



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

The Month in Review

October 2010

Don't Miss!

November Topic of the Month: [Update on IR Futures Markets for Mortgage Hedgers](#), by Don Soldatis of MF Global.

What's New?

In reaction to the latest Dodd-Frank legislation, Compass Analytics hosted a roundtable discussion with LoanSifter this past week to help guide our customers in the process of implementing these regulations. The roundtable addressed anti-steering, disclosure, loan-officer/broker compensation, rate sheet/pricing and hedging implications. Our customers who were not able to attend this roundtable may find a recording of the discussion quite valuable. To obtain a link to the recorded audio and visual of the roundtable, interested customers should send an email to lpole@compass-analytics.com.

In addition to the Dodd-Frank Roundtable held with Compass this week, four organizations whose collective expertise spans the mortgage compliance spectrum have joined forces to host a four-part webinar series explaining the implications of sweeping financial reform on mortgage lenders, bankers, brokers and other industry participants. The webinar series, "**Implications of Dodd-Frank - Four Perspectives**," begins on November 23 and will be sponsored by LoanSifter, a provider of loan pricing and product tools, and co-hosted by Compass Analytics, Wolters Kluwer Financial Services, and Del Mar DataTrac. The webinars are open to the public and are offered at no charge. Each webinar will also feature the expertise of attorney James Milano, a partner with the law firm Weiner Brodsky Sidman Kider PC, whose practice is focused on federal and state regulatory compliance matters in the financial services industry.

The webinars will take place at the following dates, at 12 noon EST/9 am PST on each given date:

Part I: Anti-Steering & Loan Officer Compensation, *Nov. 23 & Dec. 3*

Part II: Impact to Hedging, *Nov. 30 & Dec. 14*

Part III: Various Compliance Topics, *Dec. 2 & Dec. 16*

Part IV: Impact to your LOS, *Dec. 7 & Dec. 21*

To register and receive more information about this webinar series, please contact Sara Kowalke of LoanSifter by sending an email to sara.kowalke@loansifter.com or by calling 920.268.4770.



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Compass has rolled out an exciting new training feature for our customers. Instructional training videos have been created by Compass Managing Partners and Account Managers on various topics including Company Cash Flows, Rate Sheet, and Shock Summary. These videos will be made available for day long time slots so that they can be viewed at your convenience. For more information on how to schedule a video training session and a full list of available videos, please email Lucy at lpoole@compass-analytics.com.

New in CompassPoint™!

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

- Beta release of new GPS Interactive Pooling, Allocation & Delivery Upgrade
- Beta release of new GPS Interactive Hedge Selection and Trade Entry tool
- Pipeline M-T-T Enhancements
- Expanded Report Stratification Excel Support

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.



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Market Update

The much anticipated -- and mostly well priced-in -- QE2 announcement dominated recent market news. The magnitude of the \$600 billion treasury purchase plan came in close to consensus expectations but short of a more massive plan some participants had hoped for. The Fed will forgo purchases of 30-year securities and focus on the belly of the curve with 5- and 7-year securities making up much of the purchased volume over the next two quarters.

In obtaining the desired outcome of economic stimulus, the Fed is fighting the perception that lower rates will not provide the hoped-for boost. Rates are already low and have been low for some time and it remains to be seen whether additional QE adds to the slight pick-up in economic momentum seen recently. It's apparent that at this point, the Fed fears the possibility of deflation and stagnation more than they fear the possibility of inflation.

As it relates to a pick-up in momentum, recent economic reports have come in mostly better over the last month. Increases were seen in various measures including: construction spending, ISM manufacturing and services, and factory orders. October non-farm payrolls also showed a jump over a weak September reading with job growth coming in at a better-than-expected clip of 151,000. Upward revisions to September and August job numbers helped brighten the picture even further. The headline unemployment rate - at 9.6% -- remains stubborn, however, and job growth must continue to improve to chew into that.

Given the already low level rates and the possibility of further improvements in the economic outlook, it's tough to say whether further Fed purchases of treasuries will serve to push mortgage rates lower. If the appetite for spread over the belly of the treasury curve improves, improvement in mortgage prices may also follow.

-Lindsay Hill



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Topic of the Month: Update on IR Futures Markets for Mortgage Hedgers

Pipeline:

In mortgage origination hedging, Eurodollar and treasury futures/options have historically been used as adjunctive tools to address issues of adjustable and fixed pipeline convexity & pullthrough. While a range of products are available, durations of the 10 yr Treasury futures market most closely match typical pipeline duration (current 10yr Tsy future mod. dur. ~5.8years). That said, risks and opportunities are presented by the inherent spread between mortgages, swaps and the treasury curve. While the crisis of recent years have seen periods of acute volatilities in these spreads, the past 90days have seen the CC TBA/Tsy spread quiet to a ~10-15bps range, with a standard deviation under 5bps. Risk management comes through understanding.

