominal basis (and especially on a risk-adjusted basis) over the last 12 months.

Nominal Yields Have Fallen Since the Beginning of the Year

			12.31.2018		11.5.2019	
ABS Overview	Rating	WAL	Spread	Yield	Spread	Yield
Whole Business	BBB	5	168	4.25	175	3.3
Aircraft	A	4.5	160	4.17	200	3.55
Aircraft	BBB	5	285	5.42	310	4.65
Container	A	4.5	160	4.17	185	3.4
Triple Net Lease	AAA	5	95	3.52	110	2.7
Triple Net Lease	A	5	165	4.22	170	3.3

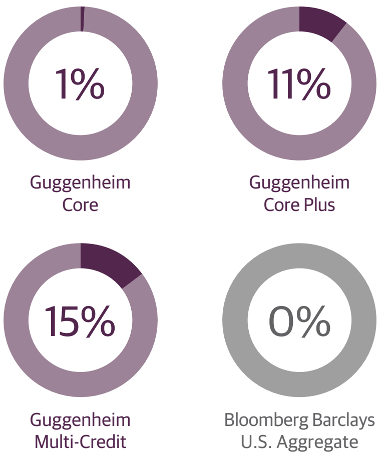
Source: Guggenheim Investments. Data as of 11.5.2019.

Credit spreads for certain ABS subsectors have widened. The underperformance of ABS credit spreads is owing to those securities' weak call protection, not credit concerns. As interest rates declined, prices rose and investors increasingly focused on yield to call analytics.

Non-Agency Residential Mortgage-Backed Securities

The Future Is Now

Portfolio allocation as of 9.30.2019



Karthik Narayanan, CFA
Managing Director

Roy Park
Director

New issuance and trading activity in the RMBS market reflect a change in investor focus.

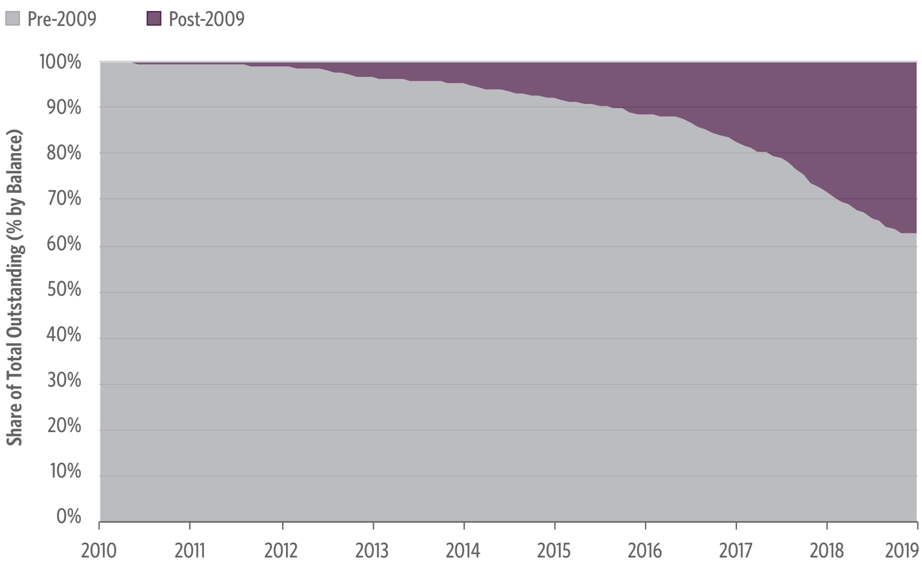
Non-Agency RMBS has exhibited positive performance over 2019, returning 1.4 percent in the third quarter and 7.4 percent year to date. Although performance was directionally positive, the sector's moderate interest rate sensitivity and spread volatility resulted in more tepid performance than the Bloomberg Barclays U.S. Aggregate index and other credit sectors.

Trading volumes and investor participation in the secondary market was low in the third quarter and did not meaningfully increase from the quiet summer months, but new issuance spiked after August and was well received by investors. New issuance reached $24 billion in the third quarter and $61 billion year to date. After 10 years of negative net issuance, 2019 issuance is expected to exceed the paydowns from the outstanding market, resulting in positive net supply and a stabilization in overall market size.

Non-Agency RMBS issuance restarted in earnest over 2013–2015 with the establishment of the GSE credit risk transfer (CRT) programs, non- and re-performing packed deals, and non-QM shelves. With increased new issuance, the composition of the non-Agency market has shifted away from pre-crisis and towards post-crisis securities (see chart, top right). Post-crisis RMBS comprised only 10 percent of the market in 2016 but now comprises approximately one-third of the market. Post-crisis RMBS has maintained reasonably stable underwriting standards, the credit-sensitive pre-crisis sector has exhibited ongoing credit improvements, and the sector has shown more modest volatility than other credit sectors in down-markets. These constructive credit trends have contributed to a decline in the overall riskiness of the sector and a corresponding broadening of investor sponsorship. Although the shift in composition away from pre-crisis deals began with the re-opening of primary RMBS issuance in 2013, trading volumes remained stubbornly focused on the pre-crisis segment and only recently began migrating towards post-crisis tranches (see chart, bottom right).

