

“BREXIT”OLOGY: LESSONS FOR FIXED INCOME INVESTING

Kevin Flanagan — Head of Fixed Income Strategy
07/06/2016

Post-Brexit, volatility has been on heightened display, as investors try to discern where value lies in such an uncertain investment environment. Against this backdrop, and with a week’s worth of trading now over, we thought it would be prudent to review where things stand in the fixed income arena. The developed world sovereign debt markets have been the beneficiaries of safe-haven flows. Our June 28 blog post, “What’s ‘Nexit’ for the Bond Market?” discussed U.S. Treasury (UST) market trends, so let’s move the focus to the other side of the Atlantic. It is interesting to note that in the initial reaction to the vote, some peripheral 10-year yields, such as in Italy and Spain, actually rose a little more than 15 basis points (bps) before reversing course and rallying sharply, underscoring some of the difficulties investors are having in figuring out the appropriate response. Meanwhile, within the core eurozone, German 10-year bunds behaved as expected, as yield levels have continued their descent into negative territory. As for the actual Brexit home, the United Kingdom gilt market has also seen plummeting yield levels, with the 10-year falling 50 bps as of this writing. This drop in yields came about even in the wake of S&P’s decision to downgrade U.K. sovereign debt two notches, from AAA to AA, similar to the UST experience in August

	2011	Key	Fixed	Income	Gauges
	Pre-Brexit Vote	Post-Brexit Hi/Lo	1 Week Later		
2-Year U.S. Treasury Note	0.78%	0.58%	0.58%		
10-Year U.S. Treasury Note	1.75%	1.44%	1.47%		
10-Year German Bund	0.09%	-0.13%	-0.13%		
10-Year U.K. Gilt	1.37%	0.87%	0.87%		
Investment Grade Corporate Spread	148	159	156		
Investment Grade Corporate Yield	3.03%	2.88%	2.88%		
High Yield Corporate Spread	557	616	594		
High Yield Corporate Yield	7.09%	7.50%	7.27%		

Source: Bloomberg, as of 7/01/2016. Past performance is not indicative of future results. You cannot invest directly in an index.

“Investment-grade corporate spread/yield” refers to the [Barclays US Aggregate Corporate Bond Index](#) “High-yield corporate spread/yield” refers to the [Barclays U.S. Corporate High-Yield Index](#). Within the credit space, there were also some noteworthy movements. Based on spread action thus far, investors are not being presented with the same “risk-off” scenario that played out during the first six weeks of the year. At that time, corporate bond spreads widened out to four- and five-year high watermarks. However, at this point, we have actually seen investment-grade (IG) spreads rise by a relatively tepid 5 to 10 bps. In the high yield (HY) sector, the initial increase was almost 60 bps, before falling back to a little more than 35 bps as of this writing. To provide some perspective, from the end of 2015 to mid-February of this year, IG and HY spreads widened by 50 bps and 180 bps, respectively. Given the drop in UST rates, IG and HY corporate yields have remained anchored, with IG yields now below pre-Brexit levels. Expectations for the Federal Reserve (Fed) have been a bit all over the place. In the days immediately following the results, [Federal Funds Futures](#) implied that probability pointed toward a nearly 25% chance of a rate cut this year, but that figure has since dropped to under 5%. **Conclusion** From a fixed income perspective, Brexit has served as a powerful reminder that a portfolio of investment vehicles, rather than one based solely on trading near-term headlines, continues to represent our preferred strategy. The WisdomTree approach brings a holistic strategy to fixed income investing, emphasizing the importance of [balance sheet](#) considerations. In other words, our focus highlights credit quality rather than trying to take advantage of shorter-term trends within the bond market that can easily reverse and catch investors in an adverse position. With [interest rates](#) expected to remain in a low, range-bound pattern and credit concerns (downgrades & defaults) still prevalent, fixed income investors will likely be searching for solutions that provide relative income opportunities in an environment where increased credit quality is desired. WisdomTree fixed income [fundamentally](#)

based strategies ([WisdomTree Fundamental U.S. Corporate Bond Fund \[WFIG\]](#), [WisdomTree Fundamental U.S. Short-Term Corporate Bond Fund \[SFIG\]](#), [WisdomTree Fundamental U.S. High Yield Corporate Bond Fund \[WFHY\]](#) and [WisdomTree Fundamental U.S. Short-Term High Yield Corporate Bond Fund \[SFHY\]](#)) emphasize such a qualitative approach, with a tilt toward income. The WisdomTree fundamental fixed income Funds can be used as either a substitute or a complement within a fixed income portfolio and fit inside WisdomTree's suite of fixed income products, potentially serving as the allocation to U.S.-based fixed income, specifically within the credit sector.

Important Risks Related to this Article

Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. Fixed income investments are also subject to credit risk, the risk that the issuer of a bond will fail to pay interest and principal in a timely manner or that negative perceptions of the issuer's ability to make such payments will cause the price of that bond to decline.

High-yield or "junk" bonds have lower credit ratings and involve a greater risk to principal.

While the Funds attempt to limit credit and counterparty exposure, the value of an investment in the Funds may change quickly and without warning in response to issuer or counterparty defaults and changes in the credit ratings of each Fund's portfolio investments. Please read each Fund's prospectus for specific details regarding each Fund's risk profile.

For more investing insights, check out our [Economic & Market Outlook](#)

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, Kara Marciscano, 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

Brexit : an abbreviation of "British exit" that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Union.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

Sovereign Debt : Bonds issued by a national government in a foreign currency, in order to finance the issuing country's growth.

Safe-haven : Characterized by being a potentially desirable focal point of investment flows during periods of increased volatility and market risk. Safe-haven is not synonymous with risk-free.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

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.

Basis point : 1/100th of 1 percent.

Eurozone (EZ) : Consists of the following 18 countries that have adopted the euro as their currency: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain (source: European Central Bank, 2014).

German 10-year bund : a debt instrument issued by the German government with an original maturity of 10 years.

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

AAA credit rating : This is the highest issuer credit rating assigned by Standard & Poor's, signaling strong confidence that the issuer will be able to maintain its payment obligations.

Barclays U.S. Corporate Index : is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by U.S. and non-U.S. industrial, utility, and financial issuers that meet specified maturity, liquidity, and quality requirements.

Barclays U.S. Corporate High Yield Index : Covers the universe of fixed-rate, non-investment-grade corporate debt.

Credit : A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future.

Spread : Typically refers to a difference between a measure of yield for one asset class and a measure of yield for either a different subset of that asset class or a different asset class entirely.

Corporate Bonds : a debt security issued by a corporation.

Investment Grade : A rating given to a municipal or corporate bond. It is a relatively favorable rating by either Moody's or Standard & Poor's indicating a higher chance an issuer performs interest and principal obligations as promised by the terms of the debt issuance.

Fed Fund Futures : A financial instrument that let's market participants determine the future value of the Federal Funds Rate.

Balance sheet : refers to the cash and cash equivalents part of the Current Assets on a firm's balance sheet and cash available for purchasing new position.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Fundamentals : Attributes related to a company's actual operations and production as opposed to changes in share price.