

# FLOATING TO THE TOP OF MORNINGSTAR PERFORMANCE PEER GROUPS

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As expected, the Federal Open Market Committee (FOMC) raised rates for the second time in 2018 during its June meeting, continuing down the path of rate stabilization. Given its transparent indications to have [sustained rate hikes for the following quarters and years ahead](#), investors should consider how they can best protect their portfolios from interest rate risk, if they haven't already done so. In many instances, investors have sought the protection of [short maturity](#) or [money market funds](#). In fact, nearly \$11.3 billion has flowed into short Treasury funds year-to-date. While this trade has generally outperformed longer maturity fixed income as rates rose, it's possible they may be leaving returns on the table. Below, we see how the [WisdomTree Floating Rate Treasury Fund \(USFR\)](#) has compared to both [active](#) and [passive](#) approaches in short maturity fixed income strategies.

## FRNs 101

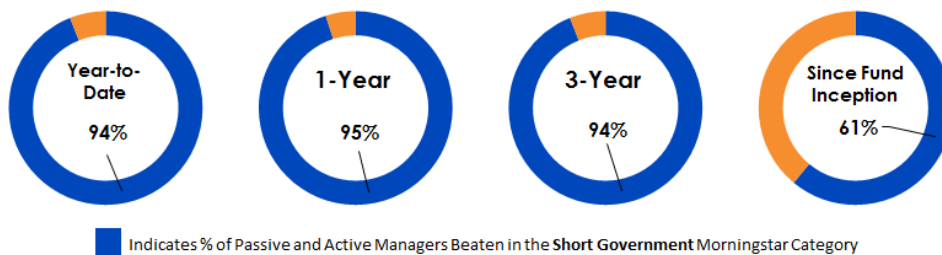
[Floating rate notes \(FRNs\)](#) were first issued in January 2014. Given that they are issued by the U.S. government, they have great [liquidity](#) and virtually no [credit risk](#). Instead of paying a fixed rate of interest like other securities, FRN coupon payments are based on a reference rate to 90-day [t-bills](#), which are auctioned every week.

The benefits of FRNs are twofold. By resetting weekly, FRNs' effective [duration](#) is one week. Given that these securities are assumed to be free of default risk, the value of them is then solely determined by the interest rate at each weekly auction. As 90-day t-bills are among the most sensitive to interest rate changes conducted by the FOMC, this provides an opportunity to boost income as the Fed hikes rates.

## WisomTree Floating Rate Treasury Fund

Year-to-date, USFR has seen inflows of over \$150 million. This Fund has become a very popular solution for those looking for a cost effective (.15% annual expense ratio) way to access these newly issued FRNs. In fact, on a percentile basis, USFR has been the [fastest-growing exchange-traded fund for 2018](#). When comparing USFR with its Morningstar peer group (the [Morningstar Short Government Category](#)), this fairly straightforward approach based on total return has been able to beat more than 94% of active and passive managers over the last three years.

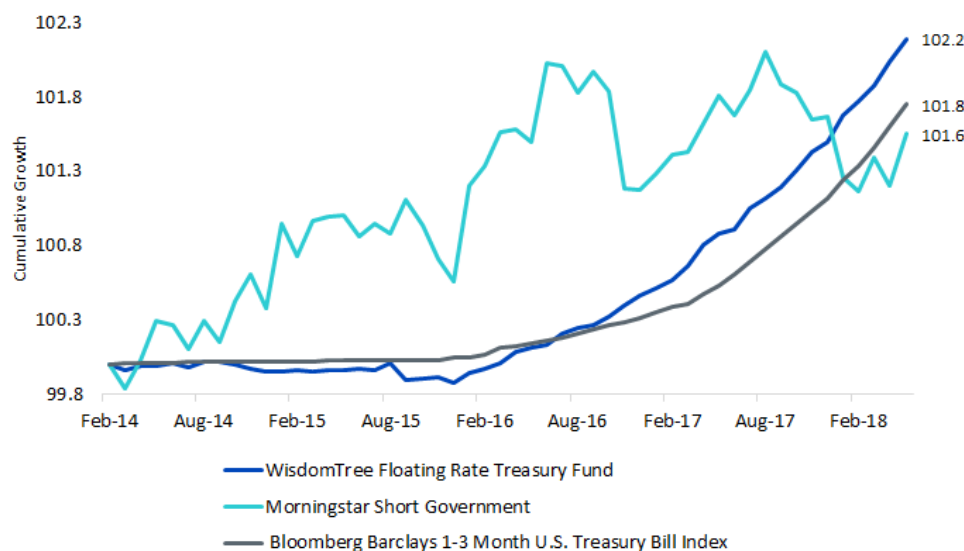
**Figure 1<sup>1</sup>: USFR Fund Performance Relative to Morningstar Short Government Peer Group**



Source: Morningstar, as of 5/31/18. Past performance is not indicative of future results. © 2018 Morningstar, Inc. 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 with all funds within the same Morningstar Category and is subject to change each month. Regarding ranking of funds, 1 = Best.

Since the Fund's inception on February 4, 2014, the strategy has also outperformed 61% of all managers. As seen in figure 2, during the very early months of USFR's lifespan, yields were at all-time lows, paying next to nothing. After the Fed began to raise rates in late December 2015, we began to see continued outperformance of the strategy over the Short Government Category and a benchmark of 1- to 3- month t-bills.