We remain constructive on the performance prospects for non-Agency RMBS as borrowers continue to benefit from favorable consumer-credit and housing fundamentals, which should translate to stable credit performance of recent issuance and improving bond cash flows for pre-crisis deals. We continue to favor senior, shorter maturity classes for their lower price volatility as well as selected credit-sensitive, pre-crisis passthroughs that should benefit from constructive credit fundamentals.

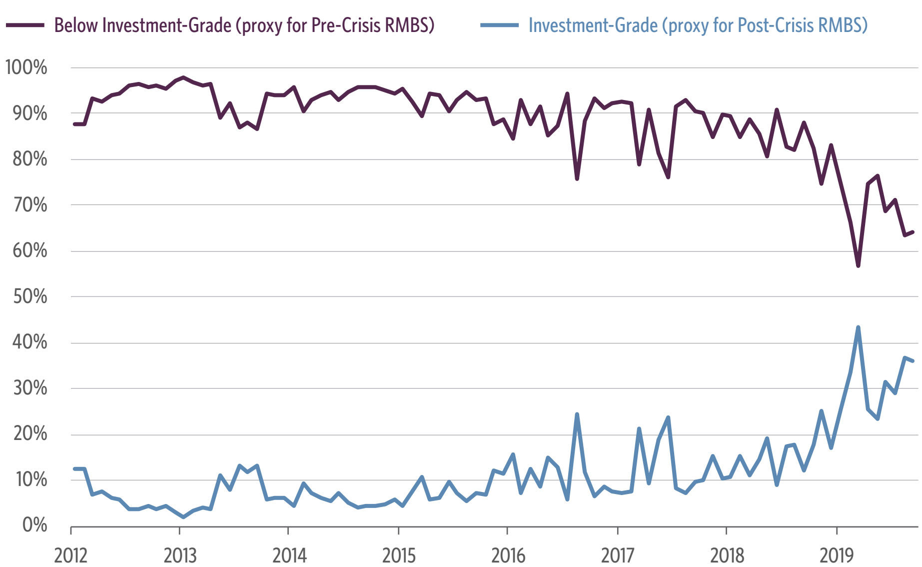
Post-Crisis Bonds Now Represent Approximately 37 Percent of the Market



Source: Guggenheim Investments, CoreLogic, Citi Research. Data as of 9.30.2019.

Post-crisis RMBS accounted for just 10 percent of the market in 2016. It now accounts for one-third.

Trading Volumes Migrated to Post-Crisis Issuance



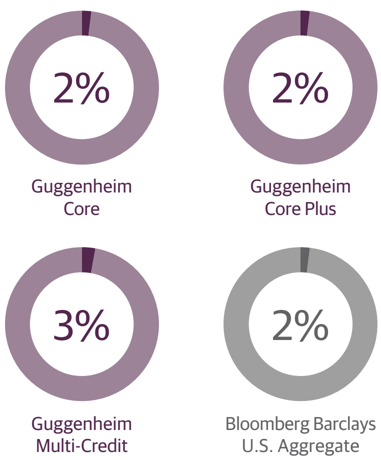
Source: Guggenheim Investments, SIFMA. Data as of 9.30.2019.

Trading volumes have mirrored outstanding volumes and have begun migrating to post-crisis issuance.

Commercial Mortgage-Backed Securities

Strong Demand, But Not for WeWork

Portfolio allocation as of 9.30.2019



Shannon Erdmann
Director

Phil Hoehn
Vice President

Liquidity remains strong after the largest post-crisis SASB and CRE-CLO deals.

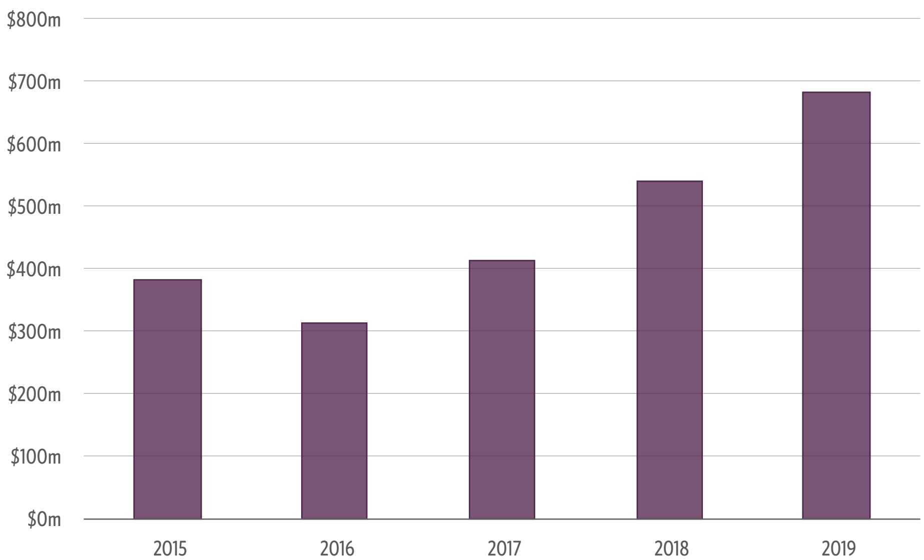
The CMBS sector continued to enjoy healthy liquidity despite new issue deal sizes growing larger in the third quarter. The largest post-crisis single-asset/single borrower (SASB) deal was issued at a staggering $5.6 billion. The deal was announced and closed in less than one week, showing the strength in demand. The deal creates a new benchmark for the SASB world as there were six co-managers on the deal and each of these dealers is making daily markets on the entire capital stack. Usually, the SASB market is more bespoke, with only a few dealers specializing in certain deals. In CRE-CLO, two transactions priced at over $1 billion, including the largest CRE-CLO issued to date at $1.2 billion. The market received both deals well, with spreads remaining relatively unchanged from previous issuances. As a result of the success of these larger transactions, we expect the average CRE-CLO pool size to continue to grow in 2020 (see chart, top right). Lastly, conduit liquidity remains strong, with as many as 10–15 dealers actively bidding on investment-grade bid lists.

