THE BARBELL APPROACH: A TIME-TESTED FIXED INCOME STRATEGY

Kevin Flanagan — Head of Fixed Income Strategy
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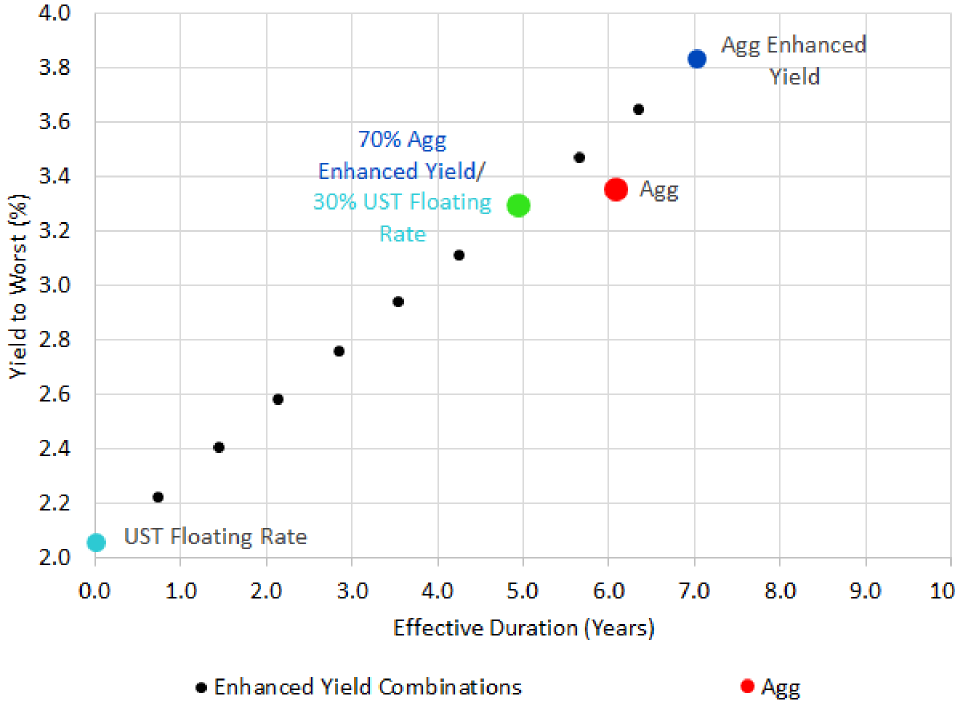
Although U.S. interest rates have risen from their record-setting depths, there is no doubt that, from a historical basis, they still remain rather low. Against this backdrop, I am asked on a regular basis: What's a prudent strategy that fixed income investors can follow to not only help mitigate the potential for a further move up in rates but also take income-conscious needs into consideration? A time-tested approach that aims to solve for both of these factors is the barbell strategy.

For those readers who are unfamiliar with such an approach, a fixed income barbell is a strategy that essentially replicates the weight-lifting apparatus. In other words, the investor utilizes two parts of the yield curve: on the one side, the focus will tend to be on an intermediate or longer-duration vehicle while the other end of the spectrum will concentrate on a short-duration instrument. These two "weights" on the barbell serve two different purposes. The intermediate/longer-duration aspect can help to solve for income needs, while the short-duration investment serves as the "rate-mitigating" force.

Yield to Worse and Effective Duration Comparison

Enhanced Yield/UST FRN vs. Aggregate



Source: Bloomberg, as of 8/8/18. Past performance is not indicative of future results. You cannot invest directly in an index .

For definitions of terms in the glossary, please click here.

So, what does the barbell look like in practice? In this blog post, I will focus on two specific indexes: the Bloomberg Barclays U.S. Aggregate Enhanced Yield Index (AEY) and the Bloomberg U.S. Treasury Floating Rate Bond Index (UST FRN). The latter index, UST FRN, will serve as the short-duration weight of the barbell and is based on the 2-Year Treasury floating rate note. AEY is a yield-enhanced index that reweights the sectors of the Bloomberg Barclays U.S. Aggregate Bond Index (Agg) and serves as the longer-duration weight.

The accompanying graph illustrates how an investor can implement various allocations between these two "weights" of the barbell in order to achieve the desired result. I would like to highlight the combination of 70% AEY and 30% UST FRN. As of this writing, this barbell offers a yield of 3.30%, or only a scant 6 basis points below the Agg, while one could potentially reduce duration by more than a year versus the Agg.

While the Federal Reserve (Fed) kept rates unchanged at last month's Federal Open Market Meeting, it does appear as if the policy makers are on track to raise the Fed Funds target range at their next gathering on September 26, and perhaps even one more additional time in 2018, finishing the year off at the December 19 convocation with another move to the upside. The Fed's outlook for 2019 calls for even more rate hikes.

Conclusion

The barbell strategy laid out here offers investors a solution that takes income needs and rate risk into the equation. The WisdomTree Yield Enhanced U.S. Aggregate Bond Fund (AGGY), which seeks to track the Bloomberg Barclays U.S. Aggregate Enhanced Yield Index, and the WisdomTree Floating Rate Treasury Fund (USFR), which seeks to track the Bloomberg U.S. Treasury Floating Rate Bond Index, can be utilized as the two "weights" discussed here. Needless to say, the Fed's monetary policy decisions are a crucial element to the fixed income investment landscape, and given the aforementioned outlook, I'll continue to revisit this issue in upcoming blog posts.

Unless otherwise noted, all data is from Bloomberg as of August 8, 2018.

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You cannot invest directly in an index.

DEFINITIONS

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

Yield curve : Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

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.

Bloomberg Barclays U.S. Aggregate Enhanced Yield Index : a constrained, rules-based approach that reweights the sector, maturity, and credit quality of the Barclays U.S. Aggregate Index across various sub-components in order to enhance yield.

Bloomberg U.S. Treasury Floating Rate Bond Index : A rules-based, market-capitalization-weighted index engineered to measure the performance of floating rate U.S. Treasury notes.

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.

Bloomberg U.S. Aggregate Bond Index : Represents the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, as well as mortgage and asset backed securities.

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