"ZERO"ING IN ON A RATE-HEDGED SOLUTION

Kevin Flanagan – Head of Fixed Income Strategy
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Can Treasury (UST) yields rise even if the Federal Reserve (Fed) doesn't raise rates or taper their quantitative easing (QE) program? The 2021 experience has shown investors that they certainly can. Thus far in Q1, this is exactly what has happened, as essentially the entire spectrum of the Treasury coupon curve (notes and bonds) has done just that. In fact, other than t-bills, the only other maturity that has managed to "escape" this rising rate fate—for now—has been the UST 2-Year note. Moreover, even 10- and 30-year TIPS yields have increased this year.

So how does a fixed income investor position their portfolio for rising rates? One potential solution is the WisdomTree Interest Rate Hedged U.S. Aggregate Bond Fund (AGZD). This strategy takes the Bloomberg Barclays U.S. Aggregate Bond Index, the Agg, and overlays a short position in Treasury futures to target a duration of zero years. Thus, the investor is provided with a "long" portfolio that is representative of the Agg, but without the duration of 6.4 years. In addition, this approach also offers a more diversified underlying basket of investment-grade asset classes, such as Treasuries, mortgage-backed securities, corporate bonds and agency securities, as compared to other rate-hedged options such as traditional floating rate notes, which are typically limited more to corporates with a concentration in the financial sector.

Total NAV Return of AGZD vs. Agg Index During Recent Rising Rate Periods			
Fund Name	Ticker	7/8/16 - 11/8/18	8/4/20 -3/25/21
WisdomTree Interest Rate Hedged U.S. Aggregate Bond Fund	AGZD	5.25%	0.66%
Bloomberg Barclays U.S. Aggregate Index	LBUSTRUU	-2.47%	-3.46%
	+/-	7.72%	4.12%
Interest Rate Move in the U.S. 10-Year Treasury Yield		188 bps	112 bps

Source: WisdomTree as of 3/25/2021. You cannot invest directly in an index. Data represents Past performance and is not indicative of future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

For month-end and standardized performance click here.

The above table offers a snapshot of how AGZD has fared versus the benchmark during the two most recent noteworthy rising rate periods for the UST 10-Year yield (the 2021 instance included). In each case, the UST 10-Year yield rose in excess of 100 basis points (bps). As you can see, AGZD registered positive readings while the Agg was producing rather visible negative performances, which resulted in total return differentials of +7.72% for the 2016–2018 period and +4.12% thus far in 2021.

Why Now

Some readers may ask the question: Why should I rate hedge now after Treasury yields have risen so much? In our opinion, the run-up in rates is not over. At the March FOMC meeting, the Fed's median economic projections revealed a setting where inflation is going to be either at or above the policymakers' 2% target, while the unemployment rate is expected to drop to 4.5% this year, 3.9% in 2022 and 3.5% in 2023. However, the Fed's consensus forecast doesn't look for a rate hike at all during this timeframe.

It is it any wonder why inflation expectations are at a decade high in some cases? In other words, the Treasury market may very well be thinking the Fed will fall behind the "inflation curve." That is the risk of a "pedal to the metal" monetary policy, which, quite frankly, the markets are not accustomed to. Our base case sees the UST 10-Year yield rising back up toward the 2% threshold this year, with a possible overshoot. Against this backdrop, we continue to advocate positioning your fixed income portfolio for a potential further rise in rates, especially viewing any rally in Treasuries as a second opportunity to do so.

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DEFINITIONS

Treasury yield : The return on investment, expressed as a percentage, on the debt obligations of the U.S. government.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Quantitative Easing (QE) : A government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.

Coupon : The annual interest rate stated on a bond when it's issued. The coupon is typically paid semiannually. This is also referred to as the “coupon rate” or “coupon percent rate.&rdquo.

Bloomberg U.S. Aggregate Bond Index : Represents the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, as well as mortgage and asset backed securities.

Duration : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

Long (or Long Position) : The buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value, the opposite of Short (or Short Position).

Diversification : A risk management strategy that mixes a wide variety of investments within a portfolio.

Mortgage-backed securities : Fixed income securities that are composed of multiple underlying mortgages.

Hedge : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

Floating Rate Treasury Note : a debt instrument issued by the U.S. government whose coupon payments are linked to the 13-week Treasury bill auction rate.

Basis point : 1/100th of 1 percent.

Inflation : Characterized by rising price levels.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.