
ENHANCED YIELD STRATEGIES & RISING RATES

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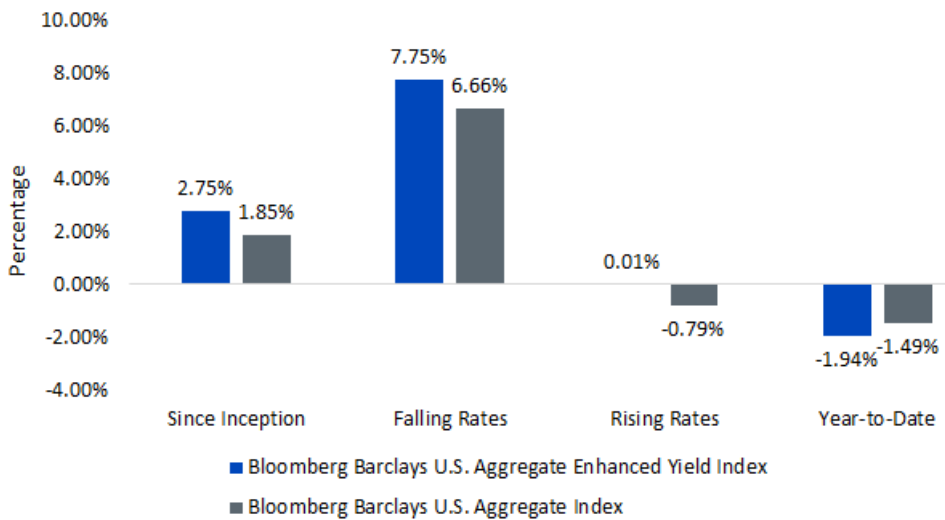
Just shy of three years ago, WisdomTree launched the [WisdomTree Barclays Yield Enhanced U.S. Aggregate Bond Fund \(AGGY\)](#), an exchange-traded fund (ETF) that seeks to track the [yield](#) and performance of the [Bloomberg Barclays U.S. Aggregate Enhanced Yield Index](#) (Enhanced Yield). While our strategy draws from the same investable universe as the [Bloomberg Barclays U.S. Aggregate Index \(Agg\)](#), it seeks to boost income by reweighting exposures across 20 buckets. In order to maintain a comparable risk profile to the Agg, a series of qualitative and quantitative constraints are run to keep credit and [duration](#) over-weights in check. Since [interest rates](#) started to rise in 2016, investors have questioned whether a strategy that is one year longer in duration than the benchmark is prudent. As we highlight below, we believe our approach continues to deliver value in the core of investor bond portfolios.

The Trade-Offs of Higher Yield

The two main levers that investors can pull to enhance yield are incremental credit and interest rate risk. Since inception, the strategy has been over-weight credit and has generally been over-weight duration by one year. On average, our approach maintained a yield advantage of 60 [basis point \(bps\)](#). As we show below, the strategy has outperformed the Agg by 90 bps per year since inception. While 5-year and 10-year interest rates rose over this period, [credit spreads tightened](#) and the [yield curve flattened](#). Put another way, our strategy was not dependent on falling rates to generate excess returns versus the Agg. Below, we quantify performance during rising and falling rate periods.

Yield Enhanced: Greater Income and Total Return Outperformance

Average Annual Returns for Enhanced Yield vs. the Agg



Sources: WisdomTree, Bloomberg. Since Inception period between 7/9/15, inception date of the WisdomTree Barclays Yield Enhanced U.S. Aggregate Bond Fund, and 4/11/18. Falling Rates period between 7/9/15 and 7/8/16. Rising Rates period between 7/8/16 and 4/11/18. Year-to-Date period between 12/29/17 and 4/11/18. Average annual returns where period greater than 12 months, otherwise cumulative returns. Past performance is not indicative of future results. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns.