The CMBS world was focused on WeWork's IPO withdrawal, its halting growth, and its cost cutting efforts, leading to speculation of potential defaults on their debt obligations and lease payments. A large portion of WeWork's portfolio is in New York, specifically midtown Manhattan (see chart, bottom right). If WeWork needed to reduce its occupied space, Midtown office rents could decline, and cap rates could rise. We have consistently maintained a bearish view on WeWork due to its business model of mismatching short-term assets with long-term liabilities. Additionally, the diversification in conduit bonds means that no one obligor can have a large impact to the overall transaction. The credit enhancement of investment-grade bonds provides additional protection from losses on any one loan.

While secondary liquidity is stable and credit metrics have remained relatively unchanged in new issue deals, we continue to be cautious about investing in conduit transactions as spreads are close to post crisis tights.

Average CRE-CLO Pool Size Should Continue to Grow in 2020

CRE-CLO Average Pool Size by Year

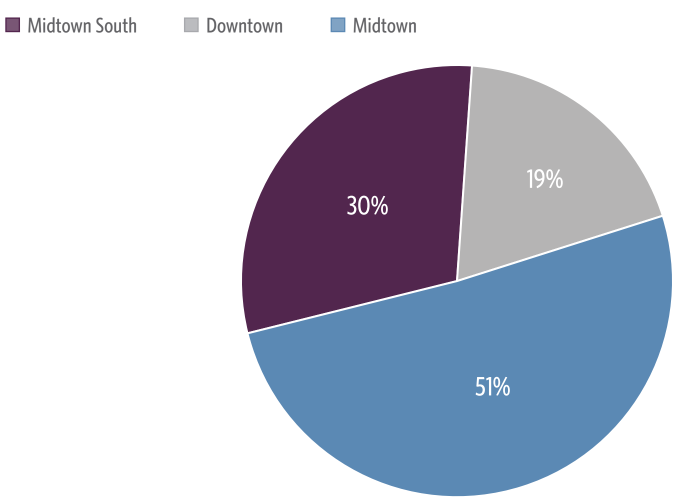


Source: Guggenheim Investments, Wells Fargo. Data as of 9.30.2019.

In CRE-CLO, two transactions priced at over $1 billion, including the largest CRE-CLO issued to date at $1.2 billion. The market received both deals well, with spreads remaining relatively unchanged from previous issuances. As a result of the success of these larger transactions, we expect the average CRE-CLO pool size to continue to grow next year.

A Contraction in WeWork's Manhattan Portfolio Could Trigger Higher Cap Rates

WeWork's Manhattan Portfolio



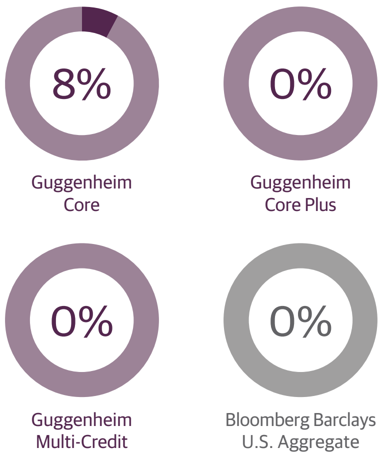
Source: Guggenheim Investments, Morgan Stanley. Data as of 9.30.2019.

A large portion of WeWork's portfolio is in New York, specifically midtown Manhattan. If WeWork needed to reduce its occupied space, Midtown office rents could decline, and cap rates could rise.

Commercial Real Estate Debt

Can Coworking Work?

Portfolio allocation as of 9.30.2019



Jennifer A. Marler
Senior Managing Director

Margot Latham
Managing Director

Zach Johnson
Vice President

WeWork's failed IPO does not signal the demise of flexible office space.