Purchasing OTM treasury puts can cover aspects of pullthrough; offsetting the put writing that is inherent to rate locks. Conversely, OTM Tsy calls on an overlying TBA forward hedge can be used to address excessive fallout/convexity.

Servicing:

In these days of FinReg; the universe of exchange traded Interest Rate products is quickly expanding beyond the long established markets of Eurodollars and Treasury futures. In the past year, 5 and 10 year Swap futures contracts have gained usable liquidity and open interest, and this Fall 2010 has seen the launch of a centrally cleared swap futures exchange (The Eris Exchange) allowing a continuous tenor of vanilla swaps out to 30 years; as well as the CBOT 'On-the-run' ("OTR") Treasury futures products, offering a new points of duration on the treasury curve.

The benefits of these products, especially for mid-tier and closely held firms, are three fold:

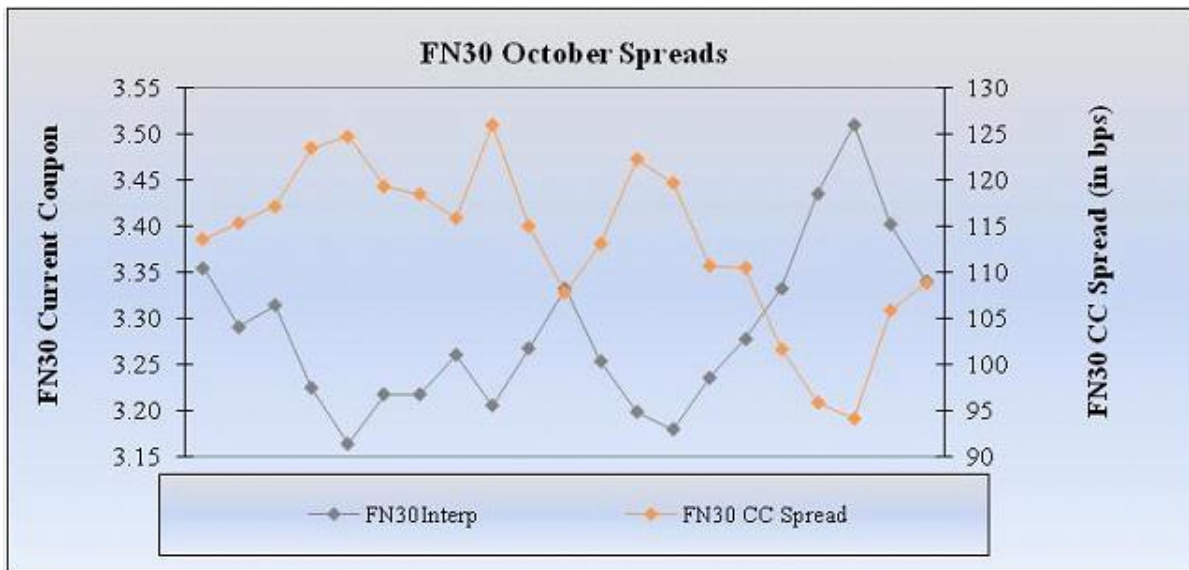
- Swap futures (5s, 10s, and Eris) are centrally cleared, backed by the CME clearinghouse which supports nearly all of the US futures/options volume. This 'mutual' clearing has never had a loss of client funds in it's 100+ year history - despite even the turmoil and bankruptcies of recent years.
- Margins requirements are further reduced by any offsetting futures positions a client may have. (think Asset/Liability hedging v. Mortgage hedging)
- Swa futures can be utilized using simply a futures account; no ISDA negotiation/agreement is needed.

