Jim Bianco’s Take on Core Bond Exposures

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Key Takeaways

- The Federal Reserve (Fed) is expected to start lowering rates, but the pace could depend more on economic and employment trends than inflation.
- The WisdomTree Bianco Total Return Fund (WTBN) uses a dynamic index-based approach to manage core bond exposures, adjusting for factors like duration, yield curve positioning and corporate credit risks.
- Bianco Research believes there is a fundamental difference between managing bond and managing stock portfolios with respect to attempting to outperform market cap-weighted benchmarks.

Bond investors had it relatively easy over the last few years. The Fed brought short-term interest rates to 5.375% to combat inflation and this anchored yields in such a manner that one could earn healthy fixed income returns while taking on little price volatility.

At his August Jackson Hole speech, Fed Chair Jerome Powell indicated the time has come for the Fed to start lowering rates at the September meeting.1 How fast rates come down is now clearly a function of the underlying trends in the economy and employment, even more than inflation.

Is now the time to add to duration as Fed rate cuts materialize?

WisdomTree collaborated with Bianco Research, one of the leading macro and bond market research firms, to provide a dynamic index-based solution for core bond exposures.

The WisdomTree Bianco Total Return Fund (WTBN) seeks to track the price and yield performance, before fees and expenses, of the Bianco Research Fixed Income Total Return Index.

On a macro basis, Bianco believes the economy is stronger than many fear and that inflation pressures will remain stickier. This could mean the Fed cuts are shallower than many expect and that rates could face some upward pressure at the long end of the U.S. yield curve.

Being dynamic in assessing the underlying direction of yields is becoming more important at this stage in the yield cycle.

WTBN was launched at the end of 2023. In the spring of 2024, as long-term bond rates were rising, staying in short-term instruments provided cushion while taking on duration provided a drawdown.

But now as rates have come down off fears of economic weakness, a broader bond exposure has started to outperform the shortest duration instruments.

To provide appropriate context for considering WTBN's pattern of returns, we looked at:

- The WisdomTree Floating Rate Treasury Fund (USFR): This strategy seeks to track the price and yield performance, before fees and expenses, of the Bloomberg U.S. Treasury Floating Rate Bond Index. Since the credit is that of the U.S. government and the interest rate is reset on a weekly basis, it is a good representation of a widely followed, extremely short duration instrument, the details of which are explained here.
- The iShares Core U.S. Aggregate Bond ETF (AGG): This strategy is designed to track the price and yield performance, before fees and expenses, of the Bloomberg U.S. Aggregate Index. This could be the most widely followed index of the performance of U.S. investment-grade fixed income, and it is one of the largest ETFs in the world on an AUM basis.2

