Revisiting "Generating Yield in a Volatile Market"

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Scott Welch, CIMA ®
Chief Investment Officer, Model Portfolios

Kevin Flanagan
Head of Investment and Fixed Income Strategy

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.

We last visited the topic of generating yield in an evolving market back in October, and it certainly is time to visit it again. We are sailing through volatile market seas these days, with rates rising, inflation fears mounting and geopolitical tensions as high as they have been in many years. How can investors continue to generate risk-controlled yield in this current environment?

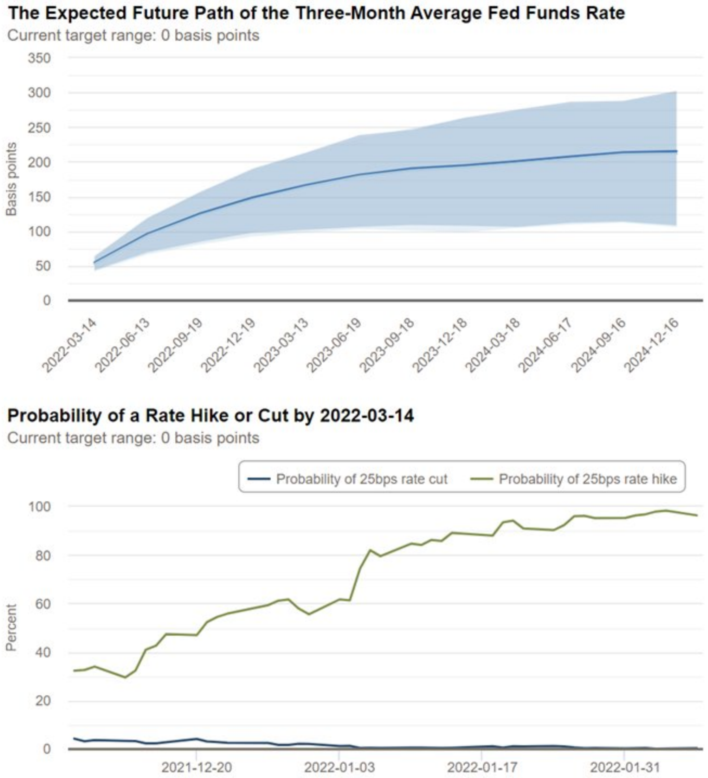
First, let's look at rates, and let's start with the Treasury yield curve. While we've seen a distinct uptick in recent weeks, real Treasury yields remain negative across the entire maturity spectrum with the exception of the 30-year, which just inched into positive territory.

U.S. Treasury Real Yields (%)

While nominal Treasury rates have been volatile, we've seen a distinct upward trend, especially in the short end of the curve, as the market reacts to a decidedly more "hawkish" tone from the Fed. We think, with fits and starts, this upward trend will continue (and note the significant "flattening" of the curve, as measured by the 10-Year minus the 2-Year spread).

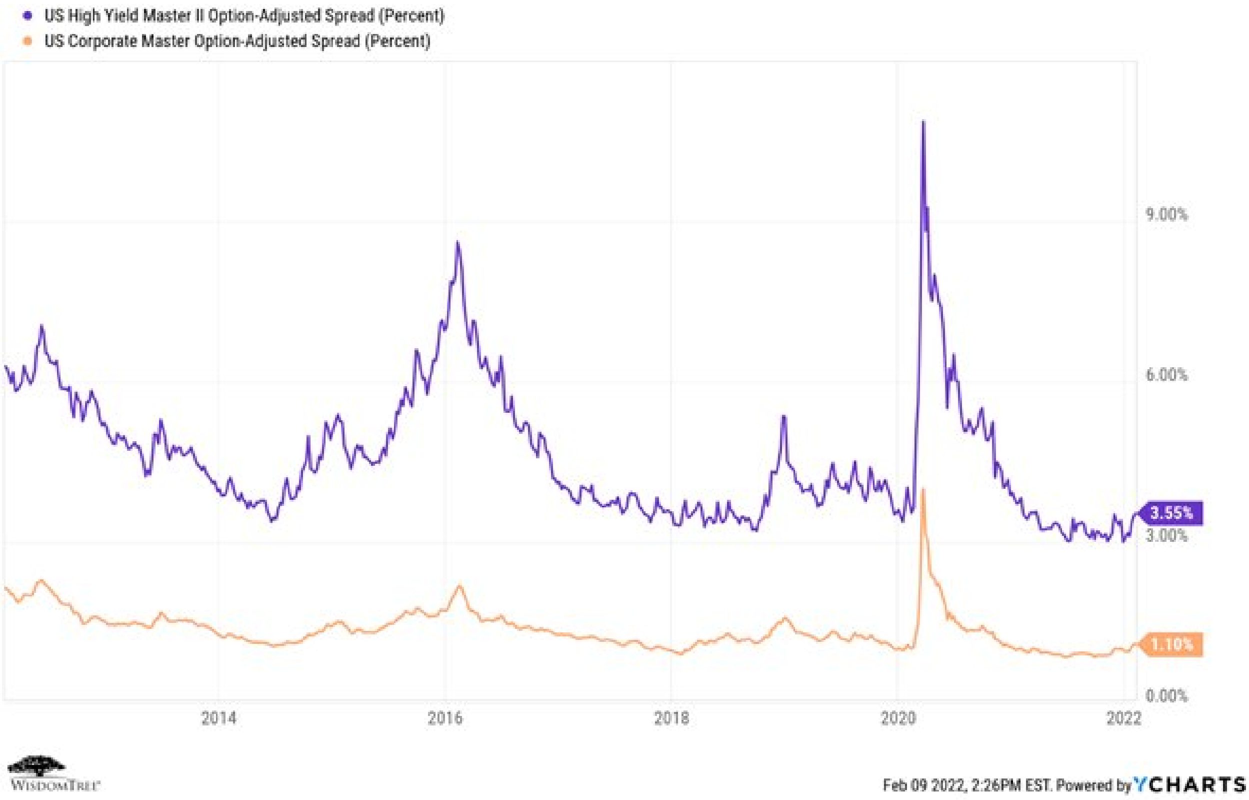
Source: YCharts, 12-month data through 2/8/22. Past performance does not guarantee future results.

