WisdomTree ETF Solutions

LET UNCLE SAM PROVIDE YOU INCOME WITHOUT THE VOLATILITY

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With nearly $26.0 trillion in marketable public debt outstanding, Treasury securities (UST) are viewed as the most liquid asset class in the fixed income universe, offering money and bond market investors a high-quality solution, with a variety of different investment aspects. With higher interest rates and elevated bond market volatility, it is important to understand the dynamics behind the different Treasury securities available in order to make an educated decision for your bond portfolio. Let's take a quick lesson on the UST market.

WHAT ARE THE DIFFERENT TYPE OF SECURITIES OFFERED?

+ Certainly, a workhorse for the nation's debt managers, the T-bill sector makes up roughly $5.3 trillion, or 20%, of the total marketable amount outstanding. Primarily, T-bills are offered in 1, 2, 3, 4, 6 and 12-month maturities. Oftentimes, Treasury will also issue cash management bills (CMBs) to bridge potential gaps in their overall financing needs.
+ Treasury notes come in maturities between one and ten years and represent the largest grouping at almost $14.0 trillion, or more than 53% of the overall amount.
+ Treasury bonds are offered in maturities over ten years, consisting of both 20 and 30-year issues. The amount outstanding here is $4.2 trillion, or 16% of the total.
+ Combined, T-bills, notes and bonds make up 90% of total marketable debt outstanding.
+ Treasury Inflation-Protected Securities (TIPS) were added to the line-up in January 1997. TIPS are currently offered in 5, 10 and 30-year maturities and total more than $1.9 trillion.
+ While the 4-month T-bill was introduced in 2022, the newest Treasury note is the 2-year Floating Rate Note (FRN), which was first offered in January 2014. These securities are auctioned on a monthly basis and have grown to a total of close to $600 billion.

UST TIMELINE

- **Dec 1929** 13-week T-bill introduced
- **1959** 26-week & 1-yr T-bills
- **1972** UST 2-yr notes
- **1976 & 1977** 5-yr notes 10-yr notes 30-yr bonds
- **1997** TIPS introduced
- **2001** 4-week T-bill
- **2008 & 2009** 3-yr and 7-yr notes reintroduced
- **2014** FRNs first auctioned
- **2018** 8-week T-bill
- **2020 & 2022** 20-yr bonds & 17-week T-bills

TRADITIONAL RATE HEDGED-STRATEGIES

+ Since their inception, TIPS have been viewed as an interest rate-hedged strategy. While these securities do help to mitigate the effects of inflation on rates, TIPS yields can still increase in a rising rate environment when the Fed is the primary catalyst.
+ In the bond market sell-off during the July 2016 – November 2018 period, 10-year TIPS yields increased by 125 basis points (bps). More recently, since the November 2021 low point, the 10-year TIPS yield has risen by over 350 bps.
+ Short-duration 'fixed' Treasury coupon issues can also experience loss of principal and heightened volatility as we have seen during this rate hike cycle.
+ In our opinion, a more optimal solution for higher rates, especially when looking for 'Fed protection' in a tightening policy setting, is the FRN space, which carries only one week in duration.
+ The interest rate for a FRN 'floats' or gets reset at the weekly 13-week T-bill auction (see below); with TIPS, the principal is adjusted for changes in the Consumer Price Index (CPI).
+ Thus, if the current bout of inflation has peaked, an investor could still be exposed to higher rates from other factors, such as a restrictive Fed monetary policy.
+ UST FRNs have revealed better liquidity prospects when compared to TIPS, with the amount outstanding roughly 1.5 times the size at comparable stages of their life cycle.
+ As a result of the Treasury's supply needs, the auction size of the FRN has increased in a rather visible fashion. Treasury views this sector as a key component in managing the weighted average maturity of U.S. marketable debt outstanding, expanding the UST investor base and helping to share the burden of escalating borrowing requirements.

THE CASE FOR AN FRN-BASED SOLUTION

The interest rate of an FRN changes, or “floats,” over the life of the FRN. The interest rate is the sum of two components: an index rate and a spread.

+ **Index rate.** This rate is tied to the highest accepted discount rate of the most recent 13-week Treasury bill (3-mo. T-bill). The 13-week bill is auctioned every week, so the index rate of an FRN is re-set every week.
+ **Spread.** The spread is a rate applied to the index rate. The spread stays the same for the life of an FRN. The spread is determined at the auction where the FRN is first offered. The spread is the highest accepted discount margin in that auction.

THE BOTTOM LINE

Although the Fed may be at, or close to, the end of this rate hike cycle, policymakers seem intent on keeping monetary policy restrictive for longer than originally expected, with the timing of rate cuts continually being pushed back. Against this backdrop, market participants will more than likely be confronted with a ‘higher for longer’ U.S. rate setting for the foreseeable future. We feel investors should be considering solutions which provide income, but without the associated volatility that can be found in ‘fixed’ coupon issues for their bond portfolios.

ACTIONABLE IDEA

The **WisdomTree Floating Rate Treasury Fund (USFR)** is a solution which seeks to track the Bloomberg U.S. Treasury Floating Rate Bond Index, before fees and expenses. Given the Fed’s guidance and market outlook for continued elevated interest rates Treasury FRNs are expected to remain one of the highest yielding Treasury securities in the months ahead.

GLOSSARY

Basis point: 1/100th of 1 percent.

Bloomberg U.S. Treasury Floating Rate Bond Index: A rules-based, market-capitalization-weighted index engineered to measure the performance of floating rate U.S. Treasury notes.

Cash management bill (CMB): A short-term security sold by the U.S. Department of the Treasury. The maturity on a CMB can range from a few days to three months. The money raised through these issues is used by the Treasury to meet any temporary cash shortfalls and provide emergency funding.

Consumer Price Index (CPI): A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

Floating rate note (FRN): A debt instrument with a variable interest rate.

Monetary policy: Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Treasury (UST): Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Treasury bill (T-bill): 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).

Treasury Inflation-Protected Securities (TIPS): Bonds issued by the U.S. government. 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.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Funds before investing. To obtain a prospectus containing this and other important information, please call 866.909.9473 or visit WisdomTree.com/investments to view or download a prospectus. Investors should read the prospectus carefully before investing.

IMPORTANT RISK INFORMATION

There are risks associated with investing, including the possible loss of principal.

USFR: 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 profiles.

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