HOW TO FIND OPPORTUNITIES IN U.S. CORE FIXED INCOME

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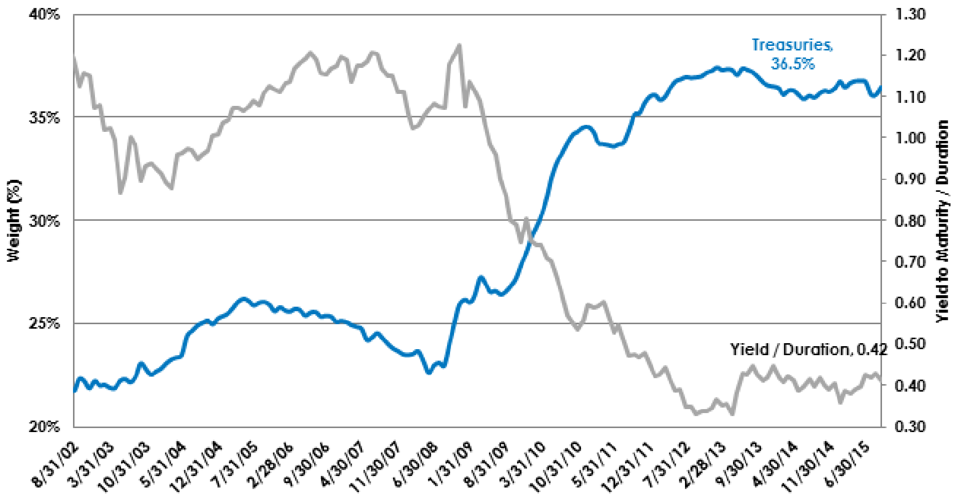
In a portfolio context, lower volatility and potentially more predictable income streams can make fixed income investments attractive complements to equities. Additionally, the general downward trend that we've seen in interest rates has helped make fixed income attractive from a total return perspective. One of the most recognized benchmarks for fixed income is the Barclays U.S. Aggregate Bond Index (Agg); however, investors have been looking outside the Agg in search of higher return potential. **Agg Does Not Rebalance Back to Constant Weights** Over time, the composition of the Agg has not been held constant, and as the patterns of issuance and eligibility in its different underlying sectors have changed, so have their weights within the Index. Today's Agg looks much different than it did when it was created in 1986.[1] Agg's Sector Exposures as of September 30, 2015:[2] • Treasuries: 36.5% • Government-related securities: 8.6% • Corporate: 24.0% • Securitized: 30.9% What this tells us at a high level is that the Index may be very well positioned for any "risk-off" environment with such a large weight in Treasuries. On the other hand, it is important to note that more than 22% of that 36.5% is in U.S. Treasuries maturing in five years or less, so if the U.S. Federal Reserve (Fed) does in fact raise interest rates at some point in the near future, this part of the Treasury curve may have a greater potential to feel the impact than the longer-maturity components. **What about a "Low & Slow" Fed and Improving Economic Conditions in the United States?** However, if the baseline view to be expressed is not one of an imminent risk-off change in sentiment, but rather a continued gradual improvement in U.S. economic conditions, is positioning with nearly 40% exposure to Treasuries the best option? We don't think so, especially with the changing risk profile of the Treasuries themselves. **What Is the Risk in U.S. Treasuries in the Current Environment?** Risk, in this context, is not meant as an outright default, as we don't see the safe-haven status of U.S. Treasuries changing anytime soon. However, the experience of investing in bonds can be quantified by two important concepts: • Yield to maturity: At the time of purchase, this statistic encapsulates a measure of the returns to expect, assuming that all future coupon and principal obligations are met. • Duration: This statistic encapsulates how responsive the price of a bond might be, given a change in interest rates, with higher numbers indicating the potential for greater responsiveness. **The Bottom Line:** When looking at the yield-to-maturity/duration ratio over time, an upward-sloping line indicates more potential compensation per unit of interest rate risk, while a downward-sloping line indicates less potential compensation per unit of interest rate risk. **Agg: More Exposure to U.S. Treasuries as Their Risk Profile Worsens**



Sources: Bloomberg, Barclays, with data from 8/31/02 to 9/30/15. Past performance is not indicative of future results. You cannot invest directly in an index.

