WHAT'S YIELD GOT TO DO, GOT TO DO WITH IT?

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This article is relevant to financial professionals who are considering offering model portfolios to their clients. If you are an individual investor interested in WisdomTree ETF Model Portfolios, please inquire with your financial professional. Not all financial professionals have access to these Model Portfolios.

"There is income back in fixed income."

We first began writing this periodic series of blog posts on "generating yield in an evolving market" back in March 2021 and, most recently, last September. It's time to revisit.

When we began this series, we were encountering the somewhat anomalous situation of equity dividend yields being higher than bond yields. It was a bleak time for bond investors—rates were near zero, and credit spreads were trading near historical lows.

Well, as Bob Dylan might sing, "The times they are a-changin'." Let's take a look.

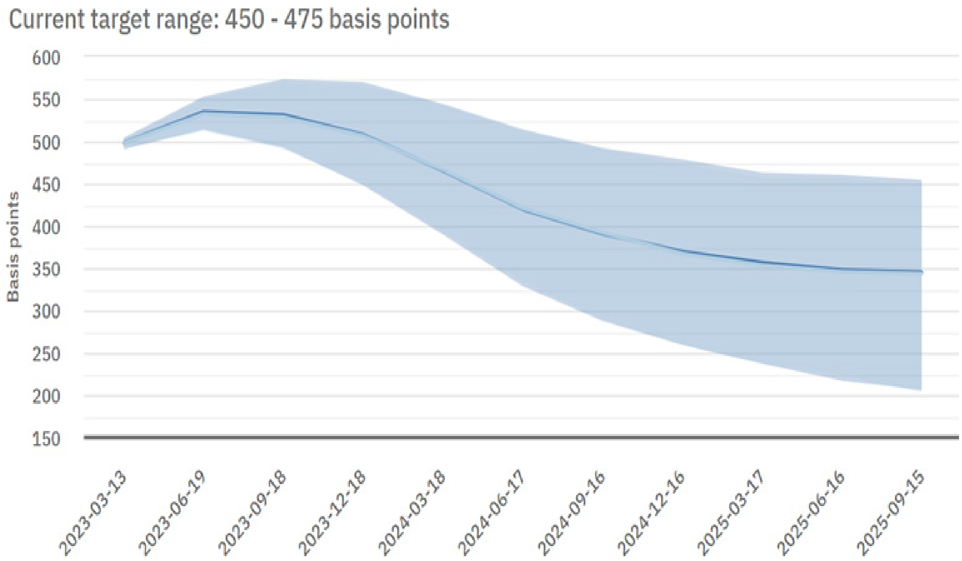
Let's start by surveying the current market environment. All eyes are on the Fed—will it continue to tighten in the face of continued strong employment and loose financial conditions? Will it "pivot" and begin easing back off in the face of a slowing economy and signs that inflation is trending downward?

Given recent economic, inflation, and labor reports, the Fed is signaling it will maintain its hawkish position and has recently provided guidance that two, perhaps three more rate hikes of 25 basis points (bps) each in March, May, and June remain a possibility. Even our since-inception strategic advisor, Professor Jeremy Siegel, who earlier in the year believed the Fed had gone too far and needed to pivot back toward easing has acknowledged that recent data is "testing his hypothesis of a quicker "pivot".

What we do know is the Fed has now shifted into full "data-dependent" mode and will, more than likely, act accordingly. We also hold an experienced belief that the bond market will, ultimately, tell us the answer. But the result, for now, is continued bond market volatility.

