CONSIDERING US TREASURY FLOATING RATE NOTES AS A POSITIONING STRATEGY

The US floating rate treasury note celebrated its fifth birthday in January of 2019. As of March 2019, the US Treasury's newest securities have grown into a market of slightly more than $396 billion in total size [1]. While this level of issuance is quite small relative to other classes of US treasury debt, it does represent an important new tool that investment managers can utilise to better control risk within their US Dollar denominated debt portfolios.

Importantly, when investors are considering how US Treasury Floating rate notes work, they must remember:

1. The credit risk depends on the credit risk of the US government, and, since it can raise tax revenues and print more dollars—the issuance and payment currency for this debt—many view this risk at the lowest possible end of the credit risk spectrum.
2. The interest rate risk on US Treasury Floating rate notes is low when compared to traditional fixed rate bonds as the coupon on US Floating rate bonds adjusts to changes in short term interest rates leading to a very low duration profile. With the coupon rate effectively reset weekly to the yield of the 13-week treasury bill auction plus a spread, there will be very short periods of time where market interest rates would change before the coupon rate of the US Treasury Floating rate notes would be adjusted.
3. The currency risk depends on the investor more than the instrument, but we mention it here because in markets outside of the US there tends to be another currency that investors are beholden to for their assets and liabilities. Due to the relative difference in interest rates between the US and the Eurozone, Switzerland, and the United Kingdom, to name a few examples, if investors wanted to hedge these returns back to their home currency, it could be costly. It is for this reason that, as we lay out potential portfolio applications for US Treasury Floating Rate Notes, we will assume that the investor has already decided that they want US Dollar denominated exposure to meet their broader portfolio goals.

1 "Monthly Statement of the Public Debt of the United States." 31 March 2019.

DE-RISKING PORTFOLIOS WITH SHORTER MATURITY FIXED INCOME OPTIONS

Framing the competitive landscape

When investors are thinking about their US Dollar denominated government fixed income portfolios today, it may not be the case that they are looking to buy treasuries directly in all cases. Instead, they may prefer index-tracking vehicles that aim to achieve the goal of very short duration, very low credit risk and US Dollar denominated fixed income exposure. Typically, we have seen:

+ Investors typically looking at very short maturity bonds to mitigate the risk of rising interest rates. Beyond rising interest rates, short maturity bonds of high credit quality can also function to bring down overall portfolio volatility. We've seen this as the primary concern amongst allocators.
+ The secondary concern amongst allocators tends to be that they don't want to see a yield of 0.00%--which is less of a problem presently than it would have been in 2014 before the US Federal Reserve had adjusted its policy rate above the 0 to 0.25% band. How much risk they are willing to take in exchange for getting a higher potential yield is the other side of the coin. Usually, volatility is positively related to yield, meaning for greater yield, the investor must stomach potential for greater risk.

We looked at Indices across three categories:

1. **Short-term US Treasury Strategies**, with the concept of framing the difference in exposure and the consequences of that since 2014. Importantly, the difference in these strategies tends to be more centred upon duration rather than credit quality, as the creditor across all cases would be the US Government.
2. **Short-term US Investment Grade Corporate Strategies**, contrasting the difference between the strategies with US Government credit risk and those with US Corporate credit risk.
3. **US Corporate Floating Rate strategies**, with the concept of taking instruments that have very low interest rate risk but could have much more significant credit risk.

Importantly, none of these approaches would be exactly identical to US Treasury Floating Rate Notes, but investors may want to see how this newer asset class compares to more longstanding options in US Dollar denominated fixed income.

SECTION 1: SHORTER-TERM US TREASURY STRATEGY COMPARISON

First, we must list the indices, and importantly, each of these indices is utilised within UCITs exchange traded funds.