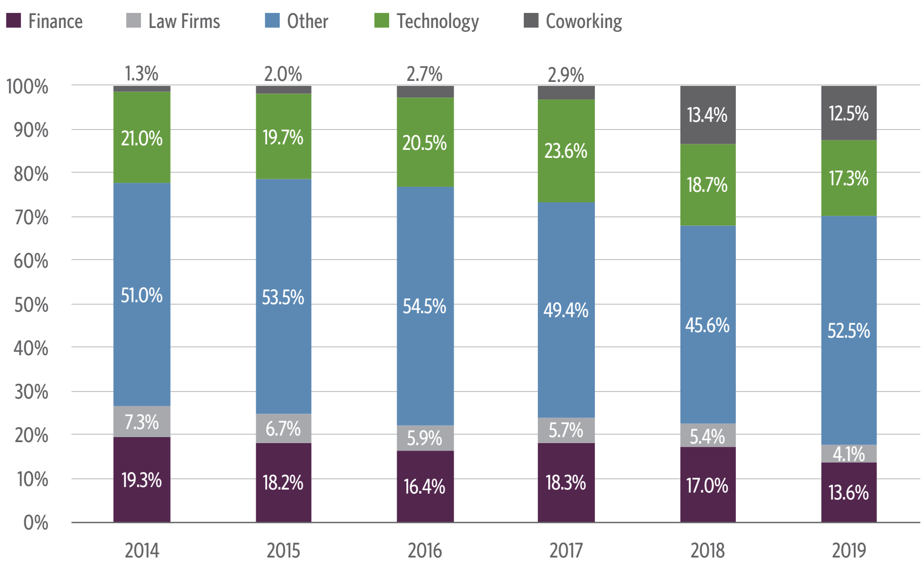
Flexible space is a commercial real estate leasing model that offers office tenants short-term leases or memberships with access to amenities that they would not receive under traditional office leases. Small- and mid-sized businesses and mobile workers were early adopters, but large enterprises are increasingly seeking flexible office platforms. Flexible space is often equated with tenants such as WeWork or Regus that lease large, long-term blocks of space from property owners, build out that space, and then sublease the space or sell memberships to use the space to short-term users. The core business model of such operators is tenant intermediation: operators pay less in rent to the property owner than they charge their customers to use the space.

While coworking spaces are not new, the market has accelerated rapidly over the past five years (see chart, top right). Traditional office space owners have responded to the rise of coworking companies by launching their own flexible office spaces, choosing to collect rents directly from users rather than take the risk of a long-term coworking operator lease. In doing so, they rely on a third-party coworking management company to build out and manage the space under a more traditional property management agreement.

Lenders view significant exposure to flexible office use with caution, preferring the certainty of long-term leases with creditworthy tenants. Transient tenants make the asset vulnerable to general market trends and can demand much higher capital expenditures for tenant improvements. CBRE recently concluded that buildings with a high concentration of coworking companies may yield a lower price in the investment sales market, and that once coworking as a percentage of tenancy exceeds 40 percent, the asset may see higher cap rates.

While the ultimate success of the flexible office space model is still uncertain, its rapid growth represents a macroeconomic trend that may influence the office sector for years to come. Regardless of the ultimate fate of one coworking company, we believe the growing demand for turnkey service without long-term commitments in our technologically dynamic, gig-economy world means that flexible office spaces are here to stay (see chart, bottom right).

Coworking Office Spaces Gain Market Share



Source: Guggenheim Investments, JLL Research. Data as of 9.30.2019.

While coworking spaces are not new, the market has accelerated rapidly over the past five years.

U.S. Flexible Workspace Operators in 19 Leading Office Markets

	Total SF Leased	Number of Sites	Space Per Site
WeWork	12,162,000	154	79,000
Regus	4,705,000	224	21,000
Knotel	2,500,000	120	21,000
Spaces	835,000	29	29,000
Covene	538,000	14	38,000
Industrious	525,000	22	24,000
Level Office	513,000	8	64,000
MakeOffices	428,000	12	36,000
Premier Business Centers	291,000	19	15,000
Jay Suites	260,000	8	33,000
Top 10	**22,757,000**	**610**	**37,000**
Other Operators	5,203,000	301	17,000
Grand Total	**27,960,000**	**911**	**31,000**

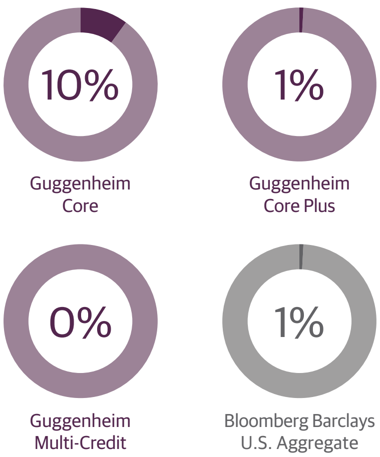
Source: Guggenheim Investments, Colliers International. Data as of 9.30.2019.

While WeWork represents the lion's share of the flexible office space market, growing demand for turnkey service without long-term commitment has fostered a thriving market.

