IF IT'S NOT ONE THING, IT'S ANOTHER

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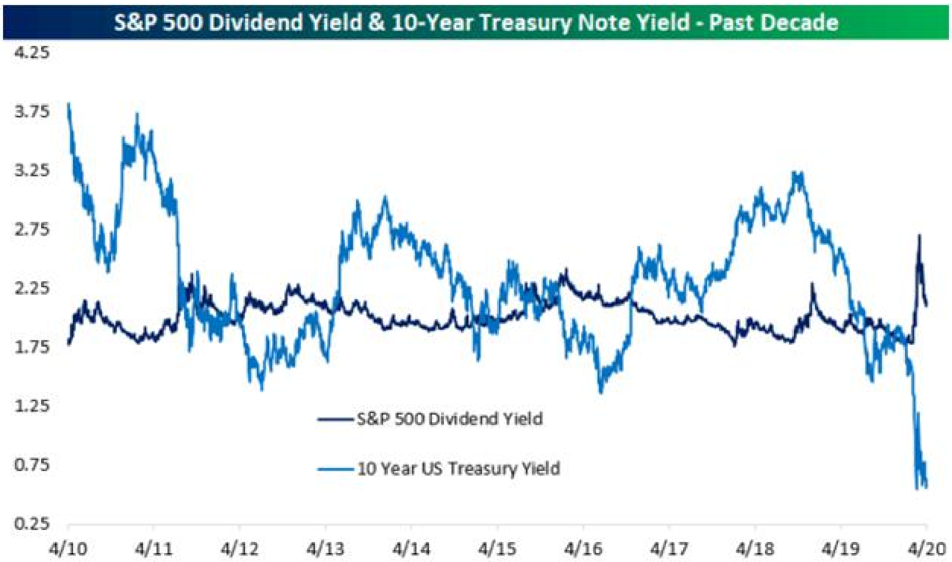
"Well, Jane, it just goes to show you, it's always something—you never can tell. If it's not one thing, it's another."

("Roseanne Roseannadanna," played by Gilda Radner, Saturday Night Live, 1977–1980)

The Evolution of Rates, Spreads and Yields

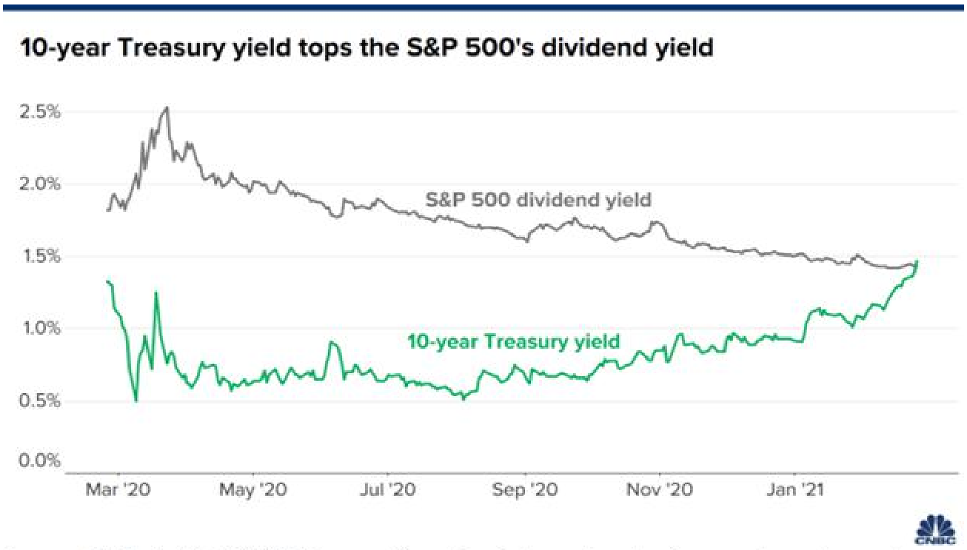
Let's begin this blog post with a graph we used in a blog post from last June, highlighting the historical disparity between the S&P 500 Index dividend yield and the 10-Year Treasury note yield:



Sources: SeekingAlpha.com, Bespoke Investment Group, 4/22/20. You cannot invest in an index, and past performance does not guarantee future results.

