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Advisors Sticking With CDs

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The U.S. government's decision to back bonds issued by some corporations is a new opportunity for investors—but many financial advisors say tried-and-true certificates of deposit still offer better yields.

Large investors like municipalities and pension funds have been scooping up tens of billions of dollars of bonds issued by companies like Bank of America and Hewlett-Packard Co. and backed by the Federal Deposit Insurance Co. as part of the government's latest effort to bolster the economy.

The bonds, which will be guaranteed up to June 2012, have boasted significantly more attractive yields than those of comparably dated Treasurys, which have grown razor thin as panicked investors clamor for the safest investments available. But many financial advisors, buying on behalf of individual investors, say the new bonds' premiums still don't match what cash-hungry banks are willing to pay on their certificates of deposit, also insured by the FDIC.

As a result, these bread-and-butter holdings may remain a better deal for investors without very large sums to invest or for whom liquidity—the ability to sell on a moment's notice—isn't a top priority.

Timothy Parker, president of Hudson Capital Management LLC in Ridgewood, N.J., recently found a Morgan Stanley FDIC-backed bond due 2010 yielding 2.53%, which was much more attractive than the 0.68% yield on a similarly dated Treasury. But a brokered Morgan Stanley CD yielded 3.72%.

"For a buy-and-hold investor, the CD is much better," he says.

One drawback of CDs is that the FDIC guarantees only up to $250,000 per individual account. The ceiling was increased from $100,000 earlier this year as credit jitters spread. Investors can also increase the limit by holding accounts at more than one issuer, although that process may be cumbersome.

"If you would like FDIC-quality paper you don't have to buy these (new bonds), you can go buy CDs," says Hildy Richelson, an investment advisor and co-author of "Bonds," a book about fixed-income investing for individual investors.

Still, what the new bond program "enables you to do is buy more than you could with a bank-issued CD," she says.

Although most financial advisors seem to be giving the new bonds a pass, they can suit large investors that want the ability to buy and sell quickly.

Tom Graff, managing director at Cavanaugh Capital Management in Baltimore, says he recently bought FDIC-backed bonds issued by JPMorgan Chase & Co., Citigroup Inc., Bank of America and Wells Fargo & Co. While no one knows how well the new bonds will ultimately trade, the early indications seem good.

"This will probably be more liquid than a CD," he says. "For the moment these are trading pretty well."

Bank CDs typically penalize investors six months' interest to exit before maturity. CDs sold through brokerage houses can change hands on the secondary market but trading costs can be high.

Graff says he's only shopping for the new bonds on behalf of investors with tax-free retirement accounts like IRAs. In taxable accounts, even for wealthy investors, he thinks there are still better deals to be found among high-quality municipal bonds.

Munis, backed by states and cities and their affiliates, are riskier than those backed by the federal government, but market jitters have pushed yields to almost unprecedented levels. Among the deals he's noticed is a triple-A State of Virginia bond due 2011 yielding at a tax-free yield of 2.3%. Currently two-year Treasurys yield 0.89%.

—Dow Jones Newswires