

Looking within the Agg for Income

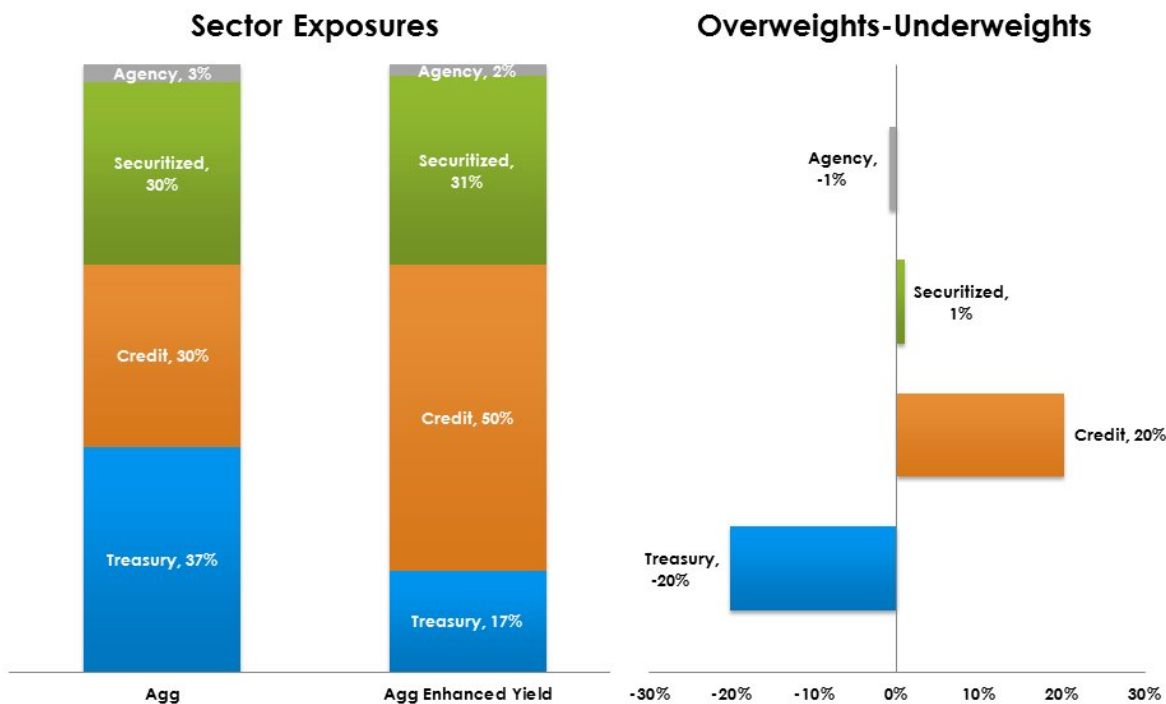
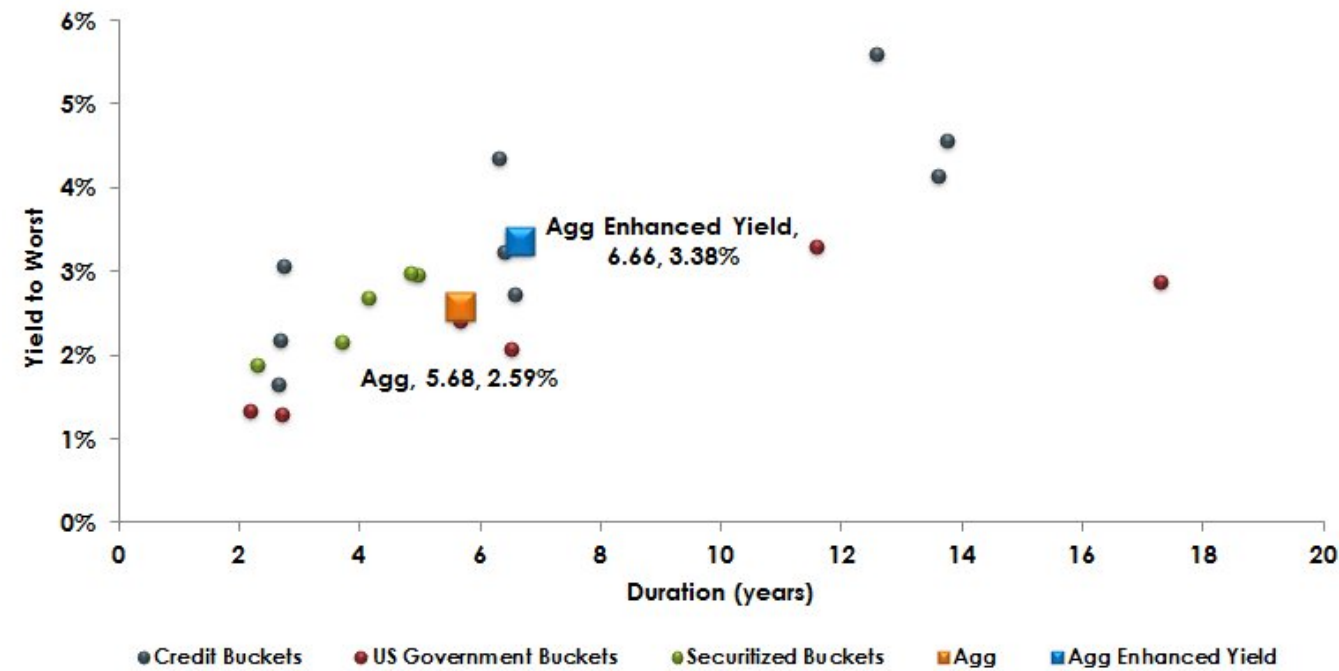
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With U.S. equity markets down nearly 9%¹ at the start of 2016, many investors are being confronted with difficult questions surrounding their asset allocation decisions. While exposure to equities may be causing pain, bond markets have not provided the typical ballast to performance that we've seen in previous sell-offs. This is primarily a symptom of today's low interest rate environment where total returns from bond strategies are being driven primarily by price returns as opposed to income. While the Barclays U.S. Aggregate Index (Agg) will likely remain the defacto benchmark for U.S. fixed income markets, we believe that relying on this strategy as a core holding in portfolios is suboptimal. In order to address these issues, WisdomTree partnered with Barclays to create the Barclays U.S Aggregate Enhanced Yield Index. In our view, this approach allows investors to construct a more intuitive portfolio with higher income potential while still retaining many of the familiar characteristics of their performance benchmark. **Enhancing Yield**