+ **ICE US Treasury 1-3 Year Total Return Index:** Within the broader ICE US Treasury Bond Index, which includes US Treasuries across the maturity spectrum, this represents the sub index focused on maturities less than 3 years but greater than 1 year. Weighting is by market value of issuance.
+ **ICE US Treasury 3-7 Year Total Return Index:** Within the broader ICE US Treasury Bond Index, which includes US Treasuries across the maturity spectrum, this represents the sub index with maturities from 3 years to 7 years. Weighting is by market value of issuance.
+ **Markit iBoxx USD Treasuries 1-3 Year Total Return Index:** Bonds within this Index are market value-weighted and only include those issued by the US Treasury and that fall within the proper maturity guidelines.

- **Bloomberg Barclays US Treasury 1-3 Year Total Return Index:** Bonds within this Index are market value-weighted and only include those issued by the US Treasury and that fall within the proper maturity guidelines.
- **Markit iBoxx USD Treasuries 1-3 Year Mid Prices TCA Total Return Index -** Bonds within this Index are market value-weighted and only include those issued by the US Treasury and that fall within the proper maturity guidelines.
- **ICE BofAML US 3-Month Treasury Bill Total Return Index –** an unmanaged index comprised of US Treasury Bills maturing in 3 months.

FIGURE 1A: RETURN ANALYSIS OF DIFFERENT SHORTER MATURITY TREASURY INDEX OPTIONS

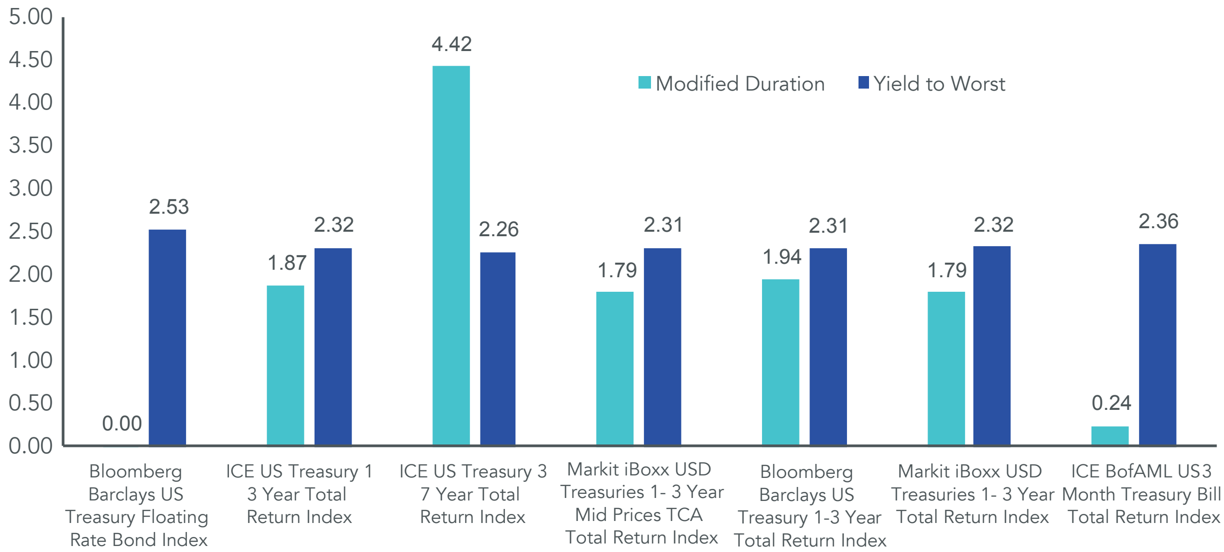
Index Name	YTD	1Y	3Y		Largest Common	
	Return	Return	Return (ann.)	St.Dev.	Return (ann.)	St.Dev.
Bloomberg Barclays US Treasury Floating Rate Bond Index	0.59%	2.15%	1.35%	0.19%	0.84%	0.23%
ICE US Treasury 1-3 Year Total Return Index	0.99%	2.73%	0.98%	0.89%	0.94%	0.82%
ICE US Treasury 3-7 Year Total Return Index	1.83%	4.31%	1.01%	2.70%	1.89%	2.75%
Markit iBoxx USD Treasuries 1-3 Year Mid Prices TCA Total Return Index	0.96%	2.68%	0.97%	0.85%	0.93%	0.79%
Bloomberg Barclays US Treasury 1-3 Year Total Return Index	0.99%	2.73%	0.98%	0.89%	0.94%	0.82%
Markit iBoxx USD Treasuries 1-3 Year Total Return Index	0.96%	2.69%	0.97%	0.86%	0.93%	0.79%
ICE BofAML US 3-Month Treasury Bill Total Return Index	0.59%	2.12%	1.19%	0.22%	0.72%	0.23%

