

AN UPDATE ON FIXED INCOME MARKET OUTLOOK AND POSITIONING WITHIN OUR STRATEGIC MODEL PORTFOLIOS

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This article is relevant to financial professionals 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.

Looking only at year-to-date returns across the U.S. [fixed income](#) market, particularly when compared to last year's historical rout, you might conclude that 2023 is off to an uneventful start.

Fixed Income Sector Returns: 2023 YTD and 2022 Calendar Year

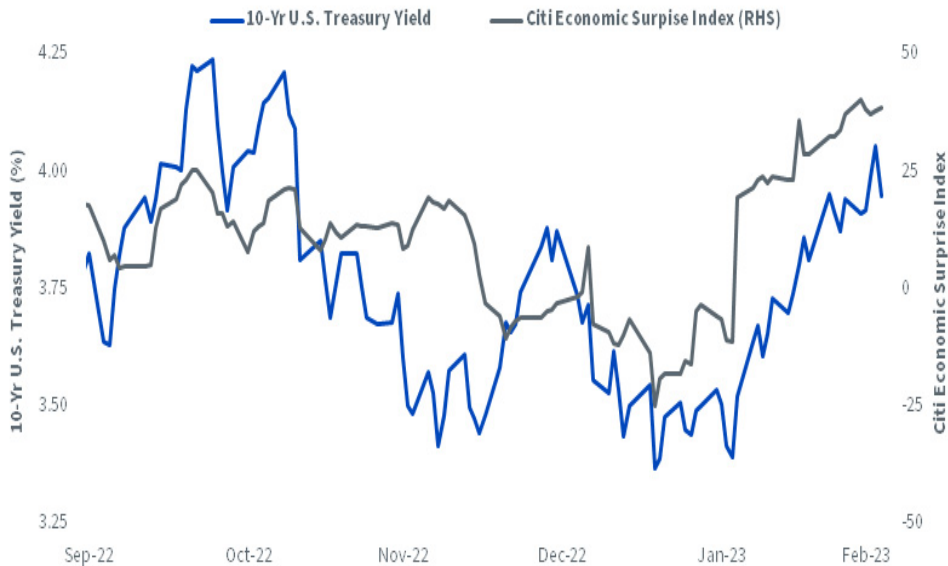
Fixed Income Sectors	2023 YTD Return As of March 3, 2023	2022 Return
U.S. Aggregate	0.28%	-13.01%
Intermediate Treasury	-0.42%	-7.77%
Long Treasury	1.55%	-29.26%
Government Related	0.40%	-11.09%
Corporate	0.91%	-15.76%
Securitized	0.21%	-11.67%
U.S. Corporate High Yield	2.79%	-12.71%
U.S. Treasury Floating Rate	0.89%	2.07%
U.S. TIPS	1.15%	-11.85%
Global Aggregate	-0.35%	-16.25%

You cannot invest directly in an index. Past performance is not indicative of future returns.

But fixed income markets have been anything but dull this year.

Throughout January, it seemed obvious to most market participants that the U.S. was entering a highly anticipated [recession](#) and [inflation](#) would cool accordingly. The yield on 10-Year U.S. Treasuries fell approximately 50 [basis points](#) in the first several weeks of the year before a string of hot economic and inflation data releases [completely shifted the market narrative](#) and pushed [yields](#) back up to 4%.

10-Yr U.S. Treasury Yield, Citi Economic Surprise Index: October 2022–Present



Sources: Citigroup, FactSet, WisdomTree, as of 3/3/23. Past performance is not indicative of future returns.

Where do we go from here?

While we did make modest adjustments to fixed income allocations throughout 2022, the strategic outlook of the WisdomTree Model Portfolio Investment Committee (MPIC) has remained intact in 2023.

WisdomTree Model Portfolio Investment Committee—Fixed Income Market Outlook

At WisdomTree, we are focused on several key themes across fixed income markets that shape our outlook and drive the positioning within our Model Portfolios:

1. Equity risk premium is near long-term average

In the years following the [global financial crisis](#), interest rates near 0% meant investors received a healthy risk premium (earnings yield minus risk-free yield) for moving out of bonds into stocks. As higher interest rates have increased this risk-free yield, this expected premium on equity investments has clearly been reduced.

However, we do not agree with the view that today's equity risk premium is dangerously low.

Importantly, since corporate earnings and dividends have historically kept up with inflation, long-term inflation-indexed ([TIPS](#)) yields are the most relevant comparator for calculating the equity risk premium. Using this approach, [today's equity risk premium has come down, but only to a level that is in line with long-term historical averages.](#)

2. There's income back in fixed income

While today's equity risk premium certainly looks reasonable, it is undeniable that [fixed income is back](#). With yields at levels a whole generation of investors have never seen, it is worth revisiting the role of bonds within a portfolio. Beyond the potential for [diversification](#) and [downside protection](#), fixed income can once again deliver meaningful returns and income.

This is true even in shorter-term maturities with little to no duration or credit risk. For example, [U.S. Treasury floating rate notes](#) have a one-week [duration](#) and are now one of the highest-yielding Treasury instruments available.

The [WisdomTree Floating Rate Treasury Fund \(USFR\)](#) provides our Model Portfolios with access to this market and can continue to play a valuable role in today's market environment.

3. Selectivity is key within corporate credit

While we are constructive on both [investment-grade](#) and [high-yield](#) corporate bonds,

recession concerns clearly remain paramount for credit investors. To help mitigate the risk of [downgrades](#) and [defaults](#) weighing on potential returns, we utilize strategies such as the [WisdomTree U.S. High Yield Corporate Bond Fund \(WFHY\)](#), which focus on fundamentally sound corporate issues.