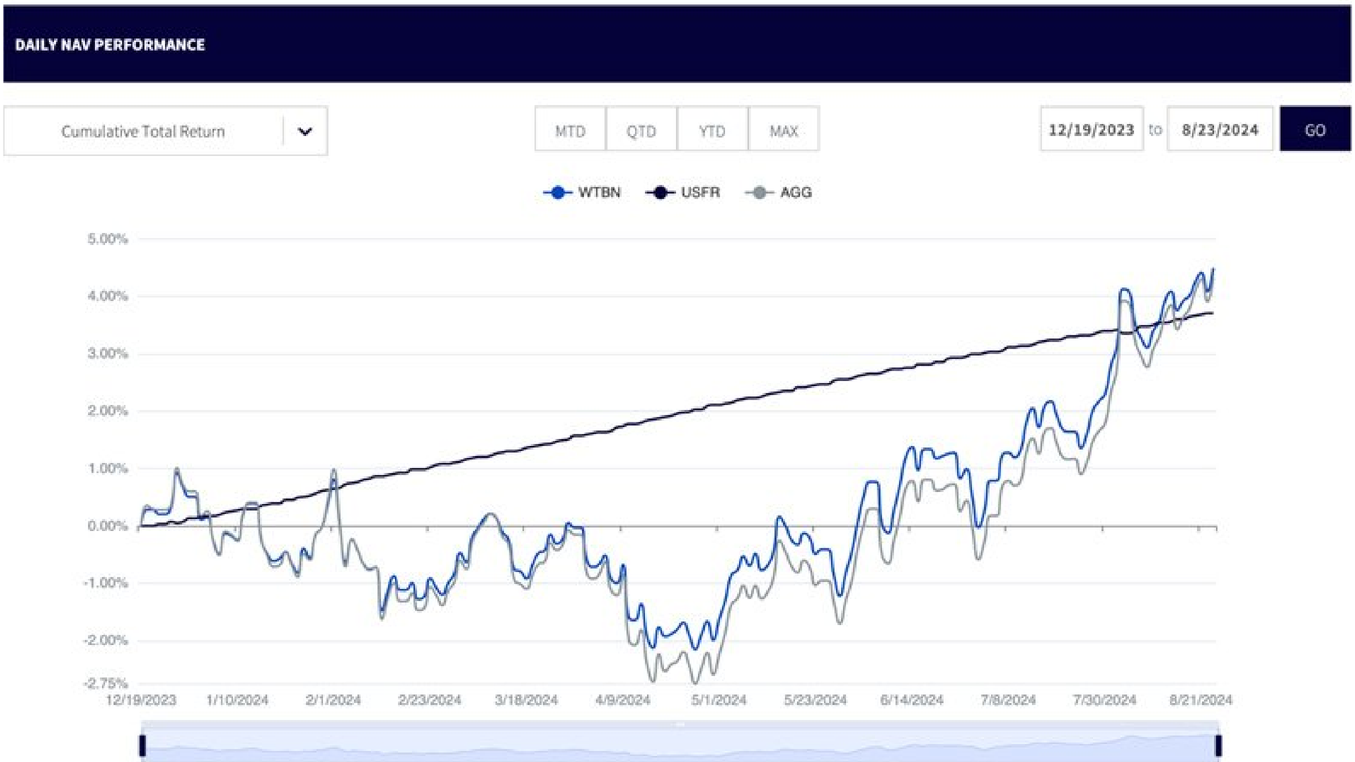
Figure 1: Standardized Performance

Fund Name	Fund Ticker	Inception Date	Fund Gross Expense Ratio	Fund Net Expense Ratio	30-Day SEC Yield (Subsidized)	30-Day SEC Yield (Unsubsidized)	Year-to-Date	1-Year	3-Year	5-Year	10-Year	Since Fund Inception
WisdomTree Bianco Total Return Fund (NAV)	WTBN	12/20/23	0.57%	0.54%	3.73%	3.70%	-0.01%	N/A	N/A	N/A	N/A	0.50%
WisdomTree Bianco Total Return Fund (MP)	WTBN	12/20/23	0.57%	0.54%	3.73%	3.70%	-0.08%	N/A	N/A	N/A	N/A	0.54%
WisdomTree Floating Rate Treasury Fund (NAV)	USFR	2/4/14	0.15%	0.15%	5.35%	5.35%	2.86%	5.57%	3.31%	2.29%	1.58%	1.52%
WisdomTree Floating Rate Treasury Fund (MP)	USFR	2/4/14	0.15%	0.15%	5.35%	5.35%	2.83%	5.48%	3.31%	2.29%	1.60%	1.51%
iShares Core US Aggregate Bond ETF (NAV)	AGG	9/22/03	0.03%	0.03%	4.66%	4.66%	-0.62%	2.61%	-3.02%	-0.26%	1.31%	2.97%
iShares Core US Aggregate Bond ETF (NAV)	AGG	9/22/03	0.03%	0.03%	4.66%	4.66%	-0.71%	2.58%	-3.05%	-0.26%	1.30%	2.97%

Source: WisdomTree, specifically data from the Fund Comparison Tool in the PATH suite of tools, as of 6/30/24. NAV denotes total return performance at net asset value. MP denotes market price performance. Gross expense ratio = the total annual operating expense ratio of a fund, including management fees, administrative costs, and operational expenses. Net expense ratio = the actual cost to investors after accounting for any fee waivers or reimbursements. For WTBN the Net Expense Ratio reflects a contractual waiver of 0.02% through December 31, 2025. **Past performance is not indicative of future results. Investment return 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. Current performance may be lower or higher than the performance data quoted. For the most recent month-end and standard-ized performance and to download the respective Fund prospectuses, click the relevant ticker: WTBN, USFR, AGG.**

Figure 2 provides a good look, going back to the full available history in WisdomTree's fund comparison tool, at WTBN and shows how the other funds, USFR and AGG, compared.

