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HIGH QUALITY BONDS: AN OASIS IN A DRY MARKET

CORPORATE DEBT INSTRUMENTS HOLD PROMISE FOR INVESTORS DESPITE RISKS, FINANCIAL EXPERTS SAY.

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With the exception of US Treasury securities, virtually all asset classes – including equities and bonds – have fallen of late. One bright spot amid the carnage: investment-grade corporate bonds. For nervous investors seeking higher yields as well as shelter from the global financial crisis, this sector could well represent a buying opportunity.

Bonds of high-quality firms normally yield one to two percentage points more than US Treasuries to compensate investors for added risk. Though spreads – the difference in price between Treasuries and investment-grade corporate bonds – have narrowed in recent weeks, they are still yielding 5 to 10 percent. That's about four or five percentage points higher than 10-year Treasury yields, making corporate bonds just too good to pass up, experts say.

"A year ago, when corporate spreads were so tight, there was little return to take on credit risk. Now, with spreads at all-time highs, you are being well compensated to take on a little credit risk," says Christopher J. Cordaro, chief investment officer of RegentAtlantic Capital LLC, in Morristown, N.J. "For folks who have fled the equity markets and are earning nothing in money markets, this is a great alternative parking place."

Bonds other than Treasuries have been hammered amid an investor crisis of confidence. Meanwhile, the stock market remains extremely volatile, and increasing unemployment is adding fuel to the fire. These forces have increased the supply of high-quality corporate bonds, driving down bond prices and driving up yields (which move inversely). The bonds of General Electric and Kraft recently traded at yields of 7 to 8 percent, while bonds of companies such as Goldman Sachs and Bank of America yielded 6 to 8 percent. These yields were previously unheard of for high-quality corporate bonds and were instead found in more speculative ones. By contrast, short-term Treasury bonds experienced yields recently as low as 0 percent.

Mutual-fund tracker Morningstar Inc. finds the sector attractive but urges caution. It notes that credit downgrades, which began in the financial sector, are spreading to the broader bond market.

Only a few mutual funds invest heavily in corporate bonds, and of those that do, some were hit hard in 2008. Nonetheless, bond-fund managers are bullish on the outlook for investment-grade debt.

"We still feel spreads are pretty attractive. We're buying A-rated corporate at 350 basis points over Treasuries," notes Mark Otterstrom, portfolio manager of the Ivy Limited-Term Bond fund. (One basis point equals 1/100th of 1 percent, or .01 percent.)

Although not bullish on either the fundamentals or technical aspects of the current bond market, Andrew O'Brien, portfolio manager of the Lord Abbett Income Fund, says, "Unlike with securities that don't produce income, with corporate bonds, you get paid to own and wait for things to get better. So it's a good time to be involved."

Furthermore, says Mr. O'Brien, "You're getting paid to take the risk, and it's a good time to have an active manager working with you, somebody who can sort through and find the babies that are getting thrown out with the bath water."

"There is no reason to step into any market and buy low-quality assets today," adds Mike Roberge, chief investment officer of US investments at MFS Investment Management in Boston. "You can buy high-quality assets at compelling valuations, so there's no reason to take excessive risk. We are in a capital-protection market, not one where you want to try to capture significant upside."

Investors seeking picks in this bond category should have exposures to all durations, from short to long, says Jeff Tjornehoj, senior research analyst at fund tracker Lipper Inc. "Whether inflation becomes the threat that many are anticipating is unknown as to its severity and timing. So you need to be everywhere because you don't know which strategies will do well at any given time," he says.

With slim opportunities elsewhere, an increasing number of financial advisers are buying corporate bonds and bond funds for clients. Financial firm L.J. Altfest & Co. has increased its purchase of individual taxable bonds and bond mutual funds for its clients by investing in funds by PIMCO, Vanguard, Loomis Sayles, and Trust Company of the West, according to Nandini Wamorkar, an investment adviser at the firm in New York.

Wealth manager Aaron Skloff, CEO of Skloff Finan-cial Group, in Berkeley Heights, N.J., is also encouraged by the potential that bond funds show. "Spreads on corporate debt have exceeded previous recession levels, and we are buying corporate bonds utilizing multisector bond funds," he says. "We acknowledge bankruptcies will accelerate, but more important, recognize that we are being fairly compensated with unusually high yields."

But some advisers remain unconvinced and are holding back, citing liquidity and credit concerns.

"With the credit crisis, there's limited liquidity with bonds. So if you were to buy a bond, you'd have a hard time selling it if you wanted to," says Jim Holtzman, a financial adviser at Legend Financial Advisors Inc., in Pittsburgh. The few bond funds the firm is buying have only limited exposure to corporate bonds, he says.