



Compass Analytics | 580 California Street, Suite 1725 | San Francisco, CA 94104 | 415-462-7500 | www.compass-analytics.com

The Month in Review

August 2010

Don't Miss!

Compass has moved! Please update your records with our new contact information:

580 California Street
Suite 1725
San Francisco, CA 94104

Phone, fax, and email remain the same.

What's New?

Compass is rolling out its **Servicing Retain or Release Dictionary and Primer** this week! This primer is a comprehensive reference for the considerations, terms and analytics originators can use to demystify the retain/release best execution decision, both on a strategic and a daily, loan-by-loan basis. Interested customers should request the Primer from Lucy at lpoole@compass-analytics.com.

To all of our customers: Please remember to RSVP to the Compass Analytics User Conference in San Francisco on Tuesday, September 21st. Sessions will cover Pipeline, MSR and general topics. If you plan to attend you can reserve a spot by sending an email to lpoole@compass-analytics.com. Ask your Compass Account Manager for more details.

Rob Kessel's next Fannie Mae Housing Finance Institute (HFI) **Secondary Marketing Class** for 2010 is in Dallas, TX from October 5-6. If you would like more information about these sessions please send an email to rkessel@compass-analytics.com.



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New in CompassPoint™!

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

- 64 Bit Implementation (Excluding Third Party Tools not Supporting 64 Bit)
- Expanded user-defined workflow email alerts and reporting
- Enhancements to LPS/AFT Credit Model
- Expanded Control and Ease of Maintenance of Mark-to-Trade Options
- Additional Rate Sheet Export Format Options
- Simplified ARM Security Pricing and Z-Spread Based TBA Price Derivation

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

As the pace of growth in the US economy continues to slow, the rallies in treasury and mortgage prices keep pushing forward. The yield on 10-yr treasury securities has dropped below 2.75% and 3.5% coupon Fannie Mae 30-yr securities are now trading above par. Those looking for clearer signs of life in the economy had thought they'd seen a glimmer in non-farm payroll gains that had moved positive earlier this year. But, as the temporary census workers were let go, overall job growth slipped back into negative territory and private sector job growth has been too modest to inspire long term confidence.

The most recent FOMC meeting held on August 10 added more fuel to the bond fire. While it is widely accepted that the Fed is unlikely to raise their Fed Funds target for at least several more months, debate has been shifting to the likely direction of the Fed's balance sheet. With the Fed's securities portfolio sitting and around \$2 trillion and given that the portfolio will naturally shrink as principle payments are received and debt matures, the question arises as to whether and how the Fed will reinvest those funds.

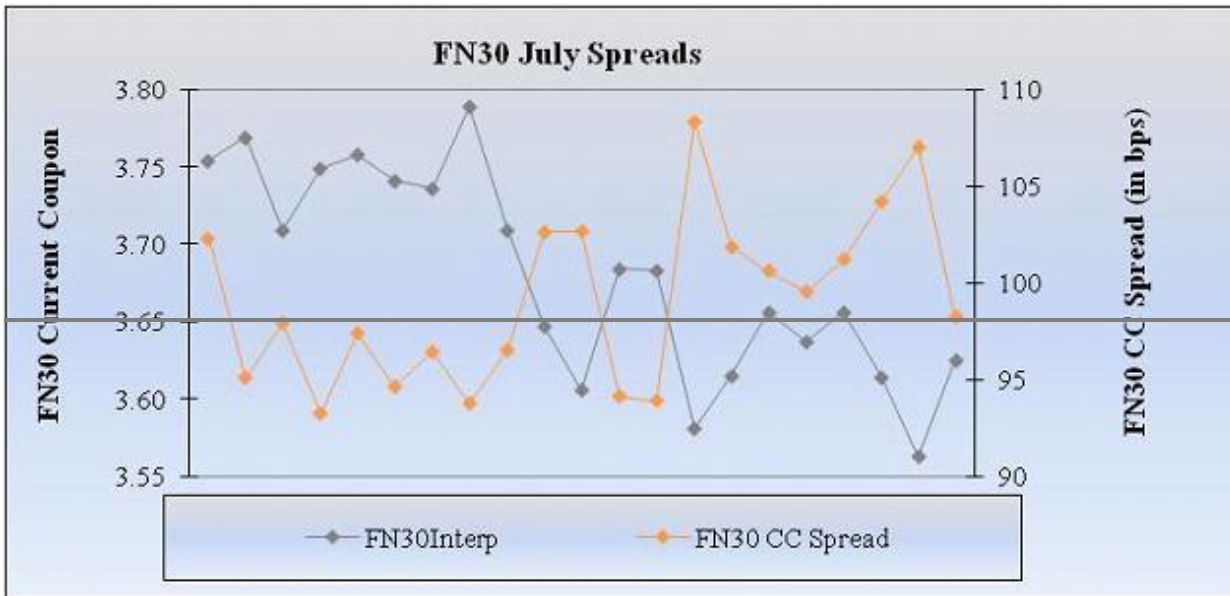
To answer that question, at least in the intermediate term, the Fed announced that they will offset portfolio shrinkage with the purchase of additional treasury securities, primarily in the 2- to 10-yr sector of the curve. While this means that no further mortgage-backed security purchases are contemplated for the time being, mortgages were still able to take advantage -- along with treasuries, of course - of the news that the Fed would look to maintain the approximate size of their portfolio through treasury purchases.



