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Don't Let Policy Volatility Overshadow Market Opportunity

Commentary by Anne Walsh, CIO for Guggenheim Partners Investment Management

The year has begun favorably enough, with bonds enjoying positive returns and equity valuations still high despite recent declines, but as we move deeper into 2025 it's clear we're sailing into uncharted waters. The return of President Trump to the White House has injected a jolt of volatility into not just the markets but the global geopolitical/economic landscape. His unpredictable approach to foreign and trade policy, coupled with an aggressive domestic agenda on immigration, taxes, deregulation, and cost-cutting, has created an environment of policy uncertainty. And let's not forget that the Federal Reserve (Fed) is keeping the market in suspense about its next monetary policy move pending more clarity on the inflation front. Frankly, in my decades in this business, I've rarely seen such a confluence of political and policy uncertainty dominate the investment landscape.

We should brace ourselves for continued volatility as these policies evolve and get implemented. The issue is that with so many policy changes taking place all at once it is hard to predict whether the end result will be stagnation or inflation. The shift in inflation expectations driven by potential tariffs is a key area to watch. In isolation, tariffs are inflationary—or at least that is the conventional wisdom. Tariffs can significantly reshape supply chains, manufacturing, and consumption patterns, and these concerns are already being captured in consumer sentiment. The big questions revolve around the scope of these tariffs, their geographic and industry focus, and their final outcome. Which of the threatened tariffs will be carried out and which are simply negotiating salvoes?

The same questions about execution can be asked about deregulation, cost-cutting, and immigration. The Department of Government Efficiency (DOGE) has grand ambitions for cost-cutting—and I have no doubt that there is significant waste and fraud waiting to be uncovered—but we can already see fights with Congress and court battles looming over many of DOGE's more aggressive moves. Similarly, it is a challenge to quantify the impact of the administration's immigration policy goals—which include significant border restrictions and mass deportation—on our national workforce, adding another reason for overall market unease.

This game of badminton between politics and policy, reflecting the tension around the administration's ambitions and the realities of Congressional negotiation, will likely send rates and equity markets rising and falling with every news cycle. In the middle of all this market noise, however, it's crucial to remain focused on the long-term signals that truly matter. And those signals are pointing in a positive direction.

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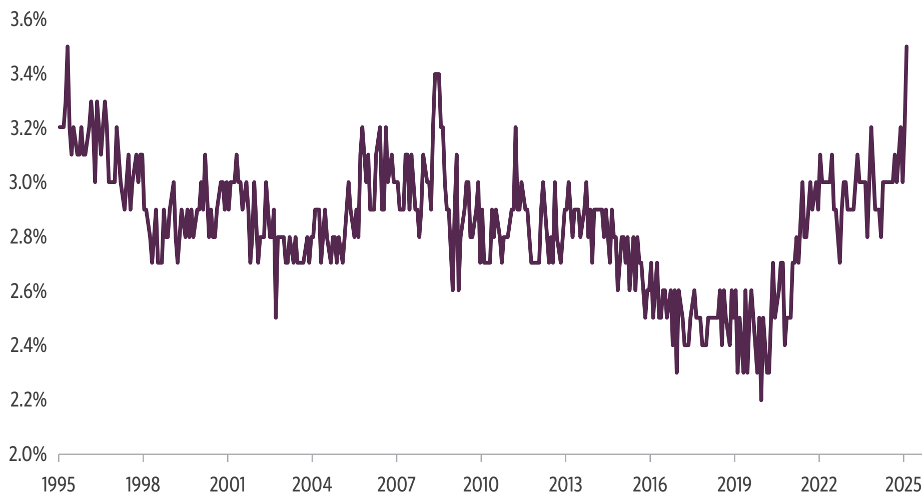
Inflation Expectations Reach Multi-Decade High

University of Michigan Consumer Sentiment Survey: Median Expected Change in Prices During Next 5-10 Years



Source: Guggenheim Investments, Bloomberg, University of Michigan. Data as of 2.28.2025.

First and foremost, inflation, while still stubbornly hovering above the Fed's 2 percent target, has been declining for almost two years, and while recent progress has slowed the overall trend appears to be intact. Some worry about the potential inflationary impact of immigration restrictions on sectors like construction and agriculture, but lower immigration reduces both aggregate supply and aggregate demand, creating ambiguous effects on wages. And tariff announcements can get delayed or changed before they are enforced, or rescinded after they are put in place.

Second, solid economic performance has strengthened credit quality for most issuers. While credit spreads are tight, adjusting them for relative strength in key metrics like leverage and interest coverage shows they are justifiable and could even tighten further. In addition, comparatively higher yields in the U.S. should sustain strong demand across sectors. Investment Grade Corporates are yielding north of 5 percent, Investment Grade ABS can be found with yields over 6 percent, high yield bond yields currently exceed 7 percent, and yields on U.S. leveraged loans surpass 9 percent. We anticipate the 10-year Treasury yield to trade within a range of 3.5% to 4.75%, and any movement above 4.5%, particularly towards 5%, would signal a buying opportunity. Both model estimates and the Fed's own commentary suggests monetary policy is still moderately restrictive, with continued pockets of vulnerability in the economy. That alone should lead to one to two rate cuts by the end of 2025, provided inflation expectations stay under control.

The U.S. economy entered 2025 with good momentum, and we have a relatively positive outlook, but it is only prudent to consider how our outlook could go wrong. Several scenarios could disrupt the current trajectory. First, there is a risk that a modest inflation uptick could loosen the anchor on inflation expectations, creating a

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cycle of rising prices and interest rates that would negatively impact growth and asset values. Second, an escalating trade war, particularly with China, could lead to trade partner retaliation, disrupt supply chains, and hurt U.S. exporters, leading to wider credit spreads and equity market declines. Third, the current optimism surrounding AI's productivity enhancements could unwind if reality falls short of expectations. The equity market is highly concentrated in mega-cap tech names reliant on AI to sustain high valuations, and the DeepSeek episode, while short-lived, echoed the tech bubble burst that brought down markets and the broader economy. Finally, a scenario where the Trump administration successfully implements its agenda could lead to sustained growth and lower inflation in the long run but create pain in the short run from deep spending cuts which reduce fiscal spending and economic stimulus and tight immigration policy shrinking the labor force. If anything, our concern is that downside risks from these policy actions, resulting in lower GDP growth, have increased. While we don't anticipate these outcomes in our base case, we remain vigilant and prepared to adjust our strategy as needed.

While President Trump's policy agenda will undoubtedly make a lot of noise that drives volatility, investors would be wise to focus on the signal provided by a solid U.S. economy, favorable disinflationary trends, and strong credit fundamentals. With moderating inflation, anticipated Fed rate cuts, and attractive yields, now is an opportune time for active fixed-income managers to potentially capitalize on these conditions. We like Investment Grade Corporate and Structured Credit—particularly asset-backed securities (ABS) backed by data centers and their supporting infrastructure—and real assets that will continue to offer income and potential for value appreciation. With so much policy uncertainty, however, we are maintaining a prudent allocation to defensive, higher-quality positions that can provide liquidity should market volatility escalate further.

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