Figure 2: Gauging When Duration Did (and Didn't) Work over WTBN's Live History



Source: WisdomTree, specifically data from the Fund Comparison Tool in the PATH suite of tools, for the period 12/20/23–8/23/24. NAV denotes total return performance at net asset value. MP denotes market price performance. **Past performance is not indicative of future results. Investment return 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. Current performance may be lower or higher than the performance data quoted. For the most recent month-end and standardized performance and to download the respective Fund prospectuses, click the relevant ticker: WTBN, USFR, AGG.**

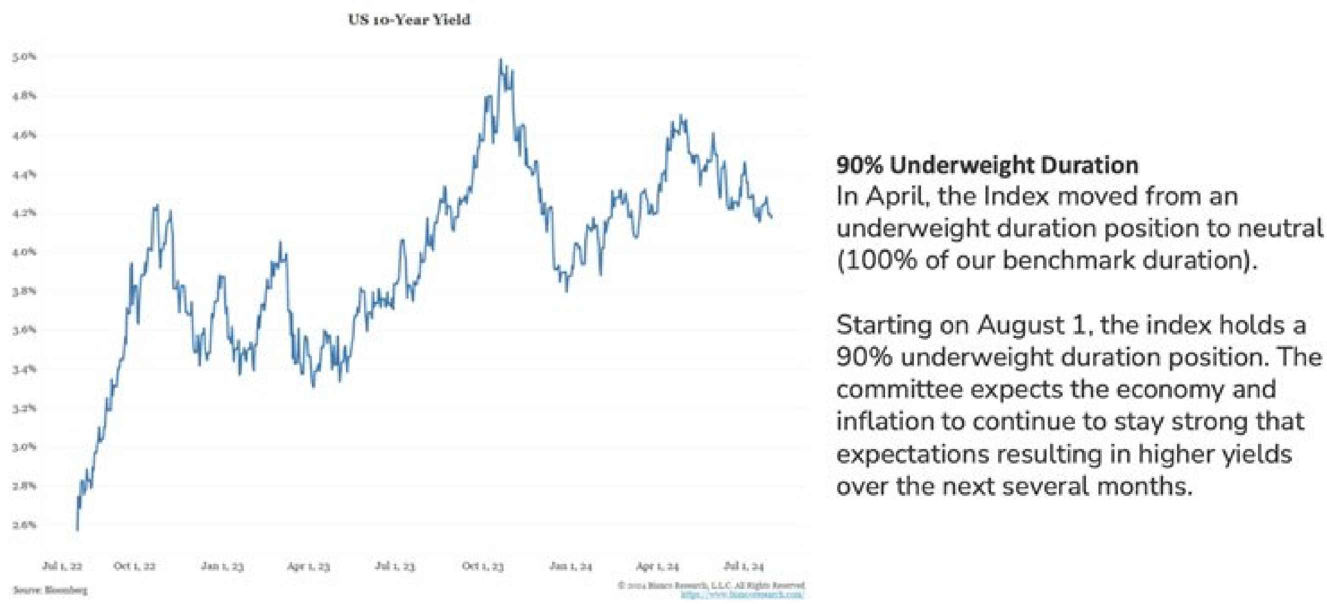
Bianco Research uses the following framework to adjust exposures in their index, typically reviewed and adjusted on a monthly basis. These components are the major return drivers of the best fixed income managers, and Bianco Research believes they can accomplish all that traditional active shops do by just allocating their index around these major buckets.

Figure 3: Bianco Research's Main Levers of Fixed Income Portfolio Management

Source: Bianco Research.

Currently the index is under-weight in duration, with a 90% duration target of the broader bond market indexes.