**Figure 2: USFR Cumulative Fund Performance Relative to Morningstar Peer Group and 1- to 3-Month T-Bills**



Sources: WisdomTree, Zephyr StyleADVISOR, Bloomberg, as of 5/31/18. Past performance is not indicative of future results. You cannot invest directly in an index

Finally, while the performance story has shown to be favorable, USFR was able to achieve these superior results with lower volatility. Again, we believe that as long as investors expect more rate hikes from the Fed, it makes sense to allocate short maturity assets in floating rate notes.

**Figure 3: Performance, Volatility, and Sharpe of USFR, Morningstar Peer Group & 1- to 3-Month T-Bills**

	Annualized Total Returns (%) as of 5/31/18			
	YTD*	1-Year	3-Year	Since Common Inception (2/28/14)
<b>WisdomTree Floating Rate Treasury Fund (USFR)</b>	<b>0.68%</b>	<b>1.29%</b>	<b>0.74%</b>	<b>0.51%</b>
Morningstar U.S. ETF/MF Short Government Peer Group	-0.11%	-0.25%	0.18%	0.36%
Bloomberg Barclays 1-3 Month U.S. Treasury Bill Index	0.62%	1.21%	0.57%	0.41%

	Annualized Standard Deviation (%) as of 5/31/18			
	YTD*	1-Year	3-Year	Since Common Inception (2/28/14)
<b>WisdomTree Floating Rate Treasury Fund (USFR)</b>	<b>0.08%</b>	<b>0.15%</b>	<b>0.20%</b>	<b>0.20%</b>
Morningstar U.S. ETF/MF Short Government Peer Group	0.69%	0.78%	0.85%	0.83%
Bloomberg Barclays 1-3 Month U.S. Treasury Bill Index	0.05%	0.08%	0.15%	0.14%

	Annualized Sharpe Ratio as of 5/31/18			
	YTD*	1-Year	3-Year	Since Common Inception (2/28/14)
<b>WisdomTree Floating Rate Treasury Fund (USFR)</b>	<b>0.49</b>	<b>0.31</b>	<b>0.75</b>	<b>0.44</b>
Morningstar U.S. ETF/MF Short Government Peer Group	-1.08	-1.91	-0.48	-0.07
Bloomberg Barclays 1-3 Month U.S. Treasury Bill Index	-0.35	-0.40	-0.12	-0.10

Sources: WisdomTree, Zephyr StyleADVISOR, Bloomberg, as of 5/31/18. \*Returns of less than a year are shown as cumulative total returns. Past performance is not indicative of future results. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns. WisdomTree, its affiliates and their independent providers are not liable for any informational errors, incompleteness or delays or for any actions taken in reliance on information contained herein.

Performance is historical and does not guarantee 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. Performance data for the most recent month-end is available at [www.wisdomtree.com](http://www.wisdomtree.com).

For standardized performance of USFR, please click [here](#).

Please visit our [glossary](#) for definitions of terms and indexes in the chart.

In our view, this heavily implies that the debate in the short maturity government category is less of a debate between "active and passive" and more between "fixed versus floating." While investors have many ways to address interest rate sensitivities, we believe that an allocation to FRNs can provide investors with a unique tool to hedge duration risk and participate in interest rate hikes while mitigating overall risks.

**Unless otherwise noted, all data as of May 31, 2018. Sources: WisdomTree, Bloomberg, Morningstar, Zephyr StyleADVISOR**

<sup>1</sup>Total number of Short Government managers: Year-to-Date = 107; 1-Year = 105; 3-Year = 102; Since Fund Inception (3/1/14) = 99.

#### 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 may decline in value. The issuance of floating rate notes by the U.S. Treasury is new and the amount of 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.

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 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.

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

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

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## DEFINITIONS

**Short (or Short Position)** : The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).

**Maturity** : The amount of time until a loan is repaid.

**Money Market Fund** : A fund that invests in high quality, liquid short-term debt securities and monetary instruments such as US Treasury bills and commercial paper.

**Active** : Funds that attempt to outperform the market by selecting securities a portfolio manager believes to be the best.

**Passive** : Indexes that take a rules-based approach with regular rebalancing schedules that are not changed due to market conditions.

**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.

**Liquidity** : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets.

**Credit risk** : The risk that a borrower will not meet their contractual obligations in conjunction with an investment.

**Treasury Bill** : A treasury bill (T-Bill) is a short-term debt obligation backed by the U.S. government with a maturity of one month (four weeks), three months (13 weeks) or six months (26 weeks).

**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.

**Morningstar Short-Government Category** : As defined by Morningstar, short-government portfolios have at least 90% of their bond holdings in bonds backed by the U.S. government or by government-linked agencies. This backing minimizes the credit risk of these portfolios, as the U.S. government is unlikely to default on its debt. These portfolios have durations typically between 1.0 and 3.5 years, so they have relatively less sensitivity to interest rates and, thus, low risk potential. Morningstar calculates monthly breakpoints using the effective duration of the Morningstar Core Bond Index in determining duration assignment. Short is defined as 25% to 75% of the three-year average effective duration of the MCBI.