Preparing for a Steeper Yield Curve in Our Model Portfolios

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Key Takeaways

- In the days leading up to the September FOMC meeting, the U.S. Treasury UST 2-Year/10-Year yield curve un-inverted, reaching positive territory for the first time since June 2022
- While the UST 3-Month/10-Year curve remains in inverted territory, both measures of yield curve steepness are forecast to be positive six months from now
- Forward curves are pricing in a normalizing yield curve with longer-term interest rates at levels much higher than what investors experienced throughout the prior decade
- In this context, we have moved to neutral duration within our model portfolios, and recommend investors consider barbell strategies to help lock in higher yields into the future

This article is relevant to financial professionals who are considering offering model portfolios to their clients. If you are an individual investor interested in WisdomTree ETF Model Portfolios, please inquire with your financial professional. Not all financial professionals have access to these Model Portfolios.

As highlighted in Kevin Flanagan's recent blog, the Federal Reserve officially initiated a new rate-cutting cycle with a 50-basis-point reduction at the September FOMC meeting, bringing the Fed Funds target range to 4.75%–5.00%.

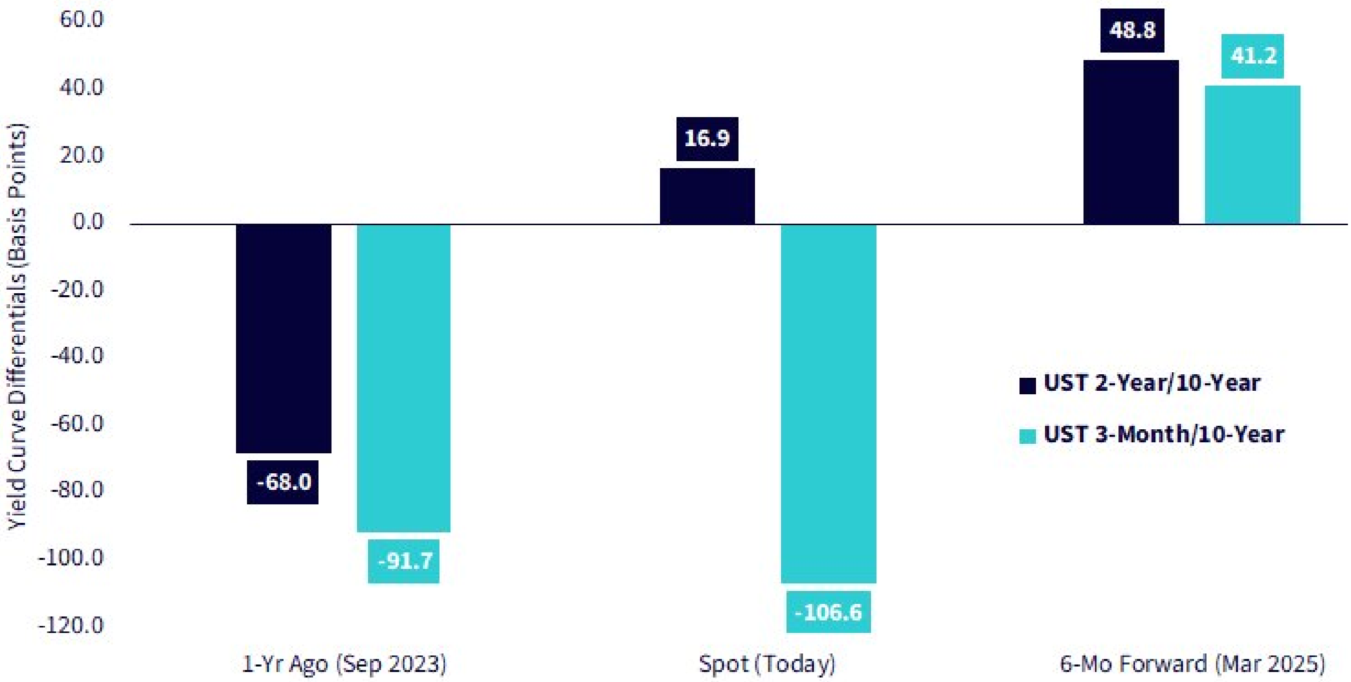
In the lead-up to this decision, the U.S. Treasury 2-Year/10-Year yield curve un-inverted, entering positive territory for the first time since July 2022.

