GLOBAL FIXED INCOME: EXPECT THE UNEXPECTED

Kevin Flanagan — Head of Fixed Income Strategy
04/26/2017

Based upon projections for 2017, it would appear as if the global bond markets have once again surpassed expectations. Indeed, following the U.S. election and the subsequent rate hike by the Federal Reserve (Fed) in December, the "student body right" mentality among investors was that the fixed income asset class could have its share of difficulties in 2017. While it is certainly early (and as we have seen in the past, developments can change over the course of a full year), the first three months of this year have been a welcome surprise for fixed income investors.

The emerging market (EM) debt space had experienced the best performance within the fixed income universe during the first quarter, continuing to build on the positive momentum seen in 2016. To be sure, EM local debt produced a total return of +6.50% (J.P. Morgan Government Bond Index – Emerging Markets Global Diversified Index) in the first quarter, after posting a nearly +10% figure for all of last year. Some of the key reasons behind this performance in the opening three months of the year have been fundamental improvements in EM countries combined with a less hostile U.S. rate setting. Although the Fed lifted rates in March and has discussed balance sheet normalization, Treasury yields have actually been range-bound at worst, helping to support the EM local debt arena, accordingly. Looking ahead for the second quarter, EM debt has a poor historical track record in May, which suggests some caution, but any setback in a range-bound rate environment could be viewed as a long-term buying opportunity.

Total Returns

	Q1 2017	2016
2-Year U.S. Treasury Note	0.24%	0.63%
10-Year U.S. Treasury Note	0.79%	-0.14%
Barclays Aggregate	0.82%	2.65%
Investment-Grade Corporate	1.22%	6.11%
High-Yield Corporate Yield	2.70%	17.13%
Emerging Market US$ Total Return	4.04%	9.64%
EM Local Debt	6.50%	9.94%

Source: Bloomberg as of 3/31/2017. Past Performance is not indicative of future results. You cannot directly invest in an index.

The U.S. corporate bond market managed to come in on the plus side of the ledger as well in the first quarter, although the returns have paled compared with last year's experience. This should come as no surprise to fixed income investors, however, as calendar year 2016 represented a stellar performance for both the investment-grade (IG) and high-yield (HY) sectors. To provide some perspective, as measured by the Barclays U.S. Corporate High Yield Total Return Index Unhedg ed, HY produced a positive reading of +2.70% during the first quarter following a very robust increase of +17.13% in 2016. Within the IG corporate market, according to the Barclays U.S. Aggregate Corporate Total Return Value Unhedged Index, the IG sector registered a first-quarter gain of +1.22% after finishing 2016 with a positive performance of +6.11%.

Perhaps the biggest surprise in the fixed income arena has been within the interest-sensitive side, specifically the U.S. Tre asury market (UST). Although the Fed implemented another rate hike in mid-March (three months sooner than market expectations to begin the year), UST yields have exhibited a range-bound pattern, and in the case of the 10-Year maturity, the yield had actually fallen nearly 25 basis points (bps) from its pre-March Federal Open Market Committee high watermark through quarter-end on March 31. The 2-Year yield followed a similar trend, dropping nearly 15 bps during the aforementioned time frame. As a result, these UST returns also managed to record positive performances in the first quarter of +0.24% and +0.79% for the 2-Year and 10-year (utilizing the Citi 2-Year and 10-Year Treasury Benchmark On-the-Run Index), respectively.

Conclusion

Where do we go from here in 2017? Well, fixed income investors have certainly digested a lot of market-related news already, but things could be just beginning to heat up as spring turns to summer. Geopolitical headlines continue to hover over the money and bond markets. Last weekend's French presidential election results provided a clear-cut example of the risk-on (Macron wins)/risk-off (Le Pen) wins) dynamic while saber-rattling from the Korean peninsula will more than likely also garner its fair share of headlines. That being said, developments in Washington, D.C., will no doubt carry the potential to move fixed income yields in a visible way, as the tax reform/tax cut debate and the Fed's monetary policy decisions (Fed Funds Rate and balance sheet) move front and center on traders' screens.

Unless otherwise noted, source is Bloomberg, as of March 31, 2017.

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)

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, Jianing Wu, and Brian Manby 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

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.

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

EM local currency debt : Debt denominated in the local currencies of emerging market governments.

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

Investment grade : An investment grade is a rating that signifies a municipal or corporate bond presents a relatively low risk of default.

High Yield : Sometimes referred to as "junk bonds," these securities have a higher risk of default than investment-grade securitie.

Barclays U.S. Corporate High Yield Index : Covers the universe of fixed-rate, non-investment-grade corporate debt.

Barclays US Agg Corporate Total Return Value Unhedged USD : The Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).

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.

Basis point : 1/100th of 1 percent.

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

Citi 2-Year Treasury Benchmark On-the-Run Index : Total return index for the Generic United States on-the-run 2-Year Treasury. Data is updated on the 1st day of the month for the last business day of the previous month and is final on that day. Index updates monthly subject to the existence of appropriate bonds for the specified period.

10- Year Treasury : a debt obligation of the U.S. government with an original maturity of ten years.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.