Navigating market turbulence: the impact of higher rates on bonds and investment opportunities

Published 23 January 2025

Ayush Babel
Director, Quantitative Research

Aneeka Gupta
Director, Macroeconomic Research

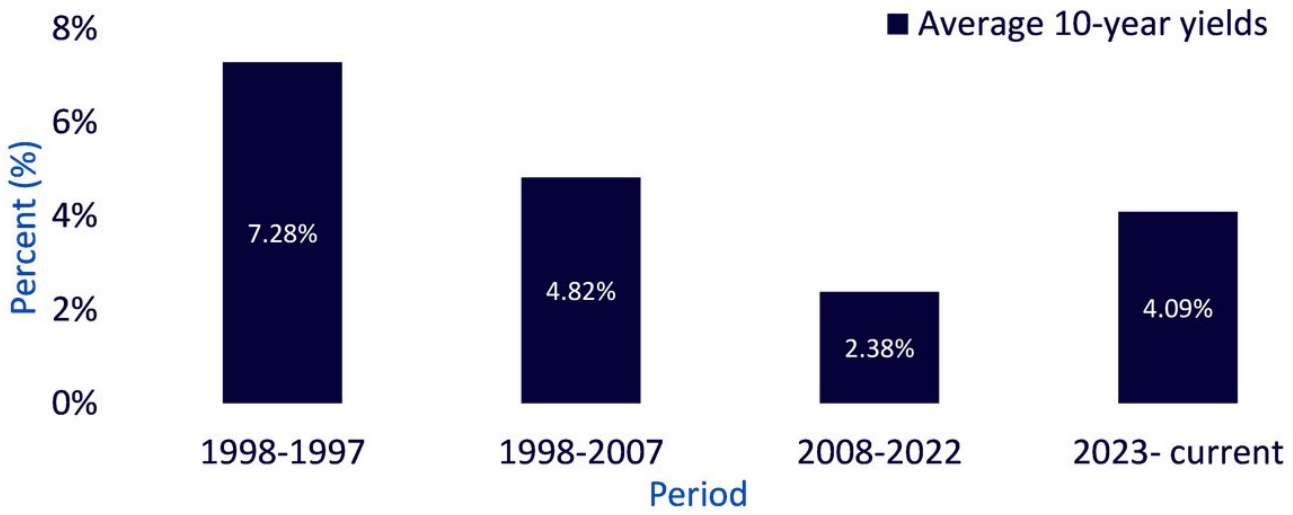
Key Takeaways

- Rising bond yields across major economies signal a ‘higher for longer’ rate environment, with US 10-year Treasury yields nearing critical thresholds, creating opportunities for yield-focused investors to manage rate volatility.
- The WisdomTree USD Floating Rate Treasury Bond UCITS ETF (TFRN) offers a low-duration, high-yield solution in the current environment, outperforming European counterparts and benefiting from the resilient US dollar.
- Contingent convertible bonds (CoCos) demonstrate resilience amid high rates, benefiting from stronger banking sector fundamentals, offering investors a compelling alternative to vulnerable high-yield corporate bonds.

The recurring selloffs in global bond markets are driving yields closer to critical thresholds, fuelled by growing concerns over persistent inflation, political instability, and rising government debt levels. The shifting narrative since mid-September regarding continued moderate growth and a “bumpy” inflation path for the U.S. economy has led the markets to visibly reduce the pace of expected Fed rate cuts in 2025.President-elect Donald Trump’s victory has also created uncertainty surrounding tariffs and the potential for a more stimulative fiscal policy that could potentially swell U.S. budget deficits.

In the US, the 10-year Treasury yield rose as high as 4.80%, pushing it toward the 5% peak hit in October 20231. The higher-rates-for-longer phenomenon looks to be rooted in changes to the US outlook but is sending ripples across major economies, resulting in higher borrowing costs. In the UK, that yield hit as much as 4.89%, the highest since August 20082. Myriad factors contributed to the higher, including the Labour government’s spending ambitions, sticky inflation, higher US rates and supply pressures. Even in Japan, the 10-year rate on government bonds has pushed over 1% to the highest in over a decade1.

