

Money in Motion: Playing the Trade with More Clarity: Rate Cuts

Published July 24, 2024

Kevin Flanagan

Head of Investment and Fixed Income Strategy

Key Takeaways

- With political uncertainty hovering over the investment landscape, we recommend focusing on the issue that arguably has more clarity: Fed rate cuts.
- The barbell strategy offers investors flexibility, balancing ultra-short/short positions with longer-duration bonds to maintain flexibility and take advantage of income opportunities.
- Our in-house barbell strategy uses our [Floating Rate Treasury Fund \(USFR\)](#) for the ultra-short/short position and our [Yield Enhanced U.S. Aggregate Bond Fund \(AGGY\)](#) for the duration counterweight.

The news of President Biden dropping out of the presidential race has no doubt created a whole new layer of uncertainty in the market backdrop. Interestingly, the spotlight is always on who is going to become President, but in reality, it's not that cut and dried. Indeed, equally important is which party is going to control the two chambers of Congress. With this much uncertainty hovering over the investment landscape, we recommend focusing on the issue that arguably has more clarity at this point: Fed rate cuts.

In this first of a series of *Money in Motion* blog posts, I want to discuss how investors should be looking to play rate cuts in their fixed income portfolios. While getting to the first rate cut has not been a smooth ride (and we're not even officially there yet), it does appear that Powell & Co. are getting more confident in such an easing move occurring at the September Federal Open Market Committee meeting.

However, what this rate cut cycle will ultimately look like is also an important consideration. At this point, the Fed seems to be gravitating toward a policy that remains restrictive, but not as restrictive as what is currently in place. In other words, inflation has made enough progress toward their 2% goal, so why not take the foot off the brake pedal a bit?

Whether or not this potential easing cycle takes on more momentum will depend a great deal on the labor market setting. If the unemployment rate holds steady to modestly higher, then rate cuts will likely not be that aggressive. Conversely, a visible weakening in labor market conditions combined with continued disinflation will no doubt lead to a more active rate-cutting policy.

So, how does an investor prepare for these possible monetary policy scenarios? With the time-tested barbell strategy. By using this approach, investors are afforded flexibility to begin adding duration in a de-

liberate fashion while still taking advantage of the income available with less volatility in the ultra-short/short portion of the inverted yield curve.

The WisdomTree in-house barbell strategy uses our [Floating Rate Treasury Fund \(USFR\)](#) for the ultra-short/short position and our [Yield Enhanced U.S. Aggregate Bond Fund \(AGGY\)](#) for the duration counterweight. I recently blogged about the “still” inverted Treasury (UST) yield curve and how the 3-month/10-Year differential remains well into negative territory to the tune of over -110 basis points, as of this writing. With UST Floating Rate Notes being referenced to the 3-month weekly T-bill auction, one can take advantage of what the negative yield curve will more than likely continue to offer even when rate cuts begin. The “adding duration” aspect is designed to not only begin locking in yield outside of shorter-dated maturities, but also offers the ability to try and take part in a bond market rally if rates reverse course and fall again.

For investors who would prefer more of a “pure” rate play and focus only on U.S. government securities in their barbell, we recommend considering a solution in our Treasury suite of Funds; the [WisdomTree 7-10 Year Laddered Treasury Fund \(USIN\)](#). This Fund would represent the “adding duration” aspect to the barbell and serve as the tool to lock in yield while potentially benefitting from a decline in rates further out on the yield curve.

Conclusion

With uncertainty surrounding the investment landscape and Fed policy becoming front and center in the discussion as summer progresses, the barbell approach provides investors with a time-tested, flexible strategy to navigate the road ahead without making an outright rate call.

Important Risks Related to this Article

There are risks associated with investing, including the possible loss of principal. Fixed income securities will normally decline in value as interest rates rise. Securities with floating rates can be less sensitive to interest rate changes than securities with fixed interest rates, but may decline in value. 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. Fixed income investments are subject to interest rate, credit, inflation and reinvestment risks. Credit risk includes 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. U.S. Treasury obligations may provide relatively lower returns than those of other securities, and changes to the financial condition or credit rating of the U.S. government may cause their value to decline. Due to the investment strategy of these Funds, they may make higher capital gain distributions than other ETFs. Because the USIN Fund is new, it has no performance history. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.