



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

The Month in Review

September 2010

What's New?

Compass will update customers on new CompassPoint™ features and training materials at the **Compass Analytics Annual User Conference** this week.

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.

New in CompassPoint™!

Compass will announce and demonstrate its exciting new CompassPoint™ features at next week's Annual Compass Analytics User Conference.

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

With the equity markets trying desperately to paint a positive picture from seemingly mixed economic data, bonds finally took a breather from the recent rally. The 10-yr treasury rate, which had dipped below 2.50% at the end of August, climbed back above 2.75% as recent data has had enough of a silver lining to push stock prices and treasury yields higher. While mortgage spreads to treasuries have remained volatile, overall, mortgage prices have followed treasury prices lower. Technically speaking, mortgage prices were due for some correction to the downside, and some of the recent data, including the August payroll report, helped provide the impetus.

While far from earth-shattering, the August unemployment report was of the better-than-expected variety and given how far rates have dropped since April, better-than-expected proved to be enough to help move the market. Overall, non-farm payrolls dropped by 54k in August and the unemployment ticked up slightly to 9.6%, but the job losses were smaller than expected and revisions to June and July improved those readings as well.

The headline unemployment rate put out by the Bureau of Labor Statistics - 9.6% in the case of August - is also called the U-3 rate. This number includes only those that are currently out of work and describe themselves as actively seeking full-time employment. To get a more complete picture of the current employment situation, it helps to look at the U-6 rate. The U-6 number also includes those that are not actively looking for work but have looked for work in the previous 12 months and are available and wanting of a job. Also included in U-6 are those that desire full-time employment but have had to settle for part-time work due to economic conditions. When the unemployment rate is derived as U-6 as opposed to U-3, the August rate balloons to 16.7%, up from 16.5% in July.

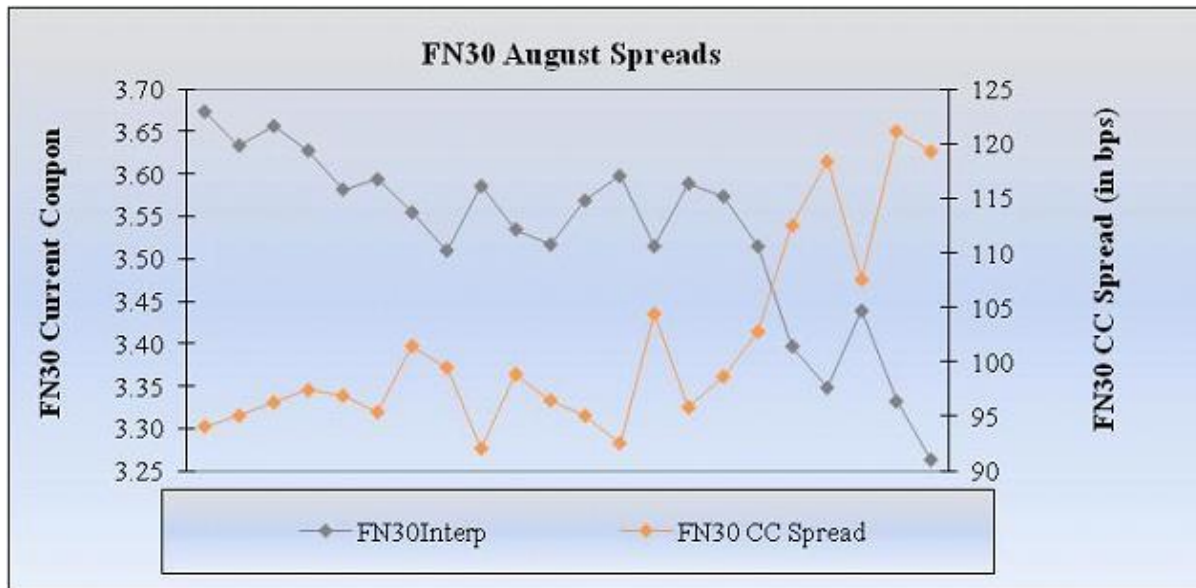
Given the increase in U-6 vs. July, it becomes more difficult to make the argument that August's U-3 increase to 9.6% is simply a product of people reentering the job search. Unless those seeking employment had dropped out of the search more than 12 months ago and had reentered in August, they would have been included in both July's and August's U-6 reading. Regardless of those reentering the job search, payroll growth is still not sufficient to cover new entrants to the job market.

