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Vultures eyeing mortgage corpse

Opportunistic investors have raised huge sums to buy mortgage-backed debt, but are not yet swooping down - a sign the eleaguered securities have further to fall.

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LONDON (CNNMoney.com) -- Since the subprime crisis erupted earlier this year, vulture investors looking for bargains have been circling battered securities backed by mortgages.

But the feeding has not yet begun in earnest - and that's not a good sign for the housing and credit markets.

While opportunistic investors may be reviled by some, their presence is often an indication that a beaten down market has reached a bottom. The longer they stay away, the more likely it is that turmoil will roil the market.

"[Distressed debt investors] are a good thing for the market - they're a new force for providing liquidity," said Mark Adelson, an independent mortgage securities analyst.

For sure, vulture investors are getting ready to strike. Fundraising in the first nine months of the year hit a record $6.6 billion, according to London-based Private Equity Intelligence.

The research firm doesn't break down how much of that total is directed at risky mortgage-related debt, but several high-profile investors are eyeing the sector. The market chattered last month about a new $2 billion fund by Allianz's (Charts) Pacific Investment Management Co. Distressed debt investor TCW Group and hedge-fund firm Marathon Asset Management also have been said to be making moves in the sector.

The mortgage meltdown has sent many investors fleeing from risky mortgage bets like subprime-backed securities and collateralized debt obligations, which are pools of bonds sold off in slices of varying credit risk. It has also brought out vulture investors who, as their name suggests, smell an opportunity.

These investors face the difficult task of determining when prices for the distressed securities have hit a bottom. Until they're sure they're getting a bargain, they're likely to hold back on investing their money.

"It's not that no one's going to want to touch [subprime securities]. The question is at what price," said Adelson, who used to head structured finance research at Nomura Securities.

But the securities are hard to value, and no one knows if things are going to get worse. Merrill Lynch & Co. Inc. (Charts, Fortune 500) said last week that it took a $7.9 billion loss on mortgage-related assets in the third quarter. That was about $3.4 billion higher than the writedown the bank had projected a little more than two weeks earlier.

Furthermore, a recently created "superfund" designed to buy bonds and other debt backed by home loans could deter distressed investors from entering the market.

Some critics, including former Federal Reserve chairman Alan Greenspan, have warned that the fund could do more harm than good by propping up prices.

"If you intervene in the system, the vultures stay away," Greenspan said in a recent interview with Emerging Markets Magazine.

"The vultures sometimes are very useful."

That some players are starting to sniff around the mortgage sector is a good sign that the market may be starting to stabilize.

Still, the murky economic outlook has left some experts anticipating a further drop off in prices of mortgage-backed securities.

And there are signs the housing woes could get worse. For example, analysts are bracing for a massive wave of mortgages to reset to higher interest rates and trigger another wave of delinquencies.

The uncertainty leaves distressed debt investors with the tricky task of "catching a falling knife," said Daniel Alpert, a partner at New York-based boutique investment bank Westwood Capital, which specializes in mortgage and related securities.

"You could argue this is a good time to go in," Alpert said. "But my view is that a good portion of the market thinks the knife hasn't even started to plummet yet."