Figure 1: U.S. Treasury Yield Curves Steepening, with UST 2-Year/10-Year Differential Now in Positive Territory

Sources: WisdomTree, FactSet, as of 9/23/24. Past performance is not indicative of future returns.

Meanwhile, another closely watched yield curve, the UST 3-Month/10-Year yield differential, remains in inverted/negative territory. However, the market is pricing in over five additional 25 basis point Fed rate cuts by March 2025, likely pushing both yield curves into positive territory.

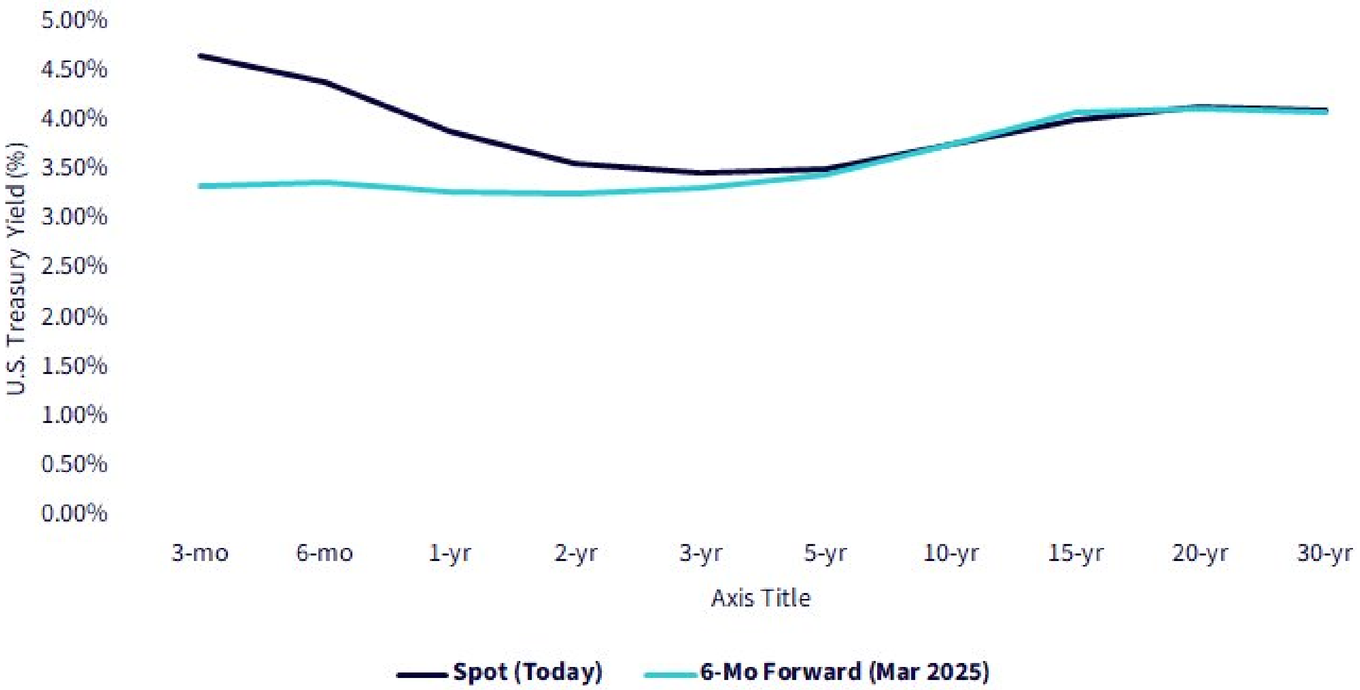
Figure 2: U.S. Treasury Yield Curve Differentials: Then, Now, and What's Ahead



Sources: WisdomTree, FactSet, as of 9/23/24. Past performance is not indicative of future returns.