By incorporating a cash flow-based quality screen and tilting toward issues with attractive fundamental and income characteristics, WFHY [has been able to avoid a large majority of the defaults experienced by the broader high-yield market.](#)

4. Interest rate volatility remains elevated

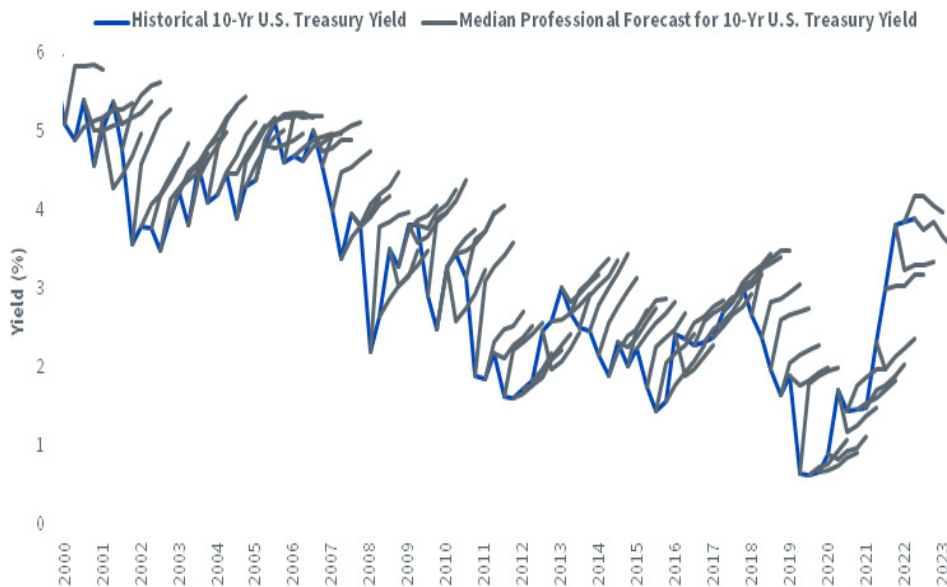
As 2023 has proven in just a couple months, the future is still very much uncertain for the U.S. economy, inflation and Fed policy.

As investors continue reacting to incoming economic data, we expect ongoing volatility in both short-term and longer-term interest rates.

We maintained a short/under-weight duration position throughout 2022 and into the current year. Although it is still our “base case” scenario that interest rates remain higher for longer, a recession-induced cooling of price pressures remains a reasonable scenario.

Given this outlook and the inherent difficulty of predicting shorter-term movements in interest rates (see chart below), we modestly lengthened duration, reducing the size of this under-weight position, as part of our quarterly rebalance last September.

10-Yr U.S. Treasury Yield: Historical vs. Median Professional Forecast



Sources: Federal Reserve Bank of Philadelphia Survey of Professional Forecasters, FactSet, WisdomTree, as of 3/3/23. Past performance is not indicative of future returns.

WisdomTree Model Portfolio Investment Committee—Fixed Income Positioning

Based on the MPIC’s fixed income outlook, our positioning across strategic fixed income Model Portfolios is the following:

Equities vs. Bonds	<ul style="list-style-type: none"> + Neutral + Equity risk premium is reasonable; near long-term average
Duration	<ul style="list-style-type: none"> + Modestly short/under-weight + Would rather be late than early to the “duration party”
Over-weight	<ul style="list-style-type: none"> + Quality-screened investment-grade and high-yield credit + U.S. Treasury Floating Rate Notes
Under-weight	<ul style="list-style-type: none"> + Treasuries

Source: WisdomTree, as of March 2023.

As we recently highlighted, [positioning within our strategic fixed income strategy delivered positive relative performance in 2022](#).

While we have kept most of these key views intact into 2023, we are certainly not complacent. Our MPIC remains focused on both mitigating potential risks and capitalizing on attractive opportunities across today’s evolving fixed income market.

Financial advisors can learn more about the WisdomTree lineup of fixed income and multi-asset Model Portfolios by visiting our [Model Adoption Center](#).

Important Risks Related to this Article

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[wisdomtree.com/investments/etfs/fixed-income/usfr](https://www.wisdomtree.com/investments/etfs/fixed-income/usfr)

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DEFINITIONS

Fixed income: An investment security that provides a return in the form of fixed periodic payments and the eventual return of principal at maturity.

Recession: two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemployment.

Inflation: Characterized by rising price levels.

Basis point: 1/100th of 1 percent.

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.

Equity risk premium: Refers to an excess return that investing in the stock market provides over a risk-free rate.

The Global Financial Crisis: Refers to the period of extreme stress in global financial markets and banking systems between mid 2007 and early 2009.

TIPS: Treasury Inflation Protected Securities.

Diversification: A risk management strategy that mixes a wide variety of investments within a portfolio.

Downside protection: A broad investment conception referring to the potential mitigation of risk or negative return experience.

Floating Rate Treasury Note: a debt instrument issued by the U.S. government whose coupon payments are linked to the 13-week Treasury bill auction rate.

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.

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

High Yield: Sometimes referred to as "junk bonds," these securities have a higher risk of default than investment-grade securities.

Downgrade: Refers to a rating agency, such as Moody's or Standard & Poor's, lowering their rating of U.S. government debt.

Default: A failure to meet the legal obligations (or conditions) of a loan.