

# THE WISDOMTREE FIXED INCOME ENHANCED YIELD SUITE OF ETFs

MAY 2019

Fixed income investors continue to search for yield in an environment where central bank policy rates in Europe are at historically low levels. As the global economy begins to show signs of slowing and inflation concerns in Europe are abated, a solution that aims to enhance the yield within traditional core fixed income indices meanwhile maintaining controlled risk parameters are providing a timely solution for clients. In our view, investors who own the market broadly using passive strategies that aim to track the Bloomberg Barclays Euro Treasury Enhanced Yield Bond Index or the Bloomberg Barclays Euro Aggregate Bond Index are faced with using tools that have large exposures to negative yielding bonds. To address the flaws inherent in these strategies, WisdomTree has developed a passive way to optimise the weights within these indices with the aim to enhance yield meanwhile applying strict risk constraints.

WisdomTree has launched a suite of enhanced yield exchange-traded funds (ETFs) for their investors in the US, Canada and most recently has launched two enhanced yield ETFs for European investors to address client demand for greater yield within their fixed income portfolios. The enhanced yield suite of ETFs in aggregate have gathered almost \$800 million in assets globally and investor interest continues to grow, as per Figure 1.

FIGURE 1: ASSETS UNDER MANAGEMENT (AUM) WITHIN WISDOMTREE'S ENHANCED YIELD FIXED INCOME SUITE GLOBALLY



Source: WisdomTree as of 26 March 2019. **Historical performance is not an indication of future performance and any investments may go down in value.** You cannot invest directly in an index.

European investors can now gain access to two approaches which are **physically replicated, offer direct investment in investment grade bonds** and are **UCITS compliant**:

- + **European Government Bond Index**: The **WisdomTree EUR Government Bond Enhanced Yield UCITS ETF**: The fund seeks to track the performance, before fees and expenses of Bloomberg Barclays Euro Treasury Enhanced Yield Bond Index which aims to achieve a higher yield than the Bloomberg Barclays Euro Treasury Bond Index (the traditional index).
- + **European Aggregate Bond Index**: The **WisdomTree EUR Aggregate Bond Enhanced Yield UCITS ETF** seeks to track the price and yield performance, before fees and expenses, of the Bloomberg Barclays Euro Aggregate Enhanced Yield Bond Index (BB Euro Agg Enh Yield Index) which aims to achieve a higher yield than the Bloomberg Barclays Euro Aggregate Bond Index (the traditional index).

Yield can typically be increased by shifting exposure along several different risk dimensions within the index. For the **European Aggregate Bond Index**, risk dimensions include sovereign, interest rate risk (i.e., duration) and credit risk (e.g. spread). For the **European Government Bond Index**, risk dimensions include sovereign and interest rate risk (i.e., duration). Both strategies use a rules-based approach to reweight the sub-components of the Euro Aggregate Bond Index such that yield is maximized – subject to certain constraints – while the risk characteristics are broadly preserved. While these indices were launched in April 2018, the rules-based approach allowed Bloomberg to provide history backfilled to January 2002. This can provide investors with the ability to review back-tested data going back past the most recent 2008 financial crisis, a period that includes severe strain to financial markets. Both WisdomTree strategies mentioned apply a similar optimisation process with slightly different constraints that aim to keep tracking error at 35 basis points against the traditional index on a monthly basis meanwhile aiming to enhance the yield versus their respective traditional indices.