Beyond these specific maturity points, the market is pricing in a yield curve that is much more positively sloped in general six months from today.

Figure 3: U.S. Treasury Yield Curves: Spot (Today) vs. 6-Months Forward Curve



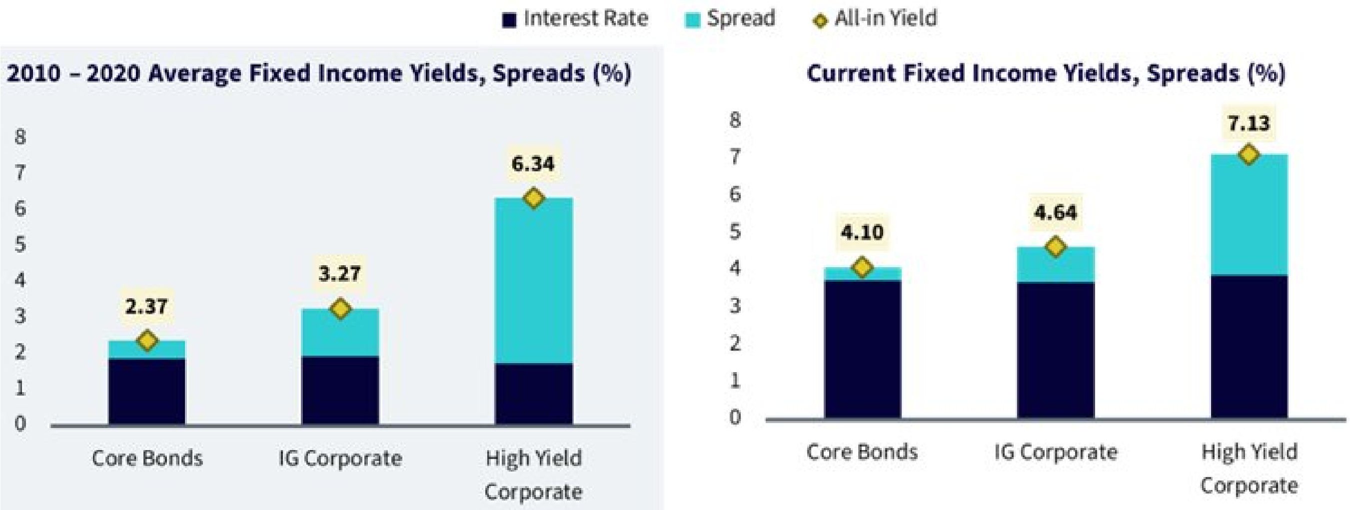
Sources: WisdomTree, FactSet, as of 9/23/24. Past performance is not indicative of future returns.

Embedded in these forward curves is the collective view among market participants that the Fed's dovish outlook will persist and the U.S. economy will remain resilient. Should either one of these come into question, these future expectations could likely shift.

How should investors position their portfolios in this dynamic interest rate environment?

While short-term interest rates are likely headed lower, we remain in a New Rate Regime, and overall bond yields are starting from much higher levels than were observed throughout the prior decade.

