With nearly $15.0 trillion in marketable public debt outstanding, U.S. Treasury (UST) securities 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. Let’s have a quick lesson on the UST market.

WHAT ARE THE DIFFERENT TYPES OF SECURITIES OFFERED?

+ Certainly a workhorse for the nation’s debt managers, the t-bill\(^1\) sector makes up roughly $2.3 trillion, or 15.3%, of the total marketable amount outstanding. Primarily, t-bills are offered in 1-, 3-, 6- and 12-month maturities. Often, Treasury will also issue cash management bills\(^2\) to bridge potential gaps in its overall financing needs.

+ Treasury notes come in maturities between 1 and 10 years and represent the largest grouping at a little more than $8.9 trillion, or nearly 60% of the overall amount.

+ Treasury bonds are offered in maturities over 10 years, with the 30-year bond being the only regular auction in this sector. The amount outstanding here is $2.0 trillion, or 13.6% of the total.

+ Combined, t-bills, notes and bonds make up just under 90% of total marketable debt outstanding.

+ Treasury Inflation-Protected Securities (TIPS)\(^3\) were added to the lineup in January 1997. TIPS currently are offered in 5-, 10- and 30-year maturities and total more than $1.3 trillion.

+ The newest Treasury security is the 2-year floating rate note (FRN), first offered in January 2014. These securities are auctioned on a monthly basis and, in a relatively short period of time, have grown to a total of $334 billion.

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1. Treasury Bill: A Treasury Bill (t-bill) is a short-term debt obligation backed by the U.S. government with a maturity of 1 month (4 weeks), 3 months (13 weeks) or 6 months (26 weeks).

2. 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.

3. 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.
**UST TIMELINE**

- Dec. 1929: 13-week t-bill introduced
- 1959: 26-week and 1-yr t-bills
- 1972: UST 2-year notes
- 1976: 5-year notes 10-year notes
- 1977: 30-year bonds replace 25-year offering
- 1997: TIPS introduced
- 2001: 4-week t-bill
- 2008: 3-year note reintroduced
- 2009: 7-year note reintroduced
- 2014: FRNs first auctioned

**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, they do not necessarily provide the rate protection fixed income investors may be looking for. In other words, TIPS yields can still increase in a rising rate environment.
- In the bond market sell-off during the second half of 2016, 10-year TIPS yields rose nearly 60 basis points (bps). Since September 7 of last year (the recent low point for the UST 10-Year yield), this same TIPS yield has risen by almost 55 bps.
- 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.
- The interest rate for an 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.
- Thus, if inflation is relatively low or range-bound, as has been the case of late, an investor would be “buying” inflation protection that is not necessarily needed and still be exposed to higher rates from other factors, such as Fed rate hikes.
- UST FRNs have revealed better liquidity prospects when compared with TIPS, with the amount outstanding almost triple the size at comparable stages of their life cycle.
- As a result of Treasury’s supply needs, the auction size of the FRN has been increased in 2018, and 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.

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4 Basis point: 1/100th of 1%.
5 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.
6 Liquidity: The degree to which an asset or security can be bought or sold in the market without affecting the asset’s price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets.
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-month t-bill). The 13-week bill is auctioned every week, so the index rate of an FRN is reset 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 (roughly 5 bps as of this writing).

THE BOTTOM LINE

As the Fed raises rates, the rate hike is reflected in the weekly 3-month t-bill auction, not only offering investors a rate hedge for their portfolios but also providing the opportunity for higher yield enhancement as a result of the Fed’s tightening moves, with essentially no duration risk. The WisdomTree Bloomberg Floating Rate Treasury Fund (USFR) is a solution that 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 additional increases in the Federal Funds Rate in 2018, if not beyond, some “Fed protection” seems warranted. As of this writing, the average yield to maturity for USFR is more than double that of a 10-year TIPS, notably without the rate risk component.

Unless otherwise stated, source for all data is WisdomTree.

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

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