Municipal Bonds

Riding the Wave

Portfolio allocation as of 9.30.2019



James Pass
Senior Managing Director

Allen Li, CFA
Managing Director

Michael Park
Vice President

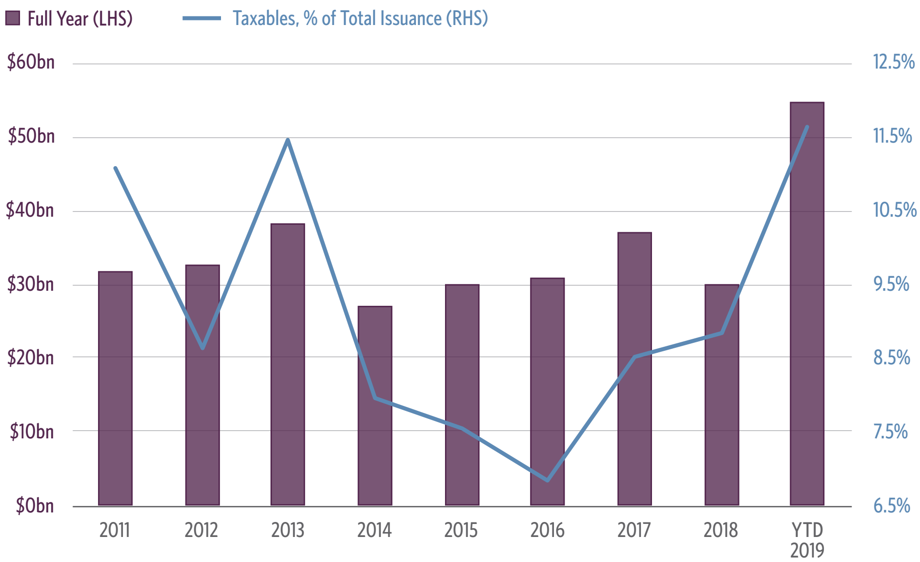
Continued strong demand enables a move up in credit quality.

After reaching all-time lows in municipal-to-Treasury ratios in May, municipals' performance began to experience relative softness throughout the third quarter. While long-duration Treasury yields fell to all-time lows in August, ratios reset to higher levels, contributing to the end of 10 consecutive months of positive performance for the Bloomberg Barclays Municipal Bond index. The municipal market's streak of consecutive weekly inflows continued for 2019, accumulating to $86 billion year to date, offsetting the 11 percent year-over-year increase in new issue supply.

Taxable new issuance, which surpassed $50 billion for the first time since the Build America Bonds program in 2009–2010, boosted overall supply (see chart, top right). Attracted to name diversification, lower default probability, healthy ESG factors, and lower correlations to corporate markets, crossover buyers welcomed the surge in taxable new issuance. Since September, issuers have capitalized on the Treasury rally by issuing taxable bonds not only for new money, but for advance refunding of tax-exempt bonds. Although the Tax Cuts and Jobs Act eliminated advance refundings with tax-exempt bonds, the arithmetic of the current rate environment has encouraged issuers to execute similar financing strategies with taxable bonds several years ahead of par call dates. Low absolute yields, combined with the Treasury curve's bull flattening, afforded issuers very low negative arbitrage (i.e., the difference between escrow earnings and borrowing rates until the call date) that can be dwarfed by the cost savings of replacing 5 percent coupons on tax-exempt bonds with borrowing rates near 3 percent.

The momentum of this supply phenomenon has broadened the municipal demand base and supported a bullish backdrop for the tax-exempt market, particularly for bonds with shorter call dates. The series of favorable technical factors throughout the year has helped push credit spreads to the tightest levels in the past decade. Meanwhile, state and local governments' debt and unfunded pension liabilities has remained above 400 percent of tax revenues since the last recession (see chart, bottom right). We believe this cognitive dissonance provides an opportunity to forgo very marginal carry in order to be selective and move up significantly in credit quality.

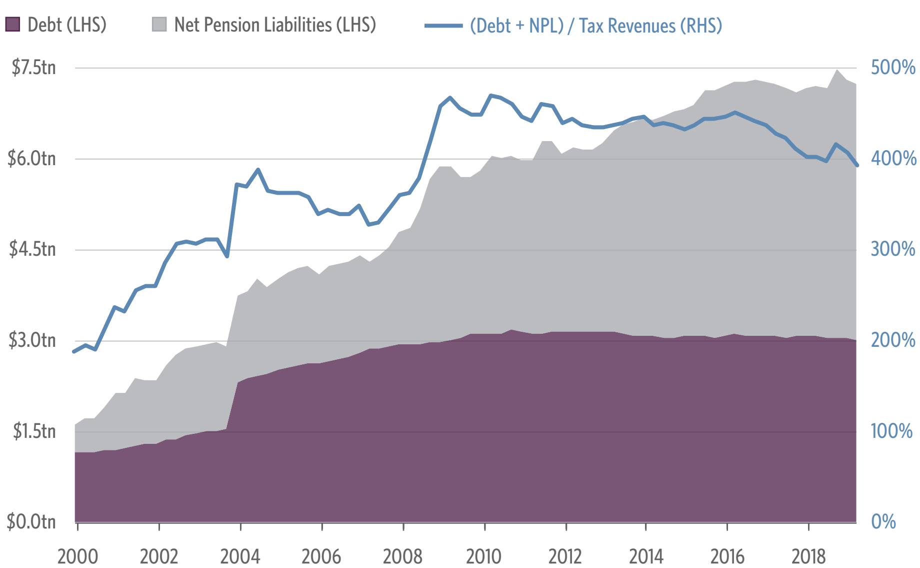
Taxable Muni Bond Issuance Is on Pace to Surpass $60 Billion



Source: Guggenheim Investments, BondBuyer, SIFMA. Data as of 11.30.2019.