At some point, it may boil down to the practice of finding the statistic that fits one's macro view or hopeful proclamation. Clarity on the economic front remains elusive and volatility in the financial markets can often be the result of a lack of clarity. *-Lindsay Hill*



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Margin Tracker



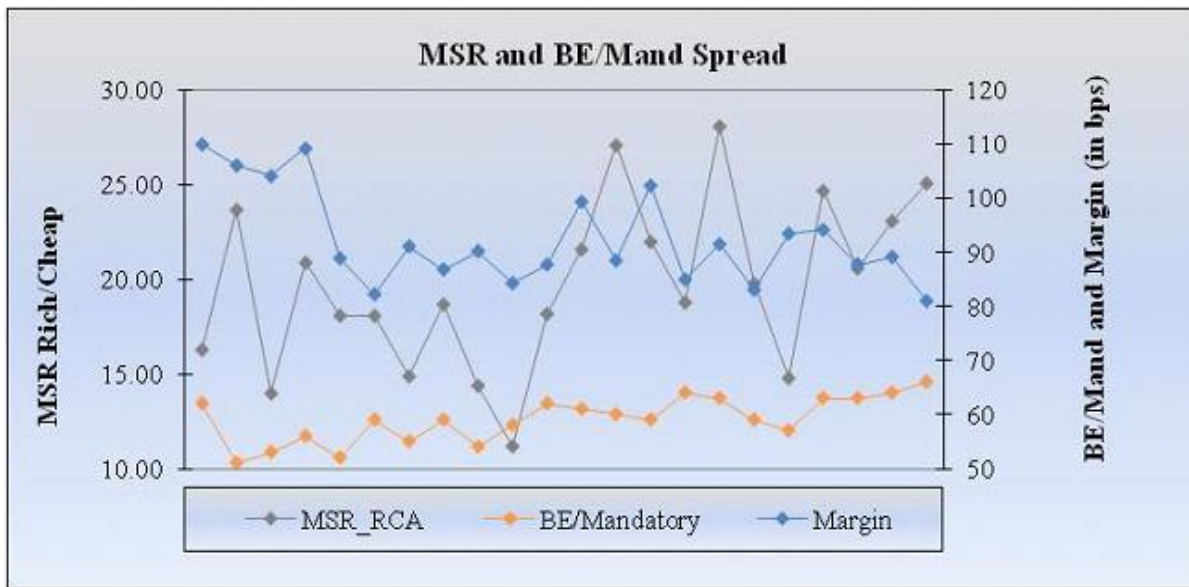
The FN30 CC Spread is the difference between the FN30 Note Rate and the FN30 Current Coupon, in basis points. During August, there was a 29bp peak to trough differential. Shown in the chart above, there is a noticeable negative correlation between rates and spreads. As rates ground lower over the course of the month, there is an inverse relationship to the spread. The tightest the spread got was 92bps; the widest was 121bps; the average was 101bps. 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 with IRR and Mand/BE spread ending at, or near month highs. The MSR Rich/Cheap averaged 19.7% with a peak of 28.1% and a low of 11.2%. The BE/Mandatory Spread averaged 59bps with a peak of 66bps and a trough of 51bps - finishing out at 66bps which has continued to widen nicely in September. The 30-year gross profit margin averaged 92bps with a peak of 110bps and a trough of 81bps.

