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# The Month in Review

**August 2008**

## What's New?

Compass continues its monthly Webinar training series with the following sessions:

- *Pricing Agency Loans & Best Execution* on Tuesday, August 19th at noon PT
- *FHA Guidelines and recent changes to FHA Lending on* Tuesday, August 26th at noon PT, led by guest host Patrick Intiso of PVI consulting and consultant for Mortgage Banking Solutions
- For Compass customers, we will be holding a report training session covering our Reconciliation series of reports including *Missing Commitment, Failed Pricing Detail and Best Execution Change reports* on Tuesday, September 16th at noon PT

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.

## New in CompassPoint™!

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

- Processing Speed Enhancements for Large Portfolios
- Group-By/Histo Capability for Cash Flow Reporting
- Expanded Valuation, Scenario and Report Batching Capabilities – Cash Flows, Shocks and Scenarios
- Expanded Stratification Subtotal and Total Functions
- Data Export Data Sources expanded to Dynamic Stored Procedures
- Expanded Accounting and Reconciliation Queries
- Key Rate Duration Diagnostic Trace

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 415-462-7500 or e-mail at rkessel@compass-analytics.com.

## Market Update

After a short climb in the latter part of July, rates are once again moving lower, albeit in a volatile fashion. With the Fed message mixed once again (both a deterioration in economic growth and a pick-up in inflation are of concern) bonds are left watching fear in the stock markets and profound weakness in the job market.  The Fed expects (hopes for?) a moderation in inflation pressures going forward, which would give them more wiggle room on overnight rates.  But, notwithstanding a somewhat more dovish Fed statement on the whole at the latest meeting, the hawks are certainly circling.

After climbing above 4.25% in June and peaking back above 4.10% recently, the 10-yr treasury yield has dipped back below 4.00%.  An early release on the July employment figures on August 1st, showing further job losses and another increase in the unemployment rate, was followed the next week by another spike higher in initial unemployment claims.  The Conference Board's consumer confidence index actually showed a slight rebound in July, but this more likely is attributed to a decline in gasoline prices than a general impression of economic improvement.  Most manufacturing and economic growth indices continue to hover near their break-even points and core inflation readings remain relatively tame.

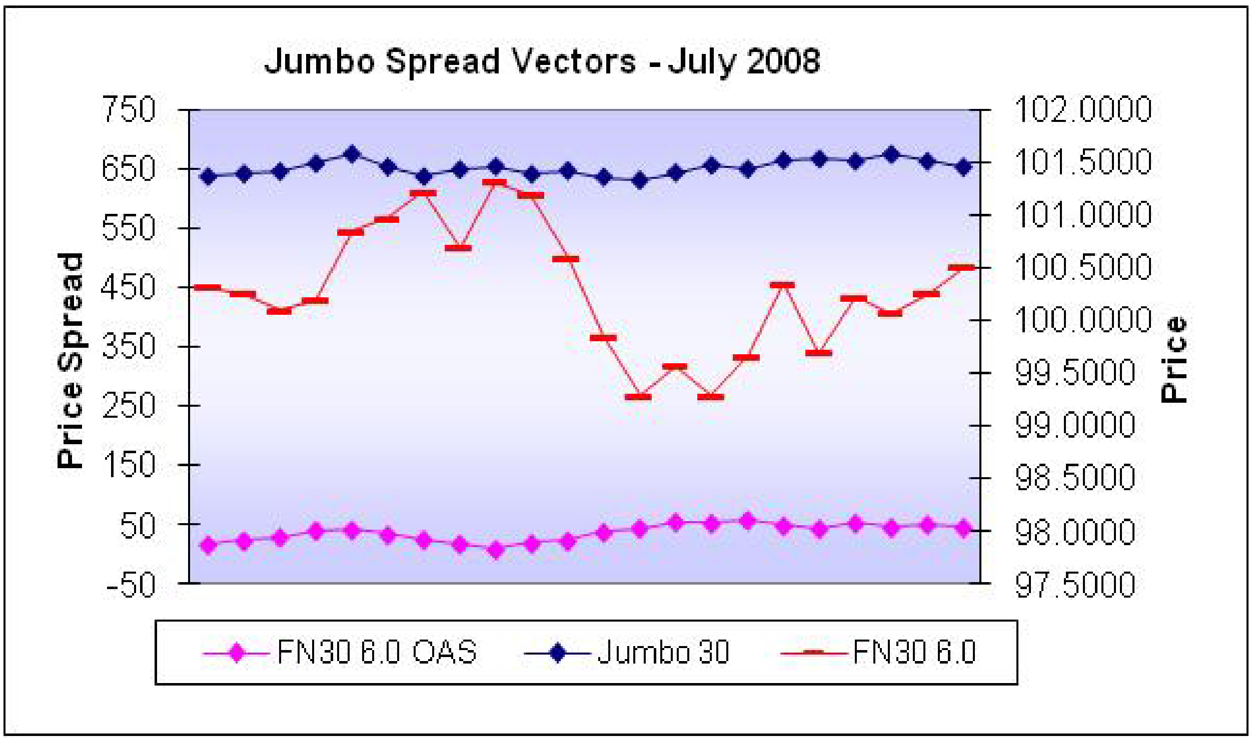
On top of a confusing economic picture for bonds is a somewhat clearer picture for the GSEs: namely, that their losses are mounting.  Freddie Mac recently released results of a brutal quarter and equity prices for both Fannie and Freddie continue to fall.  In some cases, loans closed in early 2007 are beginning to show poorer results than ones closed in 2006, meaning underwriting standards were still quite loose at that point and that housing market likely still has a ways to go before bottoming out.  In another effort to re-price the risk of current originations, Fannie Mae announced an additional .25% "adverse market" price hit to all loan purchases and, presumably, Freddie will soon follow suit.