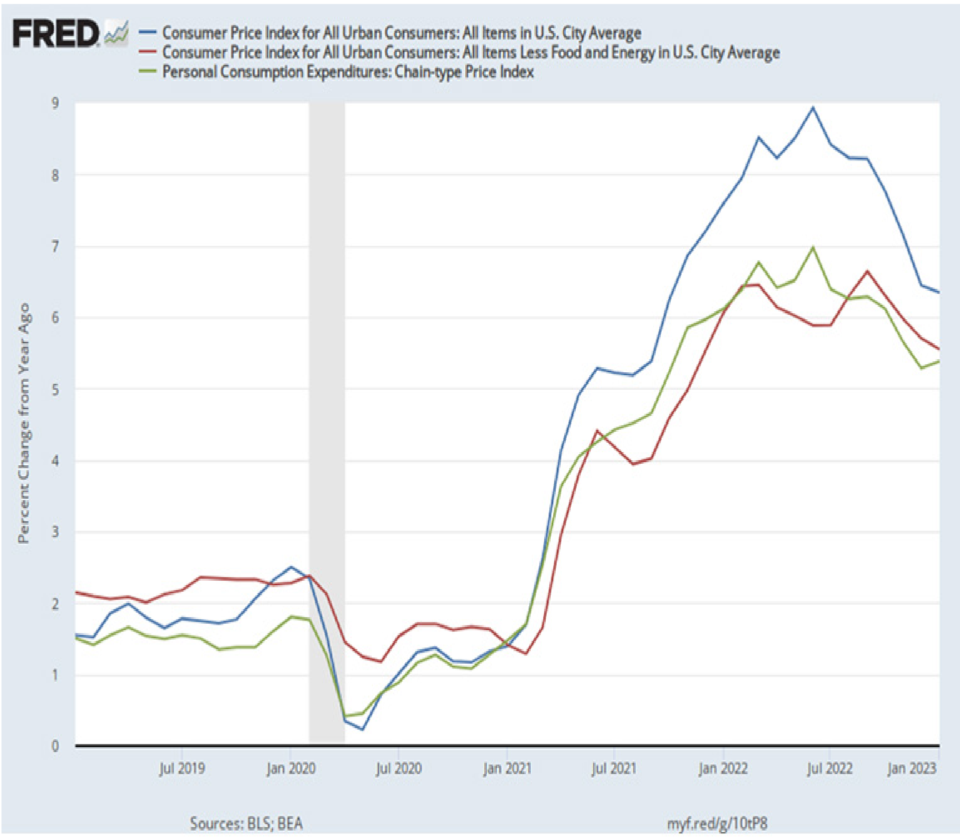
Here is the current Atlanta Fed "Market Probability Tracker," which charts the market-traded course of the Fed Funds Rate (the short-term rate controlled by the Fed). While Fed Funds Futures have not proven to be more accurate than anything else in predicting future rate movements, this chart does provide a snapshot of what the market is currently thinking—a "terminal rate" peaking above 5.25% by June and then declining over the remainder of the year.

The Expected Future Path of the Three-Month Average Fed Funds Rate



Source: The Atlanta Federal Reserve Bank Market Probability Tracker, as of 2/24/23. This tool estimates the market-implied probabilities of various ranges for the three-month average Fed Funds Rate. The methodology uses data on three-month eurodollar futures, options on three-month eurodollar futures from the Chicago Mercantile Exchange (CME), three-month LIBOR/Fed Funds basis swap spreads expiring in 12 months and the Treasury yield curve.

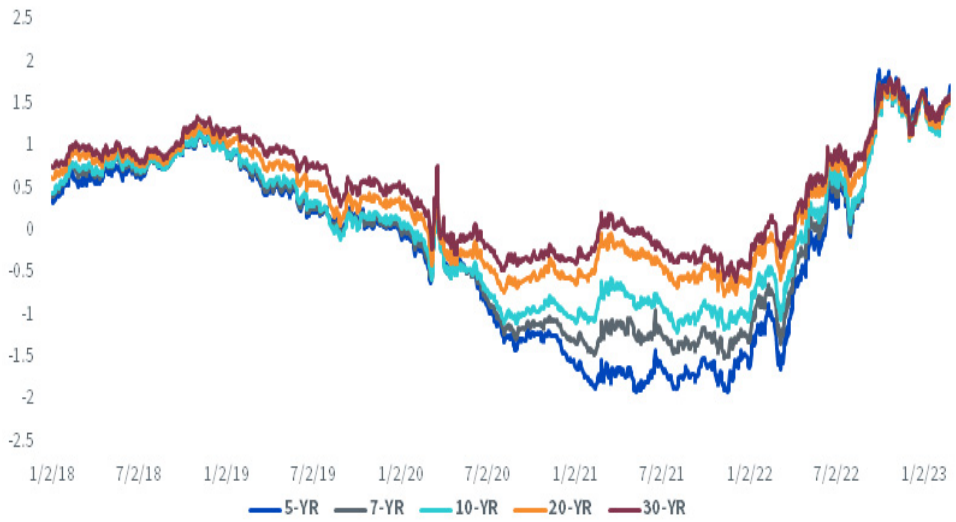
At the same time, and despite the Fed's ongoing anxiety, inflation seems to have peaked and is moving downward, though it remains well above the Fed's 2% "target rate" and recent reports have come in higher than expected