Source: Bloomberg, with data from 31 January 2014 to 31 March 2019. Standard deviation is based on monthly returns. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

- The 1-3 Year indices would be expected to have very similar returns to each other (namely the ICE US Treasury 1-3 Year Total Return Index, the Markit iBoxx USD Treasuries 1-3 Year Total Return Index and the Bloomberg Barclays US Treasury 1-3 Year Total Return Index). From a duration perspective, they are taking greater risk than the Bloomberg Barclays US Treasury Floating Rate Index, which means that they should offer greater returns. On the five-year basis, the story is quite close, but the 1-3 Year variants led. On the three-year basis, the Bloomberg Barclays US Treasury Floating Rate Index outperformed all other indices shown.
- The ICE US Treasury 3-7 Year Total Return Index is shown as a reference point for the type of returns that were available by stepping a bit further out on the maturity spectrum. Figure 1 doesn't cover the maturity period for all index constituents. The greater risk of this approach did compensate with greater returns in all periods except for the three-years ended on 31 March 2019.

- The most similar risk/return to the Bloomberg Barclays US Treasury Floating Rate Bond Index came from the ICE BoAML US 3-Month Treasury Bill Total Return Index. In particular, over the 3-Year and longest common periods, the volatility comparison was nearly identical and much lower than the other indices shown.

FIGURE 1B: YIELD AND DURATION ANALYSIS OF DIFFERENT SHORTER-TERM US TREASURY OPTIONS



Source: Bloomberg, Markit. Data as of 31 March 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.**

- Yield to Worst: Figure 1b is among the more interesting, directly indicating the shape of the Treasury curve as of 31 March 2019. The US Floating Rate Treasury Notes are closely related to the position of the Federal Reserve (Fed) Funds policy interest rate. As one steps further out on the treasury curve in terms of maturity, there is a greater impact that comes from the market's perception of future interest rates. It is possible at this point that the market was reflecting the possible expectation of a 25 basis point cut in the Fed interest rate prior to the end of 2019.. It is also notable that these yields could change in the upward direction if different economic data becomes available that supports the potential for another Fed rate hike in 2019.
- Modified Duration: This is where the comparisons will be most stark. Due to the weekly reset of the US Treasury Floating Rate notes, we would always expect to see a lower duration than what would be expected for any of the other indices shown in Figure 1b. This tells us that, in a falling rate environment, the fixed-rate coupon indices would have potential to outperform the Bloomberg Barclays US Treasury Floating Rate Index, whereas during a rising rate environment they would have the potential to underperform. Overall, we'd expect lower volatility for the Bloomberg Barclays US Treasury Floating Rate Index—which is an interesting characteristic especially if one believes that forecasting where interest rates might go is difficult.

SECTION 2: SHORTER TERM US DOLLAR DENOMINATED INVESTMENT GRADE INDEX COMPARISON

The following indices are also utilised within UCITS exchange traded funds.

- **Markit iBoxx USD Liquid Investment Grade 0-5 Index:** A market-valued weighted index of investment grade corporate debt, where new index constituents must have at least 6-months to maturity.
- **Markit iBoxx USD Liquid Investment Grade Ultrashort Index:** A market-value weighted index of investment grade corporate debt, where fixed rate coupon bonds must have a maturity between 0 and 1 year and floating rate coupon bonds (they are eligible) must have a maturity between 0 and 3 years.
- **Bloomberg Barclays US Liquid Corporates 1-5 Year Index:** A market-value weighted index of investment grade USD-denominated securities issued by US corporate issuers with remaining time to maturity of 1-5 years.
- **Bloomberg Barclays US Corporate 0-3 Year Total Return Index:** An index of investment grade USD-denominated bonds issued by US corporate issuers in industrial, financial or utility sectors with remaining time to maturity of less than 3 years.