In financial markets, there is seldom (if ever) a free lunch. Therefore, the only way to enhance the yield and return profile of a fixed income portfolio is by substituting one risk for another. In order to enhance the Agg's income potential, the enhanced strategy starts with the same investable universe as the Agg but then seeks to reweight the exposures in order to increase yield. By applying sector, credit quality and duration constraints to this process, the strategy has been able to broadly retain the risk characteristics of the Agg, but with 86 basis points (bps) of higher income potential.² Put another way, the investment's income potential is boosted by over 30%. This is generally achieved by decreasing exposure to U.S. Treasuries and increasing exposure to credit (corporate and mortgage backed securities). Nearly 22% of the Agg is concentrated in Treasuries maturing between one and five years. These securities have an average yield of 1.04%, which is only 43% of the Agg's overall yield of 2.41%.³ These securities provide protection in a risk-off environment—but not nearly as much as longer-dated Treasuries. By allocating less to the short end of the Treasury curve, the Enhanced Agg provides a more balanced exposure to the fixed income market. **Yield and Duration Comparison, December 31, 2015**



Source: WisdomTree, as of 12/31/15. Past performance is not indicative of future results. You cannot invest directly in an index. Subject to change. Yield to Worst is the rate of return generated assuming a bond is redeemed by the issuer on the least desirable date for the investor.

Increasing Yield Could Increase Total Return Fixed Income 101 teaches us that the yield of a bond is the single largest determinant of future total returns. By seeking to increase the yield, we also seek to

increase the expected total returns of the investment. While we can't make the claim that this strategy will always outperform, we believe that a higher starting yield could generally lead to greater total returns over the investment cycle. Given that the strategy is over-weight to credit, it will tend to underperform in risk-off scenarios such as 2008. In low interest rate environments such as today, excess returns from 80 extra basis points of yield could be significant given the comparable risk profile. Ultimately, investors will continue to demand fixed income in order to generate income and help mitigate the volatility of their equity investments. In our view, while many see the Agg as the barometer of their bond portfolio, we believe that the investment approach and rationale can be enhanced. By decreasing allocations to U.S. Treasuries and overweighting exposure to investment-grade securities, investors can potentially boost the income potential and total return profile of their fixed income portfolio. ¹Based on the [S&P 500 Index](#). Source: Bloomberg, as of 1/20/16. ²Source: Barclays, as of 1/20/16. ³Source: Barclays, as of 1/20/16.

Important Risks Related to this Article

Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. In addition, when interest rates fall, income may decline. 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.

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