At that time, we made the argument that investors seeking to optimize current income out of their portfolios were better off over-allocating to yield-focused equities than to traditional bond investments.

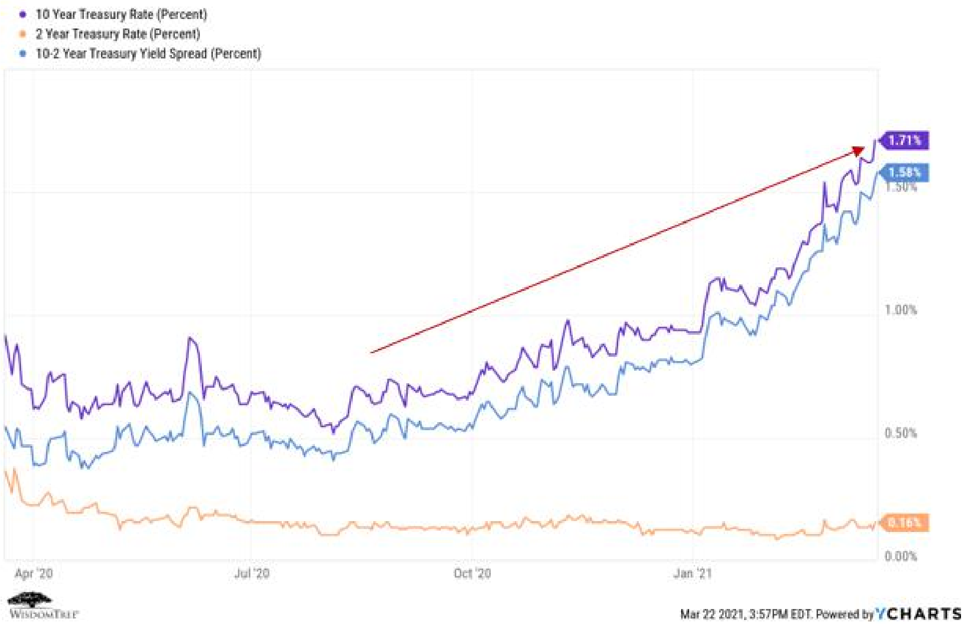
Well, what a difference eight months make:



Sources: CNBC, FactSet, 2/25/21. You cannot invest in an index, and past performance does not guarantee future results.

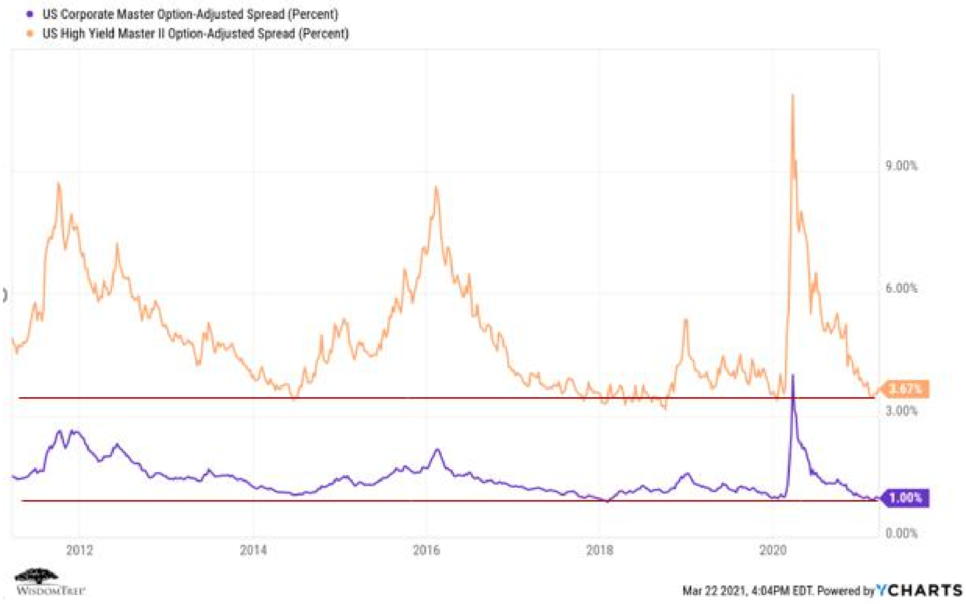
The U.S. yield curve steepened dramatically over the past several months, driven by expectations for an improving economy, massive fiscal stimulus and a continuation of accommodative monetary policy.

