

# Conservative High Yield

## Commentary

### Products Covered:

- Columbia Conservative High Yield Fund

*We believe that the fund is well-positioned to capitalize on any market upside, while its higher-quality bias offers downside protection.*

### Investment Risks

High-yield bonds (sometimes referred to as "junk bonds") offer the potential for high current income and attractive total return, but investing in them involves certain risks. Changes in economic conditions or other circumstances may adversely affect a junk bond issuer's ability to make principal and interest payments. When interest rates go up, bond prices generally drop and vice versa.

### High-yield bonds continued to perform well

Investor sentiment continued to improve across fixed-income and equity markets in the fourth quarter. Improving economic data and better-than-expected earnings, in conjunction with low Treasury yields, persuaded many investors to take on more risk in the search for higher yields. As a result, lower-quality issuers and distressed industries continued to lead the high-yield market's advance. In this environment, the JPMorgan Global High Yield Index rose 6.29% for the fourth quarter, capping off a 58.90% return for the calendar year. Low-quality CCC-rated bonds returned 13.1% for the quarter, handily beating the 4.4% return for higher quality BB-rated bonds. In this environment, the Columbia Conservative High Yield Fund slightly underperformed its benchmark, the JPMorgan Developed BB High Yield Index, which returned 4.58% for the fourth quarter. The fund underperformed its peer group, the Lipper High Current Yield Funds Classification.

### A favorable environment for high yield

As bank lending remained constrained and the default rate rose steadily, cash continued to flow into the high-yield market. A near record \$31 billion moved into high-yield mutual funds in 2009, including \$5 billion in the fourth quarter. A strong appetite for high yield allowed many companies to issue new bonds to enhance their liquidity and extend near-term loan and bond maturities. High-yield issuers raised \$60 billion from 143 new bond offerings during the quarter. For the calendar year 2009, the market absorbed 408 new bond deals, valued at a record \$181 billion. More than 70% of the new deal proceeds were directed toward debt refinancing, thereby reducing future default risk. Nevertheless, the default rate rose during the quarter. Moody's trailing 12-month default rate peaked at 13% in November and edged back to 12.5% in December to approximately where it stood at the end of the third quarter. Moody's has forecasted a dramatic improvement in the level of defaults for 2010. Its full-year estimate is 3.3%, below the historical average of 4.7%.

The high-yield market's strong performance resulted in continued spread compression. The yield spread of the JPMorgan Global High Yield Index declined by 122 basis points (bps) for the quarter, ending the year at 657 bps over U.S. Treasuries. For the full year, the high-yield spread contracted by 1,074 bps. Nevertheless, the index spread remains well above its historical median of 490 bps.

### Fund's positioning yields mixed results<sup>1</sup>

The fund's modest yield advantage relative to its benchmark benefited performance for the quarter. However, this was more than offset by an underweight in financials, the best-performing and fastest-growing sector in the index. We also believe that the fund had more exposure than its peers to higher-quality BB- and B-rated bonds and less exposure to lower-quality CCC-rated bonds than its peers, which hurt relative performance.

**Performance data quoted represents past performance, and current performance may be lower or higher. Past performance is no guarantee of future results.**

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### Looking ahead

Given the robust refinancing activity over the past year, we expect high-yield default risk to fall dramatically over the next year. We believe that the Moody's default rate has the potential to fall below historical average levels by the fall of 2010. With a year-end spread of 657 bps over Treasuries, we believe that the market continues to offer attractive absolute and relative value. However, we expect that weakness in the labor market and, consequently, weak consumer spending, will constrain economic growth over the near term. Without strong economic growth, we remain cautious on highly leveraged CCC-rated bonds, the lowest-quality, highest-risk segment of the market. We continue to favor credits with modest leverage and solid cash flow profiles, ample liquidity and strong underlying asset value relative to their debt. We believe that the fund is well-positioned to capitalize on any market upside, while its higher-quality bias offers downside protection.

**Please read and consider the investment objectives, risks, charges and expenses for any fund carefully before investing. For a prospectus, which contains this and other important information about the fund, contact your Columbia Management representative or financial advisor or go to [www.columbiamanagement.com](http://www.columbiamanagement.com).**

The **JPMorgan Global High Yield Index** is designed to mirror the investable universe of the U.S. dollar global high yield corporate debt market, including domestic and international issues.

The **JPMorgan Developed BB High Yield Index** is an unmanaged index designed to mirror the investable universe of the U.S. dollar developed, BB-rated high-yield corporate debt market.

Unlike mutual funds, indices are not managed and do not incur fees or expenses. It is not possible to invest directly in an index.

<sup>1</sup> Determinations of contributors and detractors are based on performance relative to the fund's benchmark.

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