While this is only a brief overview of some keys aspects of these products, we're always happy to assist in incorporating these into your hedging toolkit. Our Institutional team at MF Global can be reached at 312/261-7322. -*Don Soldatis, MF Global*



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Margin Tracker



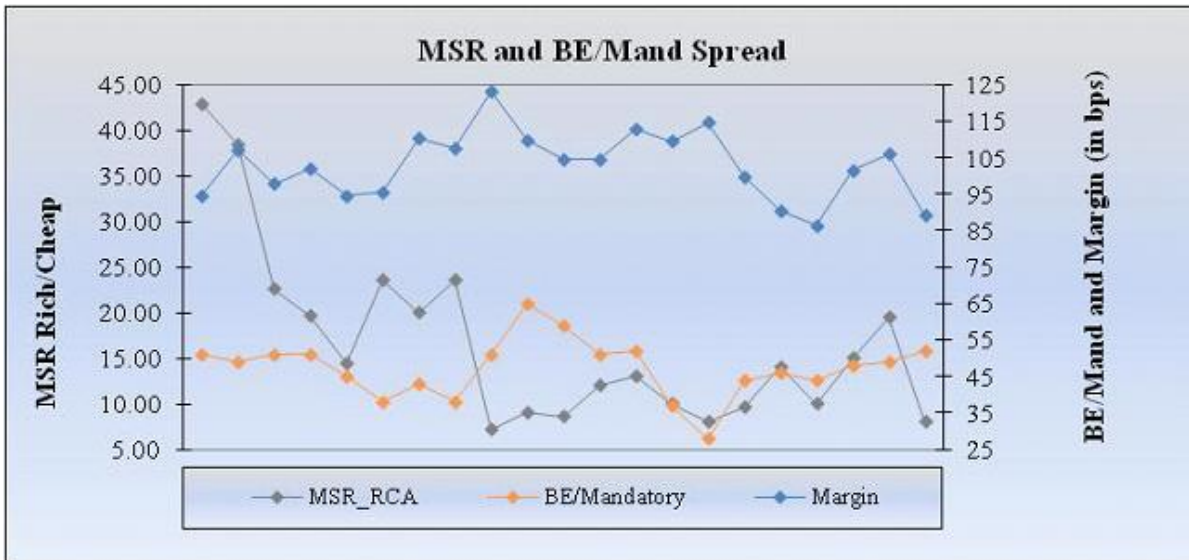
The FN30 CC Spread is the difference between the FN30 Note Rate and the FN30 Current Coupon, in basis points. During October, there was a 32bp peak to trough differential. Shown in the chart above, there is a noticeable negative correlation between rates and spreads. As rates ground lower over the course of the month, there is an inverse relationship to the spread. The tightest the spread got was 94bps; the widest was 126bps; the average was 113bps. 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

There was considerable volatility for Retain/Release Rich/Cheap IRR, Mandatory-Best Efforts Spreads and Profit Margins over the course of the month. The MSR Rich/Cheap averaged 16.6% with a peak of 42.9% and a low of 7.2%. The BE/Mandatory Spread averaged 47bps with a peak of 65bps and a trough of 28bps. The 30-year gross profit margin averaged 103bps with a peak of 123bps and a trough of 86bps.

