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The Month In Review

April 2006

What's New?

We're gearing up for the National Secondary Conference next month in Chicago and look forward to seeing many of you there. In light of this, we are taking a month off from the Topic of the Month but would like to solicit your input for topics that you would like to learn more about. Please email your suggestions to Kellie Kramer at kkramer@compass-analytics.com.

Market Update

Continuing their march higher over the last month, bond yields pushed into territory not seen in a couple of years. From March 6th through April 7th, the 10-yr treasury yield climbed about 30 basis points to 4.96%. Although it seems strange to be talking about a 5% 10-yr yield after so many months in the low to mid 4s, with expectations of the Fed Funds rate rising to 5% at the next meeting, it's almost inevitable that 10-yr yields will sit at or above 5%. Mortgage rates have followed the move higher and lock volumes are starting to feel the pinch.

Fed chairman Bernanke began his FOMC tenure as everyone expected he would - with another in the string of .25% Fed Fund hikes. The accompanying statement, though, did catch the market somewhat off guard in the fairly hawkish tone delivered. The bond market has been hoping for more clear signs of a pause or end to the Fed tightening cycle, but that message was nowhere to be found in the FOMC statement. It appears that the Bernanke and the committee see the balance of risks still leaning towards an increase in inflation pressures. The statement from the March meeting warned that more increases might be necessary to keep growth and inflation under control.

Although actual inflation numbers remain mostly tame, the economic data remains strong enough on balance to keep the Fed vigilant. European and Asian economies have shown signs of strengthening, too, which adds to the global pressure towards higher yields. In addition, crude oil again flirts with the $70/barrel mark and concerns have again arisen of higher energy prices filtering into the overall inflation picture.

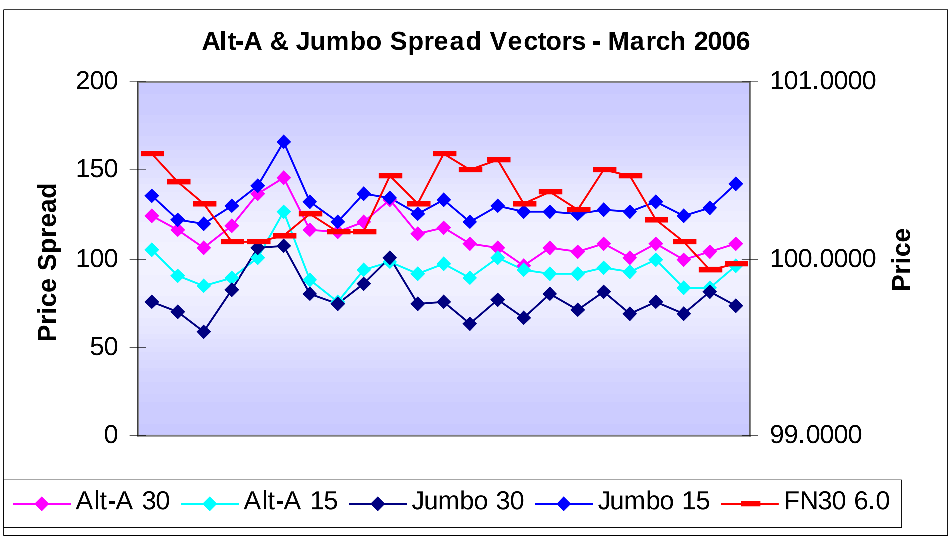
Another employment report brought an initial, false rally with a subsequent sell-off. Given the bearish tone of the market, even small rallies have the strong potential to be met with sharp selling. Job growth for March came in slightly below expectations at 211k and wage growth was tame at +0.2% but the unemployment rate fell back to 4.7% which was enough to trigger another day of selling for bond traders.

