WEIGHING IN ON OUR BARBELL STRATEGY

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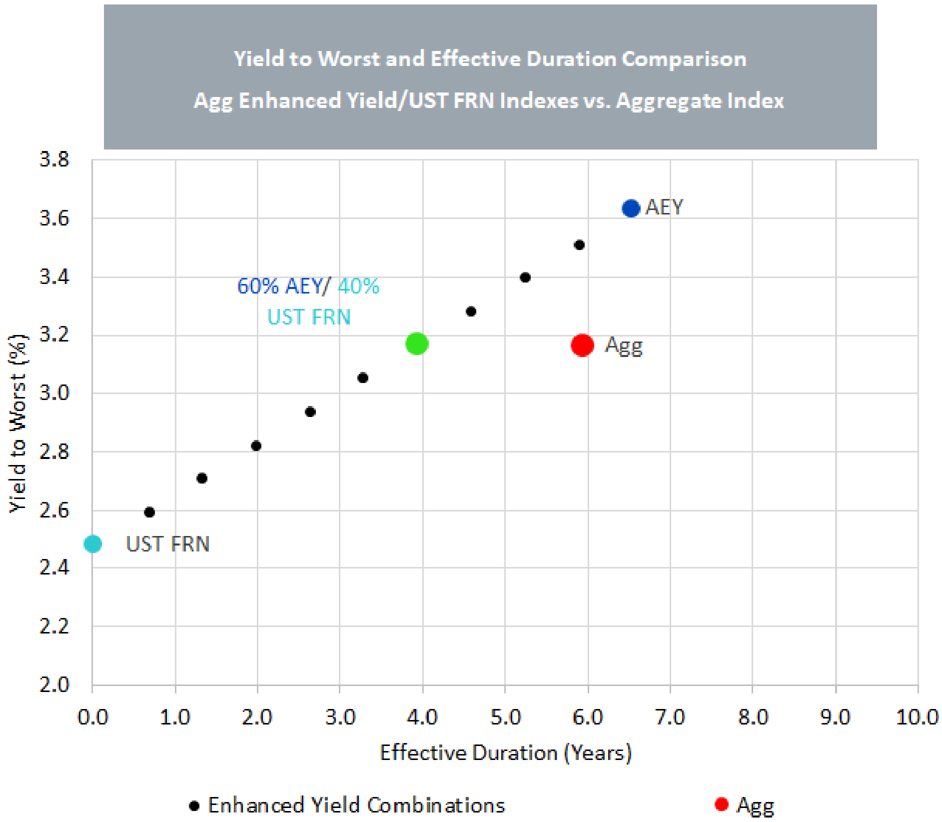
Unlike the previous two years, the 2019 outlook for fixed income has been fraught with confusion and uncertainty. Changing economic positions and attendant Federal Reserve (Fed) policy expectations have created this more challenging environment, and the lack of "fresh" economic data to begin the year—due to the partial government shutdown—has only added to this indecision. How, then, do investors navigate such a fixed income landscape? It is time to revisit the barbell strategy I first wrote about in my August 15, 2018, blog, "The Barbell Approach: A Time-Tested Fixed Income Strategy."

As a reminder, a fixed income barbell is a strategy that essentially replicates the weightlifting apparatus. In other words, the investor utilizes two parts of the yield curve: on one side, the focus tends to be centered around an intermediate- or longer-duration vehicle, while the other end of the spectrum concentrates on a short-duration instrument. These two "weights" on the barbell serve two different purposes. The intermediate-/longer-duration aspect can help solve for income needs or total return considerations, while the short-duration investment serves as a "rate fulcrum."



Source: Bloomberg, as of 2/21/2019. Past performance is not indicative of future results. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns. WisdomTree, its affiliates and their independent providers are not liable for any informational errors, incompleteness or delays or for any actions taken in reliance on information contained herein.

For definitions of terms in the chart, please click here.

In this blog post, I'll provide an update on the two indexes we highlighted six months ago: The Bloomberg Barclays U.S. Aggregate Enhanced Yield Index (AEY) and the Bloomberg U.S. Treasury Floating Rate Bond Index (UST FRN). The latter serves as the short-duration weight of the barbell and is based on the 2-Year Treasury floating rate note. AEY is a yield-enhanced index which reweights the sectors of the Bloomberg Barclays U.S. Aggregate Bond Index (Agg) and serves as the longer-duration weight.

The accompanying graph illustrates how an investor can implement various allocations between these two "weights" of the barbell to seek the desired result and, in the case of our analysis, compare this result to the Agg. Interestingly, there has been a shift in weighting since I blogged on this topic last summer. At that time, the focus was on a 70%-AEY/30%-UST FRN combination, but the updated version now sees a potentially more desirable outcome in a 60%-AEY/40%-UST FRN mix. As of this writing, this "barbell" offers a yield of 3.17%, identical to the Agg, but it cuts the duration by two years versus the Agg.

The aforementioned shift is the by-product of the Fed's two additional rate increases in September and December of last year, combined with the decline in yield levels that occurred in the intermediate/longer-term part of the curve over the last three months or so.

Conclusion

The WisdomTree Yield Enhanced U.S. Aggregate Bond Fund (AGGY), which seeks to track the Bloomberg Barclays U.S. Aggregate Enhanced Yield Index, and the WisdomTree Floating Rate Treasury Fund (USFR), which seeks to track the Bloomberg U.S. Treasury Floating Rate Bond Index, can be utilized as the two “weights” discussed here. The barbell strategy laid out in this blog offers investors a strategic solution designed to help fixed income investors navigate the choppy waters that could loom ahead, without making a “high-conviction bet” on where rates are headed in this uncertain landscape.

Unless otherwise noted, all data is from Bloomberg, as of February 21, 2019.

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You cannot invest directly in an index.

DEFINITIONS

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

Yield curve : Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

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.

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.

Bloomberg U.S. Treasury Floating Rate Bond Index : A rules-based, market-capitalization-weighted index engineered to measure the performance of floating rate U.S. Treasury notes.

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.

Bloomberg U.S. Aggregate Bond Index : Represents the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, as well as mortgage and asset backed securities.