

Reaching a "TIP"ping Point

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Is it too early to be considering [Federal Reserve](#) “exit strategy” protection for your fixed income portfolio? I’ve been focusing a lot on this topic of late, and for good reason.

Think about it. If I had asked you your thoughts on [monetary policy](#) a few short months ago, the more likely answer would have been: “Oh, nothing to worry about for the foreseeable future... Fed policy is on a ‘perma-hold’: i.e., no tapering, let alone rate hikes, will be forthcoming for quite a while.” You know what, I wouldn’t have necessarily disagreed with you either. BUT, as I’ve been blogging recently, there seem to be some “winds of change” in the air, and at a minimum, I feel investors should be contemplating some shifts in potential portfolio positioning now, so there are no “Fed surprises” lurking out there.

Total NAV Return of USFR vs. Bloomberg Barclays TIPS Indexes During Recent Rising Rate Period & Post- June FOMC Meeting			
Fund Name	Ticker	7/8/16 - 11/8/18	5/17/21 -6/16/21
WisdomTree Floating Rate Treasury Fund	USFR	2.94%	0.00%
Bloomberg Barclays U.S. Treasury TIPS 0-5 Years Total Return Index	LTP5TRUU	1.07%	-0.59%
Bloomberg Barclays U.S. Treasury Inflation Notes TR Index	LBUTTRUU	-2.31%	-0.48%

Source: WisdomTree, as of 6/24/21. **Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost**

Please find standardized performance for USFR by clicking [here](#).

For definition of Indexes in the table, please click [here](#).

While the timing of potential [balance sheet](#) tapering is certainly on my radar, it’s the pushed-up timing of the first rate hike that has gotten my attention. And as I mentioned in last week’s blog post, it would [only take three Fed members](#) to adjust their forecast for the median estimate to move to a 2022 timetable, putting portfolio positioning in a clearer focus.

One vehicle of choice that investors have chosen in the past (and present) as a solution to this backdrop is Treasury Inflation-Protected Securities, or TIPS. The TIPS arena can be broken down into two buckets, one being shorter dated (0–5 years) and the other more closely representing the entire TIPS market in general.

After closer review, one discovers that TIPS have been a less than optimal solution when the Fed is “on the move.” A better option would be to utilize a Treasury floating rate note (FRN) strategy. The chart above highlights how the [WisdomTree Floating Rate Treasury Fund \(USFR\)](#) and TIPS have fared in the most

recent rising rate period of July 2016 through November 2018, as well as the market's initial response to the just-completed June FOMC meeting. Clearly, USFR had the advantage when compared to both TIPS buckets in both instances.

Conclusion

Admittedly, the post-June FOMC meeting period was only about a month, but in my opinion, it provided a “real-time” example of how each of these rate-hedging solutions could perform when the Fed does finally begin its exit strategy. Remember, the Fed “only” talked about “talking about tapering” and pushed its timing for lift-off to 2023 from 2024. Ask yourself what could happen if/when the Fed outlines its taper outlook more succinctly AND potentially pushes up its first rate hike estimate to 2022 later this year. The next time the Fed will publish the “blue dots” is in September, less than three months from now. Against this backdrop, investors may want to start considering how USFR could fit into their fixed income portfolio for “Fed protection.”

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Securities with floating rates can be less sensitive to interest rate changes than securities with fixed interest rates, but may decline in value. The issuance of floating rate notes by the U.S. Treasury is new, and the amount of supply will be limited. Fixed income securities will normally decline in value as interest rates rise. The value of an investment in the Fund may change quickly and without warning in response to issuer or counterparty defaults and changes in the credit ratings of the Fund's portfolio investments. Due to the investment strategy of this Fund, it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

Treasury Inflation-Protected Securities, or TIPS, provide protection against inflation. The principal of a TIPS increases with inflation and decreases with deflation, as measured by the Consumer Price Index. When a TIPS matures, you are paid the adjusted principal or original principal, whichever is greater