## WisdomTree EUR Aggregate Bond Enhanced Yield UCITS ETF: Deeper dive

FIGURE 2: THE OPTIMIZATION PROCESS FOR THE BLOOMBERG BARCLAYS EURO AGGREGATE ENHANCED YIELD BOND INDEX



FIGURE 3: CAPTURES GREATER YIELD EXPOSURES ACROSS THE YIELD CURVE WITHIN RISK METRICS

	Euro Aggregate				Euro Aggregate Enhanced				Difference			
	1-5	5-10	10+	Total	1-5	5-10	10+	Total	1-5	5-10	10+	Total
France	5.1%	4.2%	5.1%	14.4%	0.2%	-	2.4%	2.6%				
Germany	4.0%	2.9%	2.6%	9.5%	-	-	3.7%	3.7%				
Spain	2.7%	3.2%	2.2%	8.2%	-	6.4%	2.7%	9.0%				
Italy	5.3%	3.5%	3.7%	12.5%	10.3%	3.3%	5.0%	18.6%				
Belgium	0.9%	1.2%	1.5%	3.5%	-	-	1.4%	1.4%				
Netherlands	1.0%	0.9%	0.9%	2.8%	-	-	-	-				
Other Countries	2.3%	2.3%	1.6%	6.2%	-	0.5%	1.3%	1.8%				
Corp AA and Above	1.2%	0.6%	0.2%	2.0%	-	2.0%	-	2.0%				
Corp A	3.5%	2.8%	0.6%	6.8%	2.7%	7.7%	1.4%	11.8%				
Corp BBB	4.8%	4.0%	0.7%	9.5%	9.8%	9.0%	5.7%	24.4%				
Covered Bonds	4.9%	2.7%	0.5%	8.1%	-	3.7%	5.5%	9.1%				
Gov Related	7.6%	6.0%	3.0%	16.5%	2.6%	11.0%	1.9%	15.5%				
<b>Total</b>	<b>43.4%</b>	<b>34.1%</b>	<b>22.5%</b>	<b>100%</b>	<b>25.6%</b>	<b>43.4%</b>	<b>31.0%</b>	<b>100%</b>				
	Euro Aggregate				Euro Aggregate Enhanced				Difference			
Yield	1-5	5-10	10+	Total	1-5	5-10	10+	Total	1-5	5-10	10+	Total
France	-0.46%	-0.04%	0.80%	0.11%	-0.46%	-	0.80%	0.73%				
Germany	-0.58%	-0.29%	0.33%	-0.24%	-	-	0.33%	0.33%				
Spain	-0.17%	0.67%	1.75%	0.68%	-	0.67%	1.75%	0.99%				
Italy	0.90%	2.08%	3.07%	1.87%	0.90%	2.08%	3.07%	1.69%				
Belgium	-0.46%	0.06%	1.00%	0.32%	-	-	1.00%	1.00%				
Netherlands	-0.52%	-0.15%	0.45%	-0.10%	-	-	-	-				
Other Countries	-0.34%	0.20%	1.08%	0.23%	-	0.20%	1.08%	0.84%				
Corp AA and Above	-0.01%	0.48%	0.97%	0.23%	-	0.48%	-	0.48%				
Corp A	0.22%	0.85%	1.34%	0.57%	0.22%	0.85%	1.34%	0.76%				
Corp BBB	0.70%	1.54%	2.08%	1.15%	0.70%	1.54%	2.08%	1.33%				
Covered Bonds	-0.10%	0.31%	0.92%	0.10%	-	0.31%	0.92%	0.68%				
Gov Related	-0.15%	0.38%	1.10%	0.27%	-0.15%	0.38%	1.10%	0.38%				
<b>Total</b>	<b>0.01%</b>	<b>0.61%</b>	<b>1.33%</b>	<b>0.51%</b>	<b>0.64%</b>	<b>0.87%</b>	<b>1.51%</b>	<b>1.01%</b>				
	Euro Aggregate				Euro Aggregate Enhanced				Difference			
Contribution to Yield	1-5	5-10	10+	Total	1-5	5-10	10+	Total	1-5	5-10	10+	Total
France	-0.024%	-0.002%	0.041%	0.02%	-0.001%	-	0.020%	0.02%				
Germany	-0.023%	-0.008%	0.009%	-0.02%	-	-	0.012%	0.01%				
Spain	-0.005%	0.021%	0.039%	0.06%	-	0.042%	0.047%	0.09%				
Italy	0.048%	0.073%	0.112%	0.23%	0.094%	0.068%	0.152%	0.31%				
Belgium	-0.004%	0.001%	0.015%	0.01%	-	-	0.014%	0.01%				
Netherlands	-0.005%	-0.001%	0.004%	-0.00%	-	-	-	-				
Other Countries	-0.008%	0.005%	0.018%	0.01%	-	0.001%	0.015%	0.02%				
Corp AA and Above	-0.000%	0.003%	0.002%	0.00%	-	0.010%	-	0.01%				
Corp A	0.008%	0.023%	0.008%	0.04%	0.006%	0.066%	0.018%	0.09%				
Corp BBB	0.034%	0.061%	0.014%	0.11%	0.069%	0.138%	0.118%	0.32%				
Covered Bonds	-0.005%	0.008%	0.004%	0.01%	-	0.011%	0.051%	0.06%				
Gov Related	-0.011%	0.022%	0.033%	0.04%	-0.004%	0.041%	0.021%	0.06%				
<b>Total</b>	<b>0.00%</b>	<b>0.21%</b>	<b>0.30%</b>	<b>0.51%</b>	<b>0.16%</b>	<b>0.38%</b>	<b>0.47%</b>	<b>1.01%</b>				

Source: Bloomberg, WisdomTree. Data as of 29 March 2019. Euro Aggregate Enhanced index is represented using the BB Euro Agg Enh Yield Index. The Euro Aggregate index is represented using the Bloomberg Barclays Euro Aggregate Bond Index.

