
FORECASTING RETURNS FOR FLOATING RATE TREASURIES

Bradley Krom – U.S. Head of Research
07/07/2022

Just like when we started 2022, our highest conviction call is that the [Federal Reserve](#) will need to continue to hike interest rates to meet their dual policy mandate. The most direct way an investor can play this view is by investing in U.S. [floating rate notes \(FRNs\)](#). Year to date,¹ the [WisdomTree U.S. Floating Rate Treasury Fund \(USFR\)](#) has taken in nearly \$4.2 billion of fresh capital. A question that we've been receiving recently is how should investors think about return potential in the second half of 2022 compared to the first half. In our view, the trade may just be getting started.

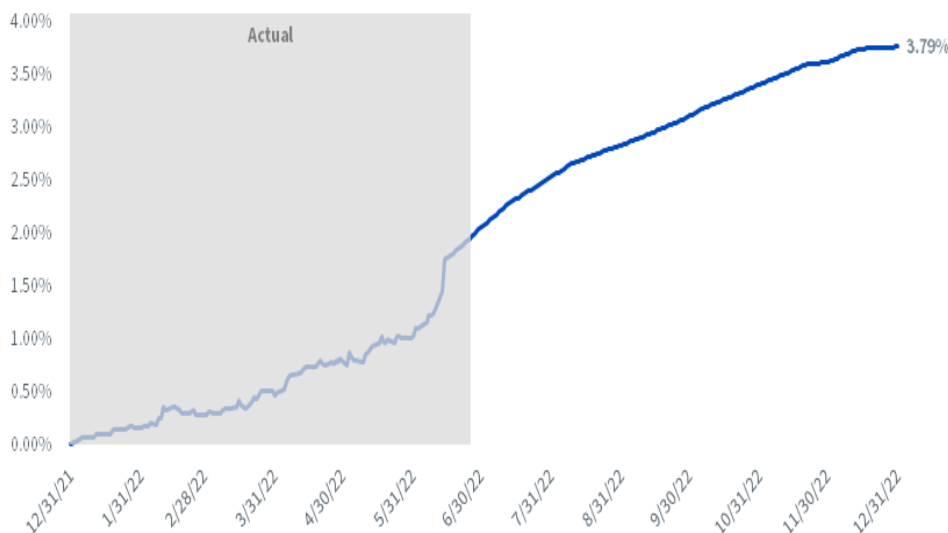
Mechanics

To review, U.S. Treasury FRNs are backed by the full faith and credit of the U.S. government. There is no credit risk. The income that these notes generate is derived from two sources: the primary source is from the weekly rate resets according to the results of the U.S. 3m T-bill auction. This means that if rates are rising due to changes in Fed policy, investors can reset to a higher level. The second component comes from a spread (positive or negative) that represents the amount of demand for FRNs when they are initially auctioned every quarter. In an average-to-low-demand environment, the spread is positive, so investors receive rates above 90-day [T-bill](#) yields. When demand is high, this spread may be zero or even negative, like we saw at the U.S. FRN auctions on January 31 (-0.015%) or May 2 (-0.075%).²

What's Priced In

As of June 15, the market is pricing in 2.00% of additional [rate hikes](#) by the Fed in 2022. Since U.S. FRNs perform best when the Fed is raising rates, we decided to model what impact this would have on the returns of [USFR](#) through the end of 2022.

U.S. 3m Treasury Bill Yield Forecast



Sources: WisdomTree, Koyfin, as of 6/15/22. Past performance is not indicative of future results.

Since the U.S. government borrows money for as little as four weeks and as long as 30 years, we are able to observe the potential future path of U.S. 3m Treasury bills based on expectations about Fed rate hikes. Based on current expectations, 3m Treasury bills are currently forecast to return 1.63% through the end of 2022. If the Fed doesn't hike as aggressively, returns will likely be lower than today's expectations. However, for our highest conviction position, this seems like a comparatively attractive level of fixed income returns in a year that has seen high levels of [volatility](#) in traditionally low-volatility assets.

Forecasting FRN Returns

While market expectations drove the forecasting of 3m T-bill returns, the potential "spread" for newly auctioned FRNs is more difficult to handicap. While the spread component has generally been positive, we are assuming a zero spread for the remainder of 2022 given the trends we've seen of more recent auctions going negative. As a result, we believe a reasonable forecast for 2022 full-year returns is below. In our view, the real value-add of [USFR](#) is the frequency of the reset to higher rates. Below, we compare the returns of a strategy rolling 3m T-bills every quarter against holding [USFR](#). Since the income component on [USFR](#) resets weekly, you ultimately accrue more income when the Fed is increasing rates.

Name	2015	2016	2017	2018	2019	2020	2021	2022 (YTD)
WisdomTree Floating Rate Treasury Fund (NAV)	-0.08%	0.61%	1.03%	1.80%	2.10%	0.52%	0.01%	0.32%
WisdomTree Floating Rate Treasury Fund (MP)	-0.24%	0.78%	1.36%	1.80%	2.10%	0.52%	-0.03%	0.36%
Bloomberg US Treasury Floating Rate Bond Index	0.05%	0.77%	1.23%	1.98%	2.27%	0.74%	0.15%	0.37%
Hypothetical 3m T-Bill Return	0.01%	0.22%	0.82%	1.80%	2.16%	0.45%	0.04%	0.20%

Sources: WisdomTree, Bloomberg, as of 6/15/22.

For most recent standardized performance, please click [here](#).

As expected, [USFR](#) has generated the most significant levels of outperformance in the years that the Fed was hiking rates. In a year like 2022, we expect a significant advantage for floating rate notes compared to 3m T-bills.

While these returns are far from guaranteed, they represent the market's best estimate of what might be in store for fixed income investors for the remainder of 2022. With high levels of uncertainty in other markets, we think [USFR](#) could offer a compelling case

for returns as the market continues to grapple with high inflation and bouts of volatility.

¹ Source: WisdomTree, as of 6/15/22.

² Source: TreasuryDirect, as of 5/31/22.

Important Risks Related to this Article

There are risks associated with investing, including the possible loss of principal. Securities with floating rates can be less sensitive to interest rate changes than securities with fixed interest rates, but may decline in value. The issuance of floating rate notes by the U.S. Treasury is new and the amount of supply will be limited. Fixed income securities will normally decline in value as interest rates rise. The value of an investment in the Fund may change quickly and without warning in response to issuer or counterparty defaults and changes in the credit ratings of the Fund's portfolio investments. Due to the investment strategy of this Fund it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

For the top 10 holdings of USFR please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/fixed-income/usfr>

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

Related Funds

+ [WisdomTree Floating Rate Treasury Fund](#)

+ [WisdomTree Yield Enhanced U.S. Aggregate Bond Fund](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an “as is” basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the “MSCI Parties”) expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only. You cannot invest directly in an index.

DEFINITIONS

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

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.

Treasury Bill: A treasury bill (T-Bill) is a short-term debt obligation backed by the U.S. government with a maturity of one month (four weeks), three months (13 weeks) or six months (26 weeks).

Rate Hike: refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

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