

“BREXIT”OLOGY: LESSONS FOR FIXED INCOME INVESTING

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Post-Brexit, [volatility](#) has been on heightened display, as investors try to discern where value lies in such an uncertain investment environment. Against this backdrop, and with a week’s worth of trading now over, we thought it would be prudent to review where things stand in the fixed income arena. The developed world [sovereign debt](#) markets have been the beneficiaries of [safe-haven](#) flows. Our June 28 blog post, [“What’s ‘Nexit’ for the Bond Market?”](#) discussed U.S. [Treasury](#) (UST) market trends, so let’s move the focus to the other side of the Atlantic. It is interesting to note that in the initial reaction to the vote, some peripheral 10-year [yields](#), such as in Italy and Spain, actually rose a little more than 15 [basis points \(bps\)](#) before reversing course and rallying sharply, underscoring some of the difficulties investors are having in figuring out the appropriate response. Meanwhile, within the core [eurozone](#), [German 10-year bunds](#) behaved as expected, as yield levels have continued their descent into negative territory. As for the actual Brexit home, the United Kingdom gilt market has also seen plummeting yield levels, with the 10-year falling 50 bps as of this writing. This drop in yields came about even in the wake of S&P’s decision to [downgrade](#) U.K. sovereign debt two notches, from [AAA](#) to AA, similar to the UST experience in August 2011. **Key Fixed**

| | Pre-Brexit Vote | Post-Brexit Hi/Lo | 1 Week Later |
|-----------------------------------|-----------------|-------------------|--------------|
| 2-Year U.S. Treasury Note | 0.78% | 0.58% | 0.58% |
| 10-Year U.S. Treasury Note | 1.75% | 1.44% | 1.47% |
| 10-Year German Bund | 0.09% | -0.13% | -0.13% |
| 10-Year U.K. Gilt | 1.37% | 0.87% | 0.87% |
| Investment Grade Corporate Spread | 148 | 159 | 156 |
| Investment Grade Corporate Yield | 3.03% | 2.88% | 2.88% |
| High Yield Corporate Spread | 557 | 616 | 594 |
| High Yield Corporate Yield | 7.09% | 7.50% | 7.27% |

Source: Bloomberg, as of 7/01/2016. Past performance is not indicative of future results.

You cannot invest directly in an index.

Income Gauges

“Investment-grade corporate spread/yield” refers to the [Barclays US Aggregate Corporate Bond Index](#); “High-yield corporate spread/yield” refers to the [Barclays U.S. Corporate High-Yield Index](#). Within the [credit](#) space, there were also some noteworthy movements. Based on [spread](#) action thus far, investors are not being presented with the same “risk-off” scenario that played out during the first six weeks of the year. At that time, [corporate bond](#) spreads widened out to four- and five-year high watermarks. However, at this point, we have actually seen [investment-grade \(IG\)](#) spreads rise by a relatively tepid 5 to 10 bps. In the high yield (HY) sector, the initial increase was almost 60 bps, before falling back to a little more than 35 bps as of this writing. To provide some perspective, from the end of 2015 to mid-February of this year, IG and HY spreads widened by 50 bps and 180 bps, respectively. Given the drop in UST rates, IG and HY corporate yields have remained anchored, with IG yields now below pre-Brexit levels. Expectations for the Federal Reserve (Fed) have been a bit all over the place. In the days immediately following the results, [Federal Funds Futures](#) implied that probability pointed toward a nearly 25% chance of a rate cut this year, but that figure has since

dropped to under 5%. **Conclusion** From a fixed income perspective, Brexit has served as a powerful reminder that a portfolio of investment vehicles, rather than one based solely on trading near-term headlines, continues to represent our preferred strategy. The wisdomTree approach brings a holistic strategy to fixed income investing, emphasizing the importance of [balance sheet](#) considerations. In other words, our focus highlights credit quality rather than trying to take advantage of shorter-term trends within the bond market that can easily reverse and catch investors in an adverse position. With [interest rates](#) expected to remain in a low, range-bound pattern and credit concerns (downgrades & defaults) still prevalent, fixed income investors will likely be searching for solutions that provide relative income opportunities in an environment where increased credit quality is desired. wisdomTree fixed income [fundamentally](#) based strategies ([WisdomTree Fundamental U.S. Corporate Bond Fund \[WFIG\]](#), [WisdomTree Fundamental U.S. Short-Term Corporate Bond Fund \[SFIG\]](#), [WisdomTree Fundamental U.S. High Yield Corporate Bond Fund \[WFHY\]](#) and [WisdomTree Fundamental U.S. Short-Term High Yield Corporate Bond Fund \[SFHY\]](#)) emphasize such a qualitative approach, with a tilt toward income. The wisdomTree fundamental fixed income Funds can be used as either a substitute or a complement within a fixed income portfolio and fit inside wisdomTree's suite of fixed income products, potentially serving as the allocation to U.S.-based fixed income, specifically within the credit sector.

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High-yield or "junk" bonds have lower credit ratings and involve a greater risk to principal.

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DEFINITIONS

Brexit: an abbreviation of “British exit” that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Union.

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

Sovereign Debt: Bonds issued by a national government in a foreign currency, in order to finance the issuing country’s growth.

Safe-haven: Characterized by being a potentially desirable focal point of investment flows during periods of increased volatility and market risk. Safe-haven is not synonymous with risk-free.

Treasury: Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

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.

Basis point: 1/100th of 1 percent.

Eurozone (EZ): Consists of the following 18 countries that have adopted the euro as their currency: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain (source: European Central Bank, 2014).

German 10-year bund: a debt instrument issued by the German government with an original maturity of 10 years.

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

AAA credit rating: This is the highest issuer credit rating assigned by Standard & Poor’s, signaling strong confidence that the issuer will be able to maintain its payment obligations.

Barclays U.S. Corporate Index: is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by U.S. and non-U.S. industrial, utility, and financial issuers that meet specified maturity, liquidity, and quality requirements.

Barclays U.S. Corporate High Yield Index: Covers the universe of fixed-rate, non-investment-grade corporate debt.

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.

Spread: Typically refers to a difference between a measure of yield for one asset class and a measure of yield for either a different subset of that asset class or a different asset class entirely.

Corporate Bonds: a debt security issued by a corporation.

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

Fed fund futures: A financial instrument that let's market participants determine the future value of the Federal Funds Rate.

Balance sheet: refers to the cash and cash equivalents part of the Current Assets on a firms balance sheet and cash available for purchasing new position.

Interest rates: The rate at which interest is paid by a borrower for the use of money.

Fundamentals: Attributes related to a company's actual operations and production as opposed to changes in share price.