Motivation

- A large fraction of the risk premium in the stock market is realized in the short period before Federal Open Market Committee (FOMC) announcements. (Lucca and Moench, 2015).
- The realization of the risk premium before FOMC announcement, along other evidences, suggests that the market learns about the FOMC announcement outcome beforehand, through informal channels (Cieslak, Morse, and Vissing-Jorgensen 2018).
- We provide empirical evidence for the Informed Trading Hypothesis.

The Key Finding

- We uncover the informed trading in corporate bond market starting several days before FOMC announcements.

I. Pre-Announcement Returns Predict Surprises

- Pre-FOMC corporate bond yield changes predict FOMC surprises, while stocks and government bonds don’t.

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<td>PreL &amp; α-8</td>
<td>0.117***</td>
<td>-0.016</td>
<td>0.169***</td>
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<td>0.169***</td>
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<tr>
<td>PreL &amp; α</td>
<td>0.189***</td>
<td>-0.024</td>
<td>0.169***</td>
<td>0.054</td>
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II. Informed Trading in Corporate Bond Market

- Corporate bond customers buy (sell) more before expansionary (contractionary) surprises.

III. Information Flow from Bonds to Stocks

- Corporate bond customer-dealer trade imbalances predict 24-hour stock market returns before announcements.

References

Gertler, M., and P. Karadi, 2015, Monetary policy surprises, credit costs, and economic activity, American Economic Journal: Macroeconomics 7:44-76