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Although it's reasonable to expect that the Fed's new treasury purchase program will widen mortgage spreads vs. treasuries, anything that keeps treasury rates low will likely help keep mortgage rates low as well. Given where treasury yields sit, investors will continue to look for products like mortgages that provide higher yields. In the current environment, any significant widening of mortgage spreads may be met with enough demand to curtail further movement. *-Lindsay Hill*

Margin Tracker

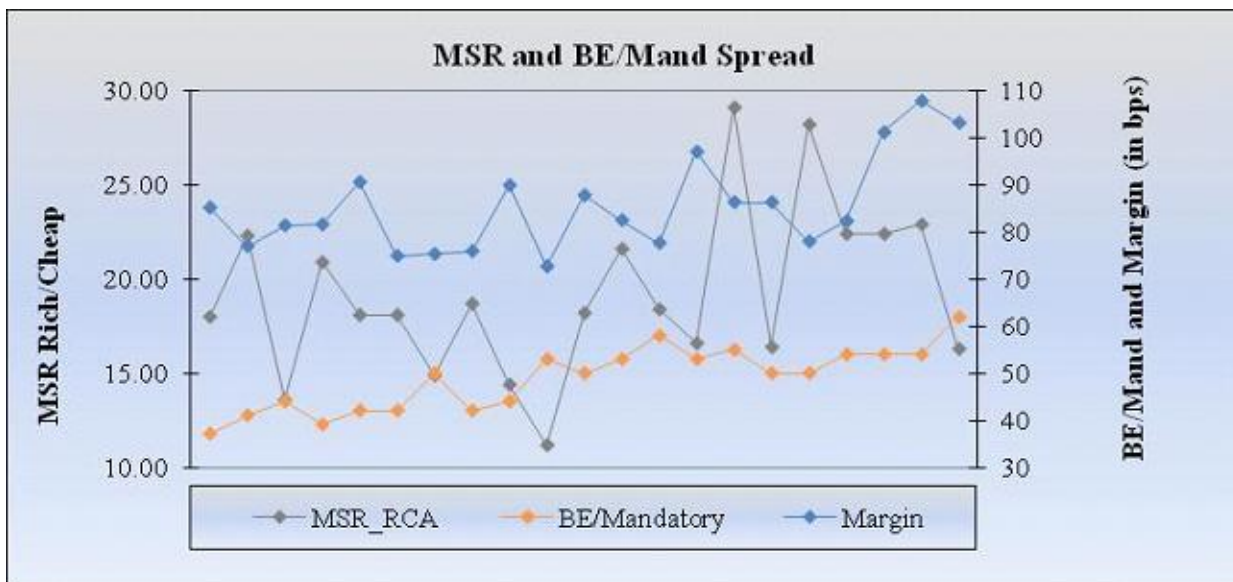


The FN30 CC Spread is the difference between the FN30 Note Rate and the FN30 Current Coupon, in basis points. During July, there was a 15bp peak to trough differential. Shown in the chart above, there is a noticeable negative correlation between rates and spreads. As rates chopped around throughout the month, there is an inverse relationship to the spread. The tightest the spread got was 93bps; the widest was 108bps; the average was 99bps. The FN30 NR is the average conventional note rate across a subset of Compass's client base normalized for volume. The FN30 CC is the Fannie 30-year Mortgage Backed Security yield at par 30 days out. The difference between these numbers gives an indication as to how much margin is priced into the secondary market. The primary factors are interest rates and warehouse line constraints. Lenders may also be slower to improve rates during a rally, and quick to drop their pricing during a sell-off. *-David Bennett*