And so it goes: every two steps forward is followed by at least one step back.  Just think, we'll soon be able to add the November elections to the list of tough-to-define issues facing bond and mortgage markets.  *-Lindsay Hill*

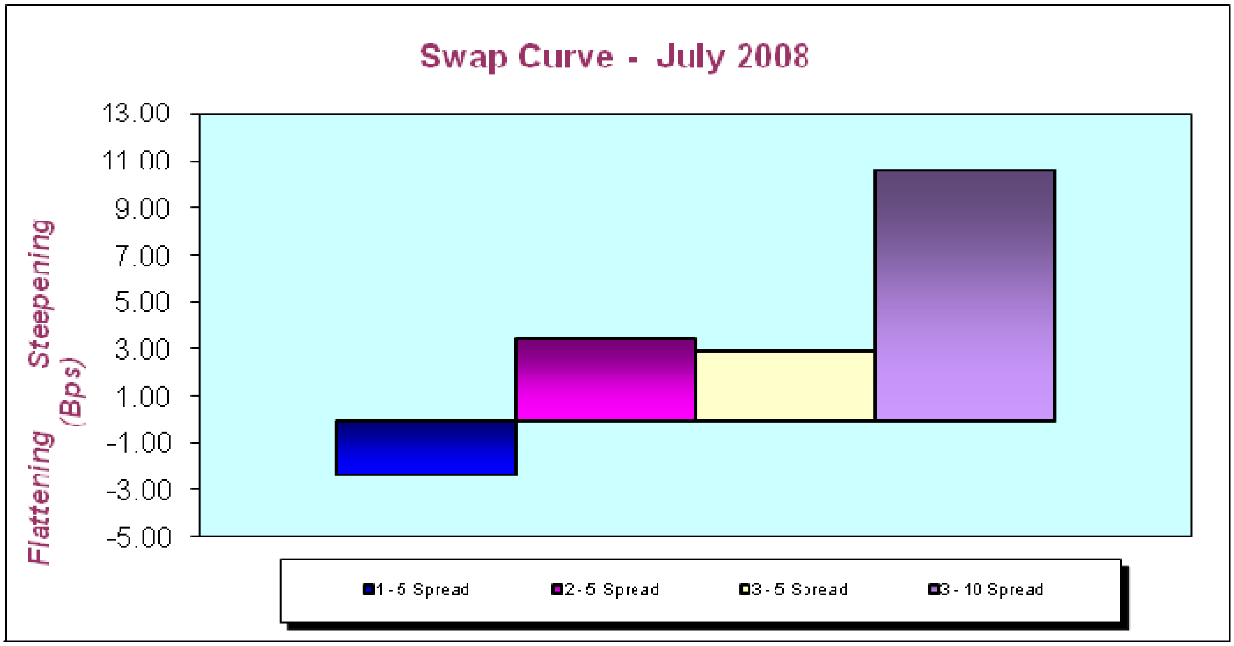
## Alt A and Jumbo Spreads

Jumbo spreads experienced relatively range-bound trading.  FN30 6.0's chopped around in another volatile month.  The range widened slightly in July (204bps vs. 203bps in June), as there continued to be pronounced swings.  The month started off with Nonfarm Payrolls printing at -62K (-62K in June, revised down from -49K) vs. an expectation of -60K and the unemployment rate rose to 5.7%.  The highlight of the month was the troubles in the market for Fannie and Freddie.  Credit Default Swaps on the $1.45 trillion in Fannie/Freddie debt were trading at an A2 Moody's rating, about 5 levels below where they normally trade.  Both stocks were off as much as 80% from their highs, which made raising capital in the equity market near impossible.  Secretary of the Treasury Paulson was forced to ask Congress for permission to buy unlimited stakes and ability to lend to both companies to keep them afloat.  Even though there is more stability now, there are still questions that have yet to be answered with both companies.  In corporate America, earnings reports were mixed.  IndyMac declared bankruptcy; Merrill announced a $9.7B writedown for a $4.65B 2Q loss, and also announced a sale of $30.6B in CDO's to Lone Star Funds for 22 cents on the dollar; Citi declared a $2.5B 2Q loss; and Wachovia posted a $8.9B 2Q loss.  On the positive side, Wells beat earnings estimates on insurance revenue and credit card fees;

