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The Month In Review

January 2007

New in CompassPoint™!

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

- Enhancements to Data Stratification Tool
- Sharable Buyup/Buydown Grids
- Expanded Pipeline Interactive Valuation Tools including:
    - Integration of Loan Level Data Views
    - Monthly, Quarterly, Annual Cash Flows for Cash Flow Valuation Methods
    - Integration of Price w/out Committing Price to db
- Lender MI, no MI Best Execution
- Expanded Trade Balance and Tolerance Tools
- Enhanced Shock Definition/Scenario Modeling
- Data Update Tool

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

The latest leg of the rally that bonds have enjoyed since June fizzled in a big way in December. Yields on the 10-yr treasury climbed over 20 basis points during the month to finish at 4.71%. Economic data released during the month pointed to stronger growth in the fourth quarter and word from the Fed, through their various appearances during the month, kept the market cautious.

In the hard-landing/soft-landing debate, the soft-landing side took control in December. While the numbers weren't exactly stellar, on balance, they showed enough strength to curtail worries about a recession in the near future. Stock markets took the cue as well with the Dow moving once again into record territory. Production numbers like the Chicago PMI and the ISM index, which had dipped below the breakeven reading of 50, climbed back above 50 to show at least some month-over-month growth. The housing market also gave a boost to the economic outlook as home sales numbers improved and the market gave the impression that the worst may soon be over.

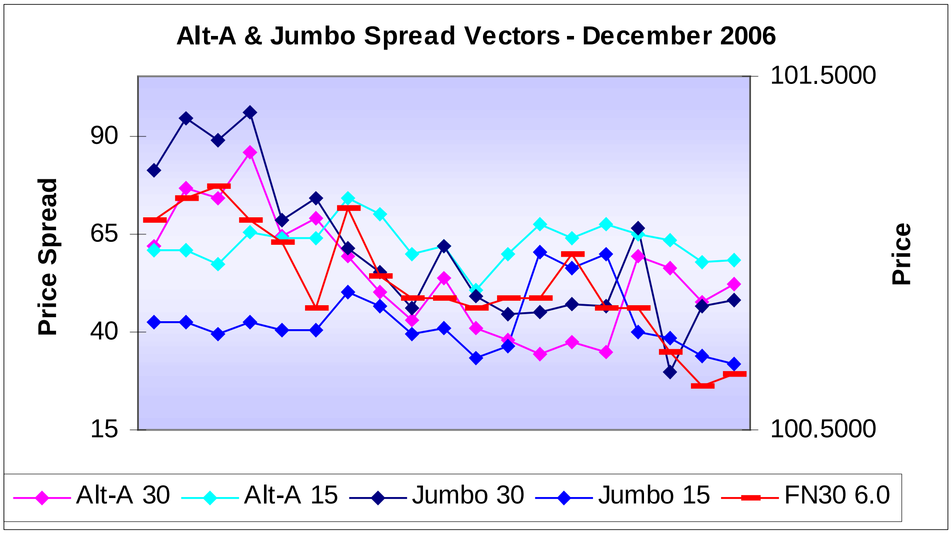
Although the bond market bounced back somewhat in the first week of January from a tough December, the December employment report released on January 5th sent the market lower once again. Payroll growth for December came in higher than expected and November job growth was also revised higher. On top of the job growth, the average hourly earnings number jumped 0.5% on the heels of a 0.3% increase in November. The employment rate held firm in December at 4.5%. Although subject to revision, the job growth numbers for the last couple of months have been running quite a bit higher than expectations.

At one point, not too long ago, the Fed Funds futures contracts had priced in a near certainty of a Fed rate cut in the spring of this year. But as the 4th quarter began to look stronger than previously expected, and with the Fed-speak continuing to push the anti-inflation message, the market eventually gave up on the notion of a spring rate cut. Futures contracts are now pricing in little chance of a March cut and many expect the Fed to remain on hold throughout the year. Some even eye another increase as the likely next step. With the 10-yr yield creeping back up towards 4.75%, confusion and volatility may be what's in store in the next month or two. *–Lindsay Hill*