Taxable new issuance, which surpassed $50 billion for the first time since the Build America Bonds program in 2009–2010, boosted overall supply.

Unfunded Pension Liabilities Outweigh Tax Revenues by 400%



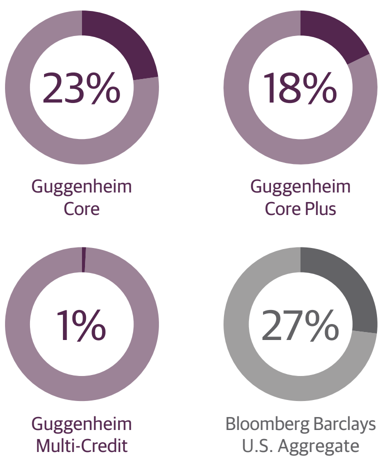
Source: Guggenheim Investments, U.S. Bureau of Economic Analysis, Federal Reserve. Data as of 3.31.2019.

State and local governments' debt and unfunded pension liabilities has remained above 400 percent of tax revenues since the last recession.

Agency Mortgage-Backed Securities

Flight Risk

Portfolio allocation as of 9.30.2019



Aditya Agrawal, CFA
Director

Louis Pacilio, CFA
Vice President

Prepayment risk for recently originated mortgages remains high as mortgage rates continue to fall.

The Mortgage Bankers Association Refinancing index, a leading indicator of prepayment volumes, is rising again (see chart, top right) as 30-year mortgage rates declined. While about 50 percent of mortgages are in the refinance zone, the most sensitivity to prepayment risk is concentrated in generic mortgages originated since 2018 by non-bank originators. These were created in the new era of automation and digitization that eases the approval process and makes streamlined refinancing possible. This is most pronounced in mortgages originated through broker channels. This fast-prepaying subset of the mortgage universe, and the continued reduction in the Fed's balance sheet holdings, have led to deteriorating performance of worst-to-deliver collateral and cheapening of residential MBS valuations. Conversely, less-negatively convex options, such as Agency multifamily and better call-protected pools, have benefited. Looking ahead, the near-term technical picture remains challenging as supply remains high, incremental prepayment risk is elevated, and demand is uncertain. Despite these concerns, RMBS valuations near their cheapest levels in recent years may provide a positive backdrop for the sector.

The Bloomberg Barclays U.S. MBS index performance has remained positive in the fourth quarter following a 1.37 percent total return in the third quarter as mortgage rates fell and interest rate volatility picked up. Option-adjusted spreads were slightly wider over the third quarter and are near the widest levels of the past six years (see chart, bottom right).

We continue to favor investments where either the collateral or structure offers some cash flow stability at reasonable spreads. Accordingly, we find select subsectors attractively priced in the current environment, including longer-maturity Agency multifamily, better call-protected pools, and some collateralized mortgage obligation structures. These investments have performed well, and we expect them to continue their performance in scenarios where interest rate volatility rises, interest rates decline sharply, or the Fed continues down the path of reducing its Agency MBS holdings.

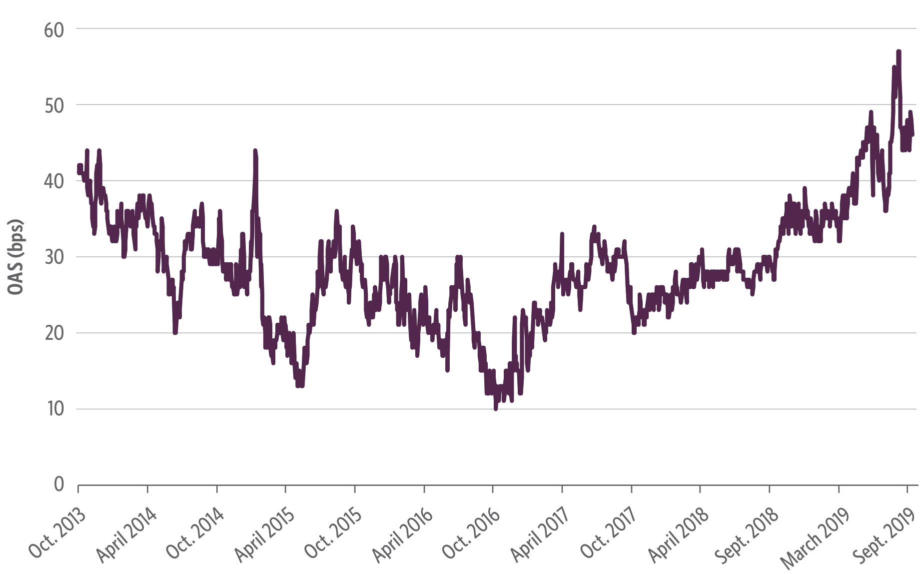
Low Mortgage Rates and High Refi Volumes Have Kept Focus on Prepayments

Source: Guggenheim Investments, Mortgage Bankers Association, Bloomberg. Data as of 9.30.2019.

