

Your Money

INVESTING

Shedding Stock-Market Vertigo (but Still Making Some Money)

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EVER since the Dow Jones industrial average first reached 14,000 in mid-July, a volatile stock market has tumbled and churned, turning many investors away from cheery calculations of capital gains to fretful thoughts of capital preservation.

Those who want little part of an iffy equities market traditionally turn to bonds, or, for even more peace of mind, to cash alternatives like bank C.D.'s and money market funds.

But Federal Reserve interest rate cuts — which bail out aggressive borrowers and arguably amount to another bonus day for Wall Street — typically penalize savers. This time, though, more than a month after the Fed's half-point cut, things have played out a bit differently. With many financial institutions needing to raise capital wherever they can find it, the humble saver and his cash are still in demand.

Many banks are still paying nearly 5 percent, and sometimes more, on C.D.'s. "Yields on C.D.'s have remained at very attractive levels and have declined only slightly since the Fed cut," said Greg McBride, senior financial analyst at Bankrate.com. "Banks are still very dependent on consumer deposits to meet funding needs."

In many cases, lenders have been offering their highest rates on some of the shortest-term C.D.'s, suggesting that banks need deposits now, but expect rates to fall in the future. Citibank, for example, has been offering promotional rates on short-term C.D.'s — currently 5 percent

on a 6-month term — and the promotions “have been very successful in attracting deposits,” said Robert Julavits, a spokesman.

The credit crisis has played a part in keeping bank yields high. “It’s still cheaper to pay 5 percent on a C.D. than to go into the capital markets and issue debt with the tightness in the credit markets,” Mr. McBride said. Some of the best rates come from banks with large mortgage-lending operations. Countrywide Bank has been offering a 5.65 percent on a 12-month C.D. Indymac Bank offers 5.5 percent on a nine-month C.D..

But even C.D.’s issued by troubled lenders are safe, of course, thanks to broad protection from the federal government. “As long as you are protected by F.D.I.C. insurance, the additional return is pure gravy,” Mr. McBride said. F.D.I.C. insurance covers \$100,000 in nonretirement accounts, and up to \$250,000 in retirement accounts.

Money market funds, which generally track Fed moves, have also held up surprisingly well. “Many funds have only dropped half of what they’d be expected to drop,” said Peter Crane, president of Crane Data, which tracks money market investments.

But the respite may be temporary. The Fed is likely to cut rates again in coming months — perhaps as soon as this week — and even if it leaves rates unchanged, money market rates could fall another 10 or 20 basis points, or hundredths of a percentage point, according to Mr. Crane. Fidelity, Putnam and Vanguard all have funds currently yielding 4.9 percent or more.

Bonds offer a rich set of alternatives for the conservative investor who wants to shield capital from turbulent equity markets. Though generally less volatile than stocks, bond prices will fall if interest rates do an about-face and rise. But investors who hold bonds to maturity do not face the risk of principal loss from a market downturn.

One government bond option for the especially risk-averse is Treasury Inflation-Protected Securities, or TIPS, which adjust

principal for inflation. But with that safety net comes a lower yield: recently 2.1 percent on the 10-year TIPS, versus 4.4 percent on the 10-year Treasury.

Individual investors with less than \$50,000 to put into bonds may find it less costly to participate through bond funds.

“It’s kind of expensive to put together a portfolio,” said Jim Peterson, head of investment manager research at the Schwab Center for Financial Research, citing commissions and wide bid-ask spreads. “It’s a dealer-oriented market; it’s difficult to get good prices,” he explained.

Hence the appeal of professionally managed bond funds, which invest in government, investment-grade, high-yield and tax-exempt debt offerings. Government bond funds offer the highest level of safety, but Treasuries have been snatched up as investors have sought safe sanctuary, deflating yields. Robert F. Millikan, a bond portfolio manager at the [BB&T](#) Asset Management in Raleigh, N.C., reckons that Treasuries are “about where they should be” and sees more opportunity in other sectors of the bond market — tax-exempt offerings and high-quality mortgages.

Diversified funds typically own a mix of government, corporate and mortgage securities of either short-, intermediate- or long-term maturities. They are riskier than government funds, but Scott Berry, senior analyst at [Morningstar](#), says he believes that some have positioned themselves well by finding bargains as the credit crunch penalized the debt of good borrowers along with bad.

“We’re trying to find opportunistic bond funds that were able to scoop up bargains,” Mr. Berry said.

Most funds have not yet reported recent changes in their portfolios, so he has not completed his list of favored funds. But he has identified two — Metropolitan West Total Return and Pimco Total Return — as likely to benefit from credit market fears.

“They both have a history of opportunistic buying,” he explained. “Great managers love volatility.”

Mr. Peterson of Schwab likes Pimco Total Return and the Loomis Sayles Bond fund, which has international exposure, along with high-yield holdings intended to enhance performance.

Daniel J. Fuss, the Loomis fund manager, has excelled at finding the optimal mix of investment-grade and junk bond holdings, Mr. Peterson said. “Loomis is more of a credit analysis play,” he said. “They shift between investment grade and high-yield.”

Nervous credit markets have created buying opportunities that Mr. Fuss described as “not momentous, but good.” One example is debt of the [General Motors Acceptance Corporation](#). [GMAC](#) has suffered from the triple-whammy of its identity as part of the overall financial sector, as a high-yield issuer and as an offshoot of the troubled [General Motors](#). But Mr. Fuss has concluded that GMAC, now jointly owned by G.M. and a private equity group led by Cerberus Capital Management, can over time improve its credit rating, lower its borrowing costs and increase profitability. Mr. Fuss says he has been adding to the fund’s position in GMAC in recent months.

In all, his fund holds 22 percent in below-investment-grade holdings, along with roughly 17 percent in nondollar credits, chiefly in the Brazil real, the New Zealand dollar and the Mexican peso. These issues provide higher yield than dollar-denominated debt and would benefit from a continued decline in the dollar. This year through Thursday, the fund has produced a total return of 9.2 percent and has outperformed its multisector bond category average in each of the last five years.

MR. MILLIKAN, the BB&T fund manager, says he has found value in high-quality mortgage securities. And he favors tax-free bond funds for investors in high tax brackets. Over the next few years, he reasoned, “there’s a greater chance for a tax increase than for either a decrease or no change.”

He sees bonds as the best long-term protection against a stock market decline: “If we do end up in a recession or the stock market falls out of bed,” he said, “the Fed would cut and money market rates would decline.” Bonds, by contrast, typically benefit from a slowdown that brings lower rates. Conversely, though, bonds would not be the place to be if inflation reared its head, sending rates up again.

Safety may be at a premium these days, but even the most risk-averse investor may want to avoid parking substantial funds in bank savings accounts.. These currently dole out a pitiful average return of 0.5 percent, noted Mr. McBride at Bankrate.com.