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The Month In Review

August 2006

New in CompassPoint™!

Compass is pleased to report its recent development progress in CompassPoint™, including:

- Integration to MS Excel on Data Strat Tool
- Batchable Excel Strat Reports
- Additional Data Conversion and Transformation Logic and Audit Tools
- Ability to Add User-Defined Fields in Import Tool
- Expanded Shock Summary Reporting
- Pipeline Warehouse Summary Report

CompassPoint™ features and capabilities reflect the business needs as defined and requested by its users. For additional information on new features or to submit suggestions and requests, please contact Rob Kessel at 415-925-2812 or e-mail at rkessel@compass-analytics.com.

Market Update

Times, they may be a-changing. The string of seventeen straight FOMC meetings ending with a ¼-point Fed Funds increase has been broken. Although core inflation readings have been picking up of late, the Fed wants a little time to monitor the effects of the increases to this point. Given that inflation pressures have increased of late, the Fed's longer-term outlook is based on slowing they see in the economy and an expectation that the recent inflation spike is temporary. Thus, until we see core inflation readings tick down, we still seem to be only a few strong economic reports, especially on the employment front, away from possible further tightening.

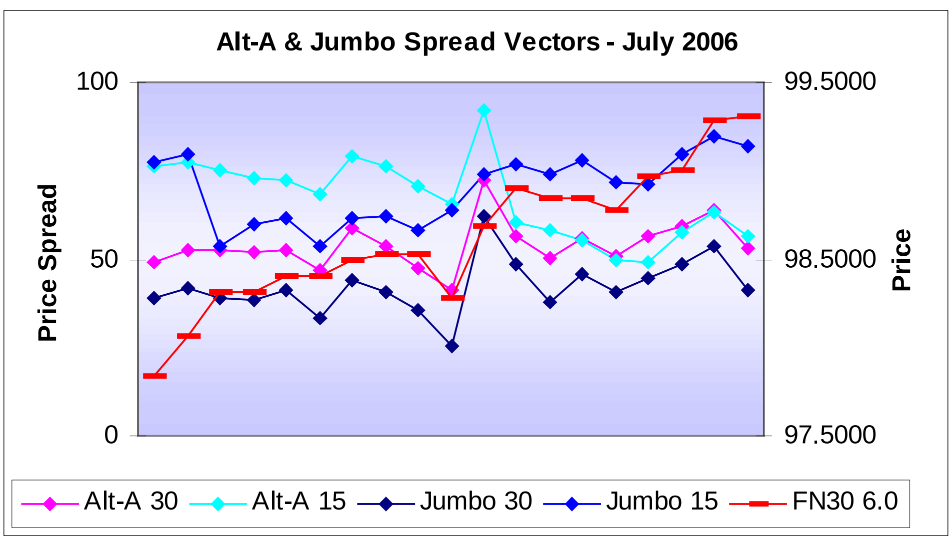
On the heels of June's sell-off, July saw bond prices rally as expectations of a Fed pause gained momentum. In addition, Israel's offensive against Hezbollah has added a flight-to-quality undercurrent to the bond market. The July rally pushed treasury yields, across the curve, to levels well below the current Fed Funds target of 5.25%. Futures trading for Fed Funds suggests an expectation of a Fed easing beginning sometime in 2007, lending some credence to Treasury the curve trading at yields below the current Fed Funds target. Although mortgage rates are higher than a year ago, the relatively cheap long-term rates should bode well for production in fixed-rate mortgages, other things equal.

As anticipated by many in the bond world, the news of the Fed pause was not cause for a continuation of the July rally. The expectation for a pause was already in place and the market had already been moving higher in response. The pause was all but confirmed when the employment report release on the Friday before the meeting showed that job growth remained somewhat weak. In the days following the Fed meeting, bond prices have trickled lower as the focus returns to upcoming inflation reports. If core inflation begins to subside, a more sustained rally in bonds could be in store. – *Lindsay Hill*

