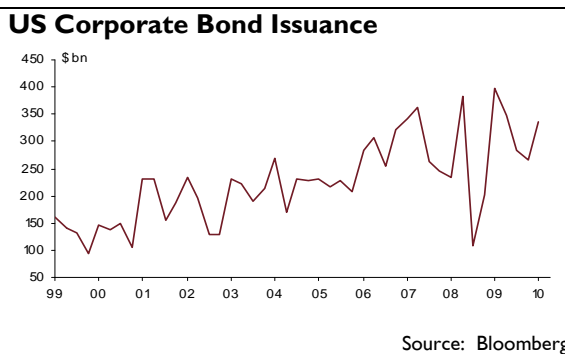


**The search for yield continues**

The yield premium available from corporate bonds has dropped sharply as the credit crisis fades into history, but relative to government bonds they still look attractive. We see scope for further modest capital appreciation in 2010 as the search for yield continues and major government borrowers remain hampered by unwieldy debt burdens.

The yield compression we have seen so far in corporate bonds versus government debt needs to be put into its current context. We envisage an environment of moderate growth in the major industrialised economies, with an absence of inflationary pressures - the central scenario highlighted on our *2010 Investment Outlook*. This would be a constructive backdrop for corporate debt, both investment grade and high-yield (below investment grade) bonds. Crucially, financing conditions have also improved dramatically over the past year, as evidenced by the chart below showing the significant increase in corporate bond issuance in 2009.



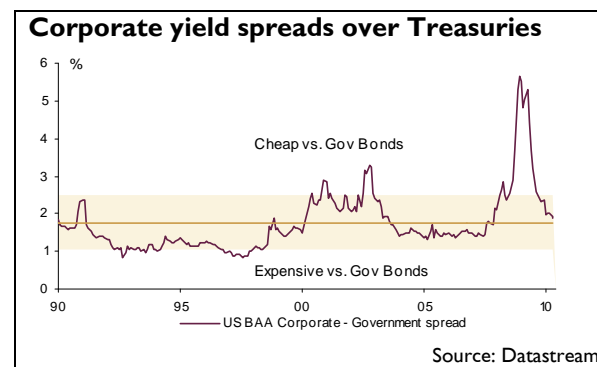
**Never average for long**

Corporate bond yield premiums over sovereign bonds are in the middle of their historical range, as the chart opposite shows. Yield spreads tend to move to either end of a long-term range, rather than to hover at their average levels. We therefore believe corporate yield premiums will continue to move toward the bottom of the range as long as recovery remains on track. High-yield premiums

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not only have more scope to fall in absolute terms, but also look attractive when considering their additional risk. In particular, high-yield debt should benefit from a continued trend of declining default rates, and are favoured along with investment-grade debt, subject to investors' appetite for risk.



As fiscal crises continue to rumble in the background, this could also continue to erode the allure of government bonds as a safe haven. As we have noted in previous commentaries, there is the distinct possibility that the bonds of large, multinational AAA-rated borrowers could overtake equivalently rated sovereign bonds as the new risk-free benchmark. In particular, we believe corporate bonds are attractively valued at current levels relative to "distressed" sovereign borrowers such as Greece.

**From one extreme to another**

In the environment that we envisage for 2010, where recovery grinds slowly on, we forecast that returns for investment-grade and high-yield bonds will surpass returns for government debt. Corporate yields remain at an attractive premium over governments, as long as the current sluggish recovery in developed economies remains on track. This premium could narrow further towards the bottom of its historical range as the search for yield continues, and corporate and high-yield bond returns could even rival equities in 2010.

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