ROBUST DEMAND CONTINUES FOR FLOATING RATE TREASURY DEBT

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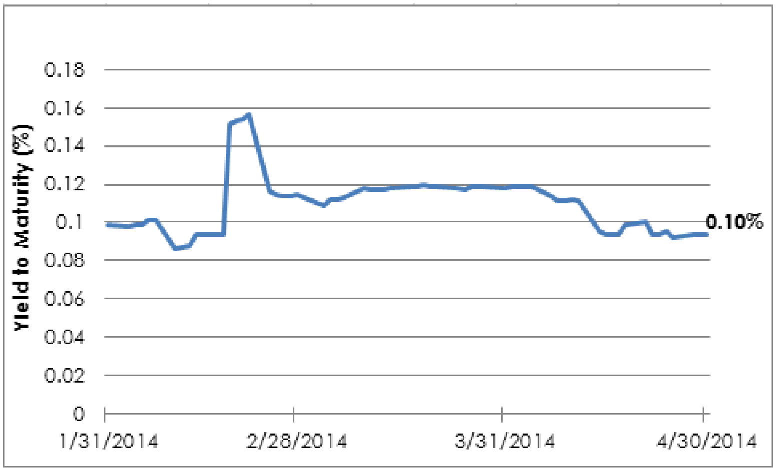
After first issuing $15 billion in two-year floating rate Treasury notes (floaters) on January 29, 2014, the United States Treasury has continued to see strong demand in each subsequent $13 billion reopening. In the current market environment, money market investors continue to be strong adopters of floating rate securities backed by the full faith and credit of the U.S. government. In an update to the evolution of this market, the Treasury auctioned its second new issue on April 29, 2014. Now, with two floating rate securities outstanding, I thought investors would be interested to hear what I believe will be next for the market and why it may make sense for certain investors to increase allocations to this new sector of the fixed income market. **Market Cap and Demand Growing Nicely** When the newly issued security settled on April 30, the market capitalization for floating rate Treasuries had grown to more than $56 billion outstanding in four months[1]. While this amount represents only a small fraction of U.S. government debt, the $750 billion market for Treasury Inflation-Protected Securities had only $15 billion of debt outstanding after the first four months of issuance. That said, I continue to believe that floaters represent an important way for the Treasury to increase the overall maturity profile of its debt, while addressing the drop in money market issuance and investor concerns about rising short-term interest rates in the U.S. For these reasons, WisdomTree was one of the first exchange-traded fund (ETF) sponsors to launch a product, USFR, that invests exclusively in these securities. Although asset levels (and yields) remain low, I believe these securities could make a great deal of sense in investor portfolios once interest rates begin to rise. **Grading the Most Recent Auction** At the April 29 auction, the $15 billion in freshly offered securities drew in bids that were 4.64 times the amount up for auction[2]. Put another way, the Treasury received bids for approximately $69.6 billion in securities for a $15 billion supply. This bid-to-cover ratio of 4.64x approached similar interest for the Treasury bill auction on the same day and was much higher than the ratios seen for recent Treasury auctions of fixed-rate coupon bonds. While completely adequate, the Treasury has seen the bid-to-cover ratio of only 2.95x for the $701 billion in fixed coupon debt issued so far in 2014. If I were to assign a letter grade to the most recent floating rate Treasury auction, it would be a “B” because of the strong investor interest implied by the bid-to-cover. Talking briefly about the freshly issued security’s characteristics, the high-discount margin at the auction was 0.069%. This implies that for the life of this two-year note, this security will be priced based on this margin above the most recently auctioned three-month Treasury bill. By way of review, we discussed briefly the mechanics of these securities in a previous blog post. **U.S. Floating Rate Treasury Note**



Yield to maturity: The single discount rate that equates the present value of a bond's cash flows to its market price. Also referred to as the internal rate of return of a bond. Source: Bloomberg, as of 4/30/14. Period limited due to issuance history of floating rate Treasury notes. Past performance is not indicative of future results.

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Catalysts for Investment In my view, floating rate Treasuries make sense in the current market environment for investors looking for a cash-like alternative with very little interest rate risk and virtually zero credit risk. Given that short-term interest rates are at all-time lows and the Federal Reserve (Fed) has stated that it could be at least a year before it begins hiking rates, it may not make sense for investors to devote a large portion of their portfolios to these securities. However, this will not always be the case. I believe that once the market has fully digested tapering and starts to focus on the timing of the first round of interest rate hikes by the Fed, the value of these securities will begin to show their worth compared to money market securities and other longer-term fixed income securities. Given the weekly reset, the floaters should adjust more quickly than Treasury bills and will likely be spared the potential losses experienced by two-year Treasury notes as the market adjusts to future hikes in the federal funds rate. [1]Source: U.S. Department of the Treasury [2]Source: Bloomberg

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Securities with floating rates can be less sensitive to interest rate changes than securities with fixed interest rates, but they may decline in value. The issuance of floating rate notes by the U.S. Treasury is new and the supply will be limited. Fixed income securities will normally decline in value as interest rates rise. 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. Due to the investment strategy of this Fund, it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

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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.

Floating Rate Security : A debt instrument with a variable interest rate usually tied to a benchmark rate such as the US Treasury Bill Rate or the London Interbank Offered Rate.

Market Capitalization : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Treasury Inflation-Protected Securities (TIPS) : Bonds issued by the U.S. government. TIPS provide protection against inflation. The principal of a TIPS increases with inflation and decreases with deflation, as measured by the Consumer Price Index. When a TIPS matures, you are paid the adjusted principal or original principal, whichever is greater.

Maturity : The amount of time until a loan is repai.

Money Market : a market for highly-liquid assets generally maturing in one year or les.

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

Bid-to-cover ratio : the amount of bids received divided by the amount of bids accepted at a U.S. Treasury auctio.

Fixed rate coupon bonds : debt securities maturing in more than one year which pay a fixed rate of interes.

High-Discount Margin : the additional compensation over the reference rate that investors demand for holding a floating rate securit.

Interest rate risk : The risk that an investment's value will decline due to an increase in interest rates.

Tapering : A shift in monetary policy by which the Federal Reserve would begin decreasing the amount of bonds it purchases.

Treasury notes : A debt obligation issued by the United States government that matures in less than 30 year.

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the "policy rate" of the U.S. Federal Reserve.