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DOW JONES NEWSWIRESSM

Treasury Curve Flatter On Rate Cut Hopes, Inflation Fears

By Steven Vames, 02/22/01

NEW YORK -(Dow Jones)- Short-dated U.S. Treasurys moved higher Thursday, helped by lingering weakness in stock markets.

Longer-dated Treasurys, which are more sensitive to inflation, fell on investors' belief that inflation will become more of a threat as interest rates move lower.

At 3:45 p.m. EST, the benchmark 10-year note was down 8/32 at 98 24/32 to yield 5.16%. The 30-year bond was down 20/32 at 97 24/32 to yield 5.53%.

The five-year note was up 1/32 at 103 17/32 to yield 4.90%, while the two-year note was up 2/32 at 100 1/32 to yield 4.61%.

Analysts said that the Treasury market was keenly focussed on equities prices Thursday. The Dow Jones Industrial Average fell for the fourth straight session and the Nasdaq Composite Index fell for the fifth straight session after flirting with two-year lows.

The stock market has been under close watch by Treasury market participants recently because it acts as a sort of up-to-the-minute economic indicator at a time when investors are grasping for every economic clue they can get, according to Andrew Brenner, senior vice president of global fixed-income at Fimat in New York.

"Weaker stocks are pointing to a weaker economy, which is the primary concern in the market right now," said Brenner, adding that the lingering in stocks has bolstered beliefs that the Federal Reserve will continue to lower interest rates to help the flagging economy.

Meanwhile, investors have grown increasingly averse to longer dated Treasurys like the 10-year note and 30-year bond.

Recent data such as the January Consumer Price Index have shown a modest pickup in inflation, compounding fears that the economic stimulus that might eventually result from the Fed's current cycle of rate cuts will spur even more inflation.

Because the outlook for the economy and for inflation is increasingly uncertain and therefore risky, for holders of long-dated securities, investors often push long-dated yields higher to compensate for the increased risk when inflation becomes a concern.

"With all of the talk about inflation, the long end of the Treasury curve looks a lot less attractive," said Rich Volpe, managing director of government bond trading at Bear Stearns in New York.

Volpe noted that the trading action had a profound steepening effect on the Treasury yield curve Thursday, forcing some investors who had been betting on a flatter yield curve Wednesday to enter the market and take a loss on those positions.

The spread between the two-year note and 30-year bond, a popular proxy for the yield curve, widened dramatically to 0.92 percentage point versus 0.83 percentage point Wednesday.

4 5/8%	2-year	100 1/32	up 2/32	4.61%
5 3/4%	5-year	103 17/32	up 1/32	4.90%
5%	10-year	98 24/32	dn 8/32	5.16%
5 3/8%	30-year	97 24/32	dn 20/32	5.53%
2-30-Yr Yield Spread: 92 BPS Vs 83 BPS				

The Dow Jones Industrial Average closed up 0.23 point, to end unchanged, while the Nasdaq Composite Index fell for the fifth straight session after flirting with two-year lows.

(An item that ran around 4:01 p.m. EST (2101 GMT) incorrectly reported the DJIA fell on the session.)

Another round of debt buybacks by the Treasury Department had been slightly supportive for Treasuries Thursday, but the effect was short-lived.

The U.S. Treasury said it paid \$2.39 billion to repurchase \$1.75 billion outstanding securities with average maturity of 16.4 years, in a reverse auction that closed Thursday.

Earlier in the session, some participants said that the shorter-dated Treasuries also got a boost after Turkey said it will abandon its fixed-exchange-rate regime and float the Turkish lira.

The move triggered weakness in many emerging-market currencies, which was "increasing the uncertainty in global markets, which is lurking at the back of peoples' minds" and which put a bid into shorter-dated Treasuries, said **Mark MacQueen**, executive vice president at Sage Advisory Services in Austin, Texas.

By late Thursday, much of that anxiety had dissipated, but market watchers said that emerging markets remain a concern for the broader credit markets.

Economic news released Thursday had little effect on Treasuries.

At 10:00 a.m. EST (1500 GMT), the Conference Board said its index of leading indicators for January rose 0.8%, higher than expectations. Simultaneously, the Conference Board reported that its help-wanted index fell to 76 points in January, down three points from the prior month.

The index was at 89 points a year ago. This showed some slackening in the tight U.S. labor market.