The Mortgage Bankers Association Refinancing index, a leading indicator of prepayment volumes, is rising again as 30-year mortgage rates declined.

Agency MBS Spreads Are Near Six-Year Wides

Bloomberg Barclays Agency MBS Index OAS



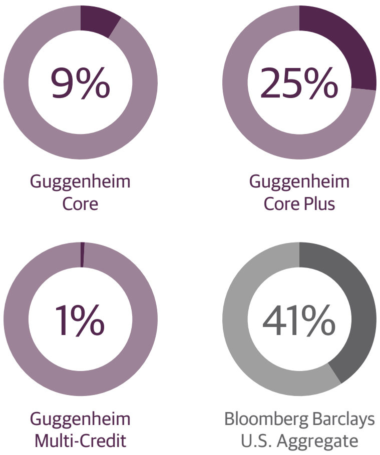
Source: Guggenheim Investments, Bloomberg. Data as of 9.30.2019.

The Bloomberg Barclays U.S. MBS index posted a 1.37 percent total return as mortgage rates fell and interest rate volatility picked up in the third quarter. Option-adjusted spreads were slightly wider over the quarter and are currently near the widest levels of the past six years.

Rates

The Long Way Home

Portfolio allocation as of 9.30.2019



Connie Fischer
Senior Managing Director

Kris Dorr
Managing Director

Tad Nygren, CFA
Managing Director

Opportunity knocks as Fed rate cuts are likely to be followed by a steepening yield curve.

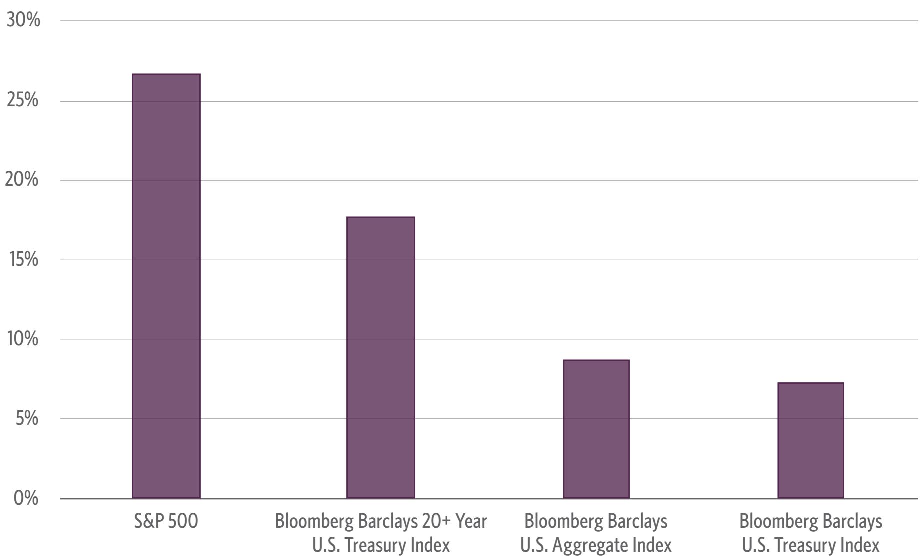
The third quarter brought a fair amount of uncertainty and volatility to global markets, primarily driven by trade tensions, political developments, and mixed signals for global growth. The Fed acknowledged the emerging risks of a more pronounced global slowdown and over the course of several months lowered the federal funds target range from 2.25–2.50 percent to 1.50–1.75 percent. Also in the third quarter, economic activity and trade wars were briefly overshadowed by funding market dislocations, which highlighted the reduced supply of short-term liquidity brought on by the decline in excess reserves, corporate tax day, and increasing Treasury financing needs. The magnitude of the market dislocation seemed to catch the Fed by surprise and led to the quick implementation of ongoing overnight and term repo operations to calm markets. These operations are ongoing. The Fed also began purchasing Treasury bills at a pace of $60 billion per month to increase the supply of reserves. This will continue into the second quarter of 2020.

Markets witnessed a significant bull flattening of the Treasury curve in 2019 and a shift lower in yields by 80–90 basis points across the curve. These moves made the Treasury market performance look almost equity-like, with the 20+ year Treasury index producing 17.6 percent total return year to date (see chart, top right). At an earlier point in the year, the long-dated Treasury index was up over 20 percent. In comparison, the Agency market delivered a total return of 7.3 percent year to date given its shorter duration profile.