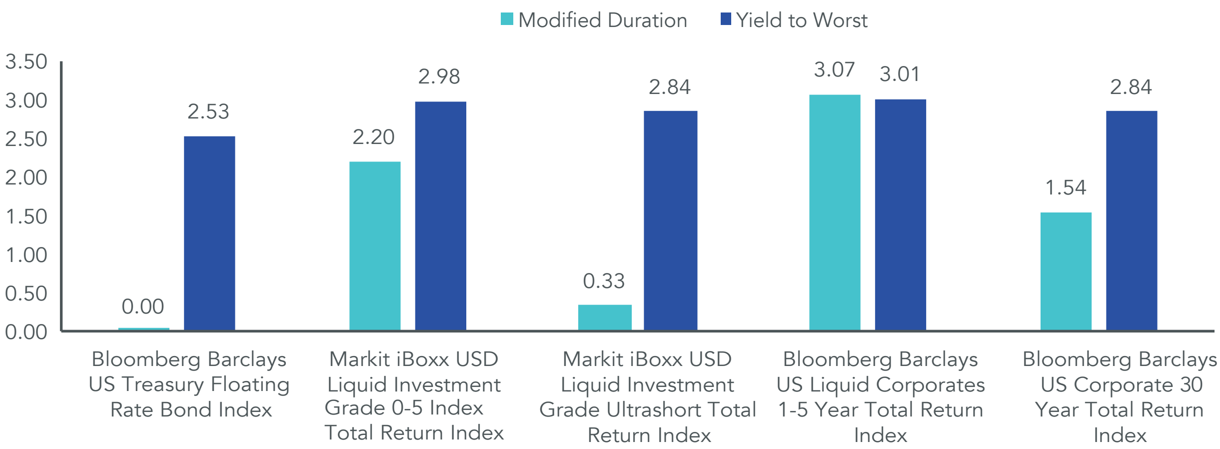
FIGURE 2A: RETURN ANALYSIS OF DIFFERENT SHORTER MATURITY CORPORATE INVESTMENT GRADE INDEX OPTIONS

Index Name	YTD	1Y	3Y		Largest Common	
	Return	Return	Return (ann.)	St.Dev.	Return (ann.)	St.Dev.
Bloomberg Barclays US Treasury Floating Rate Bond Index	0.59%	2.15%	1.35%	0.19%	0.84%	0.23%
Markit iBoxx USD Liquid Investment Grade 0-5 Index Total Return Index	2.28%	4.13%	2.18%	1.27%	2.00%	1.27%
Markit iBoxx USD Liquid Investment Grade Ultrashort Total Return Index	0.99%	2.79%	1.87%	0.26%	1.34%	0.28%
Bloomberg Barclays US Liquid Corporates 1-5 Year Total Return Index	2.94%	4.72%	2.30%	1.77%	2.38%	1.74%
Bloomberg Barclays US Corporate 0-3 Year Total Return Index	1.56%	3.53%	2.10%	0.71%	1.74%	0.71%

Source: Bloomberg, with data from 31 January 2014 to 31 March 2019. Standard deviation is based on monthly returns. 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 one goes from government risk to corporate risk, in a normal, "risk-on" environment, the corporate strategies should outperform due to their higher risk and the need to compensate investors for taking on the additional risk. The last five years were generally a strong period for risk assets, so even with the Fed raising rates, short-term investment grade corporates did well and outperformed the Bloomberg Barclays US Treasury Floating Rate Index, as shown in Figure 2a.