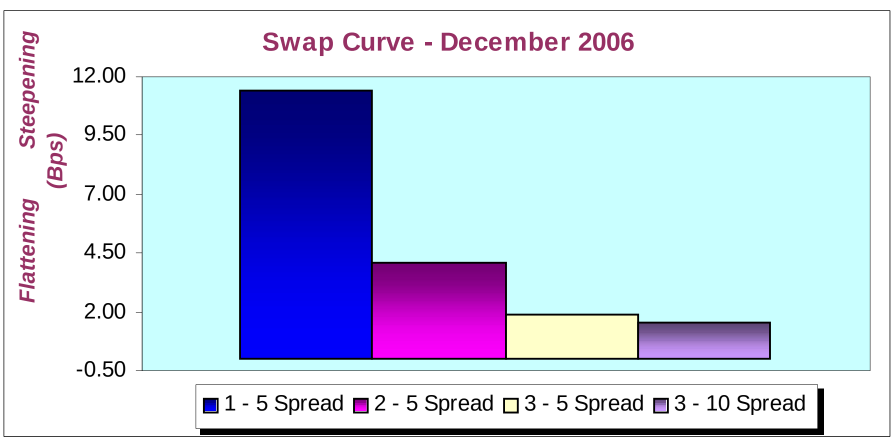
Alt A and Jumbo Spreads

The month of December observed a decline in MBS prices coupled with a tightening of Alt-A and Jumbo spread vectors. Although we typically observe greater volatility in 15 Year Spreads, the 30 Year Spreads proved to be more volatile throughout the month. Interestingly, the first dramatic move came about on a quiet market day; 30 Year Spreads sharply declined while the market lowered only slightly and 15 Year Spreads remained neutral. This atypical behavior actually seemed to be a pattern in December – sharp changes in Spreads accompanied by a flat market and vice versa. 15 Year Spreads ended the month very near to levels at the beginning, with only two significant spikes in the latter half of December. 30 Year Spreads, on the other hand, were much more volatile and ended the month significantly lower; as low as 34 bps on the Jumbo 30 Spread, as can be seen in the graph below.

Compass's valuation of the Alt-A and Jumbo Fixed bulks in December derived prices within a 16 bp average (mode) range from the winning bids. Two investors dominated the bids in December, while one investor in particular seemed to be the lowest bid for quite a few bulks. There was no notable pattern in the cover this month, and the spread between investor bids widened approaching an average range of 130 bps. *-Vimi Vasudeva*

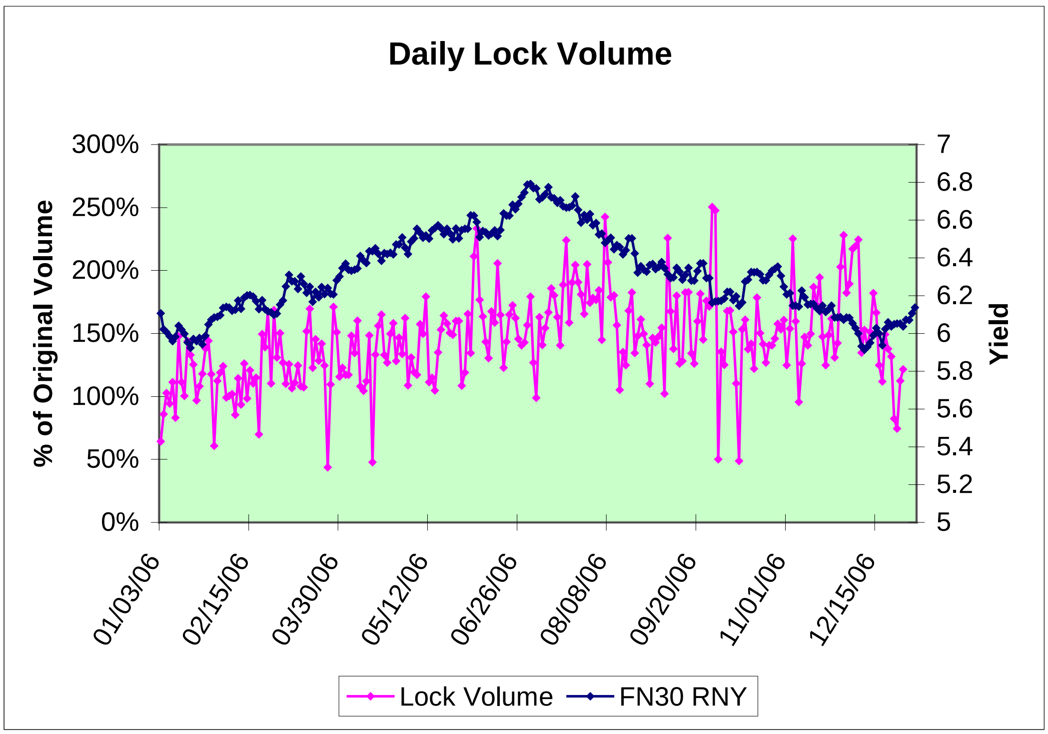


Hybrid Arm Hedge Analysis



December brought higher yields and dwindling expectations of a Fed rate cut in the first quarter of 2007. Yields rose quietly as stronger than expected economic data accumulated, calling into question the general consensus the economy was slowing sufficiently to contain inflation. The probability of a Fed rate cut at the March meeting began the month at 100% and finished at 17%, as indicated by the futures market. The 2 through 10-year swap yields gained an average of 23 bps while the 1-yr LIBOR gained only 14 bps. The 5-yr swap led yields higher, adding over 25 bps. The 1-10 swap spread moved about 11 bps towards flat, leaving the spread inverted by about 15 bps. *–Virgil Caselli*

Production Index



Production in December decreased despite rates trending lower for the fifth month in a row. Average volume for the month was 150% of our base volume (vs. 158% in November) ranging from a low of 75% to a high of 225%. The average yield on the FN30 RNY was 6.02% (vs. 6.12% in November) ranging from a low of 5.91% to a high of 6.14%. *–Bob Gundel*