JSOnline
MILWAUKEE • WISCONSIN
JOURNAL SENTINEL

Investment Trends

Corporate bonds are paying well

They trump Treasuries but stay diversified

By Kathleen Gallagher of the Journal Sentinel

Posted: Jan. 4, 2009

Maureen Busby Oster

The Journal Sentinel focuses on one Wisconsin money manager or analyst in this weekly feature, looking at a trend that helps investment pros make their decisions.

It's easy to be bearish.

The more than 20-year-old foundation investors have operated on is crumbling. No longer are securities being driven ever upward by declining interest rates and inflation, expanding margins and valuations, and low tax rates.

Hit by crises in the credit, real estate and mortgage markets, and increasingly aware of some of the side effects of globalization, U.S. consumers' balance sheets can no longer support high-octane growth.

"It's very easy to be negative because we've just been through a very difficult time and some very scary things, but let's look at where we are," said Maureen Busby Oster, chief investment officer of Milwaukee-based Cleary Gull Holdings Inc.

The markets are acting as though the world will never get better, and the most obvious imbalances in today's markets are the pricing of U.S. Treasuries and corporate bonds, Oster said.

"While Treasuries have been the only major asset class to produce positive rates of return over the last year, they're the least attractive asset class to own," she said.

Treasuries are unattractive because their returns are very low and there are much better opportunities, Oster said. Those opportunities have higher risk, but investors are being compensated to take it, she said.

The 10-year Treasury had a yield of 2.37% and the five-year Treasury had a yield of 1.65% on Friday.

Compare that with yields above 6% on high-quality corporate bonds with 10-year maturities and yields of about 18% on junk bonds.

At those levels, investors with diversified corporate bond portfolios should do very well, Oster said.

"The economic problems have to improve for equities to improve, and this is a lower-risk way to live through a period where you have a lot of angst while still getting some current return," she said.

Over the longer term, say the next three to five years, investors may want to begin buying some of the clearly cheap equities trading in today's markets, she said. Given that U.S. consumers will need to spend some time repairing their balance sheets, some of the best places to look may well be in the areas of global infrastructure, and maybe even financial services companies, Oster said.

Two funds Oster says she's been using for a global infrastructure play are **Vanguard Energy Fund** (VGELX) and **T. Rowe Price New Era Fund** (PRNEX).

The place to start, though, is with corporate bonds, she said.

Loomis Sayles Bond Fund (LSBRX) is managed by Milwaukee native Daniel Fuss and Kathleen C. Gaffney. Investors in this fund step out on the risk spectrum because the fund's managers are free to put a big percentage of the assets in junk bonds, non-U.S. bonds, preferred stocks and other longer-maturity securities, Oster said.

But the fund is well-diversified and has a long-term record that nears what an equity fund could earn, she said.

Loomis Sayles Bond Fund has an average duration, a measure similar to maturity, of 6.3 years, she said. That’s longer than the durations of many other bond funds, but if you’re looking for more upside, it might be worth the extra risk, Oster said.

She said she also uses some high-quality alternatives whose managers don’t take the average duration out as far:

Baird Intermediate Bond Fund (BIMIX) invests in investment-grade securities and seeks to match or better the performance of the Barclay’s Lehman Brothers / Credit Bond Index..Intermediate Government

Dodge & Cox Income Fund (DODIX) seeks a high and stable rate of current income by investing primarily in a diversified portfolio of high-quality bonds and other fixed-income assets.