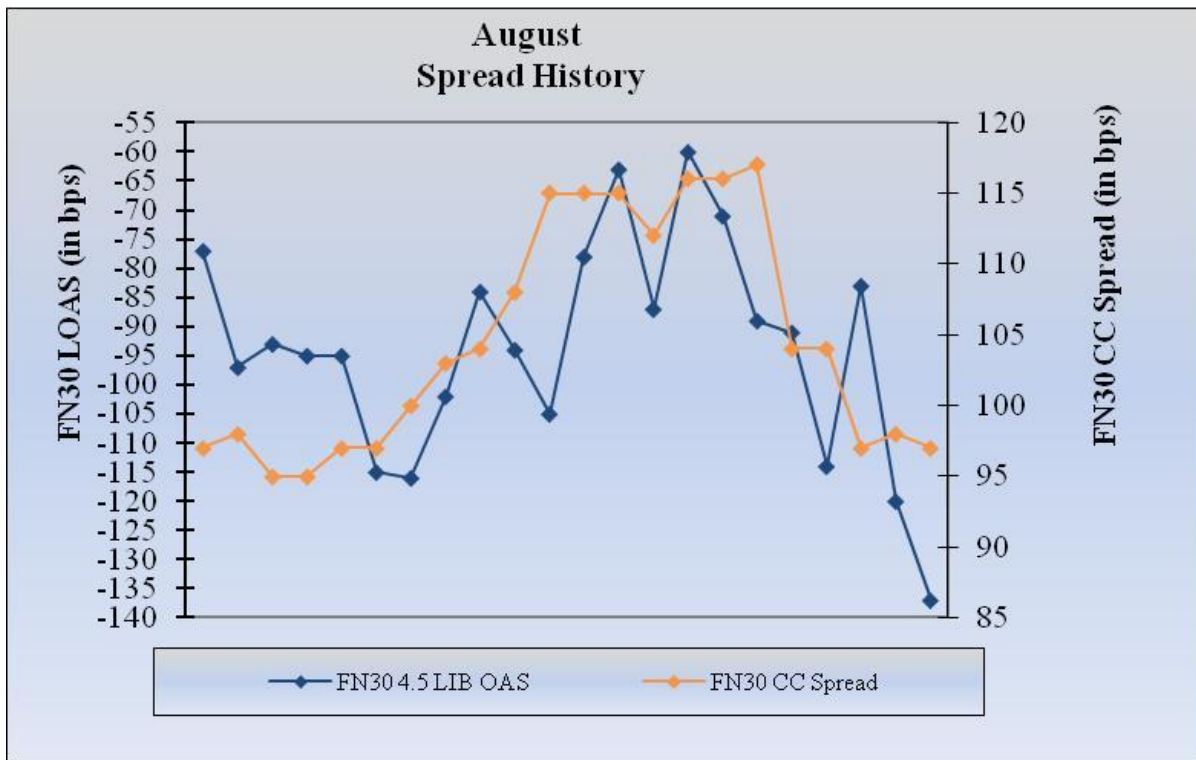


The MSR Rich/Cheap gives the internal rate of return for retaining servicing and provides a general measure of how aggressive aggregators are in their servicing bid. If a client is considering retaining servicing, or is deciding between retaining or selling servicing-released on any given day, this number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

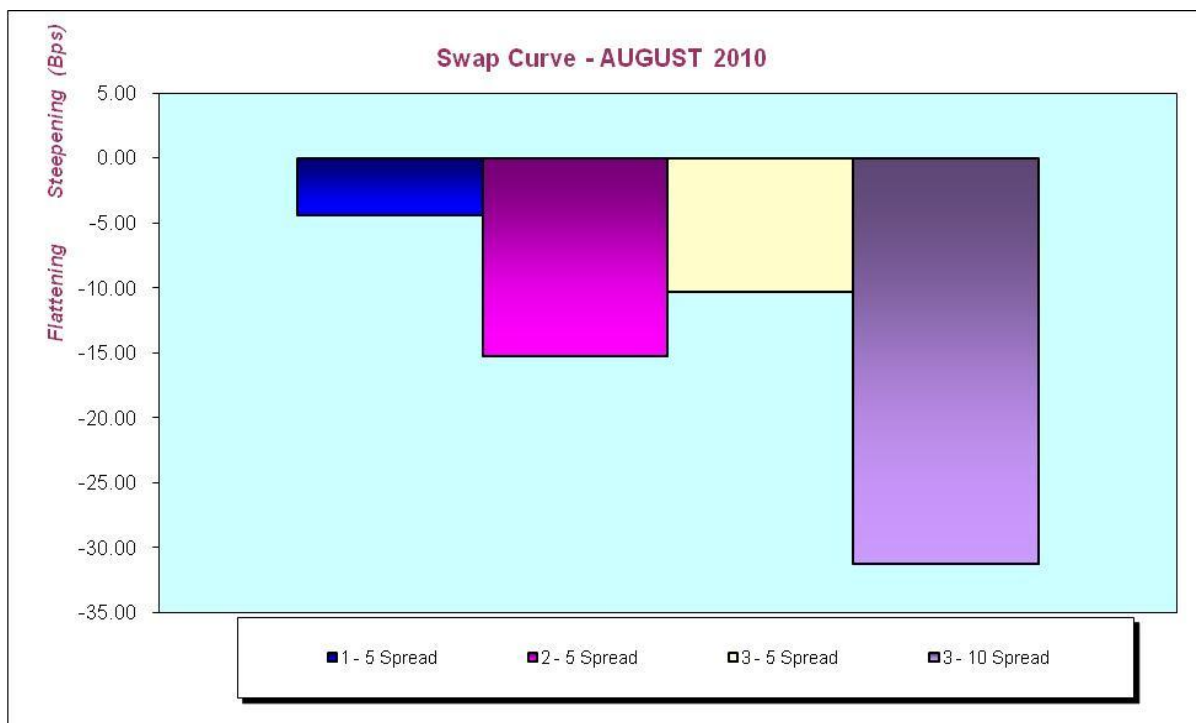


Mortgage-Libor Spreads, both on an OAS basis and as a spread over 2/10 points on the swap curve widened considerably intramonth and then tightened to starting values by month end. This mortgage-swap spread gyration is another indicator of the market's response to possible fed activity, in this case a messaged preference for treasury debt over mortgage debt with any fed balance sheet purchases - a message later softened. *-Glen Brown*



