

# PERFORMANCE ROTATION AMONG GLOBAL FIXED INCOME SECTORS

Bradley Krom — Head of U.S. Research  
06/12/2014

From 2009 through the middle of 2013, fixed income investing turned out to be fairly straightforward. The more [credit risk](#) and [interest rate risk](#) investors assumed in their portfolio, the higher their returns. In the second half of last year, interest rates rose and emerging markets fell out of favor. So far in 2014, falling interest rates have boosted longer-maturity bonds. Emerging markets are also making up for losses experienced last year. But a key takeaway, in our view, is that over the past five years, having the flexibility to rotate among the various flavors of fixed income around the world yielded the best results.<sup>1</sup> As interest rates continue to grind lower and [credit spreads](#) continue to tighten, selectivity will continue to become even more critical, in our view. The low-hanging fruit for credit investors might be gone, but selective opportunities still exist. Perhaps more importantly, potential to avoid the problem spots in the market could have a significant impact on performance in the coming years.

**Performance Rotation across Corporate Bond Sectors**

2008	2009	2010	2011	2012	2013	YTD 2014
-4.7% International Investment Grade Corporate Bonds	70.9% International High Yield Bonds	16.4% International High Yield Bonds	8.5% EM USD Sovereign Bonds	25.0% International High Yield Bonds	7.4% US High Yield Bonds	3.5% EM USD Sovereign Bonds
-4.9% US Investment Grade Corporate Bonds	58.2% US High Yield Bonds	15.1% US High Yield Bonds	8.2% US Investment Grade Corporate Bonds	18.5% EM USD Sovereign Bonds	7.0% International High Yield Bonds	3.0% US High Yield Bonds
-10.9% EM USD Sovereign Bonds	37.5% EM USD Corporate Bonds	12.5% EM USD Corporate Bonds	5.0% US High Yield Bonds	15.8% US High Yield Bonds	2.2% Global Corporate Composite Hedged (75% IG / 25% HY)	2.9% US Investment Grade Corporate Bonds
-11.0% Global Corporate Composite Hedged (75% IG / 25% HY)	28.2% EM USD Sovereign Bonds	12.0% EM USD Sovereign Bonds	4.4% Global Corporate Composite Hedged (75% IG / 25% HY)	15.2% EM USD Corporate Bonds	1.2% International Investment Grade Corporate Bonds	2.7% International High Yield Bonds
-16.8% EM USD Corporate Bonds	26.7% Global Corporate Composite Hedged (75% IG / 25% HY)	9.6% Global Corporate Composite Hedged (75% IG / 25% HY)	3.0% EM USD Corporate Bonds	13.6% Global Corporate Composite Hedged (75% IG / 25% HY)	-1.3% EM USD Corporate Bonds	2.7% Global Corporate Composite Hedged (75% IG / 25% HY)
-26.2% US High Yield Bonds	15.2% US Investment Grade Corporate Bonds	9.0% US Investment Grade Corporate Bonds	2.5% International Investment Grade Corporate Bonds	11.5% International Investment Grade Corporate Bonds	-1.5% US Investment Grade Corporate Bonds	2.4% EM USD Corporate Bonds
-29.9% International High Yield Bonds	4.4% International Investment Grade Corporate Bonds	5.9% International Investment Grade Corporate Bonds	-1.2% International High Yield Bonds	9.8% US Investment Grade Corporate Bonds	-6.6% EM USD Sovereign Bonds	2.2% International Investment Grade Corporate Bonds

Values represent calendar-year 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. International Investment Grade Corporate Bonds, U.S. Investment Grade Corporate Bonds and U.S. High Yield Bonds represented by the Barclays Global Aggregate Corporate ex-U.S. Total Return Index Hedged USD, the Barclays U.S. Aggregate Corporate Total Return USD and the Barclays U.S. Corporate High Yield Total Return Index, respectively. EM USD Corporates and EM USD Sovereigns are represented by the JPMorgan CEMBI Broad and JPMorgan EMBI Global Composite Indexes, respectively. International High Yield Bonds are represented by the Merrill Lynch ex-U.S. Issuers High Yield Constrained Index. Sources: Zephyr, Barclays, JPMorgan, BofA Merrill Lynch, as of 3/31/14.

*For definitions of terms and*

*indexes in the chart, please visit our [Glossary](#).* As shown in the graphic above, the common theme since the global financial crisis has been to increase credit risk in portfolios and also to be willing to take a global approach to fixed income. In fact, U.S. [high yield](#) debt has been a top three performer every year since 2008. Outside the U.S., emerging markets have also performed well, excepting 2013. Perhaps one of the most interesting elements, though, is the continued slow performance in the international investment-grade market. While it arguably represents one of the most resilient asset classes—having delivered positive performance in every year since 2008 (where it declined by only 4.7%)—it has remained one of the slowest-performing cuts of fixed income due to European economic difficulties in recent years. However, with the economic picture in Europe slowly improving, certain issuers in this subset of the market may present unique opportunities for value. In terms of interest rate risk, the market's view has shifted in recent months. In the second

half of 2013, virtually no analyst thought rates would fall in 2014. Now, after U.S. rates have fallen back to levels not seen since last June amid investors' grappling with Fed [tapering](#), the common refrain has changed to rates remaining "lower for longer." While the consensus sees U.S. rates still higher by the end of the year, allowing a portfolio management team whose sole focus is fixed income could be an effective way to manage risk. In our view, enlisting the expertise of a portfolio manager focused on balancing these risks could have a great deal of value in the current market environment. While these decisions will be only as effective as the analysis supporting them, we believe that allowing a dedicated team to help navigate the current uncertainty in the market may help many investors get better [risk-adjusted returns](#) in the long run. <sup>1</sup>Source: Bloomberg, as of 3/31/14

#### Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. Derivative investments can be volatile and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions. Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. In addition when interest rates fall income may decline. Fixed income investments are also subject to credit risk, the risk that the issuer of a bond will fail to pay interest and principal in a timely manner, or that negative perceptions of the issuer's ability to make such payments will cause the price of that bond to decline. Unlike typical exchange-traded funds, there is no index that the Fund attempts to track or replicate. Thus, the ability of the Fund to achieve its objective will depend on the effectiveness of the portfolio manager. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

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.

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](http://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, Kara Marciscano, Jianing Wu, Brian Manby and Scott Welch 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

**Credit risk** : The risk that a borrower will not meet their contractual obligations in conjunction with an investment.

**Interest rate risk** : The risk that an investment's value will decline due to an increase in interest rates.

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

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

**Tapering** : A shift in monetary policy by which the Federal Reserve would begin decreasing the amount of bonds it purchases.

**Risk-adjusted returns** : Returns measured in relation to their own variability. High returns with a high level of risk indicate a lower probability that actual returns were close to average returns. High returns with a low level of risk would be more desirable, as they indicate a higher probability that actual returns were close to average returns.