

How to Play the Fed Pivot in Fixed Income

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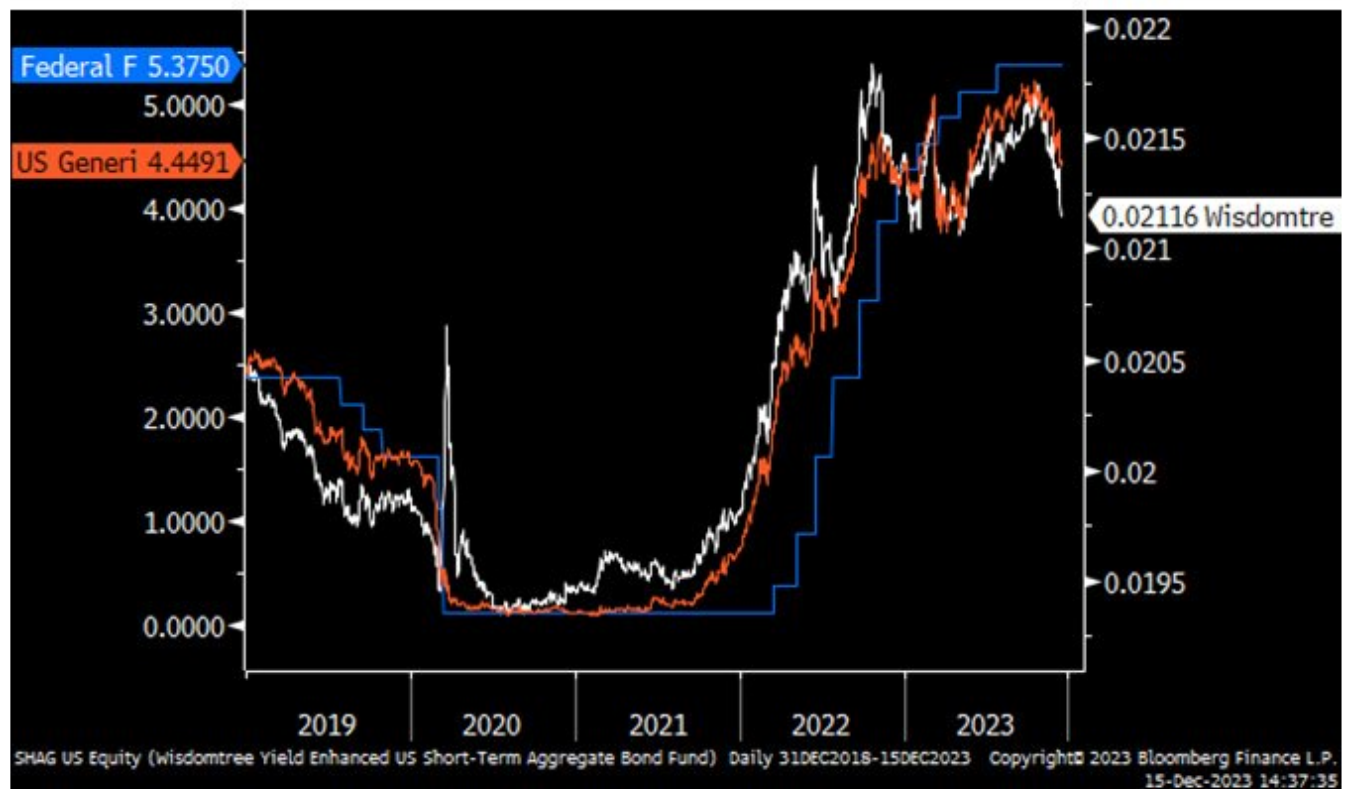
While the Fed didn't cut rates at its [December policy meeting](#), the way the money and bond markets have reacted post-FOMC, one could be forgiven for thinking the rate cuts had already begun. Indeed, most Treasury (UST) yields, especially along the coupon curve, have fallen in a rather noteworthy fashion over the last few trading sessions, as "rate cut euphoria" seems to have taken hold.

However, New York Fed President John Williams (a spokesperson for official Fed policy) interestingly pushed back on this recent market movement. He noted that "we aren't really talking about rate cuts" and that it is "premature" to think about the March 2024 FOMC meeting as the starting date for cutting rates. Ultimately, upcoming economic and inflation data will determine the timing and magnitude of rate cuts, and that will create uncertainty and volatility in the UST market.