FIGURE 2B: YIELD AND DURATION ANALYSIS OF DIFFERENT SHORTER-TERM US INVESTMENT GRADE CORPORATE OPTIONS



Source: Bloomberg, Markit. Data as of 31 March 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.**

The real question is whether the corporate investment grate indices shown in Figure 2b offer enough incremental compensation to buffer their higher expected volatility than the Bloomberg Barclays US Treasury Floating Rate Index. If one believes that the US could face a slowing economic environment, followed by increased potential for a recession, it is true that credit spreads could expand and one would have risk of negative returns from these other indices. However, if economic growth remains positive and conditions continue to be robust, one would expect corporate, investment grade alternatives to continue to outperform the Bloomberg Barclays US Treasury Floating Rate Index.

SECTION 3: US CORPORATE FLOATING RATE STRATEGIES

The following indices are also utilised within UCITS exchange traded funds.

+ **Markit iBoxx USD Liquid FRN Investment Grade Corporates 100 Index:** This index is designed to provide a balanced representation of the USD denominated investment grade floating rate securities market. Only floating rate notes with a coupon reset of at least once per year are eligible for the indices. There is a monthly rebalance and securities are weighted on a market value basis.
+ **Bloomberg Barclays US Floating Rate Note <5 Years Index:** This index measures the returns of a subset of US Floating Rate notes, which are USD denominated and investment grade. The maximum maturity of the index is 4.9999 years, and the index is market value weighted.
+ **Bloomberg Barclays US Corporate FRN 2-7 Year Index:** This index measures the performance of USD denominated, investment grade floating rate notes issued by corporate issuers, with remaining maturity between 2 to 7 years. The index is market value weighted.
+ **Bloomberg Barclays US Corporate FRN 500MM Liquid Bond Index –** This index measures the performance of USD denominated, investment grade floating rate notes issued by corporates issuers with minimum outstanding amount of 500M USD.

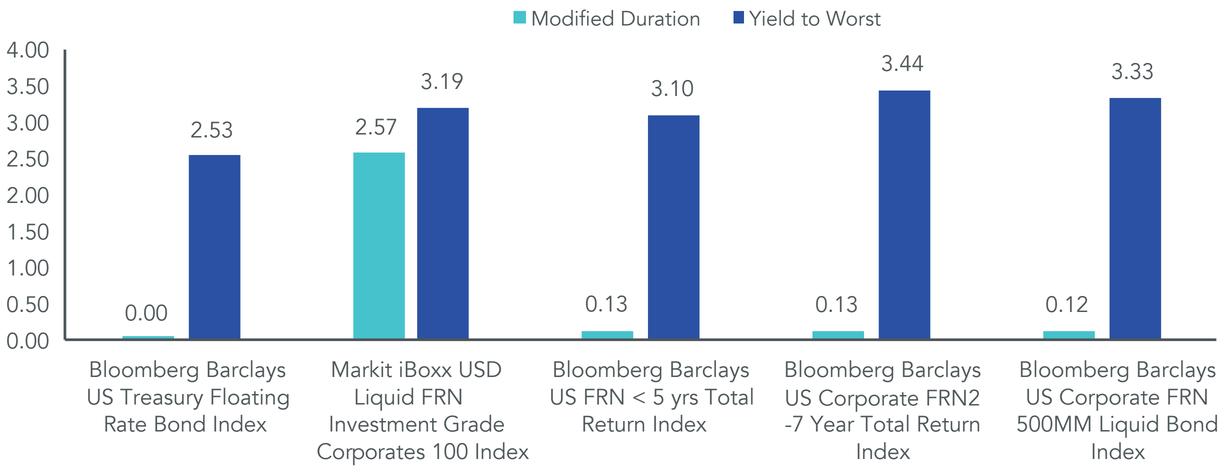
FIGURE 3A: RETURN ANALYSIS OF DIFFERENT FLOATING RATE CORPORATE INDEX OPTIONS

Index Name	YTD	1Y	3Y		Largest Common	
	Return	Return	Return (ann.)	St.Dev.	Return (ann.)	St.Dev.
Bloomberg Barclays US Treasury Floating Rate Bond Index	0.59%	2.15%	1.35%	0.19%	0.84%	0.23%
Markit iBoxx USD Liquid FRN Investment Grade Corporates 100 Index	2.04%	2.62%	2.63%	1.00%	1.68%	0.85%
Bloomberg Barclays US FRN < 5 yrs Total Return Index	1.47%	2.86%	2.32%	0.48%	1.57%	0.48%
Bloomberg Barclays US Corporate FRN 2-7 Year Total Return Index	2.22%	2.99%	3.19%	1.06%	2.06%	0.93%
Bloomberg Barclays US Corporate FRN 500MM Liquid Bond Index	2.05%	2.93%	2.78%	0.89%	1.89%	0.77%