Source: The St. Louis Federal Reserve Bank (FRED), through December 2022.

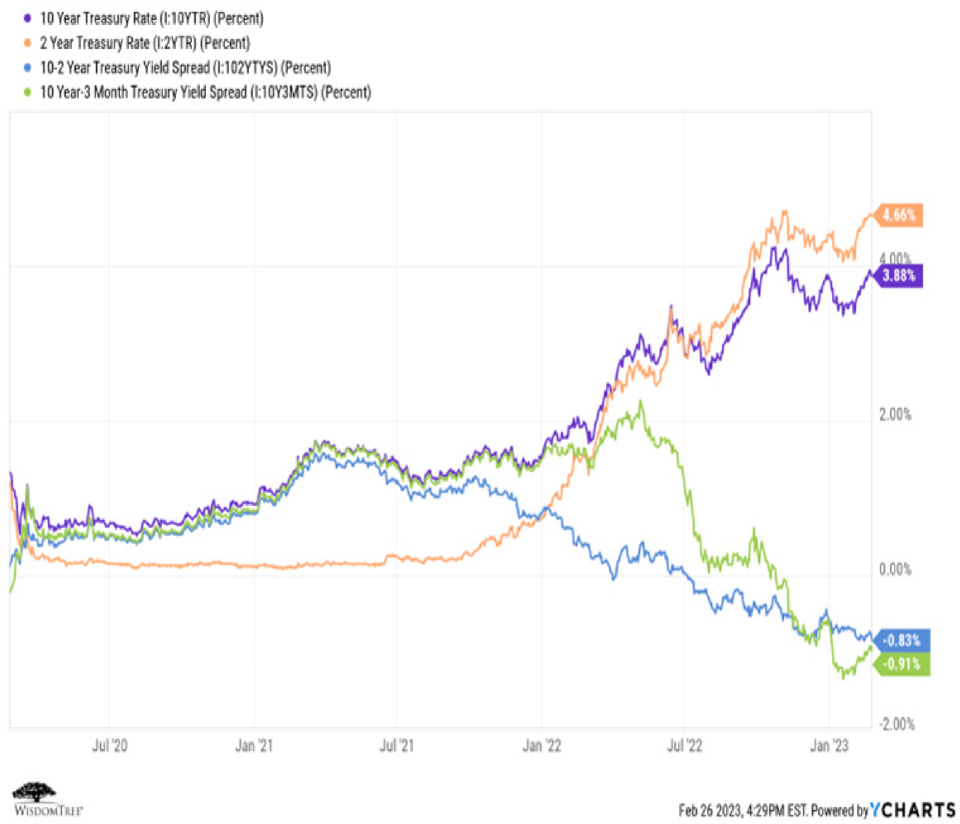
Treasury real yield rates have been solidly in positive territory across the maturity spectrum since last June. While they may be stabilizing, we see no reason why they should reverse themselves and head back toward zero again.

