



The Month In Review

June 2007

What's New?

Compass continues its monthly Webinar training series with two additional topics for July. On July 17th, 2007 at 12:00 PDT, Compass will host a session on *Prepayment Speeds – Vernacular, Acronyms, Calculations, Impact & Sources* and July 24th at 12:00 PDT, Compass will host a session on *Default and Severity Models - Vernacular, Acronyms, Calculations, Impact & Sources*. Please email Kellie Kramer at kkramer@compass-analytics.com if you have not received an invitation to a previous session so you can be added to the list of invitees. Additionally, if you would like to request a certain topic be covered in an upcoming training, please email Kellie Kramer at the above email address as well.

New in CompassPoint™!

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

- Bulk Insert Data Write
- Deal Settings Templates (Copy Forward)
- Filter Builder Tool Enhancements
- SSIS – SQL 2005 Data Tools Integration
- Cash Flow Vector Reporting and Cash Flow View Builder
- Enhancements to Report Strat, Export and SPIRE interfaces

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

So much for the quiet, sideways trade that predominated in April and early May. The last few weeks have seen one of the sharpest drops in bond prices in the last several years. Yields on the 10-yr treasury have climbed from 4.64% on May 7 to about 5.29% as of June 12. On May 11, the FNMA 30-yr 6.00% coupon was priced at 100-17 for August settlement. The same coupon closed June 12 at a price of 97-30, down over 2.5 points over the last month. The sell-off has also been focused mainly on the long-end of the curve, bringing about a pronounced steepening. As of May 7, the 10-yr treasury was still yielding 4 basis points less than the 2-yr, but as of June 12, the 10-yr was yielding about 20 bps more than the 2-yr.



By and large, the recent run-up in yields has not been a product of stronger economic data. Reports over the last month remained mixed on the growth front and core inflation numbers have not shown much change. That said, until recently, the bond markets were still leaning quite heavily towards a Fed rate cut by year-end, despite the Fed's consistent statements defining inflation as their top concern. That bias in Fed Funds futures has unwound in a big way with futures now pointing to a nearly 50-50 chance of a Fed Funds increase by year-end. This has helped push yields higher across the curve. Rate increases and potential rate increases overseas have also added to the sell-off, as did weakness in the foreign bid component for the last round of treasury auctions.

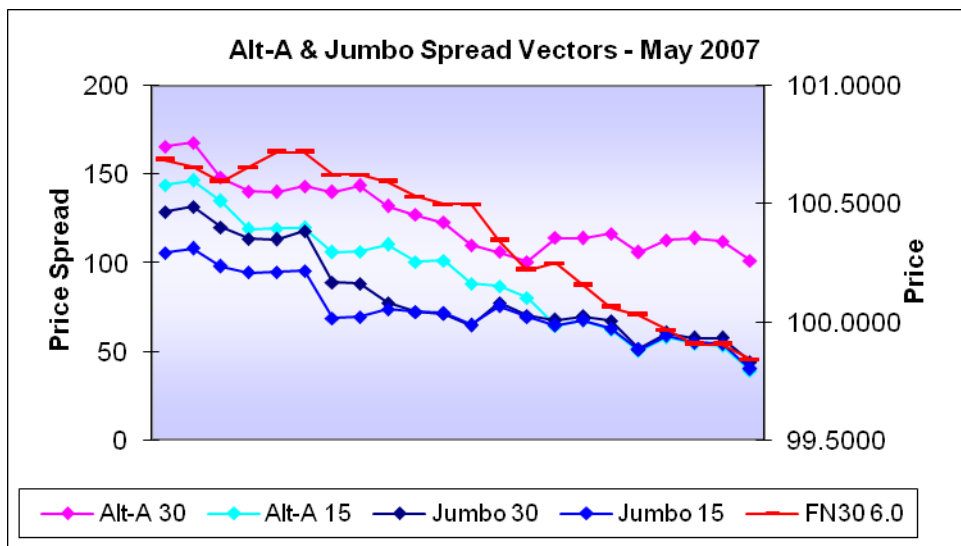
While the jump in rates seems sudden and drastic, a 10-yr treasury yielding about 5.25% does not seem unreasonable given the level of global rates, the fairly steady strength of the US economy and a Federal Reserve that is still on inflation watch. The wild card may still be the subprime mortgage and housing markets. The quick jump in rates has done nothing to help borrowers looking to salvage their mortgages and even more potential homeowners will be left out by the higher rates. To this point, the broader economy has withstood the slowdown in housing but that slowdown may just be beginning. If US consumers have to circle the wagons en masse in response to higher rates and zero or negative home equity, the next fed move may just be an easing after all. *—Lindsay Hill*



