

# WESTERN ASSET'S OUTLOOK FOR UNCONSTRAINED BOND INVESTING

Bradley Krom – U.S. Head of Research  
11/20/2015

The [WisdomTree Western Asset Unconstrained Bond Fund \(UBND\)](#), the first unconstrained bond exchange-traded fund (ETF), was launched on June 11, 2015. Recently, we thought it might be instructive to publish a discussion we had with the Fund's portfolio manager, Mark Lindbloom, from Western Asset Management Company (Western Asset). Below, we summarize Western Asset's outlook for global markets for the coming months and ultimately how these views impact the positioning of UBND. At present, the portfolio is over-weight [credit risk](#), under-weight [interest rate risk](#), with select exposures to emerging markets. **Global Macro** U.S. economic data, while somewhat stagnant in recent months, continues to support Western Asset's view of modest growth over the next year (2.0% to 2.5%). As a result of recent data, including an extremely strong payroll number on November 6, Mark believes the process of interest rate normalization is likely to begin in December. However, [inflation](#) remains low, implying a very gradual pace of [tightening](#). For this reason, he views the prospect of a sustained rise in [long-maturity](#) U.S. bond yields as less likely. Looking forward to 2016, Western Asset [estimates three to four rate hikes](#), depending on the strength of underlying economic data. Globally, the outlook remains uncertain in light of recent developments, particularly in China. As a result of a decline in global commodity prices, select emerging market (EM) countries are experiencing stress. However, Western Asset still believes EM represents [value](#) in the medium to long term. Importantly, the European Central Bank (ECB) and Bank of Japan (BOJ) are poised to increase their level of accommodation in the coming months, in Western Asset's view. As a result, it believes that the global outlook for growth may be poised to improve heading into 2016. **Global Credit Conditions** Corporate [balance sheets](#) generally remain in good shape, but the strong U.S. dollar is negatively affecting corporate earnings of some large U.S. multinationals. In Europe, Western Asset anticipates that the economy will continue to avoid recession largely due to aggressive action from the ECB. It continues to keep a close eye on geopolitical tensions in various hotspots, such as Ukraine and the Middle East. Looking ahead, Western Asset will continue to determine whether to adjust risk positions by weighing the much-improved [valuations](#), which in certain cases may now be fair, against a still-favorable backdrop of mild economic expansion and accommodative policy. **Portfolio Impact** UBND's portfolio management team expects to remain over-weight to certain [spread sectors](#) that have demonstrated strong fundamentals. It is maintaining a significant allocation to [investment-grade](#) financials, which currently offer attractive yields while appearing more utility-like in the face of increased regulation. The team also has allocations to the [high-yield](#) and [bank loan](#) sectors, as it believes these sectors should benefit from the continued economic recovery. On a [fundamental value](#) basis, very high implied [default rates](#), which are much higher than realized rates, signal attractive valuations. The spread between EM and developed market yields remains wide, and, in our opinion, presents an opportunity to add value in select countries. [View current UBND exposures, here.](#) Also, the portfolio will maintain a tactical [duration](#) strategy and will continue to favor a [curve-flattened](#) position. Western Asset believes a [short position](#) in the intermediate portion of the U.S. [yield curve](#) is warranted, as intermediate rates will likely rise the most in response to the normalization of U.S. [monetary policy](#). At the

longer end, it is possible that rates could rise by 50-75 [basis points \(bps\)](#) by the end of 2016. Additionally, market [volatility](#) has risen sharply, and the risks to a fragile global recovery are not insignificant. Western Asset's focus remains on longer-term fundamentals with diversified strategies to mitigate risk. Ultimately, it sees greater value in nongovernment sectors while maintaining a meaningful position in long-dated [Treasuries](#) as an offset against [deflation](#) or slower growth. While UBND has only been on the market a few months, our discussions with financial advisors have generally been positive. For many asset allocators, the fact that they know every day exactly what they hold has been a strong differentiator, particularly in light of the volatility that has occurred over this time. While performance will ultimately be driven by Western Asset's views on the markets, we believe an unconstrained approach to investing focused on prudent risk management has the potential to add value as interest rates in the U.S. ultimately rise.

#### Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Unlike typical exchange-traded funds, there is no index that the Fund attempts to track or replicate. Thus, the ability of the Fund to achieve its objectives will depend on the effectiveness of the portfolio manager. Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. In addition when interest rates fall income may decline. 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. High-yield, or "junk," bonds have lower credit ratings and involve a greater risk to principal.

Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. Derivative investments can be volatile, and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions. The Fund may engage in "short sale" transactions where losses may be exaggerated, potentially losing more money than the actual cost of the investment, and the third party to the short sale may fail to honor its contract terms, causing a loss to the Fund. 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 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](http://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

**Credit risk**: The risk that a borrower will not meet their contractual obligations in conjunction with an investment.

**Interest rate risk**: The risk that an investment's value will decline due to an increase in interest rates.

**Inflation**: Characterized by rising price levels.

**Tighten**: a decline in the amount of compensation bond holders require to lend to risky borrowers. When spreads tighten, the market is implying that borrowers pose less risk to lenders.

**Long-maturity**: a bond that matures in greater than 10 years.

**Value**: Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

**Balance sheet**: refers to the cash and cash equivalents part of the Current Assets on a firm's balance sheet and cash available for purchasing new position.

**Valuation**: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

**Spread sectors**: segments of the fixed income market that pay higher yields than government securities of a comparable maturity.

**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 securities.

**Bank loan**: A private debt arrangement issued by a financial institution which is senior to other creditors.

**Fundamental value**: The value of a firm that is related to a company's actual operations and production as opposed to changes in share price.

**Default Rates**: the frequency in which borrowers fail to fulfill their contractual obligations.

**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.

**Curve-flatten**: a relative-value position that benefits if the spread between short and long maturity securities declines.

**Short (or Short Position)**: The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).

**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.

**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.

**Basis point**: 1/100th of 1 percent.

**Volatility**: A measure of the dispersion of actual returns around a particular average level.&nbsp;

**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.

**Deflation**: The opposite of inflation, characterized by falling price levels.