Figure 4: The Rationale behind Bianco Research's Under-Weight Duration Position



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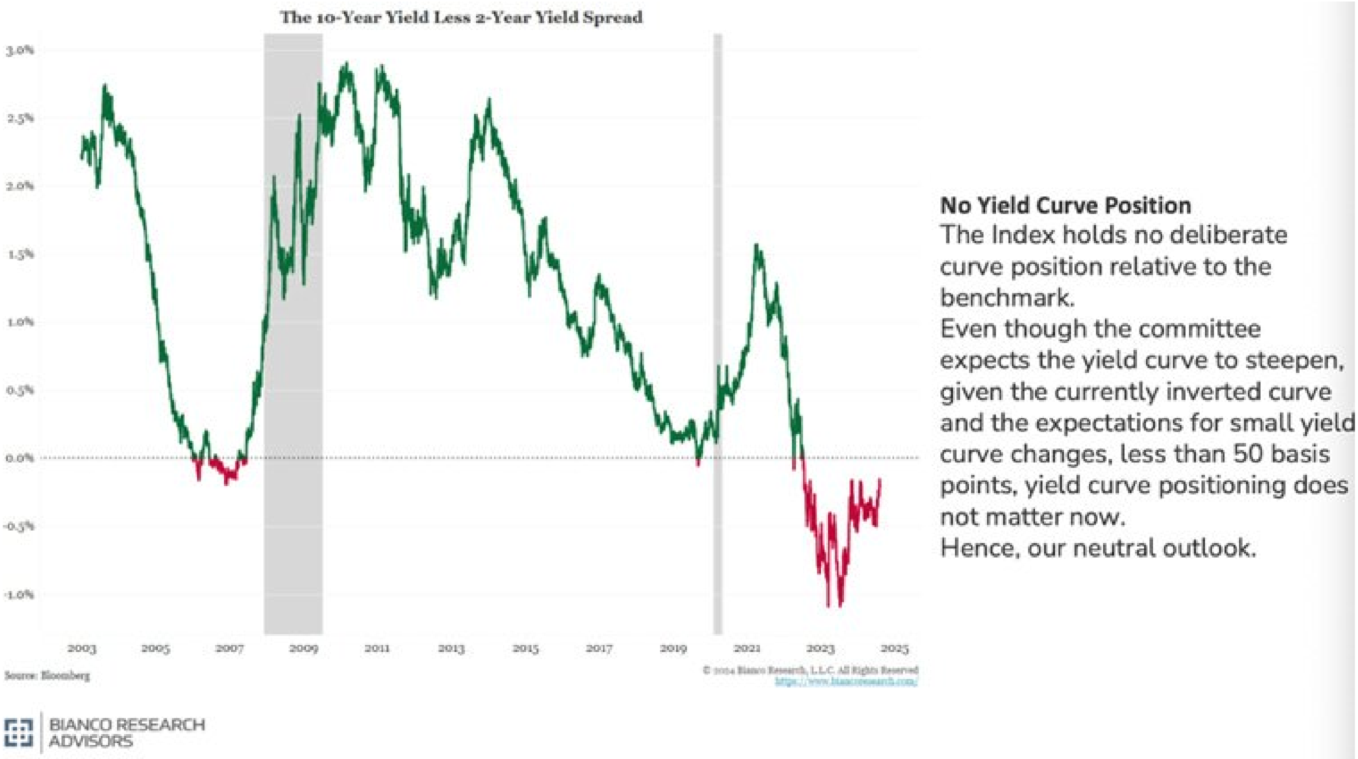
Source: Bianco Research, for the period 7/1/22–8/23/24. Figure 4 is showing the yield of the U.S. 10-Year Treasury Note. Benchmark refers to the Bloomberg U.S. Aggregate Index. Neutral relative to benchmark means essentially "the same as" that of benchmark. A 90% under-weight would mean a position 90% below that of the benchmark. **Past performance is not indicative of future results.**

When looking at figure 5, there is a discussion of yield curve positioning. To put it simply, the yield curve, looking from left to right can have a slope to it and this slope can shift. As it states in the text of figure

5, based on Bianco Research's expectations for changes in this shape being what they are, a neutral positioning makes sense, in their view.