• The reality of the Agg, going back over a period of 13 years, is that today the Treasury component is close to its highest level over this period, while the yield-to-maturity/duration ratio is close to its lowest point. Additionally, it is clear that weight to Treasuries tended to increase at the same time the risk/reward trade-off for that exposure worsened.

Introducing the Barclays U.S. Aggregate Enhanced Yield Index To address this issue of relatively higher exposure to U.S. Treasuries at a time when the risk/reward benefits of that exposure may not warrant it, WisdomTree collaborated with Barclays to introduce the Barclays U.S. Aggregate Enhanced Yield Index (Agg Enhanced Yield). The key idea is that the Agg can be broken into many subcomponents based on attributes such as sectors of the bond market, maturities, or credit qualities. The Agg Enhanced Yield in effect reweights the Agg into areas that may have better risk/return attributes, rather than simply holding more of components that have increased in issuance. Looking at the resulting exposures:[3]

• **Treasuries:** Instead of the nearly 40% that we saw in the Agg, the Agg Enhanced Yield was closer to 17%. It's worth noting that this is very close to the maximum allowable under-weight to Treasuries relative to the Agg, set at 20%.

• **Corporates:** Instead of the corporate exposure being close to 24%, as seen in the Agg, the Agg Enhanced Yield's exposure to this segment was closer to 45%.

• **Government-Related & Securitized Exposures**: Differences here between the Agg and the Agg Enhanced Yield were much less pronounced, in the 2% to 5% range.

The main difference, therefore, involved taking the exposure to U.S. Treasuries—representative of a relatively poor risk/reward potential trade-off—and pushing it toward corporates. Doing this led to the yield to maturity of the Agg Enhanced Yield looking about 80 basis points (bps) higher than that of the Agg[4]. As a firm, given that we believe that the U.S. economic picture is on an improving trend that we expect to continue, we see more opportunity today in corporate credit than we do in U.S. Treasuries.

Preparing for a "Low & Slow" U.S. Federal Reserve For those who find the concept of reweighting the Agg of interest, see our recent blog post *"Looking within the Barclays U.S. Aggregate Index to Enhance Income."*.

[1]Source: Barclays U.S. Aggregate Index Factsheet, 5/5/14. [2]Sources: Bloomberg, Barclays, with data as of 9/30/15. [3]Sources: Bloomberg, Barclays, WisdomTree, with data as of 9/30/15. [4]Source: Bloomberg, as of 9/30/15.

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DEFINITIONS

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

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

Barclays U.S. Aggregate Bond Index, 1-3 Year : This index is the 1-3 Yr component of the U.S. Aggregate index.

Rebalance : An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.

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.

Securitized : a debt security whose value is backed by an asset or pool of assets such as a mortgage.

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.

Risk : Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.

Yield To Maturity : Portfolio Yield to Maturity represents the weighted average yield to maturity of a Fund's investments in money market securities and fixed income securities as a specified date. Yield to maturity is the rate of return generated on these securities, assuming interest payments and capital gains or losses as if the instrument is held to maturity. The weighted average yield is calculated based on the market value of each security. The calculation does not incorporate yield from any derivative instruments that are part of the Fund's investments.

Coupon : The annual interest rate stated on a bond when it's issued. The coupon is typically paid semiannually. This is also referred to as the "coupon rate" or "coupon percent rate.&rdquo.

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.

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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.

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.

Government-related exposure : a debt security whose value is implicitly guaranteed by a government, government sponsored entity, or supranational organization. Securitized: a debt security whose value is backed by an asset or pool of assets such as a mortgage.

Basis point : 1/100th of 1 percent.

Corporate Credit : compensation associated with the risk of lending to a corporation.