Speaking of the Fed, the market is now pricing in five rate hikes over the course of 2022, and many believe there may be more, resulting in a Fed Funds Rate well above 1.00% by year-end. Furthermore, the market is assuming an almost 100% probability the Fed will initiate rate hikes at its March meeting, and there is open discussion that 50 bps hikes will be on the table over the course of the year. That is a dramatic shift in sentiment and expectations from even 3–4 months ago.



Source: The Atlanta Federal Reserve Bank "Market Probability Tracker," through 2/8/22. The "Tracker" estimates the market-implied probabilities of various ranges for the three-month average Fed Funds Rate. The methodology uses data on three-month eurodollar futures, options on three-month eurodollar futures from the Chicago Mercantile Exchange (CME), three-month LIBOR/Fed Funds basis swap spreads expiring in 12 months and the Treasury yield curve. Basis point: 1/100th of 1 percent.

Interestingly, the credit markets largely have yawned through all this recent uncertainty, suggesting that investors remain comfortable with default risk (although you will note the uptick in the most recent days).



Source: YCharts, 10-year data as of 2/8/22. You cannot invest in an index, and past performance does not guarantee future results.

For definitions of terms in the chart, please visit the glossary.

So, What Is a Yield-Seeking Investor to Do?

To summarize the above, we continue to believe that rates will grind higher, and inflation remains *the* story through at least the first half of 2022. All eyes and ears will be on the Fed as it tries to walk the proverbial tightrope between taming inflation and keeping the economy growing. So, rates are rising, and credit spreads remain tight—not a recipe for a great deal of optimism about risk-controlled total return potential in the fixed income markets.

What about finding yield in the equity markets? Using the information from above, let’s compare current nominal fixed income yields to current equity dividend yields. We see quite a reversal from a year ago, when equity yields were well above fixed income yields.

Instrument	10-Year Treasury	Investment-Grade Credit Spread	High-Yield Credit Spread	Total Current Yield
IG Bonds	1.92%	1.10%		3.02%
HY Bonds			3.55%	5.47%
S&P 500 Dividend Yield				1.27%
ACWI ex-U.S. Dividend Yield				2.77%

Sources: YCharts, S&P and MSCI, data through 2/8/22. Yields are approximate and security-specific. "IG" stands for "investment grade" and refers to bonds with a BBB- or higher credit rating. Investment-grade bonds are represented by the Bloomberg U.S. Aggregate Index. "HY" refers to "high yield" and refers to bonds with a credit rating below BBB-. High-yield bonds are represented by the Bloomberg U.S. Corporate High Yield Bond Index. You cannot invest in an index, and past performance does not guarantee future results.

For definitions of terms in the chart, please visit the glossary.

Investors can now generate a higher level of current income in the bond market than in the equity market (which historically is the more "normal" situation). At the same time, we see increased risk in the fixed income markets and believe that dividends and stock buybacks may represent a more sustainable approach to generating current income.

Our own Model Portfolios remain short in duration and over-weight in credit with an explicit focus on quality security selection relative to the Bloomberg U.S. Aggregate Index (the "Agg"). We definitely are not looking to take excessive risk in our fixed income portfolios in a "reach for yield."

That said, here are some ideas and solutions that may be of interest.

Fixed Income Strategy Ideas

Obviously, the investment landscape within the fixed income arena is certainly a challenging one. The combination of Fed rate hikes and continued elevated inflation requires a proactive approach to navigate what ultimately lies ahead for the bond investor.