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MSR Rich/Cheap and Mandatory/Best Efforts Spread



The MSR Rich/Cheap gives the internal rate of return for retaining servicing and provides a general measure of how aggressive aggregators are in their servicing bid. If a client is considering retaining servicing, or is deciding between retaining or selling servicing-released on any given day, this number can serve as a guide. Compass uses best execution across aggregators each day for note rates bracketing the FN30NR. The Mandatory/BE spread tracks the difference of a representative seller's basis point pick-up using mandatory delivery instead of best efforts. Compass uses several investors, for best efforts and mandatory, and compares the best execution of each of the two delivery methods for note rates flanking the FN30NR. The Conventional 30-year average gross profit margin tracks the originator's gross profit margin, i.e. the difference between what the originator pays for the loan (what is posted on a rate sheet) and what the originator could sell the loan for into the secondary market. There was considerable volatility for all three numbers over the course of the month. The MSR Rich/Cheap averaged 19.2% with a peak of 29.1% and a low of 11.2%. The BE/Mandatory Spread averaged 49bps with a peak of 62bps and a trough of 37bps. The 30-year gross profit margin averaged 85bps with a peak of 108bps and a trough of 73bps. *-David Bennett*

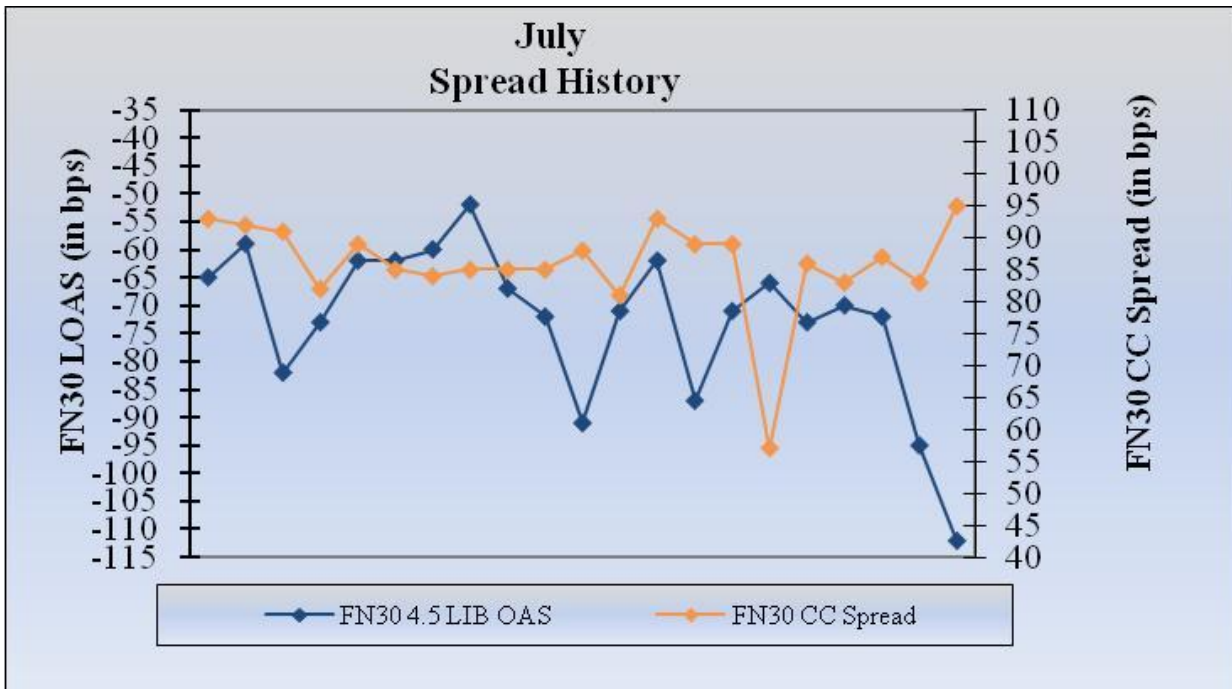
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Monthly Spreads

