

# ALIGNING THE STARS IN FIXED INCOME

Kevin Flanagan — Head of Fixed Income Strategy

07/21/2021

Anyone looking for a fresh perspective from [Federal Reserve \(Fed\)](#) Chairman Jerome Powell last week was sorely disappointed. During his semiannual monetary policy testimony to Congress, Powell essentially reiterated his stance that, yes, the economy is in a solid recovery, but no, the recent spike in [inflation](#) is only “transitory.” Sound familiar? Thought so. In fact, he went so far as to say that the bar for a potential exit strategy, “substantial further progress,” was still a ways off.

So, where does that leave fixed income investors? I find myself returning to this question rather frequently in various discussions. Despite Chair Powell’s unchanged stance, I continue to focus on two overarching themes for the second half of this year and into 2022: keeping [duration](#) short and credit over rates. Against this backdrop, I thought it would be a good exercise to highlight how investors can put these two themes to work.

First up, on the short duration theme, investors may wish to consider the [WisdomTree Yield Enhanced U.S. Short-Term Aggregate Bond Fund \(SHAG\)](#). This vehicle is the short duration version of our core fixed income flagship [WisdomTree Yield Enhanced U.S. Aggregate Bond Fund \(AGGY\)](#), which we have written about many times.

Following the same strategy as AGGY, SHAG reweights the sectors of the one- to five-year segment of the Short Agg Composite while adhering to two main guardrails: the weight of major and minor sectors cannot deviate by more than 30% from their weights in the Short Agg Composite and duration generally will not be more than half a year of this benchmark.

This approach not only focuses on mitigating interest rate risk, but it seeks to boost [yield](#). In addition, SHAG carries a five-star rating from Morningstar<sup>1</sup>.

For the second theme, I’d like to highlight the [WisdomTree U.S. High Yield Corporate Bond Fund \(WFHY\)](#). Investing in [high yield](#) can carry the potential for an elevated risk profile compared with the investment-grade sector. The approach behind WFHY is to screen for quality to potentially mitigate the possibility of future default risk. This strategy focuses on only public issuers domiciled in the U.S. and eliminates those with a negative cash flow. We then reweight this remaining universe to tilt weights toward bonds with more favorable income characteristics.

From an investment perspective, WFHY can serve as a quality screened income sleeve in a core-plus bond portfolio. Also, WFHY has a four-star Morningstar rating, with five stars over the last three-year period<sup>2</sup>.

## Conclusion

With the challenges impacting the current fixed income setting, investors have faced some difficult choices. In my opinion, SHAG and WFHY could help investors navigate the uncharted policy waters that may lie ahead.

<sup>1</sup>Based on risk adjusted returns as of 6/30/2021 out of 524 funds for the Short-Term Bond fund category for the 3 year period.

<sup>2</sup>Based on risk adjusted returns as of 6/30/2021 out of 634 and 556 funds for the High Yield Bond funds category for the 3 and 5 year periods, respectively.

## Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. 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. Investing in mortgage- and asset-backed securities involves interest rate, credit, valuation, extension and liquidity risks and the risk that payments on the underlying assets are delayed, prepaid, subordinated or defaulted on. Due to the investment

strategy of the Fund, it may make higher capital gain distributions than other ETFs. High-yield or “junk” bonds have lower credit ratings and involve a greater risk to principal. 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. While the Fund attempts to limit credit and counterparty exposure, the value of an investment in the Fund may change quickly and without warning in response to issuer or counterparty defaults and changes in the credit ratings of the Fund’s portfolio investments.

Please read each Fund’s prospectus for specific details regarding the Fund’s risk profile.

Morningstar, Inc., 2021. All rights reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance, rankings and ratings are no guarantee of future results. The % of Peer Group Beaten is the fund’s total-return percentile rank compared to all funds within the same Morningstar Category and is subject to change each month. Regarding ranking of funds, 1 = Best.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating™ metric each month by subtracting the return on a 90-day U.S. Treasury Bill from the Fund’s load-adjusted return for the same period and then adjusting this excess return for risk. Five stars are assigned to the top 10%, four stars to the next 22.5%, three stars to the next 35%, two stars to the next 22.5% and one star to the bottom 10%. The Overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its three-, five- and 10-year (if applicable) Morningstar Rating metrics. The WisdomTree Yield Enhanced U.S. Short-Term Aggregate Bond Fund was rated against the following numbers of U.S.-domiciled short-term bond funds over the following periods: 524 funds in the last three years. With respect to these short-term bond funds, the WisdomTree Yield Enhanced U.S. Short-Term Aggregate Bond Fund received a Morningstar Rating of five stars the three periods. Past performance is no guarantee of future results.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating metric each month by subtracting the return on a 90-day U.S. Treasury Bill from the Fund’s load-adjusted return for the same period and then adjusting this excess return for risk. Five stars are assigned to the top 10%, four stars to the next 22.5%, three stars to the next 35%, two stars to the next 22.5% and one star to the bottom 10%. The Overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its three-, five- and 10-year (if applicable) Morningstar Rating metrics. The WisdomTree U.S. High Yield Corporate Bond Fund was rated against the following numbers of U.S.-domiciled high-yield bond funds over the following periods: 634 funds in the last three years and 556 funds in the last five years. With respect to these high-yield bond funds, The WisdomTree U.S. High Yield Corporate Bond Fund received a Morningstar Rating of five stars and four stars for the three- and five-year periods, respectively. Past performance is no guarantee of future results.

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

- + [What’s Behind the Drop in the Treasury 10-Year Yield?](#)
- + [Could Liftoff Be Pushed Up Again?](#)
- + [Fed Watch: “Blues Clues”](#)

#### Related Funds

- + [WisdomTree Yield Enhanced U.S. Aggregate Bond Fund](#)
- + [WisdomTree Yield Enhanced U.S. Short-Term Aggregate Bond Fund](#)
- + [WisdomTree U.S. High Yield Corporate Bond 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](http://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, Brian Manby and Scott Welch 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**

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

**Inflation** : Characterized by rising price levels.

**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.

**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.

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