The tone was apparent even before the employment report as the market showed nervousness the day before the release. In the aftermath of the report, the 10-yr yield stopped short of 5.00% and, with limited data early in the following week, has been able to hold below that level but it appears to be only a matter of time. On the bright side, long-term rates are still historically low for this stage in the cycle. On the not-so-bright side, rates will have a tough time maintaining these levels while the Fed is still geared towards pushing them higher. -*Lindsay Hill*

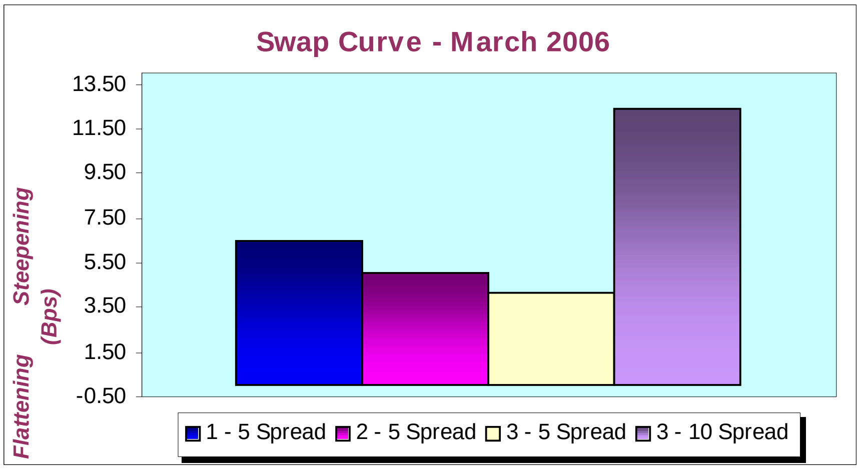
Alt A and Jumbo Spreads

March, characterized by one of the most volatile MBS markets seen in recent months, observed notably more volatility in Alt-A and Jumbo spreads, as well. The market sold off the first few days of the month on strong economic data; spreads followed the downward trend, tightening for three consecutive days. Although the market remained flat at the lower levels for a few days, spreads widened dramatically, as much as a ½ point for the Jumbo 30 year spread. All spreads tightened back to pre-widening levels in a matter of one day. Despite the unpredictable market mid-month, rallying one day and selling off the next, there were no more large spikes seen in spreads. However, the average daily change did increase to 10 bps in March, verses an average of 4 bps in February. In the last week of March, FN30 6.0's lost over a ½ point, but unlike the sell-off in the beginning of the month, spreads only moved moderately.

Compass's valuation of the Alt-A and Jumbo Fixed bulks in March derived prices within a 23 bp average range from the winning bids. The spread between investor bids, an average of 117 bps in March, decreased with respect to recent months, although the largest variance was quite notable at **229 bps**. Covers came in very close to winning bids and mostly came from the same investor, who did manage to win a couple of the bulks. Similar to what we observed in February, the rest of the bulks were won by various investors. -*Vimi Vasudeva*



Hybrid Arm Hedge Analysis



March began with the market moving lower on technical factors and strong ISM Indices, pushing swap yields higher. With bonds selling off, the 2-10 Treasury yield spread had moved to nearly flat by Friday from a -16 bps inversion on Monday. Swap spreads followed suit, widening across the curve, with the 1-5 spread widening most at 7 bps.
The selling continued into the subsequent week as the MBS market dropped 38 bps on Monday with no economic data releases. The market clawed its way back through Thursday, picking up 25 bps, though gave most of it back with Friday's NFP release. The market lost 31 bps for the week and the 3-10 spread was the only portion of the curve to widen, though spreads were close to unchanged across the curve.

The following week was quite volatile, though Monday was the exception. Benign data eased inflation concerns and led to two strong rallies which were flanked by smaller sell offs. The retail sales release on Tuesday was much weaker than expected and Thursday's CPI numbers were in line with forecasts. This marked the only week in which swap spreads were lower across the curve, however the curve was mixed again. The 1-5 portion tightened 4 bps while the rest of the curve was steeper, the 3-10 by 6 bps.

The market dealt with mixed economic data and a speech from Bernanke the ensuing week. Bernake expressed his opinion that the economy is on solid ground and the inverted yield curve is not indicative of looming recession. Bernanke's speech and a strong Core PPI reading led to MBS selling off 34 bps and higher swap yields. The market bounced around for two days then rallied 32 bps on weak New Home Sales data, which conflicted with stronger than expected Existing Home Sales. The market eked out a gain of 3 bps and for the only week in March swap spreads were tighter across the curve.