In contrast to 2019, 2020 is more likely to see the Treasury yield curve bear steepen as markets price in the Fed's successful mid-cycle adjustment (see chart, bottom right). This also suggests that the equity-like performance is unlikely to repeat in 2020. Nevertheless, market volatility will create value in longer lockout callable Agency debt and fixed-rate bullet Agency bonds.

Note: "Rates" products refer to Treasury securities and Agency debt securities. Treasury and Agency returns are represented by the Bloomberg Barclays Treasurys index and the Bloomberg Barclays U.S. Agency index, respectively.

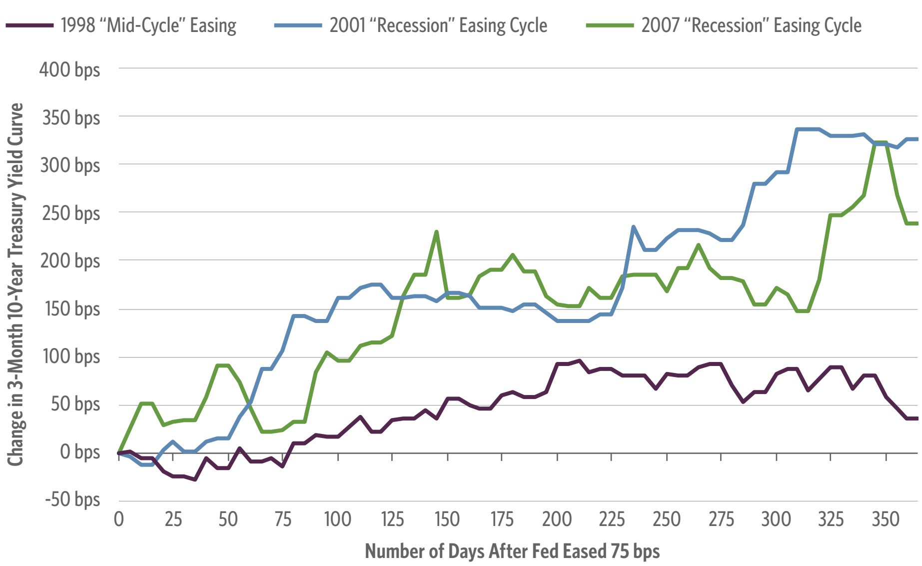
20-Year Treasurys Delivered Equity-Like Returns Year to Date



Source: Guggenheim Investments, Bloomberg. Data as of 12.6.2019.

The 20+ year Treasury market has delivered equity-like total returns of 20.2 percent year to date.

Mid-Cycle Easing or Recession Easing Cycle Have Both Led to Steeper Yield Curve



Source: Guggenheim Investments, Bloomberg. Data as of 10.29.2019.

We believe the yield curve is likely to bear steepen further as markets price in a successful mid-cycle adjustment by the Fed.

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1. Guggenheim Investments assets under management are as of 9.30.2019. The assets include leverage of $11.8bn 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 Investment Advisors, LLC, Guggenheim Funds Distributors, LLC, GS GAMMA Advisors, LLC, Guggenheim Partners Europe Limited, and Guggenheim Partners India Management.

2. Guggenheim Partners assets under management are as of 9.30.2019 and include consulting services for clients whose assets are valued at approximately $67bn.

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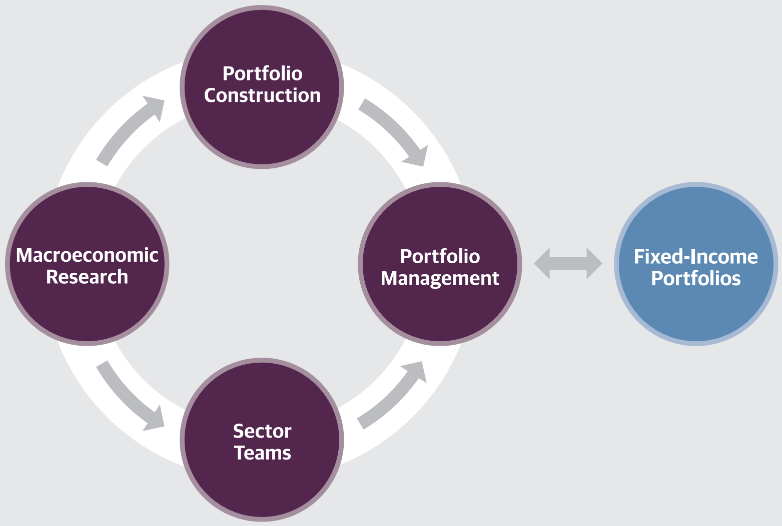

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Guggenheim Investments is the global asset management and investment advisory division of Guggenheim Partners, with more than $213 billion[1] in total assets across fixed income, equity, and alternative strategies. We focus on the return and risk needs of insurance companies, corporate and public pension funds, sovereign wealth funds, endowments and foundations, consultants, wealth managers, and high-net-worth investors. Our 295+ 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.

About Guggenheim Partners

Guggenheim Partners is a global investment and advisory firm with more than $275 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 worldwide, 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.

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