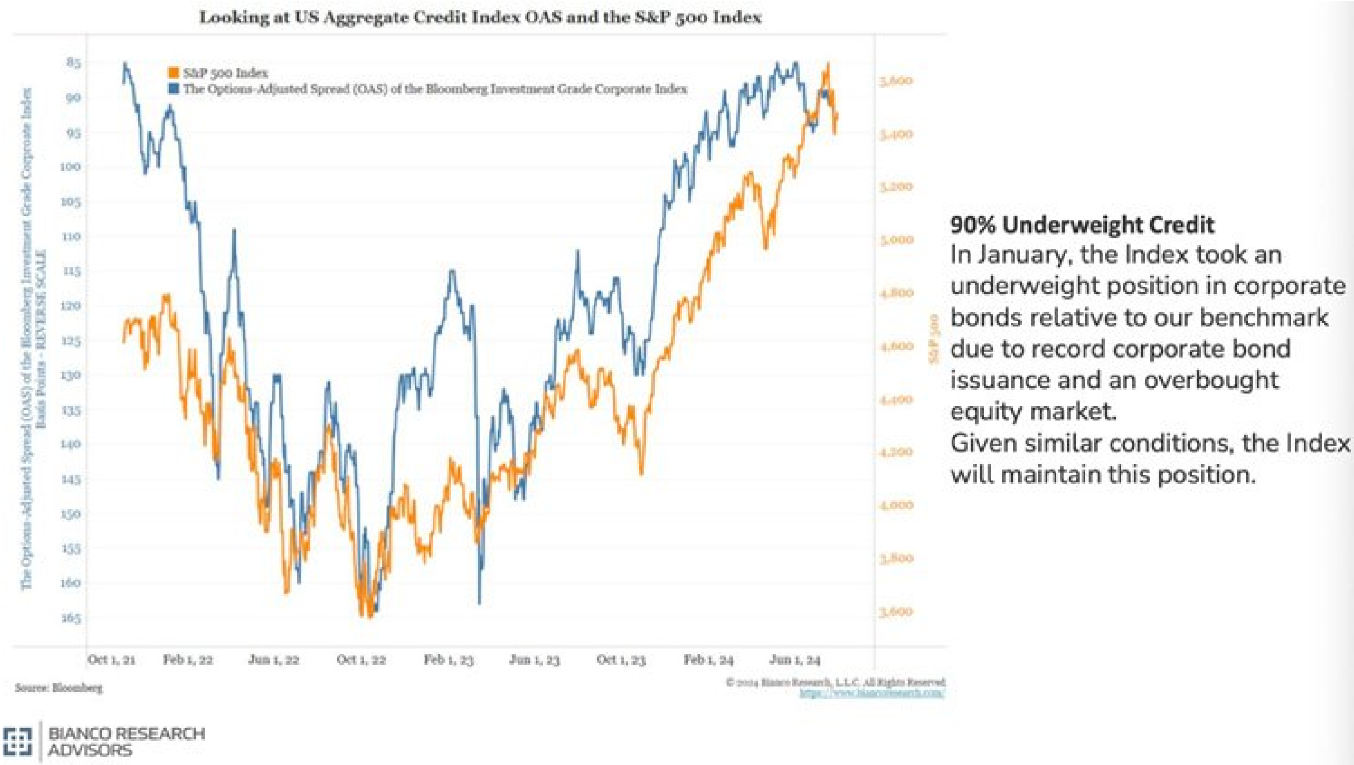
Figure 5: The Rationale behind Bianco Research's "No Yield Curve" Positioning



Source: Bianco Research, for the period 2003 to 8/23/24. The benchmark is the Bloomberg U.S. Aggregate Index. Figure 5 is showing the yield of the U.S. 10-Year Treasury Note minus the yield of the U.S. 2-Year Treasury Bond. The Green color indicates periods when the 10-Year yield is higher than that of the 2-Year. The red color indicates periods when the 2-Year yield is higher than that of the 10-Year. The red color could also be interpreted as periods of an inverted yield curve, when the shorter maturity issues have higher yields than the longer maturity issues. Basis points refer to 1/100th of 1 percent, shown as 0.01% for 1 basis point. **Past performance is not indicative of future results.**

Figure 6 illustrates that reasoning behind Bianco Research's under-weight allocation to corporate credit. As stated in the figure, there has been record corporate bond issuance and, in their view, the equity market is overbought. This is telling us that they believe the risks in corporate credit are high relative to the possible expected returns based on current prices.