Source: Bloomberg, with data from 31 January 2014 to 31 March 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.**

In Figure 3a, one would expect the Bloomberg Barclays US Treasury Floating Rate Index to have difficulty keeping up with the other corporate investment grade options. The greater credit risk of these options should lead to greater compensation to take this risk over time.

FIGURE 3B: YIELD AND DURATION ANALYSIS OF DIFFERENT FLOATING RATE CORPORATE OPTIONS



Source: Bloomberg, Markit. Data as of 31 March 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.**

In Figure 3b, it is interesting to consider the incremental compensation offered in the market to take the incremental credit risk of the other indices as compared to the Bloomberg Barclays US Treasury Floating Rate Index. Each of these yields will tend to float with market conditions across time, but it is important to recognize that corporate floating rates are most often set to be a particular spread over a reference rate, often the London Interbank Offered Rate (LIBOR). The Bloomberg Barclays US Treasury Floating Rate Index constituents will see their coupon rates resetting off of the weekly auction activities for US 13-week Treasuries plus a spread set at the initial auction.

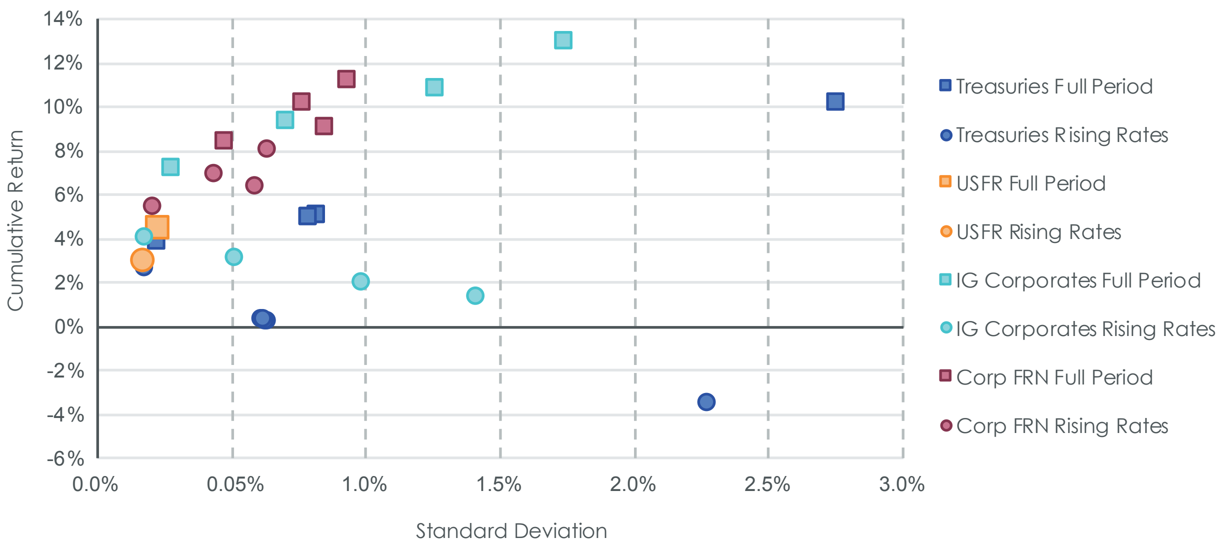
We would emphasise that the modified duration statistics in figure 3b highlight that duration within these indices tends to be partially influenced by the reset frequency of the coupon rates for the bonds within the index.