You cannot invest directly in an index. **Historical performance is not an indication of future performance and any investments may go down in value.**

As per **figure 3**, the enhanced yield index modified the weights of Germany within each sub-component of the curve. In the sub-component Germany 1-5 year, the traditional index had a 4.0% weight meanwhile the enhanced yield index reduced exposure to 0.0%. For example, this also occurred in the Germany 5-10 year sub-component as exposure went from 2.9% in the traditional index to 0.0% meanwhile in the 10+ year sub-component the exposure was increased to 3.7% from 2.6%. One notable point as of end of March 2019 is that German bonds within these sub-components of the traditional index provide yields of negative 58 basis points and negative 29 basis points, respectively. Positive yields for Germany are only achieved once we look at maturities of 10+ years where the yield turns to positive 33 basis points. This is the sub-component of the German yield curve where the enhanced yield index adds an overweight relative to the traditional European Aggregate Index. **Overall, the BB Euro Agg Enh Yield Index was able to achieve a yield of 1.01% versus the Bloomberg Barclays Euro Aggregate Bond Index which achieved a yield of only 0.51% as of end of March 2019. As a core allocation within an investors fixed income portfolio, the enhanced yield strategies will rebalance each month using the previously mentioned optimisation process aiming to optimise the yield meanwhile remain within the risk constraints.**

**The following constraints are applied, which serve to control risk and concentration while limiting turnover:**

- + **Tracking error constraints:** Tracking Error Volatility (TEV) of the BB Euro Agg Enh Yield Index relative to the Bloomberg Barclays Euro Aggregate Bond Index (Euro Agg Index) should be limited to 35 basis points each month. TEV is defined as the volatility of the difference between the performance of a portfolio and its benchmark.
- + **Duration constraints:** No more than 1 year greater than that of the Euro Agg Index
- + **Sector and sub-component constraints relative to the Euro Agg Index weights (%):** Major sector +/- 20%, minor sector +/- 10%, individual buckets +/- 5%, Baa credits +/- 15%.
- + **Bucket size constraint:** To be eligible for selection on any given monthly weight determination date, a sub-components's market value has to be at least EUR10bn, or its weight has to be at least 0.15% of the Euro Agg Index.
- + **Turnover constraints:** Portfolio turnover due to monthly rebalancing is capped at 5%. When this condition cannot be met, the turnover limit is increased incrementally by 1% until a solution is found.

## Competitor Analysis

### How does the WisdomTree EUR Aggregate Bond Enhanced Yield UCITS ETF compare to other exchange traded funds?

Below we highlight a few passive and smart beta solutions providing exposure to European aggregate or European corporate indices. Each have slightly different objectives and should be reviewed within the context of an investor's overall portfolio goals.

- + **WisdomTree EUR Aggregate Bond Enhanced Yield UCITS ETF:** seeks to track the price and yield performance, before fees and expenses, of the BB Euro Agg Enh Yield Index. The index uses a rules-based approach to reweight the sub-components of the Euro Aggregate Bond Index such that yield is maximized – subject to certain constraints – while the risk characteristics are broadly preserved.
- + **iShares € Aggregate Bond UCITS ETF EUR (Dist):** seeks to track the performance of an index composed of Euro denominated investment grade government, government-related, corporate and securitised bonds.
- + **iShares Core € Corp Bond UCITS ETF:** seeks to track the performance of an index composed of Euro denominated investment grade corporate bonds.
- + **L&G LOIM Euro Corporate Bond Fundamental UCITS ETF:** aims to track the LOIM Fundamental Euro Corporate Index by investing primarily in an optimised portfolio of fixed-rate EUR-denominated corporate bonds whose weights are determined using fundamental factors to assess issuers' creditworthiness.
- + **db x-trackers iBoxx EUR Corporates Yield Plus UCITS ETF (DR):** aims to reflect the performance of the highest yielding EUR-denominated corporate bonds (sub-index of the Markit iBoxx EUR Corporate 1-10 year index), investment grade bonds only at inclusion but downgraded bonds remain in the index (high yield bonds with a minimum rating of BB-, 20% limit on high yield bonds).
- + **IndexIQ Factors Sustainable Corporate Euro Bond:** aims to give investors access to Euro-denominated investment grade corporate bonds issued by companies that meet SRI criteria. It aims to track the performance of the Solactive Candriam Factors Sustainable Corporate Euro Bond Index.