JP Morgan beat consensus numbers; and Bank of America announced $3.41B in net income and said that Countrywide would be additive to their profits this year. For the last year, the totals stand at $493B in total writedowns and $357B for total capital raised for financial firms worldwide. Inflation concerns continued for the Fed— 5.0% y-o-y increase in CPI and PPI up 9.2% y-o-y. All-in-all, there is a mixed picture of the economy going forward. In treasuries, the bull-flattening rally left 2-10's at 133bps at the end of the month (started month at 135bps). Although spreads appear to have leveled out, there is still a great deal of volatility in the market that could push spreads wider. *–Dave Bennett*



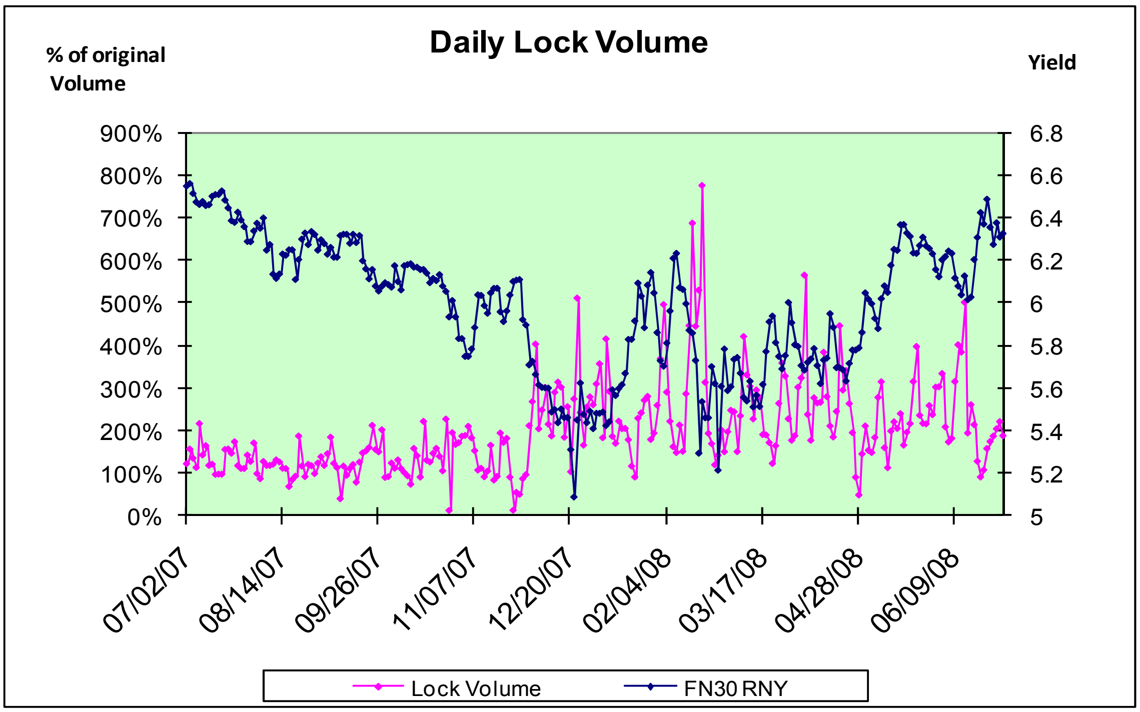
## Swap Curve Analysis




Swap yields fell across the curve in July, though the 10 year was close to unchanged, leading to a steeper curve overall with minor tightening at the front end. The financial sector remained under pressure as losses mounted and questions surrounding the solvency of Fannie Mae and Freddie Mac led the Treasury to shift from an implicit to explicit backing of the GSEs. By month end, the 2-10 Swap spread widened about 11 bps, leaving the spread at 125 bps. *-Virgil Caselli*

## Production Index




Production in July increased while rates traded in a slightly more narrow range (47bp range in July versus 49bp in June), with the average yield increasing month over month. Average volume for the month was 237% of our base volume (vs. 221% in June) ranging from a low of 89% to a high of 502%. The average yield on the FN30 RNY in July was 6.23% (vs. 6.19% in June) ranging from a low of 6.02% to a high of 6.49%. *-Dave Bennett*