The rise & fall of the US 10-Year Treasury Note yield

US Floating Rate Treasury notes do not have the benefit of a long history—we cannot look at how they have performed during different tightening and loosening cycles of the US Federal Reserve. With their short history, all we can really do to get a sense of how these instruments behave in "rising rates" and "falling rates" is to look at their behaviour in relation to the US 10-Year Treasury Note yield.

- Period from 31 January 2014 to 31 March 2019 is classified as the "full period" period. The full period is the period since the launch of US Floating Rate Notes.
- Period from 08 July 2016 to 08 November 2018 is classified as the "rising US 10-Year" period.

FIGURE 3B: YIELD AND DURATION ANALYSIS OF DIFFERENT FLOATING RATE CORPORATE OPTIONS



Source: Bloomberg. **Full period** *from 31 January 2014 to 31 March 2019.* **Rising rates period** *from 08 July 2016 to 08 November 2018. Standard deviation estimates are annualized and based on monthly returns. Standard deviation estimates for Rising rates period are based on data between 30 June 2016 and 31 October 2018.* **USFR** *is Bloomberg Barclays US Treasury Floating Rate Bond Index and does not represent returns of a fund;* **Treasuries** *represent Short-term US Treasury Strategies;* **IG Corporates** *represent Short-term US Investment Grade Corporate Strategies; Corp FRN represent US Corporate Floating Rate Strategies. For return and standard deviation figures in the chart please refer to the Appendix.* **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

During rising interest rates—and importantly later on in the Fed's rate hiking cycle—one would expect that pure Treasury exposures with fixed rate coupons would struggle. Corporate credits could still do well, as it is usual that rising rates accompany rising economic activity and tightening credit spreads. Of course, the floating rate options would see their coupons rising over time.

Floating Rate Treasury Notes have interesting characteristics against more longstanding strategies

Anytime there is the introduction of a new instrument, such as the US Treasury Floating Rate notes, it is important to view this within the context of widely understood strategies already being utilised within portfolio allocations. Within this piece, we have analysed the comparison of the Bloomberg Barclays US Treasury Floating Rate Index versus an allocation to other fixed income choices representing:

- Short-term US Treasuries
- Short-term US Investment Grade Corporates
- Floating Rate US Corporates

It is in this way that one may gain a better understanding of the trade-offs between these different investments.

APPENDIX

FIGURE 1. CUMULATIVE RETURNS AND ANNUALIZED STANDARD DEVIATIONS DURING FULL PERIOD AND RISING RATES PERIOD

Index Name		Full Period		Rising Rates	
		Return	St.Dev.	Return	St.Dev.
WisdomTree Strategy	Bloomberg Barclays US Treasury Floating Rate Bond Index	4.4%	0.2%	3.0%	0.2%
Short-Term US Treasuries	ICE US Treasury 1-3 Year Total Return Index	5.0%	0.8%	0.2%	0.6%
	ICE US Treasury 3-7 Year Total Return Index	10.1%	2.8%	-3.5%	2.3%
	Markit iBoxx USD Treasuries 1-3 Year Mid Prices TCA Total Return Index	4.9%	0.8%	0.2%	0.6%
	Bloomberg Barclays US Treasury 1-3 Year Total Return Index	5.0%	0.8%	0.2%	0.6%
	Markit iBoxx USD Treasuries 1-3 Year Total Return Index	4.9%	0.8%	0.3%	0.6%
	ICE BofAML US 3-Month Treasury Bill Total Return Index	3.8%	0.2%	2.6%	0.2%
Short-Term US IG Corporates	Markit iBoxx USD Liquid Investment Grade 0-5 Index Total Return Index	10.8%	1.3%	1.9%	1.0%
	Markit iBoxx USD Liquid Investment Grade Ultrashort Total Return Index	7.1%	0.3%	4.0%	0.2%
	Bloomberg Barclays US Liquid Corporates 1-5 Year Total Return Index	12.9%	1.7%	1.3%	1.4%
	Bloomberg Barclays US Corporate 0-3 Year Total Return Index	9.3%	0.7%	3.0%	0.5%
US Corporate Floating Rates	Markit iBoxx USD Liquid FRN Investment Grade Corporates 100 Index	9.0%	0.9%	6.3%	0.6%
	Bloomberg Barclays US FRN < 5 yrs Total Return Index	8.3%	0.5%	5.4%	0.2%
	Bloomberg Barclays US Corporate FRN 2-7 Year Total Return Index	11.1%	0.9%	8.0%	0.6%
	Bloomberg Barclays US Corporate FRN 500MM Liquid Bond Index	10.1%	0.8%	6.8%	0.4%

