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The Month In Review

June 2006

What's New?

Coming soon, Compass will have a new look to its web site, newsletters, and marketing collateral. We are in the midst of updating our web site so the content more accurately represents the full suite of products and services that we offer and presents the information in a more current format. We will also be introducing a new logo to be used on Compass newsletters, mortgage market update emails and all electronic and traditional communications. We look forward to formally rolling this out in the next 45 days.

New in CompassPoint™!

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

- Addition of Subtotals and Subreport to Data Stratification Tool
- Substantial Expansion of Data Mapping/Translation Tool
- Continued Cash-Flow Enhancements

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

This last month has been a difficult one for bond traders. Fallout from the back-and-forth comments delivered by the Fed, and particularly Bernanke, created volatility for bonds and a very tough month for stocks. Inflation fears and uncertainty in the Fed's near-term direction pushed the Dow down nearly 800 points from its recent highs. The 10-year treasury yield continues to toy with the 5.00% level but, of course, it has a tough time trading at yields below the current Fed Funds target, notwithstanding what the Fed may do at their meeting in a couple of weeks.

Criticism of Bernanke's messaging to the markets continued throughout the month. Although he's received failing grades on his delivery to this point, the new chairman has been working on his communication. Recently, various Fed governors and the chairman himself have delivered a more consistent message on the Fed's thinking: that core inflation has picked-up to an extent that makes the FOMC uncomfortable. One of the Fed's most-used inflation measures, the Core Personal Consumption Expenditure Deflator moved to 2.1% year-over-year. The Fed's stated comfort zone for the index is between 1.00% and 2.00%. Other inflation measures also seem to be on the rise and this may be sufficient to induce another .25% increase in the Fed Funds target at the upcoming meeting.



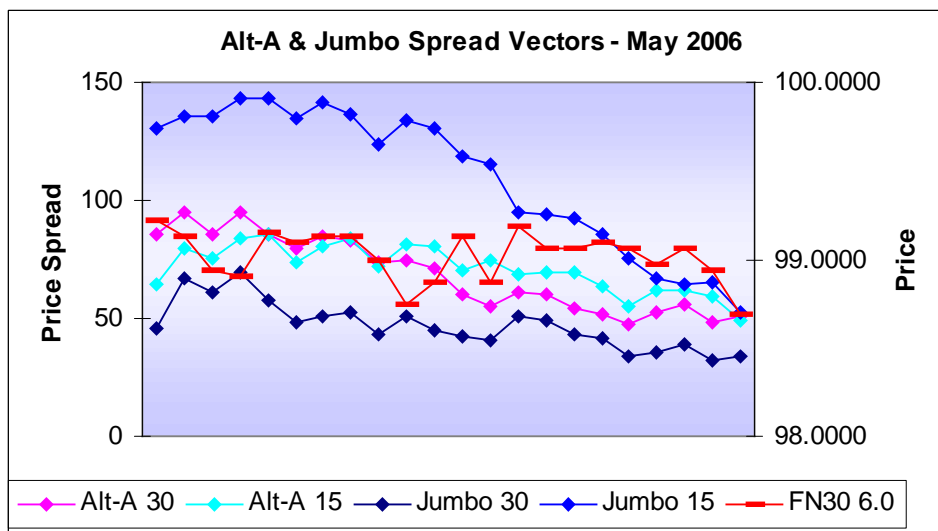
Another effect of the recent trading actions has been a re-inversion of the yield curve. The 2-year/10-year yield spread dropped back below zero with the 2-year yield remaining slightly above 5.0% and the 10-year dipping below 5.0%. Some economists have been calling for a drastically inverted curve in the coming months as fear takes hold that the Fed's anti-inflation policy moves will end up slowing the economy too abruptly.

In the face of inflation concerns, the longer-dated treasuries and mortgage bonds have fared quite well. Much of this relative strength is a product of the flight-to-quality bid as investors move from weakness in stocks, commodities and emerging market sectors. If these sectors begin to improve, the 10-year yield will likely face an even tougher time maintaining a 5.0% level. With the Fed working towards more consistent messaging, their first message appears to be that they will continue to fight signs of inflation, even if that means ignoring signs of economic weakness. *—Lindsay Hill*

Alt A and Jumbo Spreads

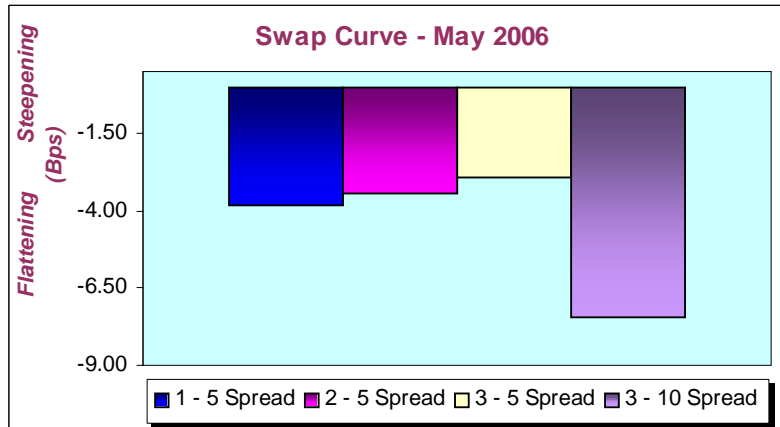
After several months of relatively stable behavior in Alt-A and Jumbo spreads, we finally observed an interesting shift in May. The Jumbo 15-year spread tightened over 65% from the beginning to the end of the month, approaching levels not seen since March 2005. Although it had been significantly wider than the other spreads for several months, it slowly tightened in the last half of May and ended at the same level as the Alt-A 15-year. The remaining spreads showed little reaction to the spiky market moves throughout May, with an average daily change of 6 basis points.