U.S. Treasury Real Yields (%)



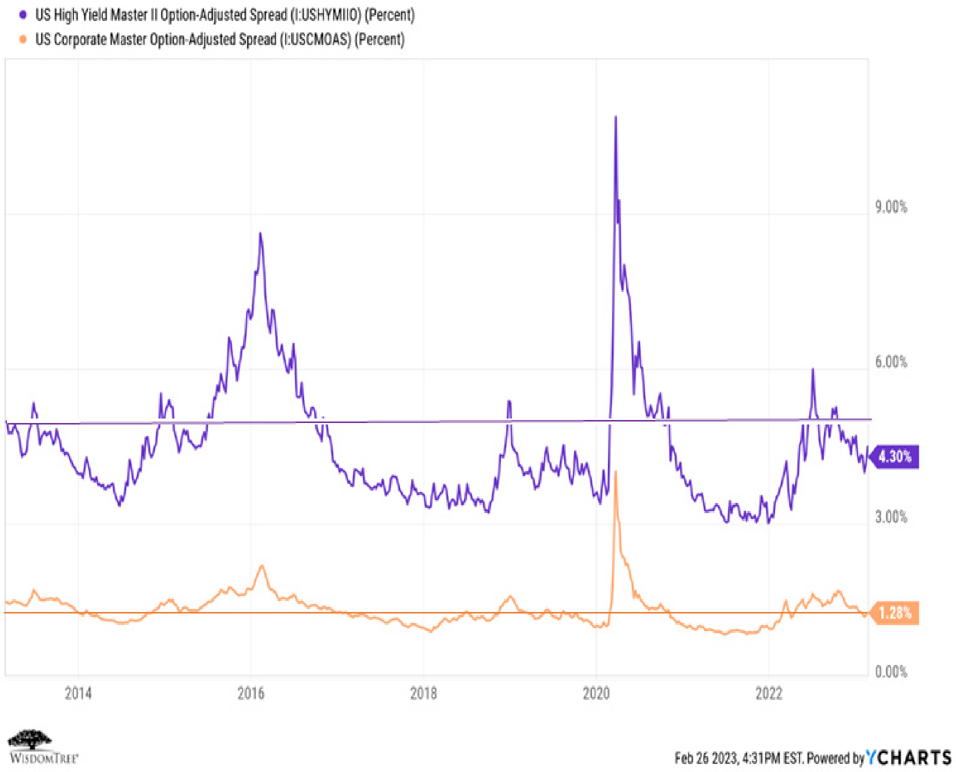
Source: Treasury.gov, data through 2/24/23. Past performance is not indicative of future results.

[Nominal Treasury]() rates have also moved higher, with the short end rising sharply in the face of the Fed's aggressive pace of rate hikes. The [yield curve]() has been inverted for months (as measured by the 10-Year minus 2-Year yield and the 10-Year minus 3-Month spreads), resulting in calls of recession by many economists and advisors. Perhaps, maybe even probably, but the market continues to send "mixed messages" regarding slowing economic activity versus a still-robust labor environment.



Source: YCharts, three-year data through 2/24/23. Past performance is not indicative of future results.

Finally, after rising for several months, credit spreads have once again slipped toward levels that are neither "wide" nor "tight" by historical standards.



Source: YCharts, 10-year data through 2/24/23. You cannot invest in an index, and past performance does not guarantee future results.

For definitions of terms in the charts, please visit the glossary.

What Is a Yield-Seeking Investor to Do?

One of our primary investment themes for 2023 is "There is income back in fixed income." Let's compare current nominal yields in the fixed income versus equity markets.

Instrument	10-Year Treasury	Investment-Grade Credit Spread	High-Yield Credit Spread	Total Nominal Current Yield
IG Bonds	3.88%	1.28%		5.16%
HY Bonds			4.30%	8.18%
S&P 500 Dividend Yield				1.69%
ACWI ex-U.S. Dividend Yield				2.58%

Sources: YCharts, S&P and MSCI, data through 2/24/23. Yields are approximate and security specific. "IG" stands for "Investment Grade" and refers to bonds with a BBB- or higher credit rating. Investment-grade bonds are represented by the Bloomberg US Aggregate Bond Index (the "AGG"). "HY" refers to "High Yield" and bonds with a credit rating below BBB-. High-yield bonds are represented by the Bloomberg US Corporate High Yield Bond Index. You cannot invest in an index, and past performance does not guarantee future results.

