

“Brexit”ology: Lessons for Fixed Income Investing

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Post-Brexit, volatility has been on heightened display, as investors try to discern where value lies in such an uncertain investment environment. Against this backdrop, and with a week's worth of trading now over, we thought it would be prudent to review where things stand in the fixed income arena. The developed world sovereign debt markets have been the beneficiaries of safe-haven flows. Our June 28 blog post, [“What's ‘Nexit’ for the Bond Market?”](#) discussed U.S. Treasury (UST) market trends, so let's move the focus to the other side of the Atlantic. It is interesting to note that in the initial reaction to the vote, some peripheral 10-year yields, such as in Italy and Spain, actually rose a little more than 15 basis points (bps) before reversing course and rallying sharply, underscoring some of the difficulties investors are having in figuring out the appropriate response. Meanwhile, within the core eurozone, German 10-year bunds behaved as expected, as yield levels have continued their descent into negative territory. As for the actual Brexit home, the United Kingdom gilt market has also seen plummeting yield levels, with the 10-year falling 50 bps as of this writing. This drop in yields came about even in the wake of S&P's decision to downgrade U.K. sovereign debt two notches, from AAA to AA, similar to the UST experience in August 2011. **Key Fixed Income Gauges**

	Pre-Brexit Vote	Post-Brexit Hi/Lo	1 Week Later
2-Year U.S. Treasury Note	0.78%	0.58%	0.58%
10-Year U.S. Treasury Note	1.75%	1.44%	1.47%
10-Year German Bund	0.09%	-0.13%	-0.13%
10-Year U.K. Gilt	1.37%	0.87%	0.87%
Investment Grade Corporate Spread	148	159	156
Investment Grade Corporate Yield	3.03%	2.88%	2.88%
High Yield Corporate Spread	557	616	594
High Yield Corporate Yield	7.09%	7.50%	7.27%

Source: Bloomberg, as of 7/01/2016. Past performance is not indicative of future results.

You cannot invest directly in an index.

“Investment-grade corporate spread/yield” refers to the Barclays US Aggregate Corporate Bond Index; “High-yield corporate spread/yield” refers to the Barclays U.S. Corporate High-Yield Index. Within the credit space, there were also some noteworthy movements. Based on spread action thus far, investors are not being presented with the same “risk-off” scenario that played out during the first six weeks of the year. At

that time, corporate bond spreads widened out to four- and five-year high watermarks. However, at this point, we have actually seen investment-grade (IG) spreads rise by a relatively tepid 5 to 10 bps. In the high yield (HY) sector, the initial increase was almost 60 bps, before falling back to a little more than 35 bps as of this writing. To provide some perspective, from the end of 2015 to mid-February of this year, IG and HY spreads widened by 50 bps and 180 bps, respectively. Given the drop in UST rates, IG and HY corporate yields have remained anchored, with IG yields now below pre-Brexit levels. Expectations for the Federal Reserve (Fed) have been a bit all over the place. In the days immediately following the results, Federal Funds Futures implied that probability pointed toward a nearly 25% chance of a rate cut this year, but that figure has since dropped to under 5%. **Conclusion** From a fixed income perspective, Brexit has served as a powerful reminder that a portfolio of investment vehicles, rather than one based solely on trading near-term headlines, continues to represent our preferred strategy. The WisdomTree approach brings a holistic strategy to fixed income investing, emphasizing the importance of balance sheet considerations. In other words, our focus highlights credit quality rather than trying to take advantage of shorter-term trends within the bond market that can easily reverse and catch investors in an adverse position. With interest rates expected to remain in a low, range-bound pattern and credit concerns (downgrades & defaults) still prevalent, fixed income investors will likely be searching for solutions that provide relative income opportunities in an environment where increased credit quality is desired. WisdomTree fixed income fundamentally based strategies ([WisdomTree Fundamental U.S. Corporate Bond Fund \[WFIG\]](#), [WisdomTree Fundamental U.S. Short-Term Corporate Bond Fund \[SFIG\]](#), [WisdomTree Fundamental U.S. High Yield Corporate Bond Fund \[WFHY\]](#) and [WisdomTree Fundamental U.S. Short-Term High Yield Corporate Bond Fund \[SFHY\]](#)) emphasize such a qualitative approach, with a tilt toward income. The WisdomTree fundamental fixed income Funds can be used as either a substitute or a complement within a fixed income portfolio and fit inside WisdomTree's suite of fixed income products, potentially serving as the allocation to U.S.-based fixed income, specifically within the credit sector.

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