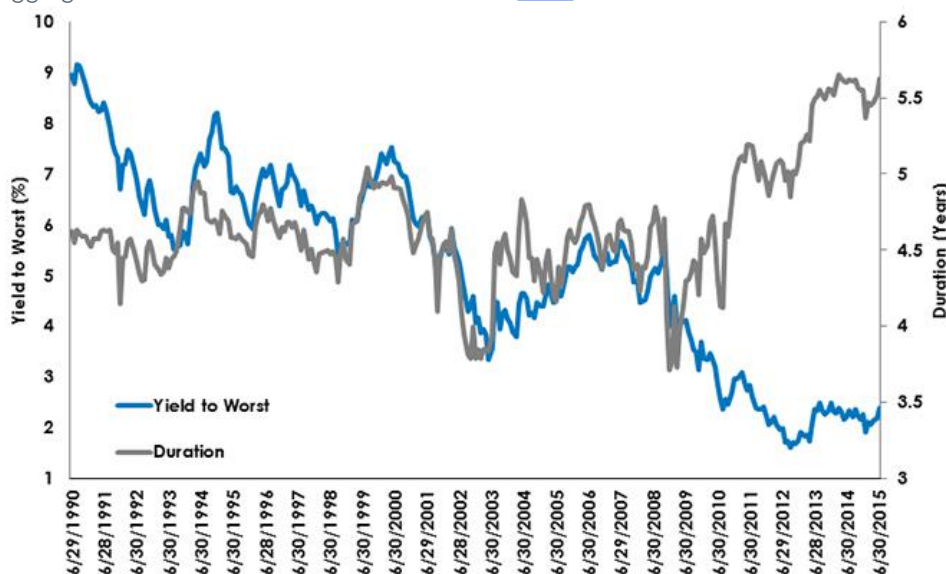


ENHANCING INCOME POTENTIAL OF THE BARCLAYS U.S. AGGREGATE INDEX

Bradley Krom — U.S. Head of Research
07/13/2015

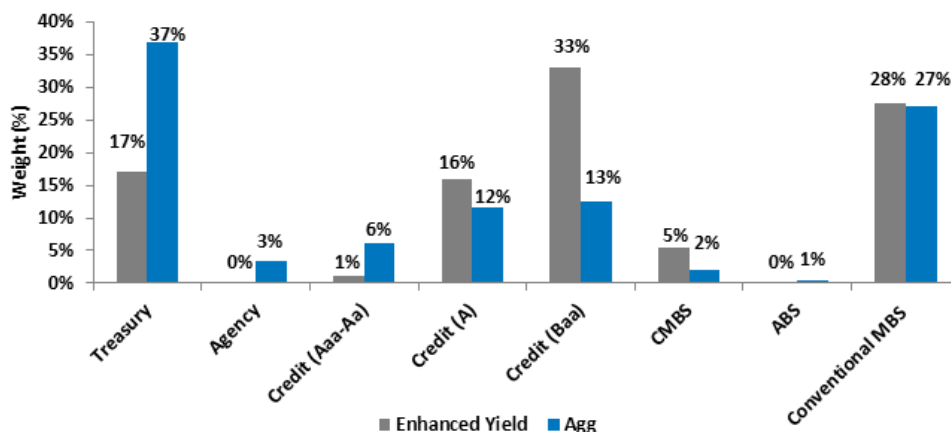
With more than \$4 trillion benchmarked against the [Barclays U.S. Aggregate Index](#), the “Agg” stands alone as the market’s pre-eminent benchmark for fixed income investors.¹ And yet this was not always the case. In fact, the Index was never meant to be the basis of an investment strategy at all. The Agg was first calculated and distributed as a way for the Kuhn, Loeb & Company bond department to position its inventory to clients. Even so, the Agg remains the barometer for a large percentage of fixed income investors around the world despite dramatic growth in markets not included in the Agg. Interestingly, when many of these managers are asked why they continue to compare themselves to the Agg, the most common refrain is simply that everyone else is doing it. In today’s market environment, the efficacy of the Agg as an investment strategy continues to come under pressure. **The Agg: Near All-Time Lows for Income vs. Risk** The Agg currently provides some of the lowest levels of income potential and highest levels of [interest rate risk](#) in its history. As we show in the chart below, since 2010, there has been a marked divergence between yields continuing to fall and rising levels of interest rate risk. Despite the deteriorating trade-offs between potential yield and interest rate risk, many investors continue to hold Agg-benchmarked core fixed income positions as a [hedge](#) against [deflation](#), equity market uncertainty and a source of income in a portfolio. **Divergence between Income Potential and Duration** Barclays U.S. Aggregate Index: [Yield](#) vs. Duration (RHS)



Source: Bloomberg, as of 6/30/15. Past performance is not indicative of future results. You cannot invest directly in an index.

