

AN UPDATE ON FIXED INCOME MARKET OUTLOOK AND POSITIONING WITHIN OUR STRATEGIC MODEL PORTFOLIOS

Andrew Okrongly — Director, Model Portfolios
03/16/2023

This article is relevant to financial professionals considering offering Model Portfolios to their clients. If you are an individual investor interested in WisdomTree ETF Model Portfolios, please inquire with your financial professional. Not all financial professionals have access to these Model Portfolios.

Looking only at year-to-date returns across the U.S. [fixed income](#) market, particularly when compared to last year's historical rout, you might conclude that 2023 is off to an uneventful start.

Fixed Income Sector Returns: 2023 YTD and 2022 Calendar Year

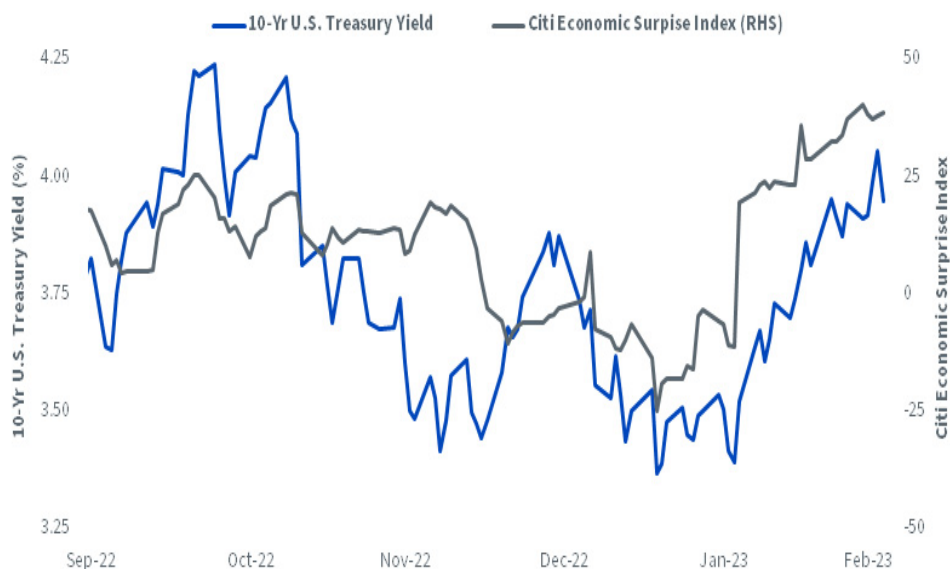
Fixed Income Sectors	2023 YTD Return As of March 3, 2023	2022 Return
U.S. Aggregate	0.28%	-13.01%
Intermediate Treasury	-0.42%	-7.77%
Long Treasury	1.55%	-29.26%
Government Related	0.40%	-11.09%
Corporate	0.91%	-15.76%
Securitized	0.21%	-11.67%
U.S. Corporate High Yield	2.79%	-12.71%
U.S. Treasury Floating Rate	0.89%	2.07%
U.S. TIPS	1.15%	-11.85%
Global Aggregate	-0.35%	-16.25%

You cannot invest directly in an index. Past performance is not indicative of future returns.

But fixed income markets have been anything but dull this year.

Throughout January, it seemed obvious to most market participants that the U.S. was entering a highly anticipated [recession](#) and [inflation](#) would cool accordingly. The yield on 10-Year U.S. Treasuries fell approximately 50 [basis points](#) in the first several weeks of the year before a string of hot economic and inflation data releases [completely shifted the market narrative](#) and pushed [yields](#) back up to 4%.

10-Yr U.S. Treasury Yield, Citi Economic Surprise Index: October 2022–Present



Sources: Citigroup, FactSet, WisdomTree, as of 3/3/23. Past performance is not indicative of future returns.

Where do we go from here?

While we did make modest adjustments to fixed income allocations throughout 2022, the strategic outlook of the WisdomTree Model Portfolio Investment Committee (MPIC) has remained intact in 2023.

WisdomTree Model Portfolio Investment Committee—Fixed Income Market Outlook

At WisdomTree, we are focused on several key themes across fixed income markets that shape our outlook and drive the positioning within our Model Portfolios:

1. Equity risk premium is near long-term average

In the years following the [global financial crisis](#), interest rates near 0% meant investors received a healthy risk premium (earnings yield minus risk-free yield) for moving out of bonds into stocks. As higher interest rates have increased this risk-free yield, this expected premium on equity investments has clearly been reduced.