Figure 1: New normal – US bond yields approaching pre-financial crisis

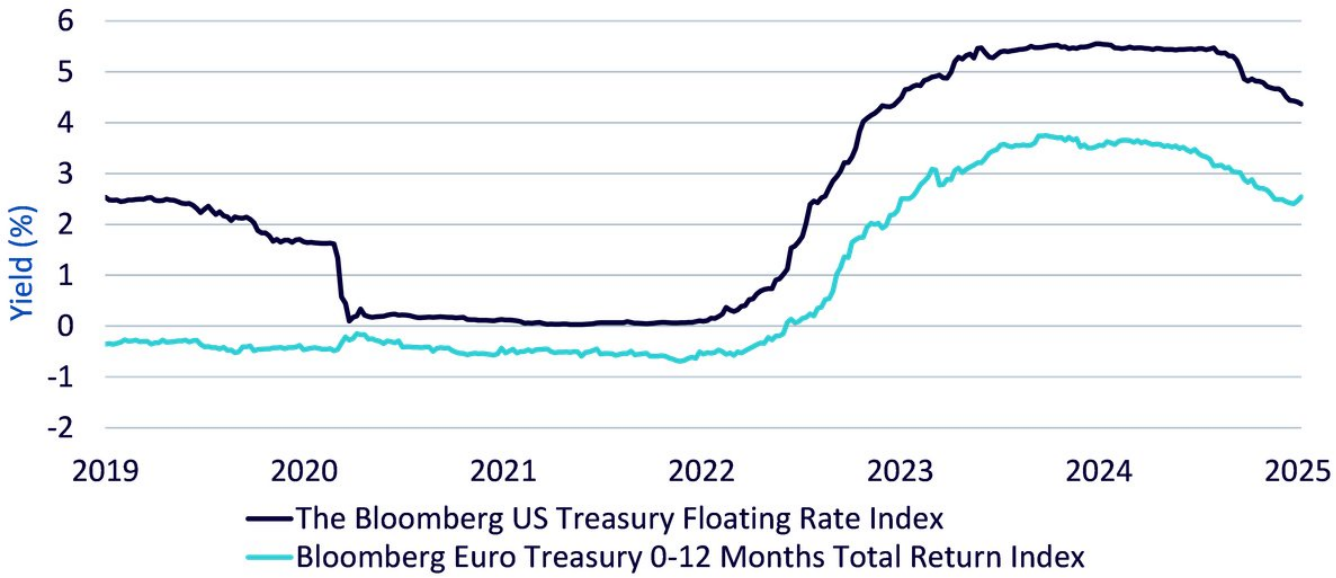


Source: Bloomberg, WisdomTree from 1 January 1998 to 10 January 2025. **Historical performance is not an indication of future performance and any investments may go down in value.**

Opportunity for a yield seeking investor

Amid the turbulence, floating-rate Treasury funds such as the WisdomTree USD Floating Rate Treasury Bond UCITS ETF (TFRN) offers investors a low-duration, high yield solution for managing rate volatility and duration. These securities seek to track the price and yield performance of the Bloomberg US Treasury Floating Rate Bond Index. With the monetary cycle still in, 'higher for longer' mode, this strategy provides investors with a means of income whilst lowering their duration. Additionally, the WisdomTree USD Floating Rate Treasury Bond UCITS ETF (TFRN) offers a higher yield that is 1.82%3 above the Bloomberg Euro Treasury Index (0-12 months), enabling investors to benefit from the additional yield.

Figure 2: Comparison of US and European yields



Source: Bloomberg, WisdomTree from 4 January 2019 to 10 January 2025. **Historical performance is not an indication of future performance and any investments may go down in value.**

Resilient dollar and European challenges

Adjusted for inflation, the Federal Reserve's (Fed) measure of the broad, trade-weighted dollar is now at the highest level since 1985. Europe remains mired in weak growth and unstable leadership. The European Central Bank (ECB) looks prepared to take the policy rate sub-neutral, perhaps as early as Q2 2025, aiding the EUR/USD's move towards parity. In comparison, the US economy appears set to continue a modest growth path, with further improvements on the inflation front proving to be 'bumpy', in line with Fed Chair Powell's description.

Figure 3: EUR/USD currency pair remains below the 200-day moving average



Source: Bloomberg, WisdomTree from 3 January 2000 to 10 January 2025. **Historical performance is not an indication of future performance and any investments may go down in value.**

Several Fed policymakers recently signalled they support keeping rates on hold for an extended period. A similar view is being reflected in the swaps market, with the next quarter-point rate cut not fully priced in until H2 20254. These factors are likely to exert downward pressure on the euro relative to the dollar, potentially benefiting EUR-based investors in the WisdomTree USD Floating Rate Treasury Bond UCITS ETF (TFRN).