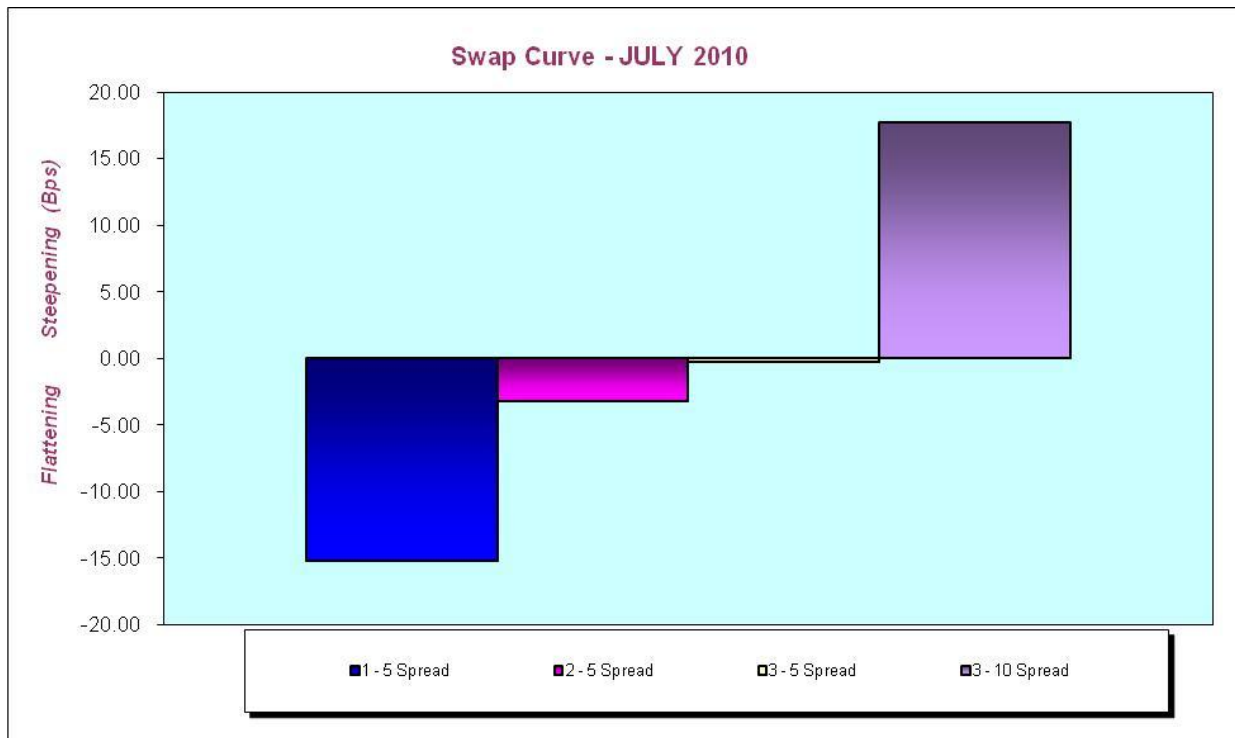


During July, with the uptick in volatility and demand trumping supply for mortgages, LIBOR-adjusted OAS dropped dramatically over the course of the month. The current coupon spread, however, remained relatively range-bound as mortgages traded in-line with swaps. *-Glen Brown*