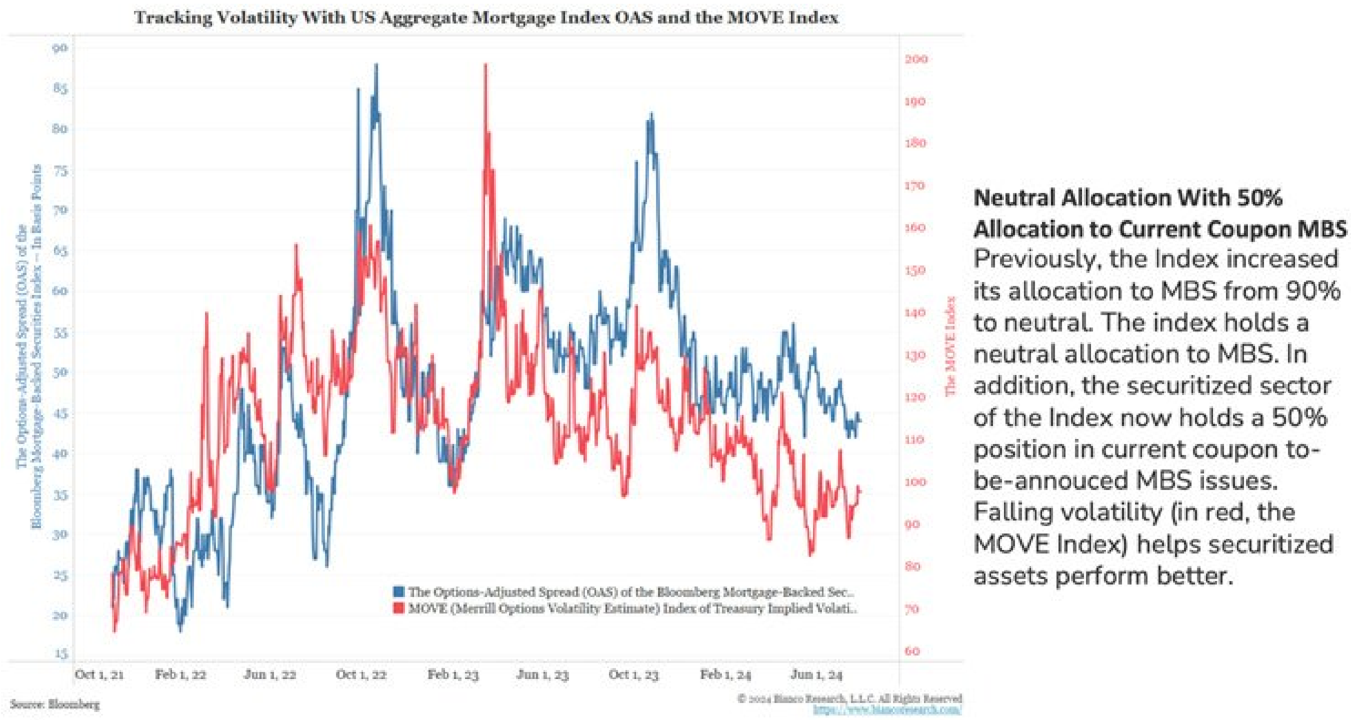
Figure 6: The Rationale behind Bianco Research's Under-Weight Allocation to Corporate



Source: Bianco Research, for the period 10/1/21–8/23/24. The benchmark is the Bloomberg U.S. Aggregate Index. The S&P 500 Index represents U.S. equities. The Options-Adjusted Spread (OAS) of the Bloomberg Investment Grade Corporate Index represents a measure of how the credit risk of the Bloomberg Investment Grade Corporate Index is being priced, with a higher spread indicating a greater potential return and a lower spread indicating a lower potential return, assuming the bonds are not called and do not default during the investment horizon. **Past performance is not indicative of future results.**

The index has a neutral allocation to mortgages, currently split with two different allocations to the mortgage space, the rationale for which is addressed in figure 7.