TABLE 4: COMPETITOR DETAILS

Strategy	Index Ticker	Index short name	Index name	ETF Brand	ETF name	Expense ratio
WisdomTree Strategy	I33852EU	BB Euro Agg Enh. Yield	Bloomberg Barclays Euro Aggregate Enhanced Yield Bond Index	WisdomTree	WisdomTree EUR Aggregate Bond Enhanced Yield UCITS ETF	0.18
Passive	LBEATREU	BB Euro Agg	Bloomberg Barclays EuroAgg Total Return Index Value Unhedged EUR DFEP LN	iShares	iShares € Aggregate Bond UCITS ETF EUR (Dist)	0.25
	LECPREU	BB Euro Agg Corp	Bloomberg Barclays Euro Aggregate Corporate Total Return Index Value Unhedged EU	iShares	iShares Core € Corp Bond UCITS ETF	0.20
SmartBeta	LOFEUCP	LOIM EUR Corp	LOIM Eur Corporate Index	L&G	L&G LOIM Euro Corporate Bond Fundamental UCITS ETF	0.30
	IBXCEY1	iBoxx EUR Corp	Markit iBoxx EUR Corporates Yield Plus TRI	db x-trackers	db x-trackers iBoxx EUR Corporates Yield Plus UCITS ETF (DR)	0.25
	SOLCACBE	Solactive Candriam Fctrs Sust Corp	Solactive Candriam Factors Sustainable Corporate Bond Index	IndexIQ	IndexIQ Factors Sustainable Corporate Euro Bond	0.30

Source: Bloomberg as of 30 April 2019. You cannot invest directly in an index. **Historical performance is not an indication of future performance and any investments may go down in value.**

TABLE 5: INDEX YIELD AND DURATION CHARACTERISTICS

Strategy	ETF Brand	Index name	Yield (%)	Dur. (years)
WisdomTree Strategy	WisdomTree	BB Euro Agg Enh. Yield	0.98	7.89
Passive	iShares	BB Euro Agg	0.50	6.90
	iShares	BB Euro Agg Corp	0.73	5.08
SmartBeta	L&G	LOIM EUR Corp	0.69	4.81
	db x-trackers	iBoxx EUR Corp	1.26	5.13
	IndexIQ	Solactive Candriam Fctrs Sust Corp	-	-

Source: Bloomberg, as of 30 April 2019. BB= Bloomberg. You cannot invest directly in an index. **Historical performance is not an indication of future performance and any investments may go down in value.**

In reference to **table 5**, the BB Euro Agg Enh. Yield Index exhibits a yield enhancement over the pure passive Euro aggregate indices as well as the smart beta LOIM Euro Corp index. The iBoxx Euro Corporate index does gain greater yield although the index rules allow for up to 20% exposure into bonds rated as high yield. On the other hand, the investment universe for the BB Euro Agg Enh. Yield index is purely investment grade.

TABLE 6: CALENDAR YEAR TOTAL RETURNS

Strategy	ETF Brand	Index name	Yearly returns										
			YTD	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
WT Str.	Wisdom Tree	BB Euro Agg Enh. Yield	4.19%	-0.31%	2.00%	4.63%	0.51%	15.41%	4.12%	13.88%	2.64%	0.49%	9.39%
Passive	iShares	BB Euro Agg	2.63%	0.41%	0.68%	3.32%	1.00%	11.10%	2.17%	11.19%	3.24%	2.18%	6.95%
	iShares	BB Euro Agg Corp	3.94%	-1.25%	2.41%	4.73%	-0.56%	8.40%	2.37%	13.59%	1.49%	4.75%	15.71%
Smart Beta	L&G	LOIM EUR Corp	3.83%	-0.87%	1.97%	5.63%	-0.68%	8.09%	1.24%	11.04%	4.71%	6.06%	21.60%
	db x-trackers	iBoxx EUR Corp	5.39%	-2.35%	4.26%	6.61%	-0.53%	8.57%	4.92%	19.66%	-0.93%	5.17%	-
	IndexIQ	Solactive Candriam Fctrs Sust Corp	2.63%	-0.73%	2.12%	3.98%	-	-	-	-	-	-	-

Source: Bloomberg as of 30 April 2019. The BB Euro Agg Enh Yield Index was launched in April 2018, with history backfilled to January 2002. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

From a performance standpoint if we include backtested data going back to 2009 as referenced in **table 6**, the BB Euro Agg Enh. Yield index has exhibited positive returns in each calendar year except in 2018 when most indices were negatively impacted by market volatility. Although in 2018 if we compare the calendar year returns within this select universe, many competing indices faced a greater impact on returns.

## Conclusion

As fixed income investors continue to search for yield, a solution that aims to enhance the yield within traditional core fixed income indices meanwhile maintaining controlled risk parameters are providing a timely solution for clients. WisdomTree's suite of enhanced yield exchange-traded funds (ETF) in UCITS form can help address this need and form the core of a clients fixed income portfolio. These ETFs rebalance monthly to adjust portfolio positions with the aim to enhance yield meanwhile not deviating from the investment universe of the traditional index in each respective strategy, a pure investment grade solution for client portfolios.

## Related products:

[WisdomTree EUR Aggregate Bond Enhanced Yield UCITS ETF – EUR](#)

[WisdomTree EUR Aggregate Bond Enhanced Yield UCITS ETF - EUR Acc](#)

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