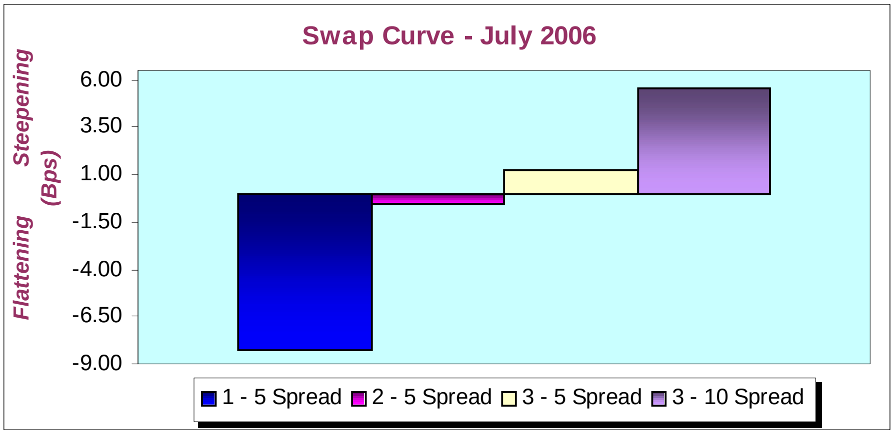
Alt A and Jumbo Spreads

Alt-A and Jumbo Spreads exhibited more volatility in July than seen in recent months. The market rallied the first couple of days, while most spreads remained neutral. Interestingly, the Jumbo 15 Yr spread decreased 26 basis points (bps) on the third day, bringing it to a much lower level versus the Alt-A 15 Yr, negating the convergence we observed between the two spreads last month. The Alt-A and Jumbo 30 Yr spreads diverged slightly as well, although the Alt-A 30 remained a consistent 10 bps above the Jumbo 30 throughout the month. A dramatic jump in spreads occurred in the third week of July as the market rallied following Fed Chairman Bernanke's testimony before Congress. FN30 6.0's rallied close to a ½ point, and spreads increased by an average of 30 bps. Although the market continued to rally the following day, all but the Jumbo 15 spread, fell back to levels seen before the rally. The Jumbo 15 edged higher, causing it to surpass the Alt-A 15, and remained higher through the rest of the month.

Compass's valuation of the Alt-A and Jumbo Fixed bulks in July derived prices within a 17 bp average range from the winning bids. Two investors won the majority of bids, while the losing bids were spread among a few. The spread between investor bids increased this past month resulting in an average range of 144 bps, with one bid seeing a range of 268 bps. –*Vimi Vasudeva*



Hybrid Arm Hedge Analysis

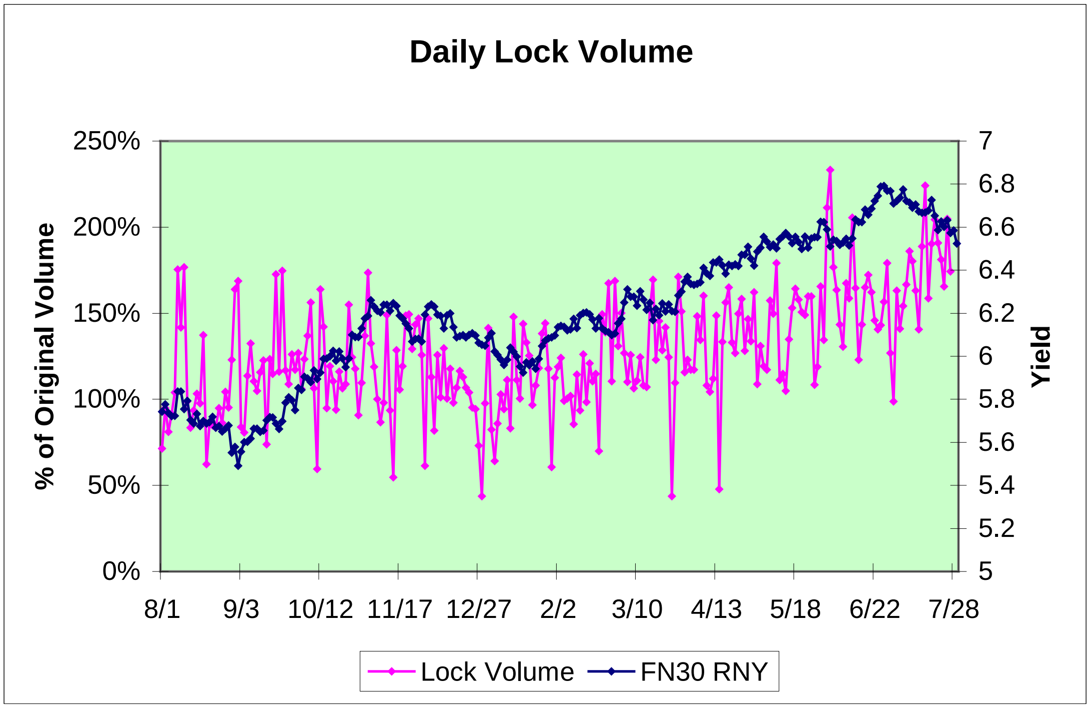


Contrary to June where yields advanced on inflation concerns, July was characterized by declining yields as hints of a slowing economy spurred a rally in the interest rate markets. Speculation of a pause in the rate hike cycle gathered steam, especially with Bernanke's mid-month testimony trumping the PPI and CPI data. The middle of the curve remained nearly unchanged as the 2 through 5-year swap yields had a near parallel shift lower by about 23 bps. With the 1-year LIBOR and 10-year swap yields falling less than the mid-yields, the front end tightened and the long end widened. July left the curve further inverted through the 5-year swap while only 2.5 bps separated the 1 and 10-year yields versus 6 bps at the start of the month.

At July month end, the Dwarf Hedge had outperformed the EDF Hedge in all three studies, with results in both positive and negative territory. *–Virgil Caselli*

Month Ending July 31, 2006	Hedge Performance ED (Bps)	Dwarf (Bps)
3/6 Arm	7	11
5/6 Arm	(12)	5
7/6 Arm	(33)	(13)

Production Index



Production in July again trended upwards as rates stayed relatively unchanged. Average volume for the month was 170% of our base volume (vs. 163% in June) ranging from a low of 99% to a high of 224%. The average yield on the FN30 RNY was 6.66% (vs. 6.64% in June) ranging from a low of 6.52% to a high of 6.78%. -*Bob Gundel*