Figure 7: The Rationale from Bianco Research for a Neutral Allocation to Mortgages



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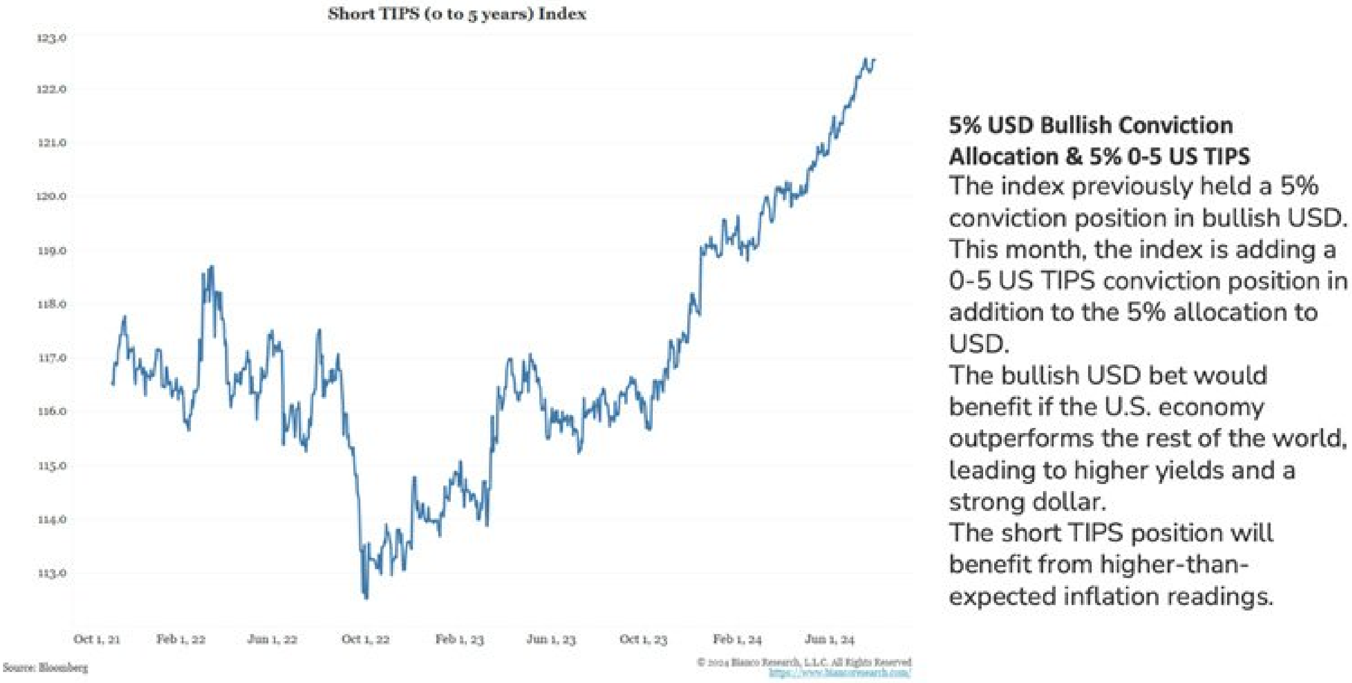
Source: Bianco Research, for the period 10/1/21–8/23/24. The current coupon mortgage-backed security is defined as the mortgage security of any issue for the current delivery month that is trading closest to, but not exceeding par value. A “to be announced” qualification means that the pool of mortgages that will back the security has not been assigned, even though the contract is about to be made. The Options- Adjusted Spread (OAS) of the Bloomberg Mortgage Backed Securities Index represents a measure of how the credit risk of the Bloomberg Mortgage Backed Securities Index is being priced, with a higher spread indicating a greater potential return and a lower spread indicating a lower potential return, assuming the bonds are not called and do not default during the investment horizon. The MOVE (Merrill Options Volatility Estimate) Index of Treasury Implied Volatility is a measure of bond market volatility.

There is a 10% ”out of benchmark” position, meaning in asset classes that are not represented within the Bloomberg U.S. Aggregate Index.

- 5% represents a bullish allocation to the U.S. dollar
- 5% represents an allocation to 0-5 Year U.S. Treasury Inflation Protected Securities (TIPS)

Figure 8 explains the rationale from Bianco Research for these positions.

Figure 8: The Bianco Research Rationale for a 10% Out of Benchmark Position



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Source: Bianco Research, for the period 10/1/21–8/23/24. A bullish USD position would be an exposure that would tend to generate more positive returns if the U.S. dollar were to appreciate against a basket of other currencies. **Past performance is not indicative of future results.**

Beating the Benchmark: Harder in Equity World

Bianco Research believes there is a fundamental difference between bonds and stocks with respect to market cap-weighted benchmarks.