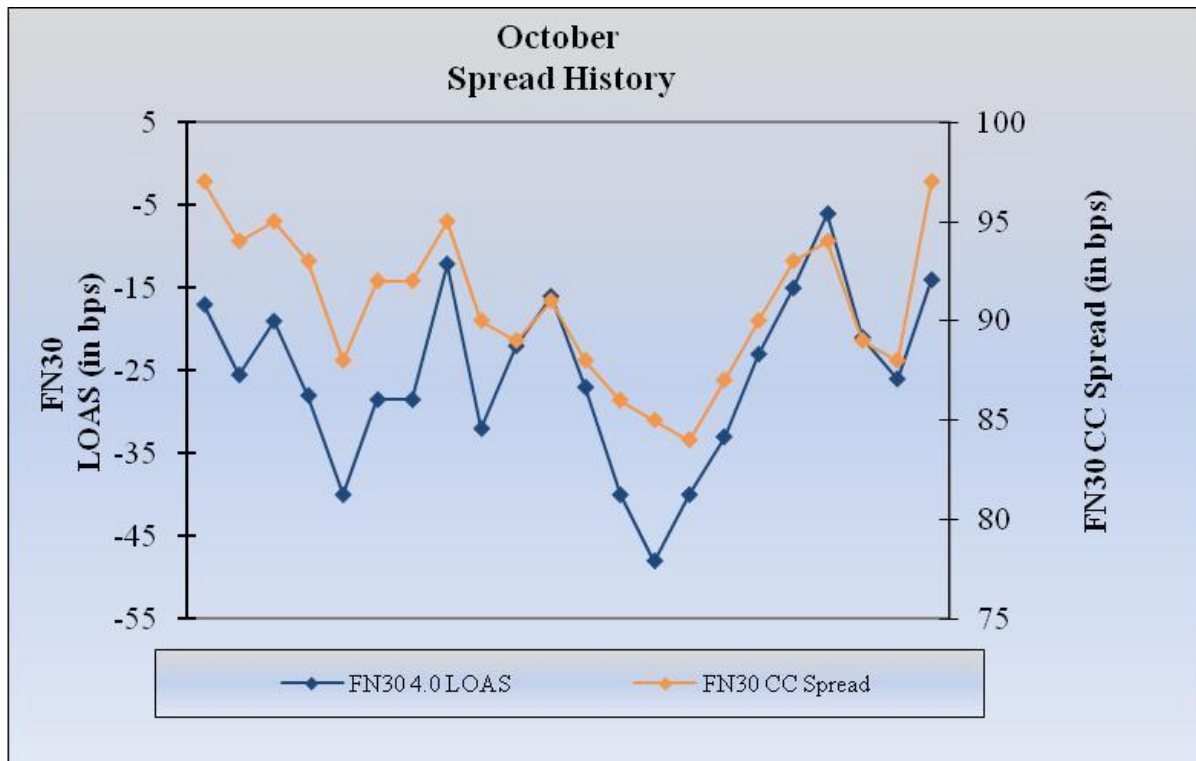


The MSR Rich/Cheap gives the internal rate of return for retaining servicing and provides a general measure of how aggressive aggregators are in their servicing bid. If a client is considering retaining servicing, or is deciding between retaining or selling servicing-released on any given day, this number 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. **-David Bennett**



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Monthly Spreads

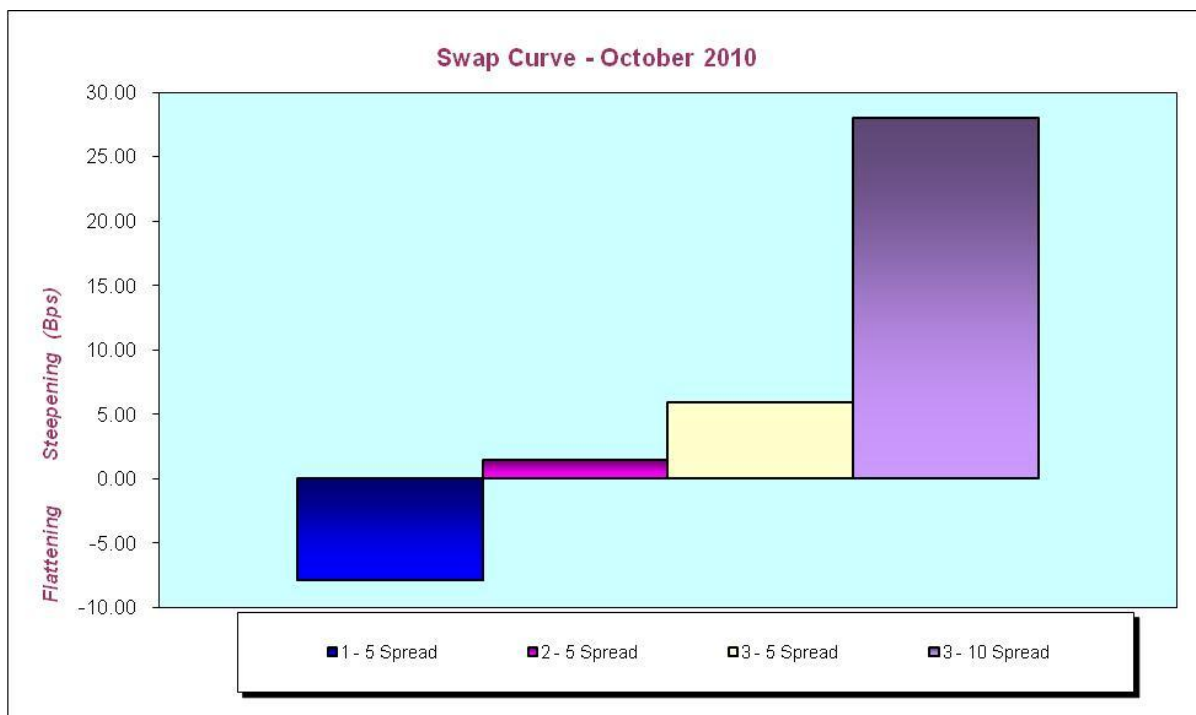


The Treasury 2-10 spread widened 18 bps in October, closing the month at 228 bps. On an OAS basis, mortgage-LIBOR spreads widened considerably intramonth before returning to beginning values by month end. Mortgage yields, measured as a spread over the 2/10 points on the swap curve, tightened 15 bps intramonth before widening out to beginning values. This end-of-month widening reflects the markets growing realization that a large Treasury purchase program was imminent. The end-of-month tightening, on an OAS basis, indicates a growing bid for mortgages, in part due to the removal of uncertainty regarding foreclosures. This increasing preference for mortgage debt also reflects the expected benefit of QE2 on bonds. -*Dylan Faerstein*