However, we do not agree with the view that today's equity risk premium is dangerously low.

Importantly, since corporate earnings and dividends have historically kept up with inflation, long-term inflation-indexed ([TIPS](#)) yields are the most relevant comparator for calculating the equity risk premium. Using this approach, [today's equity risk premium has come down, but only to a level that is in line with long-term historical averages](#).

2. There's income back in fixed income

While today's equity risk premium certainly looks reasonable, it is undeniable that [fixed income is back](#). With yields at levels a whole generation of investors have never seen, it is worth revisiting the role of bonds within a portfolio. Beyond the potential for [diversification](#) and [downside protection](#), fixed income can once again deliver meaningful returns and income.

This is true even in shorter-term maturities with little to no duration or credit risk. For example, [U.S. Treasury floating rate notes](#) have a one-week [duration](#) and are now one of the highest-yielding Treasury instruments available.

The [WisdomTree Floating Rate Treasury Fund \(USFR\)](#) provides our Model Portfolios with access to this market and can continue to play a valuable role in today's market environment.

3. Selectivity is key within corporate credit

While we are constructive on both [investment-grade](#) and [high-yield](#) corporate bonds, recession concerns clearly remain paramount for credit investors. To help mitigate the risk of [downgrades](#) and [defaults](#) weighing on potential returns, we utilize strategies such as the [WisdomTree U.S. High Yield Corporate Bond Fund \(WHFY\)](#), which focus on fundamentally sound corporate issues.

By incorporating a cash flow-based quality screen and tilting toward issues with attractive fundamental and income characteristics, WHFY [has been able to avoid a large majority of the defaults experienced by the broader high-yield market](#).

4. Interest rate volatility remains elevated

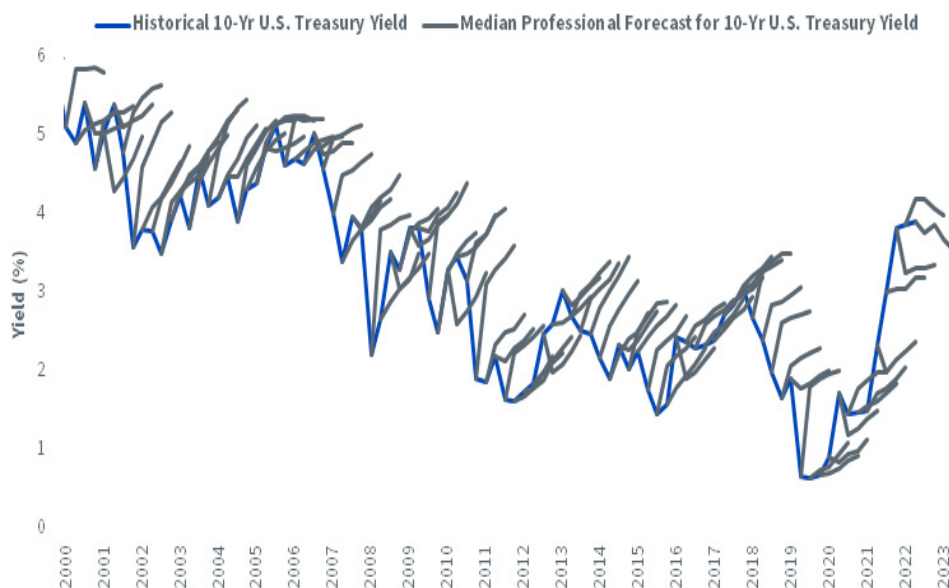
As 2023 has proven in just a couple months, the future is still very much uncertain for the U.S. economy, inflation and Fed policy.

As investors continue reacting to incoming economic data, we expect ongoing volatility in both short-term and longer-term interest rates.

We maintained a short/under-weight duration position throughout 2022 and into the current year. Although it is still our “base case” scenario that interest rates remain higher for longer, a recession-induced cooling of price pressures remains a reasonable scenario.

Given this outlook and the inherent difficulty of predicting shorter-term movements in interest rates (see chart below), we modestly lengthened duration, reducing the size of this under-weight position, as part of our quarterly rebalance last September.

10-Yr U.S. Treasury Yield: Historical vs. Median Professional Forecast



Sources: Federal Reserve Bank of Philadelphia Survey of Professional Forecasters, FactSet, WisdomTree, as of 3/3/23. Past performance is not indicative of future returns.

