Putting the “Plus” in a Barbell Plus Strategy

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Key Takeaways

- Investors using a barbell approach in fixed income can potentially enhance returns by adding securitized assets, such as the WisdomTree Mortgage Plus Bond Fund (MTGP), as a supplementary “plus” component.
- With current agency MBS spreads above their 10-year median and the Fed’s rate cut cycle underway, MTGP offers a relative value opportunity versus investment grade corporates.
- MTGP's blend of agency/non-agency MBS and other securitized assets presents an actively managed solution that could add yield and effectively manage duration within a balanced fixed income portfolio.

Within any fixed income portfolio, one should strive to build a foundation and then potentially supplement this “core” with an added component. I’ve discussed rather frequently how a barbell approach represents a time-tested, user-friendly solution to achieve a bond investor’s foundational goal. But what strategy should an investor consider as the “supplement” to the barbell approach? That’s what I wanted to discuss in this blog post.

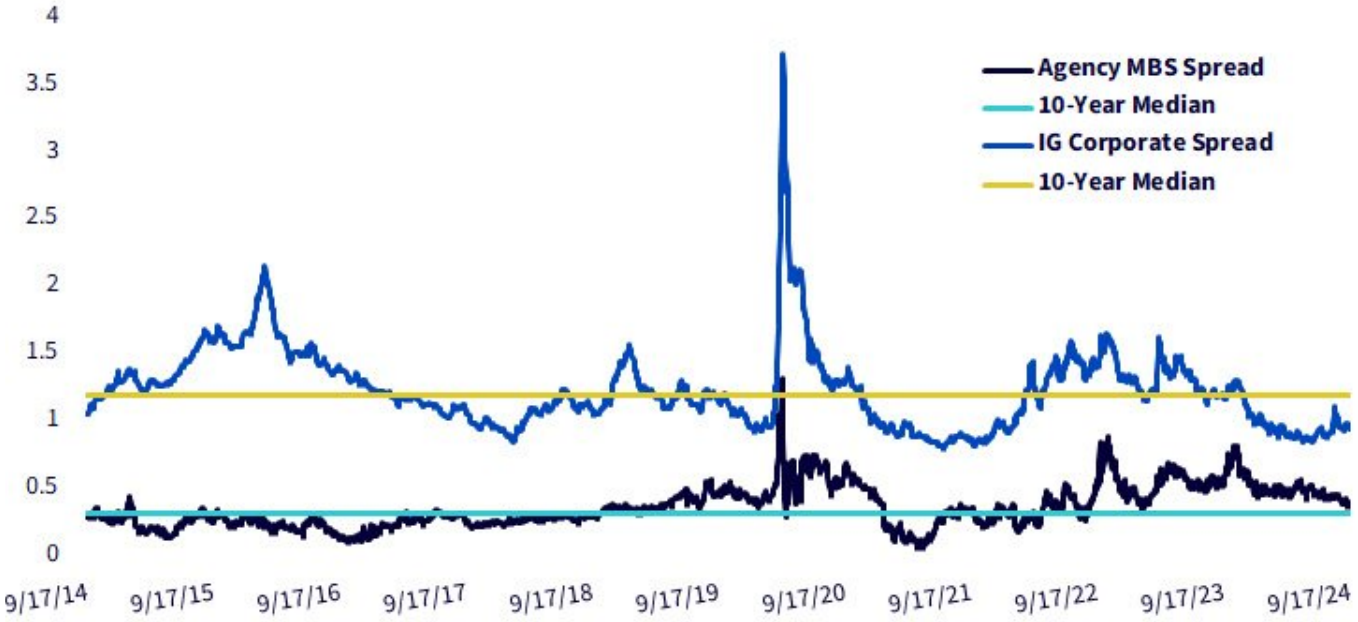
As a reminder, I recently blogged about a “Barbell for Rate Cuts” using our in-house WisdomTree Funds for Treasury floating rate notes (USFR) paired with our yield enhanced agg strategy (AGGY). This foundation offers investors a means of achieving a balance between such key factors as income, performance and managing volatility.

Once you have this foundation of your fixed income portfolio allocated, you can then consider options on how to potentially build out from there. In my opinion, one such option to consider is in the securitized fixed income space. Securitized fixed income is a debt security whose value is backed by an asset or pool of assets. Some more common examples are assets such as mortgage-backed securities (MBS), collateralized loan obligations (CLOs) and asset-backed securities (ABS). Within the MBS universe, there are well-known investments from agencies and government-sponsored enterprises like Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC). This group of MBS securities are under the conservatorship of the U.S. government. There are also non-agency MBS. CLOs are typically senior-secured, below investment-grade debt, while auto loans are an example of ABS.

Our in-house barbell plus strategy would add the WisdomTree Mortgage Plus Bond Fund (MTGP) to the solution.

- What is MTGP?
  - Think of the strategy/Fund as two key components: 1) Agency (Ginnie, Fannie Mae, etc.)/Non-Agency MBS and 2) Securitized products such as CLOs and ABS
  - MTGP's make-up as of October 25, 2024, was 98% investment grade and 1.8% BB-rated
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- MTGP's make-up as of October 25, 2024, was 98% investment grade and 1.8% BB-rated
- Why should I buy MTGP?
  - Agency MBS spreads are now above their 10-year median, offering value relative to investment-grade corporates (see below)
  - The MBS space can be characterized as interest rate sensitive, so the current Fed rate cut cycle should be supportive for valuations
  - Continued modest/moderate economic growth provides a supportive platform for the securitized portion of MTGP
  - As of October 25, 2024, the MTGP average yield-to-maturity was 5.23%, 56 basis points better than the Agg; MTGP's duration was 5.4 relative to the Agg's 6.2 years
  - The Fund is actively managed by Voya, a well-respected manager in the securitized asset class
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Agency MBS vs. Investment-Grade Corporate Spreads



Source: Bloomberg, as of 9/17/24.

Conclusion

As investors await what the current Fed rate cut cycle will ultimately look like, the barbell approach to fixed income is a way to invest without making high conviction interest rate calls. By adding a ”plus” component to the mix, investors can supplement their income needs without sacrificing the prudent strategy of building a foundation for their bond portfolios first.

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. In addition, when interest rates fall, income may decline. Fixed income investments are also subject to credit risk, the risk that the issuer of an investment 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 investment 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. Liquidity risk may result from the lack of an active market, reduced number and capacity of traditional market participants to make a market in fixed income securities, and may be magnified in a rising interest rate environment and/or with respect to particular types of securities, such as securitized credit securities. Non-agency and other securitized debt are subject to heightened risks as compared to agency-backed securities. High yield or "junk" bonds have lower credit ratings and involve a greater risk to principal. Derivative investments can be volatile and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions. Unlike typical exchange-traded funds, the Fund is actively managed using proprietary investment strategies and processes and there can be no guarantee that these strategies and processes will be successful or that the Fund will achieve its investment objective. 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.