CoCos: resilience amid high rates

Higher interest rates create a challenging environment for high-yield corporate bonds, while highlighting the relative resilience of contingent convertible bonds (CoCos). High-yield corporate bonds are particularly sensitive to high interest rates due to increased vulnerability to default risks during periods of tighter financial conditions. As borrowing costs rise, companies with weaker credit profiles face greater difficulty refinancing debt or meeting obligations, leading to wider spreads and heightened risk premiums. Additionally, the inherent volatility of high-yield corporate bonds often results in diminished investor appetite during such periods, further pressuring their valuations.

In contrast, contingent convertible bonds (CoCos) are uniquely positioned and continue to navigate this high-rate environment more effectively. Unlike high-yield corporate bonds, CoCos benefit indirectly from the improved financial health of the banking sector, as higher rates bolster banks' profitability by expanding net interest margins. This strengthened profitability reduces the likelihood of CoCo conversions or write-downs, fostering greater investor confidence. Furthermore, CoCos typically exhibit lower sensitivity to adverse rate movements, offering an added layer of resilience.

A compelling alternative for investors

This contrast underscores a key distinction: while high-yield corporate bonds tend to struggle with higher interest rates and the associated credit risks, CoCos have historically thrived on the strengthened balance sheets of their issuers. For investors seeking returns in a high-rate environment, CoCos could present a potential alternative to the heightened vulnerabilities of high-yield corporate bonds, and offer a combination of stability, robust fundamentals, and potential for capital gains.

1 Bloomberg as of 15 January 2025
2 Bloomberg as of 14 January 2025
3 Difference in yields 1.82% between WisdomTree USD Floating Rate Treasury Bond UCITS ETF (4.37%) and Bloomberg Euro Treasury Index (2.54%) as of 10 January 2025.
4 Bloomberg as of 13 January 2025.

Important Risks Related to this Article

IMPORTANT INFORMATION

Marketing communications issued in the European Economic Area ("EEA"): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as "WisdomTree" (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

This marketing communication has been prepared for professional investors, but the WisdomTree products set out in this document may be available in some jurisdictions to any investors, subject to applicable laws and regulations. As the product may not be authorised or its offering may be restricted in your jurisdiction, it is the responsibility of every person or entity to satisfy themselves as to the full observance of the laws and regulations of the relevant jurisdiction. Prior to any application investors are advised to take all necessary legal, regulatory, tax and investment advice on the suitability and consequences of an investment in the products. Past performance is not a reliable indicator of future performance. Any historical performance included in this document may be based on back testing. Back testing is the process of evaluating an investment strategy by applying it to historical data to simulate what the performance of such strategy would have been. Back tested performance is purely hypothetical and is provided in this document solely for informational purposes. Back tested data does not represent actual performance and should not be interpreted as an indication of actual or future performance. The value of any investment may be affected by exchange rate movements. Any decision to invest should be based on the information contained in the appropriate prospectus and affer seeking independent investment, tax and legal advice. These products may not be available in your market or suitable for you. The content of this document does not constitute investment advice nor an offer for sale nor a solicitation of an offer to buy any product or make any investment.

An investment in exchange-traded products ("ETPs") is dependent on the performance of the underlying index, less costs, but it is not expected to match that performance precisely. ETPs involve numerous risks including among others, general market risks relating to the relevant underlying index, credit risks on the provider of index swaps utilised in the ETP, exchange rate risks, interest rate risks, inflationary risks, liquidity risks and legal and regulatory risks.

The information contained in this document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares in the United States or any province or territory thereof, where none of the issuers or their products are authorised or registered for

distribution and where no prospectus of any of the issuers has been filed with any securities commission or regulatory authority. No document or information in this document should be taken, transmitted or distributed (directly or indirectly) into the United States. None of the issuers, nor any securities issued by them, have been or will be registered under the United States Securities Act of 1933 or the Investment Company Act of 1940 or qualified under any applicable state securities statutes.

This document may contain independent market commentary prepared by WisdomTree based on publicly available information. Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Any third party data providers used to source the information in this document make no warranties or representation of any kind relating to such data. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.

This document may contain forward looking statements including statements regarding our belief or current expectations with regards to the performance of certain assets classes and/or sectors. Forward looking statements are subject to certain risks, uncertainties and assumptions. There can be no assurance that such statements will be accurate and actual results could differ materially from those anticipated in such statements. WisdomTree strongly recommends that you do not place undue reliance on these forward-looking statements.

WisdomTree Issuer ICAV

The products discussed in this document are issued by WisdomTree Issuer ICAV (“WT Issuer”). WT Issuer is an umbrella investment company with variable capital having segregated liability between its funds organised under the laws of Ireland as an Irish Collective Asset-management Vehicle and authorised by the Central Bank of Ireland (“CBI”). WT Issuer is organised as an Undertaking for Collective Investment in Transferable Securities (“UCITS”) under the laws of Ireland and shall issue a separate class of shares ("Shares") representing each fund.

