WEDNESDAY, MARCH 18, 2009 GLOBEINVESTOR.COM

Globe Investor

FIXED INCOME

One good idea: Buy bond fund for equity-type returns

BY DIANNE MALEY

The Source: John Tabet, independent financial adviser, Industrial Alliance Securities.

The Idea: Buy the Phillips Hager & North High Yield Bond Fund.

For Mr. Tabet, the fund solves a problem: How to get equity-type yields for his clients without the risk of investing in the stock market.

"People are looking for more safety and security," he said. "They want to invest in equity markets but they're afraid. With the PH&N High Yield Bond Fund, you're looking at above average returns with less risk."

The fund is up about 3 per cent this year, although it is down about 9.3 per cent over the past year. At its current unit price, the fund is yielding about 6 per cent, Mr. Tabet says. Dividends are paid out monthly.

The fund stands to reap a capital gain when interest rates on corporate bonds eventually ease relative to yields on government bonds, which could lift its total return to the 8 per cent range, he says. That's equal to the long-term average annual return for the stock market, including dividends.

"To expect any more than an 8-per-cent average annual return over the long term is foolish," he says. "High-yield bonds in this environment sure make sense to me."

The fund's 0.93-per-cent management expense ratio is more than you would pay for a bond exchange-traded fund, but its respected management team is well worth it, he argues.

"I don't want to buy a basket. I need somebody to do the due diligence and assess the risk," said Mr. Tabet, a former bond trader with a major bank. "Management does a good job of preserving capital."

Despite the name, this is not a junk bond fund, Mr. Tabet said. The credit rating of the corporate issuers is triple-B or higher.

Its top holdings include some familiar names: Cogeco Cable Inc., Retirement Residences Real Estate Investment Trust, Sears Canada Inc., Canadian Western Bank, Sobeys Inc. and Morgan Stanley.

"They pick their issuers carefully and they don't chase returns," he says.

The Payoff: Above-average returns with less than risk than the stock market – and the potential for a modest capital gain as interest rates on corporate bonds ease.

The Big Risk: Rising corporate defaults rattle bond markets, knocking down all corporate bond funds regardless of the quality of their investments. Investors in these funds could lose money in the short term, which would be offset to some extent by the dividends.

"We are not buying the high-yield bond fund for people who need this money in a year's time," Mr. Tabet said.

Why listen to John Tabet? As a former bond trader, he understands this complex market. Among his better calls was selling some energy trusts last October, before the market tanked, and buying them back in early February as prices started to recover.

» Special to The Globe and Mail

» This story first appeared on Globeinvestor.com/magazine.