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DOW JONES NEWSWIRES℠

Treasurys Dive As Money Flows To Stks After Fed Rate Cut
By John Parry, 01/03/2001

NEW YORK -(Dow Jones)- Treasurys prices plummeted Wednesday as U.S. government securities were knocked off their pedestal by investors' ravenous appetite for stocks following a surprise Fed rate cut.

As market participants stampeded into stocks and non-government bonds, that shift drained support away from Treasurys.

At 3:45 p.m. EST, the 10-year Treasury, a de facto benchmark of the yield curve, was at 104 16/32, down 1 and 28/32. Its yield soared 23 basis points to 5.15%. Bond yields and prices move inversely to each other.

At the longer end of the Treasurys curve, the 30-year Treasury was at 110 27/32, down 2 and 17/32, its biggest daily loss in price terms since April 2000. Its yield rose 16 basis points to 5.50%.

Among shorter Treasurys maturities, the yield on the two-year note rose eight basis points to 4.95%, while the yield on the five-year note rose 21 basis points to 4.96%.

Treasurys prices slipped after Wednesday's unexpected rate cut announcement by the Federal Reserve.

Initially, Treasurys prices shot into positive territory after the 50-basis-point rate cut was announced around 1:13 p.m. EST. But prices then reversed, posting sharp losses in what one bond strategist called a "buy on the rumor, sell on the news" reaction. Also, a huge rally in the equities markets drew bidding away from U.S. government securities.

"Market participants were remembering history: that when the Fed's on your side, stocks are the place to be," said **Mark MacQueen**, executive vice-president of Sage Advisory Services in Austin, Texas.

Treasurys had put in a stellar performance Tuesday, with prices surging to extremely high levels, making them vulnerable to be knocked off their lofty perch. That's what happened once the Fed acted to slash rates Wednesday.

The central bank's aggressive rate cut already was priced into the Treasurys' levels, strategists said. However, they added that most market participants believed it wouldn't come before Friday's release the employment report for December.

The Fed's Open Market Committee cut its federal funds rate a half-percentage point to 6.0%, while the Fed Board also acted to trim the discount rate by a smaller margin - a quarter-point cut to 5.75%.

"The Board also indicated that it stands ready to approve a further reduction of 25 basis points in the discount rate to 5.5% on the requests of the Federal Reserve banks," the Fed said in its statement.

The Fed said both the discount and fed fund rate cuts " were taken in light of further weakening of sales and production, and in the context of lower consumer confidence, tight conditions in some segments of financial markets, and high energy prices sapping household and business purchasing power."

The Fed action came as "a bit of a shock," to Treasurys market participants said Mary Ann Hurley, vice president of fixed income trading at D.A. Davidson, a Seattle-based brokerage. "Everyone was looking for a Fed rate cut on Friday" after the December employment report is to be published - and did not expect one so soon, she said.

Sharply rallying stocks drew support away from Treasurys, bond strategists said. Also, Treasurys already had a lot of bond-bullish news priced in, leaving their prices at very high levels prior to the announcement, the strategists added.

"It was a buy on the rumor, sell on the news type of scenario," Hurley of D.A. Davidson added.

During trading late Wednesday, the Dow Jones Industrial Average was up 2.9% or 307 points, while the technology-laden Nasdaq Composite Index had soared 14.0% or 322 points.

After the Fed rate cut announcement, "some of (the bid for Treasurys) went back to the equities side," said Don Kowalchik, fixed income strategist at A.G. Edwards & Sons Inc., a St Louis-based brokerage.

He added, "We may be seeing a shift in momentum with some flows going back to cash, since the Treasurys market has been so rich." Prices of U.S. government securities have been at extremely high levels during recent days, he added.

Treasurys strategists noted that the two-year note held its own fairly well compared with the rest of the Treasurys curve. That's one indication that market participants are counting on further cuts in the fed funds target rate before too long.

By contrast, the much weaker performance of the long bond sent the yield gap between 2-year and 30-year Treasurys eight basis points wider on the session - to 55 basis points.

After Wednesday's easing, the fed funds futures began to price in additional rate cuts.

The Chicago Board of Trade's February fed funds futures - a contract which prices in expectations for fed funds - was pricing in a 100% chance of a 25-basis-point cut by the end of January.

"The Treasury market had been extremely overbought on a combination of the severely oversold equities market, convexity buying by mortgage investors and the weaker economy," said Richard Bodkin, manager of government bond trading at BancOne Capital Markets in Chicago. "Given how far the market has gone in its speculation about this (rate cut) move, it makes sense that Treasurys are giving up some of the henomenal gains we made," he said.

The reaction among spread products - bonds priced at yield margins or spreads to Treasurys - was decidedly favorable. Yield margins on agencies and high-quality corporate bonds tightened 0.03 to 0.07 percentage point immediately after the news the Fed had cut rates.

Corporate bond yield spreads to Treasurys tightened as non-government bond traders took confidence from the rate cut.

Some widely traded corporate spreads to Treasurys were five basis points tighter on the session after the Fed announcement – and mortgage-backed securities were also performing well compared with Treasurys, noted Glenn Migliozzi, managing director for fixed income at Fleet Investment Advisors in Boston.

"What the Fed wanted to do was stop the bleeding" in some non-government bond markets, Migliozzi said. The Fed is saying to credit markets, "we are going to hold your hand, everybody relax" and that should encourage companies to raise money in larger amounts on the corporate bond markets, Migliozzi said.

Bond traders will watch the release Friday of the employment report for December as a clue to the likelihood of future rate cuts. The first one, many participants believe, could come at the Jan. 30-31 Federal Open Market Committee Meeting.

Economists are looking for an increase of around 110,000 new nonfarm jobs, with an uptick in the unemployment rate to 4.1% in December's report.

5 1/8%	2-year	100 11/32	dn 5/32	4.95%
5 3/4%	5-year	103 13/32	dn 28/32	4.96%
5 3/4%	10-year	104 16/32	dn 1 and 28/32	5.15%
6 1/4%	30-year	110 27/32	dn 2 and 17/32	5.50%

2-30-Yr Yield Spread: 55 BPS Vs 47 BPS