A time-tested approach for a rising rate environment can center around the barbell strategy, where a core bond holding is complemented by a "zero-duration" solution. WisdomTree offers three unique approaches to the "zero-duration" or rate-mitigating strategy portion of the barbell:

- A U.S. government securities-based solution based on floating rate Treasury notes: the WisdomTree Floating Rate Treasury Fund (USFR)
- An investment-grade strategy that combines a long position in bonds representative of the Agg with a short position in Treasury securities to target zero duration: the WisdomTree Interest Rate Hedged U.S. Aggregate Bond Fund (AGZD)
- A "core-plus" approach that combines bonds representative of the WisdomTree U.S. High Yield Corporate Bond Fund and a short position in Treasury securities to target zero duration: the WisdomTree Interest Rate Hedged High Yield Bond Fund (HYZD)

Investors seeking additional yield opportunities may want to consider the WisdomTree Alternative Income Fund (HYIN). HYIN is an alternative credit vehicle that allows investors to "tap" into an asset class to which it has been difficult to gain broad-based exposure. In addition, alternative credit has exhibited less sensitivity to changes in interest rates.

Model Portfolio Ideas

WisdomTree manages three specific Model Portfolios that are yield- and income-oriented—our **Siegel-WisdomTree Longevity**, **Global Dividend** and **Global Multi-Asset Income** Model Portfolios.

These Model Portfolios focus on generating all or the majority of the current yield out of the equity allocations versus the fixed income allocations.

Let's look at the current yield of these Model Portfolios (as of December 31, 2021).

Portfolio	Current Yield/Income
Siegel-WisdomTree Longevity	3.40%
Global Dividend	2.98%
Global Multi-Asset Income (Moderate)	3.26%

Sources: WisdomTree and FactSet, as of 12/31/21. "Current Yield/Income" refers to the 12-month dividend yield, as posted on our Model Adoption Center. Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and the 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. Model Portfolio 12-month yield is calculated using the weighted average trailing 12-month distribution yields of the Fund constituents. Funds incepted less than 12 months do not have a trailing 12-month dividend yield. (Moderate) Model Portfolios in our Model Adoption Center for individual Fund standardized performance, and see the Fund Details tab for Fund-specific links for yield, most recent month-end performance and a prospectus.

"Current Yield/Income" refers to the most recently posted 12-month dividend yield as indicated here.

For Fund performance, please click the respective Siegel-WisdomTree Longevity, Global Dividend and Global Multi-Asset Income

Now, let's combine all of this into hypothetical "typical" client portfolios.

Portfolio	Current Yield/Income
60% S&P 500 / 40% IG Bonds	1.97%
40% S&P 500 / 20% ACWI ex-U.S / 40% IG Bonds	2.27%
60% S&P 500 / 30% IG Bonds / 10% HY Bonds	2.22%
40% S&P 500 /20% ACWI ex-U.S. / 30% IG Bonds / 10% HY Bonds	2.52%
Siegel-WisdomTree Longevity Model	3.40%
Global Dividend Model	2.98%
WisdomTree Global Multi-Asset Income Model (Moderate)	3.26%

Sources: YCharts, WisdomTree and FactSet. Hypothetical model data through 2/8/22. WisdomTree model data through 12/31/21. Investment-grade bonds are represented by the Bloomberg U.S. Aggregate Index. "HY" refers to "high yield" and refers to bonds with a credit rating below BBB-. High-yield bonds are represented by the Bloomberg U.S. Corporate High Yield Bond Index. You cannot invest in an index, and past performance does not guarantee future results.

Conclusions

Today's market environment is fraught with risks for fixed income investors. Despite the pickup in nominal yields, we continue to believe that taking excessive risk in the fixed income market is not a prudent approach. We believe a more appropriate approach is to focus on the global equity markets to generate yield while still maintaining an appropriate fixed income allocation, both for income generation and as a hedge to equity beta risk.

Today's yield environment is in a state of flux, and things are likely to get more unclear before they get better. But in today's yield-starved world, we believe you can still build intelligent portfolios that may potentially generate an optimal level of yield without taking excessive risk.

Important Risks Related to this Article

Investors and their advisors should consider the investment objectives, risks, charges and expenses of the funds included in any Model Portfolio carefully before investing. This and other information can be obtained in the Fund's prospectus by visiting www.wisdomtree.com for WisdomTree Funds. Visit the applicable third-party website for third-party funds. Please read the prospectus carefully before you invest. WisdomTree Asset Management, Inc., does not endorse and is not responsible or liable for any content or other materials made available by other ETF sponsors.

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Jeremy Siegel serves as Senior Investment Strategy Advisor to WisdomTree Investments, Inc., and its subsidiary, WisdomTree Asset Management, Inc. ("WTAM" or "WisdomTree"). He serves on the Model Portfolio Investment Committee for the Siegel-WisdomTree Model Portfolios of WisdomTree, which develops and rebalances WisdomTree's Model Portfolios. In serving as an advisor to WisdomTree in such roles, Mr. Siegel is not attempting to meet the objectives of any person, does not express opinions as to the investment merits of any particular securities and is not undertaking to provide and does not provide any individualized or personalized advice attuned or tailored to the concerns of any person.

The Siegel-WisdomTree Longevity Model Portfolio seeks to address increasing longevity by shifting the focus to potential long-term growth through a higher stock allocation versus more traditional "60/40" portfolios.