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Swap Curve Analysis

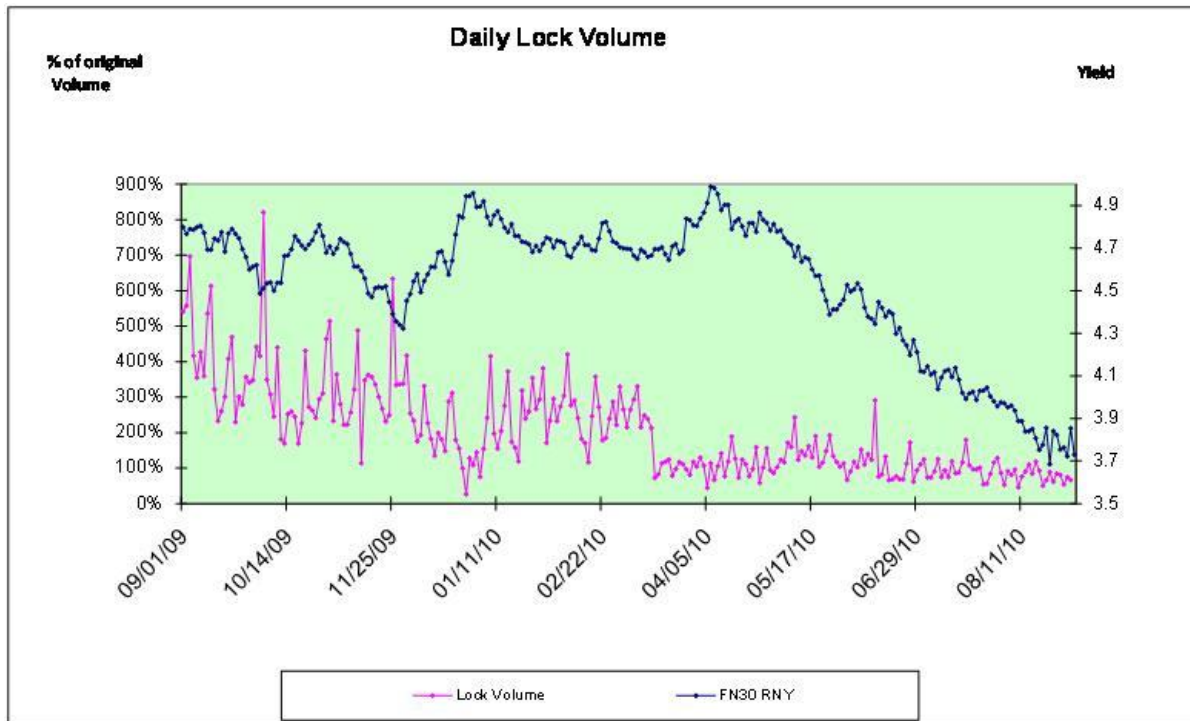


The 1 year LIBOR yield decreased 19 bps during August, closing the month at .84306%. The 2 year swap yield fell only 8 bps, while the long end had a larger drop in yield. The 5 year swap was down 23 bps and the 10 year swap yield was down 44 bps, resulting in a flatter curve. The 1-5 LIBOR/Swap spread tightened only 4 bps while the 2-10 swap spread tightened 36 bps. In August's biggest daily move, the 5 year yield increased 12 bps and the 10 year yield increased 17 bps on August 27th, following the better-than-expected GDP number and assurance from Bernanke that the Fed will act if needed. *-Dylan Faerstein*



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Production Index



Production in August decreased while rates traded in a wider range (29 bp range in August versus 19 bp in July), with the average yield decreasing month over month by 27 bps. Average volume for the month was 81% of our base volume (vs. 98% in July) ranging from a low of 46% to a high of 128%. The average yield on the FN30 RNY in August was 3.84% (vs. 4.055% in July) ranging from a low of 3.686% to a high of 3.976%. *-Brandon Case*