Stamper Capital & Investments, Inc.

“Focusing on Upside Potential with Downside Protection Since 1995.”

Desert News (Salt Lake City),

Cover bases when investing in bonds

By Andrew Leckey | 09-11-2005

Setting a personal investment strategy in bonds and certificates of deposit is a demanding task in 2005.

Short-term interest rates have notched up 10 times since June of last year, directed by the steady hand of the Federal Reserve. But longer-term rates haven't budged at all. They're definitely overdue.

Odds of Federal Reserve Chairman Alan Greenspan raising short- term rates another quarter-percent when policymakers meet Sept. 20, considered a sure thing before Hurricane Katrina devastated the Gulf Coast, are now a 50/50 proposition.

Katrina is a human crisis first and foremost, but economic fallout is powerful. Americans are learning the interconnected nature of our economy. Few knew the New Orleans area played an economic role in anything other than tourism, certainly not that it was a critical juncture in our oil supply.

Like King Solomon, Greenspan must weigh opposing considerations:

-- On the one hand, there will be lower consumer spending in the third quarter because of higher gasoline prices and general economic disruption. So he shouldn't raise interest rates, or at least not until later this year.

-- On the other hand, the economy should get a boost from higher construction spending as the historic rebuilding process begins. So he should go ahead and raise rates now like he said he would. Stay the course because financial markets expect it.

Greenspan must decide one way or another this month even though full data on Katrina's effects won't be in until October. He is known for sticking to a plan but is being heavily pressured to leave rates alone.

Whatever he decides, however, don't expect interest rates to veer out of control this year. It should still be steady going.

"Because the economy is resilient, the Federal Reserve will likely continue to increase rates," predicted Mario De Rose, chief fixed-income strategist for Edward Jones in St.

Louis. "Longer- term, the hurricane's effects could be somewhat of a drag on economic growth and keep bond prices up and interest rates lower than they otherwise would be."

The logical fixed-income strategy for average investors, De Rose is convinced, is to cover all their bases.

He suggests "laddering" a number of bonds, bond funds or CDs of different maturities and yields to avoid being tied to any one interest rate scenario. This philosophy is also practiced by large institutional investors that don't want to go out on a limb.

"With bonds you worry about rising rates, but people have been predicting rising rates for years, and they're still not that high," said Greg Habeeb, lead portfolio manager for Calvert Short Duration Income Fund, Bethesda, Md., with a 3.93 percent return over the past 12 months. "However, stay away from long-maturity bonds because it is just a matter of time before they are hit pretty substantially as long-term rates go up."

Avoid high-yield bonds that aren't compensating you enough for risk, Habeeb added. Diversify fixed-rate holdings and know each one well.

Top-performing short-term taxable bond funds in total return the past 12 months, according to Morningstar Inc., have included:

-- Scudder Limited-Duration Plus "A" (PPIAX); $791 million; 2.75 percent "load" (sales charge); $500 minimum; no three-year return yet; 5.31 percent over 12 months.

-- Security Capital Preservation "A" (SIPAX); $271 million; 3.5 percent load; $100 minimum; 4.2 percent annualized three-year return; 5.22 percent.

-- Metropolitan West Strategic Income "M" (MWSTX); $213 million in assets; no load; $5,000 minimum; no three-year return yet; 4.67 percent.

-- Calvert Short Duration Income "A" (CSDAX); $236 million; 2.75 percent load; $2,000 minimum; 5.90 percent annualized three-year return; 3.93 percent.

-- Phoenix Multi-Sector Short-Term Bond "C" (PSTCX); $1.26 billion; no load; $500 minimum; 6.18 percent annualized three-year return; 3.68 percent.

"As oil prices go higher and Greenspan raises rates, the economy will slow down and he won't have to raise them anymore," reasoned Clark Stamper, manager for Evergreen Strategic Municipal Bond Fund, Santa Cruz, Calif., with a 3.45 percent return the past 12 months. "I expect short-term rates to increase probably another 75 basis points from here, or at least 50 basis points."

Stamper doesn't consider the economy strong, seeing bubbles in real estate and elsewhere. He thinks high-yield "junk" bonds will be in real trouble.

"Longer-term rates will eventually catch up to what we've seen in shorter maturities," predicted Anne Briglia, senior fixed-income strategist for UBS Financial Services, New York. "Bond prices fall as rates rise, but the average investor tends to buy and hold."

In the top tax brackets, tax-exempt municipal bonds almost always make more sense than taxable choices, Briglia said. Since half of them are insured, it's a quality market.

Top short-term municipal bond funds in total return the past 12 months included:

-- Evergreen Strategic Municipal Bond "A" (VMPAX); $769 million; 4.75 percent load; $1,000 minimum; 3.06 percent annualized three- year return; 3.45 percent.

-- Wells Fargo Advantage Short-Term Municipal Bond (STSMX); $671 million; no load; $2,500 minimum; 3.38 percent annualized three- year return; 3.09 percent.

-- BlackRock Ultra Short Municipal (BRMSX); $44 million; no load; $5,000 minimum; no three-year return yet; 2.74 percent.

-- Schroder Short-Term Municipal Bond (STMVX); $133 million; no load; $10,000 minimum; no three-year return yet; 2.47 percent.

-- Scudder Short-Term Municipal Bond (MSMSX); $670 million; no load; $2,500 minimum; 2.52 percent annualized three-year return; 2.26 percent.
