

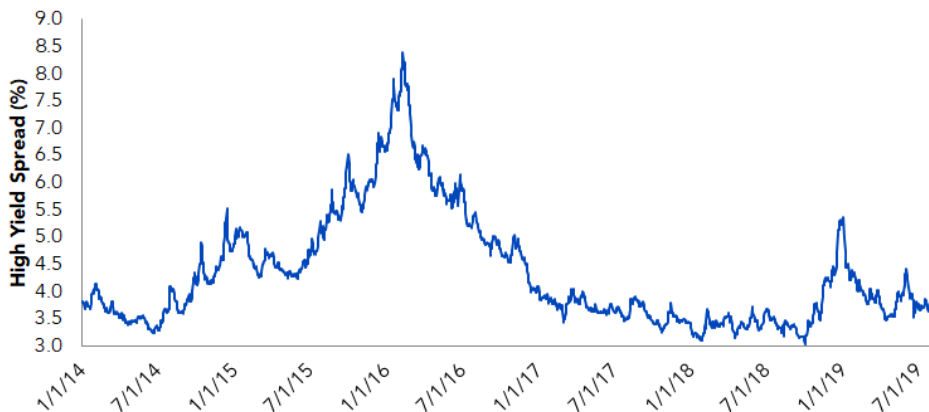
LATE INNING RELIEF FOR HIGH YIELD

Kevin Flanagan – Head of Fixed Income Strategy, Brendan Loftus – Director, Portfolio Solutions
08/28/2019

Are you tired of reading about [inverted yield curves](#) yet? Well, let's turn our attention to a recurring question in bond-land instead: is this the end of the credit cycle?

Without a doubt, [high yield \(HY\)](#) has shown definite resilience over the last few years, and has not, as yet, indicated that it's at the end of the cycle. But maybe a better way of looking at it is that perhaps investors are witnessing the late innings.

Figure 1: [HY Spread](#)



Source: Bloomberg, as of 8/21/19. Past performance is not indicative of future results.

Figure 1 illustrates the five-year trend for HY spreads ([Bloomberg Barclays US Corporate High Yield average option-adjusted spread](#)). The spike in differentials that occurred in early 2016 clearly stands out. As readers will recall, this was the by-product of the headlines relating to the plunge in energy prices and concerns regarding China's economy, which resulted in a rather significant risk-off period for the financial markets.

Needless to say, HY was an unfortunate participant in the negative side of this equation. However, after peaking at +839 [basis points \(bps\)](#) in February 2016, spreads came roaring in and hit a near-term low of +303 bps in October of last year. In this intermittent, roughly 2½ year period, each time HY spreads widened out, investors seemingly viewed it as a buying opportunity. Then “risk-off round 2” hit during Q4 2018 and lasted into the early days of this year, pushing the HY differential out nearly 235 bps to +537 bps on January 3.

Some could argue investors are experiencing “risk-off round 3” at the present. HY

spreads, once again, narrowed throughout the first half of this year, but have since climbed back up over the +400 threshold to +422 bps, as of this writing. Given the [volatility](#) of late, we feel investors should consider looking at HY through a different lens going forward; one that focuses on the health of balance sheets.

WisdomTree’s Approach to HY

We continue to advocate to investors that incorporating [fundamentals](#) into your HY bond strategies is a more intuitive way of accessing the market. By screening based on whether an issuer has positive or negative free-cash-flows, one can effectively target bonds that exhibit favorable fundamentals while presenting opportunities for income and screening out those that don’t. WisdomTree was one of the first to bring an entire suite of fundamentally weighted corporate bond ETFs to market . One fund in the HY portion of the suite that has shown strong performance over the last few years relative to the various benchmarks is the [WisdomTree Fundamental U.S. High Yield Corporate Bond Fund \(WFHY\)](#).

[WFHY’s](#) underlying Index, the [WisdomTree Fundamental U.S. High Yield Corporate Bond Index](#), employs a multistep process. It screens by fundamentals of HY corporate bonds by screening out those that have a negative average free-cash-flow over the past five years, then tilts to those that offer attractive income characteristics within a risk-constrained range. As an added layer of security, we also cut 5% of the bonds with the lowest [estimated liquidity](#), an important consideration given the universe of illiquid bonds in the HY sector.

Fund Performance Relative to HY Benchmarks

The table below shows at a high level how screening for fundamentals have provided excess return year-to-date and year-over-year compared to widely popular high [yield](#) corporate benchmarks. The old narrative, that screening for fundamentals will sacrifice on yield and ultimately on performance, seems to have not really held true, particularly in a market that has seen various bouts of volatility over the last few years.

As of 7/31/19	3-Mo.	YTD	1-Yr.	3-Yr.	5-Yr.	Since WFHY Inception
WFHY—NAV	1.86%	11.78%	8.71%	6.25%	N/A	6.96%
WFHY—MKT	1.20%	11.15%	9.90%	6.65%	N/A	6.89%
Bloomberg Barclays U.S. High Yield Very Liquid Index	1.54%	11.34%	7.45%	6.55%	4.71%	7.34%
Markit iBoxx USD Liquid High Yield Index	1.71%	10.74%	7.44%	6.48%	4.65%	7.23%

Sources: WisdomTree, Bloomberg, as of 7/31/19.. WFHY’s Inception Date: 4/27/16. WFHY’s net expense ratio of 0.38% reflects a contractual waiver of 0.10% through October 31, 2019. Periods of less than 1 year are shown as cumulative total returns. Periods 1 year and greater are shown as annualized total returns. Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost.

*For definitions of terms in chart, please visit our [glossary](#).
For standardized performance of WFHY, please click [here](#).*

Conclusion

Given recent market volatility and geopolitical/economic concerns, we continue to lean into using sound, time-tested fundamental metrics to help navigate an uncertain future. With this approach, investors have the potential to avoid those riskier names that are

more susceptible to downfalls in a volatile market, while preserving the potential to earn higher levels of income and participate in a growing part of the economy.

Unless otherwise stated, data source is Bloomberg, as of 8/19/19.

Important Risks Related to this Article

There are risks associated with investing, including the possible loss of principal. Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. High-yield or “junk” bonds have lower credit ratings and involve a greater risk to principal. Fixed income investments are also subject to credit risk, the risk that the issuer of a bond will fail to pay interest and principal in a timely manner or that negative perceptions of the issuer’s ability to make such payments will cause the price of that bond to decline. While the Fund attempts to limit credit and counterparty exposure, 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. Please read the Fund’s prospectus for specific details regarding the Fund’s risk profile.

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.

For more investing insights, check out our [Economic & Market Outlook](#)

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

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.

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

High-yield bond spread: The amount of incremental income a bondholder receives for assuming credit risk, specifically that of companies rated below investment grade credit.

Bloomberg Barclays U.S. Aggregate Index OAS: the amount of compensation in excess of Treasuries that investors demand for lending to borrowers in the Bloomberg Barclays U.S. Aggregate Index.

Basis point: 1/100th of 1 percent.

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

Fundamentals: Attributes related to a company’s actual operations and production as opposed to changes in share price.

Liquidity: The degree to which an asset or security can be bought or sold in the market without affecting the asset’s price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets.

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.