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# ALIGNING THE STARS IN FIXED INCOME

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Anyone looking for a fresh perspective from [Federal Reserve \(Fed\)](#) Chairman Jerome Powell last week was sorely disappointed. During his semiannual monetary policy testimony to Congress, Powell essentially reiterated his stance that, yes, the economy is in a solid recovery, but no, the recent spike in [inflation](#) is only “transitory.” Sound familiar? Thought so. In fact, he went so far as to say that the bar for a potential exit strategy, “substantial further progress,” was still a ways off.

So, where does that leave fixed income investors? I find myself returning to this question rather frequently in various discussions. Despite Chair Powell’s unchanged stance, I continue to focus on two overarching themes for the second half of this year and into 2022: keeping [duration](#) short and credit over rates. Against this backdrop, I thought it would be a good exercise to highlight how investors can put these two themes to work.

First up, on the short duration theme, investors may wish to consider the [WisdomTree Yield Enhanced U.S. Short-Term Aggregate Bond Fund \(SHAG\)](#). This vehicle is the short duration version of our core fixed income flagship [WisdomTree Yield Enhanced U.S. Aggregate Bond Fund \(AGGY\)](#), which we have written about many times.

Following the same strategy as AGGY, SHAG reweights the sectors of the one- to five-year segment of the Short Agg Composite while adhering to two main guardrails: the weight of major and minor sectors cannot deviate by more than 30% from their weights in the Short Agg Composite and duration generally will not be more than half a year of this benchmark.

This approach not only focuses on mitigating interest rate risk, but it seeks to boost [yield](#). In addition, SHAG carries a five-star rating from Morningstar<sup>1</sup>.

For the second theme, I’d like to highlight the [WisdomTree U.S. High Yield Corporate Bond Fund \(WFHY\)](#). Investing in [high yield](#) can carry the potential for an elevated risk profile compared with the investment-grade sector. The approach behind WFHY is to screen for quality to potentially mitigate the possibility of future default risk. This strategy focuses on only public issuers domiciled in the U.S. and eliminates those with a negative cash flow. We then reweight this remaining universe to tilt weights toward bonds with more favorable income characteristics.

From an investment perspective, WFHY can serve as a quality screened income sleeve in a core-plus bond portfolio. Also, WFHY has a four-star Morningstar rating, with five stars over the last three-year period<sup>2</sup>.

## Conclusion

With the challenges impacting the current fixed income setting, investors have faced some difficult choices. In my opinion, SHAG and WFHY could help investors navigate the uncharted policy waters that may lie ahead.

<sup>1</sup>Based on risk adjusted returns as of 6/30/2021 out of 524 funds for the Short-Term Bond fund category for the 3 year period.

<sup>2</sup>Based on risk adjusted returns as of 6/30/2021 out of 634 and 556 funds for the High Yield Bond funds category for the 3 and 5 year periods, respectively.

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performance figures associated with its three-, five- and 10-year (if applicable) Morningstar Rating metrics. The WisdomTree U.S. High Yield Corporate Bond Fund was rated against the following numbers of U.S.-domiciled high-yield bond funds over the following periods: 634 funds in the last three years and 556 funds in the last five years. With respect to these high-yield bond funds, The WisdomTree U.S. High Yield Corporate Bond Fund received a Morningstar Rating of five stars and four stars for the three- and five-year periods, respectively. Past performance is no guarantee of future results.

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## DEFINITIONS

**Federal Reserve**: The Federal Reserve System is the central banking system of the United States.

**Inflation**: Characterized by rising 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.

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