WisdomTree Model Portfolio Investment Committee—Fixed Income Positioning

Based on the MPIC's fixed income outlook, our positioning across strategic fixed income Model Portfolios is the following:

Equities vs. Bonds	<ul style="list-style-type: none"> + Neutral + Equity risk premium is reasonable; near long-term average
Duration	<ul style="list-style-type: none"> + Modestly short/under-weight + Would rather be late than early to the “duration party”
Over-weight	<ul style="list-style-type: none"> + Quality-screened investment-grade and high-yield credit + U.S. Treasury Floating Rate Notes
Under-weight	<ul style="list-style-type: none"> + Treasuries

Source: WisdomTree, as of March 2023.

As we recently highlighted, [positioning within our strategic fixed income strategy delivered positive relative performance in 2022](#).

While we have kept most of these key views intact into 2023, we are certainly not complacent. Our MPIC remains focused on both mitigating potential risks and capitalizing on attractive opportunities across today’s evolving fixed income market.

Financial advisors can learn more about the WisdomTree lineup of fixed income and multi-asset Model Portfolios by visiting our [Model Adoption Center](#).

Important Risks Related to this Article

For financial advisors: WisdomTree Model Portfolio information is designed to be used by financial advisors solely as an educational resource, along with other potential resources advisors may consider, in providing services to their end clients. WisdomTree’s Model Portfolios and related content are for information only and are not intended to provide, and should not be relied on for, tax, legal, accounting, investment or financial planning advice by WisdomTree, nor should any WisdomTree Model Portfolio information be considered or relied upon as investment advice or as a recommendation from WisdomTree, including regarding the use or suitability of any WisdomTree Model Portfolio, any particular security or any particular strategy.

For retail investors: WisdomTree’s Model Portfolios are not intended to constitute investment advice or investment recommendations from WisdomTree. Your investment advisor may or may not implement WisdomTree’s Model Portfolios in your account. The performance of your account may differ from the performance shown for a variety of reasons, including but not limited to: your investment advisor, and not WisdomTree, is responsible for implementing trades in the accounts; differences in market conditions; client-imposed investment restrictions; the timing of client investments and withdrawals; fees payable; and/or other factors. WisdomTree is not responsible for determining the suitability or appropriateness of a strategy based on WisdomTree’s Model Portfolios. WisdomTree does not have investment discretion and does not place trade orders for your account. This material has been created by WisdomTree, and the information included herein has not been verified by your investment advisor and may differ from information provided by your investment advisor. WisdomTree does not undertake to provide impartial investment advice or give advice in a fiduciary capacity. Further, WisdomTree receives revenue in the form of advisory fees for our exchange-traded Funds and management fees for our collective investment trusts.

For the top 10 holdings of USFR please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/fixed-income/usfr>

For the top 10 holdings of WFHY please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/fixed-income/wfhy>

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended

for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

Related Blogs

- + [The WisdomTree Portfolio Review, Part One: Strategic Models](#)
- + [Shelter From the Storm?](#)

Related Funds

- + [WisdomTree Yield Enhanced U.S. Aggregate Bond Fund](#)
- + [WisdomTree U.S. High Yield Corporate Bond Fund](#)
- + [WisdomTree Floating Rate Treasury Fund](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Fixed income : An investment security that provides a return in the form of fixed periodic payments and the eventual return of principal at maturity.

Recession : two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemployment.

Inflation : Characterized by rising price levels.

Basis point : 1/100th of 1 percent.

Yield : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

Equity risk premium : Refers to an excess return that investing in the stock market provides over a risk-free rate.

The Global Financial Crisis : Refers to the period of extreme stress in global financial markets and banking systems between mid 2007 and early 2009.

TIPS : Treasury Inflation Protected Securities.

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

Downside protection : A broad investment conception referring to the potential mitigation of risk or negative return experience.

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.

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.

Investment grade : An investment grade is a rating that signifies a municipal or corporate bond presents a relatively low risk of default.

High Yield : Sometimes referred to as "junk bonds," these securities have a higher risk of default than investment-grade securities.

Downgrade : Refers to a rating agency, such as Moody's or Standard & Poor's, lowering their rating of U.S. government debt.

Default : A failure to meet the legal obligations (or conditions) of a loan.