Figure 4: U.S. Treasury Yield Curves: Spot (Today) vs. 6-Months Forward Curve

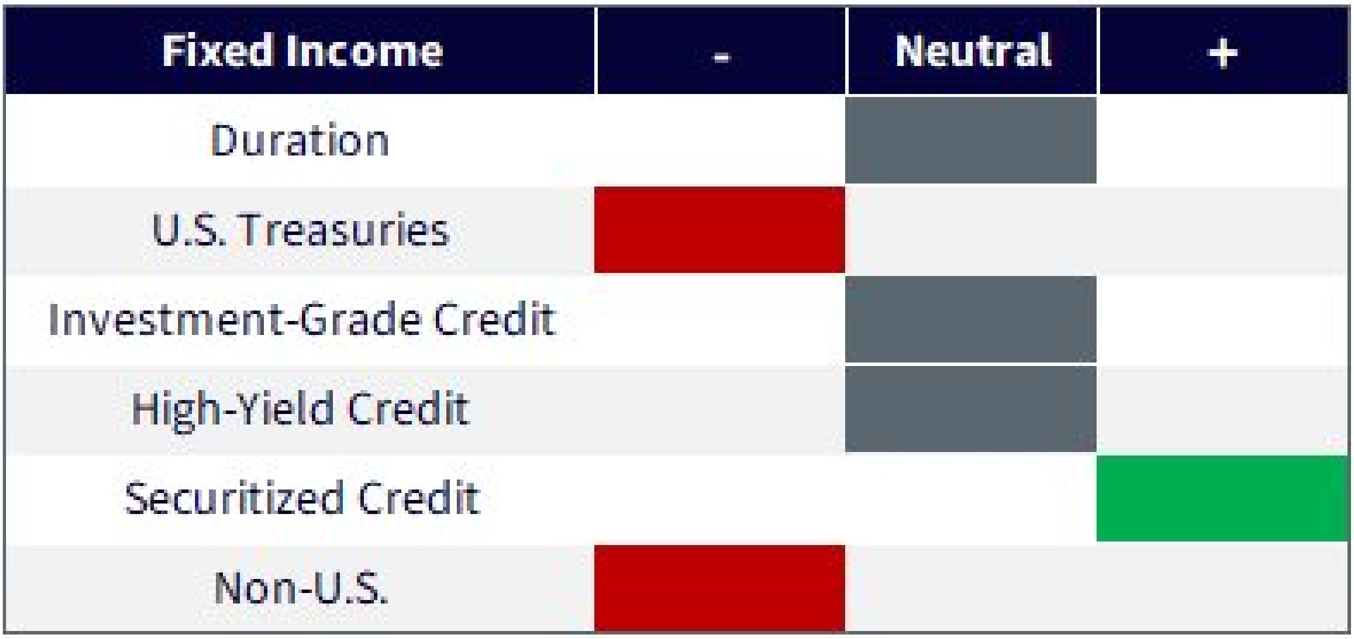


Source: WisdomTree, Bloomberg; as of September 30, 2024. Core bonds based on Bloomberg U.S. Aggregate Bond Index. IG Corporate based
on Bloomberg U.S. Corporate Bond Index. High Yield Corporate based on Bloomberg U.S. High Yield Corporate Bond Index. Past performance
is not indicative of future results. You cannot invest directly in an index.

To help manage reinvestment risk and lock in higher yields, we've shifted to a neutral duration stance in our model portfolios, recommending that investors explore barbell strategies. This approach enables investors to balance short-term/floating rate strategies with longer term bonds. The result is a portfolio that maintains exposure to the ultra-short end (which we still view as attractive) while limiting any overall interest rate sensitivity mismatch with broader fixed income performance benchmarks.

From a sector standpoint, the resilient economic landscape provides a supportive backdrop for US credit, but spreads have largely priced this in. We remain constructive on quality-screened investment grade and high yield corporate bonds but see better valuation prospects in securitized assets and agency mortgage-backed securities.

Figure 5: Current Fixed Income Strategic Positioning and Outlook



Fixed Income	-	Neutral	+
Duration			
U.S. Treasuries			
Investment-Grade Credit			
High-Yield Credit			
Securitized Credit			
Non-U.S.			

Source: WisdomTree, as of September 30, 2024.

Financial advisors can learn more about the WisdomTree CIO Managed lineup of fixed income and multi-asset Model Portfolios by visiting our Portfolio Solutions offerings.

Important Risks Related to this Article

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