Alt A and Jumbo Spreads

Alt-A and Jumbo Spreads, for the most part, tightened persistently throughout May after they blew out earlier in the year, meanwhile there was moderate volatility in the MBS Market. FN30 6.0's traded within a 90 basis point range posting only one close-to-close gain in a three week span. The only sharp move in Spreads occurred on the front end of the sell-off, but afterward stayed relatively range-bound for the remainder of the month. FN30 6.0's dropped pretty consistently, but declined more sharply mid-month with strong employment data coupled with a better than expected Philly Fed index reading. Even though 15-year Alt-A spreads converged with Jumbos toward the end of the month, Alt-A 30-years managed to buck this trend and ended the month significantly wider. This divergence may be a signal that even though investors bid spreads throughout the month, there still might be some lingering trepidation surrounding Alt-A 30-year spread product.

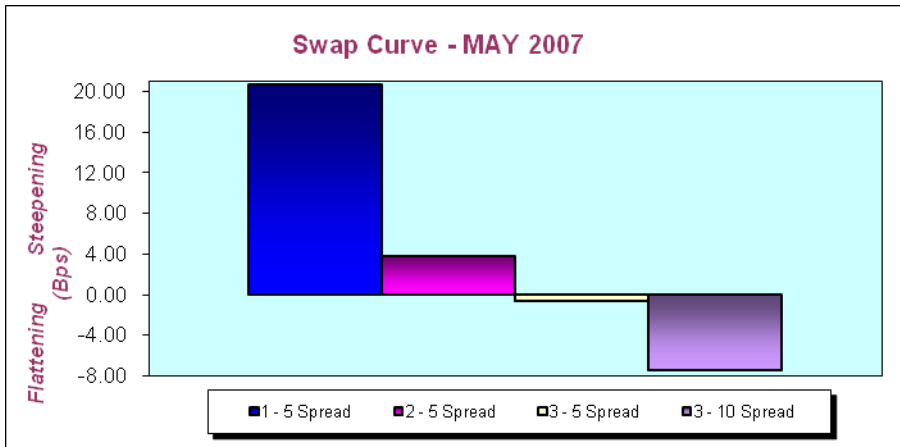
Compass's valuation of the Alt-A and Jumbo Fixed bulks in May derived prices within a 12bp average range from the winning bids. Investors have become notably more conservative and selective in their bidding on bulk products, with no consistent front-runner among investors looking to bid for bulk product. -*Vimi Vasudeva and Dave Bennett*





Hybrid Arm Hedge Analysis

The swap curve moved significantly in May as yields steadily climbed throughout the month on accelerating economic growth and mounting inflation concerns. The 2, 3 and 5 year yields gained an average of about 35 bps in yield, while the 1 year LIBOR gained only 14 bps and the 10 year gained 29. The 1-10 swap spread steepened 13 bps to finish the month with a positive slope of 4.5 bps. –Virgil Caselli





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Production Index

Production in May slowed slightly while rates traded in a wider range (26bp range in May versus an 11bp in April), with the average yield increasing 7bps from April. Average volume for the month was 129% of our base volume (vs. 137% in April) ranging from a low of 84% to a high of 168%. The average yield on the FN30 RNY was 6.21% (vs. 6.14% in April) ranging from a low of 6.11% to a high of 6.37%. -Dave Bennett