Compass's valuation of the Alt-A and Jumbo Fixed bulks in May derived prices within a 26 bp average range from the winning bids. The winning bids were spread among five investors, while three other investors consistently came in with the lowest bids. The spread between investor bids remained relatively low as seen in recent months, with an average range of 125 bps. *-Vimi Vasudeva*





Hybrid Arm Hedge Analysis



Swap spreads had widened only slightly midway through the month as the market paid little attention to mostly second tier data. A weaker-than-expected NFP number in the first week of May had only a minor effect on swap yields with the long end tightening slightly and the remainder of the curve close to unchanged. When inflation data began to hit the market mid-month, spreads began to tighten with market participants fearing higher short-term rates. The inflation jitters continued through the end of May as investors were concerned with a data dependent Fed and Bernanke's credibility as an inflation fighter.

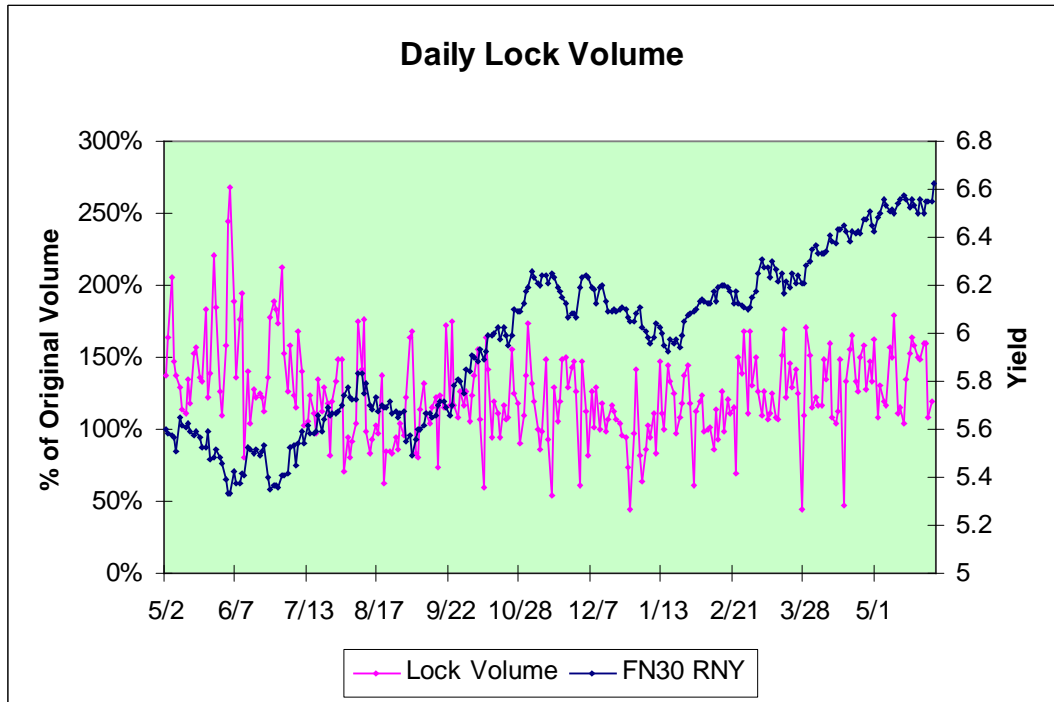
As seen in the graph above, swap yields flattened across the curve in May, with the 3-10 portion tightening most notably by 7.5 bps. The remainder of the curve flattened by an average of 3.5 bps. The market lost 75 bps and short-term yields (1, 2 and 3 year swaps) gained an average of 17 bps while the 10-year swap gained only 9 bps in yield. By month end, the curve was nearly flat through the 5-year swap yield.

At the end of last month, hedge performance was tight, with the EDF hedge outperforming the Dwarf in the 3/6 Arm study, while the Dwarf came in ahead of the EDF in the 7/6 and 5/6 Arm studies. -*Virgil Caselli*

Month Ending	Hedge Performance	
	ED (Bps)	Dwarf (Bps)
May 31 2005		
3/6 Arm	5	3
5/6 Arm	7	9
7/6 Arm	9	11



Production Index



Production in May continued to trend upward in the face of climbing interest rates. Average volume for the month was 138% of our base volume (vs. 131% in April) ranging from a low of 105% to a high of 179%. The average yield on the FN30 RNY was 6.53% (vs. 6.41% in April) ranging from a low of 6.42% to a high of 6.63%. -Bob Gundel