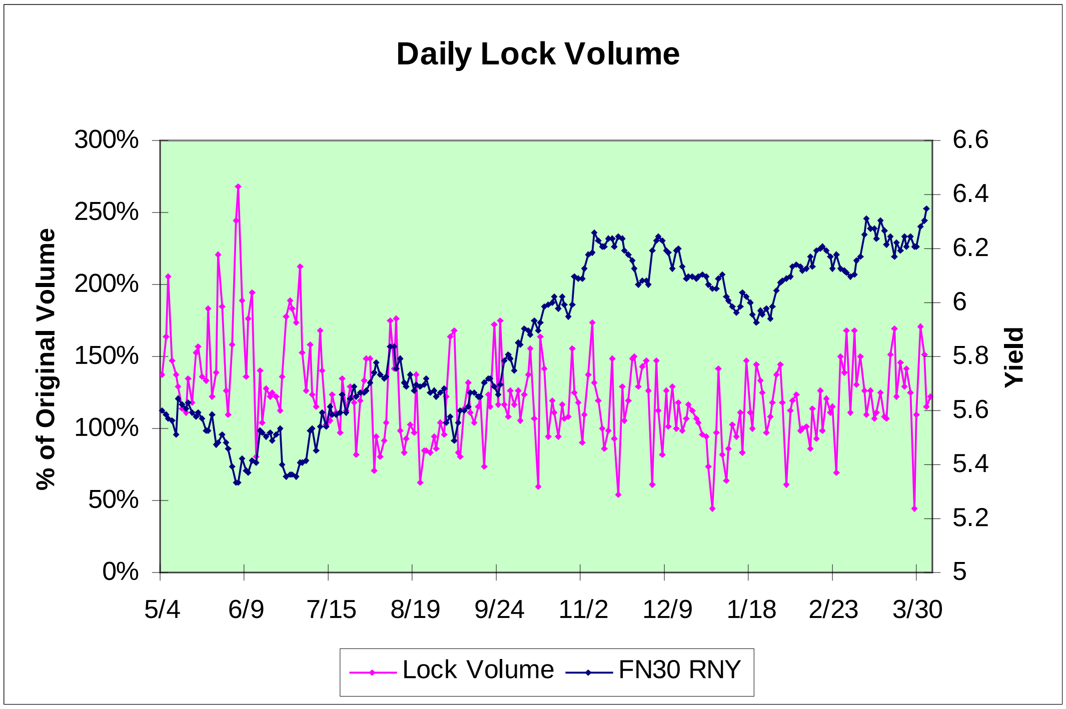
The final week of March included a fully expected 25 bps Fed Funds rate hike. The lack of change in the policy statement was interpreted as hawkish by market participants, which led to a 38 bps loss for the MBS market. With little significant data released post Fed, the market continued lower, dropping 81 bps by Friday. With more tightening expected in the future, swap yields rose across the curve, most significantly at the long end.

As seen in the graph, the swap curve steepened overall last month, with the 1-5 and 3-10 portions widening most notably. The market lost 122 bps and the 10 year swap led yields higher at 32 bps while the remainder of the curve added an average of 20 bps in yield.

At month end, the Eurodollar Future hedge outperformed the Dwarf hedge by an average of 4 bps with the 5/6 and 7/6 studies finishing in positive territory and the 3/6 EDF outperforming the Dwarf by just 1 bp. -*Virgil Caselli*

Month Ending Mar 31 2005	Hedge Performance ED (Bps)	Dwarf (Bps)
3/6 Arm	(11)	(12)
5/6 Arm	13	9
7/6 Arm	15	7

Production Index



Despite the fact that rates have continued to climb higher, production in March trended upward. The average volume for March was 126% of our base volume (vs. 117% in February) ranging from a low of 44% to a high of 171%. The average yield on the FN30 RNY was 6.24% ranging from a low of 6.11% to a high of 6.35%. -*Bob Gundel*