GLOBAL FIXED INCOME: PUTTING A BOW ON 2017

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One month into the New Year and we've already seen some interesting—some might even say unexpected—developments in the bond market. Before we get too far into 2018, I thought it would be a useful exercise to offer a final review of how the major fixed income asset classes fared for 2017, in a sense providing some frame of reference for this year's possibilities.

Perhaps the biggest surprise was found yet again in the U.S. Treasury (UST) market, specifically toward the back end of the curve. After posting a modest red-ink figure of -0.14% in 2016 (utilizing the Citi 10-Year Treasury Benchmark On-the-Run Index), the UST 10-Year note rebounded to register a total return in the plus column of +2.13%, defying expectations in the process. Indeed, following the 2016 presidential election, the overwhelming sentiment was that this rate instrument would have to finish the year higher in yield, but instead it closed out nearly 30 basis points (bps) below consensus forecasts (the fourth year in a row this happened).

Around the globe, two other closely watched developed world bond markets (Germany and Japan) did not share the U.S. experience. To be sure, 10-year German bund yields actually rose last year, helping to produce a -0.81% shortfall, while in Japan the same maturity registered an essentially unchanged performance (German and Japan generic government 10-year yield indexes).

Total Returns

	2017	2016
2-Year U.S. Treasury Note	0.21%	0.63%
10-Year U.S. Treasury Note	2.13%	-0.14%
10-Year German Bund	-0.81%	4.35%
10-Year Japanese Government Bond	0.29%	1.63%
Barclays Aggregate	3.54%	2.65%
Investment Grade Corporate	6.42%	6.11%
High Yield Corporate	7.50%	17.13%
Emerging Market US$ Total Return	9.92%	9.64%
EM Local Debt	15.21%	9.94%

Source: Bloomberg, as of 12/29/2017. Past performance is not indicative of future results.

The U.S. corporate bond market came in on the plus side of the ledger, with both investment grade (IG) and high yield (HY) posting back-to-back positive readings for 2016 and 2017. The IG performance basically matched the prior year's positive return (+6.42% vs +6.11%, according to the Bloomberg Barclays U.S. Aggregate Corporate Total Return Value Unhedged Index). The HY sector put in another robust showing (+7.50%), especially considering it was coming off an incredible total return of +17.13% (as measured by the Bloomberg Barclays U.S. Corporate High Yield Total Return Index Unhedged) in 2016.

The emerging market (EM) debt space experienced the best performance within the fixed income universe during 2017, continuing to build on the positive momentum seen for 2016. To be sure, EM local debt produced a total return of over +15% (J.P. Morgan Government Bond Index – Emerging Markets Global Diversified Index), after posting nearly +10% for all of 2016. Interestingly, these consecutive positive returns have represented a complete turnaround from where EM local debt was in 2015, when it printed a hefty shortfall of almost -15%.

Conclusion

Given where many fixed income asset classes currently reside in terms of relative value, it would seem difficult to expect such robust repeat performances as are highlighted in this blog post. Fixed income investors will more than likely need to be a bit more discerning in their investment approach and should consider the potential benefits of fundamental—or smart beta—fixed income strategies, a field where WisdomTree is a pioneer.

Unless otherwise noted, data source is Bloomberg as of December 29, 2017.

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DEFINITIONS

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.

Curve : Refers to the yield curve. Positioning on the yield curve is important to investors, especially during non-parallel shifts.

Basis point : 1/100th of 1 percent.

German 10-year bund : a debt instrument issued by the German government with an original maturity of 10 years.

Corporate Bonds : a debt security issued by a corporation.

Investment Grade : A rating given to a municipal or corporate bond. It is a relatively favorable rating by either Moody's or Standard & Poor's indicating a higher chance an issuer performs interest and principal obligations as promised by the terms of the debt issuance.

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

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).