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Swap Curve Analysis



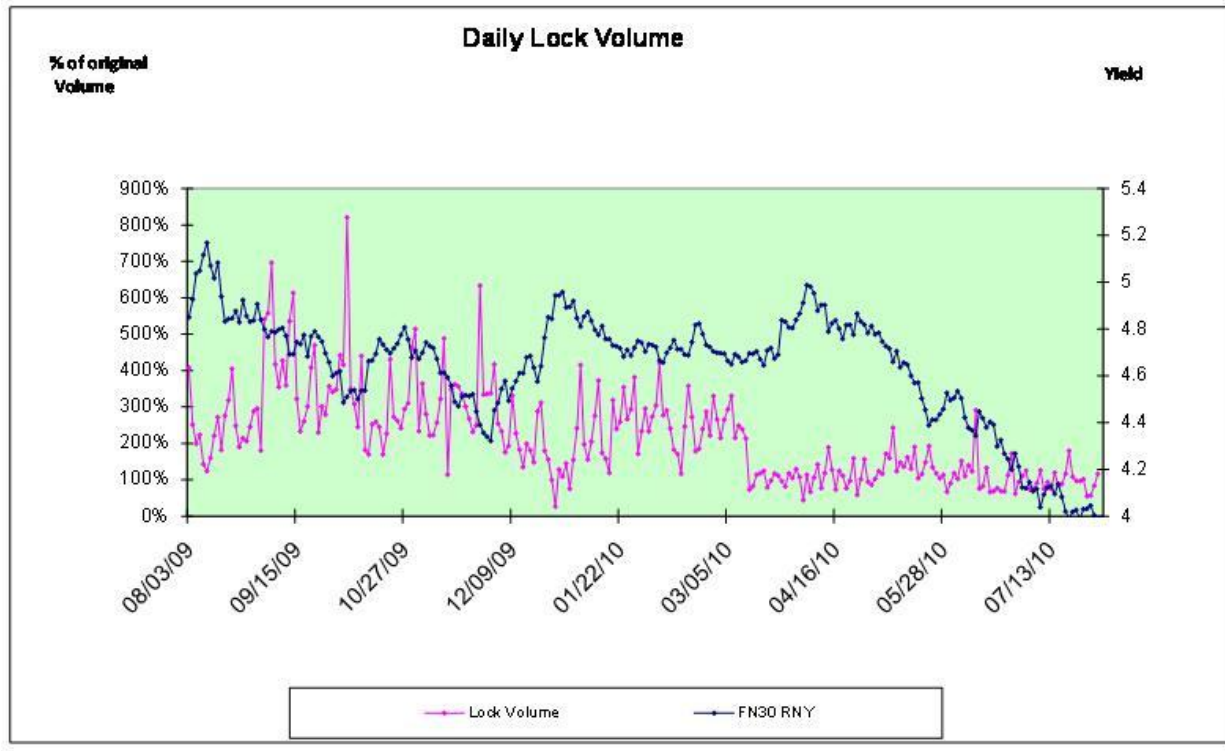
The 1 year LIBOR yield decreased 14 bps during July, closing the month at 1.0367%. The belly of the curve had a larger drop in yield, with the 2 year swap down 26 bps and both the 3 and 5 year swap yields down 29 bps. The result was flattening in the short end and steepening relative to the 10 year.

The 1-5 LIBOR/Swap spread tightened 15 bps while the 3-10 swap spread widened 18 bps. In July's biggest daily move, the 5 and 10 year yields fell 9 bps on July 15, following a slew of bad economic data including dramatic dips in the Empire State Manufacturing and Philadelphia Fed reports and a weak Industrial Production index. *-Dylan Faerstein*



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Production Index



Production in July increased while rates traded in a narrower range (19 bp range in July versus 42 bp in June), with the average yield decreasing month over month by 29 bps. Average volume for the month was 98% of our base volume (vs. 108% in June) ranging from a low of 55% to a high of 182%. The average yield on the FN30 RNY in July was 4.06% (vs. 4.35% in June) ranging from a low of 3.96% to a high of 4.15%. -*Brandon Case*