To provide some perspective, the rise in the UST 10-Year yield began early last August when the all-time low watermark of 0.51% registered on August 4. Since that date, the rate increase has been an eye-opening 120 basis points (bps) through March 18.[1] However, the development getting the lion's share of attention is what has transpired so far this year, where the rise has been a whopping 78 bps.



Source: YCharts, as of 3/18/21. You cannot invest in an index, and past performance does not guarantee future results.

At the same time, U.S. credit spreads have narrowed and come all the way back to reside at pre-pandemic levels. In fact, both investment-grade and high-yield are hovering near lows not seen since 2018.



Source: YCharts, 10-year data from 3/18/11–3/18/21. You cannot invest in an index, and past performance does not guarantee future results.

The result is that, for the first time in a long time, investors can now generate current income out of their bond portfolios that is higher than what they can get from their equity portfolios:

Instrument	10-year Treasury	IG Credit Spread	HY Credit Spread	Total Current Yield
IG Bonds	1.71%	1.00%		2.71%
HY Bonds			3.67%	5.38%
S&P 500 Dividend Yield				1.53%
ACWI ex-US Dividend Yield				2.20%

Source: YCharts, bond data through 3/18/21. Dividend data through February 2021. "IG" stands for "investment grade" (bonds with a credit rating of BBB- or better) and "HY" stands for "high yield" (bonds with a credit rating of below BBB-). You cannot invest in an index, and past performance does not guarantee future results. The proxies for the IG and HY spreads are the US Corporate Master Option-Adjusted Spread and the US High Yield Master II Option-Adjusted Spread, respectively. The MSCI ACWI ex-US index captures large and mid-cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 27 Emerging Markets (EM) countries. With 2,344 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.

Portfolio Implications

From a portfolio perspective and using the yield information above, let's begin with a comparison of the current income available from a traditional stock and bond portfolio and the WisdomTree Model Portfolios that are designed explicitly to optimize risk-adjusted current income, specifically the **Global Dividend** model, the **Global Multi-Asset Income** model and the **Siegel-WisdomTree Longevity** model:

Portfolio	Current Yield / Income
60% S&P 500 / 40% IG Bonds	2.00%
40% S&P 500 / 20% ACWI ex-US / 40% IG Bonds	2.14%
60% S&P 500 / 30% IG Bonds / 10% HY Bonds	2.27%
Siegel-WisdomTree Longevity Model	2.58%
60% WisdomTree Global Dividend Model / 40% IG Bonds	2.79%
WisdomTree Multi-Asset Income Model (Moderate)	3.40%

Source: Index data from YCharts, through 3/18/21. *WisdomTree model data is from WisdomTree and FactSet, through 2/28/21. You cannot invest in an index, and past performance does not guarantee future results.

Conclusions

Despite the higher current income available from bond allocations, we view the total return risk to be much higher in the bond market. In our base case outlook, we believe rates will continue to grind higher, resulting in a further steepening of the yield curve. Credit spreads could also continue to tighten, but the runway from present levels is a shrinking one.

From a portfolio perspective, we continue to recommend that investors seeking to optimize *risk-adjusted* current income continue to focus on their equity allocations because, well, "*you never can tell*."

[1]Source: Ycharts, as of March 18, 2020.

Important Risks Related to this Article

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You cannot invest directly in an index.

DEFINITIONS

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

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.

Dividend yields : Refers to the trailing 12-month dividend yield. Dividends over the prior 12 months are added together and divided by the current share price. Higher values indicate more dividends are being generated per unit of share price.

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.

Steepen : an increase in the spread between short-term interest rates and longer-term rates.

Fiscal Stimulus : Using fiscal policy as a tool to provide economic growth.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

10- Year Treasury : a debt obligation of the U.S. government with an original maturity of ten years.

Basis point : 1/100th of 1 percent.

Credit spread : The portion of a bond’s yield that compensates investors for taking credit risk.

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 securitie.

Risk-adjusted returns : Returns measured in relation to their own variability. High returns with a high level of risk indicate a lower probability that actual returns were close to average returns. High returns with a low level of risk would be more desirable, as they indicate a higher probability that actual returns were close to average returns.