

# FIXED INCOME: MONEY IN MOTION

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11/14/2018

Seven down, one more [FOMC](#) meeting to go for 2018. There were no surprises at last week’s penultimate [Federal Reserve \(Fed\)](#) gathering as the policy makers kept rates unchanged, but perhaps more importantly, they continued to lead money and bond markets down the path for a potential [rate hike](#) at their final convocation of the year in December. The specter of additional rate hikes next month and into 2019 has created an interesting environment in the fixed income arena, and as we get one month closer to year-end, investors appear to be putting money in motion.

As we head into the 2018 homestretch and begin preparing fixed income portfolios for what potentially lies ahead, once again, [hedging](#) rate risk remains an integral part of the equation. Investors generally utilize short duration strategies when the expectation is for higher [interest rates](#). In other words, funds will be reallocated from intermediate to longer-dated maturities and reinvested in shorter-dated instruments. Some of the more widely used options involve [U.S. Treasury](#) securities such as [t-bills](#) or focusing on the one- to three-year Treasury note sector.



Source: Bloomberg, as of 11/9/18. 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 can be found at the link below. You cannot invest directly in an index. LD12TRUU: Bloomberg Barclays U.S. Treasury Bills: 1-3 Months TR Index Value Unhedged. IDCOTSTR: ICE U.S. Treasury Short Bond TR Index. IDCOT1TR: ICE U.S. Treasury 1-3 Year TR Index.

Click [here](#) for USFR standardized performance.

While the debate on where UST 10-year yields are headed will no doubt continue, one aspect that does not seem to be up for debate is that the Fed will continue with “further gradual increases” in the Fed Funds target range. In my opinion,

investors should consider a Treasury floating rate strategy to complement their portfolios. The other aforementioned short duration Treasury strategies all involve fixed type of securities in one form or another, and while they can help mitigate some rate risk, they tend to underperform a floating strategy, especially in a Fed rate hike cycle.

The [WisdomTree Floating Rate Treasury Fund \(USFR\)](#), which seeks to track the price and [yield](#) performance of the [Bloomberg U.S. Treasury Floating Rate Bond Index](#), offers investors a vehicle to follow this type of strategy. Let's take a look at how this Fund has performed versus the aforementioned UST-based short duration options since the Fed implemented its first rate hike at the end of 2015. As of this writing, USFR has outperformed three widely used UST-based strategies. The largest differentials exist in the Treasury one- to three-year sector ([ICE U.S. Treasury 1-3 Year TR Index](#)) and one- to three-month t-bills ([Bloomberg Barclays U.S. Treasury Bills 1-3 Month TR Index Value Unhedged](#)), at 182 and 77 [basis points \(bps\)](#), respectively. Rounding out the slate, the UST floating rate vehicle also registered a higher reading, +44 bps, with the one-month to one-year part of the curve ([ICE U.S. Treasury Short Bond TR Index](#)).

## Conclusion

On a final note, it looks like bond investors are going to be confronted with an environment that they have not experienced for a number of years. Indeed, given this year's rise in interest rates and challenges in the emerging market space, a variety of fixed income investments could post losses for 2018, unless a turnaround occurs during the final six weeks or so of this year. In fact, barring any plunge in rates from here, the [Bloomberg Barclays U.S. Aggregate Bond Index](#) could register its first negative performance in a calendar year since 2013. Signs that fixed income investors are moving funds in order to potentially [harvest tax losses](#) for 2018 have already begun to emerge. Against this backdrop, USFR could also be considered a solution for these reallocated funds.

***Unless otherwise stated, all data sourced is Bloomberg, as of November 9, 2018.***

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## DEFINITIONS

**Federal Open Market Committee (FOMC)** : The branch of the Federal Reserve Board that determines the direction of monetary policy.

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

**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.

**Hedge** : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

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

**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 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).

**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.

**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.

**ICE U.S. Treasury 1-3 Year TR Index** : This index tracks U.S. Treasury fixed rate securities with a minimum term to maturity of greater than one year and less than or equal to three years.

**Bloomberg Barclays U.S. Treasury Bills 1-3 Month TR Index Value Unhedged** : This index tracks the U.S. Treasury-bill market with maturities within the one through three month range.

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

**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.

**Tax Loss Harvesting** : Selling securities at a loss to offset a capital gains tax liability. Tax gain/loss harvesting is typically used to limit the recognition of short-term capital gains, which are normally taxed at higher federal income tax rates than long-term capital gains.