Source: Bloomberg. Full period from 31 January 2014 to 31 March 2019. Rising rates period from 08 July 2016 to 08 November 2018. Due to data availability Rising rates period for the Bloomberg Barclays US Corporate FRN 2-7 Year Total Return Index and the Bloomberg Barclays US Corporate FRN 500MM Liquid Bond Index is from 30 June 2016 to 08 November 2018. Standard deviation estimates are annualized and based on monthly returns. Standard deviation estimates for Rising rates period are based on data between 30 June 2016 and 31 October 2018. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

FIGURE 2. INDICES AND FUNDS INFORMATION.

Stratagy	Index Ticker	Index Name	ETF Name	Ongoing Charge
WisdomTree Strategy	BTFLTRUU	Bloomberg Barclays US Treasury Floating Rate Bond Index	WisdomTree USD Floating Rate Treasury Bond UCITS ETF	0.15%
Short-Term US Treasuries	IDCOT1TR	ICE US Treasury 1-3 Year Total Return Index	iShares USD Treasury Bond 1-3yr UCITS ETF	0.20%
	IDCOT3TR	ICE US Treasury 3-7 Year Total Return Index	iShares USD Treasury Bond 3-7yr UCITS ETF	0.20%
	IBXXABXL	Markit iBoxx USD Treasuries 1-3 Year Mid Prices TCA Total Return Index	LYXOR CORE IBOXX USD TREASURIES 1-3Y DR UCITS ETF	0.07%
	LT01TRUU	Bloomberg Barclays US Treasury 1-3 Year Total Return Index	SPDR Bloomberg Barclays 1-3 Year U.S. Treasury Bond UCITS ETF	0.15%
	ITRR1T3	Markit iBoxx USD Treasuries 1-3 Year Total Return Index	Xtrackers II US Treasuries 1-3 UCITS ETF	0.12%
	G0O1	ICE BofAML US 3-Month Treasury Bill Total Return Index	JPMorgan USD Ultra-Short Income UCITS ETF	0.18%
Short-Term US IG Corporates	IBXXSIG1	Markit iBoxx USD Liquid Investment Grade 0-5 Index Total Return Index	iShares USD Short Duration Corp Bond UCITS ETF	0.20%
	IBXXUSU1	Markit iBoxx USD Liquid Investment Grade Ultrashort Total Return Index	iShares USD Ultrashort Bond UCITS ETF	0.09%
	BLQ3TRUU	Bloomberg Barclays US Liquid Corporates 1-5 Year Total Return Index	UBS ETF - Bloomberg Barclays US Liquid Corporates 1-5 Year UCITS ETF	0.18%
	BUC3TRUU	Bloomberg Barclays US Corporate 0-3 Year Total Return Index	SPDR Bloomberg Barclays 0-3 Year U.S. Corporate Bond UCITS ETF	0.20%
US Corporate Floating Rates	IBXXFRN3	Markit iBoxx USD Liquid FRN Investment Grade Corporates 100 Index	Amundi Floating Rate USD Corporate UCITS ETF	0.18%
	BFU5TRUU	Bloomberg Barclays US FRN < 5 yrs Total Return Index	iShares USD Floating Rate Bond UCITS ETF	0.10%
	BF27TRUU	Bloomberg Barclays US Corporate FRN 2-7 Year Total Return Index	Lyxor USD Floating Rate Note UCITS ETF	0.10%
	I33629US	Bloomberg Barclays US Corporate FRN 500MM Liquid Bond Index	Invesco USD Floating Rate Note UCITS ETF	0.10%

Source: Bloomberg, Morningstar. As of 08 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.**

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