

---

# A NOVEL WAY TO PLAY THE REFLATION TRADE

Kevin Flanagan – Head of Fixed Income Strategy  
01/21/2021

I know it's only three weeks into the new year, but the unmistakable trend in bond land thus far has been the 'Reflation Trade.' Sure, we could all debate whether this theme will continue in 2021 (I believe it will), but more importantly, ask yourself this question: Should I position my fixed income portfolio for the possibility of further increases in [Treasury \(UST\) yields](#)? It really is more of a rhetorical question, don't you think?

As I've noted before, the fundamental and technical analyses still point toward the UST 10-Year yield rising from where it stands now. Yes, it [broke through the 1% threshold rather easily and sooner than most expected](#), but that may just be the tip of the iceberg. I'm not calling for a 2% 10-Year yield (at least not now, anyway), but a move toward 1.50% does seem possible. The bond market appears to have quickly moved on from any potential economic soft patch that could be coming from the second wave of COVID-19, with last week's response to the weaker-than-expected jobs report being exhibit A. And if the economy bounces back sooner than anticipated due to the potential for another hefty [fiscal stimulus](#) package (do I hear \$1.9 trillion?) to be enacted once the Biden administration takes hold, my recommendation would be consider a rate-hedge solution for your bond portfolio.

So, what type of [interest rate hedge](#) solution are we talking about here? Allow me to introduce a unique WisdomTree strategy on this front, specifically, the [WisdomTree Interest Rate Hedged U.S. Aggregate Bond Fund \(AGZD\)](#). This approach combines a [long position](#) in bonds representative of the well-known benchmark, the [Bloomberg Barclays U.S. Aggregate Bond Index \(the Agg\)](#), with a [short position](#) in [Treasury](#) securities to target zero [duration](#).

## Why AGZD?

- Zero-duration aspect eliminates the potential for further rising rate risk
- Follows an investment-grade strategy to maintain a traditional credit risk profile
- Offers a 30-day SEC yield that is only marginally below the Agg but without the historically high duration of the Agg

## When to Use AGZD?

While we haven't yet seen the 'whites of the eyes' of [inflation](#), inflation expectations have moved visibly higher. Former [Federal Reserve \(Fed\)](#) Chair Greenspan once noted that actual inflation readings can be akin to looking in the rearview mirror. With that in mind, implementing our AGZD strategy now seems to be a prudent course of action because the UST 10-year yield will not necessarily wait to see those whites of the eyes of inflation in order to move higher—the first three weeks of 2021 being exhibit B.

## 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. The Fund seeks to mitigate interest rate risk by taking short positions in U.S. Treasuries (or futures providing exposure to U.S. Treasuries), but there is no guarantee this will be achieved. 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. 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. The Fund may engage in "short sale" transactions of U.S. Treasuries 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. 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. Investing in mortgage- and asset-backed securities involves interest rate, credit, valuation, extension and liquidity risks and the risk that payments on the underlying assets are delayed, prepaid, subordinated or defaulted on. Due to the investment strategy of certain Funds they 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

**Treasury yield**: The return on investment, expressed as a percentage, on the debt obligations of the U.S. government.

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

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

**Hedge**: Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

**Long (or Long Position)**: The buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value, the opposite of Short (or Short Position).

**Bloomberg U.S. Aggregate Bond Index**: Represents the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, as well as mortgage and asset backed securities.

**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).

**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.

**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.

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

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