That being said, we are of the mindset that rate cuts are coming in 2024; it's just a matter of when and by how much. Against this backdrop, we offer two fixed income solutions for navigating what will likely lie ahead for bond investors in the coming year from both an offense and defense perspective:

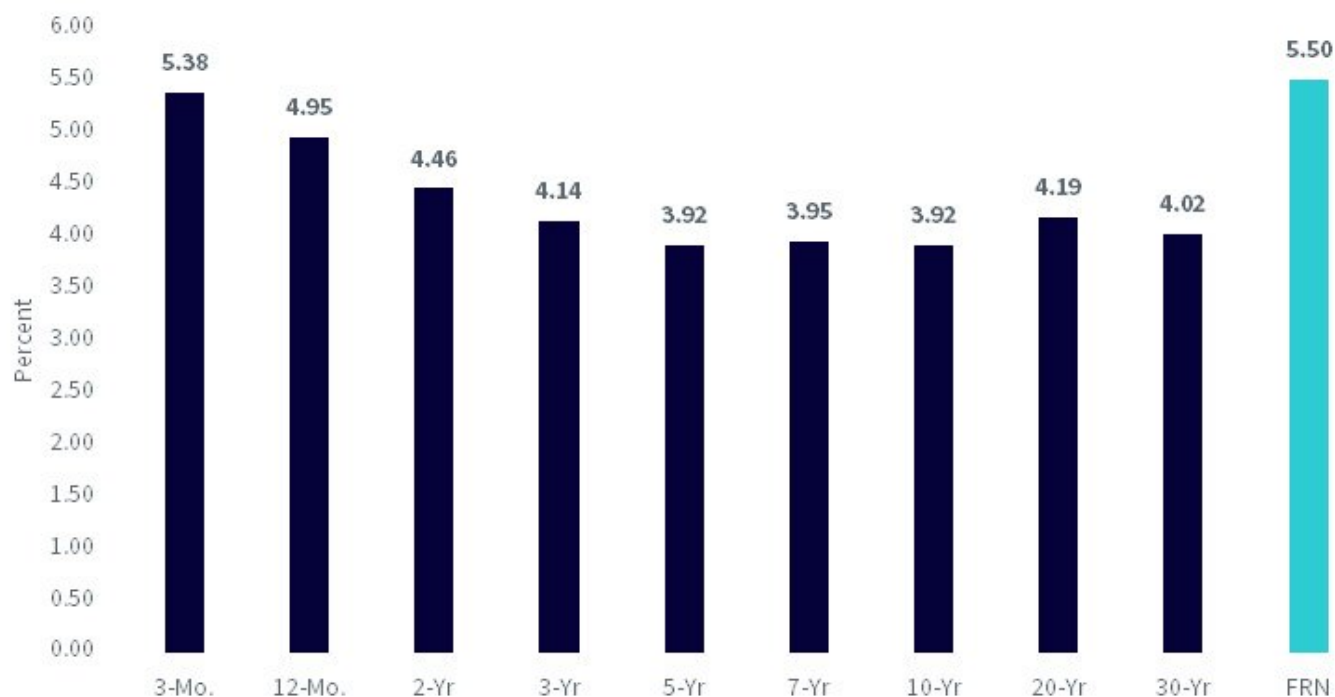
- **On Offense (Rate Cut Solution):** [WisdomTree Yield Enhanced U.S. Short-Term Aggregate Bond Fund \(SHAG\)](#)
- [SHAG](#) is very correlated to the UST 2-Year yield, which is anchored to the Federal Funds Rate (see below).
- Thus, Fed rate cuts and/or rate cut *expectations* should show through here in a more direct fashion than intermediate or long duration vehicles.
- [SHAG](#) has an effective duration of 2.42 as of December 14, 2023.

Correlation of SHAG, UST 2-Year Yield and Fed Funds Target Midpoint



- **Playing Defense (Income without the Volatility): WisdomTree Floating Rate Treasury Fund (USFR)**
- **USFR** is tied to the UST 3-month t-bill auction yield, which is directly tied to the *actual* Federal Funds Rate.
- Why is that important? Because the Fed hasn't cut rates. The 3-month t-bill yield is unchanged post-FOMC vs. declines of roughly 30 basis points along the UST fixed coupon curve as of this writing.
- As mentioned, we believe Fed rate cuts are coming, but what if the market is wrong in its aggressive pricing on this front? Volatility.
- And don't forget, the yield curve is still inverted (see below).

U.S. Treasury Yields



Source: Bloomberg, as of 12/15/23. FRN = Floating Rate Note.

For definitions of terms in the chart above please visit the [glossary](#).

Conclusion

Once again, one can make the case that the UST market has already priced in a lot of good news, so in order to maintain yields at current levels (or even lower), validation will be necessary. In other words, future economic and labor market data need to reveal a visible slowing in growth, while inflation must continue to show signs of further cooling. These two forces will be necessary for the Fed to begin its process toward rate cuts.

Important Risks Related to this Article

SHAG: There are risks associated with investing, including possible loss of principal. Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. Fixed income investments are also subject to credit risk, the risk that the issuer of a bond will fail to pay interest and principal in a timely manner or that negative perceptions of the issuer's ability to make such payments will cause the price of that bond to decline. Investing in mortgage- and asset-backed securities involves interest rate, credit, valuation, extension and liquidity risks and the risk that payments on the underlying assets are delayed, prepaid, subordinated or defaulted on. Due to the investment strategy of the 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.

USFR: 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. 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.