For definitions of terms in the chart, visit our [glossary](#). **Market Presence May ? Best Value in Fixed Income** As we have long asserted, the construction of the Agg and other [market capitalization-weighted](#) benchmarks reflects issuance, not necessarily value. As a result, issuance patterns dictate sector, duration and [credit](#) tilts that are detached from a bond investor’s desire for consistent income. For example, the current composition of the Agg is over-weight [U.S. Treasury securities](#); in fact, nearly 23% of the Agg is composed of Treasuries maturing in fewer than five years. Thus the largest sector within the Agg is concentrated in securities yielding less than 1%.² With these potential challenges in mind, WisdomTree worked with Barclays to develop a framework that enhances the income potential of the Agg while retaining its broad volatility profile

of a balanced portfolio. [Barclays U.S. Aggregate Enhanced Yield Index](#) In response to the low income and increasing duration risk discussed above, many investors have sought to increase the income potential of their portfolios by investing in securities outside the Agg. While we currently favor [credit risk](#) over interest rate risk, increasing exposure to [non-investment-grade](#) debt introduces new sources of [volatility](#). As an alternative, we believe additional income potential can be secured by building from within the constituents of the Agg. The enhanced-yield Index is constructed by separating the Agg into 20 components and then reweighting the exposures to maximize yield while adhering to certain constraints. Absent these guardrails, the Index would simply be over-weight credit and duration. The output, as shown below, results in greater weights to the higher-yielding segments of the market, while under-weighting the lower-yielding U.S. government allocations in the Agg. **Enhanced Yield vs. Agg Relative Sector Exposure**



Source: Barclays, as of 5/31/15. Subject to change. Commercial mortgage-backed security (CMBS): A security whose value is composed of a pool of commercial mortgages. Asset-backed security (ABS): A security whose value is determined by a loan, lease or series of cash flows not associated with a mortgage. Mortgage-backed security (MBS): A security whose value is determined by a pool of mortgages.

As a result, the yield-enhanced Index delivers an additional 70 [basis points \(bps\)](#) of yield compared to the aggregate with a similar volatility profile.³ In our view, this mechanical approach enhances the desirable characteristics of the Agg, while also enhancing the income potential of the strategy. For investors needing to hit minimum income targets, this modification of the Agg could help them achieve their objectives. For managers concerned about the high-yield bond market, this approach also provides higher income potential in an all-[investment-grade](#) portfolio. In today's uncertain market environment, investors are increasingly looking for ways to enhance the income potential of their portfolios. Through its yield-enhanced approach, WisdomTree seeks to maintain the key characteristics of a popular investment strategy while enhancing its income profile. ¹Source: Barclays, as of 6/30/15. ²Sources: Barclays, WisdomTree, as of 6/30/15. ³Source: Barclays, as of 5/31/15.

Important Risks Related to this Article

Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. 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. 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.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Barclays U.S. Aggregate Bond Index, 1-3 Year : This index is the 1-3 Yr component of the U.S. Aggregate index.

Interest rate risk : The risk that an investment's value will decline due to an increase in interest rates.

Hedge : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

Deflation : The opposite of inflation, characterized by falling price levels.

Duration : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

Yield : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

Market capitalization-weighting : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Credit : A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future.

U.S. Treasury Bond : a debt security issued by the United States government.

Bloomberg Barclays U.S. Aggregate Enhanced Yield Index : a constrained, rules-based approach that reweights the sector, maturity, and credit quality of the Barclays U.S. Aggregate Index across various sub-components in order to enhance yield.

Credit risk : The risk that a borrower will not meet their contractual obligations in conjunction with an investment.

Non-investment grade debt: Sometimes referred to as “junk bonds,” these securities have a higher risk of default than investment-grade securities.

Volatility : A measure of the dispersion of actual returns around a particular average level.

Basis point : 1/100th of 1 percent.

Investment grade : An investment grade is a rating that signifies a municipal or corporate bond presents a relatively low risk of default.