Falling Rates

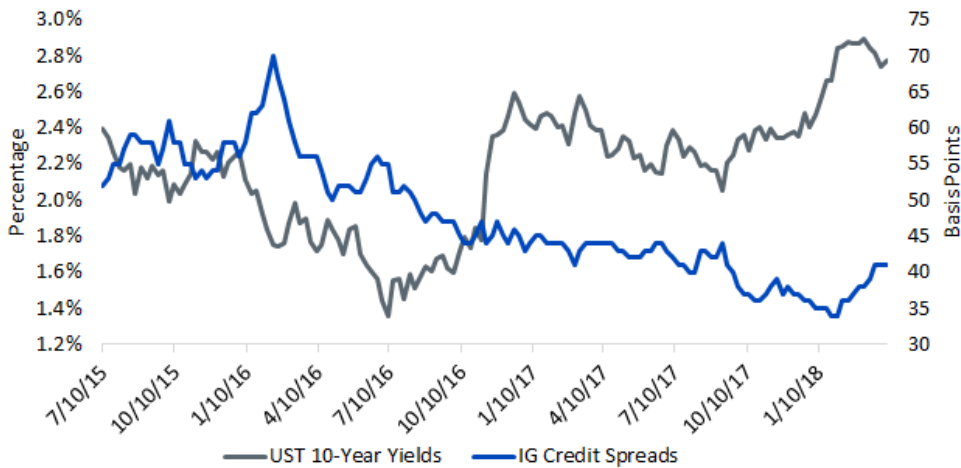
As one would expect, an index with increased duration during a falling rate environment was rewarded. Over the falling rate period, the Index outperformed the Agg by more than 100 basis points. However, what happens to credit spreads in a falling rate environment is also important. Falling rates are often associated with investor fears over slower economic growth. In this instance, credit spread [volatility](#) ticked up in the second half of 2015 and early 2016 as fears of a China slowdown weighed on risky assets and commodities. Despite those short-term concerns, credit spreads generally tightened over the period.

Rising Rates

In our view, one of the primary takeaways that investors overlook in our Enhanced Yield Index is the concept of diversification. While our approach is generally over-weight interest rate risk versus the benchmark, it is also generally over-weight credit risk. With few exceptions, periods of rising rates generally coincide with faster economic growth, increases in inflation expectations and a healthier U.S. economy. As a result, credit spreads tend to tighten as the risk of ratings downgrades recedes. In reviewing the performance over the past seven quarters, a period in which [10-Year Treasury yields](#) rose by more than 140 basis points,¹ the yield-enhanced Index outperformed the Agg by 80 basis points annualized.

- **Bottom Line:** A credit over-weight resulted in higher income and the ability to benefit from tighter spreads despite the headwinds of increased duration during a rising rate environment. The Index may have a tough time over short periods, such as the year-to-date performance, but over market cycles, the Enhanced Yield approach adds value.

UST 10-Year Yields and Investment-Grade Credit Spreads



Sources: WisdomTree, Bloomberg. Data from 7/9/15 to 4/11/18. Past performance is not indicative of future results. You cannot invest directly in an index. Investment-grade credit spreads represented by the Bloomberg Barclays U.S. Aggregate Option Adjusted Spread Index.

Current Performance

While diversification can add value in the long run, there is no guarantee that rates and credit will always move in opposite directions. Year-to-date has been a negative for both: wider credit spreads and higher rates. Over this narrow period, the Index has underperformed the Agg by 45 basis points. Much of the rate rise this year occurred in January and early February, and rates have since been range-bound. As for credit, a host of factors unrelated to economic fundamentals have been floated as to credit widening, largely due to fleeting supply-and-demand factors. In our view, it seems unlikely that this trend will continue indefinitely. As a result, we believe the income advantage has the ability to narrow the performance gap over time. As of April 11, 2018, the additional income advantage over the Agg was 47 basis points.²

Conclusion

It's impossible for this Index, or any index, to outperform in all environments. With the [Federal Reserve \(Fed\) hiking](#) interest rates at a measured pace, it seems to us that the central bank views economic conditions as strong. This gives us conviction in being over-weight credit. As a result, our income advantage should help investors generate returns during a period of rising rates, provided they do not rise rapidly. Later in the cycle, credit spreads will inevitably widen. As a result, [nominal interest rates](#) should fall as the Fed shifts its bias from tightening to easing. In our view, our Enhanced Yield strategy has the ability to add value across market cycles.

¹Source: Bloomberg, as of 4/11/18.

²Source: Bloomberg, as of 4/11/18.

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You cannot invest directly in an index.

DEFINITIONS

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 Barclays U.S. Aggregate Enhanced Yield Index : a constrained, rules-based approach that reweights the sector, maturity, and credit quality of the Barclays U.S. Aggregate Index across various sub-components in order to enhance yield.

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.

Duration : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

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

Basis point : 1/100th of 1 percent.

Credit spread : The portion of a bond's yield that compensates investors for taking credit risk.

Tighten : a decline in the amount of compensation bond holders require to lend to risky borrowers. When spreads tighten, the market is implying that borrowers pose less risk to lenders.

Yield curve : Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

Flatten : to effect a zero positio.

Volatility : A measure of the dispersion of actual returns around a particular average level. nbsp;

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

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.

Nominal interest rate : Interest rate that does not account for the impact of inflation.