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Swap Curve Analysis

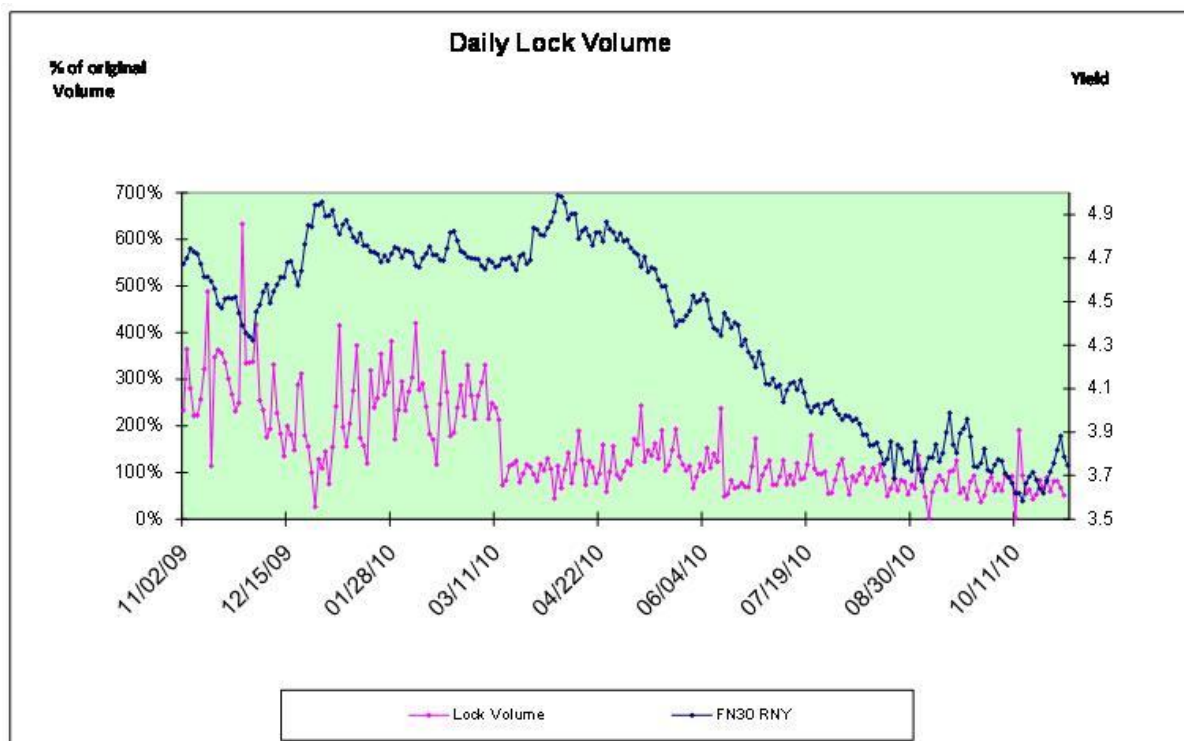


The belly of the curve rallied in October (with 2 year, 3 year, and 5 year yields falling an average of 12 bps), reflecting the market's perception of where QE2 purchases would occur. The 12 month LIBOR yield closed the month down 2 bps, causing some flattening in the short end of the curve. The 10 year swap yield increased by 12 bps, causing the 3-10 swap spread to widen by 28bps. The 1-3 LIBOR/Swap spread tightened 14 bps. In October's biggest daily move, the 2 year yield was down 6 bps and the 3 and 5 year yields were down 8 bps on the 28th, following headlines about the FOMC investigating the consequences of a sizable asset purchase program. *-Dylan Faerstein*



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Production Index



Production in October decreased while rates traded in a narrower range (17 bp range in October versus 34 bp in September), with the average yield decreasing month over month by 10 bps. Average volume for the month was 74% of our base volume (vs. 75% in September) ranging from a low of 2% to a high of 191%. The average yield on the FN30 RNY in October was 3.71% (vs. 3.81% in September) ranging from a low of 3.583% to a high of 3.882%. **-Brandon Case**