The Fund is described in a Key Information Document (KID) or Key Investor Information Document (KIID) for UK investors, and the prospectus of WT Issuer (“WT Prospectus”). A copy of the WT Prospectus and the KID / KIID is available, for EEA/UK only, in English at www.wisdomtree.eu. Where required under national rules, the KID will also be available in the local language of the relevant EEA Member State. Investors should read the WT Prospectus before investing and should refer to the section of the WT Prospectus entitled 'Risk Factors' for further details of risks associated with an investment in the Shares.

The summary of investor rights associated with an investment in the fund is available in English on WisdomTree Europe's website. WisdomTree Management Limited may decide to terminate the arrangements made for the marketing of its collective investment undertakings. In such circumstances, shareholders in the affected EEA Member State will be notified of this decision and will be provided with the opportunity to

redeem their shareholding in the fund free of any charges or deductions for at least 30 working days from the date of such notification.

WisdomTree USD Floating Rate Treasury Bond UCITS ETF

BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). BARCLAYS® is a trademark and service mark of Barclays Bank Plc (collectively with its affiliates, "Barclays"), used under license. Bloomberg or Bloomberg's licensors, including Barclays, own all proprietary rights in the Bloomberg Barclays Indices. Neither Bloomberg nor Barclays is affiliated with WisdomTree Investments Inc, and neither approves, endorses, reviews or recommends the WisdomTree USD Floating Rate Treasury Bond UCITS ETF (the "Fund"). Neither Bloomberg nor Barclays guarantees the timeliness, accurateness or completeness of any data or information relating to the Bloomberg Barclays US Treasury Floating Rate Bond Index (the "Index"), and neither shall be liable in any way to WT Issuer, investors in the Fund or other third parties in respect of the use or accuracy of the Index or any data included therein.

Notice to Investors in Switzerland – Qualified Investors

This document constitutes an advertisement of the financial product(s) mentioned herein.

The prospectus and the key investor information documents (KIID) are available from WisdomTree's website: **https:** //www.wisdomtree.eu/en-ch/resource-library/prospectus-and-regulatory-reports

Some of the sub-funds referred to in this document may not have been registered with the Swiss Financial Market Supervisory Authority ("FINMA"). In Switzerland, such sub-funds that have not been registered with FINMA shall be distributed exclusively to qualified investors, as defined in the Swiss Federal Act on Collective Investment Schemes or its implementing ordinance (each, as amended from time to time). The representative and paying agent of the sub-funds in Switzerland is Société Générale Paris, Zurich Branch, Talacker 50, PO Box 5070, 8021 Zurich, Switzerland. The prospectus, the key investor information documents (KIID), the articles of association and the annual and semi-annual reports of the sub-funds are available free of charge from the representative and paying agent. As regards distribution in Switzerland, the place of jurisdiction and performance is at the registered seat of the representative and paying agent.

For Investors in France:

The information in this document is intended exclusively for professional investors (as defined under the MiFID) investing for their own account and this material may not in any way be distributed to the public. The distribution of the Prospectus and the offering, sale and delivery of Shares in other jurisdictions may be restricted by law. WT Issuer is a UCITS governed by Irish legislation, and approved by the Financial Regulatory as UCITS compliant with European regulations although may not have

to comply with the same rules as those applicable to a similar product approved in France. The Fund has been registered for marketing in France by the Financial Markets Authority (Autorité des Marchés Financiers) and may be distributed to investors in France. Copies of all documents (i.e. the Prospectus, the Key Investor Information Document, any supplements or addenda thereto, the latest annual reports

and the memorandum of incorporation and articles of association) are available in France, free of charge at the French centralizing agent, Societe Generale at 29, Boulevard Haussmann, 75009, Paris, France. Any subscription for Shares of the Fund will be made on the basis of the terms of the prospectus and any supplements or addenda thereto.

For Investors in Malta: This document does not constitute or form part of any offer or invitation to the public to subscribe for or purchase shares in the Fund and shall not be construed as such and no person other than the person to whom this document has been addressed or delivered shall be eligible to subscribe for or purchase shares in the Fund. Shares in the Fund will not in any event be marketed to the public in Malta without the prior authorisation of the Maltese Financial Services Authority.

For Investors in Monaco: This communication is only intended for duly registered banks and/or licensed portfolio management companies in Monaco. This communication must not be sent to the public in Monaco.