Whereas market cap weighting rewards the big winners in equities, in bonds market capitalization weighting gives the most weight to those lower-quality issuers that need to borrow the most and take on the most debt.

This fundamental difference between what market cap weighting means for equities versus bonds is why more bond managers typically beat broad bond benchmark than in equities.

As bond market uncertainty remains high, we think now is a good time to consider a dynamic index solution like that offered by WTBN.

Figure 9: Additional Information on the Funds Included in This Blog

Fundamentals	WisdomTree Bianco Total Return Fund (WTBN)	WisdomTree Floating Rate Treasury Fund (USFR)	iShares Core US Aggregate Bond ETF (AGG)
Objective	The WisdomTree Bianco Total Return Fund seeks to track the price and yield performance, before fees and expenses, of the Bianco Research Fixed Income Total Return Index. The Index comprises fixed-income exchange-traded funds and is reconstituted at the end of each month or on an ad-hoc basis as circumstances dictate, such as rebalancing after an extreme market event or change in government policy. The Fixed Income ETFs may provide exposure to one or more of the following fixed income investments: government bonds, corporate bonds, mortgage-backed securities, high yield securities, inflation protected securities, municipal securities, and international and emerging markets fixed income.	WisdomTree Floating Rate Treasury Fund seeks to track the price and yield performance, before fees and expenses, of the Bloomberg U.S. Treasury Floating Rate Bond Index. Floating rate treasuries make payments to holders each quarter, with the size of these payments based on a rate that is reset daily in reference to a rate that is determined weekly. This reference rate is based on the high yield determined at the weekly auction of 13-week Treasury Bills, which is generally held every Monday.	The iShares Core U.S. Aggregate Bond ETF seeks to track the investment results of an index composed of the total U.S. investment-grade bond market. The benchmark index being tracked is the Bloomberg U.S. Aggregate Bond Index.
Risks	As is the case with any strategy which involves selecting securities, market conditions may evolve in a manner different to what was predicted during the process of selecting the underlying investments. Any underlying investment may not perform as predicted and as such could lead to negative performance.	Interest rate conditions may change, leading to overall lower interest rates which could impact the interest rates of the underlying U.S. Treasury floating rate securities. Credit risk is limited, given that it is based on the U.S. Government.	The U.S. investment grade market, as represented by the Bloomberg U.S. Aggregate Bond Index, is comprised of a large number of underlying bonds in different sectors of the bond market. These bonds may be downgraded or otherwise run into problems, causing negative returns. These bonds could also have significant interest rate risk, such that movements in the overall levels of interest rates could have a significant impact on the portfolio value.
Fund Gross Expense Ratio	0.57%	0.15%	0.03%
Fund Net Expense Ratio	0.54%	0.15%	0.03%
Total Assets Under Management (USD, millions)	$6.38	$17,227.93	$117,793.78

Source: WisdomTree, specifically data from the Fund Comparison Tool in the PATH suite of tools, as of 6/30/24. NAV denotes total return performance at net asset value. MP denotes market price performance. Gross expense ratio = the total annual operating expense ratio of a fund, including management fees, administrative costs, and operational expenses. Net expense ratio = the actual cost to investors after accounting for any fee waivers or reimbursements. For WTBN the Net Expense Ratio reflects a contractual waiver of 0.02% through December 31, 2025. **Past performance is not indicative of future results. Investment return 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. Current performance may be lower or higher than the performance data quoted. For the most recent month-end and standardized performance and to download the respective Fund prospectuses, click the relevant ticker: WTBN, USFR, AGG.**

1 Source: Jerome Powell, "Reassessing the Effectiveness and Transmission of Monetary Policy," economic symposium, Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, 8/23/24. https://www.federalreserve.gov/newsevents/speech/powell20240823a.htm.

2 As of 8/26/24, AGG had more than $117 billion in assets under management.

Important Risks Related to this Article

There are risks associated with investing, including the 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. While the Fund attempts to limit credit and counterparty exposure, 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. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit, and the Fund does not attempt to outperform its Index or take defensive positions in declining markets. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.