Flight To T-Bills Grounds Stocks

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U.S. stocks traded lower Tuesday after a flight to quality in the credit markets that could hamper a Federal Reserve rate cut.The yield on the three-month Treasury bills extended its dramatic slide Tuesday, falling 26 basis points, to 2.86%. Yields have hovered around 4.80% over the past year. The recent rush to the relative safety short-term government securities indicates continued uneasiness with short-term corporate debt called commercial paper.

Demand for commercial paper has dissipated as typical buyers wince at anything with even the whiff of contagion from the crisis in the mortgage market. Commercial paper issuers with the most difficulty finding buyers have been mortgage companies like Countrywide Financial. (See: "Countrywide Starving For Cash")

Alan Lancz, director of investment research firm LanczGlobal.com, said the slipping Treasury yields restrict the Federal Reserve's ability to cut rates. Low yields on U.S. investments weaken the dollar because they encourage investors to park their money elsewhere where they can get higher returns. The dollar already is down 4.3% against the euro this year.

The emphasis on short-term government debt is unusual since other options are offering much more attractive yields. Six-month T-bills were yielding 4.04%, a wide premium over teh three-months, while the three-month London interbank offered rate, an offshore version of the federal funds rate, was 5.49%. The Fed's overnight rate target on interbank loans known as federal funds, usually the lowest taxable interest cost, has been 5.25%. The differentials mean that some investors are willing to forgo significantly higher yields for the perceived safety of very short term U.S. government paper.

Last week, the Fed already took the smaller step of cutting the discount rate, which it charges on loans made directly to banks. While the half-percentage-point reduction did ease some of the pressure on commercial banks, a fed funds cut would have a more dramatic effect on the overall economy. An interest rate cut would particulary benefit credit-crunched companies like **Countrywide Financial** (nyse: CFC - news - people). (See: "The Fed Finds An Answer")

A rate cut could also set off a rush on gold miners like **IAMGOLD** (nyse: IAG - news - people) and **Rio Narcea Gold Mines** (amex: RNX - news - people). Gold is used as hedge against a weak dollar and thus inflation, which are caused by lower interest rates. (See: "Federal Reserve Could Start A Gold Rush")

U.S. equities couldn't stay above water in early Tuesday trading during the flight to quality. The main indexes were slightly lower in morning trading, with the Dow Jones industrial average down 36.66 points, or 0.3%, to 13,084.69.

The major stock-market indexes were hampered Tuesday by more bad news from a familiar culprit during Wall Street's recent correction. Banc of America downgraded shares of homebuilders **Standard Pacific** (nyse: SPF - news - people) and **Hovnanian** (nyse: HOV - news - people) Tuesday. Analyst Daniel Oppenheim explained that tougher lending standards will continue throttling demand for the builders. Homebuilders have been some of the biggest losers during recent falls in equities because of weak demand and oversupply throttling their sales.

Among Tuesday's most actively traded issues were **Intel** (nasdaq: INTC - news - people), which lost 26 cents, or 1.1%, to $23.85; **Apple** (nasdaq: AAPL - news - people), which gained $3.97, or 3.3%, to $126.19; and **Mircon Technology** (nyse: MU - news - people), which gained 40 cents, or 3.7%, to $11.38.