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Certainly, in comparison to the equity markets, there is income back in fixed income. In addition, most corporate balance sheets are in solid shape. Given this, generating and 8+% on high-yield bonds may seem very interesting for advisors seeking yield.

Product/Strategy Ideas

On the fixed income front, we see three "high conviction" ideas. First up, U.S. Treasury floating rate notes (FRNs). These securities are reset to the weekly UST 3-Month T-bill auction, with a spread, and contain no corporate credit risk. With the Fed still in "rate hike" mode, this strategy provides investors with a means of income without the aforementioned bond market volatility. The WisdomTree Floating Rate Treasury Fund (USFR) gives investors a means to implement this strategy.

As we just discussed, the U.S. high-yield market offers compelling income as well. However, with recession concerns remaining a key part of the investment landscape, a solution that focuses on quality will be of paramount importance. The WisdomTree U.S. High Yield Corporate Bond Fund (WFHY) uses a quality screen while tilting for income.

Finally, with a rally in rates expected for the second half of this year, investors may wish to move their bond allocation toward benchmark duration. The WisdomTree Yield Enhanced U.S. Aggregate Bond Fund (AGGY) is an investment-grade solution that offers investors a way of achieving this duration target while also focusing on augmenting income needs.

Model Portfolio Ideas

In addition to our product lineup, WisdomTree also manages three Model Portfolios we think fit nicely into today's yield environment, depending on investor objectives: an all-equity **Global Dividend** model, **Multi-Asset Income** models of different risk bands and the **Siegel-WisdomTree Longevity** model, which we manage in collaboration with our strategic advisor, Professor Jeremy Siegel.

All these models focus on generating all or much of the current yield out of the equity allocations while using the fixed income allocation to generate additional, risk-controlled yield.

Let's look at the current yield of these portfolios (as of February 24, 2023). "Current Yield/Income" refers to the most recent 12-month dividend yield.

For the most recent standardized and month-end performance, click here. All yield and total return information for these model portfolios and all of the underlying securities within those models can be found in our Model Adoption Center.

Now let's examine some hypothetical "typical" client portfolios.

Conclusion

For investors seeking yield, we believe there are multiple ways to achieve this goal without taking on excessive risk, including incorporating quality-screened high-yield and dividend-focused equities within the portfolio. For investors wishing not to take on duration risk while benefitting from the Fed rate hiking regime, our floating rate U.S. Treasury product may fit the bill.

Additionally, our yield-focused Model Portfolios are all delivering on their mandates of generating enhanced yield in a risk-controlled manner.

The bottom line is that we have rotated almost 180% from our first blog post on this topic—there is, indeed, income back in fixed income. And that's what yield's got to do, got to do with it.

Important Risks Related to this Article

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The Siegel-WisdomTree Longevity Model Portfolio seeks to address increasing longevity by shifting the focus to potential long-term growth through a higher stock allocation versus more traditional "60/40" portfolios.

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.

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You cannot invest directly in an index.

DEFINITIONS

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Bond yield : Refers to the interest received from a bond and is usually expressed annually as a percentage based on its current market value.

Spread : Typically refers to a difference between a measure of yield for one asset class and a measure of yield for either a different subset of that asset class or a different asset class entirely.

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

Fed tightening : Refers to the Federal Reserve enacting monetary policies that have the overall impact of reducing the availability of credit, which is widely thought to have the potential to slow economic growth.

Inflation : Characterized by rising price levels.

Hawkish : Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

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.

Basis point : 1/100th of 1 percent.

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.

Fed fund futures : A financial instrument that let's market participants determine the future value of the Federal Funds Rate.

Nominal Treasury : Rate on the treasury security not adjusted for inflation.

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

Fixed income : An investment security that provides a return in the form of fixed periodic payments and the eventual return of principal at maturity.

Balance sheet : refers to the cash and cash equivalents part of the Current Assets on a firms balance sheet and cash available for purchasing new position.

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.

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).