

---

# FIXED INCOME: “THE BOY WHO CRIED WOLF” ... PERHAPS NOT THIS TIME

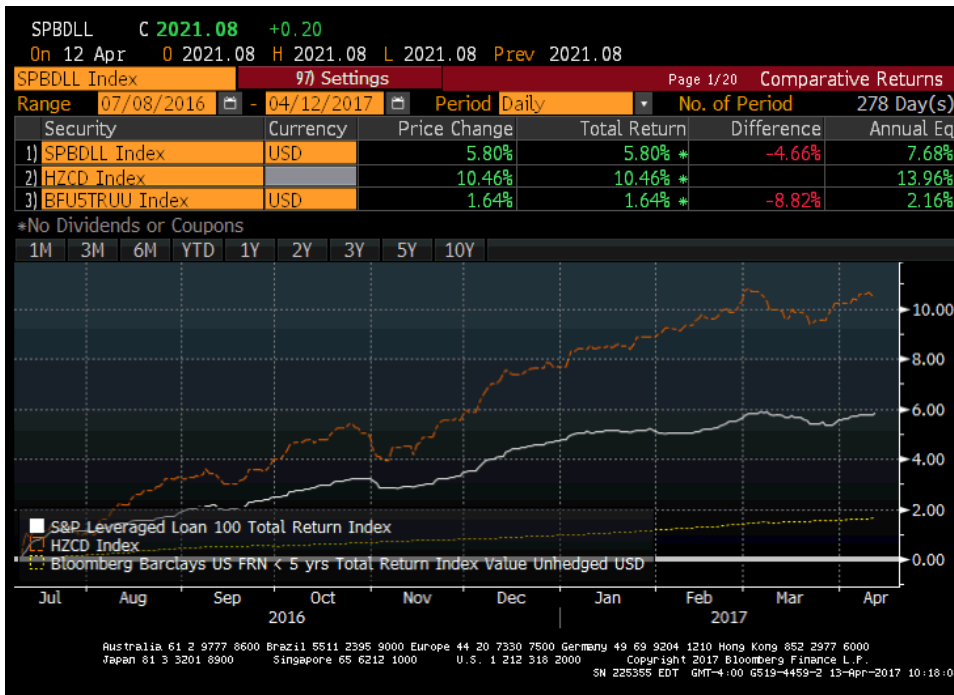
Kevin Flanagan — Head of Fixed Income Strategy

04/19/2017

Certainly, a main theme for fixed income investors in 2017 has been one of rising interest rates. There is no doubt that we have been down this road before, only to witness no increases, or in some instances even falling rates. So, what makes this time different, and should investors listen to, or ignore, “the boy who cried wolf”?

One of the key differences this time around is the [Federal Reserve \(Fed\)](#). The late 2016/early 2017 experience has highlighted this development, as policy makers raised the [Fed Funds](#) target range twice, for a total of 50 [basis points \(bps\)](#) in a three-month time frame. This latest [rate hike](#) by policy makers also came about three months earlier than market participants had initially anticipated, with the Fed projecting two more rate hikes this year and further moves for both 2018 and 2019. In addition, the Fed has also begun discussing the balance sheet normalization plan, specifically their reinvestment policy for Treasuries and agency [mortgage-backed securities \(MBS\)](#). If economic and financial conditions continue to match policy makers’ outlook, such action could commence later this year or early next year and, when combined with additional rate hikes, would most likely create a more challenging setting for the fixed income markets.

Obviously, the fiscal policy front got the ball rolling in the [U.S. Treasury \(UST\)](#) market following the election. The reassessment of what a Trump presidency and a Republican Congress could accomplish to jump-start the economy played an important role as well and continues to dangle over the rate outlook, notwithstanding the recent failure on the health care initiative.



Source: Bloomberg as of 4/13/2017. You cannot directly invest in an index. Past performance is not indicative of future results.

"SPBDLL Index" refers to the S&P Leveraged Loan 100 Total Return Index  
 "HZCD Index" refers to the BofA Merrill Lynch 0-5 Year US High Yield Constrained, Zero Duration Index  
 "BFUSTRUU Index" refers to the Bloomberg Barclays U.S. FRN < 5 Years Total Returns Index Value Unhedged USD

For definitions on indexes in the chart, visit our [glossary](#).

If fixed income investors are looking to insulate their portfolios from potential rate risk, two common strategies that have been used over time are: leveraged bank loans and/or floating rate products. The graph above illustrates how these two approaches fared over the last nine months, from when the [UST 10-Year yield](#) hit an all-time low on July 8, up to where rates stood as of this writing, or nearly 100 bps higher. By investing in the leveraged bank loan field, as represented by the [S&P Leveraged Loan 100 Total Return Index](#), investors witnessed a positive return of +5.8%, whereas taking the floating rate approach ([Bloomberg Barclays U.S. FRN < 5 Years Total Return Index Value Unhedged USD](#)) also kept them in the plus column but at a measurably lower reading of +1.64%.

It is interesting to note that during this time frame, there was a more optimal way to help reduce the risk of higher rates while also outperforming the two aforementioned strategies. Indeed, by dialing down rate exposure by using a [zero duration](#) approach, as represented by the [BofA Merrill Lynch 0-5 Year US High Yield Constrained, Zero Duration Index](#), investors would have observed a positive total return of roughly 10.5%. This came close to doubling the leveraged bank loan method and towered over the [floating rate](#) strategy.

### Conclusion

With the UST 10-Year yield falling 40 bps from its mid-March high point on geopolitical concerns, among other factors, fixed income investors have been given a second opportunity to consider complementing their core holdings with an interest rate hedged strategy that utilizes the zero duration approach. The [WisdomTree Interest Rate Hedged High Yield Bond Fund \(HYZD\)](#), which tracks the BofA Merrill Lynch 0-5 Year US High Yield Constrained, Zero Duration Index, is a vehicle investors could utilize to achieve this goal.

**Unless otherwise noted, source is Bloomberg, as of April 13, 2017.** Double-digit returns were achieved primarily during favorable market conditions. Investors should not expect that such favorable returns can be consistently achieved. Performance, especially for very short time periods, should not be the sole factor in making your investment decision.

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](#).

## **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.

**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.

**Basis point** : 1/100th of 1 percent.

**Rate Hike** : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

**Mortgage-backed securities** : Fixed income securities that are composed of multiple underlying mortgages.

**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.

**Treasury yield** : The return on investment, expressed as a percentage, on the debt obligations of the U.S. government.

**S&P/LSTA U.S. Leveraged Loan 100 Index** : designed to reflect the performance of the largest loan facilities in the leveraged loan market.

**Zero duration strategies** : Refer to WisdomTree’s Interest Rate Strategies that target an overall portfolio duration of zero; namely, the WisdomTree Barclays U.S. Aggregate Bond Zero Duration Fund and the WisdomTree BofA Merrill Lynch High Yield Bond Zero Duration Fund.

**BofA Merrill Lynch 0-5 Year US High Yield Constrained, Zero Duration Index** : Tracks the performance of the combination of a long position in short maturity US high yield bonds and a short position in on the run US Treasuries where the net interest rate exposure of the index is adjusted to a zero year duration. Market values of long and short positions are rebalanced at month-end.

**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.